Transportation Infrastructure Funding: Policymakers Eye New Financing Options to Fit Changing Economy

Overview
California’s transportation infrastructure is facing a crisis. The state needs more investment in road systems but the current financing methods are insufficient for the magnitude of work. According to the 2015 Ten-Year State Highway Operation and Protection Program (SHOPP) plan, maintenance and repair of the state’s highway system is undersupplied by $5.7 billion a year. In addition, a report by the California Legislative Conference Committee on transportation funding (Committee Report) recently estimated that it would require $7.8 billion annually to bring local street and road repair up to the best management practice level. In comparison to other states, the Reason Foundation ranked California’s highways 42nd in overall performance and 43rd in maintenance in 2016. These deficits and rankings reveal that the state needs new funding solutions.

In response to this crisis, Governor Edmund G. Brown Jr. called for a special session on transportation and infrastructure funding in June 2015. Throughout the special session, the Legislature and the Governor’s office put forth a number of funding proposals differing in amount of total funding and combination of revenue sources. Ultimately, none of the proposals made it through the Legislature during the special session, but concerted efforts to pass a viable funding proposal will continue in 2017.

California’s Transportation Funding Needs
Since the 1980s, California’s population has increased by more than 50%, and the rate of automotive travel has mirrored this growth. In fact, the Federal Highway Administration reports that more than 80% of California’s urban interstates are congested every single day. Although residents are driving more, improved vehicle efficiency and consumer demand for high miles-per-gallon and zero-emission vehicles has cut fuel consumption. The average fuel mileage has increased approximately 37% since 1991, meaning that for every mile traveled on state highways, less gas tax is being raised.

That same gas tax won’t buy as much as it once did. Today it costs about $180 to buy the same amount of asphalt or concrete that $100 would have bought in 1991—the last time there was an increase in the gas tax. The reduction in revenue coupled with rising construction costs means that much-needed maintenance projects and new construction will continue to be deferred or cancelled.

Each year, Californians drive an average of 13,000 miles and the roads suffer wear-and-tear accordingly. The most recent Needs Assessment conducted by the California Transportation Commission (CTC), revealed that 58% of the state’s roadways require rehabilitation or pavement maintenance and 26% of its bridges require major maintenance, preventative maintenance, or complete replacement. The Federal Highway Administration estimates that California will need approximately $70 billion to modernize and fix its highway systems and another $118 billion to widen its busy highways, sticking California with the largest reconstruction cost as compared to other states.

Additionally, the state Legislative Analyst’s Office (LAO) found that the level of funding for California’s transportation infrastructure was less than 30% of the requisite amount. Looking forward 10 years, the CTC estimates that California will face $300 billion in unmet transportation funding over and above what is currently available for base levels of maintenance and preservation.

The lack of investment in the transportation system will have real consequences for Californians. The Road Information Program (TRIP) calculated that California’s substandard roads cost California motorists $18.3 billion out of pocket annually ($739 per driver) for automobile repairs, tune-ups, tires, and accelerated depreciation. The total cost to drivers of California’s dilapidated road systems is 53.6 billion a year.

Most troubling is that this bleak scenario is not improving. The CTC estimates that the amount of freight on California’s highways will increase 75% within the next 20 years and TRIP estimates that total vehicle miles traveled will increase 15% by 2030.

In addition, deferring maintenance and preventative improvements compounds the funding problem as streets, roads and highways that are not properly maintained necessitate costlier

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*VOC: Vehicle Operation Costs
Source: California Transportation By The Numbers, TRIP, August 2016 Report
Expanding Opportunity
An Agenda for All Californians
2017 Business Issues and Legislative Guide

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rehabilitation and reconstruction—up to 10 to 12 times the cost of maintenance. According to the Committee Report, 68% of California roads are in “poor” or “mediocre” condition with much of this deterioration occurring over the last six years. This deterioration has and will continue to exacerbate funding issues.

The state must soon address the transportation funding problem and explore other financing opportunities to modernize the road systems.

**Funding Sources**

Policy debates continue throughout the state—including the special legislative session—on the most effective way to adequately fund California’s transportation infrastructure. These policies range from more of the same (increased gas taxes and additional bonds) to new ideas untested at scale (mileage-based user fees). Each concept differs in its funding mechanism, amount of funding burden, and political viability. Highlighted below are some of the options discussed by state organizations and leaders.

