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California's Propositions 1A and 1B:
Adapting the Results to the Current Landscape of Transportation Finance

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California's Propositions 1A and 1B: Adapting the Results to the Current Landscape of Transportation Finance

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EXECUTIVE SUMMARY

In this November's election, Californians will vote on the largest collection of bonds to be put forth on a single ballot. The biggest of these is Proposition 1B—\$19.9 billion for transportation projects. Its companion measure, Proposition 1A, would limit the ability for the Legislature and Governor to raid dedicated transportation funding for other budgetary purposes. Both of these propositions respond to the mounting demand to secure funding to improve California's crumbling transportation infrastructure and increasing congestion. However, both measures have serious shortcomings that call into question how effective they will be at alleviating the problems they purport to solve. Neither will remove the primary pitfalls to transportation funding in California that make it such a challenge to maintain and upgrade the State's transportation infrastructure.

We identify three main faults with the transportation funding process in California—boom-or-bust funding, unstable funding, and the use of earmarks or categorical accounts. Boom-or-bust funding refers to the fact that transportation funding tends to come in spurts. Decades of miserly funding are punctuated erratically by an infusion of cash when the economy is good. This pattern creates a backlog of compounding maintenance and construction needs and complicates long-range planning.

Unstable funding, in contrast, refers to the fact that even after transportation funding is allocated, it may not be available in the expected way. For instance, the Traffic Congestion Relief Program, which allocated about \$5 billion to alleviate congestion hot spots, was raided for four years, with the money being diverted to the General Fund at the last minute in the budget cycle. This instability makes it difficult to coordinate project programming, leading to inefficient use of remaining funds. Proposition 1A attempts to limit such suspensions, but leaves open other loopholes that have been exploited in the past. If it is effective, it will largely be due to making it politically unacceptable to suspend funding, rather than by making it illegal.

Thirdly, the use of earmarks—money designated for a single project or category of projects—limits the flexibility of transportation planners to respond to the most pressing of infrastructure needs. These categorical accounts create parallel funding streams, whereby, for instance, a highway and a transit project may be evaluated along different criteria by virtue of the fact that they are being funded from separate accounts. Such processes obscure side-by-side comparisons, making impartial project prioritization based on absolute costs and benefits difficult. Proposition 1B's accounts may also create competition for available funds, which could result in the pursuit of large and expensive projects rather than a set of properly prioritized ones, as well as favor counties with local transportation sales taxes when local matches are required.

All three of these phenomena threaten the efficacy of the State's primary transportation planning tool, the State Transportation Improvement Plan (STIP). The STIP process, while by no means flawless, allows various agencies to coordinate planning and programming activities, and to seek public input as they identify the highest-priority projects within each county and across the state. However, Proposition 1B's \$19.9 billion will mostly not flow through the STIP, but through several newly created categorical accounts, multiplying the existing number of parallel funding streams, with the potential to further obscure project prioritization.

Finally, the specific applicability of bond financing is questioned. The use of bonding is particularly inappropriate for projects, such as maintenance, that will not generate benefits over a long time horizon. Yet, a notable amount of this bond's funding is directed at such projects.

Given Proposition 1B's favorable poll numbers, we suggest ways in which it can be administered most effectively to minimize the effects of these flaws. Specifically we make recommendations related to guidelines, prioritization, and the distribution of money among recipients for new accounts that are slated to primarily bypass the STIP. The applicability of bond financing is also stressed. In many cases, the equitable and efficient distribution of bond funds, and in some instances, their proper use is not written into the language of the bond; if Propositions 1A and 1B pass, the way they are interpreted and administered will make the difference between \$20 billion well-spent on essential upgrades and \$20 billion squandered.

INTRODUCTION

California is poised to make a massive investment in infrastructure: Governor Schwarzenegger and the State Legislature have proposed a \$37 billion bond package for the November ballot, \$19.9 billion of which will be spent on transportation. The transportation bond—Proposition 1B—and the accompanying State Constitutional Amendment 7 (SCA 7)—Proposition 1A—would increase the overall level of funding for transportation within the state. Public support currently favors passage of the bond in the upcoming election. Two major polling entities produce similar numbers when presenting Californians with the actual ballot wording. A Field Poll conducted in late September indicated support of 52% in favor, versus 36% opposed, with 12% undecided (Field Research Corporation, 2006). A survey by the Public Policy Institute of California saw 51% in favor, 36% opposed, and 13% undecided in September as well (Baldassare, 2006). Although not guaranteed, this paper examines the outcome of the bond and the constitutional amendment passing. Given its vast implications on state transportation funding and that its language demands much interpretation, we analyze how the bond could be managed in the most beneficial way.

On the Governor's Strategic Growth Plan webpage, originally established to explain and promote his proposed infrastructure improvements, the Governor promises these propositions will "fund repairs, reduce congestion, improve bridge safety, expand public transit and improve port security" (Office of the Governor, 2006b). But the way in which that money flows—from collection, through the state planning process, and ultimately to individual projects—may have just as much of an impact on the final transportation system as the overall level of funding. This paper analyzes current areas of turbulence in this flow, and identifies where the bond may create new areas of potential conflict, and its likely effects on the state's transportation infrastructure.

Ironically, California's highly interconnected network of transportation infrastructure—which links roads, transit, ships and planes—is currently paid for by a disjointed, convoluted financing system that channels tax dollars from various sources through a bewildering array of accounts and agencies. In their comprehensive review of state infrastructure investment, Hanak and Baldassare (2006) note that "transportation... is the sector in which the finance system is the most broken" (p. 11). We find that at present, the boom-or-bust nature of overall funding is detrimental to long-term transportation planning, as is the instability in individual transportation accounts and the existence of categorical funding mechanisms. Because transportation infrastructure represents a long-term investment, one with massive implications for land use and environmental quality, it is essential that it be the result of a comprehensive, deliberate and inclusive planning process.

The need for transportation investment is apparent. Over the past several decades, California's traffic congestion and its demand for infrastructure have been growing faster than revenues that pay for such infrastructure. In its (in)famous 1999 10-year assessment of transportation needs, the California Transportation Commission (CTC) identified \$112 billion in unfunded projects (CTC, 1999), a figure which has since been updated to \$160 billion by 2009 (CTC, 2004b). Within the transportation sector, the bulk of current funding is spent on maintenance and repair, rather than construction (de Alth and Rueben, 2005). And in 2004, the Bureau of Transportation Statistics (BTS) reported that only 2% of the roads in California were rated as being in 'very

good' condition, compared to 13% in the nation as a whole; conversely, 19% were rated 'poor,' compared to 7% nationwide (BTS, 2004). In recent years, the amount of spending on all forms of infrastructure has actually increased, and is currently comparable, in real per capita terms, to the levels of the 'Golden Age' of California infrastructure construction in the 1960s (Hanak and Rueben, 2006). However, the types of projects on which this money is being spent have shifted radically, with sectors such as education receiving a larger share. These factors have combined to create a widespread perception that the State should be spending more on transportation (Hanak and Rueben, 2006; Tausher, 2005); as one planner put it: "we are still riding on the tails of infrastructure patrimony bequeathed to us by William Mulholland, Pat Brown, and Tom Bradley" (Erie, 2001).¹

One main reason for these unmet needs is that traditional sources of transportation funding have been decreasing in purchasing power. In the past, transportation investments were almost wholly paid for by the motor fuels (gasoline and diesel) excise tax, known simply as the gas tax. Funding transportation with these monies is attractive for several reasons—it is a fairly substantial and steady revenue stream, and this mechanism generally conforms to the beneficiary-pays principle, whereby the taxpayers—in this case, drivers—paying for the services are the ones benefiting from them, and those who do not use the services, such as cyclists and pedestrians, are not taxed for services they do not use. However, gas tax revenues, since they are levied per gallon, rather than as a percentage of pump price, have lost purchasing power in real terms due to inflation, fuel efficiency gains, and rapidly rising construction costs (Wachs, 2003; Puentes and Prince, 2003).

Another traditional, but no longer significant source of transportation monies is local property taxes. Since 1978, these taxes have been held to a constant rate of increase by Proposition 13. As a result, localities in California have no power to increase property taxes in response to infrastructure needs (or in response to any other service needs). Localities have increasingly turned to optional increases in their sales taxes (as well as developer fees, and vehicle registration surcharges), called local transportation sales taxes, to fund transportation projects (Goldman and Wachs, 2003).² The revenues from these taxes account for half of all money spent on transportation in the state, and are currently the largest single source of funding for local transportation projects (Hanak and Rueben, 2006).

Concurrent with this drop in real funding levels, travel has increased significantly. Vehicle miles traveled have increased at three times the rate of population between 1965 and 2005 (PPIC, 2006). The two most congested cities in the nation are San Francisco and Los Angeles, with Riverside, San Diego and San Jose also in the top ten (Schrank and Lomax, 2005). This increase is not limited to passenger travel alone: In 2003, a full 47% of the freight coming in containerships to the United States arrived at a port in California (BTS, 2004), and this cargo was

¹ William Mulholland built the Los Angeles aqueduct; Pat Brown was governor during the 'Golden Age' of infrastructure investment in the 1960s, which saw the creation of the UC system, and major road and water projects, Tom Bradley, as the mayor of L.A., re-introduced rail transit and brought the Summer Olympics to the city.

