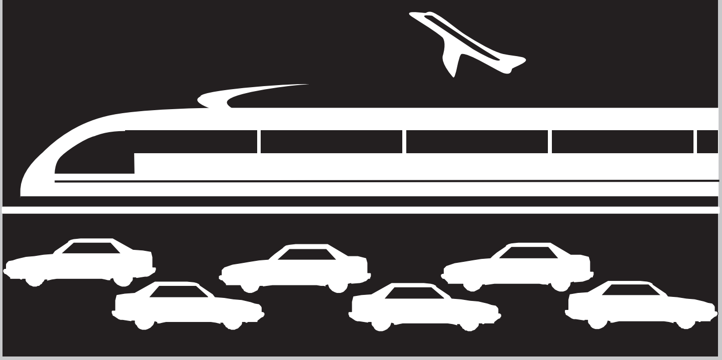
TRANSPORTATION



LAO

60 YEARS OF SERVICE

2004-05 Analysis

Major Issues

Transportation

Transportation Project Delay Harms the Economy

- State transportation funding has been highly unstable for several years, causing project delays. Since 2001-02, $2.2 billion has been diverted from the Traffic Congestion Relief Program and Proposition 42 to address the state's budgetary shortfall. Transportation projects have been planned and started expecting these funds, but they have not materialized. The Governor's proposals would divert an additional $2 billion from transportation. When the transportation system fails to keep pace with the state's population and travel demand, traffic congestion worsens. Such delays cost California drivers more than $4.7 billion in wasted time and fuel a year—thereby diverting these resources from more productive use, causing higher costs and reduced profits for businesses, and potentially reducing economic output and jobs (see page A-23).

State Should End "Stop-and-Go" Transportation Funding

- State transportation funding has not kept pace with increasing travel for various reasons, including the fund transfers noted above. Stabilizing transportation funding would increase the efficiency of transportation expenditures. We recommend the Legislature (1) ask voters to repeal Proposition 42, (2) replace the lost transportation revenue with an increase in the gas tax, and (3) index the gas tax to prevent future erosion of transportation revenues relative to travel demand (see pages A-29 through A-36).

Failure to Invest in Pavement Maintenance Shortchanges Taxpayers

- Timely pavement maintenance protects the taxpayers' investment in the highway system and can reduce long-term costs by postponing the need for more expensive roadway rehabilitation.

Poorly maintained roadways increase costs to motorists for vehicle repair, costing drivers in Los Angeles or San Jose an average of more than $700 a year for instance. There is now a backlog of $587 million in pavement maintenance work. We recommend Caltrans refocus its maintenance efforts by developing an investment plan for highway maintenance. We also recommend Caltrans develop performance measures that link the state's investment to the resulting quality of the highway system (see pages A-52 through A-62).

☑ One-Time Accounting Change Creates Ongoing Workload, Increases Project Risk

- The budget proposes to free up one-time money to help the General Fund by changing how the state accounts for federal funds used by local transportation projects. This change will create unknown, ongoing workload for Caltrans. It will also put potentially thousands of local projects at risk of not receiving enough funds to cover anticipated project expenses. We recommend the Legislature specify in statute the priority of future cash expenditures to reduce the risk to local projects (see page A-36). We also recommend Caltrans provide workload and risk information to the Legislature prior to budget hearings (see page A-44).

☑ Wait Times Grow Longer for DMV Customers

- Every year, over 30 million customers visit the Department of Motor Vehicles (DMV) field offices. Staff reductions in recent years have caused average customers wait times to grow significantly, from 35 minutes in 2001-02 to a projected 80 minutes in 2004-05. We recommend that the Legislature reexamine the levels of service to be provided by DMV. If the Legislature determines that current wait times and overall service levels are unacceptable, we recommend the Legislature restore selected field office positions (see page A-71).

☑ Opportunities Exist to Improve Driver Licensing Process

- The DMV's driver licensing process can be improved in terms of customer service, driver safety, and cost effectiveness. We recommend the department report at budget hearings on the viability of making administrative changes to reduce the millions of in-person visits at field offices. We further recommend the enactment of legislation for various fees to encourage fewer in-person visits at field offices and offset costs related to the program (see pages A-75 through A-82).

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OVERVIEW

Transportation

Total state-funded expenditures for transportation programs are proposed to be lower, by 4.3 percent, in 2004-05 than estimated current-year expenditures. This decline is primarily from lower expenditures for transportation projects as the result of no funding for the Traffic Congestion Relief Program, which the budget proposes to repeal. In addition, following the current year's partial suspension, the budget proposes to suspend in 2004-05 the full Proposition 42 transfer of about $1.1 billion from the General Fund to transportation programs.

For traffic enforcement, the budget proposes no growth in the expenditure levels of the California Highway Patrol and the Department of Motor Vehicles. However, the level of service, in terms of staffing, provided by these departments would be lower.

EXPENDITURE PROPOSAL AND TRENDS

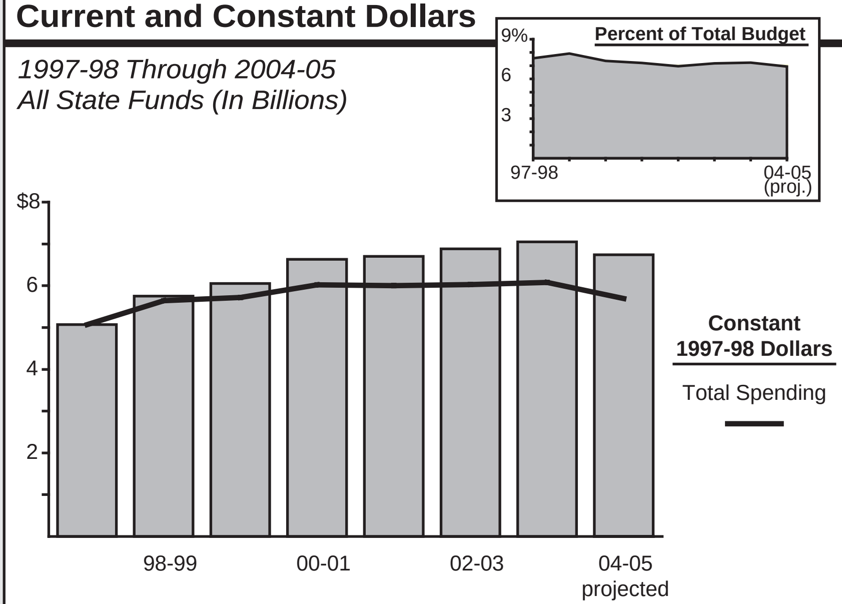
Budget Proposal. The budget proposes total expenditures of about $6.7 billion from all state funds for transportation programs and departments under the Business, Transportation and Housing Agency in 2004-05. This is a reduction of $301 million, or 4.3 percent, below estimated expenditures in the current year. The reduction is mainly due to lower capital expenditures for both state and local transportation projects as a result of the proposed repeal of the Traffic Congestion Relief Program (TCRP).

The seemingly modest reduction, however, masks the real impact of the budget proposal. Specifically, the budget proposes to suspend the transfer of about $1.1 billion in gasoline sales tax revenue to transportation programs, as required by Proposition 42. This would be the second year in which Proposition 42 is suspended in whole or in part. In the current year, the Proposition 42 transfer is partially suspended: only $289 million is being made available to transportation, with the remaining $856 million to be transferred for transportation by June 30, 2009. In contrast, the suspension proposed for the budget year would provide no deferred repayment. Absent the budget's proposed suspension of Proposition 42, transportation expenditures in 2004-05 would be significantly higher than the current year. In fact, together with other proposals to use transportation funds to help the General Fund, a total of about $2 billion would be diverted from transportation in the current and budget years combined.

Figure 1

Transportation Expenditures Current and Constant Dollars

1997-98 Through 2004-05
All State Funds (In Billions)



Historical Trends. Figure 1 shows total state-funded transportation expenditures from 1997-98 through 2004-05. As the figure shows, over the period, these expenditures are projected to increase by $1.7 billion, or 33 percent. This represents an average annual increase of 4.2 percent. Figure 1 also displays the spending for transportation programs adjusted for inflation (constant dollars). On this basis, expenditures are estimated to increase by 12 percent from 1997-98 through 2004-05, at an average annual rate of 1.6 percent.

As Figure 1 shows, state-funded transportation expenditures increased each year from 1997-98 through 2003-04, but would drop in 2004-05. This expenditure trend was driven by a combination of factors. First, state-funded expenditures by the Department of Transportation (Caltrans) increased significantly from 1997-98 through 2000-01—at an average annual rate of about 14 percent—due to increasing expenditures (both support and capital outlay) for highway improvements, including the seismic retrofit of state highways and bridges. Also in 2000-01, under the TCRP, the state allocated $400 million in General Fund money for local streets and road improvements. Since 2000-01, state transportation funding has been diverted each year to help the state General Fund. These diversions total about $2.2 billion through the current year. As a result, state-funded transportation expenditures have remained relatively flat. With the budget proposals to repeal TCRP and to suspend $1.1 billion in Proposition 42 transfer, expenditures are projected to decline in 2004-05.

Second, from 1997-98 through 2003-04, state funding for both the California Highway Patrol (CHP) and the Department of Motor Vehicles (DMV) grew considerably. Specifically, CHP expenditures grew about 48 percent, from $804 million in 1997-98 to $1.2 billion in 2003-04. The DMV expenditures grew more modestly throughout the period, by about 27 percent.

The growth in CHP expenditures is driven mainly by increases in the cost of employee (primarily uniformed staff) salaries and benefits. Additionally, beginning in 2001-02, the department increased its staff and overtime expenditures in order to enhance its statewide security activities after September 11, 2001. The growth in DMV expenditures was also mainly to accommodate higher employee compensation costs.

For 2004-05, the budget proposes slight decreases in both CHP and DMV expenditures as a result of lower anticipated reimbursements and elimination of one-time expenditures.

As a share of total state expenditures, Figure 1 also shows that transportation expenditures have declined since 1998-99 after a slight increase in 1997-98. In 2004-05, proposed transportation expenditures will constitute about 6.9 percent of all state expenditures—the lowest level over the eight-year period.

Spending by Major Program

Figure 2 shows spending for the major transportation programs and departments from all fund sources, including state, federal, and bond funds, as well as reimbursements.

Caltrans. The budget proposes total expenditures of about $7.3 billion in 2004-05—a reduction of $1.1 billion, or 13 percent, below estimated current-year expenditures. The lower expenditure level reflects primarily reductions in two areas. First, as the budget proposes to repeal the

TCRP, there would be no expenditures on the program in 2004-05. Second, the budget shows a drop of $836 million in federally funded expenditures in 2004-05 below the current-year level. This significant decrease in federal reimbursements somewhat overstates the real impact of the reduction. This is because part of the reduction is the result of a change in how Caltrans accounts for federal expenditures between the current and the budget years. (Adjusting for this change, the decrease would be smaller—about $500 million instead.)

Figure 2

Transportation Budget Summary Selected Funding Sources

2002-03 Through 2004-05 (Dollars in Millions)

	Actual 2002-03	Estimated 2003-04	Proposed 2004-05	Change From 2003-04	
				Amount	Percent
Department of Transportation					
State funds	$3,541.8	$3,756.6	$3,309.0	-$447.6	-11.9%
Federal funds	2,710.4	3,294.4	2,458.1	-836.3	-25.4
Bond funds	51.6	199.9	525.6	325.7	162.9
Other	385.9	1,232.9	1,066.3	-166.6	-13.5
Totals	**$6,689.7**	**$8,483.8**	**$7,359.0**	**-$1,124.8**	**-13.3%**
California Highway Patrol					
Motor Vehicle Account	$1,101.0	$1,144.3	$1,142.2	-$2.1	-0.2%
State Highway Account	28.3	46.0	46.8	0.8	1.7
Other	80.2	96.2	83.2	-13.0	-13.5
Totals	**$1,209.5**	**$1,286.5**	**$1,272.2**	**-$14.3**	**-1.1%**
Department of Motor Vehicles					
Motor Vehicle Account	$356.2	$375.6	$382.3	$6.7	1.8%
Vehicle License Fee Account	271.6	274.0	269.3	-4.7	-1.7
State Highway Account	41.1	40.1	36.6	-3.5	-8.7
Other	19.6	29.7	17.1	-12.6	-42.4
Totals	**$688.5**	**$719.4**	**$705.3**	**-$14.1**	**-2.0%**
State Transit Assistance					
Public Transportation Account	$98.0	$104.6	$101.4	-$3.2	-3.1%

The overall reductions are offset to a limited extent by anticipated increased expenditures of bond funds. Specifically, the budget proposes to issue Grant Anticipation Revenue Vehicles (GARVEE) bonds, backed by anticipated future federal funds, in both the current and budget years. The budget anticipates expenditures of these bond monies to be about $133 million in the current year, and about $492 million in 2004-05.

CHP and DMV. Spending for the CHP is proposed at about $1.3 billion—$14 million, or 1.1 percent, lower than the estimated current-year level. About 90 percent of all CHP expenditures would come from the Motor Vehicle Account (MVA). For DMV, the budget proposes expenditures of $705 million—$14 million, or 2 percent, less than in the current year. These expenditures would be funded primarily from the MVA and the Motor Vehicle License Fee Account.

While expenditures would be only slightly lower than the current year for both departments, the level of service provided by each (measured in terms of staffing), would be much lower. This is because employee compensation costs are anticipated to be higher in 2004-05 due to scheduled salary increases for uniformed officers and higher health insurance for all employees. To pay for the higher costs, both departments would have to reduce total staffing levels by holding some positions vacant. In the case of CHP, 126 personnel-years, mostly in uniformed staff, would not be funded. For DMV, an additional 95 personnel-years would not be funded. For both departments, the staffing cutback would be in addition to the positions eliminated pursuant to Control Section 4.10 and Executive Order D-71-03 in the current year. The reduction would likely mean reduced traffic patrol by CHP officers and longer wait times at DMV offices.

Transit Assistance. The budget proposes to fund the State Transit Assistance (STA) program in 2004-05 at $101.4 million, which is $3.2 million, or 3.1 percent, less than the current-year level. Annual STA funding is determined based on a statutory formula, and the level varies depending on anticipated revenues into the Public Transportation Account (PTA). The lower 2004-05 funding level reflects the projected decrease in diesel sales tax revenue into the PTA. In addition, the amount does not include about $45 million that otherwise would be made available to the program under Proposition 42.

Rail Bond. In addition, the budget proposes to repeal Chapter 697, Statutes of 2002 (SB 1856, Costa), the High Speed Passenger Train Bond Act that is scheduled to be on the November 2004 ballot. The bond act, subject to voter approval, would authorize $9.95 billion in general obligation bonds for the development of a high speed passenger train system in the state.

MAJOR BUDGET CHANGES

Figure 3 highlights the major changes proposed for 2004-05 in various transportation programs.

Figure 3

Transportation Programs
Proposed Major Changes for 2004-05

Department of Transportation	**Requested:**	**$7.3 billion**	
	Decrease:	**$1.1 billion**	**(-13.3%)**

+ $310 million in state highway capital outlay expenditures

– $1.2 billion in federal funds for local projects

– $296 million in Traffic Congestion Relief Program projects

California Highway Patrol	**Requested:**	**$1.3 billion**	
	Decrease:	**$14.3 million**	**(-1.1%)**

– $13.4 million in reimbursements for enhanced security activities

Department of Motor Vehicles	**Requested:**	**$705.3 million**	
	Decrease:	**$14.1 million**	**(-2%)**

– $10.3 million in one-time administrative cost to refund vehicle license fee

Caltrans. The major changes proposed in the budget would affect mostly local transportation projects. As Figure 3 shows, the budget projects a reduction of $1.2 billion in federally reimbursed expenditures on local transportation projects in 2004-05. As mentioned earlier, the drop is overstated due to the department's change in the methodology used to account for federal expenditures. The budget also proposes no expenditures on TCRP projects due to the proposed repeal of the program. Compared to the current year, there would be a reduction of $296 million in these expenditures, mostly on local projects.

The reductions in expenditures on local transportation projects would be offset to some extent by a projected increase of $310 million in expenditures for state highway projects from all fund sources, including GARVEE bonds.

CHP and DMV. As Figure 3 shows, the budget proposes only minor reductions in expenditures for both CHP and DMV. For CHP, reimbursed expenditures for enhanced security activities are expected to be lower by about $13.4 million. For DMV, a reduction of $10.3 million is in one-time current-year expenditures to refund vehicle license fees paid by certain motorists.

CROSSCUTTING ISSUES

Transportation

FUNDING FOR TRANSPORTATION PROGRAMS

In recent years, transportation funding has been both constrained and uncertain due to various factors including the use of transportation funds to help the General Fund. The Governor's mid-year and budget-year proposals include $2 billion in transfers and loans from transportation funds to the General Fund. These proposals would delay many state and local transportation projects. They would also increase the uncertainty regarding future transportation funding, which adds risk to ongoing projects and makes planning for new projects difficult.

We make several recommendations intended to stabilize transportation funding. Specifically, we recommend the Legislature (1) ask the voters to repeal Proposition 42 and (2) increase the gas tax to provide the same amount of revenue as would be generated under Proposition 42. We also recommend that the gas tax be indexed to prevent future erosion of transportation funding relative to travel demand.

California's state transportation programs are funded by a variety of sources, including special funds, federal funds, and general obligation bonds. Two special funds—the State Highway Account (SHA) and the Public Transportation Account (PTA)—have traditionally provided the majority of ongoing state revenues for transportation. Additionally, in 2000, the Legislature enacted the Traffic Congestion Relief Program (TCRP), which created a six-year funding plan for state and local transportation needs. Later statutes have delayed much of the funding for this program, so that funding for TCRP projects now extends through 2008-09. The program is funded by two fund sources—the Traffic Congestion Relief Fund (TCRF) and the Transportation Investment Fund (TIF)—from a combination of General Fund revenues (one-time) and ongoing revenues from the sales tax on gasoline. In March 2002, voters passed Proposition 42, which permanently extended the transfer of gasoline sales tax revenues into the TIF and dedicated the funds to various transportation programs. These programs include local street and road improvement, the State Transportation Improvement Program (STIP), State Transit Assistance, and other mass transportation activities funded by the Department of Transportation (Caltrans).

The STIP. The state's primary program for the construction of new transportation projects is the STIP. Funding comes primarily from the SHA and federal funds. In addition, under Proposition 42, a portion of TIF money will annually be made available for the STIP. Each even-numbered year, the California Transportation Commission (CTC) programs new projects to receive STIP funding based on an estimate of the funds available over the next five years. Statute allows Caltrans to spend 25 percent of the available STIP funds on interregional transportation improvements, with the remaining 75 percent going to designated regional transportation planning agencies for regional transportation improvements. The regional funding is further allocated to counties based on statutory formula.

The TCRP. The TCRP is the second major project construction program. It mainly consists of 141 statutorily-defined projects located throughout the state, with each project receiving a specified amount of money. Collectively, TCRP projects are to receive about $4.9 billion through 2008-09 from the General Fund and the sales tax on gasoline. Through 2003-04, they will have received about $500 million from these sources, in addition to loans from other transportation accounts. Because TCRP does not provide full funding for all of the projects, many of them are funded from multiple sources, including STIP money.

