CALIFORNIA BUDGET PROJECT

Budget Brief

September 1999

CALIFORNIA'S PUBLIC INVESTMENT GAP
FINANCING INFRASTRUCTURE: ISSUES AND IMPLICATIONS

By nearly unanimous agreement, California faces a significant gap between available resources and the amount needed to build and maintain the state's public infrastructure.[1] Governor Gray Davis' appointment of a Commission on Building for the 21st Century and recent reports issued by State Treasurer Phil Angelides and the California Business Roundtable evidence growing interest in the lack of investment in public infrastructure.[2] Finally, a number of major infrastructure proposals are currently pending before the Legislature. This *Budget Brief:*

- Examines how infrastructure is currently financed.
- Reviews the magnitude of the state's unmet infrastructure needs.
- Discusses major policy issues affecting infrastructure planning and financing.
- Presents a set of policy recommendations designed to help the state meet unmet infrastructure needs without compromising other budget priorities.

HOW IS INFRASTRUCTURE CURRENTLY FINANCED?

State infrastructure is funded through a combination of federal and state funds. State funding for infrastructure comes from the General Fund, special funds (i.e., gas tax revenues), and bonds. Most of the state's debt is repaid from the General Fund. Over the past five years, state General Fund expenditures for bond debt totaled $11.5 billion, while direct expenditures for capital outlay totaled $735 million. Approximately a third of the direct expenditures went toward the purchase of the Headwaters Forest. The primary tools used for state infrastructure finance are:

Pay-as-you-go finance: Pay-as-you-go is the least expensive method to pay for capital outlay. It is infrequently used, particularly during the 1990s, due to the scarcity of available resources. The gas tax and truck weight fees pay for road and highway projects. Most state transportation spending is pay-as-you-go, rather than debt financed.

General Obligation (GO) bonds: GO bonds are a form of debt backed by the state's General Fund. GO bonds are repaid from the General Fund and have constitutional priority over other expenditures in the

[1] This report uses the terms capital outlay and infrastructure interchangeably.
[2] State Treasurer Phil Angelides, *Smart Investments* (June 1999), and California Business Roundtable, *Building a Legacy for the Next Generation* (August 1998).

event of a shortfall. State bond measures require approval of a majority of the voters. The 1999-00 budget includes $660 million in GO bond expenditures for capital outlay.
Lease payment bonds: Lease payment bonds are repaid out of rent payments made to bond holders over the life of a facility. Lease payment bonds are slightly more expensive than GO bonds and do not require voter approval. The 1999-00 budget includes $507 million in lease payment bond expenditures.

Federal Funds: Federal dollars provide a significant fraction of the state's current pay-as-you-go dollars. Over the past ten years, the state received an average of $1.14 billion in federal infrastructure funds each year. The State Highway Construction Program is the largest recipient of federal funds, averaging $362 million per year over the past decade. In addition to highways, federal dollars fund flood control, veterans' homes, and National Guard armories.

Last year's Transportation Efficiency Act for the 21st Century (TEA-21) significantly boosts federal transportation funding. California will receive approximately $15 billion for highway programs and $5 billion for mass transit over the next six years, a $1.8 billion increase. The bulk of the transit dollars will go to Los Angeles ($1.2 billion over six years) and the San Francisco/Oakland areas ($699 million over six years). The TEA-21 earmarks $690 million for fixed rail programs, with the reminder allocated to local governments using a population-based formula. In addition, project delays attributable in large part to former Governor Wilson's unconstitutional efforts to contract out CalTrans' work, produced a $1.5 billion surplus in the State Highway Account. The Legislative Analyst notes that the infusion of federal funds may make it difficult for CalTrans to deliver projects on a timely basis and spend down the existing surplus.[3]

What About The Gas Tax?

The state Constitution dedicates motor fuel tax revenues to transportation. Proposition 111 of 1990 increased the gas tax by nine cents per gallon over a five year period, raising an additional $1 billion per year for transportation at full implementation. In total, fuel taxes will raise approximately $3.0 billion in 1999-00. Approximately a third of the revenues raised by fuel taxes are allocated to local governments for streets and highways.

State law designates the proceeds of the sales tax levied on fuel taxes to the Public Transportation Account (PTA). PTA revenues can be used to purchase busses or other "rolling stock." The Governor's Proposed Budget estimates 1999-00 PTA revenues at $173 million.