² The use of local option sales taxes is a national trend, since the federal gas tax revenues are falling in real terms as well. In California, these sales taxes currently range from one-quarter to one-half cent, with Santa Barbara County seeking an increase in their tax rate to three-quarters of a cent. These monies are dedicated by ballot measure specifically to transportation, even to specific projects; other states allow varying degree of flexibility in how the money is spent (Goldman and Wachs 2003; Wachs 2003).

shipped to the rest of the state and nation predominantly on trucks, which are the primary source of wear and tear on roads. The State's investment in transportation infrastructure has languished since the 1960s, the last period of major road building. Furthermore, while measuring spending on a per capita basis makes sense for a sector such as education, transportation needs are more closely tied to the amount of travel, rather than population. California's spending per road mile traveled has decreased: From 1965 to 1980, it fell by 75%, and has remained roughly constant since then (PPIC, 2006). Accordingly, in recent years, the demand for new transportation infrastructure has intensified.

By proposing the issuance of nearly \$20 billion in general obligation bonds, Proposition 1B is the latest attempt to invest significantly in transportation. Although the State has occasionally used bonding for transportation in the past to augment its user fees that 'pay-as-you-go', this level is unprecedented. As California built new roads, bridges, and airports, bonds were used to pay for specific projects. The Golden Gate Bridge was one of the first; its \$35 million bond passed in 1930, and was paid off over the next 40 years (Dresden, 2006). In more recent years, however, bonding has been used as a way to pay for needed transportation infrastructure without raising taxes. Up until the current bond measure, the only general purpose transportation bond to be proposed at the state level failed in 1988, put forth by a governor who had pledged not to raise taxes (Gray, 1988; Walters, 1988).³ Bonding has gone beyond infrastructure as well. Governor Schwarzenegger approved a \$15 billion bond shortly after his election to cover the state budget deficit, essentially using long-term debt to pay for short-term debt and ongoing operations, an unwise principle of which the dangers are elaborated upon later.⁴

In total, the purposes of and projects outlined in Proposition 1B certainly qualify as a large infrastructure program, and may be an appropriate use of bond money. But to understand the merits and effects of the bond, one must consider the current landscape of funding structures into which the bond will place its \$20 billion. One of the main features of this landscape is the State Transportation Improvement Plan (STIP), a process and program that prioritizes and schedules projects and authorizes allocation of State funding. The STIP is generally a successful process, but it currently faces three main threats, which are pervasive throughout transportation funding in California: a pattern of boom-or-bust funding, unstable funding sources, and the use of earmarks, or categorical accounts. All three of these represent potential hindrances to creating a sophisticated and efficient transportation system, regardless of how much money is pumping through the system.

THE STIP

The primary tool to implement transportation capital improvements is the State Transportation Improvement Program. The most recent version of the STIP, adopted in early 2006, has programmed \$5.91 billion in capital funds over the next five years (CTC, 2006a). The STIP is a

³ Proposition 74 (1988) would have enacted a \$1 billion general obligation bond to help pay for local road, state highway, and transit capital improvements, but it failed by roughly 600 votes. Governor George Deukmejian initially opposed a gas tax increase in favor of this bond. Three other specific-use transportation bonds have since passed and are discussed further later.

⁴ This bond passed in 2004 concurrently with Proposition 58, which prohibits future use of bonds to finance structural deficits.

fiscally constrained “resource management document” (Govt. Code, § 14529(f)) detailing a schedule for funding allocations to transportation capital projects expected for implementation over a period of five years. Managed by the CTC and updated biennially, it has consisted of two broad programs since modifications under Senate Bill (SB) 45 in 1997. Seventy-five percent of available capital funding is allocated to projects in the Regional Improvement Program (RIP), comprised of individual Regional Transportation Improvement Programs (RTIPs) submitted by regional agencies (i.e., Regional Transportation Planning Agencies (RTPAs) in urbanized areas and county transportation commissions in non-urbanized areas). Projects on an RTIP include any that facilitate regional transportation including local roads, the state highway system (SHS), public transit, bike and pedestrian projects, demand management, and others. Comparatively, the remaining 25% for the Interregional Improvement Program (IIP) comprises projects from Caltrans’ Interregional Transportation Improvement Program (ITIP), designed to facilitate interregional travel, and primarily covers the SHS and intercity rail. Funds for the RIP are allocated to regional agencies on a county share basis, where shares are based on formulas calculated using population and SHS miles. Further, all RIP funds and 40% of IIP funds are subject to the North-South split, whereby 40% of funding is allocated to counties in Northern California and 60% to counties in Southern California.

The STIP is generally viewed as one of the more successful tools for the implementation of infrastructure planning, funding, and construction. Barbour and Lewis (2005) identify the transportation sector as the one area of infrastructure planning that “provides the state’s most well-developed model...to guide a stable *process* of ongoing intergovernmental planning coordination” (p. 188, emphasis in original). They recommend other infrastructure sectors adopt STIP-like processes themselves. The STIP’s success is directly linked to the cooperation among local and regional agencies, Caltrans, and the CTC, who must come together in the STIP process. The California State Association of Counties (CSAC) (2006) writes: “The STIP process assures each part of the state an equitable share of funds and allows for the selection of the best projects of any type” (p. 2). The STIP’s ability to foster collaboration means that stakeholders have faith in the process. CSAC (2006) argues that “support for the STIP process” should be a top priority for the bond, and recommends that “the majority of additional funding should utilize the primary and successful existing process for project selection” (p. 2).

Nonetheless, the STIP process is not perfect. With an emphasis on directing most funding and ultimately control to local agencies in developing projects, larger regional solutions to transportation demands have not been extensively fostered. Overriding parochial interests at a local level and a lack of regional-scale accountability have contributed to this situation (Barbour and Lewis, 2005; SCR, 2002). In addition, incentives for tying transportation improvements to land use strategies that improve efficiency and reduce environmental impacts have generally not been realized through current transportation development channels, including the STIP (Barbour and Lewis, 2005). These shortcomings do not imply the de-emphasis of such a process is recommended, however; although future reforms and investments should target these concerns.

More specific to the topic of this paper, the success of the STIP process has been challenged and limited by the funding-related threats below. For transportation infrastructure, the ability to realize effective and efficient solutions along with a long-range planning perspective through the STIP has been vulnerable to an erratic pattern of transportation funding because of an inability to

provide a consistent base of funding from which to prioritize and plan. In addition, specific funding source stability and the challenge of earmarking or categorical accounts creating parallel funding streams has made utilizing the STIP and realizing its benefits more difficult to achieve.

BOOM-OR-BUST FUNDING

In California, transportation funding has been subject to the rise and fall of funding availability. A brief focus on just the last 20 years illustrates this phenomenon. By the end of the 1980s, gasoline excise tax receipts were far too little to fully fund the state's transportation needs, culminating in a \$3.5 billion deficit in the 1988 STIP (Kopp, 1989). A proposed partial solution was a failed bond, noted in the previous section. Funding was eventually secured through an increase in the gas tax (as well as two bonds issued for rail purposes), increasing the revenue transferred to the State Highway Account (SHA).⁵ This boost to the SHA, the primary source of STIP funding at the time, was short-lived and was again on the decline following the 1989 Loma Prieta and 1994 Northridge earthquakes that precipitated a need to seismically retrofit over 2,000 state highway and as well as several toll bridges. Expenses for these projects left the SHA unable to adequately fund other capital projects, but in 1996, its funds became more available again after Proposition 192 enacted a \$2 billion bond to instead pay for the seismic retrofitting (CTC, 1999).

Transportation funding has also been subject to rapid increases in times of plenty, recently for example with the creation of the Traffic Congestion Relief Program (TCRP) in 2000, passed at the crest of the technology boom, which earmarked approximately \$5 billion in capital projects over six years.

The problems associated with severe cuts in funding are obvious, and it is generally assumed that more funding for transportation will lead to wholesale improvements in system performance (for examples, see Sprague, 2006; Bizjak, 2006). However, sudden increases may create problems as well as solutions for funding infrastructure. For instance, the rapid increase in school funding (between 1997 and 2002, it increased 70% in real per capita terms) created problems; there was such demand for contractors to build schools that their prices shot up overnight (de Alth and Rueben, 2005). These boom-or-bust spending cycles can have unintended consequences, such as the approval of poorly-vetted projects in times of plenty, and long construction delays during fiscal droughts (Hanak and Rueben, 2006; David Brewer, lecture, UC Davis, June 2, 2006). This in turn plays havoc with support costs and engineering and staffing levels at Caltrans and local agencies. Overall, boom-or-bust funding makes planning with long-term revenue predictions unreliable, introducing cause for cost increases and an inefficient or compromised selection of projects.