In addition to funding specified projects, the TCRP also provides funding for STIP projects, local street and road improvements, and mass transportation programs. In total, the TCRP was envisioned to provide $7.6 billion to transportation through 2005-06.

Funds Redirected. In the past three years, funds designated for transportation have been redirected annually to help the General Fund. The 2004-05 budget continues this practice. The repeated diversion of transportation funds, while helping the General Fund condition, raises a number of issues regarding the predictability and adequacy of funding for transportation over both the near and the long term. In the following three sections, we discuss the Governor's proposals for the use of transportation funds from several angles. The first section covers the

Governor's proposals and their effect on the General Fund only. The second section discusses the immediate implications of the Governor's proposals on transportation in the current and budget years. In the third section, we discuss the actions' longer-term implications and provide broader recommendations.

GOVERNOR PROPOSES $2 BILLION IN TRANSPORTATION AID TO GENERAL FUND

In both the mid-year cuts submitted in November 2003 and in the *2004-05 Governor's Budget*, the administration has proposed to use a number of transportation funds to provide about $2 billion in one-time General Fund aid over the current and budget years. This section discusses the proposal's key elements and its General Fund effects.

Transportation to Provide a Large Portion of Proposed Mid-Year Cuts

In November, the administration proposed to use about $920 million in transportation funds to aid the General Fund. This amount is about one-quarter of the administration's proposed mid-year General Fund savings. Most of this money would be made available through a change in accounting for federal transportation funds. Other sources of funding include a transfer to the General Fund of additional Transportation Congestion Relief Program money and certain funds that are normally deposited in the Public Transportation Account.

In November 2003, the administration proposed a number of mid-year savings proposals to aid the General Fund, totaling about $3.9 billion in the current and budget years. Of this amount, $920 million, or about one-quarter of the total package, is to come from transportation funds. Figure 1 (see next page) lists the proposed loans and transfers, which we describe in more detail below.

"Cashing In" Federal Money Sooner Through Change in Accounting. Most of the $920 million would be made available from a change in how the state accounts for federal money that it gives to local transportation agencies. Each year, the state sets aside about $900 million of its federal expenditure authority to be used by local transportation agencies for their own projects. The rest is used for state purposes, including the STIP.

Local governments do not expend all of the federal money in the year it is provided. Typically, the full amount of federal funding needed for a project is set aside at the beginning of the project, even if it will take

Figure 1

Governor's Proposed Mid-Year Transportation Actions

(In Millions)

	2003-04 and 2004-05			
	General Fund	SHA	TCRF	PTA
Federal funds accounting change	—	$800.0	—	—
Transportation bond payment	$406.0	-406.0	—	—
Three-year loan	200.0	-200.0	—	—
TCRP transfer	189.0	—	-$189.0	—
Miscellaneous revenue transfer	107.6	—	—	-$107.6
Sales tax "spillover" retained	17.5	—	—	-17.5
Totals	**$920.1**	**$194.0**	**-$189.0**	**-$125.1**

SHA = State Highway Account; TCRF = Traffic Congestion Relief Fund; PTA = Public Transportation Account; and TCRP = Traffic Congestion Relief Program.

Figures are total of current-year and budget-year effects. Positive numbers are transfers into account; negative numbers are transfers from the account.

several years to expend those funds as the project goes from engineering to construction. This leaves several hundred million dollars in federal funds waiting to be expended at any given time. The administration proposes to cash in this amount, which it estimates at $800 million over two years, and deposit it in the SHA, to be used as follows:

- ***Debt Service on Transportation Bonds.*** $406 million would be transferred to the General Fund to pay the debt service on three existing general obligation bonds for transportation.
- ***Loan to General Fund.*** $200 million would be loaned to the General Fund under the provisions of Article XIX of the State Constitution. Repayment would be required by June 30, 2007.
- ***General Transportation Purposes.*** The remaining $194 million would remain in SHA for statewide transportation purposes.

From the budget year onwards, the state would provide the cash needed each year to cover the expenditures incurred on local projects. The state would then seek reimbursement from the federal government out of the state's annual share of federal money.

Our review shows that Caltrans can administratively change its accounting methodology and cash in the $800 million in federal money without the Legislature's approval. However, action by the Legislature is required to transfer and loan the proposed amounts to the General Fund. Our review further shows that the accounting change and the use of the funds for General Fund purposes could have negative effects on local transportation projects, as the proposal increases the uncertainty of their funding source. We discuss this issue later in the section on long-term transportation effects of the Governor's proposals.

Funding for TCRP to Be Eliminated; Money Reverted to the General Fund. The administration also proposes to transfer $189 million from TCRF to the General Fund in the current year. As part of the 2003-04 budget, Proposition 42 was partially suspended. As a result, only $289 million (out of a projected $1,145 million) from the sales tax on gasoline would be transferred to TCRF in the current year. Of this amount, $100 million would repay a loan from SHA. The remaining $189 million would be used to pay for the current-year costs of some TCRP projects. The mid-year proposal would eliminate the current-year funding for TCRP projects, and instead revert the amount to the General Fund.

PTA Income to Be Transferred to General Fund. The administration also proposes in its mid-year cuts to transfer several sources of PTA income to the General Fund. First, the administration proposes to transfer certain miscellaneous income, totaling $108 million in the current and budget years, from SHA to the General Fund. This income, which includes such sources as sales of documents and rentals and sales of state property, is normally transferred to PTA each year to support transportation planning and public transportation programs.

Second, the administration proposes to retain in the General Fund all "spillover" revenue of extra gasoline sales tax money that would normally be deposited in PTA. The 2003-04 budget provided up to $87 million of the spillover amount to the General Fund, with any excess amount to be transferred to the PTA. The administration now proposes to keep in the General Fund the additional $17.5 million that it projects will be available. (When the mid-year cuts were proposed in November, the administration estimated that this extra spillover revenue would total $30 million in 2003-04, but it has since revised its estimate downward to $17.5 million.)

Suspension of Proposition 42 Proposed for Budget Year

The budget proposes to suspend in 2004-05 the transfer of $1.1 billion derived from the sales tax on gasoline to the Transportation Investment Fund.

Proposition 42, passed by the voters in March 2002, provides that all sales tax on gasoline that would otherwise be deposited in the General Fund shall be used for specified transportation purposes beginning in 2003-04. However, the transfer of this money to transportation may be suspended under certain circumstances. Proposition 42 was partially suspended as part of the 2003-04 budget.

Proposition 42 Suspension to Provide $1.1 Billion to General Fund. The budget proposes to again suspend the Proposition 42 transfer in 2004-05. As noted above, this would be the second suspension, in whole or in part, in the first two years of the proposition's existence. The budget estimates that the suspension would save the General Fund about $1.1 billion. Unlike the current-year suspension, which requires the suspended amount ($856 million) to be repaid by June 30, 2009, the budget-year suspension would be permanent, with the suspended amount never returning to transportation.

Transportation Funds Provide One-Time General Fund Aid

The Governor's proposals would provide about $2 billion to the General Fund over the current and budget years. This would bring to about $4.3 billion the total amount of transportation funds loaned or transferred to the General Fund since 2001-02. The use of transportation funds to help the General Fund provides only a one-time fix, while adding to future-year General Fund obligations for loans which must be repaid. After 2004-05, the General Fund obligations covered by these transfers will have to be addressed by new cuts, transfers, or revenue enhancements.

Proposed Transportation Aid to General Fund Is Substantial. The Governor's mid-year proposals together with the Proposition 42 suspension in 2004-05 would provide about $2 billion in transportation funds to the General Fund in the current and budget years. This is about 13 percent of the administration's total proposed solutions of about $16 billion to balance the General Fund over the two years.

General Fund Has Already Borrowed a Large Amount of Transportation Funds. Since 2001-02, the General Fund has borrowed about $2.2 billion from TCRF and TIF. As Figure 2 (see next page) shows, this includes loans from TCRF of $238 million and $1,145 million in 2001-02 and 2002-03 respectively, and $856 million from TIF in 2003-04. The Governor's mid-year and budget-year proposals would bring the total aid to the General Fund from various transportation funds to about $4.3 billion over the four-year period.

Figure 2

Transportation Loans and Transfers to the General Fund

(In Millions)

	TCRF	TIF	Other	Totals
2001-02	$238	—	—	$238
2002-03	1,145	—	—	1,145
2003-04	189[a]	$856	$731[a]	1,776
2004-05	—	1,127[a]	—	1,127
Totals	**$1,572**	**$1,983**	**$731**	**$4,286**

a Governor's current-year and budget-year proposals.

TCRF = Traffic Congestion Relief Fund and TIF = Transportation Investment Fund.

Transfers and Loans Do Not Address General Fund Structural Deficit. While significant in magnitude, the proposed transportation transfers and loans are all one-time actions. As such, they do not provide an ongoing solution to address the state's structural imbalance between current law General Fund revenues and expenditures. Indeed, the loan proposal would add to the General Fund's future expenditure obligation. Absent ongoing solutions, the General Fund's structural budget problem will remain, even in the face of an improving statewide economic outlook. This means that, even if the transportation proposals are adopted, the General Fund obligations that they cover will have to be addressed by new cuts, transfers, or revenue enhancements in the future.

GOVERNOR'S PROPOSALS REDUCE ALREADY LIMITED NEAR-TERM FUNDING

The Governor's proposals not only have a significant General Fund impact, they also have a substantial impact on transportation programs, in both the near and long term. This section discusses the Governor's proposals in the context of the funding difficulties faced by transportation in the near term—the current and budget years. We also identify several issues the Legislature should consider when weighing the Governor's proposals to help the General Fund and addressing near-term transportation funding.

Expected Transportation Funding Has Dropped Precipitously

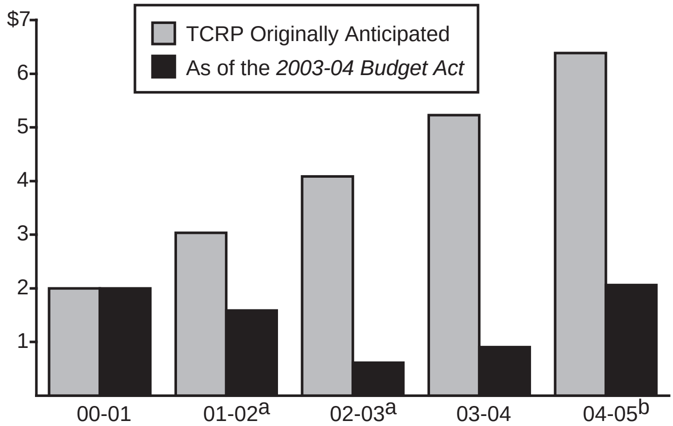
During the past few years, a large influx of funding was expected in transportation, but this influx has not materialized. Funding promised in the Traffic Congestion Relief Program has been delayed and loaned back to the General Fund, the federal government has delayed reauthorization of its six-year transportation funding legislation, and other revenues such as truck weight fees have been lower than anticipated.

Promised General Fund Money for Transportation Has Not Materialized. The TCRP was enacted in 2000 to invest more money in transportation, primarily from the General Fund. As Figure 3 shows, as originally envisioned, it would have provided about $5.2 billion to transportation by 2003-04. About $7.6 billion would have been provided by the time the program was to expire in 2005-06. (This includes $4.9 billion for TCRP projects, with the remaining $2.7 billion divided among STIP projects, local street and road improvements, and mass transportation programs.) However, as mentioned earlier, most of the funding has been deferred to later years or loaned back to the General Fund. With the actions taken in the *2003-04 Budget Act*, the cumulative amount of General Fund money made available to transportation through the current year would only be $906 million, including about $500 million for specific projects and $400 million for local street and road improvements. This is $4.3 billion less than envisioned in the original statute.

Figure 3

Cumulative General Fund Money for Transportation

(In Billions)



[a] Cumulative General Fund money for transportation fell in these years due to loans from transportation back to the General Fund.

[b] This is not the amount proposed for the budget year. It is the cumulative amount that would have been estimated for the year under the *2003-04 Budget Act*.

Federal Funding Reauthorization Is Delayed, Reducing Current-Year Funding. The federal government reauthorizes transportation funding on a six-year cycle. The last reauthorization (TEA-21) in 1998 provided more than a 40 percent increase in annual funding over the prior transportation funding act. The next reauthorization is almost certain to provide a large increase as well. In fact, each of the three versions of the next transportation act being debated in Congress represents a marked increase in funding over the current level. In adopting the 2002 STIP (covering the five years from 2003-04 through 2006-07), the state anticipated a 20 percent increase in annual federal funding after the new reauthorization, and transportation projects were programmed for funding based on that anticipated increase.

Reauthorization of the federal act was due in October 2003. However, Congress did not pass a bill at that time; instead it extended transportation funding at the existing level through February 2004. Current indications are that this deadline will be extended again and it is likely that reauthorization will not occur in time to increase federal transportation funding in 2003-04. As a result, current-year federal funding would be $366 million lower than expected. The total impact of the delay in federal reauthorization is unknown as it would depend on when a new federal transportation act is adopted.

Weight Fee Revenues Have Declined. Revenues from truck weight fees are a major source of income to the SHA. As we discussed in the *Analysis of the 2003-04 Budget Bill*, weight fee revenues declined sharply in 2002-03 following the passage of Chapter 861, Statutes of 2000 (SB 2084, Polanco), which changed how truck weight fees are collected. Although the change was intended to be "revenue neutral," weight fee revenues in 2002-03 were $124 million lower than was anticipated prior to the change. Chapter 719, Statutes of 2003 (SB 1055, Committee on Budget), subsequently increased weight fees as of January 1, 2004 to correct the decline. Nonetheless, about $223 million of transportation funding has been permanently lost since the adoption of Chapter 861.

Reduced Funding Means Fewer New Projects, Project Delays

The decline in expected funding severely restricted the state's capacity to fund new capital projects, thereby causing project delays. Project delays, in turn, can have negative effects on the state's economy. The state plans to proceed with some projects using borrowed funds.

New Allocations Severely Curtailed. The reduction in expected transportation funding caused CTC to stop all allocations for new capital projects in December 2002. This included both STIP and TCRP projects, as well as projects in the State Highway Operation and Protection Program (SHOPP), which funds capital projects that improve the state highway system without expanding capacity. Throughout 2003, CTC only allocated $600 million for new STIP projects and $500 million for new SHOPP projects, with no new TCRP allocations. By way of comparison, CTC typically allocates more than $2 billion annually for STIP and SHOPP projects alone. Without an allocation from CTC, a project that is ready to begin a new phase of work is unable to continue unless the regional or local agency can come up with alternative funding.

Without fund allocations, a backlog of "ready-to-go" projects has developed. These projects, which are in various phases of development, are all ready to begin a new phase of work, but must wait until the funding becomes available. The CTC reports that, as of the end of December 2003, the backlog of STIP and SHOPP projects totaled $672 million, and could grow to $1.6 billion by June 2004 if new allocations remain suspended. Similarly, over $150 million worth of TCRP projects were ready to go by December but were held back due to a lack of funding.

Project Delay Harms the Economy. Constraining the delivery of transportation projects can cause negative economic consequences. Most obviously, if the transportation system—whether roads or transit—fails to keep pace with the state's population and travel demand, traffic congestion will increase rapidly. This in turn wastes billions of dollars worth of time and fuel used by California drivers each year. These costs are incurred by both businesses and individuals. As Figure 4 shows, by the year 2000, over 1,800 miles of the state's urban freeways were congested, resulting in about 530,000 vehicle-hours of delay. Caltrans estimates that this delay cost California drivers $4.7 billion in wasted time and fuel that year. Delays in upcoming transportation projects will only worsen this trend.

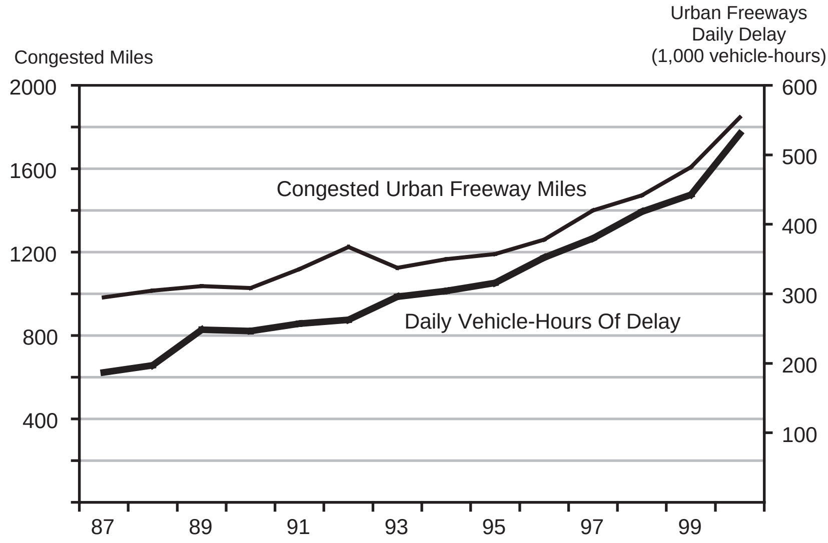
Delaying the construction of transportation projects also affects employment in the state. The Federal Highway Administration estimates that $1 billion spent on projects generates an equivalent of 26,000 jobs.

Some Projects Progressing With Borrowed Money. To minimize project delays, some projects have proceeded with money borrowed from other sources. For example, several local transportation agencies have received "Letters of No Prejudice" from CTC. Created by Chapter 908, Statutes of 2001 (AB 1335, Cohn), a letter of no prejudice allows a local agency to use its own funds to continue work on phases of TCRP projects that do not have TCRP allocations. These letters indicate that, should TCRP funds become available, the local agencies will be reimbursed for the local funds they have spent. Local agencies are advancing $270 million worth of TCRP projects in this manner.

The state is also planning to borrow money to advance certain projects. Federal legislation allows states to issue Grant Anticipation Revenue Vehicle (GARVEE) bonds, which are repaid with future federal transportation revenue. In January 2004, CTC approved the issuance of GARVEE bonds for eight STIP projects worth $632 million, with bond issuance expected in February. Because the bonds are secured only by federal funds and are not a debt of the state, they are expected to achieve a higher investment rating and carry lower interest rates than state general obligation bonds.

Figure 4

Urban Highway Congestion Has Accelerated in Recent Years



Governor's Proposals Further Reduce Available Funding

By reducing near-term transportation funding in the current and budget years, the administration's proposals would further slow transportation projects. Traffic Congestion Relief Program (TCRP) projects would be hardest hit. Work on many projects would have to stop completely, resulting in unknown closeout costs. Furthermore, if TCRP projects are to compete for State Transportation Inprovement Program (STIP) funding, they would crowd out some existing STIP projects as well.

Governor's Proposals Would Remove Funds from Several Programs. Figure 5 summarizes the programmatic impact of the Governor's mid-year and budget-year proposals. As the figure shows, the largest effect would be a reduction of $867 million for TCRP projects. This amount includes $189 million transferred to the General Fund in the current year and $678 million that otherwise would be available from TIF in 2004-05. Local street and road improvements and mass transit programs would also lose money due to the suspension of the Proposition 42 transfer. Also, mass transit programs would lose additional money due to the proposed transfers of PTA revenues.

