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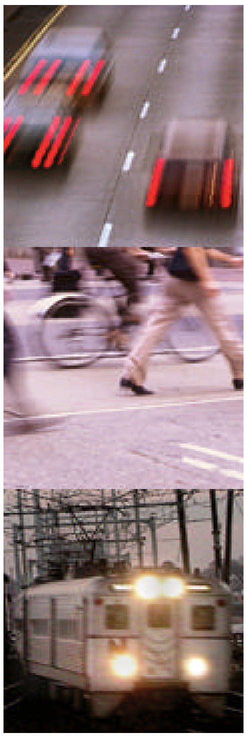

The Crisis in State Transportation Finance: *Lessons Learned from the New Jersey Experience*

October 2004

An Invited Article Published in
The Journal of Transportation Law, Logistics & Policy

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THE STATE UNIVERSITY OF NEW JERSEY
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The Crisis in State Transportation Finance: *Lessons Learned from the New Jersey Experience*

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In November 2003, New Jersey's transportation financing system was declared on the brink of insolvency. By July 2006, New Jersey's Transportation Trust Fund, the state's key source of non-federal transportation capital funding for 20 years, would be capable only of paying off its accumulated debt service and no longer capable of generating capital for transportation projects. Capping 12 years of increased spending, rampant borrowing and insufficient new revenue sources, the financing capacity of the trust fund, come July 1, 2006, was projected to collapse from its current level of $1.2 billion to zero, meaning no new state-funded projects could be authorized. Without an ongoing state-funded capital program, New Jersey could surrender another $1.3 billion in federal transportation funding for failing to meet its matching share requirements. In short, New Jersey's transportation program would be reduced to little more than paying off debt, plowing snow, picking up litter and running scheduled trains and buses.

A national model for prudent, stable and sufficient fiscal management since it was created in 1984, the Transportation Trust Fund[1] has now become a case study of lessons learned about political leadership pursuing too many objectives, meanwhile providing too few resources and doing so in a governmental framework with no effective accountability. A principal ingredient to the downfall of the Transportation Trust Fund has been, as current New Jersey Commissioner of Transportation Jack Lettiere terms it, "the narcotic of debt." A series of politically appealing actions, spread over several different gubernatorial administrations of both political parties, cumulatively destroyed the viability of the financing system.

In particular, the reliance on debt allowed elected officials and transportation managers with a way to meet the State's increasing desire for transportation capital expenditures and add other responsibilities to the capital program, such as paying for transit "preventive maintenance." The appeal of the "narcotic of debt" was that political leaders could achieve their transportation construction and operational objectives for a number of years, while avoiding asking the public

[1] Created under New Jersey P.L. 1984, c. 73

to sacrifice, but raising the stakes ever higher when the sacrifice would be sought. At some point this policy would reach a cliff – and the cliff is just around the bend.

New Jersey has a voracious appetite for transportation investment, so this impending insolvency is a matter of grave public concern. New Jersey is a transportation-intense state, serving as a national center for goods distribution, containing two highly urbanized metropolitan areas and providing a corridor for the heavily populated Northeast region. The state has been in the forefront of investing in its transportation system for more than 80 years to support its citizens' economic activity and personal mobility, having assembled for the New Jersey Department of Transportation a large capital stock of 2,345 miles of state highways, the most heavily used per lane mile in the U.S. Through its state-wide public transit agency, NJ TRANSIT, New Jersey operates a highly evolved transit system of commuter rail, light rail and bus services with 1,042 pieces of rail rolling stock and 3,043 owned and leased buses.