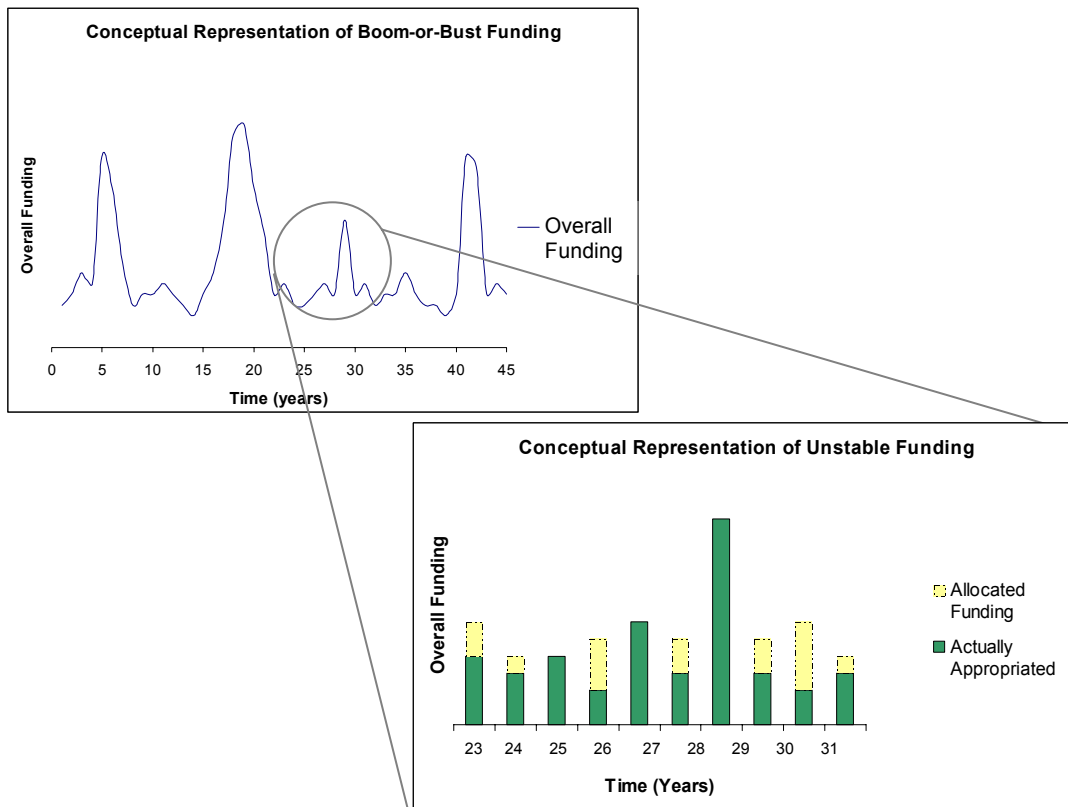
UNSTABLE SOURCES

Boom-or-bust funding broadly describes the ebb and flow of the overall picture of transportation finance. More specifically however, the instability of funding within established mechanisms

⁵ Proposition 111 was approved by voters on June 5, 1990 raising the state gasoline excise tax initially from \$0.09 to \$0.14 on August 1 and then by an additional \$0.01 each of the next four years to \$0.18 on January 1, 1994, its current rate.

also contributes to compromised planning and implementation. This distinction is shown in Figure 1 where boom-or-bust funding is illustrated as a general macro-level trend occurring over a large time scale, whereas unstable funding describes more micro-level behavior such as insufficiently funding one account versus another or diverting funding from one account to another.

Figure 1: Boom-or-Bust vs. Unstable Funding



These graphs do not represent real data, only the general trends identified.

Recent unstable funding for the STIP illustrates this phenomenon, and has been duly highlighted by the CTC in its recent annual reports and 2006 STIP recommendations (CTC, 2004c; 2005b; 2006a). The CTC (2006a) states: “with the exception of [a] small ... program [funded at \$70 million annually], the STIP is now entirely dependent on revenues that are subject to annual decisions made through the state budget process” (p. 3). This refers to the fact that traditional sources of STIP funding, the gas tax and truck weight fees, are now exhausted by highway maintenance and operations demands, as well as commitments to the State Highway Operation and Protection Program (SHOPP) (CTC 2005b; 2006a).⁶ The SHOPP receives priority funding prior to the STIP in order to fund projects that preserve the existing highway system and improve its safety, but do not add new capacity. Such gas tax receipts are protected by Article XIX of the

⁶ The fact that there is not enough funding currently to support both the STIP and the SHOPP could be considered the result of boom-or-bust funding, as the most recent, prolonged, and insufficient funding in the SHA may mark a ‘bust’ period. However, for the purposes of this discussion, STIP’s funding trouble will be considered unstable, as its causes and perpetuation are more complex than a simple lack of funding.

State Constitution, which states they must be spent on particular transportation purposes. However, the STIP must now rely on the ill-protected gasoline *sales* tax, which is transferred first to the Transportation Investment Fund (TIF) and remains vulnerable to the annual budget process.⁷

A second large source for current STIP funding is the Public Transportation Account (PTA), which itself is unstable.⁸ Roughly 50% of its balance helps fund the STIP. However it can only be used to fund mass transportation capital projects, sometimes, as in this most recent STIP, resulting in unused funds, with the capacity for funding exceeding the value of proposed projects (CTC, 2006a).⁹

Thus, despite increased funding levels, whether money will actually be available for projects is uncertain. For the five years after it was created, through fiscal year 2004-2005, all or part of the money from the TIF has been delayed or suspended and diverted to the General Fund to cover State budget shortfalls, and the CTC, which oversees use of the fund, had not been able to fund projects with it.¹⁰

A look at the 2006 STIP encapsulates the most recent results of funding instability. The CTC concluded that proposals for highway projects far exceeded the available funding capacity; it received \$1.23 billion in proposals compared to an estimated fund capacity of \$455 million for the highways and road programming portion of the 2006 STIP. This capacity was based on a STIP fund estimate adopted in September 2005 (CTC, 2006a). In actuality, the State's 2006-07 budget, adopted at the end of June 2006, provides an amount for STIP programming in 2006-07 at just over \$1 billion (LAO, 2006c). This is primarily due to budget action to repay ahead of schedule previously suspended funding from the TIF, as well as higher than expected sales tax revenue from gasoline. The suspended funding repayment would have occurred anyway during the five-year 2006 STIP time period, but its unexpected prepayment further illustrates recent instability in transportation funding sources.

CATEGORICAL ACCOUNTS AND EARMARKING

One strategy to cope with relatively tight budgets and unstable funding is earmarking, which can take many forms. In the narrowest sense, a specific project is identified in legislation appropriating the money for it. In this fashion, the proposed bond earmarks \$1 billion for

⁷ The TIF was created alongside the TCRP to accept the remaining revenue from gasoline sales tax receipts after first funding the TCRP's earmarked projects. The details of the TIF will be discussed further in the section on Proposition 1A.

⁸ The stability of the PTA will be discussed in detail in the section of Proposition 1A. Its current, variable sources include 1) the sales tax on the *increase* in the gasoline excise tax passed in 1990 (see note 5), 2) the sales tax on diesel fuel, 3) a percentage transfer from the TIF, identical to the transfer to the STIP, after funding TCRP projects, and 4) gasoline sales tax 'spillover funds.' For an explanation of spillover funds see: CTC, 2005b, pp. 17-18. Suffice it to say that they are open to diversion by legislative statute, an action which has occurred continuously since 2001-02 (CTC, 2005b).

⁹ Note that funding flows directly from the TIF to the STIP, as well as from the TIF to the PTA and then the STIP. The other half of PTA funding is transferred to local governments for State Transit Assistance.

¹⁰ The 2005-2006 budget year was the first year in which the full transfer—worth \$1.3 billion—was made, and the 2006-2007 transfer of \$1.4 billion was made as well. Again, these details will be discussed further in the section on Proposition 1A.

improvements to Highway 99. The second type of earmarking dedicates a pot of money to a specific purpose or agency or category of improvement, without identifying individual projects upon which it is to be spent. California has made extensive use of these categorical accounts in the past, which create parallel funding streams whereby similar projects are paid for out of separately earmarked pots of money. Such an arrangement requires more interagency coordination and can create confusion, as the same project may fall into the funding purview of several different accounts. Parallel funding streams also complicate side-by-side project comparisons, obscuring trade-offs between how project dollars are spent (David Brewer, personal communication).

Prior to its most recent significant revisions with SB 45 in 1997, legislation known as the 'Blueprint' had used such dedicated accounts to define the STIP process beginning in 1989. Within the STIP, it established broad categorical funding accounts for an interregional road system, mass transit and intercity rail projects, soundwalls, and others. Outside the STIP, it established an account for non-capacity increasing projects designed to improve highway-use efficiency as well as others including a state-local partnership program (discussed later) and a precursor to today's SHOPP. Originally intended to function inside a decade-long funding estimate, these programs were eventually repealed by SB 45 as part of an effort to increase funding flexibility. An Assembly caucus reviewing SB 45 noted that "dedicated pots of funds reduce the flexibility of policy makers to allocate funds to meet priorities or changing needs" (CA State Legislature, Assembly, Comment 1).

More recently, the TCRP and the STIP provide an example of how parallel funding streams exacerbate the instability in transportation funding. The TCRP identifies 141 specific projects on which its money is to be spent. However, these projects may receive and usually have required funding from other sources, including the STIP (LAO, 2003). When TCRP funding is redirected to the General Fund, as it was in substantial amounts from 2001-2005, agencies have a couple of options. They may be able to make up for the shortfall by diverting money from other STIP projects, or they can use local sources of money to provide themselves a loan or advance to cover the gap. In either case, a TCRP project is placed in direct competition for funds against projects with which it was never explicitly compared on the basis of merit or cost-effectiveness. In some situations, the local agency has little option but to suspend the project, an action which may itself be costly should contracts be cancelled (LAO, 2003).

The negative effects of parallel funding are felt outside California as well. A national conference on transportation finance warned that adjustments are needed "so that transportation decisions are not driven by inconsistencies in the funding processes" (TRB, 2005, p. 4). This same conference pointed out that there is "a critical need ... to address the seemingly inflexible silos that ... have come to dominate that nation's transportation funding" (TRB, 2005, p. 5). These silos are particularly entrenched, since they feed a vicious cycle, where the limited funding leads to pressing needs, and a constituency carves out a pot of money reserved exclusively for that need, reducing the amount of money for other needs, and creating a constituency for a new, dedicated account.

This fragmentation of the funding stream, combined with the other two threats of boom-or-bust and unstable funding has created a temptation to "default...to conflict and short term crisis

management” (Barbour and Lewis, 2005, p. 188), rather than long-term planning that the STIP is intended to foster. The hurdles identified here, if left unaddressed, may derail this example of successful planning, leaving the State without a model on which to base future reforms.