California Infrastructure Bank

The California Infrastructure and Economic Development Bank, created in 1994, aims to facilitate economic development by providing funding assistance for infrastructure projects, such as drainage and flood control, parks and recreation facilities, upgrades of utilities, and streets and county highways. Local jurisdictions must apply to the bank for assistance and put up matching funds as a condition of receiving aid. The Bank was capitalized in 1998 with a $50 million allocation from the General Fund. To date, the Bank's efforts consist of issuing rate reduction bonds as part of the deregulation of the electric utility industry. The 1999-00 budget increases the Bank's funding by $425 million.

HOW BIG IS CALIFORNIA'S UNMET NEED?

[3] Legislative Analyst's Office, *Analysis of the 1999-00 Budget Bill* (February 1999), p. A -21.

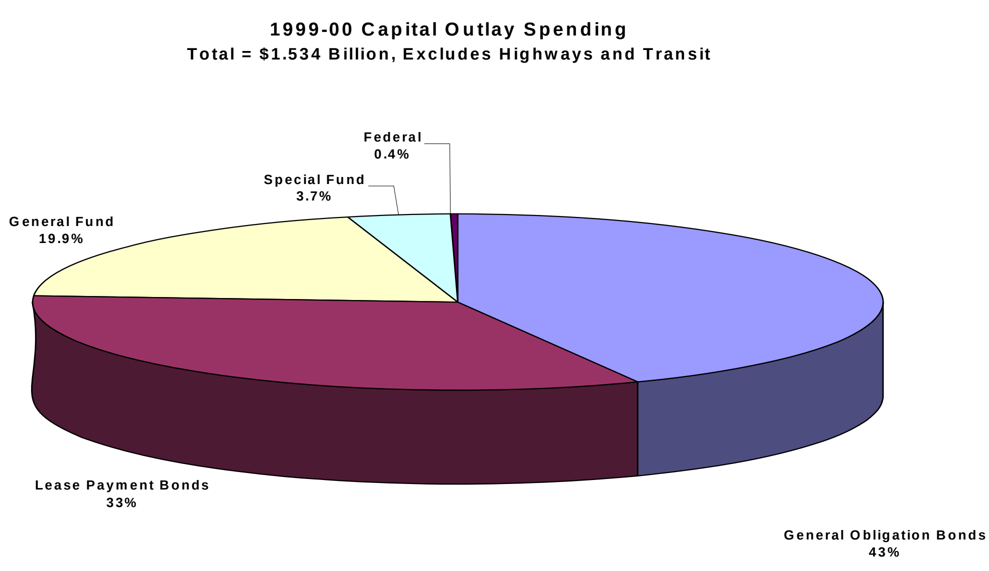
The Department of Finance estimates the state's unmet capital outlay needs at $40.4 billion over the next ten years, exclusive of transportation. There are no good estimates of the need for transportation investments and estimates vary substantially. The Business Roundtable estimates that unmet transportation needs are in the range of $15 to $25 billion.[4] The $40.4 billion estimate does not include the need for local facilities, such as hospitals, jails, or other public buildings. There is no comprehensive estimate of local governments' unmet infrastructure needs or current spending on capital outlay.

What Resources Are Available To Meet This Need?

Resources available for infrastructure include all of the financing tools discussed above: federal funds, gas tax and other state special funds, and General Fund supported debt. Over the next ten years, the Department of Finance estimates that $33.1 billion will be available for infrastructure including $16.2 billion in federal funds; $13.3 billion from state Special Funds, such as the fuel tax proceeds; and $3.6 billion in miscellaneous revenues, primarily private contributions for the University of California and resource-related programs.[5] The state also has $2.5 billion in previously authorized General Obligation bonds that were unissued as of September 1, 1998.[6]

How Does Local Government Finance Infrastructure?

Local government uses the same financing mechanisms as the state. Local bonds are generally repaid through a special rate added to the property tax. Local bonds must be approved by a two-thirds vote of local voters. As previously noted, local government receives approximately a third of fuel tax revenues for transportation, and revenues from 1/4-cent of the 1-1/4-cent local sales tax go to county transportation programs (approximately $1 billion per year). The state also funds a substantial amount



Source: Legislative Analyst's Office, *California Spending Plan 1999-00* (August 1999).