**Gas Tax**

California receives a large portion of its transportation funding from a per gallon gasoline excise tax and a per gallon diesel fuel excise tax. The gasoline excise tax was modified (and increased) by the Fuel Tax Swap Fix passed in 2011, which eliminated the state sales tax on gasoline, reduced the state excise tax on diesel fuel, and increased the state sales tax on diesel fuel. This plan was designed to generate revenues commensurate with the previous state gasoline sales tax.

Historically, these excise tax revenues have generated more than $3 billion a year. In recent years, however, the tax revenue has decreased due to higher fuel efficiencies and increased use of alternative fuels and electric cars. The LAO recently estimated that receipts from the gas tax will be about $2.6 billion—$400 million below average yields. According to the California Plug-In Vehicle Collaborative, since 2011 Californians have bought nearly half of all electric vehicles in the country and the trend shows no signs of slowing down as approximately 3,692 new electric cars are sold in the state each month. Additionally, Governor Brown recently adopted a goal of having all new passenger vehicles sold in the state be zero-emission by 2050.

Although fuel consumption has decreased, the excise tax rate has remained largely stagnant since 1994, resulting in declining tax revenues for California’s transportation infrastructure. As a result, some groups, including Transportation California, argue that the state should increase the gas tax in order to make up the financing gap. Opponents contend, however, that Californians already face one of the highest transportation tax burdens in the country and increasing the excise tax is not a viable solution. Further, some experts argue that raising the gasoline excise tax could have a disparate impact on low-income residents who already spend a significant portion of their income on gasoline, including those who cannot afford newer, more fuel-efficient vehicles.

A number of proposals considered in the special session contained different gas taxes, including per gallon sales taxes, excise taxes, and tax indexing on both gasoline and diesel. The LAO estimates that every one-cent increase will raise $150 million from the gasoline excise tax and $30 million from the diesel excise tax.

**Vehicle License and Registration Fees**

The vehicle license fee, introduced in 1935, was initially designed to replace a personal property tax levy on automobiles by cities and counties. Historically, the fee was 2% of vehicle value. The Legislature began reducing the fee in 1998, lowering it to 0.65% of the vehicle’s market value, paid annually with registration and set to a charted depreciation schedule. In 2003, Governor Gray Davis increased the fee to its original value of 2% to combat budget deficits. The decision was later rescinded by Governor Arnold Schwarzenegger when he took office months later. Although the fee was temporarily increased to 1.15% from May 2009 through June 2011, it was subsequently returned to 0.65% in the 2011 budget and it has remained at that level since. Almost all revenue derived from the vehicle license fee is distributed to California’s cities and counties.

It is important to note one key distinction between the two types of fees. Funds from the registration fees are constitutionally protected and cannot be diverted to purposes outside of transportation as opposed to licensing fees, which are a general tax and not protected.

Although none of the special session funding proposals contained license fees, they did contain registration fees, which are flat fees set by statute and paid concurrently with the annual vehicle registration. Some of the proposals added an additional fee for zero-emission vehicles on the basis that the gas tax paid by owners of these vehicles is not reflective of road usage. The LAO estimates that each dollar increase in the registration fee will produce $33 million in new revenue and for each 1% increase in the license fee, $3 billion will be created.
Local Funding

County sources account for $11 billion of transportation funding. Those sources include local voter-approved sales taxes, property taxes, and fares from public transit. Voters have historically approved most local taxes for transportation purposes and this trend continued in 2014 with the passage of a $500 million transportation bond in San Francisco and three local road and street improvement measures. Last fall, voters throughout the state approved nearly half of the local sales tax measures for transportation.

While local funding has served as a valuable tool to fund local transportation projects, it historically has been insufficient to cure statewide infrastructure problems. The amount of funds available can fluctuate significantly by county, and many counties focus these funds on local transportation issues rather than a comprehensive state plan.

While none of the special session proposals had a local funding source, two of the proposals—including Governor Brown’s—would have allocated significant portions of the new revenues to local programs.

Bonds

Proposition 1B was approved in 2006 and allowed the state to issue almost $20 billion in general obligation bonds over a 10-year period for transportation purposes. These bonds are subject to annual appropriations by the state Legislature and will expire soon. While many view bonds as an effective funding source, there is skepticism that voters will approve another proposition, given California’s substantial debts and need to spend available monies on services other than transportation and the significant bond funding already committed to construction of the high-speed rail. Additionally, the interest payments for bonds substantially add to the overall transportation project cost when compared to a pay-as-you-go system, like a fuel tax.

Proposing another bond was not part of the special session discussions as Governor Brown indicated he is not willing to take on additional debt for transportation projects.