Figure 5

Current- and Budget-Year Impact of Governor's Transportation Proposals

(In Millions)

Program	Impact
Traffic Congestion Relief Program	-$867
Local street and road improvements	-180
State Transportation Improvement Program	14[a]
State Transit Assistance	-54
Other mass transit programs	-161

[a] Assumes $180 million loss will be offset by $194 million due to accrual-to-cash accounting change.

Suspending Proposition 42 also reduces STIP funding. The administration, however, expects this loss to be offset by funds to be generated from shifting local projects from an accrual to a cash basis. On balance, the Governor's proposals would result in a net increase of $14 million for the STIP, as shown in Figure 5.

However, Caltrans is still assessing the status of local projects to determine how much it can realize by making the proposed accounting change. Until that assessment is complete, it is not known whether $800 million is in fact available. To the extent the available amount is lower, STIP funding would be reduced in the budget year.

Stopping All TCRP Projects Would Result in Unknown Closeout Costs. The Governor's proposals would halt all expenditures on TCRP projects as of February 1, 2004. This would leave a number of projects—those for which work is being done under contract—unable to complete outstanding contracts. The administration proposes to examine these existing contracts and determine for each whether it would be cheaper to complete work on the contract or terminate it, possibly paying a penalty to the contractor. However, Caltrans has not yet performed this assessment and does not know what the costs would be to the SHA.

Furthermore, the administration's proposal would rescind all letters of no prejudice already granted by CTC. This would likely cause local agencies that are currently spending their own money on TCRP projects to stop work on some of these projects, as they would no longer have reason to expect reimbursement from the state.

TCRP Projects Would Crowd Out STIP Projects. In addition to removing TCRP funding, the administration proposes to repeal the statutory funding guarantee for the 141 projects included in the program. Without a dedicated funding source, TCRP projects would have to compete with other projects for state funding in the STIP. This would cause a reprioritization of projects in many regions of the state, with some existing STIP projects being pushed back in favor of TCRP projects. In this way, the proposal would delay not only TCRP projects, but STIP projects as well.

Near-Term Funding: Issues and Options for Legislative Consideration

We recommend that the California Transportation Commission and Caltrans report expected Transportation Congestion Relief Program (TCRP) project closeout costs to the Legislature by April 2004. We also note that the Legislature can allow work to continue on a subset of TCRP projects, if it chooses to do so, by providing partial funding. In addition, the Legislature should consider whether a certain number of engineering staff resources should remain in the agency to work on a "shelf" of transportation projects to be delivered in the future.

Closeout Costs Should Be Estimated. As was the case last year, the Legislature is again faced with determining whether TCRP projects should continue in the near term, and if so, at what level of funding. A key piece of information required to make this determination is what the expected TCRP project closeout costs would be if all TCRP funding were terminated. Without this information, the Legislature cannot compare the potential fiscal impacts of all of the options before it. Because this vital information was not yet available at the time this analysis was prepared, we recommend that CTC and Caltrans, in consultation with local transportation agencies, review TCRP project status to estimate project closeout costs and report the findings to the Legislature by April 2004.

Legislature Must Decide Level of TCRP Funding. The more significant near-term transportation funding decision facing the Legislature is whether to suspend all TCRP funding and repeal the program, as proposed by the administration, or to continue funding the program at some level. If the Legislature decides not to terminate the program, it can consider various funding options to allow the program to proceed.

Figure 6 presents four options.

- ***Repeal TCRP, as Proposed.*** This option would reduce expenditures on TCRP projects in the current year and remove them altogether in the budget year, but would also result in unknown close-out costs.
- ***Fund Only Projects With Existing Allocations.*** This option would require not transferring $189 million to the General Fund in the current year, and would also require an additional transfer of $163 million into TCRF in 2004-05. This option is similar to the Legislature's decision in the *2003-04 Budget Act* to fund only projects with existing allocations.
- ***Fund Projects With Existing Allocations and Projects With Letters of No Prejudice.*** This option would require $258 million in 2004-05 in addition to retaining the $189 million in the current year.
- ***Fund All Expected Costs of TCRP Projects in the Current and Budget Years.*** This option would allow new TCRP allocations to begin in the budget year. This would cost $498 million in 2004-05, in addition to retaining the $189 million in TCRF in the current year.

Of course, using General Fund money for TCRP projects, as described in three of the four options listed, would require additional General Fund expenditure savings or revenue to make up the difference.

Staff Resources Can Be Retained to Work on Shelf Projects to Provide Steady Project Delivery. As funding of projects fluctuates, project delivery workload also fluctuates. This causes Caltrans' capital outlay support staffing, which is based on estimated project delivery workload, to fluctuate as well. Another near-term issue the Legislature should consider is whether project delivery staffing should remain more stable than available project funding in order to ensure that a steady stream of shelf projects is being readied for construction, in anticipation of increased funding in the next few years as past loans to the General Fund are repaid and federal reauthorization is finalized. Retaining more staff may help to prevent a loss of expertise, ensuring the department's ability to deliver projects when sufficient funding returns. We discuss this issue in greater detail in our Caltrans (Item 2660) write-up.

Figure 6

Near-Term TCRP Funding Options

(In Millions)

	Repeal TCRP	Fund Existing Allocations	Fund Existing And Letters of No Prejudice	Fund All Projects
Beginning TCRF Balance	$377	$377	$377	$377
2003-04 funding	—	189	189	189
2003-04 project expenditures[a]	-296	-492	-492	-492
2003-04 closeout costs	Unknown	—	—	—
2003-04 Ending Balance	**Unknown**	**$74**	**$74**	**$74**
2004-05 project expenditures[a]	—	-$237	-$332	-$572
2004-05 closeout costs	Unknown	—	—	—
2004-05 Funding Needed	**Unknown**	**$163**	**$258**	**$498**

[a] Based on local and Caltrans projections of project expenditures.

TCRP = Traffic Congestion Relief Program and TCRF = Traffic Congestion Relief Fund.

Transportation Needs Stable Long-Term Funding

While the Governor's proposals will affect total transportation funding mainly in the current and budget years, the impact on transportation programs will extend beyond 2004-05. This section discusses the longer-term funding problems faced by transportation and how they are affected by the Governor's proposals. In particular, the section discusses the need for stability in transportation funding and makes recommendations to provide long-term funding stability.

Long-Term Funding Outlook Is Limited and Uncertain

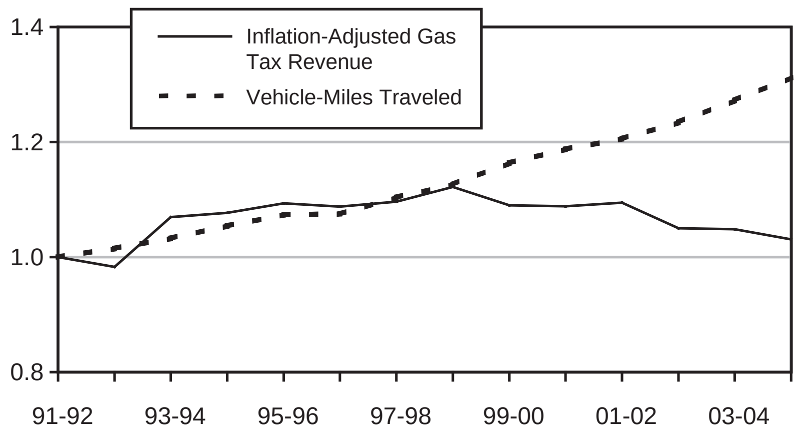
While annual vehicle travel continues to increase, inflation-adjusted state transportation revenues have declined over the past decade. In addition, the level of future transportation revenues is highly uncertain due to several factors, including unknown Proposition 42 commitments and the federal funds consequences of the state's conversion to ethanol-blended fuel. Some of these factors are reflected in the 2004 State Transportation Improvement Program (STIP) Fund Estimate, which will add no new transportation projects over and above those planned in the 2002 STIP.

Real State Transportation Funding Has Not Kept Pace With Increasing Travel. The number of miles driven on California roads has steadily increased over the past decade. As Figure 7 indicates, vehicle-miles traveled on all California roads increased 20 percent between 1991-92 and 2001-02. This trend is projected to accelerate through the budget year, with vehicle-miles traveled expected to be over 30 percent higher in 2004-05 than in 1991-92. However, state transportation funding has not kept pace with this trend. At the state level, transportation is funded primarily by the excise tax on gasoline and diesel fuel. Figure 7 shows that revenues from this tax roughly kept pace with miles traveled throughout the 1990s, as the tax rate was gradually increased in that period from 9 cents to 18 cents per gallon. From 1998-99 through 2004-05, however, inflation-adjusted state gas tax revenues are projected to decline 8 percent while vehicle-miles traveled increase by more than 16 percent.

Figure 7

State Gas Tax Revenues Have Not Kept Pace With Road Use

Index Value = 1 in 1991-92



As Funding Has Declined, Requirements Have Increased. In 1999, SR 8 (Burton) required CTC, in consultation with Caltrans and regional transportation agencies, to produce a ten-year assessment of the funding requirements of the state's transportation system. The resulting report identified over $100 billion in *unfunded* transportation needs over the following decade. The TCRP and Proposition 42 would have addressed a relatively small portion of this need, but to date they have not provided significant additional funding to do so. While the SR 8 study has not been updated since 1999, the lack of significant additional state funding to date and the declining value of the gas tax suggest that the state's unfunded transportation requirements are still of this magnitude.

Several Factors Add Uncertainty to Future Funding. Many transportation funding sources are highly unpredictable, adding uncertainty to the future transportation funding picture. For example:

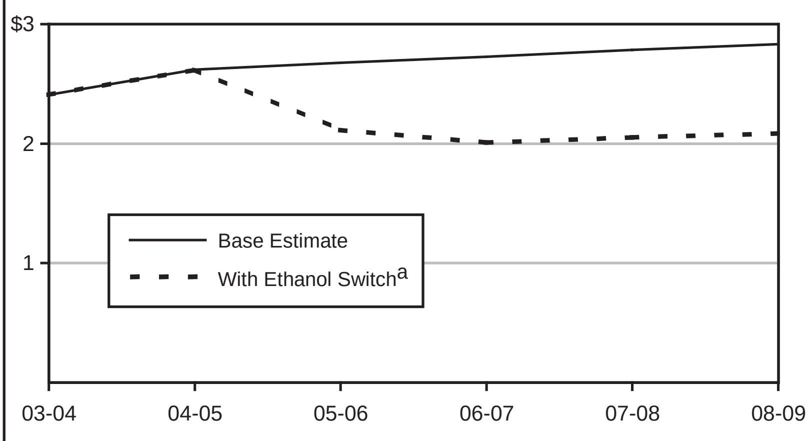
- ***Proposition 42 Revenue Is Not Guaranteed.*** The largest uncertainty for long-term transportation funding in California is how much money to expect from Proposition 42. The ability to suspend the transfer of Proposition 42 funds to transportation on an annual basis, combined with the General Fund's ongoing funding problems, calls into question future scheduled transfers and makes long-term planning based on this funding source impossible.
- ***Timely Repayment of General Fund Loan Is Highly Uncertain.*** Another uncertainty is whether the General Fund will repay on schedule the loans it has received from transportation. As currently scheduled by statute, the General Fund is to repay almost $1.4 billion to TCRF in 2005-06, with another payment of $856 million due to TIF in 2008-09, of which $389 million is to go to TCRF. These loan repayments represent significant General Fund obligations that contribute to the projected General Fund shortfall in future years beyond 2004-05. Given our estimates of the state's fiscal condition, even if all of the Governor's solutions are adopted, we believe repayment of the loans on this schedule is highly unlikely.
- ***Toll Bridge Seismic Cost Increases May Affect STIP.*** Yet another uncertainty in future STIP funding is the cost of toll bridge seismic retrofit projects. Current statute provides no more than $5.1 billion to complete the seismic retrofit of seven state-owned toll bridges. As of October 2003, Caltrans estimates that total retrofit costs will equal $4.9 billion. However, work is still ongoing on two bridges, and several large contracts for the east span of the San Francisco-Oakland Bay Bridge have not yet been awarded. If the cost of ongoing work increases, or if bids come in higher than expected, more funding may be required for these projects. This increase in funding would likely come at the expense of STIP projects.

- ***Federal Funding Level After Reauthorization Is Uncertain.*** As mentioned in a previous section, reauthorization of the federal transportation funding bill was due in October 2003, but appears unlikely to occur for at least several months. While this reauthorization seems certain to increase federal transportation funding, the amount and timing of the increase are uncertain.
- ***Conversion to Ethanol Will Reduce Funding Under Current Law.*** Complicating the federal funding picture is uncertainty regarding the federal tax on ethanol-blended fuel. The state recently completed its conversion from fuel blended with MTBE to an ethanol blend. Because the federal tax on ethanol-blended fuel is about 29 percent less than on fuel with no ethanol content and a portion of the revenue is directed to the federal General Fund, federal funding for transportation would be less than before the conversion. Due to a lag between federal gas tax collection and the distribution of funding to the states, this decrease in funding will not materialize until 2005-06. However, it is projected to be quite substantial, decreasing expected federal revenue to California by $563 million in 2005-06, and by more than $700 million annually thereafter. Figure 8 shows the impact of the ethanol conversion on federal transportation funding available to the state, as projected in the 2004 STIP Fund Estimate.

Figure 8

Estimated Federal Transportation Funding For California

(In Billions)



[a]Revenue reduction due to lower federal tax rate and distribution of some revenue to nontransportation purposes.

It is expected that the federal government will take some action to address this funding drop, but until reauthorization occurs, it is not yet known whether the full impact of the conversion will be mitigated. Thus, the funding level remains uncertain.

2004 STIP Fund Estimate Reflects Reduced, Uncertain Funding. Primarily because of the delay in the reauthorization of the federal transportation bill and the projected impact of ethanol on federal revenues to the state, the 2004 Fund Estimate, approved by CTC in December 2003, projects significantly less funding over the next five years than previously assumed. Compared to the five years covered by the 2002 STIP, the 2004 Fund Estimate projects $4.5 billion less in funding. Funding through 2008-09 is expected to be just enough to cover the costs of the projects already programmed in the 2002 STIP through 2006-07. As a consequence, the 2004 Fund Estimate expects to provide *no new* programming capacity through 2008-09 over and above those projects that are already programmed in the 2002 STIP.

The longer-term funding picture could worsen considerably from that projected by the 2004 Fund Estimate. This is because the fund estimate projects revenues based on current law. Specifically, it assumes that the annual Proposition 42 transfers will occur as provided by current law. If these transfers do not occur throughout the five-year period, $1.7 billion-worth of projects will have to be deleted from the STIP.

Uncertain Funding Delays Projects, Causes Waste

Large transportation projects are funded from multiple sources, which makes them particularly vulnerable to funding fluctuations. If expected funding does not materialize after a project is started, it may have to be cancelled or delayed, incurring potentially large costs in the process. In addition, fluctuations in Caltrans' project delivery staffing due to funding changes can add delay and additional costs to projects.

Projects With Multiple Funding Sources Need Predictability. Large projects with high costs often must be funded from multiple sources. If expected funding from a given source does not materialize, the project could be delayed while awaiting replacement funding. Also, some funding sources are contingent on other funding sources remaining in place. For example, much federal transportation funding requires matching funds. If the matching funds are lost on a project, the federal funds are too. Thus, a project's funding is only as stable as its least-predictable funding source.

Stopping and Restarting Projects Increases Cost, Causes Waste. Perhaps more serious for a project is the loss of funding while work is being performed. If the project is only in its early stages and work is being performed by Caltrans staff, then project work can stop with potentially minimal cost impact. If work under contract has to cease before the contract is complete, however, there could be financial penalties to the state to stop work. This problem is exacerbated if the project is under construction, as there would likely be additional costs to bring the partially completed project to a state in which it can safely be left unattended for an indefinite period of time. Some of the closeout costs associated with stopping TCRP projects are of this nature.

Staffing Changes Can Worsen the Effects of Funding Fluctuations. Much of the design and engineering work performed by Caltrans staff is on projects that will not incur significant expenditures until several years into the future when they are in the middle of construction. If Caltrans cuts back work on projects too severely during lean funding years, it could significantly reduce the delivery of projects in future years when more funding is available. This would lead to large fund balances that sit idle for some time until project delivery catches up. Conversely, if project delivery capability is increased too quickly in good times, too many projects may be ready in the future, when the funding situation may have worsened. This would cause projects to have to wait in line for funding. The ideal way to address this problem would be to stabilize transportation funding, as we recommend at the end of this section. Even if funding is not stabilized, the problem could be addressed by stabilizing project delivery staffing. We address this possibility in our analysis of Caltrans' budget (Item 2660).

Transportation Funding Should Be Stabilized

We recommend the Legislature take several actions to stabilize ongoing transportation funding. These actions include (1) asking the voters to repeal Proposition 42, (2) increasing the gas tax to replace the Proposition 42 funding, and (3) indexing the gas tax to adjust for inflationary cost increases.

Stability Is Paramount for Transportation Funding. Uncertainty in funding for transportation projects makes long-term planning difficult. Large fluctuations in funding result in money being wasted due to stopping and restarting projects. Thus, stabilizing transportation funding would increase the efficiency of transportation expenditures. However, actions taken in the current year and proposed for the budget year, together with projections of ongoing General Fund shortfalls in future years on a current law basis, suggest that Proposition 42 cannot be relied upon as a predictable ongoing fund source for transportation. The Legislature has primarily two options to reduce this uncertainty, both requiring a change in the State Constitution.

- ***Firewall Proposition 42.*** This change would entail removing the provision within Article XIX B of the State Constitution that allows for the suspension of Proposition 42. This would ensure that transportation projects receive all the funds that are expected from this source. However, this would eliminate a means for the state to address any significant future General Fund problems.

- ***Repeal Proposition 42.*** This change would remove Article XIX B from the State Constitution and remove all statutory references to TCRP. This would allow the sales tax on gasoline (roughly $1 billion annually) to remain in the General Fund, as was the practice prior to Proposition 42. However, transportation funding, while more predictable, would be at a lower level unless alternative sources are provided.

While both options would contribute toward long-term transportation funding predictability, they differ in terms of the amount of transportation funding they provide. As noted in a previous section, identified transportation funding requirements far outweigh available funding. In adopting Proposition 42, voters recognized that state funding for transportation ought to be higher than the level provided by the existing 18-cents-per-gallon gas tax. If the Legislature chooses to ask voters to repeal Proposition 42, we believe the lost transportation funding should be replaced from a different source.

Gas Tax Is a Logical Transportation Funding Source. Transportation spending has traditionally been funded by an excise tax on gasoline and diesel fuel. This tax has several qualities that make it a logical source for transportation funding:

- ***Roughly a User Fee.*** The gas tax is charged to drivers only, in rough proportion to the amount of driving they do. The relationship is not exact due to the fact that gas mileage varies according to vehicle type and driving conditions, but the amount of tax paid does vary closely with the amount of mileage driven. Thus the gas tax approximates a fee charged for the provision of a service—that is, the road used by the driver. Most other potential transportation funding sources, such as local sales taxes, bear no relationship to miles driven. Only direct tolls for road use are closer to a user fee for driving than the gas tax.