The New Jersey Transportation Trust Fund, an initiative of Governor Thomas H. Kean and his Commissioner of Transportation John Sheridan, has been the envy of other state transportation professionals for its stability and sufficiency for the past 20 years. Its purpose, strongly endorsed by the late State Senator Walter Rand who provided bi-partisan leadership, was to establish a "stable and assured" funding source for transportation capital expenditures. The concern of the Republican Kean Administration and Senator Rand, a Democrat, was forged from 25 years of frustrating experiences with the paucity and unpredictability of transportation financing. Transportation capital needs had fared poorly in the annual competition for appropriations from the state's General Fund and referenda on general obligation bond issues had failed more often at the polls than succeeded. To assure its stability, the Trust Fund was originally designed to operate largely on a pay-as-you-go, self-replenishing basis.[2] The Trust Fund has given New Jersey a robust transportation capital program over its 20-year life raising $13.3 billion in capital since its inception, generating over the past four years alone approximately $4 billion in capital for the NJ Department of Transportation and NJ TRANSIT. [3]

This report, based in large part on the findings of a Blue Ribbon Transportation Commission, will offer a New Jersey perspective on shared issues confronting the states regarding transportation capital funding. In particular, it will assess:

- The November 2003 report of the Blue Ribbon Transportation Commission;
- the sequence of policy choices that destabilized the Transportation Trust Fund, and

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[2] Section 9 of P.L. 1984, c. 73, provided that the Transportation Trust Fund Authority "…shall minimize debt incurrence by first relying on appropriations and other revenues available in the authority before incurring debt to meet it statutory purposes."
[3] The New Jersey state budget operates on a July 1 - June 30 Fiscal Year.

- the reforms and accompanying efforts that are necessary to win back public trust.

The Blue Ribbon Transportation Commission

The dire prognosis of insolvency was rendered last November by a Blue Ribbon Transportation Commission that had been created by New Jersey Governor James E. McGreevey to devise a long-term strategy to restore the Transportation Trust Fund to sound fiscal health. The bi-partisan commission, composed of two former transportation commissioners, the head of the state's largest public utility and other well-regarded leaders, spent months evaluating data, program needs and various financing alternatives. It called upon the Alan M. Voorhees Transportation Center and other consultants for expert advice before arriving at its conclusions. Key among the Commission's recommendations was a call for greater accountability to assure stricter financial controls and new accountability standards governing project selection.

To meet existing debt obligations and simply sustain the condition of New Jersey's transportation infrastructure at status quo, the commission recommended a 12.5-cent per gallon increase in the state's gasoline tax, a near doubling of the current effective rate of 14.5 cents per gallon. [4] The state's effective gasoline tax of 14.5 cents per gallon is the fourth lowest gas tax in the nation. The last increase occurred 16 years ago in 1988, when a five-cent per gallon proposal was whittled down to 2.5 cents.

The plan and its recommendations were rolled out for the short, lame duck legislative session in November 2003 with the intention that Trust Fund reauthorization be enacted in the limited window created by the session's end in January 2004. Less than three weeks later, it was dead. With anti-tax zealots re-energized and Republicans in the State Senate, then split politically 20-20, announcing their opposition, Governor McGreevey, a Democrat who is expected to seek re-election in November 2005, withdrew his support, saying, "it is the wrong time to increase the gas tax." Meanwhile, states such as Ohio, Washington, Indiana and Wisconsin were raising their levies.

In order to sustain a transportation capital program, the Governor announced his intention to fully tap out the remaining year of borrowing capacity in the Trust Fund to cover the state's 2005 budget needs. For 2006, the Governor said that the state would borrow another $900 million through the sale of a form of "indirect GARVEE bonds," unless the Trust Fund was reauthorized in the meantime. At this time, there are no visible signs that the State legislative leadership is willing to take on the issue before the crisis is entirely unavoidable after the 2005 gubernatorial and legislative elections.

[4] New Jersey charges 10.5 cents at the pump for gasoline and 13.5 cents for diesel fuel plus a four cents through a Petroleum Products Gross Receipts Tax

In the brief public discussion that followed release of the Commission's report, a number of commentators called for assurances of future accountability in the administration of the Trust Fund, especially in light of the controversial size of the gasoline tax hike required. The Blue Ribbon Transportation Commission had anticipated this issue. It had determined that another contributing cause to the Transportation Trust Fund's demise is the structural lack of accountability for the myriad decisions that brought about the insolvency.

