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The Op/Ed Page for Virginia's New Economy

The Maintenance Mantra

The Road Gang wants you to believe that the surging maintenance budget for Virginia's roads justifies another tax increase. Take a closer look at the numbers before you buy their story.

By James A. Bacon

Even Philip Shucet admits that the business of road maintenance is not very glamorous. Highway engineers spend a lot of time worrying about potholes, drainage ditches, pavement edges and the integrity of the roadbed underneath the asphalt, notes the former Virginia Department of Transportation commissioner. No one holds a ribbon-cutting ceremony when a repaving job is completed. Highway maintenance is a thankless job. Most people, frustrated by construction crews blocking traffic lanes, are as likely to shake their fist at you as thank you.

Yet highway maintenance is moving to the forefront of the transportation debate in Virginia. The expense of maintaining the Commonwealth's road network is outpacing the growth in transportation revenues by ever wider margins. Indeed, according to VDOT projections, the maintenance costs are so voracious that they will consume literally *every* state highway dollar by 2018 -- leaving no state funds for new construction and eating into federal allocations.

With traffic congestion getting steadily worse, many people find that prospect alarming. Citing $74 billion in unfunded highway projects needed by 2025, powerful politicians and businesses interests are calling for a major tax hike to keep the construction budget intact. The most compelling argument they offer -- published in official state documents, projected in PowerPoint presentations, and disseminated by e-mail -- is a simple chart cryptically entitled, "State Construction Dollars to HMOF," that graphically depicts how repairs are consuming the construction budget.

As the tax-averse House of Delegates approaches a showdown with the tax-happy state Senate in the 2006 session, considerable attention will focus on that chart. Any forecast emanating from the Warner administration is likely to invite scrutiny, especially given the massive budget surplus that the administration failed to anticipate when jacking up General Fund taxes in 2004. Skeptics are entitled to ask, just how hard are those VDOT numbers? How subject are they do being revised at a later date?

To jump start the questioning, I met Shucet one morning last week for coffee, just a mile or so from his home in Virginia Beach. He had spent his last day at VDOT only the week before and was relishing the time off from the grueling job. Shucet stood by VDOT's projection and he reiterated his belief that Virginia desperately requires more money to build more roads. But he candidly conceded that there was more to the numbers than met the untutored eye.

I walked away from that meeting with three major conclusions. Yes, the maintenance budget is eroding the funds available for new construction. However:

- One reason the maintenance budget is growing is that the Warner administration has set the goal of working down a roughly $2 billion backlog in major maintenance projects that previously had been carried over from year to year.

- VDOT is projecting that construction costs will increase indefinitely at the rate of 4 percent per year, roughly double the general rate of inflation.

- The projections do not include the impact of management changes -- particularly the increased use of outsourcing -- that hold out the potential of reducing maintenance expenditures by 20 percent or more.

Before the Warner administration, VDOT did not have a firm handle on exactly how big its construction backlog was, Shucet says. People "kind of knew" what needed to be done, but there were no hard numbers. Now he can say with confidence that $1 billion (in round numbers) of new road and bridge maintenance projects enters the pipeline every year, swelling a backlog of roughly $2 billion. Spending $1 billion annually on maintenance keeps the backlog about the same size from year to year.

During the budget crunch in the first two years of the Warner administration, Shucet says, the state was falling behind in its maintenance obligations. "In three years [as commissioner], I drove about 120,000 miles on state roads. Over 36 months, I saw our system deteriorate. I saw the result of failing to address that backlog and flatlining maintenance."

Now VDOT policy is to work down that backlog a little bit each year. The current six-year spending plan calls for adding $97 million a year to maintenance and then increasing total maintenance spending by four percent per year. Current spending policies should trim the backlog by 22 percent over six years, Shucet says.

At that rate, VDOT will have cut down the project backlog by about half by the time maintenance spending is projected to consume the state highway budget -- a significant accomplishment never mentioned by advocates of tax increases. "Will we have a better road system as a result?" asks Shucet. "Yes, as far as the integrity of the system, we will. We will have a better maintained system."

And a better maintained system will, in turn, ameliorate traffic congestion by reducing one of the major causes of congestion -- road maintenance crews. "Road construction is a major cause of bottlenecks," Shucet explains. "Whether you're adding a lane or repaving a lane, you're in the middle of the road. If you maintain your system to appropriate standards, you'll need to be in the road fewer times."

Shucet doesn't have any hard numbers -- indeed, the benefits may be impossible to quantify -- but he says it would be reasonable to expect a 25 percent reduction in maintenance-related road work. The benefits to motorists of fewer construction-related delays are something that the pro-tax advocates never mention.

A second major assumption in the VDOT chart is the expectation of continued four percent inflation in construction costs. It's a historical fact, says Shucet: Inflation in the construction sector has run roughly double the rate of consumer price inflation over the last 15 years. "Generally speaking, the demand for construction services has been very high. That drives prices up."

