

## 5. PUBLIC FACILITIES AND QUALITY GOVERNMENT SERVICES: THE FOUNDATION OF WELL-MANAGED ECONOMIC GROWTH

Public facilities and services provide the foundation for economic growth. Transportation, water, sewer, and other utilities are necessary for companies to function. These facilities, along with public schools, police and fire protection, parks, museums, and other recreation services, create a quality of life that attracts productive people to a region.

This strategic planning process did not include a committee on public facilities and public finance. In retrospect, such a focused effort clearly would have been helpful. Infrastructure and public facility issues were forcefully raised by the State and Local Government Partnership Committee, which expressed concern about the financial capacity of local governments to finance public works. It also was raised in the Policy Committee, where the availability of roads, sewers, water, and other services was identified as an influential component of a state's economic climate.

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The basic concern raised is that as the state has attempted, especially during the 1980s, to maintain basic government services at reasonable levels, state and local governments have been forced to cut back on investment and maintenance of public facilities. Unless we are able to develop tax and fee structures that smoothly finance necessary investments in infrastructure and public services, the state risks entering the next century with overburdened and deteriorating facilities.

Oregon's expenditures on public facilities and infrastructure have declined significantly over the past decade. There are growing indications that state and local government infrastructure is deteriorating, and that state and local government may not be making the investments needed to maintain and expand public facilities. In communities that continue to experience economic distress, raising taxes and fees to levels necessary for maintenance and improvements is exceedingly difficult. In Oregon's rapidly growing communities, tax revenues and fees collected may not be sufficient to finance the infrastructure and public services required by growth.

The State has produced a number of reports in recent years relating to the quality of public facilities. These reports consistently conclude that infrastructure needs far outrun the ability of state and local government to meet those needs. What Oregon has not developed is a comprehensive strategy for assuring that an adequate infrastructure is maintained, including a process for setting priorities among critical needs, and developing a tax and user fee structure that will smoothly finance needed improvements. Oregon's infrastructure needs are out of balance with available funds. To secure its economic future, Oregon needs a general strategy for addressing this imbalance.

This section focuses particularly on Oregon's ability to finance public facilities at the state and local level (the terms public facilities and infrastructure are used interchangeably). Infrastructure financing is linked with the yet broader issue of financing government services in general; the same revenue sources used to provide basic public services often are used to pay for and maintain infrastructure. Because basic services typically are needed more immediately, infrastructure often tends to be starved when budgets are tight overall. Ultimately, however, a strategy for financing infrastructure must also encompass a review of the ability of the state's tax and fee system to finance *all* public services both at the state and local levels.

This section is organized in four parts. The first discusses the linkage between infrastructure and economic growth. The second summarizes the current condition of Oregon's infrastructure. The third discusses the capacity of the state's tax and user fee system to pay for infrastructure and other public services. The final segment suggests short- and long-term steps to assure that Oregon is able to provide infrastructure and other public services necessary to provide the foundation for a productive economy.

## **5.1 THE LINK BETWEEN INFRASTRUCTURE AND ECONOMIC GROWTH**

Investments in public infrastructure appear to be linked with economic productivity and growth. An analysis recently completed by David Aschauer for the Federal Reserve Bank of Chicago identified a direct relationship between growth in investment in public facilities and productivity growth in the U.S. economy during the post war period. The study compared infrastructure investments and productivity growth across seven industrialized countries, and found a striking correlation. Between 1973 and 1985, the United States was last in both public infrastructure investment and productivity. Japan was first in both.

Public infrastructure includes many different assets -- roads, sewers, waste disposal facilities, water systems, ports and airports, parks, buildings, schools, and in some

cases electric services. Each has an impact on productivity and economic growth. At the most basic level, when businesses start a new facility or expand an existing one, they generally need access to roads, water, sewage, and other utility services. More broadly, the quality of public facilities affects the ability of firms to move products and people to markets, to dispose of waste, and to obtain the necessary water supplies needed for business. Poorly maintained or congested highways not only are unpleasant, they slow movement of goods and services.