No single official or body had the specific responsibility and political independence to safeguard the financial solvency of the Trust Fund and to raise warnings about the cumulative imprudence of the Trust Fund's management and no one in official position did. The Transportation Trust Fund Authority, which administers the Fund, is nominally independent of the Department of Transportation,[5] but is staffed by department employees. The Authority is charged to concern itself with bond placements, interest rates, bond refinancing and payment of debt service,[6] but has no explicit authority to safeguard the future solvency of the Fund's capital generating capacity. Other parties with a substantial policy role are either actually or practically subservient to the Governor, such as the Commissioner of Transportation and the Board of Directors of NJ TRANSIT, the state's public transit agency. When the State Legislature is in the control of the Governor's political party, as occurred through most of the past decade, little motivation exists there to second-guess the Governor and his/her appointees.

The Blue Ribbon Transportation Commission looked at the Trust Fund's past history and did not want to see its promise of "stable and assured" funding undermined once more by policy choices that were not transparent to the public and the State Legislature. The Commission recommended the creation of an independent Oversight Board (Financial Policy Review Committee) that would annually report to the Governor, the State Legislature and the public on the financial condition of the Transportation Trust Fund. It would be responsible for certifying that the annual Capital Program met newly prescribed ratios that disallow borrowing to exceed pay-as-you-go financing, that the capital program adhered to limits on the diversion of capital expenditures to operations, and the level of the capital program did not exceed financial resources.

This thoughtful response was hardly noticed in the rush of the lame duck session and the quick scuttling of the Commission's recommendation; however, the issue of "restoring trust to the Trust Fund" will not go away and must be addressed when the Trust Fund reauthorization is eventually reconsidered.

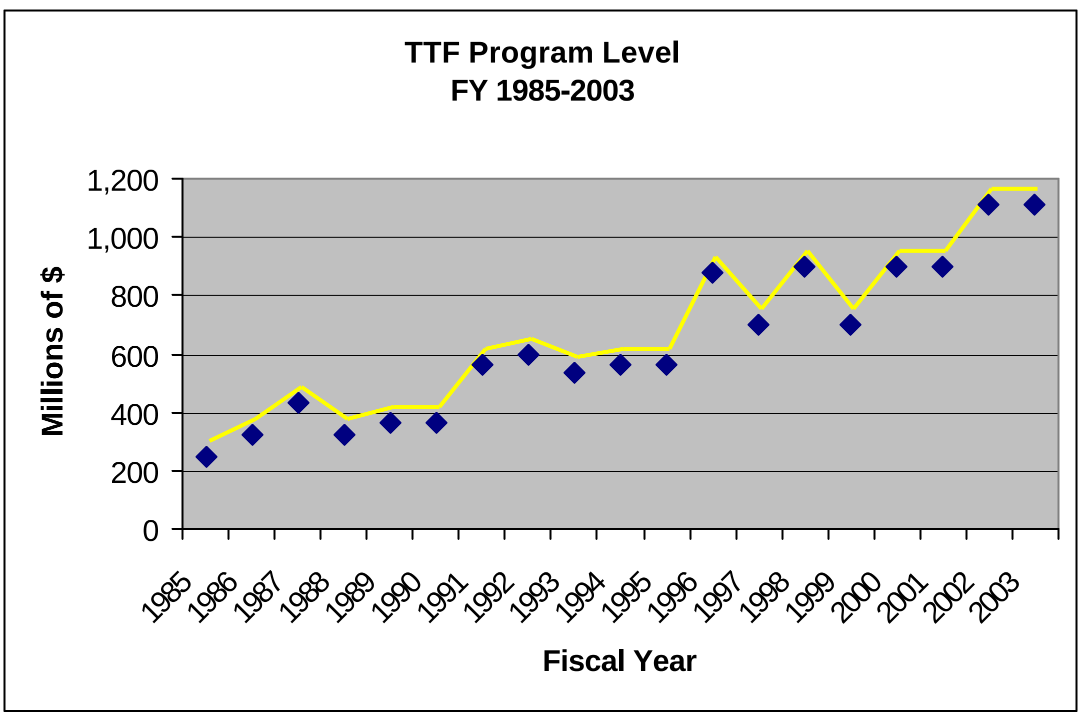
[5] P.L. 1984, c. 73, sec. 4
[6] P.L. 1984, c. 73, sec. 9