Mileage-Based User Fees

Another funding option is to collect mileage-based user fees by relying on existing technology to collect data on individual motorists’ mileage use, convey that information to data processing centers, evaluate the data, and collect fees from drivers based on usage levels.

According to a report by the nonpartisan Congressional Budget Office released in 2011, mileage-based user fees would provide more efficient highway financing than fuel taxes because usage pricing is connected directly to how often a person uses surface transportation. Motorists would receive a bill for the amount they drove the previous month. The Reason Foundation and other groups support the concept as a straightforward and transparent approach that will allow individuals to adjust their usage as needed.

Others, however, argue that the costs of implementing new technology associated with a mileage-based user fee will negate the prospective earnings. Additionally, opponents contend that it will result in more out-of-pocket spending than the gas tax. According to Transportation California, a charge of one cent per mile would raise about $3.3 billion per year, but the cost this approach may have on individual drivers is unknown.

In 2014, the Legislature passed legislation that authorized a mileage-based user fee pilot program in California. The program is administered by a 15-member panel that will report findings on the viability of the program back to the Legislature. This panel issued its initial recommendations for the pilot project in December 2015. The panel envisions the user fee will replace the gas tax—it would not be additive—and there would be no exemptions or rate differentials amongst drivers. In addition, the project provides test participants with a menu of options for recording mileage information, including pre-paid mileage, odometer checks and automated reporting with or without data. This broad range of options will allow the committee to conduct a more robust policy analysis in its report, evaluating convenience, administrative and privacy issues, and pricing. Based on this report, the Legislature will ultimately determine the components of any potential mileage-based user fee program.

Truck Weight Fees

California instituted a commercial weight fee schedule in the first half of the 20th century. The fees are based on commercial vehicle weight and generate about $1 billion per year. This fee was enacted to reimburse the state for the wear and tear of heavy trucks on streets and highways. In 2011, however, AB 105 (Committee on Budget, Chapter 6) diverted the revenue from truck weight fees from the State Highway Account to the General Fund, where it is used to pay general obligation bond debt service for specified voter-approved transportation bonds.

During the last legislative session, multiple bills were introduced seeking to redirect truck weight fees away from bond debt service and back to new transportation projects. Both bills made it out of their respective policy committees, but ultimately failed to pass through the appropriations committees. This policy, however, was reintroduced as part of the special session proposals.

Priced Managed Lanes

Managed lanes are highway lanes that restrict vehicle eligibility, often taking the form of carpool lanes, transit bus lanes, and truck-only lanes. Priced managed lanes—a subset of managed lanes—charge users a fee for lane access. A common example of priced managed lanes are toll roads. The usage fee for these lanes can vary based on the level of congestion and/or the time of day. These lanes combine congestion pricing and lane management to moderate demand during peak driving periods of the day, with the twin goals of incentivizing motorists to shift their driving habits and generate infrastructure funds. The number of priced managed lanes throughout the United States has increased in recent years and new projects are planned.

According to a September 2013 nationwide study by the Reason Foundation, expanding the use of toll financing is an ideal
funding mechanism to replace the gas tax. All-electronic highway tolling is technologically simple and relatively inexpensive to establish. The study found that a majority of states could charge a toll of 3.5 cents per mile for cars and 14 cents per mile for trucks. In California, however, the recommended toll charge would have to double to make any impact on infrastructure financing due to high construction costs.

California began using priced managed lanes in Orange County almost 20 years ago. Recently, the Orange County Transportation Authority (OCTA) proposed a $1.47 billion plan to add toll lanes to particularly congested areas of the 405 freeway but was met with widespread local opposition. Although Caltrans supported the plan due to the additional revenue that would be raised for road improvement projects, critics claimed that toll lanes would cause traffic on local streets and those motorists paying the toll would be less likely to exit the freeway to frequent local businesses. Opponents also complained that the fees would be exorbitant with the most expensive tolls reaching almost $10 one-way. Ultimately, the OCTA voted to not move forward with the project, but Orange County’s experience with priced managed lanes, along with the experience of other counties such as San Diego and Alameda, will be analyzed by policymakers as the infrastructure funding discussion progresses.

**Public-Private Partnerships**

A public-private partnership occurs when a public agency and a private sector organization join forces to provide a service or build a project for the public. Advocates of this funding avenue stress that because public transportation budgets are sparse, bringing on a private entity to support and expedite projects is a win-win for the public agency, the private organization, and the public at large, which benefits from project completion in less time.