Infrastructure affects the cost of doing business in other ways. The costs of infrastructure generally are incorporated in the costs of business through taxes and user fees. Well managed infrastructure that is maintained adequately will ultimately lead to lower taxes and fees for a region than will infrastructure that is poorly maintained, and which requires substantial reinvestment later.

Some investments in infrastructure can generate greater economic activity than others. An investment in new sewer and water lines for a large new manufacturing firm will have a much greater economic impact than an investment in a commercial park that takes several years to develop and lease up. Highway improvements can be a critical ingredient for accelerating local economic growth, if other resources are already in place. On the other hand, a highway improvement to a region that lacks other critical resources for economic growth may not have much impact economically. Because infrastructure investments will differ in their economic payoffs, we need to be attentive to the returns individual infrastructure investments yield. It is also important, though exceedingly difficult, to consider the tradeoffs in different infrastructure investments. Given that the state has a backlog in many different infrastructure needs --ranging from local roads to sewers to public parks - - it would be useful to have some means for explicitly evaluating priorities among those needs. This is particularly important at times such as these, when infrastructure demands greatly exceed available funds.

## 5.2 DIAGNOSIS OF OREGON'S INFRASTRUCTURE

An important report issued in 1988 by the National Council on Public Works Improvement reached the disturbing conclusion that "the quality of America's infrastructure is barely adequate to fulfill current requirements, and insufficient to meet the demands of future economic growth and development." The report, *Fragile Foundations: A Report on America's Public Works*, goes on, "(i)f our public works were graded on an academic scale, their recent performance would earn a scant C -- barely adequate to support current demands." For individual categories, the grades include a D in the case of hazardous waste cleanup, Cs for solid waste, waste water, highways, and mass transit, and low Bs for water supply and aviation.

The report noted the significant decline in public works investment over the past 15 years. While private investment increased by about 51 percent between 1975 and 1985, during the same period there was a 6 percent drop in public works expenditures. Capital spending on infrastructure dropped from 2.3 percent of GNP in 1960 to 1.1 percent today. The report concludes that, "our current level of capital investments is barely enough to offset annual depreciation, much less meet new demands..." and that "[i]n the long run, our ability to compete in the international economy will be weakened, and our standard of living will suffer..." if we invest too little on public works..."

Oregon prides itself in having good quality public services. State and local governments have the reputation for being honest and efficient, and the quality of public facilities historically has compared favorably with many other states. When we think about deteriorating infrastructure, the urban centers of so-called "rust belt" states come more immediately to mind.

Unfortunately, Oregon is not immune from the national trend. Over the past decade, the quality of Oregon's infrastructure appears to have deteriorated seriously. Between 1975 and 1985, investment in infrastructure per capita dropped from roughly \$500 to \$370 per person. This decline came during a period when additional demands for better water and sewage treatment facilities have increased. The average annual expenditure during this period was \$461 per person. In contrast, Washington spent approximately 75 percent more, \$806 per person.

Beyond these aggregate numbers, examination of specific categories of infrastructure confirm that Oregon faces a shortfall in infrastructure both at the state and local levels. While the state does not systematically review its entire infrastructure needs, a number of studies have been produced on various categories. Each study concludes with a similar refrain: projected needs for infrastructure maintenance and growth far outstrip revenues available.

### **Roads and Highways**

In an important report, *Making the Right Turn: Protecting the Public Investment in Oregon's Road's and Bridges*, (December 1986) an independent consultant reviewed the condition of Oregon's roads and bridges. The study concluded that the state's road system would require \$32 billion in investment between 1987 and 2004 while at current revenues, the state would have \$11 billion available for expenditures. The study found \$6 billion in immediate maintenance needs, with one third of the state's roads needing immediate repair and reconstruction. The report stressed that delays in repairs are sure to result in much higher costs in the future. An updated version of this report issued in March 1989 essentially confirmed the earlier findings.