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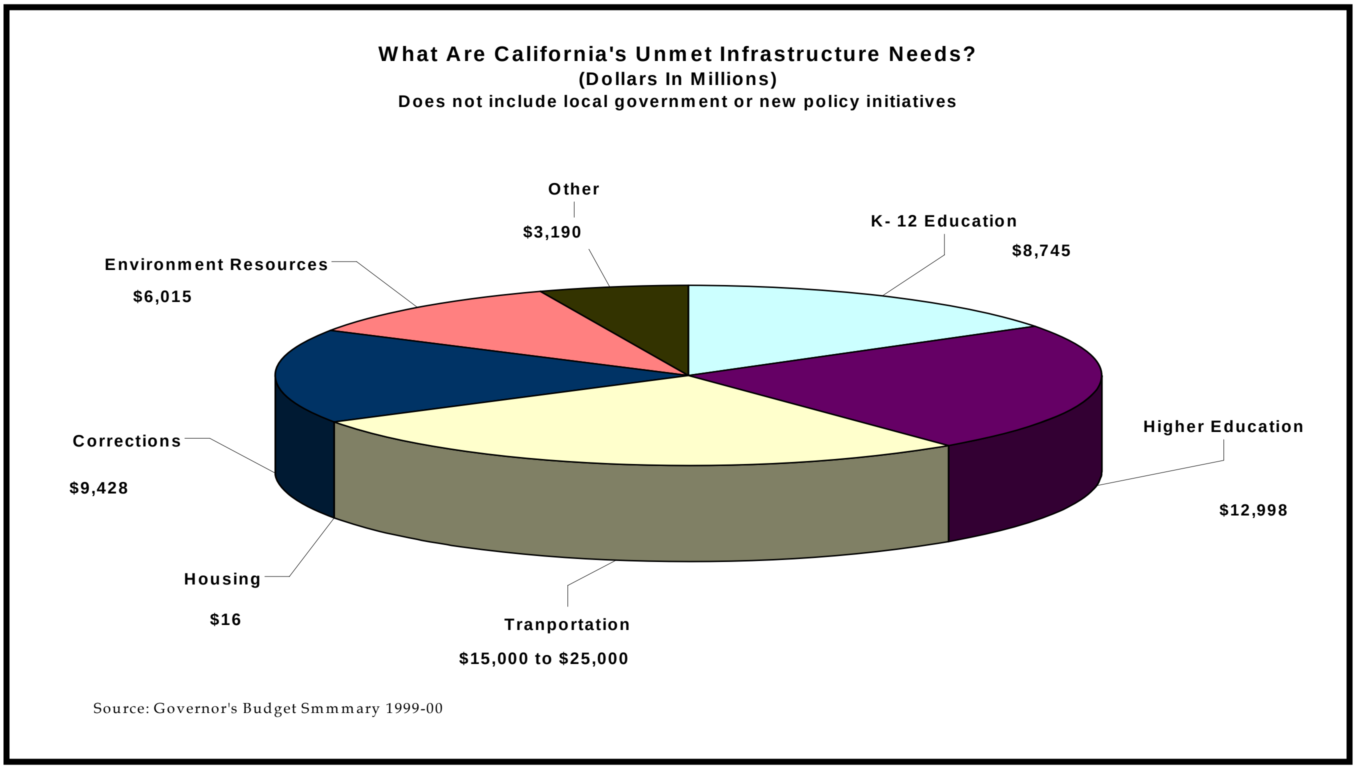
[4] California Business Roundtable, *Building a Legacy for the Next Generation* (no date), p. 10.
[5] Department of Finance, 1999 *Capital Outlay and Infrastructure Report* (no date), pp. 47-48.
[6] Department of Finance, 1999 *Capital Outlay and Infrastructure Report* (no date), p. 69. This figure does not reflect school bonds authorized by Proposition 1A on the November 1998 ballot but does include $544 million authorized by the Clean Air and Transportation Improvement



of local infrastructure. Approximately 60 percent of the state's 1998-99 debt service payments go for local facilities. Approximately half of the state support for local facilities is for K-12 education. Between 1987 and 1996, the value of lease purchase debt issued by counties increased 563 percent, from $1.6 billion to $10.6 billion. Over the same period, counties' General Obligation bond debt declined 36 percent, from $111 million to $70.8 million. Counties have also turned to revenue bonds -- bonds backed by a particular revenue stream such as a sales tax rate -- to finance infrastructure. The value of county revenue bonds increased from $6.5 million in 1987 to $5.9 billion in 1996. Passage of Proposition 218 in 1996, requiring two-thirds voter approval for any designated tax rate increase, will likely reduce the use of revenue bonds as a financing tool.

