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STATEMENT OF ALAN S. BOYD, SECRETARY OF TRANSPORTATION, BEFORE THE SENATE AND HOUSE PUBLIC WORKS COMMITTEES IN JOINT SESSION ON THE FEDERAL-AID HIGHWAY PROGRAM - FEBRUARY 27, 1967.

I am pleased to appear here today at the joint session of the Senate and House Public Works Committees to discuss the Federal-aid Highway Program and the Administration's effort to keep it and the overall economy on a sound, progressive and efficient basis.

Your respective Committees as well as the Administration are vitally concerned with this program and its contribution to our economy, to the growth and prosperity of our country and to the improvements it provides to our transportation system.

As you know, a decision was made last November to defer the obligation of some of the Federal-aid highway funds which had been apportioned to the states for the 1967 and previous fiscal years. This was part of the overall Administration program to try to relieve some of the inflationary pressures which were building up rapidly in our economy. I would like to briefly summarize this overall program and the economic setting in which it took place.

From 1961 to 1965, fiscal policy and government expenditures contributed to a steady rate of economic growth. Beginning in late 1965, it became evident that some inflationary pressures were building. This tendency strengthened in 1966 as the economy approached full employment and capacity.

The rate of growth in real GNP increased from the 5 percent per year rate which had characterized the 1961-65 period to a 7.2 percent annual rate.

-- Unemployment fell from a rate of about 7 percent in 1961 and

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4.5 percent in 1965 to 3.8 percent of the civilian labor force.

-- Credit became increasingly scarce and interest rates rose sharply.

-- Average consumer prices and wholesale prices, after several years of relative stability, started rising rapidly.

-- As a result of these and other compelling factors, the President last September took a number of steps. These included:

-- A request to the Congress for a suspension of the 7 percent investment tax credit and accelerated depreciation.

-- A commitment to the Congress to reduce or defer $3 billion in Federal program obligations during fiscal year 1967.

The President ordered government agencies to reduce or defer purchasing, travel, employment and other activities to minimize expenditures.

Direct Federal programs as well as grants-in-aid programs were thoroughly reviewed.

Reductions or deferrals were ordered for assistance for housing, the PL 480 program, loans to farmers and small businesses, aid to education, medical programs and many others.

It was in this setting that the President also reviewed the Federal-aid highway program and its relationship to the state of the economy.

The inflationary trends which were apparent in the overall economy were even more pronounced in the highway construction program.

In the first three quarters of calendar year 1966, prior to the announcement of the deferral in obligations, actual bid prices for Federal-aid highway construction increased by 8-1/2 percent. This compares with an annual average increase of 2-1/2 percent.

Some of the most significant economic indicators within the highway construction program or their relationship to other parts of the economy are:

-- The 8-1/2 percent increase in highway construction bid prices compares with a national increase of 4.3 percent for all contract construction bids as estimated by the Department of Commerce.

-- Construction material prices increased 3.2 percent.

-- Prices for equipment rose 3.1 percent and a Department of Commerce survey of equipment manufacturers indicated that they would have difficulty in filling all orders in 1967.

-- Average hourly earnings of all construction workers rose 4.3 percent.

-- The average number of bidders per contract, regardless of the size of the project, dropped during the last part of 1965 and continued through the first six months of 1966.

Perhaps most significantly of all, productivity in highway construction rose rapidly up to 1961 and has increased to a much lesser extent since then. While bid prices were going up 8-1/2 percent during the first three quarters of 1966, productivity fell behind. Although we do not have productivity figures that are directly comparable, it is probable that highway construction productivity increased only about 2 percent during 1966, less of an increase than in the total non-farm sector of our economy.

These factors made it apparent that the Federal-aid highway program, as well as street and highway programs carried on by the states and local governments with their own funds, faced an inflationary threat.

Several alternatives were considered before any decision was made on the deferral. The primary criteria established was:

1. To remove from the obligational process of the program only that amount considered necessary to take the inflationary fire out of the highway program and to make a contribution to the Administration's overall anti-inflationary program.

2. To treat all states equitably.

3. To constantly review the impact of the deferral and ease the restriction as rapidly as possible when conditions warranted such action.

The decision was made to hold obligations to a total of $3.3 billion for the fiscal year 1967. This is a total higher than any other year in the Federal-aid highway program prior to 1963. It represented a 17-1/2 percent decrease from our earlier estimates of the amount of funds which otherwise would have been obligated in the 1967 fiscal year.