PROPOSED SOLUTIONS

So far, this paper has reviewed the circumstances of California’s ailing transportation infrastructure. The decreasing purchasing power of revenues from the gas tax, increasing congestion and demands on transportation infrastructure from a fast-growing population, and a process that has been vulnerable to periodic states of financial weakness have often combined to make transportation planning an exercise in crisis management. Three key threats have been identified that have led to or exacerbated these current conditions. They have in turn combined to threaten and undermine the STIP process, a well-understood and procedurally sound planning and implementation tool that is a proven significant factor in successfully fulfilling the state’s transportation needs.

This paper now turns to the two measures, Propositions 1A and 1B, on this November’s ballot that have significant relevance to these unfavorable trends and their direct impact on the STIP process. For the most part, in examining the proposed bond (Proposition 1B), our findings conclude that transportation funding’s boom-or-bust nature is continued with this latest ‘boom’, while funding instability and categorical or parallel funding streams potentially will be exacerbated, with too little opportunity to place transportation planning and financing back on a successful track. At the same time, the appropriate use of bond financing comes into question. The state’s most successful component in meeting the demands for transportation infrastructure, the STIP, is unfortunately de-emphasized or worse, in some cases wholly bypassed. Only 10% of the bond’s money will go to STIP projects (see Table 1, the TFA), although we do not suggest that the bond’s full \$19.9 billion should be directly channeled through the STIP. Discouragingly, in many cases, the proposed alternative to using the STIP does not provide a means that addresses its shortcomings. Recommendations are made where possible to minimize these negative aspects and are offered as a means to successfully utilize this new source of funding.

Proposition 1A’s more focused purpose is to better secure the gasoline sales tax for transportation uses. Although the stability of this significant funding source is improved, we find that critical loopholes remain in the ability to borrow from this, as well as other sources. Such loopholes may in turn perpetuate a threat to effectively plan long-term, and may jeopardize reliable funding for transportation projects.

PROPOSITION 1B: THIS NOVEMBER’S TRANSPORTATION BOND

This section will first outline new funding mechanisms in Proposition 1B and highlight its features that further threaten or subvert the STIP process, illustrating how much of its funding parallels or displaces the use of the STIP. The use of categorical accounts and its effect on project prioritization and system-wide coordination will be a focus of this analysis. More generally the boom-or-bust pattern of transportation funding and the use of bond financing will also be discussed. Appropriate proposed alternatives to the STIP process are presented, although

we conclude that there is little evidence to justify this strategy among many of the new funding mechanisms.

Proposition 1B's Content

We have outlined the funding accounts created by the proposed bond in Appendix A. Funds are primarily divided among new categorical accounts or programs as well as existing ones. Accounts can have multiple funds assigned within them. We will make reference to funds or an account itself, in the case where there are no further subdivisions of the funding. A simplified table (Table 1) illustrates each specific fund and whether it is new, an augmentation to an existing one, or a not easily categorized direct grant. Additionally, the table indicates the extent to which a new fund will be used to pay for projects that would have fallen under the domain of the STIP process. As shown, \$11.9 billion, more than half of the bond's value, will potentially be spent on projects that normally would have been part of the STIP process. This de-emphasizing of the STIP as the primary planning and funding tool for the state's transportation infrastructure expansion creates an incentive for regional agencies to maximize their own share of the bond, rather than an emphasis on prioritization and selection of projects that make the best use of the available funding.

Table 1: Proposition 1B Funding

New Funding Mechanisms/ Earmarks				
<i>Fund*</i>	<i>Parent Account*</i>	<i>Responsible Agency</i>	<i>Amount</i>	<i>Projects would have been on a STIP?</i>
CMIA	Itself	CTC	\$4.5 billion	Yes, although some could be unlikely due to county share limitation
TCIF	Ports and AQ	CTC	\$2.0 billion	Yes, many
SLPPA	Itself	CTC	\$1.0 billion	Probably
Highway 99	-	Caltrans	\$1.0 billion	Yes, many; otherwise SHOPP
Intercity Rail	Public Trans.	Caltrans	\$400 million	Yes, all
Transit Security	Itself	Unnamed	\$1.0 billion	Some
Local Roads	Itself	Counties and Cities	\$2.0 billion	Likely some rehabilitation projects (similar to local streets and roads subvention through the TIF)
		<i>Total</i>	<i>\$11.9 billion</i>	
Augmentation to Existing Programs or Accounts				
<i>Fund</i>	<i>Parent Account</i>	<i>Responsible Agency</i>	<i>Amount</i>	<i>Existing Program/ Source</i>
TFA	Itself	CTC	\$2.0 billion	STIP
-	Public Trans.	RTPAs	\$3.6 billion	State Transit Assistance, with a limitation to capital projects
LBSRA	Itself	Caltrans	\$125 million	Prop 192 (1996), Gas sales tax spillover
HRCSA	Itself	Caltrans	\$250 million	Grade Separation Program (Streets and Highways Code §§ 190, 2450 et seq.)
HSRPA	Itself	Caltrans	\$750 million	SHOPP
		<i>Total</i>	<i>\$6.7 billion</i>	
Other Dedicated Funding Grants				
<i>Fund</i>	<i>Parent Account</i>	<i>Responsible Agency</i>	<i>Amount</i>	<i>Notes</i>
-	Ports and AQ	Air Resources Board	\$1.0 billion	Emission reduction measures
-	Ports and AQ	Office of Emergency Services	\$100 million	Port/harbor/ferry security projects
School Bus Retrofit	-	Unnamed	\$200 million	Emission reduction measures
		<i>Total</i>	<i>\$1.3 billion</i>	

*CMIA: Corridor Mobility Improvement Account

Ports and AQ: California Ports Infrastructure, Security, and Air Quality Improvement Account

TCIF: Trade Corridors Improvement Fund

TFA: Transportation Facilities Account

Public Trans.: Public Transportation Modernization, Improvement, and Service Enhancement Account

SLPPA: State-Local Partnership Program Account

Transit Security: Transit System Safety, Security, and Disaster Response Account

LBSRA: Local Bridge Seismic Retrofit Account

HRCSA: Highway-Railroad Crossing Safety Account

HSRPA: Highway Safety Rehabilitation, and Preservation Account

Local Roads: Local Streets and Road Improvement, Congestion Relief, and Traffic Safety Account of 2006

New Funding Mechanisms

The following is a more detailed look at some of the new funding allocations in the proposed bond, evaluated in the context of the identified trends threatening the STIP. These examples are taken from the first third of Table 1 where many funded projects would have otherwise been subject to the STIP process.

The Corridor Mobility Improvement Account

Four and a half-billion dollars are slated to be set aside in the new Corridor Mobility Improvement Account (CMIA). The CTC is charged with allocating funds from this account for improvements to the State Highway System and its major access routes in order to reduce congestion in critical corridors. The bill requires that nominated projects come from Caltrans or regional planning agencies and must be on long-range transportation plans (RTPs), the source document from which projects are selected for inclusion in RTIPs and ITIPs, which in turn form the STIP. Although the source of projects is the same as those for the STIP and documentation is required establishing their qualitative and quantitative merits in reducing congestion, a parallel process for project selection and funding erodes the significance of the STIP as the state's comprehensive planning and scheduling tool for transportation projects. This program is undoubtedly designed to fast-track project implementation and to provide an infusion of badly-needed cash. However, at the same time, this new, large source of money duplicates an existing process of funding transportation.

The CTC must adopt guidelines for administering the funds by December 1, 2006, nominations are then due by January 15, 2007, and an initial program of projects will be selected by March 1, 2007. This adopted program then will be updated biennially in conjunction with the STIP. To generate these guidelines, the bill's language gives some guidance by stating, "...the program [will be] geographically balanced, consistent with the geographic split for funding ... [and will] provide mobility improvements ... in all regions of California..." (Stats. 2006, ch. 25 (SB 1266), Govt. Code § 8879.23(a)(8)). Draft guidelines and a summary of CMIA work group discussions were made available by the CTC at the end of September 2006 (CTC, 2006b; 2006c).

While the CMIA infuses badly-needed funds into the transportation system, there are some problematic areas. First, the proposed account parallels the generally perceived successful STIP process in terms of how projects are to be nominated, however, what is less clear is how the prioritization and scheduling of the CMIA projects will coordinate with existing STIP projects, currently programmed in the 2006 STIP through fiscal year 2010-2011. Most projects programmed in the current STIP are those most needed in the near-term, as determined by Caltrans and regional planning agencies. There is a risk that projects would be selected from RTPs that otherwise would not have been considered for STIP programming any earlier than 2008, except by amendment, thus potentially compromising scheduling and system efficiency.

For example, in 2003, when the most recent state budget crisis was peaking, Los Angeles County Metropolitan Transit Authority (MTA) was forced to shift three TCRP priority transit projects to its RTIP because of the continued deferment of the TCRP's funding (LACMTA, 2003). One project risked losing federal money if it did not proceed; another risked increased costs on a

favorable contract bid. By shifting these projects to its RTIP and in turn the state's RIP, an equivalent decrease in funding occurred for other projects that had already been programmed in the STIP. Nine local road projects were deleted as a result of adding the TCRP transit projects (CTC, 2004a). In effect, road projects in the RTIP and RIP came into direct competition with the TCRP transit projects, a problematic scenario for prioritization that was never addressed at the outset because of the parallel funding streams. When projects are shifted between funding categories, there is a risk that system inefficiencies can occur both in terms of operational aspects of the system itself and also in project delivery.

It is also possible that an imbalance in a transportation system could occur if improvements are made in one area that exacerbate problems in another, problems which should have been addressed first. For example, this might occur if throughput in a critical interchange is improved, and it worsens congestion further downstream.

