

From: Board.Secretary
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Cc: Burns, Michael
Subject: Legislative Update for the week of December 15, 2008

MEMORANDUM

TO: Santa Clara Valley Transportation Authority
Board of Directors
FROM: Kurt Evans, Government Affairs Manager
Santa Clara Valley Transportation Authority
DATE: December 22, 2008
SUBJECT: Weekly Legislative Update: Week of December 15, 2008

FEDERAL

Economic Stimulus Package: Eager to jolt the nation's worsening economy back to life, President-elect Barack Obama's aides are assembling a two-year stimulus package that could cost \$850 billion with a blend of new jobs, middle-class tax relief, and expanded aid for the poor and the unemployed. While Obama has not settled on a grand total, his advisers, after consulting with outside economists of all political stripes, have begun telling Congress that the stimulus package should be bigger than the \$600 billion initially envisioned.

The President-elect is promoting a recovery plan that would feature spending on roads and other infrastructure projects, energy-efficient government buildings, new and renovated schools, and environmentally friendly technologies. There would also be some form of tax relief aimed at middle- and lower-income taxpayers, but no tax increases for wealthy Americans. In addition, Obama is expected to seek more funding for numerous programs that experience increased demand when joblessness rises, such as food stamps and other nutrition programs, health insurance, unemployment insurance, and job training.

While some economists consulted by Obama's team recommended spending up to \$1 trillion over two years, a more likely figure seems to be \$850 billion. There is some concern that a package that looks too large could worry the financial markets, and the President-elect's incoming economic team also wants to signal fiscal restraint. Furthermore, a stimulus package that approaches \$1 trillion could run into significant Republican opposition in Congress, and could cause heartburn for moderate and conservative Democratic lawmakers, known as Blue Dogs, who oppose large budget deficits.

In February, Congress passed a \$168 billion economic stimulus bill that featured \$600 tax rebates for most individual taxpayers and tax breaks for businesses. Pelosi largely bowed to President George W. Bush's insistence to keep the measure free of spending on federal projects. The upcoming effort would dwarf that earlier measure, as well as a \$61 billion stimulus bill that the House passed just before adjourning for the November elections. That measure died after a veto threat from President Bush and GOP opposition in the Senate.

Transportation: When President-elect Obama says he wants to get the economy moving again, he means it quite literally. Transportation will play a central role in his first months in office, not only in terms of policy changes aimed at improving highway, air and rail travel, but also as a way toward economic recovery, energy independence and environmental protection. According to the President-elect, “We will create millions of jobs by making the single largest new investment in our national infrastructure since the creation of the federal highway system in the 1950s.”

This expansive approach contrasts with the Bush Administration’s policy that transportation—like other federal government functions—works best when it is in private hands, or at least in a public-private partnership. Adopting a smaller-government-is-better approach to repairing and modernizing the nation’s transportation infrastructure, President Bush sought to shift more responsibility to state and local governments, and to encourage the use of tolls and private enterprise to pay for it. Obama is not necessarily against such arrangements. He just thinks the federal government should play the leading role in a transportation network on which the country and its economy depend.

President-elect Obama takes office as many critical transportation issues are coming to the fore, creating what some experts see as a once-in-a-generation opportunity to remake national policy. His transition team is working with congressional Democrats on an economic stimulus bill that is expected to include tens of billions of dollars for highway, mass transit, airport, and intercity passenger and freight rail improvements. While President Bush proposed what some lawmakers described as “starvation budgets” for Amtrak, Obama has pledged support for the passenger rail carrier and for developing a national network of high-speed passenger trains. The Bush Administration has feuded bitterly with air traffic controllers since the Federal Aviation Administration (FAA) imposed a contract in 2006. The President-elect has promised to appoint an FAA administrator who will work cooperatively with controllers. President Bush tried to ease cross-border trucking between the United States and Mexico, angering domestic truckers who fear the competition and contend that safety would be compromised. Obama promised the International Brotherhood of Teamsters to aggressively inspect cross-border trucks and buses, and enforce safety regulations.