The Road to Insolvency

A major factor in the slide toward insolvency has been the heavy reliance on debt. It has impaired the fiscal judgment of New Jersey's leaders and transportation managers, allowing each step to be justified for its current benefits, avoiding the prudent step of raising sufficient revenue to meet these objectives and obscuring for the public the cumulative impact of these actions on the Trust Fund. This politically appealing course allowed elected officials and managers to point with special pride to the fact that the state-funded capital program had quintupled over 20 years (see Chart 1) in pursuit of numerous laudable objectives, although the burgeoning capital program also included some projects whose merit was questioned by the public. The combination of state and federal dollars financed a program that included:

- launching three "New Start" light rail projects (the Hudson-Bergen Light Rail Line, the River Line in South Jersey and the extension of the Newark City Subway at a cumulative cost of approximately $3 billion),
- building four commuter rail connections (the Kearny Connection, the Hunter Connection, Montclair – Boonton Connection, and Secaucus Junction at a cumulative cost of nearly $1 billion), and
- constructing a number of new highways (e.g., the marina tunnel in Atlantic City, the Route 29 tunnel, Route 55) and rebuilding difficult interchanges (e.g., the Route 4/17, the Route 1/130 and the Route 1/9/21/22 interchanges.)

Chart 1.



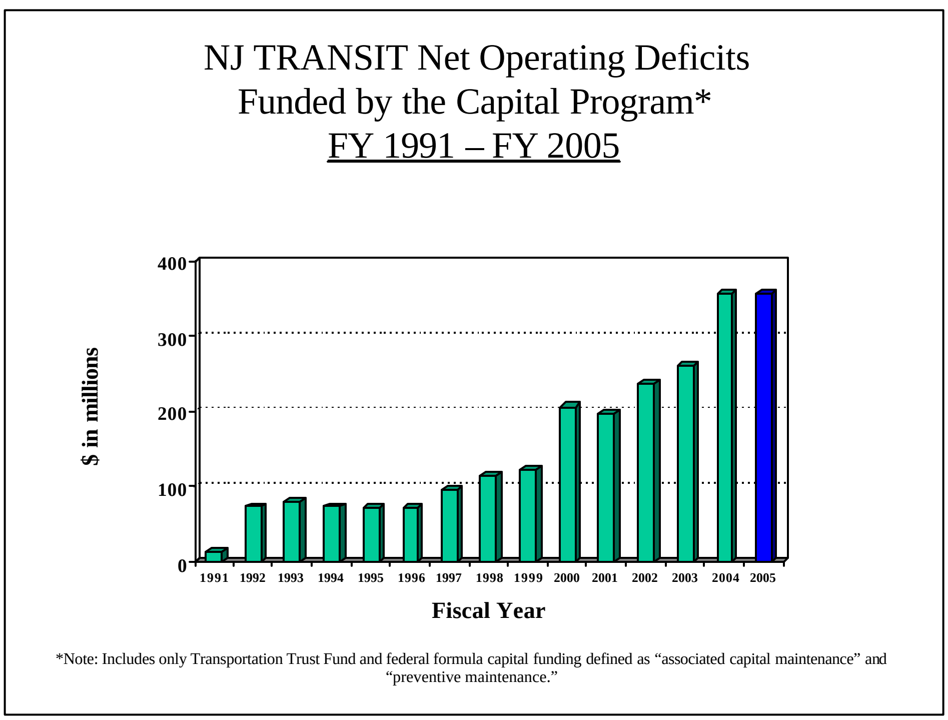
This high profile spending crowded out the practical imperative to maintain an up-to-date fleet of transit rolling stock, because no new revenues were added to the Trust Fund. Instead, the procurement of this equipment required unprecedented debt financing outside the Trust Fund, now accumulating to $300 million in annual debt service. In fact, NJ TRANSIT, in just the past few months, had to resort to this practice once again, adding another $27 million to the debt service burden on its annual capital programs.

Meanwhile, politically appealing policies to stabilize transit fares and tame General Fund appropriations to protect the viability of a tax reduction program combined to drain the capital program. Transit fares remained unchanged for 11 years. During part of this period, Governor Christine Todd Whitman reduced income taxes, decreed that she would not raise any taxes and asserted that fare increases were a tax.

