Massachusetts Taxpayers Foundation

333 WASHINGTON STREET
BOSTON, MA 02108-5170
617-720-1000
FAX 617-720-0799

News Release

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State's Capital Budget Reaching the Breaking Point

Despite economic prosperity and operating budget surpluses, the Commonwealth's hard-won fiscal stability and long-term economic health are threatened by growing pressure on the state capital budget that has now reached a crisis stage, according to a major report released today by the Massachusetts Taxpayers Foundation.

MTF warned that unless a series of steps—some of them politically unpopular—are taken soon, the state will face an even more unpleasant choice: jeopardize its fiscal recovery and stability by breaking through its capital spending limits, or sacrifice a host of capital investments, from roads and bridges to schools and seaports, that are essential to its economic future.

"State leaders need to face up to this stark reality," said MTF President Michael J. Widmer. "Unless we find new and creative ways to finance critical capital projects while paying for the Central Artery, we will be forced to abandon the fiscal discipline that has been central to the state's recovery or sacrifice a wide range of capital investments that are vital to the long-term health of the state. The longer we delay, the deeper the crisis."

The report, *Reaching the Breaking Point: The Commonwealth's Capital Dilemma*, urges a variety of measures to relieve the growing pressure on the capital budget, including immediate steps to provide additional resources for capital projects by increasing tolls more and sooner than currently planned, restoring vehicle registration and drivers' license renewal fees and tapping operating budget surpluses. For the longer term, the report recommends initiatives to stretch the Commonwealth's capital dollars by reforming construction procurement and increasing funding for deferred maintenance.

In coping with the challenges of financing the Artery after sharp reductions in federal funds, state leaders have adopted a set of policies that shift much of the costs of the massive highway project into the next decade and beyond. At least $1.6 billion in federal aid and state bonds which could have been directed to other important capital investments will instead be used to pay off Artery borrowings until as late as 2015, a decade after the project is scheduled to be completed. At the same time, the borrowing is creating huge financing costs for the Commonwealth, including $2 billion in extraordinary interest payments and debt service assistance to the Turnpike. While the project's legitimate cash flow needs make some of the borrowing inevitable, much of this could have been avoided if adequate resources had been dedicated to the Artery early on.

Even with the state's remarkable fiscal recovery, Massachusetts is seriously limited in undertaking new capital spending by its major debt burden, the third highest in the nation. In order to control the growth in debt, the administration has rightly limited annual borrowing for capital projects to $1 billion annually, a sum, however, which pales in comparison to more than $11 billion in important capital priorities already authorized by the Legislature and the Governor. The situation is so serious that even under the administration's best-case scenario, no more than $3 billion of the $11 billion in authorizations will be undertaken over the next <u>five</u> years. Moreover, the $11 billion total of approved projects greatly understates the Commonwealth's capital needs—major proposed transportation projects such as the North-South rail link, the urban ring, Route 3 South and the I-93 North/Route 128 interchange, for example, have not yet even been considered by the Legislature.

The enormous difficulty of containing spending within the bond cap is reflected in the $1.8 billion spent on capital projects in 1998. Only by borrowing against future federal aid and Turnpike toll revenues was the state technically able to live within its $1 billion bond cap. Because federal highway aid to Massachusetts has been cut by more than a third, the state must finance $3 billion in Artery costs over the next three years. The current strategy for financing these costs leaves no room to handle inevitable cost overruns or additional cuts in federal aid without borrowing even further against the Commonwealth's future. However, given the extent of the state's investment in this important project, attempting to address shortfalls in Artery funding by reducing the scope of the project or extending its schedule would be a serious mistake.

At the present rate of spending on transportation projects—the Artery, the statewide road and bridge program, and Chapter 90 local aid—bond-funded capital outlays would likely exceed the bond cap by as much as $1.5 billion over the next five years. In view of the intense pressure to complete a backlog of projects already in the pipeline, MTF projects that non-Artery highway spending could outstrip the administration's plans by up to $1 billion over five years; modest Artery cost overruns of ten percent would add another $500 million to the Commonwealth's financial burden. The severe challenges of managing this problem are apparent—the administration has recently put the brakes on road and bridge projects already underway and delayed payments to some contractors in an attempt to slow highway spending.