The President-elect’s transportation goals face several potential roadblocks. The current authorization for federal surface transportation programs—the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU)—expires on September 30, 2009. It was funded at \$286 billion over six years. Its cost is mainly underwritten by the federal 18.4-cent-per-gallon gas tax, but revenues have failed to keep up with obligations. Last January, the National Surface Transportation Policy and Revenue Study Commission recommended increasing the gas tax by as much as 40 cents a gallon over five years. The additional money would help cover the federal share of an estimated \$225 billion that the commission says is needed each year to upgrade the nation’s transportation infrastructure. But boosting the gas tax carries political risks. The last time it was raised, a backlash against Democrats in the 1994 elections helped the GOP capture control of the House and Senate. Obama has expressed concern about raising taxes in the current economic climate. Even without an increase, the President-elect will have to deal with environmentalists who want to undo a bargain struck during the Reagan Administration that funnels roughly 80 percent of gas tax revenues to highway projects and 20 percent to public transit. Environmentalists want to redirect money away from highways to alternative forms of transportation.

New Transportation Secretary: Retiring Rep. Ray LaHood (R-IL) has accepted President-elect Obama's offer to become secretary of transportation. LaHood is the second Republican named to Obama's Cabinet, joining Defense Secretary Robert Gates, a holdover from the Bush Administration. The Illinois congressman, who served 10 years as a top aide to House Minority Leader Bob Michel before succeeding him in 1994, is well-respected on Capitol Hill. He managed to develop close ties with Democrats, including fellow Illinois Rep. Rahm Emanuel, the incoming White House chief of staff.

A Catholic schoolteacher before entering politics, LaHood made it his mission to restore civility to Capitol Hill. He spearheaded a series of bipartisan retreats in the late 1990s to mend relationships damaged by the impeachment trial of then-President Bill Clinton. Later, he and Emanuel issued regular invitations to groups of six Republicans and six Democrats to dine together in an effort to bridge the partisan divide.

LaHood, who did not run for re-election this November, served several terms on the House Transportation and Infrastructure Committee before leaving to take a post on the more influential House Appropriations Committee.

Obama's "Green Dream Team": President-elect Obama announced four appointments that will play key roles in implementing his "green" agenda. One is a Nobel Prize winner overseeing research of alternative energy. The other three all have one thing in common—experience working for the U.S. Environmental Protection Agency (EPA). Together, the group will make up President-elect Obama's team to oversee energy and environmental issues. It is a lineup that drew mostly praise from environmental and industry groups alike.

Of the three EPA veterans, the most experienced is Carol Browner, Obama's pick for energy "czar." She will be responsible for coordinating energy issues across the federal government. As head of the EPA during the Clinton Administration, Browner won battles with other top officials to tighten air pollution limits, and cut emissions from cars and trucks.

Nancy Sutley, tapped as head of the White House Council on Environmental Quality, was a special assistant to Browner before working as a top energy and environmental official in California. She led the effort to cut huge amounts of air pollution emitted by the Port of Los Angeles as the city's deputy mayor for energy and environment.

And Lisa Jackson, who will be the first African-American chief of the EPA, served for a short time in the agency's headquarters during the 1980s. Jackson, who is currently New Jersey Gov. Jon Corzine's chief of staff, was described by both environmental and industry leaders as a pragmatist who listened to both sides during her two years as New Jersey's top environmental official. She helped push the state to become one of the first to adopt limits on pollutants that cause global warming.

Only Steve Chu, a Nobel Prize-winning physicist selected as secretary of energy, has never been immersed in the rough-and-tumble world of Washington, D.C., politics. But supporters say Chu, who overhauled the U.S. Energy Department's Lawrence Berkeley National Laboratory to focus on energy efficiency and renewable energy, is up to the job of leading the department.