Local governments can also impose sales tax rates for either specific or general purposes. Most of the local sales tax rates are used to support transportation. Revenues raised by these rates can be used to support transit or highway programs and both capital investment and operating costs. In addition to transportation, current rates support open space, libraries, public safety, flood protection, and a hospital. In a 1991 decision, Richard J. Rider et al. v. County of San Diego et al., the state Supreme Court ruled that limited purpose local authorities could not impose a sales tax rate without two-thirds voter approval. Proposition 218, approved by the voters in 1996, ratified the Rider decision by requiring any local tax dedicated to a specific purpose to be approved by two-thirds of the voters.

Over the next fifteen years, nineteen dedicated local sales tax rates will sunset and must be reauthorized by local voters. A majority of these rates were originally imposed by majority vote, including rates supporting the Alameda County Transportation Authority, Orange County Transportation Authority, Sacramento Transportation Authority, and San Diego Regional Transportation Authority. The thirteen expiring rates dedicated to transportation generated $779 million for transportation in 1997-98. The remaining six rates initially received two-thirds voter approval.

Bond Act of 1990, $166 million from the Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990, $707 million from the Safe, Clean Reliable Water Supply Act of 1996, and $516.7 million from the Public Education Facilities Bond Act of 1996.

> **Bonds versus Pay-As-You-Go Finance: Pros and Cons**
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> **Bonds**
>
> **Advantages:**
> - Suitable for most projects.
> - General obligation bonds have lowest financing cost of all non-cash options.
> - Spreads the cost of major investments to those who use an investment over a number of years.
> - Allows larger up front investment for a given level of expenditure.
>
> **Disadvantages:**
> - More costly than pay-as-you-go.
> - Must be approved by the voters.
>
> **Pay-As-You-Go**
>
> **Advantages:**
> - Lowest total cost.
> - Suitable for all projects.
>
> **Disadvantages:**
> - Requires largest initial outlay.
> - Competes with other priorities for scarce General Fund resources.
> - Imposes full cost on current taxpayers, rather than all who benefit from an investment's use over time.

Local governments also use parcel taxes and benefit assessments to support infrastructure investment. The ability to use both of these revenue sources was severely limited by the enactment of Proposition 218.

CALIFORNIA'S DEBT LOAD

Competing demands on the budget make it impossible to meet the state's large and growing infrastructure needs through pay-as-you-go funding alone. The available resources can be increased using debt. However, only a certain amount of debt can be authorized and issued without interfering with the state's ability to meet other spending priorities and needs.

High amounts of debt can carry several consequences. The state's bond rating may be reduced, which in turn increases the cost of borrowing in the form of higher interest rates. Since debt service has first call on the state's resources in the event of a budget shortfall, higher interest costs reduce discretionary revenue in the budget. This leaves the Legislature with less ability to respond to changing priorities.

Credit rating agencies and other analysts consider a number of factors when evaluating how much a state should spend on debt. Six percent is often viewed as the maximum desirable allocation of General Fund revenues to debt principal and interest repayment. Lower levels of debt can lead to better credit ratings, which can significantly reduce borrowing costs, but limit the state's ability to meet unmet needs. For example, an upgrade from an A rating to an AA level on a $1 billion bond issue would amount to $30 million in interest savings over the life of the bonds.[7] In 1998-99, 4.4 percent of the state's General Fund resources went to long-term debt repayment, slightly higher than the national average of 4.1 percent. California ranked 20th among the states with respect to the share of state personal income devoted to debt service in 1996.[8]

California's General Obligation debt carries a high, but not the highest, rating by bond rating agencies.[9] The state's ratings slipped during the recession of the early 1990s. California fails to achieve the highest ratings possible due to rating agencies' concern over the voter initiative process in California, which they perceive as limiting the Legislature's ability to respond quickly to financial problems. Rating agencies have also indicated a preference for a budget reserve of three to five percent to provide a comfortable "cushion" to guard against unforeseen expenses. In recent years, California's budgets have generally provided a reserve of approximately one percent. A reserve equal to five percent of General Fund expenditures would equal $3.2 billion, more than three times the amount set aside in the 1999-00 budget.

[7] California Treasurer Matt Fong, *California's Debt Affordability Report* (October 1997), p. 3.
[8] Department of Finance, *1999 Capital Outlay and Infrastructure Report*, p. 49.