The study concluded that state highways are in better condition than city or county roads. Five percent of state roads were judged to be very good, 22 percent good, 33 percent fair, 33 percent poor, and 7 percent very poor. Local roads were in worse shape. Forty percent of roads in urban areas require immediate repair, and the report concluded that local governments are able to cover only 67 percent of basic maintenance needs.

A major source of funds for roads is the gasoline tax, which is distributed between the State and counties and cities. In addition, local governments appropriate property tax revenues for maintenance and assess fees for new construction. Counties draw on federal forest revenues to cover a substantial share of their road improvements.

Since the 1986 study, the State has raised the gasoline tax, which will reduce the shortfall between requirements and revenues by about \$2 billion. Even with these increases, total need appears to surpass anticipated funds.

### **Locally Provided Infrastructure**

Much of the responsibility for infrastructure investment is borne by cities, counties, and special service districts. A 1984 study, *The Oregon Public Works Report*, reviewed the condition of infrastructure provided by local government, including streets and roads, bridges, drinking water systems, sewer systems, storm drainage systems and, solid waste facilities. It found that local governments reported a need for \$2 billion in critical repair and replacement projects between 1985 and 1989. Local governments could fund only \$1.3 billion, leaving a shortfall of \$700 million.

Interestingly, the greatest shortfalls in meeting infrastructure requirements came in roads, bridges, and storm drainage systems. None of these are financed through direct user fees. Water, sewage, and solid waste infrastructure was found to be in much better shape, in part reflecting the fact that those services are financed directly through user fees. Financing for local roads, bridges, and storm drainage must compete with other uses for property taxes and state gasoline taxes. In times of budget constraints, infrastructure maintenance is usually cut back severely. This backlog of unmet needs does not include new investments needed to meet the demands of growth and to upgrade systems to satisfy environmental requirements.

### **Other Public Facilities**

Besides traditional infrastructure assets such as roads, sewers and utility systems, other public facilities also are showing signs of overuse and disrepair.

The Governor's Task Force on Corrections Planning, in August 1988, issued *A Strategic Corrections Plan for Oregon: RESTORING THE BALANCE*, which concludes that, "Oregon's correctional system is critically out of balance..." "[t]he

demands being placed upon the system far exceed the current available capacity of its institutions and community supervision programs. State prisons are dangerously overcrowded, understaffed, and plagued with unprecedented levels of inmate idleness." While the Legislature made major strides in financing new construction of prisons in the 1987 session, the report estimates that the state will require 2,233 new prison beds by 1997 to keep up with capacity demands.

The Oregon State Parks *2010 Plan* highlights the increasing usage and declining investment in the state park system. Deteriorating rest rooms, picnic shelters, and water systems are noticeable. The Plan calls for additional investments of \$1 million each year to rehabilitate the facilities, and provide for growth.

Other public facilities have similar problems. State mental hospitals are overcrowded and in disrepair. The State's fish hatcheries are badly in need of rehabilitation. Even the State's office building have suffered neglect during the recession, and are in need of improvements.

### **5.3 OREGON'S STATE AND LOCAL FINANCE SYSTEM**

Oregon's tax structure has been reviewed and criticized from many perspectives. Businesses have argued that Oregon's reliance on property and income taxes as the primary source of revenues makes the state unattractive for some businesses. Concerns are also raised about the inequity created by the disparity of property tax rates among the regions of the state. Poorer communities must pay higher property tax rates than wealthier ones to achieve the same level of services. From the perspective of infrastructure, the tax structure merits one additional criticism: it apparently doesn't generate funds sufficient to meet infrastructure needs and, in some cases, basic services.

Regardless of whether current tax levels are appropriate to meet the state's current services and infrastructure needs, the tax structure itself and the limitations on expenditures within that structure create problems for financing government services and facilities as economic conditions change.