In essence, the parallel project selection and prioritization structure that will be created by the proposed bond will be especially vulnerable to the funding of lower priority projects or those delayed for fiscal reasons. Caltrans and regional planning agencies are given only a 1½ month window to submit nominations following the adoption of the CTC's guidelines. Projects selected directly from the RTPs, the result of regions' long-range planning (typically 20 years) have not been prioritized, and in some cases, have not undergone as much vetting as those on the corresponding RTIPs. This short timeframe for project selection lends itself to the pushing forward of projects without the benefits of the full consideration of comprehensive planning and scheduling afforded through the RTIP process. Local agencies have an incentive to maximize their return from the bond, to secure funding for their most costly projects, rather than prioritize their nominations to maximize efficient use of the funding and make selections that will result in the best combination of improvements. It is also questionable, given the 1½ month timeframe, as to what degree of coordination can be reasonably expected between regional agencies and Caltrans in the nomination process for projects of interregional significance. It will be the responsibility of the CTC to minimize these potential misuses of funding.

Selection for CMIA funding will depend on what the CTC will accept as sufficient documentation supporting the nominated projects. If a project were to have been included in an RTIP and the STIP, it would have undergone the thorough development of a Project Studies Report (PSR) or Major Investment Study.¹¹ The draft guidelines indicate that nominations should include a PSR or equivalent, although it is not clear whether it is absolutely mandatory (CTC, 2006c). The CTC will be asked to make this assessment when it selects projects by March 1, 2007, again within a tight 1½ timeframe. Bond financing, by definition, should be aimed at producing significant long-term benefits. It is particularly important in the first biennium of project selection that the CTC selects projects using criteria that maximize the potential for long-term returns to the state and reduce the likelihood of funding lower-ranking projects simply because the time periods specified for nominating and selecting projects is short. On the other hand, not sufficiently programming and making use of the \$4.5 billion may carry political ramifications and be seen as a questionable level of commitment following the bond's approval. Achieving the required construction start deadline of December 2012 also will be made more difficult.

¹¹ Government Code § 14527(g).

The second potentially problematic area in the CMIA is its distribution of money, although the CTC appears to be taking the necessary steps to address this concern. Although the CMIA may be a more flexible programming tool than the STIP, as it is not stipulated that it must adhere to the county share formula, a fair distribution of the money is not guaranteed. The proposed bond specifically requires a geographic balance between the North and South, which still leaves an opportunity for an inequitable distribution of money within each of the North-South geographic splits without incorporating another balancing means (such as county shares in the case of the STIP) to ensure a regional balance. To address this potential inequity, “regional programming targets” are to be applied and are currently defined in the draft guidelines as eight broad regions of the state. By using such broad regions, an opportunity is created to fund larger-scale, less parochial projects that would have unlikely been implemented through the STIP’s narrower county share allotments. However, rather than creating a parallel funding stream to address this drawback of the STIP, reforming the county share process to better address regional-scale needs would be a preferable policy solution.

The Trade Corridors Improvement Fund

Two billion dollars will be allocated to the Trade Corridors Improvement Fund (TCIF). Under this provision, the CTC is to select projects from unspecified nominations using the findings of the Business, Transportation and Housing Agency’s and the California Environmental Protection Association’s Goods Movement Action Plan (GMAP).¹² As part of the selection process, the CTC is also asked to review individual RTPAs’ goods movement plans and the statewide port master plan.¹³ It is likely that many of the projects that will be targeted for funding through the TCIF would otherwise have been revenue-sourced from the STIP if the recipients of these funds will be primarily public agencies like RTPAs, as selected projects are intended to increase highway and freight rail capacity and provide other goods movement-related operational improvements. To date it has been unclear what projects on the STIP are primarily goods movement-oriented; an examination of the 2006 STIP reveals no apparent distinctions (CTC, 2006a). The development of the GMAP to identify goods movement needs is the first real attempt at quantifying specific projects statewide (BTH and Cal/EPA, 2006).

Goods movement is a significant, statewide transportation issue that carries with it stronger justification for a separate funding process. Careful oversight of project selection and prioritization, however, is critical to achieving an integrated and balanced upgrade to the state’s multimodal goods movement network. The notion of balance is especially critical given the stipulated, additional requirement that projects “have identified and committed supplemental funding from appropriate local, federal, or private sources” (Stats. 2006, ch. 25 (SB 1266), Govt. Code § 8879.23(c)(1)(C)). In order for projects to be selected and prioritized under the TCIF, a 50% match must be identified. Regions lacking financial capacity to meet this mandatory 50% matching requirement will be ineligible. However, one positive feature is that the availability of private capital (e.g., from shipping and receiving businesses) for matching funds is likely to be high and would fairly attribute the costs of a project to its users. Involvement of private entities may also result in projects that would not have been possible through the STIP process, justifying the use of this account.

¹² The GMAP is due for completion by the end of 2006.

¹³ The statewide port master plan is established in Harbors and Navigation Code § 1760.

The State-Local Partnership Program Account

The \$1.0 billion State-Local Partnership Program Account (SLPPA) is established to further encourage local capital augmentation for transportation by requiring at least a 50% local share for eligible projects. The funds will be administered by the CTC, and there is no reference in the bill for the development of process or criteria guidelines, such as those required for the CMIA for selecting and prioritizing nominated projects. Guideline and selection criteria are yet to be determined by legislative statute. In principle, this account is similar to the State-Local Transportation Partnership Program (SLTPP) enacted in 1989, repealed by SB 45, and eventually concluded in July 2000 after a one-year extension for construction contract letting. The new partnership program will have a five-year lifespan, with an intended approximate average annual funding of \$200 million, a level similar to the annual funding of the former SLTPP. Presumably the motivation behind the new SLPPA is similar to the SLTPP: for the State and local regions or cities to share in the costs of locally-supported, expedited projects without significant State oversight. Under the SLTPP, as long as projects met the criteria for the program's qualification, they received a share of the annual state funding, divided among all eligible projects. Eligible projects were required to be a local road, state highway, or mass transit guideway and increase capacity, extend service, or in the case of rehabilitation, extend a road's useful life by at least 10 years (Caltrans, 1996).

The SLTPP proved sufficiently popular among local agencies that there were enough eligible projects to reduce the state share from the maximum allowable of 50% to a range of about 5.6% to 30% over the program's life (Robert McCleary, unpublished data). Despite numerous letters of objection received from local agencies (CA State Legislature, Senate), the SLTPP was repealed in 1997 under SB 45; recall that one of the primary motivations of SB 45 was to consolidate categorical accounts as a way of increasing the flexibility of the STIP and state transportation funding. Reasoning for its cancellation also hinged on the uncertainty of the exact amount of the State's annual contribution and its effect on delaying construction starts.

Programs that foster collaborative funding efforts and are well-received by participating agencies have strong merit. However, it is worth exercising some degree of caution in the implementation of such programs, as it is possible to have projects funded through this mechanism create an inequitable geographic distribution of funding, depending upon a region's ability to raise local capital. Raising local capital also carries equity considerations within a particular region that *is* able to do so.

The previous partnership program, the SLTPP, was simultaneously implemented with the increase in the state's gas tax in 1990. Because of this, the ability to fund the STIP through the SHA was more secure then than today; as noted previously, decreasing real receipts from the gas tax have depleted the State's ability to sustain both its obligation to the SHOPP and the STIP. With weakened support for the STIP then, there is an increasing trend to leverage local capital to make the State's dollars go further, as intended by the SLPPA (as well as the TCIF), placing a burden upon transportation systems' users and non-users alike. Fees or taxes generally levied uniformly are typically required of local regions to raise the necessary matching capital. Although in theory this should encourage more frugal and efficient fiscal management at the local level, it will come at the expense of the beneficiary-pays principle of transportation finance.

These costs to both users and non-users come in addition to those borne by all for the general obligation bonds the State will issue to generate the new funding in the first place.

New Accounts and Local Transportation Sales Taxes

The new SLPPA, the TCIF, and potentially some projects using the CMIA will all require matching local capital from regions and counties to receive funding from the proposed bond. This requirement provides clear encouragement from the State for the adoption or extension of a local transportation sales tax measure, which is one of the most obvious mechanisms for generating such a match. A recent internal report from the Santa Barbara County Association of Governments (SBCAG) planning for the potential passage of the bond points out that counties with such measures are at a distinct advantage for receiving state funds from the bond, as a means of encouraging the passage of its own sales tax measure, Measure D, in November (SBCAG, 2006).¹⁴ With specific reference to the new SLPPA, SBCAG staff note that their understanding is "...that the program was included in the bond because the expired State-Local Partnership program was very popular and successful with measure counties and helped expedite the delivery of sales tax measure projects so the drafters of Prop 1B wanted to revive it" (p. 4). There is some suggestion that SBCAG also perceives that the revival of the SLTPP is directly correlated to state support of local transportation sales tax measures. Consequently, it is possible voters in November will not see them as competing means of financing transportation but rather complementary, choosing to vote for them both rather than just one or the other.

Overall, 17 counties have local transportation sales tax measures currently in effect (LAO, 2006b). In November, four are up for renewal (as well as an increase in the case of Santa Barbara County), and they are accompanied by five new measures (in Amador, Kern, Madera, Merced, and Stanislaus Counties).¹⁵ These taxes require a two-thirds vote for approval since the *Guardino* case in 1995 and the passage of Proposition 218 in 1996 (Matsubara, 1996);¹⁶ thus passage is not guaranteed despite the public perception of significant traffic congestion problems. In June 2006, four counties (Merced, Monterey, Napa, and Solano Counties) had new measures on the ballot and all failed to pass. An additional measure also failed in Santa Clara County, which already has a local option tax, to help fund an extension of BART to Silicon Valley.