STATE

State Budget: Although he has not yet done so, Gov. Arnold Schwarzenegger has said he would veto a package of 16 bills approved by Democratic lawmakers that would increase taxes and make program cuts, an \$18 billion effort that passed the Legislature without Republican votes. The Governor said the package did not include provisions to stimulate the economy by loosening environmental standards, by making more use of contractors on public works projects, and by giving him the flexibility to furlough state workers without union intervention. Meanwhile, GOP lawmakers claimed that the Democratic package was illegal because it raised \$9.3 billion in taxes without a two-thirds vote of the Legislature. However, Gov. Schwarzenegger did not criticize that approach.

By adroitly stitching together proposals that lower some taxes and raise others, Democratic legislators contended that the package is “revenue-neutral” and thus could be passed by a simple majority rather than the constitutionally required two-thirds vote for tax increases. The plan calls for raising taxes on gasoline, personal income and sales; cutting state spending on schools, state universities and programs for the needy; and lowering the state’s payroll by \$657 million. Democrats portrayed their plan as an inventive solution in a desperate time for California, one that comes as a last-ditch acknowledgement that Republicans may never vote for tax increases. They argued that GOP alternatives for raising revenues, such as asking the voters to raid other dedicated state funds, were insufficient.

But Republicans accused Democrats of subverting the will of the voters and setting a historic precedent for raising taxes in California, calling the maneuver “stunningly cynical.” They warned that Democrats would soon increase other fees to make up for budget shortfalls if they are successful with their majority-vote plan. “This is a very historic day,” commented Senate Minority Leader Dave Cogdill (D-Modesto) during the floor debate on the package. “Certainly we’ve been a long time coming to this point where we have reached such frustration with the laws of this state, with the people and their will as it relates to how taxes should be raised, that you’ve decided to take an unprecedented step. Something we believe, quite frankly, is illegal and will be overturned quickly in the courts.”

Meanwhile, Senate President Pro Tem Darrell Steinberg (D-Sacramento) and Assembly Speaker Karen Bass (D-Los Angeles) pointed out that they were prepared to meet Gov. Schwarzenegger “more than halfway” on his demands for meaningful economic stimulus measures. Therefore, included in the Democratic plan are bills to accelerate \$3 billion in infrastructure bonds that have already been approved by the voters, to relax some environmental regulations to speed up construction projects, and to ease some rules that limit the use of private companies on public works projects.

The \$9.3 billion in tax provisions consist of: (a) a half-cent increase in the state portion of the sales tax and a quarter-cent hike in the local part of the tax; (b) a 2.5 percent surcharge on personal income taxes starting in 2009; (c) elimination of the 18-cent-per-gallon excise tax on gasoline, as well as the sales tax on gasoline, both of which would be replaced by a new 39-cent-per-gallon gas fee; (d) a new “severance tax” on oil production; and (e) a new 3 percent income tax withholding requirement for payments to independent contractors. The \$7.3 billion in cuts include: (a) \$2.5 billion from spending on elementary and high schools,

and on community colleges; (b) \$677 million from programs for the aged, blind and disabled; (c) \$132 million from the University of California and California State University systems; and (d) \$100 million from welfare programs. Compensation to state employees also would be reduced by \$657 million, subject to negotiations with employee unions.

How the Democratic Plan Works: The Democratic budget package attempts to employ a legal theory that has been kicking around the State Capitol Building for years—that one bill could simultaneously raise some taxes and reduce others by the same amount without triggering the two-thirds vote requirement. The plan works this way:

- One bill eliminates both the 18-cent-per-gallon excise tax and the sales tax on gasoline, an annual reduction of \$4.6 billion. The same bill also raises the overall state sales tax rate by a half-cent per \$1 of sales (\$2.3 billion a year), imposes a 2.5 percent surcharge on all personal income taxes (\$1.5 billion a year) and create a first-ever “severance tax” on oil production in the state (\$845 million a year). Because this bill eliminates \$4.6 billion in taxes and raises \$4.6 billion in taxes, Democrats say it is “revenue neutral” and, therefore, not subject to the two-thirds rule.
- A second measure replaces the gas tax and the sales tax on gas by imposing a new 39-cent-per-gallon fee. The proceeds of this new gas fee, about \$7 billion a year, would go to transportation. Democrats contend that such user fees can be passed with a simple majority vote.
- A third measure unwinds a 2004 three-way tax maneuver known as the “triple flip” that provided guarantees of repayment to purchasers of state bonds to cover the General Fund deficit that year. It would indirectly raise the local government portion of the sales tax by a quarter-cent (about \$1.15 billion a year), but cities and counties would lose an identical amount of property tax revenues to schools, and the state’s payments to schools out of the General Fund could then be reduced by the same amount.