Limitations on growth of state and local expenditures in times of economic growth make it difficult to finance infrastructure improvements required by growth. Both state and local governments face limits on their total expenditures distinct from limitations on total property taxes. At the state level, a spending limit enacted in 1979 constrains growth of general fund appropriations to the growth of state personal income. Under the spending limitation, expenditures for a future biennium can be no greater than the percentage increase in total personal income between the last biennium and the current one.

The apparent intent of the spending limitation was to hold State expenditures to a fixed percentage of statewide income. In reality, the spending limit has effectively *reduced* the size of State Government expenditures, and it limits funds available at current tax levels that can be invested in infrastructure and other public services. The expenditure limit has effectively locked the State permanently into the austerity budget that was adopted during the early 1980s. During the last recession, State Government expenditures fell well below the level required by the spending limit. This occurred because the income tax system is "elastic" (that is, tax rates increase with the level of household income), and during the downturn tax revenues for the State dropped more than the level of personal income overall. Expenditures on maintenance were deferred to maintain basic services. This austerity budget became the base upon which future expenditure growth would be calculated.

In addition to the expenditure limit the Legislature in 1979 also adopted the "2 percent kicker". Under that law, if the State revenues received are 2 percent higher than the revenue forecast at the time the State budget is adopted, an income tax credit is given to tax payers. Corporate and personal income taxes are calculated separately. From the perspective of meeting the needs for infrastructure and increased services during periods of growth, this provision is counterproductive. If Oregon succeeds beyond expectations in growing its economy, the funds generated by that increased economic activity cannot be reinvested to service growth.

Both the expenditure limitation and the 2 percent kicker appear to be a constraint to providing the infrastructure and basic services Oregon needs during periods of growth.

Similarly at the local level, Oregon is unique among states in that it constrains local government revenue collections from property taxes (not tax levels) to 6 percent annually, regardless of actual growth in the local economy. This can create serious difficulties for high-growth communities in providing services and infrastructure. Since expenditures for public services and facilities need to rise during periods of growth to meet increased demand for services and facilities, this system seriously impairs the ability of communities to manage growth well. While local governments can ask the voters for increases beyond the 6 percent limit, in times of growth such levy approvals can lag the actual growth in the community and make planning for improvements difficult.

The second major problem with the current tax structure from the perspective of financing infrastructure is its heavy reliance on property taxes as a source of funds for many local services, including schools, maintenance, and other essential services. Such heavy reliance on property taxes places an enormous burden on the

communities with weak tax bases to raise funds for improvements. Given other priorities in distressed communities, infrastructure development and maintenance is often the first casualty of budget cuts.

Public facilities are financed in many different ways. Local roads are funded through such means as special assessments, property taxes, and state gas tax revenues. Public facilities that are financed through fees on users apparently are in better repair than those that rely on general revenues. Specifically, according to the *Oregon Public Works Report*, water and sewer facilities, which are funded through connection fees and monthly charges, are typically in better repair than are roads, bridges, and drainage systems that compete for funds with schools and other services. As Oregon contemplates financing alternatives for infrastructure, it needs to examine the merits of direct fees compared to reliance on general taxes for financing and maintaining infrastructure improvements.

The State has employed lottery dollars through the Special Public Works program to provide infrastructure improvements for projects that will lead to start up or expansion of businesses in targeted communities. While that fund is critical for helping communities to meet immediate economic development needs, the \$15 million fund does not begin to address larger needs for local infrastructure.

#### **5.4 DEVELOPING AN INFRASTRUCTURE STRATEGY**

The National Council on Public Works Improvement concluded that there are no short-term fixes to the nation's infrastructure problem. "Our infrastructure problems are manageable, but only if we begin to mobilize our resources now. These problems cannot and should not be solved through a crash program. Rather, success requires that all levels of government and the private sector dedicate themselves to a sustained effort."

This advice is appropriate for Oregon as well. Oregon's economic development strategy depends on maintaining a quality of life that is enviable among the regions in order to attract productive people to start and expand businesses here. It also depends on providing infrastructure that meets business needs. Yet Oregon is not providing sufficient funding for infrastructure maintenance and improvements to give us a strong economic foundation in the next century.