- ***Simple to Collect.*** Collection of the gas tax is relatively efficient. Drivers are not inconvenienced, as they pay the tax whenever they stop for fuel. Collection at the state level is simple as well, as the state collects the tax directly from fuel distributors, which are few in number.

- ***Economically Efficient.*** Gas taxes can also result in greater economic efficiency by reducing the amount of gasoline consumption to a more "optimal" level. Gas usage results in "external" costs (such as pollution and congestion), and an excise tax results in a higher price that reflects these additional social costs. This in turn can have the effect of decreasing gasoline consumption to a more acceptable level.

Because of the qualities noted above, we believe that the state should rely on the excise tax on gasoline and diesel fuel as the main source of transportation funding as it has in the past. We estimate that an increase of 6 cents per gallon in this tax would generate about the same amount of revenue that otherwise would be provided by Proposition 42. In addition, since Proposition 42 revenues increase with inflation over time, a per-gallon excise tax meant to replace this revenue would also need to grow over time.

Legislature Should Raise and Index Gas Tax to Provide Stable Transportation Funding. In order to stabilize transportation funding at a level equivalent to that envisioned under current law, we recommend that the Legislature take actions to (1) ask the voters to repeal Proposition 42 and (2) increase the state gas tax to provide an equivalent amount of revenue as would be generated under Proposition 42. Furthermore, to prevent the future erosion of transportation funding relative to road use, we recommend that the gas tax be indexed to the California consumer price index.

Governor's Proposals Raise Additional Long-Term Funding Issues

The Governor's proposal to manage local projects on a cash basis (instead of accrual) increases the risk that future funding may not be sufficient to cover project expenditures. If the Legislature concurs with this proposal, we recommend that the Legislature specify in statute the priority of cash expenditures to ensure local projects are not delayed due to a shortage of cash. We further recommend that Caltrans be directed to report periodically to the California Transportation Commission on the use of state cash for local projects.

Furthermore, we note that the proposal to pay debt service with transportation funds removes $406 million in transportation funding in the long run. Finally, while the Governor's proposal addresses some of the long-term uncertainty surrounding Traffic Congestion Relief Program projects, several funding issues must still be addressed.

Changing Accounting Basis of Locals' Federal Funding Puts Local Projects at Risk. The Governor's proposal to free up $800 million in federal funding by managing local projects on a cash basis would remove the guaranteed federal funding locals now get at the front end of their projects and replace it with a commitment from the state to provide cash for the projects on an as-needed basis. This proposal could theoretically have no impact on the local agencies' ability to deliver projects *if* (1) Caltrans and local agencies can accurately project the future cash flow needs of projects, (2) future funding amounts are predictable without big fluctuations (particularly, drops) and state cash is available when needed, and (3) other demands on future funding can be anticipated. However, if local expenditures occur at a higher level than projected in a given year, such as when a project progresses faster than expected, the state may run short of cash to meet the local project's need, while funding all other activities including state projects. Also, Caltrans may face unanticipated demands for state cash that compete with the needs of local projects. In such instances, Caltrans would have to determine the priorities for the use of state cash. Depending on the priorities set by Caltrans, local projects could be delayed, potentially causing cost increases and defaults on ongoing contracts.

Recommend Priority Setting for Cash Use. If the Legislature concurs with the Governor's proposal to cash in federal funds to help the General Fund, we think action should be taken to minimize the funding risk to local projects. Accordingly, we recommend the enactment of legislation specifying priorities for the use of state cash to meet local project needs. We further recommend that Caltrans be directed to review local projects' cash flow needs and report to the CTC on a quarterly basis information on the use of state cash for local projects. This would provide oversight to ensure that the progress of local projects is not hindered in the long run by the proposal to shift the management of federal funds from accrual to cash. (In our analysis of Caltrans' budget, we further review Caltrans' capability to manage cash for local projects and make related recommendations.)

Payment of Bond Debt Service Reduces Transportation Funding by $406 Million Over the Long Run. By cashing in federal funds via a change in accounting methodology, the Governor proposes to generate one-time funds to provide $606 million for the General Fund. Of this amount, $200 million would be a loan that would be repaid by June 30, 2007. The remaining $406 million would be a direct transfer to the General Fund to make the debt service payments on transportation bonds. Thus, in the long-run, total transportation funding is reduced by $406 million. If the state were to retain this amount for transportation uses instead of paying the General Fund for debt service on transportation bonds, additional transportation projects could be funded more quickly.

Proposal Signals No Commitment to TCRP Projects; Long-Term Funding Should Be Addressed. Given the General Fund condition in recent years, funding of TCRP has been highly uncertain from year to year. Terminating the program, as proposed by the Governor, would eliminate that element of uncertainty for the program. However, it would require individual TCRP projects to find new funding sources, which would increase the funding risk for other STIP projects. This is because high priority TCRP projects, under the proposal, would compete for funding under the STIP process. As we mentioned earlier, some STIP projects would be crowded out. If STIP funding is not augmented, this would force local agencies to reprioritize their projects, pushing some further into the future. Additionally, some large TCRP projects might never be constructed. This is because currently some TCRP projects are designated to receive state funds far exceeding the share of STIP money that is allotted to the county in which the project is located. Funding such projects may mean that the county would not have any STIP funds for other transportation priorities for many years. To the extent that these TCRP projects are still of high priority to the Legislature, it may have to separately provide funding for them.

DEPARTMENTAL ISSUES

Transportation

CALIFORNIA TRANSPORTATION COMMISSION (2600)

The California Transportation Commission (CTC) is responsible for adopting specified multiyear transportation capital outlay programs and allocating funds appropriated by the Legislature to carry out those programs. The commission is also responsible for assisting the administration and the Legislature in developing transportation policies. The major responsibilities of the commission include:

- Adopting biennially: (1) a State Transportation Improvement Program for capacity-expanding capital projects to be funded from state and federal funds expected to be available over a five-year period, and (2) a four-year State Highway Operations and Protection Program that includes capital projects that protect and improve the operation and safety of the highway system.
- Allocating funds appropriated by the Legislature for transportation capital outlay among eligible projects ready for construction.
- Developing and adopting guidelines for various transportation funding methods, including loaning of state funds and the issuance of Grant Anticipation Revenue Vehicle (GARVEE) bonds for projects.
- Providing administrative oversight of specified programs, including the Proposition 116 (1990) rail bond program and the Traffic Congestion Relief Program (TCRP).

- Reporting annually to the Legislature on policies adopted by the commission, major project allocations made in the previous year, and significant transportation issues facing the state.

The CTC consists of nine part-time members appointed by the Governor. In addition, one member each from the Senate and the Assembly serve as ex-officio members of the commission.

The CTC is authorized 17 positions in the current year, including three positions to administer the TCRP. Pursuant to Control Section 4.10 of the current-year budget and Executive Order D-71-03, the administration is proposing to reduce the commission's current-year staff from 17 to 13 positions. For 2004-05, the administration is proposing to eliminate an additional three positions associated with the proposed repeal of the TCRP. This would leave the commission with a staff of ten positions.

Elimination of TCRP Staffing Should Await Determination of Program Status

We recommend that the Legislature withhold action on eliminating three positions and $256,000 for the Traffic Congestion Relief Program until it determines the status of the program. Based on that decision, the Legislature should adjust the commission's staffing level accordingly.

The TCRP, enacted in 2000, provides $4.9 billion to fund 141 specified projects over multiple years. The CTC is statutorily responsible for providing administrative oversight for the funding of these projects, including the development of administrative guidelines, review and approval of project applications, allocation of state funds, and periodic reporting on program status. In 2000-01, the commission was provided three positions to handle TCRP-related workload.

Currently, TCRP projects are in various phases of development and funding. The Governor proposes to repeal the program in 2004-05 and eliminate the commission's staff related to the program. If the Legislature decides to repeal the program, as proposed, thereby eliminating all TCRP workload, the three positions should be terminated. Alternatively, the Legislature may choose to keep the program intact or modify the program, with ongoing workload for the commission. Because the Legislature has yet to make a decision regarding the program's status, we recommend that it withhold action on the budget proposal to eliminate the three positions pending that decision. Based on the decision, the Legislature should adjust the commission's staffing accordingly.

Excessive Staff Reduction Would Hinder Commission's Function

We recommend the Legislature eliminate only two instead of four positions as proposed in the budget because the proposed reduction would curtail the commission's ability to carry out its duties. (Augment Item 2600-001-042 by $127,000 and two positions.)

In addition to eliminating the TCRP positions, the budget proposes to make permanent the current-year reduction of four positions. This would bring the commission's non-TCRP-related staffing to ten positions, a 29 percent decrease in staffing for all such activities and duties.

However, there would not be any reduction in the commission's workload. In fact, in the current and budget years, the commission will have the added workload of issuing GARVEE bonds and administering the bond program in accordance with Chapter 862, Statutes of 1999 (SB 928, Burton). Additionally, if the Legislature concurs with the administration's proposal to change the accounting of federal fund expenditures by local projects, we think that the commission should be given responsibilities in the oversight of Caltrans' projection and management of the cash flow for local projects to ensure that the delivery of these projects are not jeopardized. (Please see our discussion in the "Crosscutting Issues" part of this chapter regarding transportation funding.)

Given the workload, we think that the reduction of four positions is excessive, and it would hinder the commission's ability to carry out its duties. Our review of the commission's annual workload shows that a staff of 12, not including the TCRP staff, is justified. This level would provide essentially the same level of support the commission has had since the late 1980s. Accordingly, we recommend that the proposal to eliminate four positions be rejected, and only two positions be reduced instead. Correspondingly, we recommend that two positions and $127,000 be restored.

DEPARTMENT OF TRANSPORTATION (2660)

The Department of Transportation (Caltrans) is responsible for planning, coordinating, and implementing the development and operation of the state's transportation systems. These responsibilities are carried out in five programs. Three programs—Highway Transportation, Mass Transportation, and Aeronautics—concentrate on specific transportation modes. Transportation Planning seeks to improve the planning for all travel modes and Administration encompasses management of the department.

The budget proposes total expenditures of $7.3 billion by Caltrans in 2004-05. This is about $1.1 billion, or 13 percent, less than estimated current-year expenditures. This decrease is primarily due to (1) the proposed repeal of the Traffic Congestion Relief Program (TCRP), (2) a drop in federally funded expenditures, and (3) a change in the accounting of federally funded expenditures.

HIGHWAY TRANSPORTATION

Accounting Inconsistencies Make Budget Comparisons Difficult

The budget proposes expenditures of $6.5 billion for the highway transportation program, about $1.1 billion, or 14 percent, less than estimated current-year expenditures. However, proposed accounting changes by the administration and differences in accounting for state and federal funds make it difficult to compare Caltrans' expenditures from year to year, from category to category, or to aggregate information presented in the Governor's budget.

The major responsibilities of the highway program are to design, construct, maintain, and operate state highways. In addition, the highway program provides local assistance funds and technical support for local roads. For 2004-05, the budget proposes to spend $6.5 billion on highway transportation, approximately 89 percent of the department's proposed budget. This is a decrease of $1.1 billion, or 14 percent, from estimated current-year expenditures. This decrease is primarily due to a sizable drop in projected expenditures for local assistance, as discussed below.

As shown in Figure 1, the budget indicates that state funds would support about $3.4 billion (51 percent) of highway program expenditures in the budget year. Federal funds would fund about $2.3 billion (35 percent) of the program, while the remaining $900 million (14 percent) would be paid through reimbursements, primarily from local governments.

Figure 1

Department of Transportation
Highway Transportation Budget Summary

(Dollars in Millions)

Program Elements	Actual 2002-03	Estimated 2003-04	Proposed 2004-05	Percent Change From 2003-04
Capital outlay support	$1,219	$1,149	$1,187	3.3%
Capital outlay projects	2,342	2,998	3,308	10.3
Local assistance	977	2,437	991	-59.3
Program development	65	73	73	—
Legal	58	62	62	—
Operations	165	150	150	—
Maintenance	760	765	761	-0.5
Totals	**$5,586**	**$7,634**	**$6,532**	**-14.4%**
State funds	*$2,766*	*$3,518*	*$3,360*	*-4.5%*
Federal funds	*2,610*	*3,123*	*2,272*	*-27.2*
Reimbursements	*210*	*993*	*900*	*-9.4*

Accounting Changes Make Comparison of Local Assistance Expenditure Between Years Difficult. Of the $6.5 billion in proposed expenditures, the budget proposes $991 million in local assistance expenditures, a decrease of 59 percent below the estimated 2003-04 level of $2.4 billion. This decrease is overstated mainly due to two changes in the way the Governor's budget accounts for federal expenditures for local projects. First, according to Caltrans, many federally funded local projects that were "delivered" (that is, projects ready for construction) in the last quarter of 2002-03 did not obligate any funding until 2003-04, thereby overstating the 2003-04 expenditure level. Caltrans expects this to recur at the end of the current year. To adjust for this lag in obligating funds, the administration proposes to change its accounting procedure beginning in 2004-05 to more accurately reflect actual expenditures in the budget year. However, the department is not proposing similar changes for the current year.

A second accounting difference is in how the budget treats the federal funds the administration plans to "cash in" by shifting local projects from an accrual to a cash accounting basis. Specifically, the local assistance expenditure figure for 2004-05 does *not* include the amount of cash the administration hopes to generate to help the General Fund, whereas the figure for the current year does. This difference in accounting explains about $320 million of the difference between current-year and budget-year local assistance expenditures.

Inconsistent Accounting Methodology Makes Federal and State Expenditures Not Comparable. Our review also shows that Caltrans' expenditure figures as shown in the Governor's budget do not use a consistent accounting methodology. In fact, a different accounting basis has been used for state and federal expenditures for several years. The Department of Finance (DOF) has chosen to display state-funded expenditures on a cash basis, but federal expenditures are displayed on an accrual basis (consistent with the display of federal funds throughout the budget). This means that the federal and state components of Caltrans' budget are not directly comparable. Caltrans does not have precise figures on federal cash expenditures each year, although it can make rough estimates based on expenditure models. For example, while the Governor's budget shows federal funding for Caltrans at $3.3 billion in the current year, Caltrans budget staff estimate cash expenditures of federal funds in 2003-04 at about $2.9 billion.

The inconsistent accounting also means that aggregating state and federal expenditure data as contained in the Governor's budget provides only a rough approximation of the department's program activities. Furthermore, this inconsistency, combined with the accounting changes described above, means Caltrans' budget figures should be interpreted with caution.

Essential Information Needed on Accounting Change Proposal

The administration proposes changing the accounting basis for federally funded local transportation projects to generate cash to help the General Fund. However, generating this one-time cash will create ongoing workload for Caltrans and local transportation agencies and increase the risk that funding will not be available for some projects in

the future. We recommend Caltrans provide workload and risk information to the Legislature prior to budget hearings regarding its proposed accrual-to-cash accounting change. Absent this information, we recommend that the Legislature withhold action on the transfer of any generated cash to the General Fund.

Accounting Shift Proposed to Aid General Fund. As we describe in our analysis of transportation funding, the Governor proposed in November 2003 to change the way the state manages federal money used on local transportation projects. (Please see the "Crosscutting Issues" section of this chapter.) The administration estimates that shifting the accounting from an accrual to a cash basis will enable the state to cash in $800 million in federal money over the current and budget years, without delaying any local projects. The additional cash (to the State Highway Account [SHA]) is proposed to be used by the state to (1) pay the General Fund $406 million for debt service on general obligation transportation bonds and (2) loan $200 million to the General Fund. The administration can make the accounting change without legislative approval, but transferring the proposed amounts to the General Fund will require legislative action.

Caltrans to Reimburse Local Expenditures. This accounting change will alter Caltrans' role in funding local projects. Under the current method of accounting, all the federal money for a local transportation project is set aside for that project up front. This money is then expended over several years. Under the proposed shift, however, local agencies will get only an assurance from Caltrans that the money will be available to reimburse them when they need it. As they expend the "federal" portion of their projects' funding, local agencies will submit requests to Caltrans for reimbursement. Caltrans will reimburse them with SHA funds. It will then request the same amount of money from the federal government.

Accurate Expenditure Projections Will Be Needed. By no longer setting aside the full amount of federal funding for a project up front, the accounting shift increases the risk that future funding may not be sufficient to cover local project expenditures. The proposal could theoretically have no impact on local agencies' ability to deliver projects, but only if Caltrans can accurately estimate and budget for the amount of federal funds local projects will expend in a given year. If expenditures do exceed available funds, the SHA will be required to make up the difference under the administration's proposal, taking funds from other state transportation projects. If the SHA does not have the funds, some local agencies will not be reimbursed for their work. In order to ensure that these situations do not occur, it is essential that Caltrans and local agencies accurately project the timing of future expenditures for all affected local projects.

Projecting Expenditures Will Increase Workload; Caltrans Has No Estimate. Currently, Caltrans does not have a system in place to allow it to track and project federal expenditures by local projects. It does have staff to monitor and project expenditures for about 1,500 state projects. By contrast, there are about 7,000 federally funded local projects ongoing at any one time, and Caltrans would have to project expenditures for a significant number of them as a result of the proposal. At the time this analysis was prepared, Caltrans did not have a firm estimate of the number of local projects that it would need to track on an ongoing basis.

Regardless of the number of local projects affected by the proposal, local agencies would have to bear much of the additional workload of tracking and estimating the cash needs of projects. Caltrans' workload could also be significantly higher, as it would have to collect and combine all the information from local agencies, double-check suspected errors, and ensure that different agencies used the same methodology. Even so, it would be impossible to guarantee that all local agencies projected their expenditures in exactly the same way.

In view of the potential workload implication and the risk the proposal creates for local projects, we have requested Caltrans repeatedly—when the proposal was first made in November 2003 and again during the development of this analysis—to provide an estimate of the new workload associated with this expenditure tracking. The department had not provided that information at the time this analysis was prepared in early February.

Essential Information Needed Before Legislature Takes Action. The administration can make the proposed accounting change without legislative approval, and Caltrans indicates that it is currently working to establish a tracking system. However, we think that the Legislature should be assured that the department is capable of projecting and managing the cash needs of local projects before deciding on the proposal to use the realized cash for General Fund purposes. Accordingly, we recommend that Caltrans provide the Legislature, prior to budget hearings, with a workload estimate associated with the proposed accounting change and an assessment of the increased risk to transportation projects and to the SHA. Absent this information, we recommend that the Legislature withhold action on the transfer and loan of $606 million from the SHA to the General Fund.

Capital Outlay Support Request Will Be Revised

The budget proposes to decrease capital outlay support (COS) positions by 2.4 percent to reflect the proposed repeal of the Traffic Congestion Relief Program (TCRP), but the administration will revise

its total COS proposal in the spring based on new information. We recommend that the Legislature withhold action on the proposed reduction pending its decision on the status of TCRP and the administration's revised COS budget proposal.

