

MEMORANDUM

TO: Santa Clara Valley Transportation Authority
Board of Directors

FROM: Kurt Evans, Government Affairs Manager
Santa Clara Valley Transportation Authority

DATE: January 18, 2010

SUBJECT: Weekly Legislative Update: Week of January 11, 2010

FEDERAL

Air Quality: The U.S. Environmental Protection Agency (EPA) issued new air quality standards that would lower the permitted concentration of ground-level ozone, the main ingredient in smog, to a level of between 60 parts per billion to 70 parts per billion. The exact level would be decided later this year after a series of hearings. The previous standard, adopted in 2008 by the Bush Administration, put the limit at 75 parts per billion. Parts of Texas, California and the Northeast Coast have historically struggled with heavy smog. However, EPA documents show that counties in states as diverse as Indiana, Oregon and Utah would be in violation of the tougher limits if they went into effect today. Under the EPA proposal, counties and states would have up to 20 years to meet the limits or face government sanctions, most likely the loss of federal highway dollars. That could force power plants, oil producers, factories, and other manufacturing facilities to find new ways to cut emissions.

Health Care: The House and Senate are “very close” to finalizing historic legislation intended to revamp the nation’s health care system, House Speaker Nancy Pelosi (D-CA) said after she and other Democratic leaders met with President Barack Obama at the White House. Pelosi’s optimistic prediction came after days of frantic work by staff members, lawmakers and the President himself to iron out the differences between measures passed by the House and Senate before Christmas. President Obama wants final legislation on his desk in time for his State of the Union Address early next month, and Democratic leaders are rushing to deliver despite the numerous discrepancies between the bills.

President Obama is playing a more direct role in the negotiations, convening a series of Oval Office meetings with House Democratic leaders, who have to compromise the most so that Senate Majority Leader Harry Reid (D-NV) can get a bill through his chamber with his fragile 60-vote majority. Under a fast-track process worked out with the President, lawmakers are bypassing the usual conference committee negotiations between the two chambers in the interest of speed. The plan is for the House to work off the Senate legislation, amend it and then send it back to the Senate for final passage.

While the bills passed by the House and Senate both would require nearly all Americans to obtain health care coverage and would provide subsidies for those who cannot afford the cost, they differ on hundreds of details. Among them are who to tax, how many people to cover, how to restrict taxpayer funding for abortions, and whether illegal immigrants should be allowed to buy coverage in the new markets with their own money. The cost of the House version tops \$1 trillion over 10 years; the Senate measure is cheaper.

While House Democrats are reluctant to abandon elements of their legislation favored by liberals but rejected by Senate moderates, they may end up having to do just that. It would mean no new government insurance plan, which the House wanted but the Senate omitted, and changes to the House's preferred payment scheme. The House wants to raise income taxes on individuals making more than \$500,000 and couples over \$1 million. The Senate, however, has suggested imposing a new tax on high-cost insurance plans. The House is looking at accepting the insurance tax if it hits fewer people than the Senate's design now does. And in place of a new government insurance plan, House Democrats are working on stronger affordability measures for middle- and lower-income people. House members also want the Senate to agree to revoke the current antitrust exemption for insurers as a way to hold them accountable in the absence of direct competition.

Financial Industry: President Obama will try to recoup as much as \$120 billion of the money spent to bail out the nation's financial system, most likely through a tax on large banks. While the President has yet to settle on the details, his senior economic advisers are weighing a number of options as they finish the FY 2011 budget plan that the White House is scheduled to submit to Congress next month.

The general idea is to devise a levy that would help reduce the federal deficit, which is now at a level not seen since World War II, as well as discourage the kinds of excessive risk-taking among financial institutions that led to a near collapse of Wall Street in 2008. But the President also has a political purpose—to respond to the anger building across the country as big banks, having been rescued by the taxpayers, report record profits and begin paying out huge bonuses while millions of Americans remain out of work.

The Obama Administration previously rejected two ideas that have received much attention in recent months: (1) a transactions tax on financial trades; and (2) a special tax on executives' bonuses. The most likely alternatives are a tax based on the size and riskiness of an institution's loans and other financial holdings, or an assessment on profits.

The \$120 billion recovery goal is the most that administration officials expect to lose from the government's \$700 billion Troubled Asset Relief Program (TARP), which provided assistance to banks, automakers and other financial firms. Most of the TARP losses are expected to come from the auto industry and insurance conglomerate American International Group (AIG). The 2008 law that created TARP requires the President to seek a way to recoup unrecovered money from financial institutions, but five years after the law was enacted. It does not specify how the money should be recovered.