The approach has never been tested. Senate President Pro Tem Steinberg claims that he suggested a similar maneuver five years ago to offset newly elected Gov. Schwarzenegger’s declared intention to reduce the vehicle license fee by two-thirds after his predecessor, Gray Davis, raised it. But Steinberg says he could not get other lawmakers to go along. One reason for the reticence is the uncertainty about its legality. It is clear that if the new maneuver is enacted, it will be challenged in court.

On the expenditure side, the Democratic plan calls for making the following cuts:

- ✓ K-12 Education: Roughly \$4 billion, including the current year and FY 2010.
- ✓ Community colleges: \$200 million over two years.
- ✓ University of California and California State University: \$264 million over two years.
- ✓ Personnel: \$657 million over two years. How this cut would be distributed—layoffs, furloughs, salary freezes—would be determined by various state agencies and their bargaining units.
- ✓ SSI/SSP Grants: \$600 million over two years, primarily by eliminating the scheduled federal cost-of-living increases for low-income aged, blind and the disabled.
- ✓ CalWORKS: \$100 million by suspending the cost of living increase.
- ✓ Regional Centers: \$112 million over two years.
- ✓ Public Transit: \$312 million over two years.
- ✓ Judiciary: \$35 million.
- ✓ Local Public Safety Programs: \$250 million in the current year and \$500 million in FY 2010, though some of the funding (roughly \$500 million over the two years) would be restored through a new \$12 fee on vehicle registrations.
- ✓ Williamson Act: \$35 million.

Transportation Details of the Democratic Plan: The Democratic budget plan calls for a major restructuring of state transportation funding, as follows:

- (1) Eliminates the state excise taxes on gasoline and diesel fuel.
- (2) Eliminates the sales tax on gasoline, which is the funding source for Proposition 42 and one of the funding sources for the Public Transportation Account.
- (3) Replaces those two revenue sources with a new “fee” on gasoline at 39 cents per gallon. This fee would generate more money for transportation than the sales tax on gasoline, and the excise taxes on gasoline and diesel fuel combined.
- (4) The new fee on gasoline would be tied to the California Consumer Price Index, and would be automatically adjusted every three years. The revenues from the new gas fee would be allocated annually as follows:
 - 33 percent (12.87 cents) for local streets/roads. Of this amount, roughly 6 cents would be allocated to cities and counties according to the traditional gas tax subvention formula and roughly 7 cents according to the Proposition 42 formula.
 - 45 percent (17.55 cents) to the State Highway Account, with a minimum of 20 percent (3.51 cents) going to the State Transportation Improvement Program (STIP). The remaining 80 percent (14.04 cents) would be appropriated for all other uses of the State Highway Account, including state highway rehabilitation projects under the State Highway Operation and Protection Program (SHOPP).

- 22 percent (8.58 cents) to a new “Transportation Stabilization Fund,” the uses of which would be subject to future legislative appropriations.

The gas fee revenues could not be diverted or loaned to the General Fund because existing state law requires fee revenues to be used for expenditures that have a “nexus,” i.e., those paying the fee would benefit from the use of the revenues. In addition, the Legislative Counsel’s Office has opined that the protections contained in Article XIX of the state Constitution would apply, which would restrict the use of the revenues to transportation capital expenditures, excluding public transit vehicle purchases. However, there is some question as to whether other public transit capital expenditures would meet the nexus test and, therefore, be eligible to receive any of the revenues generated by the new gas fee.