It is worth noting that the 17 existing counties with local transportation sales taxes represent about 82% of the state's population, 87% if the five November measures pass. However, in terms of total street, road, and highway mileage per county, only 59% of the state's mileage is covered by the 17 measures, 68% if the five additional measures pass.¹⁷ Since sales tax measures are a

¹⁴ Santa Barbara County has an existing transportation sales tax measure enacted in 1989 that is set to expire in 2009. The County's November ballot seeks to extend the tax for another 30 years as well as increase it from one-half to three-quarters of a cent.

¹⁵ Madera County had a local transportation sales tax from 1990 to 2005. However since it has expired, its renewal this November is considered a new tax for the purposes of this discussion.

¹⁶ *Santa Clara County Local Transportation Authority v. Guardino* affirmed an original judgment under Proposition 13 passed in 1978 that a 1992 transportation sales tax measure approved by 54.1% of the voters in Santa Clara County was unconstitutional, this time noting that the tax violated Proposition 62 passed in 1986. Proposition 218 was then passed in 1996 closing any further loopholes under Propositions 13 and 62 regarding special tax assessments, now necessitating a supermajority vote for their passage.

¹⁷ These figures are calculated using county information made available by the California Department of Finance.

likely source of matching funds, at least 18% of the state's population, as well as potentially up to about 40% of its streets, roads, and highways would be potentially excluded, unpalatable from either a social or road infrastructure equity perspective. It is quite obvious that needs are not always balanced across the state, such that we require an equal investment on every street, road, or highway, but the fact remains each citizen of the state will be paying part of the cost of the state's bond, and those living in a county without a local sales tax measure may not see much of it invested in the area in which they reside.¹⁸

Encouraging the adoption of local transportation sales tax measures should also consider the findings of past analyses on their use. Researchers raise a number of concerns (Crabbe et al., 2002). First, sales-tax ballot measures often spur the promotion of large, capital-intensive projects without future consideration of maintenance and operations, or indeed come at the expense of maintenance and operations. They might also displace less visible and strongly supported, but of better value, smaller-scale solutions. Additionally, with an attempt to fairly allocate sales-tax revenues throughout a county, the ability to plan regionally and to meet overall regional needs is compromised by fragmenting the funding. Finally, transportation sales taxes often create inflexibility by committing the revenues to specific ballot-box approved capital projects by requiring a set expenditure plan (Crabbe et al., 2002). Overall, the encouragement of local transportation sales taxes through the proposed bond's measures is not necessarily a positive trend for state transportation policy, although without them, there would significantly less capital investment.

Highway 99 Earmark

The \$1.0 billion set aside specifically for Highway 99 through the state's Central Valley is the most obvious use of earmarking in the proposed bond package. There is no doubt it is a critical component of the state's transportation network and sorely in need of modernization and expansion for both people and goods movement.¹⁹

Caltrans has developed a Route 99 Corridor Business Plan which identifies three phases of work over a 20-year timespan to complete four priority categories of work (Caltrans, 2005). This timeframe is based on current estimates of future funding as of 2005, and thus does not consider the proposed bond. According to Caltrans, Central Valley planning agencies have generally viewed this timeframe as unacceptable, given the immediate urgency for improvements to the route. Caltrans views an accelerated implementation schedule as preferable to waiting, but notes that there are associated risks with such a rapid rate of financing. Caltrans (2005) states that these include negotiating a "ramp-up period" of typically five years to undergo environmental review processes and other planning stages, the complexities associated with managing traffic flow

¹⁸ Counties may raise matching funds through other sources, such as developer fees, but the local option sales taxes are a much more lucrative and predictable revenue stream, one that will likely be able to leverage more State dollars than developer fees.

¹⁹ Senate Concurrent Resolution 17 (Ch. 84, Resolutions of 2001) formalized the importance the State places on Route 99, especially as the major access route to the heart of California's agricultural industry, and recognized that it needs significant infrastructure improvements. It also asked Caltrans to develop a report on its people and goods movement-related needs. Additionally, comments submitted in reference to the draft version of the GMAP, as to its inclusion or otherwise of Route 99, significantly emphasize its importance and level of need (see: www.arb.ca.gov/gmp/gmp.htm).

during construction, and the ability of Caltrans itself and the contracting industry to adequately deal with the workload.

In addition to the \$1.0 billion earmark, work on Highway 99 could be facilitated by the bond's augmentations to the STIP and SHOPP (see Table 1). Caltrans' Business Plan (2005) prioritizes 67 projects, 13 projects of which are currently programmed in the STIP, but only 20% funded. These 13 projects will complete all 'freeway gaps' along Highway 99, currently its highest priority. Potentially then, the STIP and SHOPP augmentations would help fully fund these 13 programmed projects in addition to others out of the 67. Of course, only 25% of the STIP augmentation would be available for the ITIP, which is the primary source for mainline improvements to Highway 99.

The earmarked \$1.0 billion theoretically can be applied to any Highway 99 project that would accelerate progress, and is not explicitly limited to those identified in the Business Plan. Its language is open-ended, only indicating the funding is available to Caltrans for a variety of improvements (Stats. 2006, ch. 25 (SB 1266), Govt. Code § 8879.23(b)). Because additional funding for Highway 99 improvements could also come from the bond's CMIA, TCIF, and SLPPA, as well as the STIP and SHOPP augmentations, there is a potential for creating too great an influx of funding. And since the earmark does not come with any restrictions on the use of other funding sources for the route, despite its priority status, an inequitable overemphasis on Highway 99 could develop.

Other New Funding

Three other funds listed in Table 1 have been identified as financing projects that normally would have, at least partially originated through a STIP process: the Intercity Rail, the Transit Security, and the Local Roads funds. Intercity rail is ordinarily funded through the IIP. And although the Transit Security fund details are not very specific, its inclusion of "transit capacity increasing projects" suggest that it too would have likely used the STIP process. However, these are not necessarily inappropriate funding mechanisms outside the STIP.

Of the \$400 million allocated to Caltrans for intercity rail, nearly one-third must be spent on rolling stock, which because of restrictions in the State Constitution currently can only be acquired through the IIP using federal funds.²⁰ This allocation for rolling stock and the remaining \$275 million for intercity rail are reasonable uses for funding outside the STIP.

A significant investment in security projects is a recent phenomenon. Much like seismic retrofitting, which was in response to a sudden, critical need and required its own dedicated funding through a bond, security-related projects may follow suit. If security is considered a high-priority undertaking, the Transit Security fund bypassing the STIP and using bond financing is justifiable, as long as projects are coordinated and of long-term benefit.

The Local Roads fund is direct assistance to cities and counties that will be distributed in the same way that the State subvents a portion (generally 40% after TCRP projects are funded) of the sales tax on gasoline to cities and counties through the TIF to fund local road rehabilitation

²⁰ Article XIX, § 1 excludes the use of state motor vehicle fuel tax revenue for "mass transit vehicles."

and maintenance.²¹ Although some of these projects again would have gone through the STIP process, this subvention will potentially alleviate some of the future burden of the RIP and its RTIPs to cover such needs, which in turn would help secure more future funding for the STIP.²² Nonetheless, the prudence of financing local road maintenance through bonds, without clear long-term benefits or state oversight is dubious.

The Use of Infrastructure Bond Financing

Aside from the use of earmarking and categorical account funding, and with such a massive planned investment in transportation infrastructure, the appropriate use of bonding as a finance tool deserves attention. California's three past bond measures (Propositions 108 and 116 in 1990 and Proposition 192 in 1996) were issued for narrowly specified capital improvement purposes. Proposition 108 created the Passenger Rail Bond Fund to finance the acquisition of right-of-way, capital expenditures, and rolling stock for rail projects on legislatively defined corridors.²³ Proposition 116 was an initiative assembled on a project-for-pay basis for which nearly \$2.0 billion could be spent for similar rail-related purposes. Six year later, Proposition 192 was part of the answer to the significant funding deficit and drain on the SHA for seismic retrofitting of state highways and bridges. Proposition 192 bond money was dedicated only for projects specifically identified by Caltrans as part of its seismic retrofit program.

In general, projects suitable for bond financing should produce a sufficiently long period of benefits so as to balance a stream of returns with the costs of debt. Bonds are also useful for projects that might accrue additional costs (e.g., inflation or hazard costs) if a project is delayed or constructed later in time with a pay-as-you-go scheme (for similar remarks see: LAO, 2006a; Cal-Tax, 2006). Projects like seismic retrofitting are more easily evaluated and justified under the test of bond financing.

The magnitude and scope of the proposed bond makes commitments to transportation funding at all project specification levels: specific earmarks (Highway 99), categorical funds (e.g. CMIA, TCIF), and augmentation of existing broadly defined programs (e.g. STIP, SHOPP). Not only does this have the net effect of complicating funding management and project prioritization, and in many cases, subverting the existing STIP process, it also sets the stage for programming projects that might not generate the long-term benefits needed by a bonding mechanism. Ordinarily, state general obligation bonds are subject to §16727 of the Government Code whereby subdivision (a) states that bonds are issued only for the purpose of "the costs of construction or acquisition of capital assets." However, SB 1266, the legislative statute enacting Proposition 1B, exempts the proposed bond from this requirement through its addition of §

²¹ However, this funding from the TIF has been inconsistent up until 2005, as further elaborated in the section on Proposition 1A.