The cost of transportation projects will leave precious few dollars for the long list of other pressing capital needs. Only about $500 million per year will be available for non-transportation projects under the administration's capital plan, which represents a mere eight percent of authorized projects. Given the realities of funding for the Artery and the statewide highway program, even this modest level of non-transportation spending will be difficult to achieve. A wide variety of important capital projects, such as college facilities, courthouse renovations, new libraries and seaport improvements, will be sacrificed or delayed as a result.

Escalating capital spending by the MBTA adds to the Commonwealth's capital dilemma. Driven by commuter rail expansion and the need to rehabilitate and maintain its existing infrastructure, bond-funded spending by the T more than quadrupled between 1986 and 1996, when spending peaked at $358 million. While the T's bonds are outside the state's $1 billion annual bond cap, the Commonwealth covers 90 percent of the T's debt service with a direct subsidy, and pays for most of the rest by underwriting the T's annual operating loss with an additional subsidy. The state debt service subsidy—$268 million in 1999—has nearly tripled over the last decade, growing almost 12 percent per year, due to the T's accelerated capital spending.

As a result of increased borrowing to support capital spending demands, debt service payments have jumped more than ten percent annually during the past three years. The combination of higher bond-funded spending and Artery-related interest costs will cause debt service to increase by at least $470 million over the next ten years.

Founded in 1932, the Massachusetts Taxpayers Foundation is an independent, nonprofit organization which conducts research and policy analysis on state and local taxes, government spending and the economy. Dedicated to the public interest, MTF ranks as one of the largest and most effective organizations of its kind in the country. The Foundation has earned three national awards in the past three years for its work on capital spending, business costs, and managing the state's surpluses.

Summary of Recommendations

Resolving the Commonwealth's capital dilemma will require the state's policy makers to increase the resources available to support the capital program without undermining the fiscal health of the Commonwealth, as well as develop long-term approaches to maximizing the results of the Commonwealth's capital spending.

Toll Revenues Metropolitan Highway System tolls should be increased more and sooner than currently planned in order to provide additional bonding capacity for the Central Artery. The administration plans to increase tolls on the harbor tunnels from $2 to $3 and the Boston extension of the Turnpike from $0.50 to $1 in 2002. Increasing tolls on the extension to $2 and on the tunnels to $4 would generate enough additional revenue to support about $700 million in bond-funded capital spending. Increasing tolls sooner than 2002 would provide additional revenues.

Registry Fees Vehicle registration and drivers' license renewal fees which are being phased out by the administration should be restored to support up to $900 million in additional capital borrowing.

Operating Budget Surpluses The Legislature and administration should dedicate a significant portion of any surpluses in fiscal 1999 and the next several years to offset the costs of the Artery.

Project Financing Massachusetts should take advantage of alternative project financing methods that offer the possibility of leveraging the Commonwealth's limited capital resources, such as dedicated revenue sources, revenue bonds, lease financing, private financing, new user fees, tax increment financing, state infrastructure banks and revolving loan funds. The administration's proposal to reconstruct Route 3 North with private financing and a design-build-operate contract should be adopted as a pilot project to test the effectiveness of these approaches.

MBTA Forward Funding The Legislature should enact legislation to put the MBTA on the same prospective funding basis as all other state agencies and replace the state's open-ended subsidies with a dedicated revenue source in order to provide stronger incentives to manage spending and limit the Commonwealth's financial exposure.

Construction Reform The Commonwealth should implement the recommendations of the administration's Construction Reform Task Force, including alternatives to the current low-bid procurement requirement such as quality and price-based or time and price-based selection processes, and alternatives to the traditional design-bid-build contracting process, such as design-build and build-operate-transfer.

Funding and Incentives for Preventive Maintenance The Legislature and administration should expand funding for preventive maintenance on the Commonwealth's capital assets in fiscal 2000 and make this a permanent line item in the state budget in order to reduce the need for more expensive reconstruction and replacement projects down the road.

Project Labor Agreements The Commonwealth should establish uniform criteria for the use of project labor agreements that limit the requirement to projects of sufficient size and complexity that the benefits of such agreements outweigh their costs.

Strategic Planning and Priority Setting The Commonwealth should undertake a strategic assessment of its capital needs and establish a set of priorities to guide the capital budgeting process.