STATE

State of the State: In his final State of the State Address, Gov. Arnold Schwarzenegger struck an aggressive and optimistic tone that gave little hint that he considers himself to be plagued by his lame-duck status. Before a packed Assembly chamber, the Governor acknowledged the struggles ahead, proposed a \$500 million jobs package to jump-start the state's ailing economy, and called for pension, tax and other reforms. He also warned of more "painful" budget cuts, promised to protect money for public education while linking funding for the University of California and California State University systems to a plan to privatize prisons, and vowed to seek money from the federal government that he claimed is "owed" to the state. Gov. Schwarzenegger made his appeal amid a stubborn economic morass and his lowest public approval ratings. With roughly a \$20 billion deficit facing him, an election year looming, and voters poised to choose his successor, the Governor insisted that he and lawmakers would be able to overcome any obstacles.

As outlined in his State of the State Address, Gov. Schwarzenegger's six priorities during his final year in office will be the following:

Higher Education Funding: The Governor proposed a constitutional amendment to ensure that California does not spend a greater percentage of its General Fund on prisons than on higher education. Specifically, the constitutional amendment would mandate that no less than 10 percent of the General Fund could be allocate to support the University of California and California State University systems, while no more than 7 percent could go for prisons. These mandatory limits would take effect in FY 2015. The constitutional amendment also would expand the authority of the Department of Corrections and Rehabilitation to contract with private entities to build and operate state prisons.

Jobs and Economic Growth: In his State of the State Address, Gov. Schwarzenegger outlined five proposals that he believes would create new jobs, "foster a more business-friendly environment" and get California's economy "back on track." They are: (1) implementing the California Jobs Initiative Program to create or retain up to 100,000 jobs, as well as to provide training to 140,000 individuals to enable them to retain their current positions or compete for higher paying jobs; (2) streamlining the permitting of construction projects that already have a completed environmental impact report (EIR); (3) extending and expanding the \$10,000 homebuyer tax credit to include the purchase of existing homes in addition to new residences; (4) eliminating the sales tax on manufacturing equipment for clean technology projects; and (5) changing regulations to cap punitive damages in class action and product liability lawsuits.

Budget and Tax Reform: Gov. Schwarzenegger called on lawmakers to enact the recommendations of the Commission on the 21st Century Economy, a bipartisan panel that was established to come up with ways to overhaul California's tax structure in order to stabilize state revenues and reduce budget volatility. The commission submitted its final report to the Governor and the Legislature in September 2009, and generally recommended: (a) flattening the state's personal income tax brackets to lessen the General Fund's reliance on this revenue source; and (b) replacing the corporate income tax and the state sales tax with a new "business net

receipts tax” to reflect the shift in California’s economy from manufacturing to service industries.

Pension Reform: The Governor called on lawmakers to pass legislation to reduce state employee pension costs.

Federal Funds: “Federal funds have to be part of our budget solution because the federal government is part of our budget problem,” the Governor commented during his State of the State Address. “When President Clinton was in office, California got back 94 cents on the dollar from the federal government. Today, we get only 78 cents back.” He further stated: “California must be reimbursed for unfunded and under-funded federal mandates and relieved of the overly restrictive maintenance-of-effort requirements placed on our programs that prohibit us from living within our means.” The Governor also noted that federal health care reform legislation currently being considered by Congress would result in \$3 billion-\$4 billion in additional costs to the state. He urged California’s senators and House members to either oppose the legislation or to ensure that federal funds would be provided to cover the state’s costs to implement it.

Operation Welcome Home: Gov. Schwarzenegger announced a new outreach initiative to help returning military veterans transition from “the battle front to the home front.” Dubbed Operation Welcome Home, the program calls for: (a) establishing nine full-time, regional teams to assist veterans in finding employment and job training, educational opportunities, housing, mental and physical health care, federal benefits, and support for their families; and (b) launching the California Veteran Corps, a volunteer network that would serve as liaisons between veterans and the program.

State Budget: California has an “almost non-existent” chance of reaping a \$6.9 billion windfall from Washington, D.C., to reduce its deficit, Legislative Analyst Mac Taylor said in his initial review of Gov. Schwarzenegger’s budget plan. He estimates that California would receive only \$3 billion in new federal aid for FY 2011, less than half of what the Governor expects. Taylor also warned the Legislature that it should use more realistic assumptions when approaching the state’s current budget dilemma. He noted that in the last two years, lawmakers passed “balanced” budgets that included legally risky maneuvers and false assumptions, some of which have contributed to the current deficit.

The Department of Finance emphasized that Gov. Schwarzenegger has laid out a series of spending reductions that would be pursued as a backup plan if the federal government does not come through with additional money. These “trigger” cuts include eliminating welfare-to-work, in-home care and Healthy Families medical insurance for children, as well as reducing state worker pay by an additional 5 percent. While Taylor gave credit to Gov. Schwarzenegger for coming up with a list of solutions that the state could pursue in case federal help does not arrive, he suggested that rather than wiping out entire programs such as CalWORKs and Healthy Families under a “trigger” plan, lawmakers should find ways to maintain services for the most vulnerable recipients. He also warned that the wholesale elimination of the In-Home Supportive Services Program could lead to higher state costs in the end.