²² It has been the policy of the CTC to allow the funding of local street and road rehabilitation, but not maintenance, with the STIP (CTC, 2005a). An attempt to codify this policy by the Legislature was made in 2006 with AB 2295 but was vetoed by the Governor.

²³ Two additional \$1.0 billion rail bonds were part of the Passenger Rail and Clean Air Act of 1990 that led to Proposition 108. They were placed on the ballot as Proposition 156 in 1992 and Proposition 181 in 1994, but both failed to pass.

8879.26 to the Government Code.²⁴ This leaves the bond's statute and guidelines developed thereof to direct how the bond funding can be spent. In some cases, non-capital projects could easily be funded. For example, the \$1 billion marked for Ports and AQ (see Table 1) emission reduction measures does not come with an explicit capital project expenditure stipulation. More directly, spending on maintenance from the Local Road fund is explicitly allowed.

Recommendations for Proposition 1B

Since the bond, if approved, would have a significant impact on transportation planning in California, we have assembled a set of recommendations designed to alleviate or minimize the concerns raised in the previous sections. We identified three primary concerns, two of which were detailed in the introduction as pervasive in California's transportation finance. First, the potential for, and in some cases, permitted circumvention of the STIP process through earmarking and categorical accounts elevates the potential for overlapping funding to fund lower priority projects or create an imbalance in system improvements. A second concern is that the impact of such a large influx of money will exacerbate the boom-or-bust nature of transportation finance on the management, planning, and construction of many new projects. The final concern, specific to Proposition 1B, is the legitimacy of using bond financing for projects that do not generate a sufficiently long-term downstream benefit flow.

The potential for project funding source overlap leading to the funding of lower priority projects arises from the eligibility criteria provided in the bond's bill language. This is especially the case for highway improvements and capacity expansion projects, which can be funded through the CMIA, TCIF, and SLPPA, the bond's main categorical accounts. Of these three programs, the CTC is asked to develop explicit project selection guidelines only for the CMIA. Consistent and compatible project selection guidelines should be developed for all three categories of funding. This will streamline the selection process, ensure that the highest priority projects are programmed and minimize the shortcomings of categorical account funding. Since the requirement for a local match is only optional under the CMIA, an efficient and equitable distribution is more likely to be realized if all three accounts use similar principles for prioritization. Specifically we recommend the following:

- For the CMIA, the CTC should consider adopting only a small initial program by the first deadline, given the very short timeframe to develop and select it. The initial limited-scale selection should prioritize projects of interregional significance that have been delayed due to a lack of sufficient STIP funding. Although the CMIA is an opportunity to transcend the more restrictive STIP county shares, the ability to achieve interagency coordination and nominate more regional scale projects in the short initial timeframe may not be easily attained. The next period of project selection, presumably in 2009, may be better timed to select projects of this nature. The December 2012 construction start deadline is still realizable if kept in mind during the coordination effort prior to the next selection period.

²⁴ Section 8879.26 states: "The bonds authorized by this chapter shall be prepared, executed, issued, sold, paid, and redeemed as provided in the State General Obligation Bond Law (Chapter 4 (commencing with Section 16720) of Part 3 of Division 4), except subdivision (a) of Section 16727 to the extent that subdivision is inconsistent with this chapter..."

- For the TCIF, projects should document direct benefits to those who supply the “supplemental funding from appropriate local, federal, or private sources” (Stats. 2006, ch. 25 (SB 1266), Govt. Code § 8879.23(c)(1)(C)). If direct benefits to funding source providers cannot be well-documented, project funding should be considered through other accounts. The TCIF presents an opportunity to pursue public-private partnerships by leveraging privately-sourced money, which not only follows a beneficiary-pays scheme, but also legitimizes a new funding process outside the STIP. If TCIF funding is channeled mainly to local agencies, this justification is less evident.
- A prioritization process for funding projects through the new SLPPA will be necessary given the large volume of eligible projects from the previous state-local partnership program. Previously, the Legislature simply appropriated its annual partnership program funding on a pro-rated basis to all eligible projects (Caltrans, 1996). To adhere to the stipulated one-to-one match guarantee, a prioritization process that is consistent and compatible with the STIP criteria should be developed.

Additionally, we recommend:

- The \$1 billion earmark for Highway 99 should be the sole source for funding projects along the route, after full funding for the 13 currently programmed projects is secured through standard channels. State-level funding for the remaining 54 prioritized projects from Caltrans’ business plan should come solely from the earmark until it is exhausted. Only then should the route be eligible for further state assistance, including other bond revenue, if available. This restriction is not incorporated in the current draft guidelines for the CMIA (CTC, 2006c). This will be the fairest use of the earmark relative to other priorities and reduce the impact of too great a funding influx.
- Overall, wherever possible, the state agency responsible for project selection (Caltrans, CTC, etc.) should develop guidelines that consider the applicability of bond financing when selecting projects. The Legislature should restrict the new SLPPA to at least the types of capital projects funded under the old SLTPP. Unfortunately, for some existing program augmentation or subvented funds, thorough consideration of bond financing’s applicability is not possible.

Proposition 1B: Conclusion

Proposition 1B, by providing nearly \$20 billion in general obligation bonds, would dramatically advance the means to finance California’s substantial transportation needs through categorical funding or earmarks and to a lesser extent, augmentations to existing programs. This policy action has serious implications that add additional obstacles to the state’s primary, established, and workable transportation implementation tool: the STIP. Current drawbacks to the STIP such as insufficient opportunity to support large, regional-scale projects is not best-addressed through a vast and complicated mechanism like the proposed bond. Rather, Proposition 1B perpetuates themes highlighted in this paper as contributing to transportation’s critical state of affairs. Overall, an environment for inefficiency and missed opportunity is being created, moving California further away from a workable and sustainable solution to providing for its future

transportation requirements. By infusing a large amount of borrowed capital through this bond proposal, the real problem of securing a stable and predictable revenue stream that can be administered through a workable, long-range planning process is mostly neglected.

Nonetheless, if voters approve the proposed bond, this level of capital is also a chance to make progress, if used carefully. Recommendations have been proposed here that favor using the available funding in a manner that mirrors or preserves the STIP process. Clear prioritizations and oversight to identify the most efficient and equitable distribution of monies, rather than funding uncoordinated and potentially ‘pet’ projects are imperative to successful use of this capital. Whenever possible, use of the money should also reflect an appropriate use of bond financing—i.e., funding capital projects with well-defined long-term benefits.

The theme of funding stability is now examined with an in-depth look at Proposition 1A, a constitutional amendment designed to better protect transportation funding collected from the sales tax on gasoline.

PROPOSITION 1A: THE “CONSTITUTIONAL FIX” TO PROPOSITION 42

Although an under-addressed issue, California has not been entirely blind to its transportation’s funding instability. Governor Schwarzenegger vowed to improve stability by “[p]rotecting Proposition 42 permanently through a constitutional amendment to eliminate the option for future governors and legislatures to suspend funding” (Office of the Governor, 2006a). Encouraged by the Governor’s proposed Strategic Growth Plan, Senator Torlakson (D-Antioch) drafted State Constitutional Amendment Number 7 (SCA 7) to address the issue of suspended funding abuses under Proposition 42. The amendment will also be on the November 2006 ballot as Proposition 1A, titled the “Transportation Funding Protection Legislative Constitutional Amendment” (Stats. 2006, ch. 30 (AB 1540)). Before a detailed discussion of SCA 7 can begin, the history of Proposition 42 must be reviewed.

Background to Proposition 42 and SCA 7

In 1998, Proposition 2 was approved statewide by voters. The proposition changed § 6 of Article XIX and added Article XIXA to the California Constitution, which allowed funds in the Public Transportation Account (PTA) as well as all motor fuels excise tax revenues, to be loaned to the General Fund under one of two possible circumstances:

- a) The amount is fully repaid to the PTA in the same fiscal year or not more than 30 days after the date of enactment of the budget bill for the subsequent fiscal year.
- b) The amount is fully repaid within three fiscal years so long as one of the following has occurred: the Governor declares a state of financial emergency OR the projected general fund revenue for the current year is less than the general fund revenue from the previous year (Cal. Const. Art. XIXA).

Although Proposition 2 appeared to have strong and enforceable language, upon a closer examination and over time numerous loopholes became apparent. For example, the government

was not required to pay back loans to the General Fund, or any other fund, with interest.²⁵ An even larger loophole is the failure to specify a timeline for repayment when loans are made to government funds other than the General Fund (Schnaidt, 2005). Thus, through clever legislation and accounting known as loan laundering, the Governor and the Legislature may avoid, and did avoid, the timelines for returning borrowed transportation funds and intended limits to that borrowing.

In 2000, Assembly Bill (AB) 2928 dedicated gasoline sales tax receipts to specified transportation purposes and established the Traffic Congestion Relief Program (TCRP) and the Transportation Investment Fund (TIF). Under AB 2928, each year a specified amount of gasoline sales tax revenues was provided first to 141 earmarked projects in the TCRP, with the remainder deposited into the TIF and divided 40% to the STIP, 40% to cities and counties as a subvention for local streets and roads, and 20% to the PTA (Stats. 2000, ch. 91 (AB 2928)). This arrangement is collectively known as the '40-40-20 Program'. The establishment of the TCRP was Governor Gray Davis' response to the continued and mounting unfunded transportation needs of the state, punctuated by the CTC's 1999 10-year \$112 billion needs assessment (CTC, 1999). In 2000, a notable budget surplus made this program possible. The very next year, however, economic circumstances, including the technology downturn, turned the budget surplus into a deficit. In order to close the budget gap, the gas sales tax transfer to the TCRP and the 40-40-20 Program was delayed for two years. Subsequently, a complicated series of loans in fiscal years 2001-02 and 2002-03 channeling money to the General Fund through the TCRP's account from other transportation sources, including bypassing Proposition 2's addition of Article XIXA in the case of the PTA, left transportation funding in an unstable state, and left scheduled projects in limbo.