Capital outlay support (COS) is the work required to produce capital outlay projects. Before a capital outlay project can be constructed, Caltrans must assess environmental impacts, acquire rights-of-way, and design and engineer the project. Caltrans is also responsible for overseeing the progress of project construction. The COS budget consists primarily of the salaries, wages, benefits, and operating expenses of the more than 10,000 state staff who perform these functions. It also includes the costs of consultants who perform a portion of this work. The COS budget does not, however, include the salaries and benefits of the contractors who construct the actual projects; these costs are part of the capital outlay projects budget.

Budget Proposes COS Reduction. The budget proposes $1.2 billion to fund 10,001 COS personnel in the budget year. This represents a net decrease of 246 personnel-years (PYs), or 2.4 percent, from the estimated current-year level. The bulk of this drop is due to a proposed elimination of 276 TCRP-related PYs. This reduction conforms to the administration's proposal to repeal TCRP in the budget year.

COS Adjustment for TCRP Should Await Determination of Program Status. Caltrans is responsible for the development of TCRP projects on the state highway system. Currently, TCRP projects are in various phases of development and funding. If the Legislature decides to repeal the program, as proposed, thereby eliminating all TCRP workload for Caltrans, the TCRP-related positions should be deleted. Alternatively, the Legislature may choose to keep the program intact or modify the program, resulting in the continuation of COS workload for the department. As we discuss in the transportation funding write-up, the Legislature has several options to consider regarding the level of funding to be provided for TCRP projects in 2004-05. (Please see the "Crosscutting Issues" section of this chapter.) Because the Legislature has yet to make a decision regarding the program's status, it would be premature to eliminate the related COS positions at this time. Depending on the Legislature's decision, the department should revise its COS workload estimate and adjust the proposed COS staffing level accordingly.

COS Proposal Will Be Revised. The administration typically revises its proposed COS budget in the spring. By that time, the department will have more accurate estimates regarding the amount of project development work that will be performed during the upcoming fiscal year. We expect the department to do the same for its 2004-05 COS budget.

Accordingly, we recommend that the Legislature withhold action on Caltrans' COS request, including the request to eliminate TCRP-related COS staffing pending the Legislature's decision on the program's status and the department's updated workload estimation in the spring.

Reduce COS Fluctuations for More Efficient Project Delivery

In approving a level of capital outlay support (COS) staffing resources, we recommend that the Legislature consider funding COS at a stable level to avoid large fluctuations in project delivery.

COS Budget Based on Budget-Year Workload; Subject to Funding Fluctuations. Caltrans develops its annual COS budget using primarily a bottom-up process, by aggregating the estimated staffing needs for each of the capital outlay projects that it plans to work on in a given year. (Please see a discussion of the COS budget process on page A-52 of the *Analysis of the 2003-04 Budget Bill*.) This approach ensures that staffing is adequate to work on all capital outlay projects so that they are delivered as scheduled.

This approach works well when there is relative stability in the funding of the capital outlay program. Specifically, a stable capital program allows the department to retain a stable corps of staff. If, however, there are big fluctuations in capital funding from year to year, workload and staffing levels would experience big fluctuations as well. This is because the department would have to expand or contract its staff to match the changing workload of a fluctuating capital program.

Big Fluctuations in Staffing Cause Inefficiencies. As we noted in our analysis of transportation funding, fluctuations in the COS budget can have adverse effects on project delivery several years into the future. (Please see the discussion in the "Crosscutting Issues" section of this chapter.) This is because much of the design and engineering work performed by Caltrans staff is on projects that will not incur significant expenditures until several years into the future, when they are in the middle of construction. If Caltrans cuts back work on projects too severely during lean funding years, it could significantly reduce the delivery of projects in future years when more funding is available. This would lead to large fund balances that sit idle for some time until project delivery catches up. Conversely, if project delivery capability is expanded too quickly in good times, too many projects may be ready in the future, when the funding situation may have worsened. This would cause projects to have to wait in line for funding.

Previous large fluctuations in transportation funding have caused large staff fluctuations in the department similar to those discussed above.

The most recent fluctuation occurred in the early 1990s, as Caltrans faced restricted transportation funding that forced the attrition of about 2,000 COS staff over several years. When funding expanded again in the late 1990s, Caltrans' project delivery ability was far below what was needed to deliver the higher level of capital projects. This lag in project delivery resulted in the SHA's fund balance climbing rapidly and peaking at more than $2 billion by the end of the 1990s. Caltrans subsequently expanded its COS staffing and increased project delivery in an attempt to reduce that balance.

It is important to note that reducing and rehiring staff to match the funding fluctuations add to project costs and delays. This is because the department experiences the loss of staff expertise in the case of cutbacks and incurs the cost of recruiting and training in the case of heavy staff expansion. A lack of experienced staff in the face of an expanding capital program would lead to more delays in project delivery, particularly in the case of large, complex projects.

Enhance Project Delivery by Stabilizing COS Budget. With the diversion of transportation funds to help the General Fund in recent years, Caltrans' COS workload and staffing have been reduced, pushing out the delivery of TCRP and State Transportation Improvement Program (STIP) projects to later years. With the current-year elimination of 369 COS positions pursuant to Control Section 4.10 and the budget proposals to repeal the TCRP and to fully suspend Proposition 42, we expect the COS staffing level to be further reduced when Caltrans revises the budget in the spring. This means that less work would be done on fewer projects in 2004-05. When funding does increase beyond 2004-05, as a result of additional federal funds and the repayment of loans, there may not be sufficient projects ready for construction.

The ideal way to stabilize project delivery would be to stabilize transportation funding, as we recommend in our funding analysis. Without funding stabilization, however, we recommend that the Legislature consider staffing the department for project delivery at a relatively stable level over the long term, so that COS staffing levels from year to year are less driven by funding fluctuations. Such a staffing level would attempt to match the average funding level (and therefore workload) over the long term. In this way, Caltrans may retain more staff in lean years to work on a "shelf" of projects that could be delivered quickly when the funding situation improves. In years when funding increases significantly and workload expands, the department is authorized to rely on contracting to accomplish additional workload.

Program Impact of Reducing Contracts Unknown

The administration proposes to reduce funding for non-project-specific capital outlay support contracts by $6 million, but it has not yet identified the programmatic impacts of those reductions. We withhold recommendation pending receipt of further information.

The administration proposes to reduce funding for non-project-specific COS contracts by $6 million in the budget year, in addition to a cut of about $4 million already taken in the current year. These contracts include activities such as aerial photography, business process improvement studies, and environmental studies not related to specific projects. The current-year and budget-year cuts combined reduce the funding level for this type of contracting by about 45 percent, from $22 million down to $12 million. We have asked the department to indicate the programmatic effects of such a large cut, but we have not received a response to date. Accordingly, we withhold recommendation on this reduction pending receipt of further information.

Storm Water Management Staffing Inadequate

The budget proposes to make permanent 77 of 148 limited-term personnel-years (PYs) for storm water management activities. This provides a staffing level lower than that justified by ongoing workload. Combined with the statewide hiring freeze, Caltrans would have to continue redirecting staff from other maintenance activities to meet storm water management requirements. In order that Caltrans can meet these legal requirements and adequately maintain the highway system, we recommend that all storm water positions be made permanent. We further recommend the adoption of budget bill language expressing the intent that these positions are exempt from the statewide hiring freeze. (Augment Item 2660-007-0042, Schedule 4, by $2,853,000 and 71 PYs.)

Budget Proposes Extending Some Limited-Term Positions. The *2002-03 Budget Act* provided a total of 263 PYs in Caltrans' maintenance division to perform storm water management activities, increasing the base level of staffing by 148 limited-term PYs. Storm water management activities are required under the federal Clean Water Act and a Storm Water Management Plan (SWMP) negotiated between Caltrans and the State Water Resources Control Board (SWRCB). The SWMP delineates all the activities Caltrans must perform to comply with its statewide pollution discharge permit. Caltrans' original request was that the 148 limited-term PYs be permanent, but the Legislature determined that Caltrans did not have reliable workload estimates to justify their permanent status. The Legislature provided the requested positions on a limited-term basis, requiring Caltrans to rejustify its workload in the 2004-05 budget.

The 2004-05 budget now proposes to make 77 of the 148 limited-term personnel permanent, allowing the rest of the positions to terminate at the end of 2003-04. This would leave the maintenance division with 192 PYs for storm water management.

Required Storm Water Activities Exceed Budgeted Amount; Staff Redirected. Our review shows that the department actually used 305 PYs for storm water activities in 2002-03, exceeding the authorized level of 263. Based on expenditures to date, the department expects it will use 287 PYs in the current year. The department states that these personnel are necessary to perform all the activities required by its SWMP. In order to use more personnel for storm water management than were budgeted, the maintenance division redirected staff from other maintenance activities, reducing the amount of other maintenance work performed.

In fact, because of the statewide hiring freeze, Caltrans could not hire any new people to fill the temporary positions. Therefore, Caltrans had to redirect maintenance staff to perform all the workload envisioned for the 148 limited-term PYs. In addition, in 2002-03, Caltrans redirected enough additional staff time to perform 42 more PYs of work than the budgeted level (305 PYs of work rather than the 263 PY authorization). This means that storm water activities reduced other maintenance activities by 190 PYs in 2002-03.

Finance Report Finds That Costs Will Increase. Concurrent with the approval of the limited-term positions in the *2002-03 Budget Act*, the Legislature provided funding for DOF to review Caltrans' storm water management activities and assess their likely long-term costs. That study, issued in November 2003, found that, while the ultimate cost of compliance was unknown, Caltrans' storm water management costs were likely to continue escalating. The report cited a recent study that estimated the total costs of complying with storm water quality standards in the Los Angeles basin alone could reach $102 billion. Caltrans' costs would be only a portion of that figure, but the department's statewide compliance costs are sure to expand beyond the $85 million budgeted in the current year.

The DOF report also made several recommendations to improve the administration of the storm water program and deal with rising costs. For example, the report found that Caltrans was not accurately tracking all storm water management costs, and it recommended that Caltrans develop tools and practices to accurately account for the costs of storm water compliance. Other recommendations included taking action to ensure statewide consistency in the department's storm water activities, increasing staff training to minimize resistance to the requirements, and better tracking enforcement actions. The report's recommendations appear reasonable, and Caltrans should make every effort to follow them.

Caltrans Cannot Comply With Storm Water Requirements and Budget Simultaneously. In order to remain in compliance with the Clean Water Act, Caltrans must perform the activities agreed to in its SWMP. If it fails to do so, it is subject to enforcement actions by SWRCB—including monetary fines—and potential legal action at the state and federal levels. Although the DOF report found that the projected costs of storm water compliance are escalating, the Governor's budget proposes to reduce the number of positions dedicated to storm water management activities. As Caltrans has had to redirect maintenance staff with other responsibilities to perform all of its storm water management activities in 2002-03 and 2003-04, it will almost certainly have to continue to do so in 2004-05. The continued redirection of other maintenance staff to storm water activities means less work is being done in other maintenance functions. (We discuss the importance of highway maintenance in the following section.)

Storm Water Staffing Should Be Permanent; Hiring Freeze Exemption Should Be Granted. Our review shows that the workload for storm water management justifies making permanent all 148 limited-term PYs of staff. Accordingly, we recommend that the Legislature reject the budget proposal, and instead make all existing storm water staff in the maintenance division permanent by augmenting Item 2660-007-0042 by $2,853,000.

However, adding storm water management personnel in the budget will have no effect unless the department is exempted from the statewide hiring freeze. Accordingly, we further recommend the adoption of the following budget bill language to exempt these positions from the statewide hiring freeze.

> Of the amount appropriated in this item, $29,076,000 is for 263 permanent personnel-years of staff for storm water management activities conducted by the department's maintenance division. It is the intent of the Legislature that these positions be exempt from the statewide hiring freeze.

Pavement Maintenance: Protecting the State's Investment

Preventive and corrective maintenance of highway pavement can save the state a great deal of money in future rehabilitation and reconstruction, but pavement maintenance funding has sharply declined. We recommend Caltrans develop a plan for investment in the maintenance

of the state highway system, which can guide future budgets. We also recommend Caltrans adopt performance measures that link the state's investment to the resulting quality of the highway system.

In addition to developing and constructing the state highway system, Caltrans is responsible for maintaining the system. This work is carried out by the maintenance division. With a 2003-04 budget of $765 million and 5,452 PYs, the division is responsible for the upkeep of all aspects of the system, including all pavement, structures, roadsides, and signage. The division does not, however, perform major rehabilitation and reconstruction projects on the state highway system. Those activities are included in the State Highway Operation and Protection Program (SHOPP) and are performed as part of the capital outlay program. Current law allows state maintenance staff to work only on projects of $25,000 or less; larger projects, such as repaving long stretches of highway, are classified as "major maintenance," and are done through contracting with the private sector.

The state highway system for which the maintenance division is responsible encompasses more than 15,000 miles of highway with more than 50,000 miles of lanes. The roads in this system range from large urban freeways to two-lane rural roads to major city streets. In total, they carry more than 170 million miles of vehicle travel per year.

Pavement Maintenance Is a Core Mission of the Maintenance Division. Caltrans' maintenance division has several important responsibilities, as shown in Figure 2 (see next page). Structures maintenance, for example, ensures that structures like bridges and retaining walls remain structurally sound. Traffic guidance and electrical maintenance ensures the continued functionality of guardrails, signs, striping, and other systems that help drivers understand how to proceed. Of at least equal importance to these functions is pavement or roadway maintenance, which ensures that the surface on which drivers travel remains smooth and safe to drive on. Pavement maintenance can be divided into two categories; *preventive* maintenance includes activities such as sealing chips and cracks in the roadway to slow the rate of pavement deterioration, while *corrective* maintenance involves activities like filling potholes and repairing concrete slabs to correct problems before they get worse.

This analysis focuses on the pavement maintenance that the division performs, as opposed to its other functions. While the maintenance division performs many important functions, we believe maintaining the functionality of the roadway is its core responsibility.

Figure 2

Main Functions of Caltrans Maintenance

- ***Pavement Maintenance.*** All roadways, including shoulders.
- ***Roadside and Drainage Maintenance.*** Includes landscaping, rest areas, fencing, park and ride areas, and storm water management.
- ***Structures Maintenance.*** Includes bridges, retaining walls, and pumping plants.
- ***Traffic Guidance and Electrical Maintenance.*** Includes guard rails, signs, striping, markers, lights, electrical systems, and highway advisory radio.
- ***Support and Training.*** Program administration, facilities, and training.
- ***Snow and Storm Response.*** Snow and storm debris removal, other emergency response.
- ***Radio Communications.*** All emergency radio communication for the department.

Pavement Maintenance Spending: A Wise Investment in the Highway System

Adequate maintenance of highway pavement significantly reduces future costs for roadway rehabilitation and reconstruction, and state law recognizes it as one of the highest priorities for transportation spending. The importance of pavement maintenance will only increase as the highway system ages and traffic increases.

Preventive Maintenance Costs Less Than Road Reconstruction. Pavement maintenance expenditures are important because the cost of adequately maintaining a stretch of highway is significantly lower over the long run than the cost of rehabilitating and reconstructing that highway. Specifically, the Federal Highway Administration (FHWA) has found that one dollar spent on preventive maintenance can save up to *six* dollars in future costs, and FHWA staff indicates that this estimate is out of date and probably should be revised upward.

The State of Michigan's recent experiences support that view. Michigan instituted a preventive maintenance program in 1992 for the purpose of preserving its highway system in the face of declining resources. Since that time, the Michigan Department of Transportation estimates that its $80 million investment in preventive maintenance activities such as crack sealing and minor concrete repair has saved it $700 million in rehabilitation and reconstruction costs that would have otherwise been necessary—a savings of eight to nine dollars for each dollar spent. Increasing pavement maintenance expenditures in the near term can save significant money in the long run, freeing up more money for other purposes, such as new construction projects.

If a stretch of pavement is not maintained on a regular basis, it eventually reaches the point at which it must be rehabilitated at significant cost. This brings the pavement back to an almost new condition, but without subsequent preventive maintenance, the rehabilitated pavement will continue to degrade and need to be rehabilitated on a regular basis, at great expense. The pavement's life cycle is very different if it receives regular preventive maintenance. While preventive maintenance requires some money to be spent earlier, the result is that the pavement lasts much longer, and stays in a much better average condition, before it must ultimately be rehabilitated. Money is saved by significantly delaying the point at which the pavement will need expensive rehabilitation.

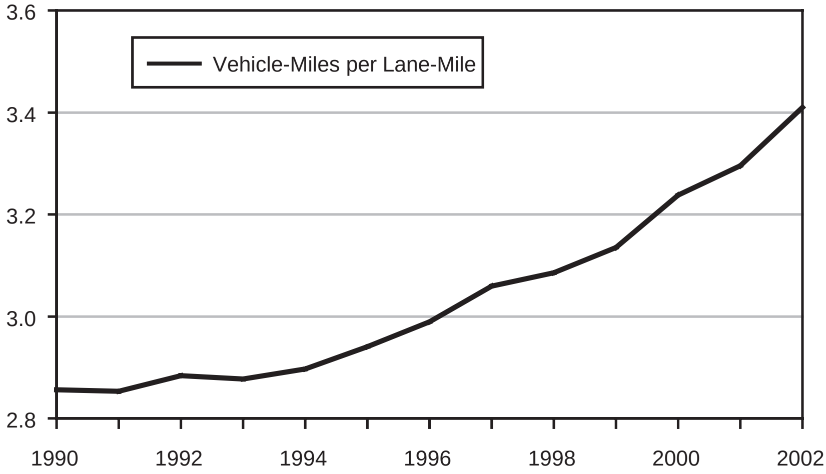
State Law Recognizes Importance of Maintenance. Maintenance of the state highway system is recognized as a first priority for the expenditure of state transportation funds. Specifically, state law lists maintenance, along with operation and rehabilitation of the highway system, as one of SHA's first priorities, ahead of safety improvements, capacity expansion, and environmental enhancement and mitigation. This makes sense, as Caltrans estimates the value of the existing state highway system at around $300 billion. It is fiscally prudent to maintain the quality of the huge existing investment by the state before spending money to expand it.

Importance of Maintenance Increases as Traffic Increases and Highway Ages. The importance of adequate highway maintenance is increasing over time. Much of California's highway system was built in the 1960s. As the highway system ages, the pavement requires more maintenance to retain basic functionality. However, the real driver of maintenance needs is not the physical age of the pavement, but rather the amount of traffic that has driven over a given location. As Figure 3 (see next pge) shows, the average lane-mile of the state highway system now carries more than 3.4 million vehicles per year. Much of this travel is concentrated in urban areas, so average vehicle travel on urban lane-miles is much higher. As vehicle-miles of travel increase in the state, the aging and deterioration of the state's pavement accelerate.

Figure 3

Annual Vehicle Travel Per State Highway Lane Has Increased

(In Millions)



Limited Funding Has Reduced Pavement Maintenance Work

Pavement maintenance must compete for funding with other transportation priorities. In recent years, expenditures on pavement maintenance have declined, resulting in the accumulation of a significant backlog. The State Highway Operation and Protection Program (which focuses on reconstruction/rehabilitation) has faced similar pressures in recent years. Limited pavement maintenance has resulted in a rough road system that costs the state money in rehabilitation and reconstruction costs, and costs drivers money for vehicle repairs.