(5) Continues the sales tax on diesel fuel, which generates approximately \$400 million per year. The diesel sales tax would become the sole funding source for the Public Transportation Account. Of these revenues, \$150 million per year would be dedicated to the State Transit Assistance Program (STA). However, this STA funding would not be protected, and could be allocated to other eligible expenditures under the Public Transportation Account, such as yellow school bus service, transportation for the clients of the state’s regional occupational centers and transportation bond debt service, through the enactment of subsequent legislation.

(6) With the elimination of the sales tax on gasoline, there would be no more “spillover” calculation.

(7) Authorizes counties to increase the Transportation Development Act (TDA) sales tax for mass transportation purposes within their jurisdictions by a quarter cent, subject to a vote of the electorate. There are differing opinions as to whether such a sales tax increase would require a simple majority or a two-thirds vote to be enacted.

Infrastructure Projects: On December 8, the Legislature convened an unprecedented joint session to hear testimony from Treasurer Bill Lockyer, Controller John Chiang, Legislative Analyst Mac Taylor, and Finance Director Mike Genest on the state’s budget crisis. All four called for prompt action by the Legislature, and pointed out that the sooner lawmakers act to resolve the current-year and FY 2010 General Fund deficit, the better off California will be as it prepares to meet future challenges. Lockyer specifically talked about the fact that California is short of cash, which threatens the solvency of the General Fund and the state’s overall credit rating.

In the case of transportation, because Proposition 1B transportation bond projects are funded with general obligation bonds, the condition of the General Fund also affects the ability of Caltrans and other project sponsors to access cash to meet bond-funded project commitments. Proceeds from bond sales are deposited into the Pooled Money Investment Account (PMIA), which is then used to advance funds for capital projects statewide. The PMIA is also a source of funding for the temporary internal “borrowing” that occurs to keep state government operating. This enables the Controller’s Office to “balance” revenues with expenditures, since most expenditures occur relatively early in the fiscal year, while most revenues are received in the second half of the fiscal year. Normally, the PMIA is replenished through the issuance of bonds throughout the year. However, current market conditions and the lack of a

balanced budget have restricted the state's ability to sell those bonds. As a result, the cash reserve in the PMIA has dropped precipitously.

In response to the PMIA cash condition, the account's Board of Directors, which consists of Gov. Schwarzenegger, Lockyer and Chiang, decided to defer expenditures until bonds can be sold. This action means that the state will be unable to meet its funding commitments for new Proposition 1B bond-funded projects or for bond projects that have already been awarded contracts. Fortunately, there are no VTA-sponsored projects that are impacted by this decision.

REGIONAL

Metropolitan Transportation Commission (MTC): At its December 17 meeting, MTC approved its legislative program for 2009. Under the program, MTC would support efforts to pass a constitutional amendment to eliminate the two-thirds vote requirement to pass a state budget. In addition, the commission would seek to create a coalition of transportation interests to build support for a constitutional amendment that would fully dedicate the sales tax on gasoline and diesel fuel to transportation. Under this proposal, the so-called "spillover" would be eliminated, and all gasoline sales tax revenues would flow through Proposition 42—40 percent to the STIP, 40 percent to local streets/roads, and 20 percent to public transit.

Other state highlights of the program include: (a) supporting efforts for a new statewide gas fee to fund state highway rehabilitation work and local streets/roads maintenance; (b) supporting lowering the two-thirds vote for local transportation sales taxes to 55 percent; (c) seeking statutory authorization to develop a regional express lane network in partnership with Caltrans, the California Highway Patrol (CHP) and the Bay Area congestion management agencies (CMAs); and (d) seeking to broaden the potential uses for STA dollars to include discounted fare programs.

In the case of Washington, D.C., MTC would advocate for a much simpler federal surface transportation program that includes clearer national goals, an emphasis on relieving congestion in major metropolitan areas, a focus on goods movement, and much higher levels of funding for all transportation modes. In addition, MTC would advocate for the inclusion of transportation funding in any national economic stimulus package.

NOTE: Also contributing to this report were Susan Lent with Akin, Gump, Strauss, Hauer & Feld; Mark Watts with California Strategies; and Scott Haywood, VTA's Policy and Community Relations Manager.