

Innovative Finance: The Basic Toolbox

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In recent years, states have begun to use a diverse set of financial tools to leverage their federal highway funds, improve cash-flow patterns for federal-aid projects, and ease matching requirements. Following is a brief summary of some of the more common tools.

Flexible Match

A state may meet the nonfederal matching requirement for a given project (typically 20 percent) with a variety of alternative funding sources. Among the newly eligible sources of matching funds are private cash and in-kind donations, including right-of-way donations, and certain federal funds from nontransportation sources (e.g., Bureau of Land Management).

Partial Conversion of Advance Construction

Advance construction permits a state to use its own resources to construct a project while preserving the project's eligibility for future federal-aid reimbursement. The state can then wait until the project is under way or completed before committing federal obligation authority, at which point the project is "converted" to federal aid. Under partial conversion of advance construction, conversion can occur gradually, according to cash-flow requirements. Thus a state can spread its consumption of federal obligation authority for a single project over several years.

Program-Level Match (Surface Transportation Program)

A state may bundle individual Surface Transportation Program projects together for purposes of approval, administration, and matching requirements. In this way, certain projects may be wholly funded with federal funds and others wholly funded with nonfederal funds, as long as the overall federal contribution does not exceed the federal-aid matching limit across the full program of projects.

Reimbursable Bond Costs

States have recently begun to experiment with grant anticipation revenue vehicles, or GARVEEs. A GARVEE is simply a debt instrument (short-term note or long-term bond) that uses a state's future federal-aid apportionments as the credit to support payment of principal and interest. Issuance costs and bond insurance premiums are also eligible for federal-aid reimbursement.

Reimbursable Loans

A state may lend funds to sponsors of projects that generate revenues (e.g., tolls or dedicated tax receipts). The state may then obtain a "double reimbursement": (1) immediate federal-aid reimbursement of the lent funds, and (2) over time, principal and interest payments from the project sponsor. The state may use the repaid funds to support additional transportation projects or to capitalize a revolving loan fund.

Tapered Match

On any given project, the federal-to-nonfederal matching ratio is permitted to vary over time, as long as the overall federal contribution does not exceed the federal-aid matching limit by the time the project has been completed.

Toll Credits

Subject to maintenance-of-effort requirements, a state may apply the value of certain previous toll-funded expenditures toward the nonfederal match on current projects.

◆ Why are spending proposals now beginning to be assessed with the sorts of budgetary charges normally limited to tax code changes?

◆ And perhaps most important, why do the least effective innovative finance tools tend to be the most easily implemented?

The answers to these questions lie in federal budgetary scoring rules. Scoring is defined simply as estimating the fiscal effects of pending and enacted legislation. These calculations, carried out by federal budgeteers or "scorekeepers," are then compared against limits set in annual budget resolutions or periodic balanced-budget legislation (such as last year's Balanced Budget Act of 1997). The House and Senate Budget Committees, with the assistance of the Congressional Budget Office and the Joint Committee on Taxation, are the scorekeepers for the Congress. The Office of Management and Budget and the Department of the Treasury keep score for the Administration.

The current regime of budget controls was ushered in by the Budget Enforcement Act of 1990 (BEA). The overriding goal of the BEA was to bring discipline to the federal budget process and reduce the deficit, primarily by constricting discretionary spending (annual appropriations). By most accounts, the BEA has achieved remarkable success; federal budgeteers have attributed hundreds of billions of dollars in savings to its budget controls and scoring rules. The federal budget would not now be entering a period of temporary surplus were it not for the BEA.

However, this discipline at the aggregate level has come at the price of distortion at the program level. The centralized, prescriptive, cash-focused budget control process that has so successfully reduced (temporarily eliminated) the deficit has also favored short-term budgetary results over long-term policy goals. A framework in which all policy initiatives and fiscal decisions are viewed primarily in terms of their budgetary impacts over a 5- or 10-year "scoring window" is not necessarily conducive to good program decisions. Indeed, it is with this arcane though necessary process in mind that some refer to the federal budget-scoring "tail" as wagging the transportation policy "dog." And this situation pertains not just to transportation programs, but to virtually all federal spending.

Federal Finance Tools To Encourage Capital Investment

In light of existing budget-scoring strictures (see box page 17), what highway financing tools can the federal government use to leverage public funding

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