by encouraging additional capital investment? The specific tools available fall into three categories:

- ◆ Expanding regulatory incentives
- ◆ Pursuing tax incentives
- ◆ Encouraging alternative spending incentives

Expanding Regulatory Incentives

Regulatory incentives range from straightforward administrative guidelines to major policy-driven requirements. Most of the innovative finance tools developed to date for highway funding are administrative improvements to the existing grant reimbursement program. Generally, these changes do not significantly leverage public funds with additional sources of capital. But they do improve cash flows and give the states greater flexibility in managing their programs and projects, as demonstrated by the application of "tapering" in Washington State (see box below).

Examples of "cutting red tape" and otherwise streamlining procedures include the following:

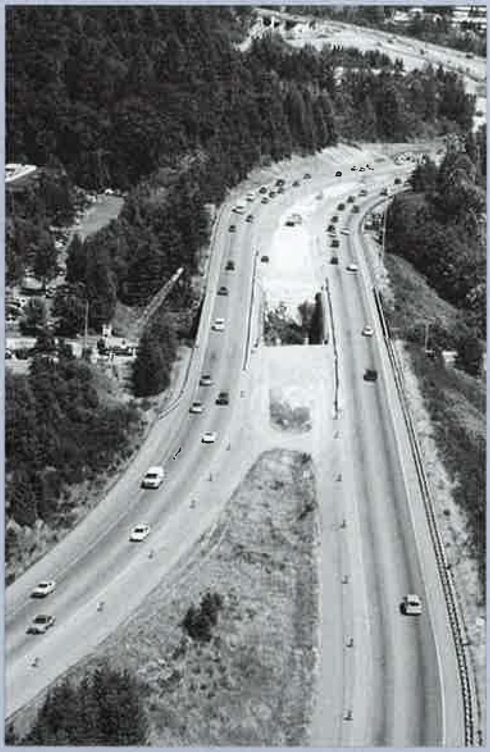
◆ Allowing flexible matching of federal funds, for example, allowing private donations or "toll credits" to count toward the nonfederal share of project costs, or allowing the nonfederal share to vary over the life of a project.

◆ Permitting federal funds for state-advanced projects to be obligated (committed) in stages instead of all up front (partial conversion of advance construction).

◆ Approving greater participation of federal funds in toll projects, including demonstrations of congestion or value pricing.

Although the above tools generally support improved grants management rather than improved leveraging, they are viewed favorably by the states and are attractive to federal policy makers because they have no discernible budgetary impact.

The major policy-oriented regulations also tend to have minimal budgetary effects, but their political costs can be considerable. Some of the more notable examples include environmental



Innovative financing enabled WSDOT to complete SR 520 HOV lanes in Bellevue, Washington, 2 years early.

Regulatory Incentives

Tapering on SR 520, Bellevue, Washington

MIRIAM A. ROSKIN

Administrative innovations that solve cash-flow problems generally have a minimal effect on capital formation. However, regulatory incentives can prove quite helpful when state and local transportation planners must overcome timing mismatches in funding for individual projects.

In 1995 the Washington State Department of Transportation faced just this kind of budgetary predicament. The state has a biennial budget process, which compels WSDOT to predict expenditures for individual projects and programs from 24 to 32 months in advance. If WSDOT errs in its predictions, the amount of state matching funds available to cover the nonfederal share of federal-aid project costs may prove insufficient.

By 1996 WSDOT officials recognized that a cash-flow crunch in matching funds was imminent. They also recognized that a significant portion of this shortfall was for the nonfederal share of a permitting; labor protections, especially Davis-Bacon prevailing wages; affirmative action; and procurement provisions, such as Buy America requirements and design–build restrictions.

Sponsors of smaller projects tend to identify Davis-Bacon wage requirements as fertile ground for regulatory relief that would reduce project costs. Sponsors of larger projects want the federal government to do more to enable procurement using design–build contracts that would help control construction risks by offering incentives to private developers. (Under TEA-21, a state or local transportation agency may award a design–build contract, under regulations to be developed by FHWA, for a project costing at least $50 million generally, or $5 million for an intelligent transportation systems project.) Almost all project sponsors point to the National Environmental Policy Act review process as a candidate for federal streamlining. Not surprisingly, the above three measures are strongly opposed by organized labor, small contractors, and environmentalists, respectively.

Although waiving or otherwise rolling back such policies would arguably bolster highway investment by reducing costs and improving efficiency, the federal government has a legitimate interest in enforcing certain requirements related to national policy goals. It is at this end of the regulatory spectrum that promotion of infrastructure investment must be balanced with protection of national interests. This policy dilemma was evident in the contentious reauthorization debate concerning whether Davis-Bacon wage requirements should apply to SIB recyclings (funds that are repaid to the banks from nonfederal sources and then relent to subsequent rounds of borrowers)—a debate that resulted in the new SIB pilot program under TEA-21 being limited to just four states.

Observing the Tail

As far as we can tell, the budget-scoring tail for regulatory incentives is fairly short and harmless (like a Chihuahua's). This is to be expected, since such measures have little or no budgetary impact

$21.3 million segment of a high-occupancy vehicle (HOV) project near the city of Bellevue. Postponing the HOV project until the spring of 1997 offered one way for WSDOT to stay within the rigid bounds imposed by state spending limitations that had been enacted the year before. At the same time, however, all parties acknowledged that deferral was an imperfect solution, for it would delay a badly needed improvement and subject the project to potential cost inflation.

A grants management strategy known as "tapering" came to the rescue. Tapering allows a more flexible schedule of federal reimbursement by permitting states to vary the percentage share of nonfederal matching funds over the course of construction. The state may vary its match in whatever manner it chooses, as long as the overall federal contribution on a given project does not exceed the prescribed federal-aid limit. For example, the state may submit vouchers to the Federal Highway Administration for 100 percent of its expenditures in the early phases of a project's development and wait until later in the construction process to assume responsibility for the nonfederal share.

In the case of SR 520, WSDOT has begun by submitting periodic vouchers to FHWA to obtain federal reimbursement of 100 percent of the state's actual expenditures. WSDOT will continue to do so until the entirety of the permissible federal contribution has been met. From that point on, WSDOT will bear 100 percent of the cost of remaining expenditures until the project has been completed. Tapering allowed this project to get under way 2 years sooner than might otherwise have been the case.