Higher costs are reflected in the price of materials - steel, cement, plywood, petroleum-based asphalt, as well as labor. It is getting very difficult to find skilled construction labor, Shucet says. Of course, he admits, there's no way to know if construction costs will continue to outstrip the general inflation rate. That's why VDOT has built into its cost-estimating methodology an annual review of the construction cost index.

In other words, the four-percent projection is no more than VDOT's best guess, based on past experience. It's possible that inflation could turn out to be far more benign. A roaring housing boom, made possible in part by low interest rates, has driven up the cost of materials and labor. If interest rates rise, the housing market could deflate -- many observers believe it could *crash* -- easing pressure on the cost of commercial and infrastructure construction.

Another wild card is China. The Chinese construction market is so hot that it has driven up the cost of steel, cement and other construction materials across the globe. Should the Chinese construction boom cool -- and given the high commercial vacancy rates in many cities and the fragility of the Chinese banking industry, that's not a remote possibility -- price pressures on heavy construction could moderate worldwide.

Any number of factors could throw off VDOT's projections. A global economic slowdown. Rising interest rates that choke off commercial construction. An increase in steel- and cement-making capacity that eliminates scarcities. The construction industry is highly cyclical, and we're at the peak of a cycle. In sum, there is nothing certain about VDOT's four percent inflation projection. VDOT is using the four-percent number because it has to use *something*. But Shucet acknowledges that the number is subject to change.

If inflation in construction costs moderated to the general inflation rate, about two percent, projected maintenance expenditures could be 25 percent less than VDOT projects by 2018. Given the volatility of the construction cost index, we could conceivably experience a year or two of price *deflation*. To my way of thinking, it makes no sense to increase taxes *now* on the basis of a conjectural forecast of what might happen to construction costs 10 to 15 years in the future.

Shucet's greatest contribution to VDOT has been to impose order and discipline to the management of its multi-million dollar construction projects. VDOT now is bringing in roughly 80 percent of its projects on time and on budget -- a pretty good track record given the uncertainties associated with construction work.

But that's only Phase 1 of VDOT's managerial transformation. Phase 2, should the next governor choose to pursue it, would be to overhaul the way VDOT manages maintenance. Shucet envisions redefining VDOT's job away from doing the maintenance itself to ensuring that the maintenance gets done -- even if it means outsourcing the work. VDOT's core mission, he suggests, should be setting standards, putting out the work for competitive bids, and monitoring the winning bidders to make sure they are meeting performance standards.

Managing the road system on a programmatic basis will require a major change in the way VDOT operates, Shucet says. Instead of managing the system in two-year budget cycles, VDOT managers will be called upon to manage roads over natural maintenance cycles. Instead of patching holes, VDOT will pay more attention to the substructures of roads to ensure that they last longer. In sum, VDOT will think more like a business managing a multi-billion dollar asset base for maximum efficiency.

Again, Shucet has no definitive numbers on how much can be saved, but he says that it would not be unreasonable to aim for 20 percent gains through a programmatic approach to management. The implication is that it should be possible eventually to save *hundreds of millions of dollars a year* in maintenance costs.

It would be irresponsible, Shucet says, to base his long-range forecast on the assumption that some future administration might put into place the management changes he envisions. At the same time, I would hasten to add, it would be irresponsible for the next governor *not* to put those changes into place. And it would be just as reckless for the General Assembly to enact huge tax increases on the pretense that there aren't still massive efficiencies yet to be wrung out of VDOT's maintenance program.

Instead of devoting their creative energies to finding ways to raise taxes, I would contend, the General Assembly should do everything in its power to ensure that Shucet's vision for the transformation of VDOT is carried to completion.

I'm open to the possibility that it may be necessary some day to increase taxes to properly maintain Virginia's roads. But that day is not yet here. To my mind, the impending "maintenance crisis" is not inevitable, nor even a crisis. The widely circulated "State Construction Dollars to HMOF" chart reflects (a) a policy decision to increase maintenance standards by pumping $100 million+ into base funding for maintenance, (b) an anticipated four percent construction inflation that may never materialize, and (c) the omission of hundreds of millions of dollars in potential savings through the implementation of new management methods.

It's way too early to tell how much money will be needed. Change financial assumptions and management policies, and Virginia could well have more than half a billion a year left over in 2018 to devote to new construction.

The state's current surplus has exposed the folly of basing the 2004 tax hike on short-term forecasts of revenue shortfalls. The uncertainties of VDOT's long-range forecast are an order-of-magnitude greater. Virginians should insist upon a greater level of certainty before the General Assembly compounds the error of its 2004 tax increase with another in 2006.

-- July 11, 2005

Read more columns by Jim Bacon at
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