In his initial review of the Governor's budget proposal, Taylor cautioned against broad-based tax increases because of their potential to harm the economy. However, he recommended that lawmakers eliminate or suspend corporate tax benefits that were passed recently in the name of job creation.

In his budget plan, Gov. Schwarzenegger recommended a major restructuring of state transportation funding that calls for eliminating the state sales tax on gasoline and diesel fuel, and partially backfilling for this cut by increasing the per-gallon excise tax on gasoline and diesel fuel by 10.8 cents. The revenues from the excise tax increase would be used to: (1) pay debt service on transportation-related bonds; and (2) compensate the State Transportation Improvement Program (STIP) and local streets/roads for the amount of funding that they would lose through the elimination of the state sales tax on motor vehicle fuels. In his report, Taylor offered the following comments on this rather complex proposal:

Funding state transportation based on road use has benefits: Taylor pointed out that the Governor's proposal is consistent with past recommendations made by the Legislative Analyst's Office (LAO) that the state rely on the excise tax as the primary funding source for state transportation programs.

Proposal provides ongoing General Fund relief: Taylor noted that the Governor's plan would provide a substantial and ongoing source of funding to pay transportation bond debt service, which would significantly lessen the burden on the General Fund.

Constitutional and statutory requirements may pose legal problems: Taylor said the use of the state sales tax on gasoline and diesel fuel is restricted under provisions of California's Constitution and statutes passed by the voters. He pointed out that the Governor's proposal would not amend or eliminate any of the restrictions, but rather it would eliminate the source of revenues that are subject to the restrictions. He recommended that the Legislature carefully review whether all aspects of the proposal can be implemented in keeping with these legal restrictions.

What should the state's role be in funding public transit: In weighing the Governor's proposal to eliminate all of the revenue sources for the Public Transportation Account, Taylor said the Legislature should consider: (a) whether providing funding assistance to regional and local public transit agencies is a policy priority; and (b) what the type (capital versus operating) and level of any assistance that it chooses to provide should be. He noted that because the state Constitution prohibits using excise tax revenues to support public transit operations, lawmakers would have to identify a different source of funding for this purpose if the Governor's proposal were to be adopted.

Proposal provides no additional highway funding: Taylor said funding for highway maintenance and rehabilitation has not kept pace with cost increases due to an aging system and inflation. As a result, the state faces billions of dollars in highway repair and reconstruction needs. He pointed out that the Governor's proposal would not provide any additional funding specifically for these activities. He suggested that the Legislature consider whether the excise tax should be increased

beyond the level proposed by the Governor in order to provide funding for highway maintenance and rehabilitation.

Oil Severance Tax: Legislation to impose a new severance tax on oil and natural gas extraction to help bolster higher education funding passed the Assembly Revenue and Taxation Committee by a party-line vote. The action came several days after Gov. Schwarzenegger released a budget plan for FY 2011 that relies largely on spending cuts and funding from Washington, D.C., to bridge a projected \$19.9 billion shortfall. By supporting AB 656 (Torrico), Democrats signaled a willingness to press for targeted tax increases, even though 2010 is an election year and odds are slim of winning the necessary two-thirds majority to pass such measures. AB 656 would generate an estimated \$1.3 billion annually for community colleges, California State University campuses, and the University of California system by imposing a 12.5 percent tax on the gross value of oil and natural gas extracted from California.

REGIONAL

Bay Area Toll Authority (BATA): At its January 11 meeting, the BATA Oversight Committee approved a plan to raise tolls on seven Bay Area bridges beginning July 1. Under the plan, the toll for cars would increase from \$5 to \$6. For the first time, carpoolers would be charged a toll, which would be set at \$2.50 per vehicle. The committee also agreed to test a congestion pricing program for the Bay Bridge. Under this program, cars would be charged \$6 during peak periods, \$4 during off-peak hours and \$5 on weekends. The committee also voted to raise tolls by 40 percent for trucks with three or more axles, but to phase in the increase over two years. The new toll would be \$10.50 for a three-axle truck beginning July 2011. It would increase to \$15 in July 2012. According to BATA, the toll increase is needed to raise additional money to offset higher financing costs and to fund \$750 million in seismic retrofit work on the Dumbarton and Antioch Bridges. BATA will consider the committee's recommendation at its January 27 meeting.

NOTE: Also contributing to this report were Steve Palmer with Van Scoyoc Associates; Mark Watts with Smith, Watts & Company; and Scott Haywood, VTA's Policy and Community Relations Manager.