Table 1: What Impact Would Increasing The State's Debt Burden Have On The General Fund? (Dollars In Millions)									
	Projected General Fund Revenues	Revenue Growth From Prior Year	Cost Of Currently Authorized Debt	Additional Cost For Increasing The Percentage Of General Fund Dollars Spent For Debt Service			Additional Debt Service Cost As Percent Of Additional Revenues -		
				5.5%	6.0%	6.5%	5.5%	6.0%	6.5%
1999-00	$60,272	$3,979	$2,809	0	0	0			
2000-01	$63,439	$3,167	$3,005	$506	$825	$1,140	16%	26%	36%
2001-02	$66,920	$3,481	$3,213	$494	$828	$1,137	14%	24%	33%
2002-03	$70,769	$3,849	$3,318	$600	$948	$1,272	16%	25%	33%
2003-04	$74,739	$3,970	$3,349	$763	$1,140	$1,490	19%	29%	38%
2004-05	$79,084	$4,345	$3,301	$1,014	$1,461	$1,822	23%	34%	42%
2005-06	$83,444	$4,360	$3,181	$1,399	$1,839	$2,266	32%	42%	52%
2006-07	$87,828	$4,384	$3,150	$1,717	$2,156	$2,586	39%	49%	59%
2007-08	$92,682	$4,854	$3,041	$2,089	$2,545	$3,003	43%	52%	62%
2008-09	$97,780	$5,098	$2,958	$2,460	$2,949	$3,433	48%	58%	67%

Source: CBP calculations from Department of Finance, *1999 Capital Outlay and Infrastructure Report.*

Table 2: How Much Additional Debt Can The State Issue At Different Debt Service Ratios? (Dollars in Billions)			
	5.5%	6.0%	6.5%
Additional Debt	$26.8	$32.5	$38.1

Source: Department of Finance, *1999 Capital Outlay and Infrastructure Report.* Assumes all new debt is in the form of General Obligation bonds.

HOW MUCH DO BONDS COST?

Most General Obligation bonds are paid off over a period of 20-30 years, with interest and principal payments spread over the entire period. Principal and interest payments on a $2 billion bond, for example, would total $3.3 billion over 25 years with an average annual cost of $132 million. Because the dollars used to repay debt are worth less (since inflation reduces the purchasing power of a dollar), the true cost of debt in current dollars is less.

WHAT ARE THE MAJOR POLICY ISSUES?

The state lacks a comprehensive approach to infrastructure planning. Infrastructure is financed on a department-by-department basis. There is no process for comparing and prioritizing infrastructure across program areas, even though the various demands compete for scarce state resources and bonding capacity. While the Department of Finance prepares an annual report detailing the state's infrastructure needs, this document fails to provide a comprehensive spending plan or blue print for state expenditures.

The state has limited resources to expend on new policy priorities. A shortage of financial resources exacerbates the lack of comprehensive planning and prioritization. The state's bond capacity is limited

[9] Department of Finance, *California Municipal Bonds Rating History* (January 1999). Rating agencies evaluate the riskiness of various investments. Fitch rates California's debt as AA-, Standard and Poor's as A+, and Moody's as Aa3.

Table 3: How Do Various Funding Sources Compare From A Tax Equity Standpoint? Ratio Of Taxes Paid As A Percentage Of Personal Income							
	Lowest 20% to Top 1%	Second 20% to Top 1%	Middle 20% to Top 1%	Fourth 20% to Top 1%	Next 15% to Top 1%	Next 4% to Top 1%	Top 1% to Top 1%
Sales Tax	6.0	4.9	3.9	3.3	2.4	1.7	1.0
Property Tax	2.4	1.5	1.5	1.5	1.5	1.3	1.0
Gasoline Tax	15.0	10.8	8.0	6.2	4.2	2.6	1.0
All State and Local Taxes Except Property Tax	0.8	0.6	0.6	0.6	0.7	0.8	1.0

Source: Institute for Taxation and Economic Policy, 1996. Tax burdens calculated for married, non-elderly households.

by the resources available to make principal and interest payments, as well as the need to keep the ratio of debt service to overall expenditures within the range considered prudent in order to obtain desirable interest rates.

Bonds are not "free money." Using debt to finance investments in assets of lasting usefulness is generally accepted, allowing those who will benefit from the investment to contribute to its cost. Bonds leverage limited resources in the short term. Debt does, however, complete with other spending priorities for scarce General Fund resources.