Maintenance Must Compete for Funding. Although highway maintenance is important, there are other demands on transportation funding as well. Capacity expansion projects are the highest-profile use of transportation funds, and the delivery of STIP projects receives a great deal of attention from external observers, in part because these projects provide a tangible measure of efforts to reduce congestion and meet increasing travel demand. Regional transportation agencies are also motivated to advocate for STIP expenditures over other priorities, because 75 percent of STIP funds are used for regionally chosen projects. Maintenance and SHOPP expenditures, on the other hand, reduce the "bottom line" funding available for STIP projects and thus are not typically regional priorities. These factors combine to reduce the visibility and apparent priority of maintenance expenditures.

Pavement Maintenance Must Compete With Other Maintenance Activities. Even within the total funding for highway maintenance there are competing demands. The largest maintenance function within Caltrans in terms of both funding and staffing is not pavement, but roadside maintenance. As Figure 4 shows, roadside maintenance grew from 27 percent to 35 percent of the maintenance budget from 1990-91 through 2002-03. One of the reasons for roadside maintenance's relative size is that it contains much of the storm water management activities conducted by the department. These activities, which are required by agreements with state and local resources agencies, have grown rapidly in recent years. Roadside maintenance also includes landscaping and litter pick up. Maintenance division representatives indicate that local governments often request more spending in this area due to its high visibility. These factors have led to the growth of roadside maintenance as a percentage of total maintenance expenditures over time.

Figure 4

Pavement Maintenance Is a Declining Portion of Maintenance Budget

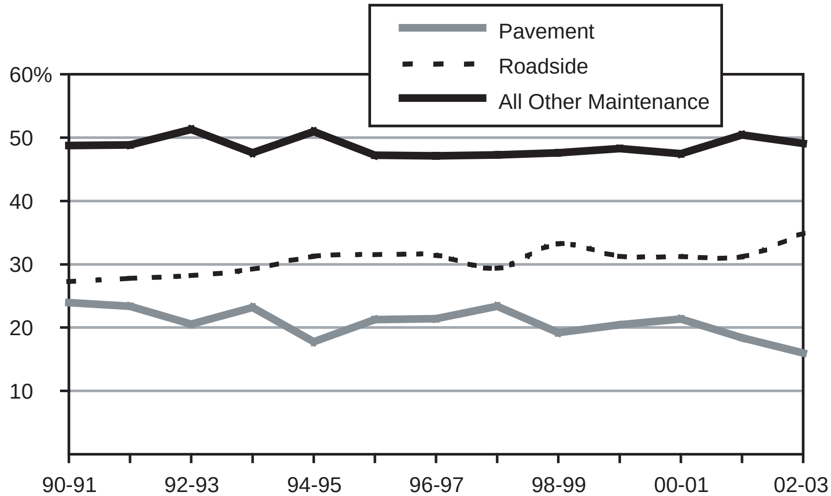
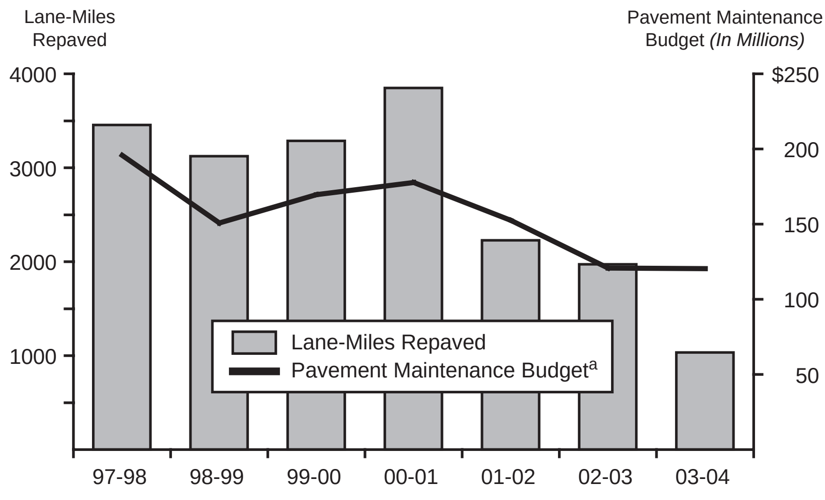


Figure 4 shows that the increase in roadside expenditures was mirrored by a corresponding decrease in pavement expenditures, but there was no similar decrease in other maintenance activities. From 1990-91 through 2002-03, pavement maintenance expenditures declined from 24 percent to 16 percent of the maintenance budget, while all maintenance expenditures other than pavement and roadside maintenance hovered around 50 percent of the budget.

Pavement Maintenance Expenditures and Accomplishments Are Declining. The other priorities for transportation dollars have resulted in a sharp decline in pavement maintenance. As Figure 5 shows, inflation-adjusted pavement maintenance expenditures have dropped precipitously in recent years, with a decline of 39 percent in expenditures between 1997-98 and 2003-04. This has led to a concurrent decline in road repaving. Figure 5 also shows that lane-miles of road repaved dropped from a high of 3,850 in 2000-01 to just over 1,000 planned in 2003-04.

Figure 5

Pavement Maintenance and Road Repaving Are Declining



[a] In constant 2003-04 dollars.

As Maintenance Activity Drops, Significant Backlog Has Accumulated. While pavement maintenance expenditures and activity have declined in recent years, maintenance needs have not. In fact, Caltrans' maintenance division estimates that the value of necessary pavement maintenance that has been deferred in recent years totals $587 million. This work includes both preventive maintenance, such as sealing cracks in the road, and corrective maintenance, such as repairing potholes. All of the work included in this figure is classified as major maintenance, meaning that it must be performed by contractors under state law. If these activities are not performed, the problems they are meant to correct will eventually grow and become far more expensive SHOPP projects. In addition to this backlog in basic pavement maintenance, Caltrans has identified several recurring problems that can threaten stretches of the highway system, such as drainage and erosion problems, rockfalls, and slope movement. While a thorough assessment of needs in these areas has not been performed, Caltrans staff believes the work necessary to remedy these problems would potentially cost several billion dollars. This unfunded amount is in addition to the $587 million backlog identified above.

SHOPP Is Facing the Same Pressures. While the maintenance division is supposed to do preventive work and correct small problems before they grow, Caltrans' SHOPP program is tasked with correcting major highway system issues through rehabilitation or reconstruction. As maintenance funding has not kept pace with the highway system's maintenance needs, SHOPP workload has grown. In 2002, Caltrans estimated that one in every five lane-miles of state highway needed rehabilitation or major reconstruction. At that time, Caltrans created a SHOPP plan that would, among other things, reduce the number of lane-miles on the highway system that need this type of work from 11,000 to 5,500 within ten years. This plan would have cost $22 billion, or about $2.2 billion per year for a decade. However, the California Transportation Commission (CTC) has not funded SHOPP at this level. Rather, average annual SHOPP funding is projected to be about $1.65 billion over the next five years. Underfunding pavement maintenance and SHOPP now will only make the problems more expensive to fix when they are eventually addressed.

State Highway System Is Poorly Maintained. The state's inadequate investment in pavement maintenance is apparent in the condition of the state's roads. According to statistics published annually by FHWA, California's roadway system, including interstate highways, state highways, and major arterial streets and roads, is the second roughest in the nation, with over 26 percent of those roads rated by drivers as unacceptably rough. As Figure 6 indicates, only Massachusetts has more roads at this level of roughness, and California is far worse than the national average of just over 8 percent of roads being unacceptably rough. Many of the roads included in this statistic are the responsibility of regional transportation agencies, demonstrating that more pavement maintenance is necessary at both the state and local levels.

Figure 6

States With the Roughest Road Systems in 2002

	Percent Rated Unacceptably Rough[a]
Massachusetts	35.9%
California	**26.3**
New Jersey	21.4
Hawaii	18.3
Louisiana	18.1
Rhode Island	18.0
New York	16.5
Michigan	15.5
Connecticut	15.2
Iowa	14.0
U.S. Average	**8.4%**

a "Unacceptably rough" means at or above the level of road roughness that was found to be unacceptable to most drivers in a Federal Highway Administration study.

Poorly Maintained Roads Cost the State and Drivers Money. As already noted, insufficient maintenance effort leads to higher SHOPP expenditures and ultimately higher total expenditures to rehabilitate and rebuild state highways. But this is not the only cost of insufficient maintenance effort. The rough roads that result create direct costs for California drivers as well, in the form of higher vehicle operating costs and accidents. The Road Information Program (TRIP), a nonprofit group, aggregated FHWA's data on road roughness by urban area, and found that six of the ten urban areas with the highest proportion of rough roads are in California, with Los Angeles and San Jose having the roughest roads in the nation. Using models to estimate how much more drivers will pay on average for repairs, fuel, and tire costs due to rough roads, TRIP estimated that while the average U.S. driver will pay $396 extra annually due to rough roads, the average driver in Los Angeles or San Jose will pay more than $700 annually. Thus, increased investment in pavement maintenance can save both the state and its residents money in the long run.

Caltrans Should Refocus Efforts on Highway System Maintenance

We recommend the enactment of legislation requiring Caltrans to develop a long-range plan to reduce the backlog of maintenance projects, which in turn will provide the basis for future maintenance budgets. We also recommend that the maintenance division examine potential ways to spend its money more efficiently. Finally, we recommend the enactment of legislation directing Caltrans to develop performance measures to track the results of the state's maintenance investment.

Investment Plan Needed. The decline in pavement maintenance funding and the condition of California's roads argue strongly for more investment in pavement maintenance. However, we do not recommend that the Legislature invest the state's money blindly. Rather, we recommend the enactment of legislation that requires Caltrans to develop and update biennially a multiyear plan to reduce its pavement maintenance backlog. This plan should be developed in conjunction with the ten-year plan currently required for SHOPP. Planning long-range maintenance and SHOPP expenditures together makes sense, as maintenance expenditures will directly affect the level of needed SHOPP expenditures. This plan should be reviewed by CTC and submitted to the Legislature and the Governor, as the SHOPP is now. This plan should form the basis for the pavement maintenance budget and should be used in the development of the biennial STIP fund estimate, similar to the use of the SHOPP ten-year plan currently. Such a plan should explicitly identify the funding requirements and provide a timeline to address the backlog. Reducing the maintenance backlog would in turn slow the flow of projects into the SHOPP.

Plan Should Identify Means to Increase Efficient Use of Maintenance Dollars. The plan should not only include a listing of work to be completed, but also examine and identify strategies and means to increase the efficiency of use of pavement maintenance dollars to ensure that the state gets the greatest possible return on its investment. For instance, the efficacy of different maintenance methods and materials should be examined in terms of their costs and benefits. Accordingly, we recommend that, concurrent with the development of a long-range plan, the department assess and report on possible means of spending its money more efficiently, such as:

- Performing work at night to reduce interference with traffic.
- Identifying conditions and situations where it makes sense to use long-life pavement that costs more, but requires less upkeep after installation.

Again, this effort should be modeled after the SHOPP plan, which statute requires to contain strategies to control costs and improve the efficiency of the program.

More Information Needed on Relationship Between Funding and Road Quality. If the Legislature is to dedicate more money for pavement maintenance, it should be able to measure the return the state is getting on its investment. A model that links pavement maintenance funding to the ultimate condition of the road would be valuable in holding the department accountable for its use of the funding provided. Such a measure would also provide useful information for the internal allocation of resources and management of the program.

Caltrans' maintenance division has taken the first steps toward creating such a budget model, but much work remains before the model will be able to link pavement maintenance funding to road condition. We recommend that the legislation mandating the development of a long-range maintenance plan also require the maintenance division to develop a budget model that will:

- Link dollars spent on each maintenance function with a specific level of outputs for that function (for example, number of lane-miles repaved for a given dollar investment).
- Link outputs with their resulting changes to the quality of the state highway system (for example, change in statewide road roughness or level of service expected from a given number of lane-miles repaved).
- Estimate the amount of new maintenance workload added each year due to natural aging and use of the system.
- Estimate the amount of maintenance workload that becomes SHOPP workload each year, as well as the amount of SHOPP workload avoided or postponed by maintenance activities.

Upon development of this model, we recommend that its findings be included in the biennial maintenance plan recommended earlier.

PROJECT DELIVERY

Project delivery is one of the most critical elements in Caltrans' mission to improve mobility. Failure to deliver projects in a timely manner can delay congestion reduction and cause project costs to increase. Caltrans' staff is responsible for preparing state highway projects for construction—including environmental clearance, right-of-way acquisition, and project design—awarding projects for construction, and overseeing project construction through completion. Local agencies are responsible for local street and road improvement projects and mass transportation projects. For the purposes of this analysis, a project is considered delivered when all preconstruction work is completed and the project is ready to receive a fund allocation from the CTC so that construction can proceed. Comparing the number of projects delivered in a year to the number scheduled to be delivered in that time period provides an indication of how well the department and local agencies perform in meeting STIP and SHOPP targets.

In the following section, we describe Caltrans' and local agencies' STIP and SHOPP delivery performance in 2002-03, Caltrans' environmental document delivery, and the effects that limited funding is having on project delivery.

Little Change in Caltrans and Local Project Delivery

In 2002-03, Caltrans delivered 92 percent of programmed State Transportation Improvement Program (STIP) and State Highway Operation and Protection Program projects, and 91 percent of programmed expenditures on those projects. These delivery percentages are slightly lower than those in the previous year. Caltrans also advanced other projects that were originally programmed to be delivered in other years. Local agencies delivered 82 percent of programmed STIP projects and 88 percent of programmed expenditures. Like Caltrans, they delivered some projects scheduled for other years as well.

Caltrans Project Delivery Percentages Decline Slightly. According to information provided by CTC, in 2002-03 Caltrans delivered 87 percent of STIP projects that were programmed for delivery in that year, as shown in Figure 7. The SHOPP project delivery percentage was better, at 94 percent. For the two programs combined, the department delivered 92 percent of all programmed projects, slightly below the combined percentage of 95 percent in 2001-02. Nonetheless, the combined delivery exceeds Caltrans' goal of delivering at least 90 percent of scheduled projects each year.

Figure 7

Caltrans Project Delivery by Number of Projects

2002-03

	STIP	SHOPP	Totals
Programmed	39	146	**185**
Programmed projects delivered	34	137	**171**
Percent delivered	**87%**	**94%**	**92%**
Advanced projects delivered	6	12	**18**
Total projects delivered	40	149	**189**

In dollar terms, Caltrans delivered a similar percentage (88 percent) of scheduled STIP dollars and 93 percent of programmed SHOPP dollars, as shown in Figure 8. For the two programs combined, Caltrans delivered 91 percent of all dollars of projects scheduled for 2002-03, slightly below the previous year's average of 94 percent.

Figure 8

Caltrans Project Delivery by Dollar Value

2002-03
(Dollars in Millions)

	STIP	SHOPP	Totals
Programmed	$459	$645	**$1,104**
Programmed dollars delivered	402	599	**1,001**
Percent delivered	**88%**	**93%**	**91%**
Advanced dollars delivered	$85	$54	**$139**
Total dollars delivered	$487	$653	**$1,140**

In addition to delivering projects that were scheduled for delivery in 2002-03, the department also delivered projects that were scheduled for delivery in later years. Specifically, as Figures 7 and 8 show, the department delivered 18 STIP and SHOPP projects that were not scheduled for delivery in 2002-03, worth $139 million. While Caltrans' goal should be to deliver the projects it is scheduled to deliver, advancing projects from other years when programmed projects are delayed allows the department to utilize project delivery staff and resources efficiently.

Local Project Delivery Improved Slightly. Under Chapter 522, Statutes of 1997 (SB 45, Kopp), local agencies are responsible for determining how to spend 75 percent of STIP funds. To the extent that local agencies decide to spend their share of STIP funds on highway capacity improvements, they have traditionally depended on Caltrans to deliver the projects. However, to the extent that they choose to spend their share of funds on transit projects or local road improvements, *they* are responsible for that delivery.

In 2002-03, local agencies delivered 376, or 82 percent, of the local street and road or mass transit projects programmed in the STIP for delivery in that year. These projects totaled $362 million—about 88 percent of the local agencies' goal to deliver $410 million worth of projects. These numbers represent a slight improvement from 2001-02, when local agencies delivered 81 percent of both projects and expenditures. Like Caltrans, however, local agencies also delivered a significant number of projects that were scheduled for different years. These additional projects bring total STIP delivery by local agencies to $517 million.

Fewer Environmental Documents Completed, but Backlog Reduced

Compared to prior years, Caltrans completed fewer environmental documents for State Transportation Improvement Program and State Highway Operation and Protection Program projects in 2002-03. Despite the reduced level of completion, Caltrans appears to have worked through its backlog of environmental documents.

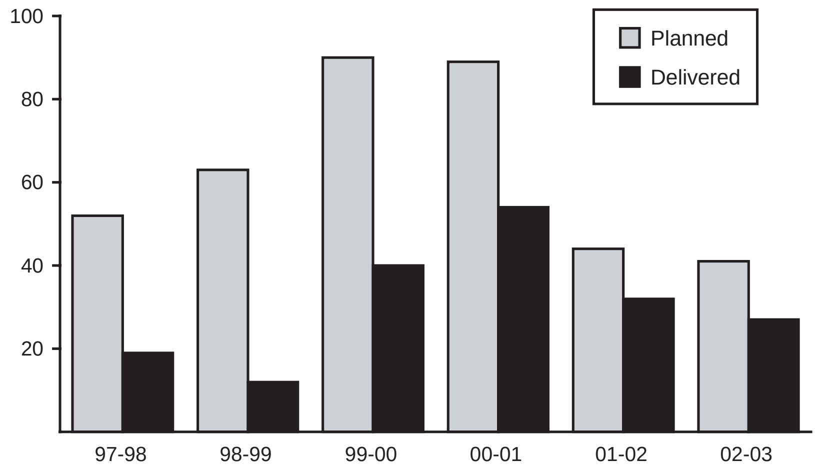
Number and Percentage of Completed STIP Environmental Documents Drop. Our review shows that of the 41 environmental documents for STIP projects the department planned to complete during 2002-03, 27 were completed. The remaining 14 rolled forward to 2003-04 and beyond. This completion rate (66 percent) represents a decline from the 73 percent completion rate achieved in 2001-02. In addition, as Figure 9 (see next page) shows, the 27 documents completed in 2002-03 is the lowest number of documents completed since 1999-00. In 2003-04, Caltrans plans to complete 43 final environmental documents for STIP projects. Caltrans completed only one of these documents in the first quarter of the current year.

Environmental Document Completion Rate for SHOPP Higher. For SHOPP projects, Caltrans completed 54 out of 63 planned environmental documents in 2002-03. This represents a completion rate of 86 percent, compared to 76 percent in 2001-02. Similar to the trend for STIP projects, the number of documents completed in 2002-03 for SHOPP projects was the lowest in three years. In the current year, Caltrans plans to complete 69 environmental documents, of which five were completed in the first quarter.