Simultaneously, annual General Fund appropriations for transit operations were being squeezed well below agency request levels. Annual appropriations in FY 2004 for transit operating assistance had fallen to about 80 per cent of the level they had reached in FY 1993, without adjusting for inflation.

The combination of these policies led to another ongoing drain on the capital program. Both federal and Trust Fund capital monies are now routinely diverted to pay for otherwise uncovered net transit operating expenses denominated "preventive maintenance." As Chart 2 demonstrates, this practice has grown to more that $350 million per year. In FY 2004 this amount was nearly double the amount appropriated by the State Legislature for operating assistance.

Chart 2.

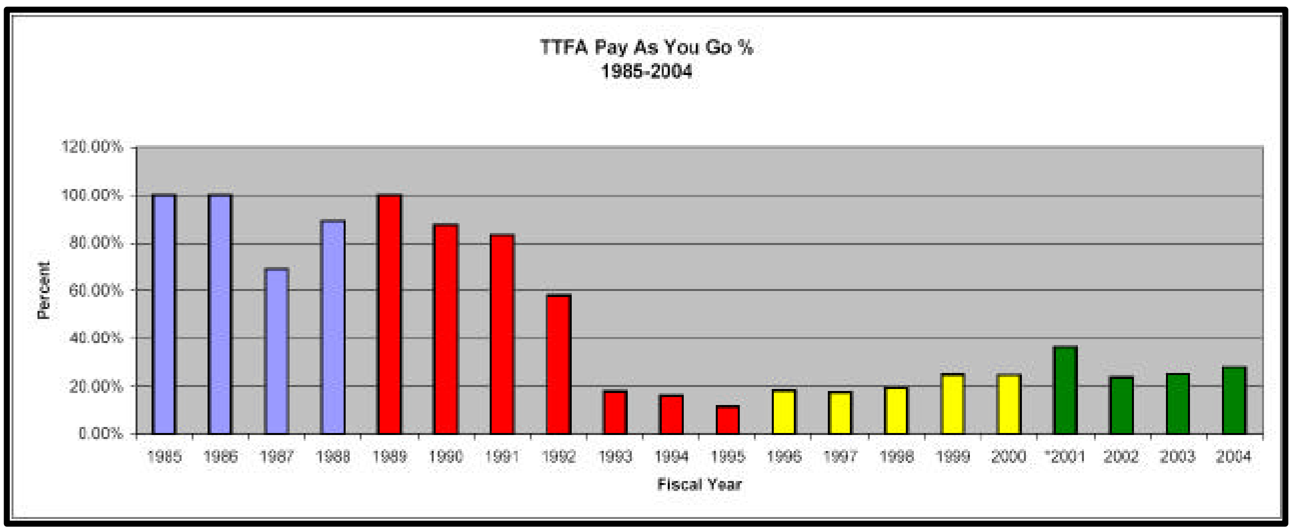


These two drains – the debt incurred to purchase transit rolling stock and the diversion of capital to pay for "preventive maintenance" -- now consume more than 50 percent of NJ TRANSIT's annual combined federal-state capital program.[7]

An underlying theme on the road to insolvency has been the failure by political leadership to seek adequate resources to keep pace with expenditure growth. This has involved avoidance of asking the public to sacrifice to support this robust program of transportation capital spending. It has two dimensions. One was the decision to shift the Trust Fund from dominantly pay-as-you-go to borrowing to meet the increasing appetite for transportation expenditures. The second has been the reliance on Constitutional dedication of existing revenue streams from the State's General Fund, as opposed to creating new constitutionally dedicated revenue streams, to pay that debt service.

As noted earlier, the framers of the Trust Fund intended it to function mainly on a pay-as-you-go, self-replenishing basis, with short-term borrowing used as an adjunct to smooth the flow of capital. Chart 3 tracks the percentage of the Trust Fund's capital program that has been funded on a pay-as-you-go basis.

Chart 3.