The state lacks clear-cut goals for evaluating competing demands for investment. Many programs have no defined goals for rating infrastructure proposals. Without clear-cut goals, much needed projects may go without funds, while others that are inconsistent with long-term goals may get funded as "pork" through the whims of the budget process. The State Transportation Improvement Plan (STIP), which outlines a four-year plan for state transportation improvements, provides a model for long-term planning that could be adopted for other infrastructure planning purposes.

Who pays? General Obligation bonds compete with other programs for limited General Fund resources. The share of resources devoted to debt, or debt burden, is commonly measured by the percentage of General Fund revenues expended for principal and interest payments on long-term borrowing (borrowing for longer than one year).

Increasing the share of state General Fund revenues dedicated to debt service from 4.5 to 6.0 percent would necessitate a major shift in budget priorities. An increase from the 1998-99 level of 4.5 percent to the 6.0 percent level generally considered prudent would increase state debt service costs by $825 million in 2000-01 and $2.949 billion in 2008-09, a 136 percent increase. General Fund revenues, in contrast, are only forecast to increase 74 percent. At six percent, debt service would consume $6 out of every $100 in the state General Fund. Taken as a share of the year-to-year growth in revenues, however, the increase in debt service costs as compared to that required for currently authorized bonds would require one out of every four dollars, rising to more than half of the projected growth in revenues by 2007-08. Such an increase would likely require substantial reductions in programs that depend on the General Fund for support in order to accommodate population growth and inflation.

Transfer of existing revenues would leave a hole in the General Fund. The impact of dedicating existing revenues to infrastructure would require reductions in other General Fund programs. The Business Roundtable's proposal to shift 1/4 cent of the sales tax, roughly $1 billion, to infrastructure would erase the state's reserve in the current year and potentially require substantial reductions in the foreseeable future. Programs outside of the Proposition 98 guarantee that depend on the General Fund would be particularly vulnerable under either a sales tax shift or debt service increase, since the transfer does not change the school funding base.

How do the various financing alternatives compare from a tax equity standpoint? Both taxes typically used to fund transportation, the sales and the gas tax, are regressive taxes. That is, they impose a greater burden on low income households as a share of household income. The gas tax is even more regressive than the sales tax. The property tax, used to fund local infrastructure, is a less regressive alternative. From the standpoint of equity, General Fund support is the most progressive.[10] This option is progressive from a tax equity standpoint due to the state's highly progressive personal income tax, which provides half of all General Fund revenues. Moreover, local property and state income taxes are deductible for federal income tax purposes. Deductibility allows the state to "export" approximately a quarter of the cost of any increase in either of these two taxes to the federal government.

Local needs are not identified. Budget constraints have reduced local governments' ability to meet their own infrastructure needs. This process is exacerbated by the lack of a process for assessing local governments' unmet infrastructure needs and their ability to meet these needs out of their own resources. Finally, there are no mechanisms in place to coordinate state and local infrastructure planning.

Local governments' ability to finance infrastructure is hampered by supermajority vote requirements. Nearly all of the financing tools traditionally used by local government to finance infrastructure are subject to two-thirds voter approval requirements. As a result of court decisions and Proposition 218, dedicated sales tax rates must be approved by two-thirds of the voters. While state General Obligation bonds can be imposed by a majority of the voters, local bonds backed by property tax rates require two-thirds voter approval. Supermajority vote requirements allow a minority of local voters to block projects supported by the majority. The discrepancy between state and local bond approval requirements, and the limitations placed on local governments, force local governments to look to the state for assistance in meeting local needs.

COMMISSION ON BUILDING FOR THE 21ST CENTURY

Earlier this year, Governor Davis created a new Commission on Building for the 21st Century to explore the state's infrastructure needs. The 47 member Commission is specifically charged with looking at high-speed rail options to reduce congestion problems on commuter routes and making recommendations regarding the amounts of transportation, parks, and water bonds which should be submitted to the voters in the year 2000.[11] In August the Commission issued an interim report recommending that the state:[12]

- Place at least a $750 million to $1 billion housing bond on the ballot in 2000.
- Develop a long-term capital planning process.
- Place up to $3 billion in bonds on the year 2000 ballot to support natural resource projects including water, parks, and open space.
- Place a bond of $500 million to $1 billion on the 2000 ballot to support passenger rail and ferry projects.
- Place a constitutional amendment on the ballot to reduce the voter approval requirement for local transportation taxes from 2/3 to a majority of voters voting.