Backlog of Environmental Documents Reduced. The large numbers of environmental documents delivered in 1999-00 and 2000-01 were due to Caltrans' efforts to reduce an existing backlog. Even though total document delivery numbers in the last two years have been lower, Caltrans has actually delivered more *new* documents due to the reduction of the backlog. For example, of the 54 STIP environmental documents Caltrans completed in 2000-01, 50 were carried over as backlog from previous years—only four were new projects. In contrast, of the 27 STIP environmental documents completed in 2002-03, 12 of these were carried over from previous years and 15 were new projects.

Figure 9

STIP Environmental Documents Planned Versus Delivered



Project Delivery Affected by Funding Shortage

The state's fiscal crisis has affected project delivery. Caltrans' borrowing of federal funds from locals delayed their timely use of federal funds for local projects. Also, the California Transportation Commission could not allocate funds for many delivered projects, delaying the start of construction. Current-year delivery plans also have been constrained by available funding. Additional diversion of transportation funds will further delay project delivery.

Caltrans' Borrowing of Federal Funds Delays Local Projects. Over the last few years, local agencies have used federal funds that they receive in a more timely manner. In 1998 and 1999, the first two years of the current federal transportation act (TEA-21), local agencies underspent their allotment of federal funds by 41 percent and 57 percent, respectively. As a result, by October 1999, local agencies had accumulated $1.2 billion in unexpended federal allocations.

To remedy this situation, Chapter 783, Statutes of 1999 (AB 1012, Torlakson), was enacted to allow CTC to redirect most of a local agency's unused federal funds to another local transportation agency before the federal spending authority expired. In response, local agencies increased markedly their use of the major categories of federal funds, reducing the outstanding backlog to about $600 million by October 2002.

However, Caltrans borrowed $200 million in unexpended federal funds from the local agencies in July 2003, in order to prevent a cash shortfall in the SHA that resulted from the delay in the enactment of the *2003-04 Budget Act*. This borrowing made federal funds unavailable to local agencies for two months, in turn delaying their use of federal funds.

Allocations for Delivered Projects Delayed, Thereby Slowing Construction. As mentioned earlier, projects are considered delivered when they are ready to receive a fund allocation from CTC so that construction can proceed. The shortage of available transportation funds in the last two years (due mainly to transportation funds being diverted to help the General Fund) has caused CTC to limit project allocations, thereby delaying project construction. Of the $1.6 billion in delivered 2002-03 STIP and SHOPP projects mentioned above ($1.1 billion delivered by Caltrans, $517 million delivered by local agencies), CTC could not make allocations for $359 million worth of projects. When combined with delayed allocations for other phases of projects and new projects delivered in the current year, the total allocation backlog for STIP and SHOPP projects as of January 2004 is $671 million. There is a similar backlog of $155 million for TCRP projects. Most of these projects could begin work within months if funding were available.

Funding Problems Constrain Current-Year Delivery. In addition to constraining allocations for delivered projects, limited funding has caused Caltrans to scale back the number of new projects it plans to deliver in 2003-04. Instead of delivering 233 STIP and SHOPP projects in 2003-04 worth $1.9 billion, it now plans to deliver 203 projects worth $1.3 billion. The shortage of transportation funding in the current year also means that CTC's ability to allocate construction funds to these projects is even more constrained than it was in 2002-03. In fact, CTC only plans to allocate $800 million to SHOPP projects in the current year, with *no* allocations for STIP projects. This means that even if Caltrans can deliver all of its planned projects, many of them will have to wait until funding is available before they can begin construction.

Additional Transportation Fund Diversion Will Further Delay Project Delivery. Within the past four years, the state has gone from having a large transportation funding surplus to being unable to fund its existing commitments. In 2001-02 and 2002-03, the funding surplus allowed transportation funds to be loaned to the General Fund with little immediate impact on project delivery. Once the surplus disappeared, however, further diversion of transportation funds reduced Caltrans' ability to deliver projects and CTC's ability to allocate funds for those projects, as described above. As the Legislature considers using transportation funds to help the General Fund in the budget year, it must weigh the potential General Fund benefits against the fact that any loss of transportation funding at this point will likely delay projects and postpone any related traffic congestion relief.

HIGH-SPEED RAIL AUTHORITY
(2665)

The California High-Speed Rail Authority (HSRA) is responsible for planning and constructing an intercity high-speed train service that is fully integrated with the state's existing mass transportation network. The California High-Speed Rail Act of 1996 (Chapter 796, Statutes of 1996 [SB 1420, Kopp]) established HSRA as an independent authority consisting of nine board members appointed by the Legislature and Governor. The HSRA has an executive director and three staff positions.

The HSRA was due to expire December 31, 2003. Chapter 696, Statutes of 2002 (SB 796, Costa), repealed the expiration date, making HSRA permanent. Additionally, Chapter 697, Statutes of 2002 (SB 1856, Costa), enacted the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century. The act, if approved by voters at the November 2004 election, would authorize the issuance of $9.95 billion in general obligation bonds for development of the initial stages of a high-speed rail network.

Budget Proposes to Cancel Bond Measure

The budget proposes to repeal Chapter 697, thereby removing the high-speed rail bond measure from the November 2004 ballot. Our review shows that postponing the bond measure to a later date would likely not cause delay in the development of a high-speed rail system. However, total costs of the system have been revised upward and will be significantly higher than previously reported to the Legislature.

In view of the state's fiscal situation, the administration believes that it would be premature for the state to proceed with additional general obligation debt for a high-speed rail system. Consequently, the administration is proposing to repeal the high-speed rail bond act, thereby canceling the measure from the November 2004 ballot. The administration, however, has not indicated whether it will propose to postpone the bond measure to a later election, and if so, when that would be.

Authority Will Continue Work on System Development. Despite the proposal to repeal Chapter 697, the budget proposes $1.1 million in support of HSRA in the budget year. The amount includes $300,000 for the legal defense of the final environmental impact report for the system. Discussion with HSRA staff indicates that this funding level would be sufficient to allow the authority to continue work in 2004-05, including the completion of an implementation plan for the system that will lay out in detail, among other things, the various construction and funding stages of the project.

In addition, given the current progress in the system's planning, HSRA staff indicates that a substantial amount of funding is not expected to be needed until 2005-06 or later. Thus, postponing the bond measure to a later election would likely not delay the system's development.

Cost of System Will Be Significantly Higher Than Previously Estimated. In January 2004, HSRA released a draft environmental impact report, which provides a cost and benefit analysis of high-speed rail as compared with other transportation options. The report now projects the cost of the system to be $37 billion—50 percent higher than originally estimated in 2000. The study nonetheless concludes that a high-speed rail system is the best overall alternative for the state given projected increases in travel demand within the system's planned service area.

DEPARTMENT OF MOTOR VEHICLES (2740)

The Department of Motor Vehicles (DMV) is responsible for protecting the public interest in vehicle ownership by registering vehicles, and for promoting public safety on California's streets and highways by issuing and renewing driver licenses. Additionally, the department licenses and regulates vehicle-related businesses such as automobile dealers and driver training schools, and also collects certain fees and tax revenues for state and local agencies. The DMV operates 167 field offices statewide, as well as nine telephone service centers, a headquarters, and several driver safety and investigations offices.

The budget proposes total expenditures of $705 million for support of DMV in 2004-05. This is a reduction of $14 million, or 2 percent, below estimated current-year expenditures. The reduction includes primarily adjustments for one-time administration expenditures in the current year to issue vehicle license fee refunds to certain vehicle owners.

About $382 million (54 percent) of the department's total support will come from the Motor Vehicle Account (MVA) and $269 million (38 percent) from the Motor Vehicle License Fee Account. The remaining support will be funded primarily from the State Highway Account and reimbursements.

Significant Reductions in Staffing; Wait Times at Record Levels

The staffing level at the Department of Motor Vehicles (DMV) has declined by about 1,000 positions in recent years due primarily to hiring freezes and position abolishments. Workload levels, meanwhile, have grown steadily. As a result, levels of service provided to the motoring public have declined significantly. We recommend that the Legislature reexamine the level of service to be provided by DMV. If the Legislature determines that current wait times and overall service levels are unacceptable, we recommend the Legislature restore some of the abolished positions particularly in the department's field offices and telephone centers.

The DMV's various responsibilities require it to engage in a significant amount of contact with the public. The department is charged with licensing 23 million drivers and registering 27 million vehicles, as well as issuing identification cards, transferring vehicle ownership, and providing numerous other services. Each year, over 30 million people are served in DMV's field offices, with the department performing millions of additional transactions for customers by mail, over the phone, and on-line.

Staffing Level Down, Workload Up . . . The DMV's staffing level has declined in recent years as a result of multiple rounds of cutbacks from hiring freezes and position abolishments, as well as the need to hold positions vacant to meet salary savings requirements. As Figure 1 (see next page) shows, after peaking at about 8,900 personnel-years (PYs) in 2001-02, staffing will drop to about 7,900 PYs in the budget year. Most of the reduction is pursuant to Control Section 4.10 and Executive Order D-71-03, which together eliminated about 600 vacant positions from DMV in the current year. These eliminated positions affect all functions of the department, including field operations, the telephone service centers, departmental divisions such as the investigations unit, and headquarters administration. The hardest hit is the field operations division, which suffered the majority of the cutbacks with over 300 positions being eliminated.

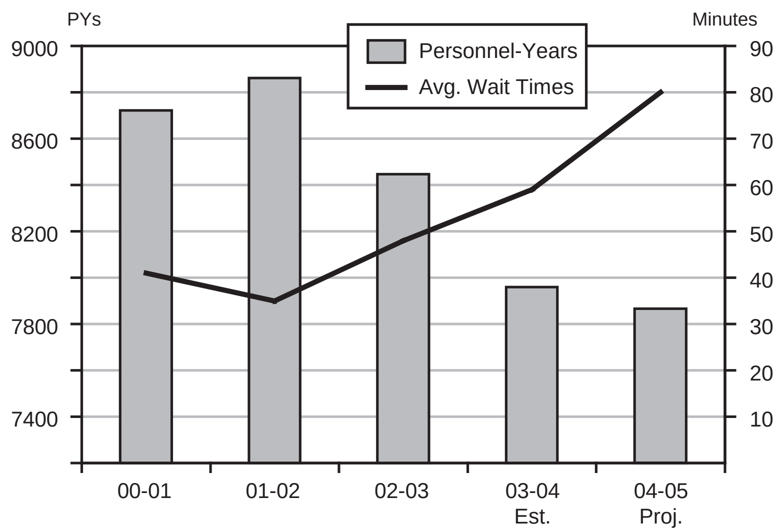
As a result of these reductions, there are an average of 12 percent fewer customer service "windows" open at any given time in the field offices today than in 2000-01. In addition, the number of Motor Vehicle Field Representatives (MVFRs) working in DMV's telephone service centers has decreased by about 40 positions (or about 8 percent).

While the staffing level has declined, DMV's workload has increased. For instance, since 2000-01, the total number of drivers licensed by DMV has increased by over 1 million (about 5 percent), to 23 million. The number of vehicles registered has also increased annually and is expected to increase further, by about half a million (or 2 percent) in the budget year. Overall, the department now performs about 44 million transactions a year, about 2 million more than four years ago.

. . . and Service Levels Deteriorating Rapidly. This combination of staffing cutbacks and workload growth has impacted significantly the level of service provided by DMV to the public. As Figure 1 shows, average wait times for walk-in customers have increased dramatically with the staffing decline. Currently, the *average* wait time at DMV's field offices is about 60 minutes. This time does not include the initial period when a walk-in customer stands in line to obtain a "queuing number," which can add several more minutes to the overall wait time. At some large-volume urban offices, the wait time can be significantly higher. The DMV reports that at offices such as San Mateo, Glendale, and Fullerton, *maximum* wait times are up to four hours. Absent corrective actions in the budget year, DMV projects that average wait times statewide will increase to about 80 minutes. These wait times are significantly longer than the statutory intent that customers not be required to wait in line at a field office for more than 30 minutes.

Figure 1

Department of Motor Vehicles
Staffing Levels Down; Customer Wait Times Up



Customers wishing to avoid long lines at DMV have the option of making an appointment (by phone or on-line) before visiting a field office. The DMV's scheduling system allows customers to make an appointment up to 30 days in advance. Customers using the appointment service are usually served within ten minutes of their scheduled appointment time. However, due to a high demand for appointments and reduced staffing to accommodate that demand, customers currently must wait an average of two to three weeks to schedule an appointment to register their vehicle or apply for a driver license. Average wait times for *drive test* appointments are nearly a month long. At offices in San Francisco, Los Angeles, and San Diego, some customers are unable to schedule *any* type of appointment because there are no available slots within the 30-day scheduling period. The difficulty in setting an appointment as well as the long wait for appointments often provide customers with no options but to visit a field office as a walk-in customer.

Wait times apply to customers trying to access DMV *by phone*, as well. Customers can use DMV's toll free number to make an appointment or inquiry, request forms, and perform certain transactions such as vehicle registration renewals. Currently, calls by customers to the telephone service centers are placed on hold for an average of about four minutes before being answered by an MVFR. This is almost double the average wait time in 2002-03. Recently, it has become difficult for customers to even get through to DMV's phone system: reduced staffing levels at the telephone service centers have caused some customers to encounter a "busy" signal, sometimes for hours, when dialing the number. As a result, many of these customers must also visit their local field office as a walk-in, which further adds to congestion and wait times.

Recommend Restoration of Select Abolished Positions Depending on Legislature's Assessment of Service Levels. In light of the recent cutbacks, we recommend that the Legislature reexamine the level of service to be provided by DMV. To some extent, DMV can improve services through administrative efficiencies and actions to encourage a reduction in field office visits by customers. (In the following section, we recommend several changes to the driver licensing program to that end.) However, given the magnitude of DMV's workload, it is unlikely that administrative actions alone will reduce wait times to any significant degree. Rather, additional staffing will be needed. Thus, if the Legislature determines that the present levels of service provided by DMV, as reflected in wait times, are unacceptable, we recommend the Legislature restore some of the abolished positions.

In our view, the highest staffing priority for the department is in the field operations division and the telephone service centers, which together lost over 300 positions in the current year pursuant to Control Section 4.10. By adding primarily MVFRs, DMV would be able to serve more customers by phone, and more workstations and appointment slots could be made available for customers in the field offices—thereby reducing wait times. According to DMV, an additional 100 field office staff would reduce wait times on average by about five minutes. We estimate that restoring 100 MVFR positions would cost about $5 million annually. Funding would come largely from the MVA. Because of the substantial balance (over $300 million) the MVA is projected to have by year end, an increase of this magnitude would not have a significant negative impact on the account condition.

If the Legislature chooses to restore some positions to the department, we recommend that it also adopt budget bill language to exempt these positions from the hiring freeze. Otherwise, the department would not be able to fill these positions.

The Driver Licensing Program

State law requires motorists who reside in California to hold a valid driver license in order to drive on public streets and highways. The DMV is responsible for issuing original driver licenses to qualified applicants, as well as renewing expired licenses. Annually, the DMV issues about 850,000 (original) noncommercial driver licenses and renews about 4.7 million noncommercial driver licenses. The fee for original and renewal driver licenses is $24, and both are valid for five years. Department staffing for driver license services totals approximately 2,700 positions, about 400 positions (13 percent) less than levels in 2000-01.

The MVA is the sole source of funding for DMV's driver licensing program. The MVA derives most of its revenue from driver license, identification card, and vehicle registration fees.

Improving Efficiency and Effectiveness in the Issuance of New Driver Licenses

The Department of Motor Vehicles' process of issuing new driver licenses is labor-intensive and costly. Our review finds opportunities to improve the process in terms of customer service, driver safety, and cost effectiveness. We recommend the department report at budget hearings on the viability of making several administrative changes to the written test. We further recommend the enactment of legislation to (1) increase the existing fee on drive test retakes and (2) impose a new fee on drive test appointment "no-shows." Lastly, we recommend legislation to create a pilot project to evaluate the feasibility and cost implications of outsourcing drive tests.

Issuance of Driver Licenses Is Lengthy, Labor-Intensive Process. The current process to issue an original driver license requires DMV staff to perform a number of functions with direct contact with license applicants. Unlike the driver license renewal process, most of which can be done by mail, every new driver license applicant must visit a DMV field office at least twice. In many cases, applicants visit a field office multiple times.

Figure 2 (see next page) summarizes the key steps involved in the issuance of a driver license. An initial visit is required in order for the customer to be issued a learner permit. For that visit, the applicant may choose either to make an appointment (by phone or on-line), or to walk in without an appointment and be served on a "first-come, first-served" basis. Wait times for appointments currently vary from a few days (primarily in rural areas) to over a month (primarily in urban areas).

Figure 2

Issuance Process for New Driver Licenses

Initial Field Office Visit by Applicant

- Motor Vehicle Field Representative (MVFR) #1 provides license application.
- MVFR #2 processes application, checks identity and legal documentation, administers vision test, collects fee.
- MVFR #3 takes applicant's thumbprint and picture.
- MVFR #4 issues and corrects written test (and retests); issues learner permit when applicant passes.

Subsequent Field Office Visit

- Examiner administers drive test (and retests).
- MVFR issues interim driver license if applicant passes.

Headquarters

- Staff verifies applicant's social security number and legal status documentation with federal government; investigates cases of suspected fraud.
- Staff processes and mails photo license.

At the field office's "check in" station, an MVFR provides instructions to the customer on completing the driver license application form. The applicant fills out the form and waits for further assistance. Currently, walk-in customers must wait an average of about one hour; with wait times ranging up to three or four hours at several high-volume urban field offices (for example, Glendale and Escondido). A second MVFR then enters the information from the application form into DMV's computer database. As required by law, the staff member reviews the applicant's age, identity, and legal status documentation. The authenticity of this documentation is also verified by a supervisor. After collecting the fee from the applicant, the MVFR administers a vision test.

Next, the applicant moves to the photo station, where another MVFR takes the applicant's thumbprint and picture. Afterwards, the applicant is sent to another section of the field office, where a fourth MVFR administers the written test. The test is corrected by hand. If the applicant passes, the MVFR issues a learner permit so that the applicant can practice for the behind-the-wheel drive (road) test.

During the period between the written and drive test, DMV staff at headquarters electronically verifies the citizenship and legal immigration status of driver license applicants with the Social Security Administration and, if applicable, the Immigration and Naturalization Service. Cases of suspected fraud are investigated by department staff.

The applicant *must* call to make an appointment in order to take a drive test. Currently, applicants have to wait about a month for a drive test appointment at many field offices. If the applicant fails the 20-minute drive test, he/she has two more chances to retake the test. When the applicant passes, an MVFR enters the applicant's score into the computer system and issues an interim license. Staff at headquarters completes the processing of the application, and mails a photo license to the applicant within four to six weeks.

High Costs to Issue New Driver Licenses. This labor-intensive process results in significant costs to the department. In fact, DMV estimates that it costs about $67 in direct costs to issue a new driver license. These costs include mailing and printing charges, as well as paying staff to process the applications and to administer the written and drive tests. Given that about 850,000 people apply annually for a driver license, it costs DMV about $57 million a year in direct costs to issue original driver licenses. This cost is only partially offset by $20 million in license fee revenues, resulting in net *costs* (over revenue) of approximately $37 million annually.