The progressive decisions to resort to increased borrowing in 1992 and 1993 were made to ease pressure on the General Fund during a period of severe economic recession and anti-tax fervor. Borrowing was established as the dominant, permanent financing technique through a variety of amendments to

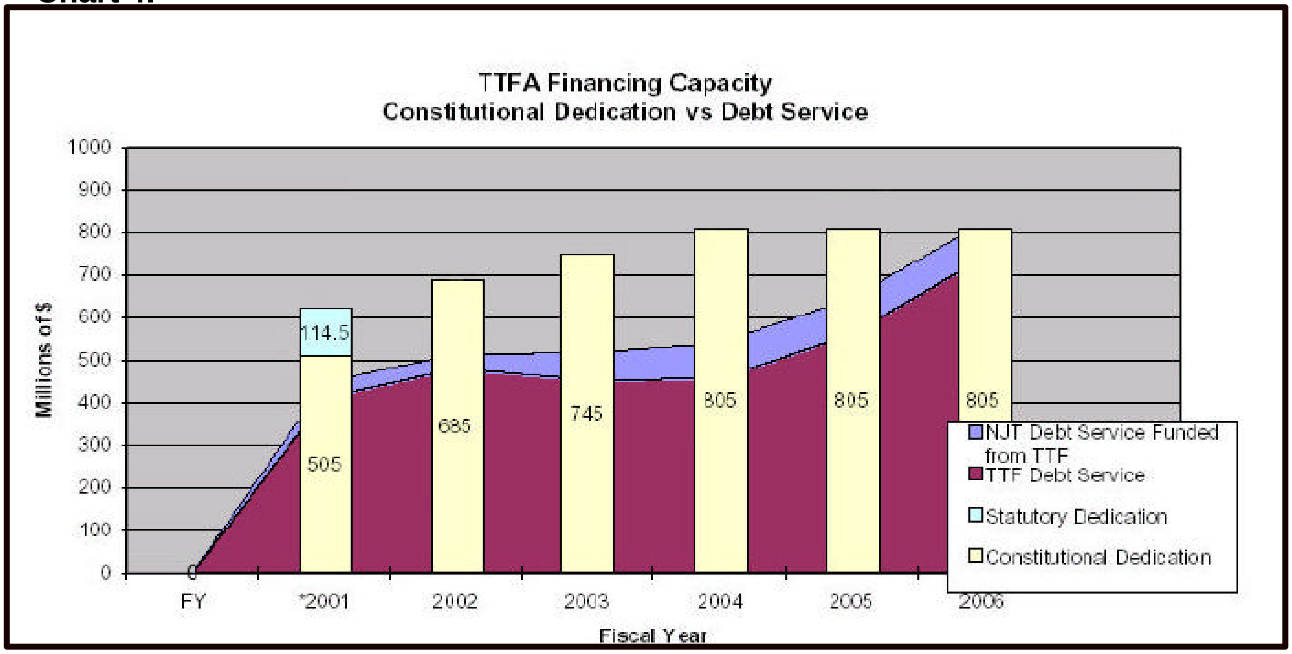
[7] A second consequence, reported by the Blue Ribbon Commission, has been the reduction in maintenance practices on NJDOT facilities. NJDOT now estimates that in order to cut roadside plants, clear storm drains, maintain lighting, and replace signs adequately, its annual appropriation for operations must grow more than three times higher than the current annual level of $85 million.

the Trust Fund reauthorizing legislation adopted in 1995. This included constitutionally dedicating an additional 6-1/2 cents of the motor fuels tax to the Trust Fund and obtaining permission to borrow with bonds with a life of 20 years instead of a maximum of 10 years. The voters ratified the plan in a referendum which made the revenue source "permanent" and provided a "stable source of funding" for the Transportation Trust Fund, even though destabilization of the financing system was inherent in an approach reliant mainly on borrowing. The reversed ratio with borrowing dominating pay-as-you-go has not changed much since 1995. This created a potential crisis in 2000 and now another after FY 2005.