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[10] The distributional impact of total state and local taxes, minus the property tax, is used as a proxy for General Fund revenues.
[11] Governor Gray Davis, Speech to the Commission on Building for the 21st Century (March 30, 1999).
[12] Commission on Building for the 21st Century, *Interim Report to the Governor* (August 2, 1999).

The Commission will issue a final report in December 2000.

WHAT ARE THE MAJOR LEGISLATIVE PROPOSALS?

In addition to the Governor's commission, a number of infrastructure bills are pending before the Legislature. Pending proposals include measures that address infrastructure planning, bond acts, and modify local governments' ability to finance infrastructure development. While not exhaustive, this list illustrates the depth and range of interest among policymakers in the infrastructure debate.

Infrastructure Planning

AB 636 (Migden): Requires each state agency to annually submit a five-year plan of capital outlay and infrastructure needs to the Department of Finance (DoF) and Legislative Analyst's Office (LAO). Requires the DoF to annually submit a five-year capital outlay and infrastructure master plan as part of the budget. The plan must include priorities, descriptions of projects costing more than $250,000, and an explanation of changes in the list of projects from the prior year's inventory.

AB 1473 (Hertzberg): Requires the Governor to submit to the Legislature a three-year capital expenditure plan in conjunction with the budget identifying proposed funding sources for all projects included in the plan.

SCA 9 (Peace): Requires the Governor to submit to the Legislature a three-year capital expenditure plan including proposed projects and expenditures in conjunction with the budget.[13]

SB 915 (Sen. Budget Committee): Requires the Governor to submit a five-year capital outlay and infrastructure financing plan to the Legislature in conjunction with the budget. The plan must include funding sources, priorities, and proposed capital outlay legislation outside the Budget Bill to authorize or fund specific projects.

Bond Proposals

The Legislature approved five bond measures for the March 2000 ballot (described below). The Governor signed AB 18, sending that measure to the voters. The remaining four measures approved by the Legislature await the Governor's signature. A number of other bills placing bonds before the voters are currently pending before the Legislature. The measures listed below as pending before the Legislature have moved out of their house of origin. In other words, this list includes only those Assembly measures that are currently pending in the Senate and Senate bills pending before the Assembly.[14]

Approved by the Governor:

AB 18 (Villaraigosa/Keeley): Authorizes $2.1 billion in General Obligation bonds for parks, recreation, cultural, historical, fish and wildlife, and coastal resources.

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[13] A SCA is a Senate Constitutional Amendment. Constitutional amendments put before the voters by the Legislature require the approval of two-thirds of each house of the Legislature, but do not require the Governor's signature. The California Business Roundtable recently proposed dedicating 1/4 cent of the state's sales tax rate from the General Fund to a special infrastructure fund. This proposal was previously contained in SCA 9.

[14] The size and status of the various measures is based on the most recent information available as of September 28, 1999.

Pending Before the Governor for the March 2000 Ballot:

AB 1391 (Hertzberg): Authorizes $220 million in bonds to finance construction and renovation costs for local forensic laboratories and facilities.

AB 1584 (Machado): Authorizes $1.97 billion in bonds to finance a variety of projects including safe drinking water, flood protection, watershed protections, clean water and water recycling, water conservation, and water supply infrastructure.

SB 3 (Rainey): Authorizes $350 million in bonds to finance public library construction and renovation.

SB 630 (Dunn): Authorizes $50 million in bonds to construction and renovation of state Veterans' homes.

Pending Before The Legislature:

AB 398 (Migden): Authorizes $750 million in General Obligation bonds for state housing and homeless programs.

AB 564 (Machado): Authorizes $1.89 billion in bonds designed to meet safe drinking water and clean water standards, to protect rivers and streams from pollution, to provide flood protection, protect the water supply, and provide water reliability.

SB 57 (Hayden): Authorizes $2 billion in General Obligation bonds for parks and wildlife, natural sites, or for science and environmental education centers, museums, and other facilities. Aimed at the November 2000 ballot.

SB 315 (Burton): Authorizes $16 billion in transportation bonds ($4 billion per ballot), to be submitted to the voters on the 2000, 2002, 2004, and 2006 ballots, for repair and upgrading of California's transportation infrastructure.