In response to the continued pressing needs for transportation investment and support from the CTC, transportation interests, and legislators for permanently dedicating the gasoline sales tax to transportation, and as part of the final state budget agreement, Proposition 42 was placed on the March 2002 ballot and approved by voters. The proposition grandfathered the TCRP and made the TIF and its 40-40-20 Program permanent by adding Article XIXB to the State Constitution. Proposition 42 effectively eliminated the sunset date for the TIF after the delayed conclusion of the TCRP in 2008. But the proposition also allows a suspension of TIF funding, in whole or in part, for a given fiscal year, upon the Governor issuing a proclamation that the TIF allocation would have a significant negative effect on the range of other government functions funded through the General Fund. A two-thirds vote by the Legislature is then required for a suspension to take effect in any given year (Cal. Const. Art. XIXB). As part of the 2002 budget agreement, this suspension stipulation was included as a fail-safe for those concerned that Prop 42 would severely limit the budgetary flexibility necessary to close any future budget shortfalls. Unfortunately for transportation, Prop 42, although enacted four years after Proposition 2, contained the same critical loopholes as the earlier proposition; interest was not required on loans,

²⁵ Assembly Bill 2928, as enacted in 2000, added section 7102(d) to the California Revenue and Taxation Code (Stats. 2000, ch. 91 (A.B. 2928), § 11). This subdivision required that loans made to the General Fund were paid back with interest at the Pooled Money Investment Account rate (Cal. Rev. & Tax Code § 7102(d)). But, there is still no constitutional or statutory requirement to collect interest on loans made to any other government fund.

and a timeline for payback could be avoided by making loans to or through government funds other than the General Fund.²⁶

The loopholes did not go unexploited, as TIF funds were diverted in fiscal years 2003-04 and 2004-05 to address the State's continued fiscal hardships. Now with the state's economic recovery, only this past year, 2005-06 was full transfer to the TIF made. The recently passed 2006-07 budget also includes the full transfer as well as a substantial and early repayment of loans to borrowed accounts and the Prop 42 suspensions of 2003-04 and 2004-05. Nonetheless, an outstanding \$750 million remains unpaid, and shortfalls of Prop 42 remain, threatening the future predictability of the TIF funding and prompting this November's proposed Constitutional amendment, SCA 7 or Proposition 1A, which would require full payback in 10 years.

Proposition 1A: Closing the Proposition 42 Loopholes?

Proposition 1A or SCA 7 is the Governor's and Legislature's response to the shortcomings of Prop 42. It amends Article XIXB of the Constitution to add further specific restrictions on suspending TIF payments. The transfer of funds to the TIF, in whole or in part may only be suspended if all the following conditions are met:

- 1) Governor declares a severe state of hardship.
- 2) Each house of the Legislature approves the suspension by a two-thirds vote.
- 3) Prior to or concurrent with the above vote, a separate statute is enacted that requires full repayment, including interest, of the suspended amounts no later than three fiscal years after the fiscal year in which the suspension was applied.
- 4) Suspension is only allowed in two fiscal years during any period of ten consecutive fiscal years.
- 5) Suspension is not allowed in a fiscal year in which full repayment required by a statute, as specified in 3) above, has not been completed.

Unfortunately, although this legislation is a step in the right direction, it fails to adequately address the stability and transparency issues related to the gasoline sales tax funding stream. To understand the full value of SCA 7, the impacts on both of the two main transportation accounts funded by the gasoline sales tax, the TIF and the PTA must be considered.

SCA 7's most direct and positive impacts are on the TIF, but there still exists unresolved issues. First, Governor Schwarzenegger vowed to eliminate the option to suspend Prop 42 funding in exchange for spreading repayment over 10 years. While SCA 7 adds additional restrictions on suspensions, it still allows them on a limited basis. Further, SCA 7 requires that a statute be created providing the details of repayment with interest for all suspensions. By including the interest requirement in a statute instead of in Article XIXB itself, SCA 7 creates a loophole in which the Legislature can choose to repeal the statute after its creation, allowing it to circumvent the intention of Proposition 1A. Although such action is, in all likelihood, politically infeasible,

²⁶ Article XIXB of the Constitution, which was created by Proposition 42 does not contain any payback timeline, but Article XIX, § 6 requires that loans of revenues to the General Fund from taxes imposed by the State on motor vehicle fuels are paid back in a maximum of three years (Cal. Const. Art. XIX). Thus, Article XIXB contains an implied timeline, but only for funds loaned to the General Fund.

the State does have a history of using unexpected and unconventional machinations to finesse the budget when it faces dire financial straits, as seen in the loan laundering and issuance of general obligation bonds to cover its most recent budget deficit. Ironically, a ‘hard fix’ for Prop 42, which would ban all suspensions outright, was placed on the June 2008 ballot by initiative.

Finally, SCA 7 does not specify how to calculate the interest, as it does for fuel excise tax loans to the General Fund in Article XIX § 6. The Legislature will likely use the same Pooled Money Investment Account (PMIA) rate, although there is nothing to prevent it from using a lower one. Construction costs’ inflation could easily outstrip any interest rate.

Proposition 1A: No Impact on Articles XIX and XIXA

As originally drafted and introduced on February 15, 2005, SCA 7 was a very different piece of legislation. It directly affected the PTA under Article XIXA as well the tax revenue covered under Article XIX.²⁷ Originally for Article XIXA, it expanded the PTA loan payback requirements to every government fund or account, not just the General Fund. It did the same for Article XIX and the tax and fee revenue to which it refers. The payback provisions were originally added by Proposition 2 in 1998, but the loopholes remain if loans are made to accounts other than the General Fund, as was done in 2001-02 and 2002-03.²⁸ Additionally, SCA 7’s original language added interest rate requirements, based on the PMIA, to loans made under both Articles.

Because SCA 7 was wholly altered when it was reintroduced in January 2006, it is currently relevant to the PTA only because 20% of the TIF’s funding is transferred to the PTA. However, once the money is in the PTA, which includes revenue from other sources,²⁹ it will remain susceptible to the Article XIXA loopholes discussed previously. One potential negative result of this situation is that future borrowing needed to address fiscal crises may shift from TIF suspensions to PTA loans not made directly to the General Fund. Certainly with all the new accounts created under the proposed bond, there is no shortage of means to funnel money to the General Fund without the recourse of a strict payback timeline and interest requirement. Since currently the PTA and the TIF are jointly the two main funding streams for the STIP,³⁰ increasing the stability of the TIF at the expense of the PTA will not have a positive impact on the overall stability of funding for STIP projects. Additionally, the same loopholes that afflict the PTA in Article XIXA exist for the SHA in Article XIX (see note 25), which currently does not impact the STIP, but would so the SHOPP.

Recommendation

SCA 7 does make the funding of the TIF more secure, reducing the ease with which suspensions can occur under Proposition 42 and Article XIXB. This in turn helps protect and make more

²⁷ Article XIX of the California Constitution states that tax revenue from motor vehicle fuel and tax and fee revenue from motor vehicle use can only be used for certain transportation purposes. This revenue primarily is deposited in the SHA and the Motor Vehicle Account.

²⁸ Loans were made from the SHA and the PTA to the TCRP’s account to “backfill” a loan to the General Fund from the TCRP.

²⁹ See note 8.

³⁰ Recall that the SHA is exhausted just through commitments to the SHOPP (CTC, 2005b).

predictable about half the overall funding to the STIP, sourced directly from the TIF as well as the PTA. Nonetheless, we recommend that the remaining loopholes in Articles XIX and XIXA be reexamined as well. The original language of SCA 7 as it existed February of 2005 was the proper step to take, further limiting the ability to borrow from the PTA and fuel excise tax and vehicle fee revenues. The proposed amendments to Article XIXB in the current SCA 7 should be considered for Articles XIX and XIXA as well, and loans from any transportation funding source should be paid back with an interest rate at least equal to the PMIA.

CONCLUSION

The current landscape of transportation finance in California contributes to the poor quality of the state's infrastructure, which in turn has created the demand for Propositions 1A and 1B. The potholes of boom-or-bust funding, unstable funding, and categorical accounts render long-term planning challenging at best. The bond on this November's ballot is not the ideal solution to smooth these areas of turbulence, but may allow the State to drastically improve transportation infrastructure if its shortcomings are addressed through proactive management by participating agencies and further direction by the Legislature.

Given the latest poll numbers, the bond has a good chance of passing. Securing \$20 billion for transportation through borrowing, however, unfairly shifts the burden of paying for these improvements to younger Californians. But the unfavorable climate for raising the gas tax or the long period of time required to introduce road tolling—two alternative solutions favored by transportation economists (Sorenson and Taylor, 2005)—renders bonding perhaps the most politically viable way to direct this much money to transportation at the present time. The disbursement of these monies will need to be carefully managed to ensure that this infusion of resources is used to construct a foundation of capital improvements that future tax revenues can maintain. Specifically, care must be taken that projects are prioritized in a transparent way so that the most beneficial projects are built first, rather than the most expensive or politically popular ones. Coordination among the regional and local agencies, the CTC, and Caltrans will be critical to ensuring such prioritization. The improved stability of funding offered by Proposition 1A should facilitate this coordination, as long as the Legislature and the Governor abide by the spirit of this law.

The potential to deliver on the promises of this November's Propositions 1A and 1B should provide motivation for overcoming their inherent and pervasive flaws. It will not, however, be easy.

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