Another politically appealing facet of the road to insolvency has been the practice of constitutionally dedicating streams of revenue from the General Fund to the Trust Fund. In 2000, a year of a booming state economy, the Legislature bailed out the Trust Fund that had been on a borrowing binge by proposing the constitutional dedication of General Fund revenue streams that were to ultimately amount to $400 million per year. It proposed, and the voters ratified in a referendum, the constitutional dedication of the Petroleum Products Gross Receipts Tax and one-third of the revenue from the general sales tax on new automobiles. Insiders understood that borrowing heavily against this revenue stream would produce another destabilizing Trust Fund crisis in four or five years, depending on the level of interest rates.

These successive carve-outs of revenue streams from the General Fund worked in flush economic times, when the General Fund had the resiliency to absorb them. As soon as the State entered a period of economic stress (as it did beginning in 2001) and the General Fund lost that resiliency, political leaders would have to confront the difficult task of asking the voters to raise taxes to support the Trust Fund. To compound the risk, the larger the appetite for transportation expenditures became, the higher the price rose at the next reauthorization in terms of new taxes required to maintain funding at accustomed levels.

Chart 4.



As this telling chart (Chart 4 above) demonstrates, the Trust Fund's constitutionally dedicated funds, now at $805 million annually, seen in the yellow vertical bars, are about to be consumed by sharply rising debt service, represented by the maroon background and the purple layer above it. The maroon represents the debt service on bonds issued by the Trust Fund; the purple represents debt service on bonds issued by the NJ Economic Development Authority to finance light rail projects, such as the diesel light rail River Line that opened recently in southern New Jersey. The Transportation Trust Fund Authority has adopted this debt service.

Note also that some $114 million in statutorily dedicated funding sources, available to the Trust Fund most years through FY 2001, have been channeled since then instead to the General Fund. Given New Jersey's continuing budget problems, restoring these dedicated sources to the Trust Fund (as represented above) remains more a transportation official's wish than a reality.

The heyday of New Jersey's robust transportation capital program is clearly in jeopardy. Gasoline prices have spiked and no one can predict where they will stand when the political question to reauthorize the Trust Fund is next raised. We know that in the context of the economics and politics of 2003, a 12-1/2 cent gas tax increase to support a minimalist capital program was deemed politically imprudent. The price of maintaining that minimalist capital program has risen by several cents on the gas tax for two reasons: the outcome of the TEA-21 reauthorization is unlikely to produce the increases for New Jersey that the Blue Ribbon Transportation Commission had assumed; the indirect GARVEE bonds to be employed to bridge the FY 2006 transportation capital program will have to be paid from some source, most likely a re-authorized Transportation Trust Fund. Meanwhile, the relentless needs for upkeep, rehabilitation and replacement mount. The roads, bridges and transit facilities continue to deteriorate, the traffic and transit congestion continues to build, and transit rolling stock continues to age. Yet too few in the political world will acknowledge the impending collapse of the Transportation Trust Fund until after the next election. Can one expect the public to swallow the bitter medicine of a massive gasoline tax hike without plenty of public education, widespread stakeholder endorsements and lively debate to lay the groundwork? Without a thorough airing of the issue and public recognition of the sizable needs, the outcome is likely to be a half-measure that will see New Jersey slip further behind in maintaining its sizable and vital transportation capital stock.

Thus, the sobering lesson learned is that the combination of lofty intentions to build glamorous, “big ticket” highway and transit projects, freeze fare levels, reduce transit operating assistance and not raise new gasoline taxes, all supported by addictive debt financing, will produce a serious financial hangover – in this case insolvency of New Jersey’s Transportation Trust Fund. Without built-in independent safeguards for the preservation of its financial integrity, a model of capital-generating mechanisms, such as the Transportation Trust Fund, can be wrecked by the “narcotic of debt” and its induced dream state that hard decisions need not be addressed.

Hopefully, New Jerseyans and leaders in other states coping with transportation financing problems will learn from this case the dangers of the political system deluding the public that it can achieve numerous popular objectives, without leveling about the true costs and sacrifices needed to achieve those objectives. That is why it is equally important to create and protect independent institutions that can monitor and safeguard the promise of sufficient, sound and stable transportation funding and alert the public when financial stability is in jeopardy.