SB 510 (Alarcon): Authorizes $980 million in General Obligation bonds ($245 million per ballot), to be submitted to the voters on the 2000, 2002, 2004, and 2006 ballots, for housing programs.

SB 530 (Costa): States legislative intent to meet safe drinking water and clean water standards, to protect rivers and streams from pollution, to provide flood protection, protect the water supply, and provide water reliability.

Local Bond/Tax Vote Proposals:

Current law requires 2/3-voter approval for local bonds repaid by special property tax rates and local taxes dedicated for specific purposes, such as local sales tax rates dedicated to transportation.

ACA 3 (Mazzoni): Allows approval of local General Obligation bonds for school facilities by majority vote.

SCA 1 (O'Connell): Allows approval of local General Obligation bonds for school facilities by majority vote.

SCA 3 (Burton): Allows approval of local sales tax rates for transportation by a majority vote, rather than 2/3, of the voters.

HOW SHOULD THE STATE PROCEED?

Institute a comprehensive planning process. The magnitude of the state's unmet infrastructure needs and the scarcity of available resources make comprehensive planning imperative. Any comprehensive infrastructure plan should prioritize needs across state departments, as well as between the state and local government. Any major investments should be made within the context of a comprehensive plan. Any other approach risks exhausting scarce resources (such as revenues and bonding capacity) without addressing the most pressing needs.

A comprehensive planning process should involve an assessment of local needs. The financial affairs of state and local government are increasingly interrelated. Many local infrastructure needs are directly related to state policy priorities, such as the need for local courts, criminal justice facilities, and health care facilities. Maximizing the effectiveness of limited resources at all levels of government demands an integration of state and local planning priorities.

New investment requires new money. Infrastructure investments have been deferred due to a lack of resources and competing demands on existing state and local resources. In the last three years alone, tax cuts totaling nearly $3 billion have severely limited the state's ability to meet current program demands, much less make new investments. Rebuilding the state's infrastructure, while meeting the demands of education and other policy priorities, will require an infusion of new funds.

Supermajority vote requirements limit local governments' ability to invest in infrastructure. Allowing local voters to approve bonds and special tax rates by majority, rather than two-thirds, vote would increase local governments' ability to meet local needs. Moreover, failure to reform the two-thirds vote requirement for local special taxes endangers current resources for transportation.

The cost of infrastructure investment should be spread among those most able to pay. Gas and sales taxes are regressive taxes that impose a disproportionate burden on low income families. These same families have not shared in the state's recent economic prosperity. Personal and corporate income taxes, which provide 60 percent of General Fund revenues, and the property tax offer more equitable alternatives. Moreover, income and property taxes are deductible for federal tax purposes, thereby "exporting" approximately a quarter of the cost of additional resources to federal coffers.

Change the State Constitution to allow gas tax revenues to be used for mass transit. The Constitution prohibits the use of fuel tax revenues for the purchase of busses and mass transit vehicles. While fuel taxes raise approximately $3 billion per year and there is a $1.5 billion surplus in the State Highway Account, the Public Transportation Account (proceeds from the sales tax levied on fuel taxes) will receive an estimated $174 million in 1999-00 and the Legislative Analyst projects that the PTA will experience shortfalls through 2003-04. In many parts of the state, the most pressing transportation issue is funding for mass transit vehicles. Changing the Constitution to allow gas tax moneys to be used for mass transit vehicles would help meet this need in a fiscally and environmentally appropriate manner.

ADDITIONAL READING

Department of Finance, *1999 Capital Outlay and Infrastructure Report.* Available on the Internet at www.dof.ca.gov/html/capoutly/co-home.htm.

Legislative Analyst's Office, *A Primer on State Bonds* (January 30, 1998). Available on the Internet at www.lao.ca.gov/lao_archives.html#1998.

State Treasurer Phil Angelides, *Smart Investments*, *California's Debt Affordability Report* (June 1999). Available on the Internet at www.treasurer.ca.gov/stodar.htm.

The California Budget Project (CBP) is a nonpartisan, nonprofit organization whose goal is to promote a better understanding of state fiscal issues in order to promote a healthy public sector based on a fair and equitable tax system. General operating support for the California Budget Project is provided by grants from the California Endowment, James Irvine, Ford, Charles Stewart Mott, Friedman Family, Streisand, and California Wellness Foundations and individual donations and subscriptions. Jean Ross wrote this Brief, with the assistance of Erin Riches.