Each state was allocated its share of the $3.3 billion based upon the combined formulae used for the apportionment of both Interstate and primary, secondary and urban funds. In this way, each state was assured that it was being treated equitably with all sister states for the period of the deferral. Other methods were considered and Mr. Bridwell will go into more length about these during his testimony.

We recognize that the impact in individual states varies to some degree because there was no way to take into consideration what each state would have obligated during the fiscal year had there been no deferral. In other words, some states had planned proportionately higher programs than could be accomplished under the lower obligation amounts whereas there was little or no impact in some states because they had not planned large programs.

The point that I would like to stress here, however, is that each state had equal opportunity to avail itself of the funds under the $3.3 billion limitation in exactly the same ratio as all Federal-aid funds are apportioned to them.

There apparently have been some questions raised about what has been and is being done with the funds which are building up in the highway trust fund as a result of the deferral.

First, it is important to recognize that there was a balance of only $30 million in the highway trust fund on December 31, 1966. This amount of money is frequently handled in a single day's business in the Federal-aid highway program. Obviously, then, there was no backlog of accumulated money in the trust fund.

There have been suggestions that the deferral was decided upon in order that highway trust fund revenues could be diverted for other purposes. This is not so. The actions taken are all in accord with provisions of existing law.

The law requires the Secretary of the Treasury to invest any surplus funds in interest bearing obligations of the Federal Government.

The highway trust fund must be kept highly liquid since money flows in and out of it rapidly -- usually within a year. The consistent policy of every Secretary of the Treasury since the fund was established in 1956 has been to invest the fund's surplus money in special Treasury obligations with maturities of a year or less issued directly to the fund.

Although legally the trust fund could buy FNMA participating certificates, there never has been any intention of investing any part of the fund in such paper because of the lack of liquidity. To reinforce this intention the President has specifically requested that any surplus trust fund money be invested only in regular special Treasury issues. These issues, which come under the debt limit like any other Treasury issue, do not give the Treasury any more or any less ability to finance Government activities than any other type of borrowing.

If the surplus funds were not invested at all, the trust fund would lose income from interest, but the money still would be in the Treasury for use without a charge to the debt limit.

The legal requirements and the management policy for the operation of the highway trust fund merely reinforce the point that we must look to the inflationary forces that have been at work in the economy generally and in highway construction specifically as the reason for the deferral.

There are indications that the Administration's overall anti-inflationary program -- including highway program deferrals -- has had the effect of reducing the inflationary pressures on the economy. Although these indications are preliminary in nature, we believe that because the deferrals are having the desired effect, we can start to ease off the restraints which were imposed last November.

The cost-price index maintained by the Bureau of Public Roads for the last quarter of calendar year 1966 showed a decline of 2-1/2 percent. This was after a rise, as I pointed out in my testimony earlier, of 8-1/2 percent for the first three quarters of the calendar year.

It is difficult to make a sound judgment on the basis of one quarter's experience with the cost-price index. However, it is encouraging to note that the 2-1/2 percent decline had the effect of holding the overall average increase in highway construction costs in 1966 to just under 7 percent.

It also is encouraging to compare the 2-1/2 percent decline in the last quarter to the behavior of the cost-price index for the same quarter in the last two years. In both 1964 and 1965, the index remained essentially unchanged from the third to the fourth quarters.

Based upon the experience in the highway construction cost-price index as well as other economic indicators in our economy, we have come to certain policy and program conclusions and decisions as follows:

1. Examination and careful consideration of the need for an additional $400 million deferral in highway construction obligations shows that such action is not necessary.

2. A total of $175 million of deferred funds will be released for preliminary engineering and right of way acquisition

... to take care of safety and other pressing problems, and

... to enable the states to move ahead rapidly with construction once the deferred funds are released.

3. A full annual program level of $4.4 billion will be put into effect with the start of the new fiscal year on July 1.

4. Additional amounts of the deferred funds will be released as soon as the economic situation warrants. If the moderation in economic activity and in price trends -- including highway prices -- which has characterized the past several months continues, additional funds can be released this fiscal year.

5. Funds which have been accumulated during the deferral period may be used to increase the program above the $4.4 billion budgeted level for fiscal year 1968 provided economic circumstances permit and depending upon decisions yet to be made in this fiscal year.

I sincerely hope that my testimony and the information I have brought to you have been of some assistance to the Committees sitting in joint session and considering our important Federal-aid highway program.

Lowell K. Bridwell, Acting Under Secretary of Commerce for Transportation and soon to be Federal Highway Administrator in the Department of Transportation, will provide additional information as requested by the two Committees.

Thank you.