Therefore, Oregon needs to place a high priority on reviewing public funding for infrastructure development, and it needs to make sure that infrastructure is adequately provided. There are specific near-term steps that would protect the quality of the state's infrastructure. Longer term, the state needs to develop much better tools for monitoring infrastructure conditions, and set priorities among



infrastructure needs. Oregon must also review the system of state and local taxes and fees that are used to pay for infrastructure, along with associated loan and bond programs, to evaluate whether changes would enable us to meet infrastructure needs more smoothly.

Two actions by this session of the Legislature would directly address infrastructure needs. First, removal of the expenditure limitation and the 2 percent kicker would enable the State to spend funds collected at current tax rates in times of economic growth on necessary maintenance and rehabilitation of infrastructure. The Governor's budget includes funds in several areas to upgrade infrastructure, ranging from fisheries to mental health facilities to prison construction to hazardous waste cleanups. Equally important, the budget proposes tax relief for school finance, which would provide increases in State funding for local school districts, relieving the overall financial burden of local communities. Second, the State should consider increases in gas taxes and vehicle registration fees to address maintenance and improvements for state and local roads.

Longer term, to assure that the state's infrastructure needs are met, local governments and the State will need to improve the economic and financial tools used to analyze infrastructure priorities. Oregon needs to develop a consistent measure for the rate of investment and depreciation of public infrastructure, both at the state and local levels. Without such tracking it is difficult to make judgement on infrastructure requirements, and to set priorities for improvements. This will require a budgeting process that separates current operating expenditures from long-term investments, and measures whether net investment (new investment plus maintenance less depreciation) is growing or declining by major infrastructure category. In conjunction with this accounting system, Oregon needs a mechanism to evaluate the payoff of various infrastructure improvements, looking both at the economic payoffs of infrastructure investments, and at the future costs of deferred maintenance (in many cases, routine maintenance prevents much larger outlays in the future).

The Transportation Commission and the Department of Transportation are already emphasizing priorities based on anticipated economic activity that will derive from the investment. For example, the Access Oregon program is designed to target highway improvements that will provide large economic benefits for regional economies. The department is attempting to identify key airport improvements to benefit local economies. This kind of attention to targeting of investments to make the greatest use of funds is critically important.

Finally, the State needs to analyze the capacity of State and local taxes and fees to pay for necessary infrastructure and public services under different economic conditions. As part of this review, the feasibility of placing greater reliance on user

fees to finance infrastructure should be examined. The Department of Revenue, university economists specializing in government finance, and local finance officers should be drawn into this complex undertaking.

### **Actions on Infrastructure and Public Services**

- The Legislature should modify the expenditure limitation and the 2 percent kicker so funds received during times of economic prosperity can be invested in maintenance and physical improvement required by growth.
- The Legislature should consider raising the gasoline tax and vehicle registration fees to provide funds for state and local road improvements.
- The Executive Department should develop a capital budget for the state which measures current value of the state's assets and depreciation rates, and which regularly measures the condition of the State's infrastructure.
- The Executive Department and the Department of Transportation should jointly develop a tool to measure the economic payoff of various infrastructure investments (examining costs of deferral and the payoff of improvements.)
- The Department of Land Conservation and Development (through its Public Facilities Planning) and the Economic Development Department (through the Community Development Program and the Oregon Partnership program) should encourage cities to develop accounting systems which measure depreciation accurately, and develop infrastructure development plans which consider the economic payoff of alternative development strategies.
- The Governor should appoint an interagency task force to review, in cooperation with local governments, the capacity of State and local tax and fee systems to finance infrastructure and public services required to meet Oregon's future needs. Further, it should evaluate the merits of alternative structures. The examination should include:
  - Review of the current conditions of Oregon's infrastructure
  - A review of the accounting and decision making tools used by the State and local governments for making infrastructure investments
  - A review of the adequacy of the State's tax and fee structures to finance infrastructure improvements.