Opportunities Exist to Improve Testing. Our review finds that given the costs of certain equipment, the logistics of serving hundreds of thousands of customers, and the need to safeguard the integrity of the process and prevent fraud, the department's procedures in processing driver license applications are warranted. For example, for logistical reasons multiple staff members are needed to process the application, verify legal documentation, and take the customer's photograph and thumbprint. However, we find that there are a number of opportunities to improve the process, particularly in terms of the written and drive tests, as discussed below.

Written Test Marked by High Failure, Retest Rates; Recommend Changes to Improve Learning of Traffic Laws, Reduce Costs. Currently, if an applicant fails the written test, he/she can retake it two more times without paying another $24 fee. Except for minors, there is no minimum waiting period before the applicant can retake the test. This retesting policy contributes to the heavy workload the department faces. The DMV estimates that it spends over $11 million annually to correct millions of written tests (including tests for original and renewal licenses).

According to the department, the success rate for the written test is about 50 percent. A key reason for failure among examinees is that they did not study enough beforehand. In fact, many examinees do not obtain and review the 80-plus-page book until the day they visit a field office to apply for a driver license.

Our review finds that another group of examinees do not study the handbook at all. Currently, most examinees are given back their corrected tests. Some examinees take advantage of this policy by obtaining corrected copies of the test from friends or family and committing to memory the answers. In addition, as there are multiple versions of the test (ten in English, but only five in Spanish, and three in the other foreign languages), some examinees take and retake the test (sometimes in the same day) until they get a version that they have seen before. Of course, these practices defeat the purpose of the test, which is to ensure drivers' knowledge of traffic laws in order to promote road safety. It also increases staff time to administer retests, and causes additional congestion in the field offices.

By encouraging more studying, and discouraging strategies such as "exam shopping," DMV can reduce the number of written test retakes—thereby reducing costs—as well as improving the exam's integrity. Our review shows that there are a number of actions DMV can take administratively to that end. We recommend that the department report to the Legislature at budget hearings on the feasibility and fiscal impact (cost and savings) of implementing the following actions as well as other actions it is considering:

- Make driver handbooks more available by placing them in public places (libraries, community centers, post offices, et cetera).
- Increase the number of versions of written tests in each language to ten in order to reduce the incidence of exam shopping.
- Retain all written tests after sharing the results with the applicant. Some field offices already have an internal policy of not returning written tests in foreign languages other than Spanish.
- Require a minimum waiting period for all applicants before they can retake the test. This would encourage examinees to take more time to study.
- Rewrite the Spanish language handbook and written tests to make them more accessible to applicants. The current material is written in the formal "Castilian" dialect, which makes it difficult for some examinees to understand some of the vocabulary.

- Provide the test on "touch screen" computers, such as those used in North Carolina and Wisconsin. This option would allow DMV to free up staff from correcting tests and reassign them to other activities, reduce paper waste, and eliminate the problem of cheating and "test sharing."

Create Incentive to Pass Drive Test; Recommend Higher Fee for Retests. Of the approximately 1.1 million drive tests given annually by DMV, about 33 percent result in a failing score. The primary reason why applicants fail the road test is that they did not spend enough, if any, time practicing their driving skills. Current law allows applicants to take up to three drive tests before they have to reapply and pay another $24 fee. The department charges a nominal $5 fee for each drive retest. We think that a higher fee would be more effective in encouraging applicants to practice more before taking the drive test, thereby reducing the need for retesting. In addition, a higher fee for each drive retest would offset a larger portion of the $32 in direct costs that DMV incurs to administer each drive test. Accordingly, we recommend the enactment of legislation to increase the retest fee to encourage applicants to practice more and to more fully cover costs. A $15 retest fee (an increase of $10), for example, would generate about $5 million in revenue.

Reduce Drive Test No-Shows; Recommend New Fee. As stated earlier, drive test examinees must schedule an appointment for a drive test. Department staff arrange for a date and time that is convenient for the applicant, subject to availability by a drive test examiner. However, our review finds that there is a considerably high no-show rate among examinees. While DMV does not compile records on the incidence of drive test no-shows, field office staff suggests that about 20 percent of appointments (over 200,000 annually statewide) are not kept by applicants. No-shows reduce the efficiency and productivity of drive test examiners as they must wait for applicants who never appear, and make unavailable a slot that another applicant might have filled. We recommend the enactment of legislation to impose a new fee on applicants who fail to cancel their drive test appointments ahead of time. In so doing, DMV might be able to reduce the incidence of no-shows, as well as collect additional revenue from those whose behavior is not changed by such a fee.

Recommend Pilot Project on Out-Sourcing Drive Tests as Way to Improve Customer Service, Reduce Costs. Under current law, third parties such as licensed privately owned driving schools and public high schools are authorized to provide driving classes (in the classroom and on the road) to individuals seeking a noncommercial driver license. Only trained DMV staff are authorized to conduct the actual drive tests. (The DMV allows certified companies to test their own drivers for a commercial license.) With staffing cutbacks due to hiring freezes and position abolishment pursuant to Control Section 4.10 and Executive Order D-71-03, wait times for drive test appointments average about one month long.

A potential solution to reduce the long wait time for customers would be to authorize third parties to conduct drive tests, similar to what is done in other states such as Colorado and Michigan. In Colorado, residents can choose either to schedule a test with a DMV examiner, or, for faster service, to pay a third party tester directly for the cost of the test. In Michigan, all drive tests are given by third parties, which are bonded and regularly monitored by the state. In order to evaluate the workability of using third party testers for the drive test, we recommend the enactment of legislation that directs DMV to pilot test third-party testing at select field offices for a period of time, such as two years, and to report to the Legislature on the pros and cons and cost implications of implementing the project statewide.

Reducing Office Congestion and Costs Associated With In-Person Renewals

While the majority of motorists are eligible to renew their driver licenses by mail, a large number of them opt instead to renew in person. In so doing, these customers contribute to congestion in the field offices, and significantly increase costs to the department. We recommend the department report to the Legislature at budget hearings on ways of reducing unnecessary in-person renewal visits. We further recommend the enactment of legislation to allow the Department of Motor Vehicles to impose new fees on photos and temporary licenses under certain circumstances.

The DMV renews about 4.7 million driver licenses annually. Approximately 40 percent of renewal customers (about 1.9 million) are required by DMV to visit a field office to renew their driver license in person for a number of reasons. For example, they may have received multiple traffic tickets during the previous renewal period. Renewal customers who will be over age 69 on the license expiration date, and those with certain medical conditions, must also renew in person. These customers are often required to take a written test, and in some cases, may be required to take a drive test as well. License holders who were eligible to renew by mail the previous two five-year periods are also required to visit a field office to take an updated photo and eye exam.

Many Renew Driver License in Person Instead of by Mail, Increasing Office Congestion and Costs. The remaining 60 percent of renewal customers are eligible to renew by mail. However, DMV estimates that of the 2.8 million applicants who are eligible to do so, about 750,000 (27 percent) opt instead to renew in person. Reasons that these customers cite for their field office visit include:

- Unhappy with the current driver license photo and wish for a replacement.
- Want to pay with cash.
- Prefer in-person visits to the mail system.
- Did not receive a renewal form because DMV mailed it to an old address.
- Need for a temporary license because missed renewal deadline and license expired.

Regardless of the reason, by renewing in person rather than by mail, this group of applicants increases wait times for customers who have no option but to conduct their business in-person. In-person license renewals also increase the department's costs significantly. Specifically, the department estimates that it costs about $3 to renew a driver license by mail, but about $18 for an in-person renewal. This difference is due, in part, to the different way the department processes a mailed-in renewal versus an in-person renewal. Currently, for renewals by mail, staff at headquarters simply process the renewal notice and mail out a new driver license using the applicants' photo on file. In contrast, the department requires *all* in-person renewal customers—including those who are eligible to renew by mail—to take a new photograph and vision test and to submit another thumbprint. As a result, the 750,000 customers who renew in person add about $11 million in additional costs to DMV.

Recommend Measures to Reduce In-Person Renewals. As in the case of new driver license issuance, our review shows that there are a number of administrative actions which DMV can take to encourage customers to renew their driver license by mail. We recommend that DMV report at budget hearings on the feasibility and fiscal effect (cost and savings) of the following actions as well as other actions that it is considering:

- Installing "express boxes" for driver license renewal and directing customers who appear in-person at field offices to drop off renewal applications instead of waiting in line. (Currently, express boxes are already in use for vehicle registration renewal purposes.)
- Advising customers who prefer to pay with cash to use a check or money order instead (and to use the express box) in order to avoid a substantial wait time.

- No longer require a new photo, thumbprint, and vision test from applicants who are eligible to renew by mail but who insist on renewing in person. This would avoid the higher cost of renewing these licenses as well as reduce wait times of customers.
- Linking DMV's vehicle registration and driver license databases so that a change of address reflected in one system is automatically updated in the other. Because vehicle registrations are renewed annually, that database is more up-to-date than the driver license database. Linking the two systems would significantly reduce the incidence of DMV mailing renewal forms to an incorrect address. However, it would likely involve significant one-time costs for the department to link the two databases.

In addition, to defray some of the additional cost imposed by in-person renewals and to encourage prompt driver license renewal, we recommend the enactment of legislation to authorize DMV to charge a fee (1) to customers that are eligible to renew by mail who want to take a new photo and (2) for a temporary license in cases where a licensee failed to renew on time.

FINDINGS AND RECOMMENDATIONS

Transportation

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Crosscutting Issues

Funding for Transportation Programs

A-17 ■ **Transportation to Provide a Large Portion of Proposed Mid-Year Cuts.** About one-quarter of the administration's mid-year savings proposal entails using $920 million in transportation funds to aid the General Fund. Most of this money would come from a change in accounting for federal transportation funds. Other sources include a transfer to the General Fund of additional Traffic Congestion Relief Program (TCRP) money and certain funds that are normally deposited in the Public Transportation Account.

A-19 ■ **Suspension of Proposition 42 Proposed for Budget Year.** The budget proposes to suspend in 2004-05 the transfer of $1.1 billion derived from the sales tax on gasoline to the Transportation Investment Fund.

A-20 ■ **Transportation Funds Provide One-Time General Fund Aid.** The administration's proposals would provide about $2 billion in one-time aid for the General Fund over the current and budget years, but would add to future-year General Fund obligations.

A-22 ■ **Expected Transportation Funding Has Dropped Precipitously.** Within the past few years, a large influx of funding was expected in transportation, but this influx has not materialized.

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A-23 ■ **Reduced Funding Means Fewer New Projects, Project Delays.** The decline in expected funding severely restricted the state's capacity to fund new capital projects, thereby causing project delays that can have negative effects on the state's economy. The state plans to proceed with some projects using borrowed funds.

A-25 ■ **Governor's Proposals Further Reduce Available Funding.** By reducing near-term transportation funding in the current and budget years, the administration's proposals would further slow transportation projects. Many TCRP projects would have to stop work completely, resulting in unknown closeout costs. Furthermore, if TCRP projects are to compete for State Transportation Inprovement Program (STIP) funding, they would crowd out existing STIP projects as well.

A-27 ■ **Near-Term Funding: Issues and Options for Legislative Consideration.** Recommend that the California Transportation Commission (CTC) and Caltrans report expected TCRP project closeout costs to the Legislature by April 2004. If the Legislature chooses to do so, it can provide partial funding to allow work to continue on certain TCRP projects. In addition, the Legislature should consider whether some engineering staff resources should remain in Caltrans to work on "shelf" projects to be delivered in the future.

A-29 ■ **Long-Term Funding Outlook Is Limited and Uncertain.** While annual vehicle travel continues to increase, inflation-adjusted state transportation revenues have declined over the past decade. In addition, the level of future transportation revenues is highly uncertain due to several factors, including unknown Proposition 42 commitments and the state's conversion to ethanol fuel. Some of these factors are reflected in the 2004 STIP Fund Estimate, which will add no new transportation projects over and above those planned in the 2002 STIP.

A-33 ■ **Uncertain Funding Delays Projects, Causes Waste.** Large transportation projects funded from multiple sources are particularly vulnerable to funding fluctuations. If expected funding does not materialize after a project is started, it may

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have to be cancelled or delayed, incurring potentially large costs in the process. Fluctuations in project delivery staffing also can add delay and additional costs to projects.

A-34 ■ **Transportation Funding Should Be Stabilized.** Recommend the Legislature take actions to increase the stability of ongoing transportation funding. These actions include (1) asking the voters to repeal Proposition 42, (2) increasing the gas tax to replace the Proposition 42 funding, and (3) indexing the gas tax to adjust for inflationary cost increases.

A-36 ■ **Governor's Proposals Raise Additional Long-Term Funding Issues.** The Governor's proposal to manage local projects on a cash basis increases the risk that future funding may not be sufficient to cover project expenditures. If the Legislature concurs with the proposal, recommend that it specify in statute the priority of cash expenditures on local projects. Further recommend that Caltrans be directed to report periodically to CTC on the use of state cash for local projects. Further note that the proposal to pay debt service with transportation funds removes $406 million in transportation funding in the long run.

California Transportation Commission

A-40 ■ **Elimination of Traffic Congestion Relief Program (TCRP) Staff Depends on Determination of Program Status.** Recommend that the Legislature withhold action on eliminating three positions and $256,000 to administer the TCRP until it determines the status of the program. Based on that decision, the Legislature should adjust the commission's staffing accordingly.

A-41 ■ **Excessive Staff Reduction Would Hinder Commission's Function. Augment Item 2600-001-0042 by $127,000**. Recommend that two instead of four positions be eliminated because the commission's workload justifies the higher staffing level, which is also consistent with the commission's staffing level since the late 1980s.

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Department of Transportation

Highway Transportation

A-42 ■ **Accounting Inconsistencies Make Budget Comparisons Difficult.** The budget proposes expenditures of $6.5 billion for the highway transportation program, about $1.1 billion less than estimated current-year expenditures. Proposed accounting changes by the administration and differences in accounting for state and federal funds make it difficult to compare Caltrans' expenditures from year to year, from category to category, or to aggregate information presented in the Governor's budget.

A-44 ■ **Essential Information Needed on Accounting Change Proposal.** The administration proposes changing the accounting basis for federally funded local transportation projects to generate cash to help the General Fund. Doing so will create ongoing workload for Caltrans and local transportation agencies and increase the risk that funding will not be available for some projects in the future. Recommend Caltrans provide workload and risk information to the Legislature prior to budget hearings. Absent this information, recommend that the Legislature withhold action on the transfer of any generated cash to the General Fund.

A-46 ■ **Capital Outlay Support Request Will Be Revised.** The budget proposes to decrease capital outlay support (COS) positions by 2.4 percent to reflect the proposed repeal of the Traffic Congestion Relief Program (TCRP), but the administration will revise its total COS proposal in the spring based on new information. Recommend that the Legislature withhold action on the proposed reduction pending its decision on the status of TCRP and the administration's revised COS budget proposal.

A-48 ■ **Reduce COS Fluctuations for More Efficient Project Delivery.** Recommend that the Legislature consider funding COS at a stable level to avoid large fluctuations in project delivery.

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A-50 ■ **Program Impact of Reducing Contracts Unknown.** The administration proposes to reduce non-project-specific COS contracts by $6 million, but has not yet identified the programmatic impact of those reductions. Recommend withhold pending receipt of further information.

A-50 ■ **Storm Water Management Staffing Inadequate. (Augment Item 2660-007-0042 by $3,924,000 and 71 Personnel-Years).** Recommend augmentation because storm water management workload justifies a higher staffing level on an ongoing basis. Further recommend adoption of budget bill language to exempt these staff from the statewide hiring freeze.

Pavement Maintenance: Protecting the State's Investment

A-54 ■ **Pavement Maintenance Spending: A Wise Investment in the Highway System.** Adequate pavement maintenance significantly reduces future road rehabilitation and reconstruction costs. The importance of pavement maintenance will only increase as the highway system ages and traffic increases.

A-56 ■ **Limited Funding Has Reduced Pavement Maintenance Work.** Competition for available transportation funding has led to declining expenditures on pavement maintenance and a reduction in the amount of pavement maintenance work done. This has resulted in a rough road system that increases the state's rehabilitation and reconstruction costs and costs drivers money for vehicle repairs.

A-61 ■ **Caltrans Should Refocus Efforts on Highway System Maintenance.** Recommend the enactment of legislation requiring Caltrans to develop a long-range plan to reduce the backlog of pavement maintenance work. Further recommend that the department examine ways to spend maintenance funds more efficiently, and develop performance measures to track the results of the state's maintenance expenditures.

Project Delivery

A-63 ■ **Little Change in Caltrans and Local Project Delivery.** In 2002-03, Caltrans delivered 92 percent of programmed State Transportation Improvement Program (STIP) and State

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Highway Operation and Protection Program (SHOPP) projects and 91 percent of programmed expenditures on those projects. Local agencies delivered 82 percent of programmed STIP projects and 88 percent of programmed expenditures.

A-65 ■ **Fewer Environmental Documents Completed, but Backlog Reduced.** Compared to prior years, Caltrans completed fewer environmental documents for STIP and SHOPP projects in 2002-03. Despite the reduced level of completion, Caltrans appears to have worked through its backlog of environmental documents.

A-66 ■ **Project Delivery Affected by Funding Shortage.** The state's fiscal crisis has affected project delivery. Caltrans' borrowing of federal funds from locals delayed their timely use of federal funds for local projects. The California Transportation Commission could not allocate funds for many delivered projects, delaying the start of construction. Current-year delivery plans have also been constrained by available funding. Additional diversion of transportation funds will further delay project delivery.

High Speed Rail Authority

A-69 ■ **Budget Proposes to Cancel Bond Measure.** The administration proposes to repeal Chapter 697, Statutes of 2002 (SB 1856, Costa), thereby removing the high-speed rail bond measure from the November 2004 ballot. Postponing the bond measure to a later date would likely not delay the development of a high-speed rail system; but the latest estimate of the system's costs shows that it will cost significantly more than previously reported to the Legislature.

Department of Motor Vehicles

A-71 ■ **Significant Reductions in Staffing; Wait Times at Record Levels.** Wait times and the levels of service provided by the department have worsened significantly with substantial staff reduction in recent years. Recommend that the Legislature reexamine the levels of service to be provided by the

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department. If the Legislature determines that the current service levels and wait times are unacceptable, recommend that some positions particularly in field offices and telephone centers be restored.

A-75 ■ **Improve Efficiency and Effectiveness of New License Issuance.** Recommend the department report at budget hearings on the viability of administrative changes to the written test. Further recommend the enactment of legislation to (1) increase the fee on drive test retakes and (2) impose a fee on "no-shows" for drive test appointments. Further recommend the enactment of legislation to create a pilot project to evaluate the feasibility and cost implications of outsourcing drive tests.

A-80 ■ **Reduce Office Congestion and Costs Associated With In-Person License Renewal.** Recommend the department report at budget hearings on ways to reduce unnecessary in-person license renewals. Further recommend the enactment of legislation to allow the department to impose new fees on photos and temporary licenses under certain circumstances.