Many transportation experts hail the use of public-private partnerships for building infrastructure because each party has distinct capabilities and unique resources at its disposal. Expertise by the government includes knowledge of the legislative and decision-making processes, political savvy know-how regarding public financing methods, ability to mitigate risks, and a good command of local, state and federal regulations. Private entities also contribute with project management skills, considerable financial resources, ability to expedite infrastructure investment, knowledge of operations and best practices, and construction and design acumen.

While public-private partnerships create opportunities to address some transportation funding issues, they still require underlying revenue streams to finance projects. The use of private financial resources can reduce—but does not eliminate—the public cost. State and local governments still must find financing mechanisms to pay for these projects.

**Federal Funding**

Nearly a quarter of California’s transportation funding comes from the federal government. In December 2015, Congress passed the first major transportation funding bill since 2005, providing California with $26 billion for projects over the next five years, a 14.5% increase.

Over the last decade, Congress was unable to pass comprehensive legislation and relied on a series of two-year stopgap bills. These short-term bills created funding uncertainties for planning and developing transportation projects that have long completion timelines. While the most recent bill expands funding for five years, it did not include any new dedicated and sustainable funding sources such as an increase in the federal gas tax. Rather, it relies on shifting revenue from other areas of the budget. This has created skepticism that the cycle of short-term fixes will return once the bill expires in five years.

Additionally, despite the increase in federal funding, California remains a donor state when it comes to the portion of federal transportation revenue the state receives. California will receive only 8.5% of the $305 billion allocation, while paying between 11% and 12% of the total federal gas tax revenue.

The biggest unknown, and potential new source of significant revenue, is a new national transportation funding proposal pitched during his campaign by President Donald Trump. This proposal would allocate $1 trillion to upgrade the country’s infrastructure, including roads, tunnels, bridges and airports. The details of the proposal are vague at this point and it is unknown how much of that funding California would receive. The proposal will undoubtedly face a number of political hurdles in Congress, namely how to create the revenue sources to fund it.

**Special Session**

In June 2015, Governor Brown announced an extraordinary legislative session dedicated to enacting legislation that would create additional and stable long-term transportation and infrastructure funding. In response, the Legislature held a number of committee hearings and considered different funding proposals from the Governor and caucuses in both houses. The Legislature ultimately failed to pass a funding proposal by the end of the special session.

At the conclusion of the special session there were two primary funding proposals, one proposed by the Governor and one by the Legislature co-authored by the Transportation Committee chairs, Assemblymember Jim Frazier (D-Oakley) and Senator Jim Beall (D-San Jose). These proposals differed in the amount of funding and the mix of revenue sources.

While the special session failed to produce new funding, these efforts will likely continue in earnest at the start of the new legislative session. Policy and political challenges remain, the most significant of which is the debate over tax increases to create new revenue. Increasing taxes will trigger a two-thirds vote of the Legislature and can be a politically difficult vote for legislators. With the Democratic Party reclaiming a supermajority in the Assembly and in the Senate, it may be
easier to pass a funding package in 2017. If history is a guide, however, passing tax increases will remain tricky: no tax increase passed in 2014, the last time the Democratic Party had a supermajority in both houses.

**CalChamber Position**

California needs a comprehensive, well-financed, dependable and efficient transportation financing mechanism that allows for maintenance of deteriorating infrastructure, encourages new construction projects, and ultimately creates well-paying and reliable jobs for Californians.

California’s continued economic development will be closely tied to an improved transportation system, both for workers and students commuting to jobs and classes, and for the movement of goods around the state and to our international seaports and airports.

Challenges to new transportation funding proposals remain, however, as many voters continue to resist increased fees and taxes.

To overcome this challenge, the Legislature should look to local transportation funding measures for guidance on how to build trust with the voters. The local measures tend to pass when local officials successfully make their case to constituents by identifying the specific need for and benefits of transportation projects, and ensuring there is transparency in how the funds will be utilized. The Legislature must take this approach in developing its final proposal.

None of the options outlined above is perfect; indeed, one or another user or interest group will oppose any new tax or fee or revenue source. The key to optimizing a financing solution for surface transportation will be to ensure that any solution:

- Does not discriminate against any user or economic sector;
- Is broadly spread among all road and highway users;
- Is stable and grows with the economy;
- Is sufficient to address the system’s legitimate maintenance and expansion needs; and
- Is packaged with cost-saving reforms to reduce administrative and litigation overhead.

*Article written by Jeremy Merz while serving as CalChamber policy advocate. He now is vice president, state affairs – western region at the American Insurance Association.*

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