COUNCIL on FOREIGN RELATIONS

Renewing America

POLICY INNOVATION MEMORANDUM NO. 17

Date: April 11, 2012

From: Scott Thomasson

Re: Encouraging U.S. Infrastructure Investment

Despite the pressing infrastructure investment needs of the United States, federal infrastructure policy is paralyzed by partisan wrangling over massive infrastructure bills that fail to move through Congress. Federal policymakers should think beyond these bills alone and focus on two politically viable approaches. First, Congress should give states flexibility to pursue alternative financing sources—public-private partnerships (PPPs), tolling and user fees, and low-cost borrowing through innovative credit and bond programs. Second, Congress and President Barack Obama should improve federal financing programs and streamline regulatory approvals to move billions of dollars for planned investments into construction. Both recommendations can be accomplished, either with modest legislation that can bypass the partisan gridlock slowing bigger bills or through presidential action, without the need for congressional approval.

THE PROBLEM

The United States has huge unpaid bills coming due for its infrastructure. A generation of investments in world-class infrastructure in the mid-twentieth century is now reaching the end of its useful life. Cost estimates for modernizing run as high as $2.3 trillion or more over the next decade for transportation, energy, and water infrastructure. Yet public infrastructure investment, at 2.4 percent of GDP, is half what it was fifty years ago.

Congress has done little to address this growing crisis. Ideally, it would pass comprehensive bills to guide strategic, long-term investments. The surface transportation bill, known as the highway bill, is a notable example of such comprehensive legislation. It is the largest source of federal infrastructure spending, allocating hundreds of billions of dollars over several years for highways, rapid transit, and rail. But the most recent six-year highway bill expired in 2009, and Congress has been unable to agree on a new multiyear bill since then. The Senate passed a new bill in March 2012 that provides only two years of funding and efforts in the House to pass a longer-term bill have nearly collapsed. The continuing impasse forced Congress to pass its ninth temporary extension of the old law at the end of March 2012, this time for ninety days. Transportation Secretary Ray LaHood announced in February that he does not expect a bill to pass before the 2012 election, a view many experts share.

Even if Congress passes a new highway bill, the country's infrastructure debacle is hardly resolved. Transportation is only one part of the problem, and the pending bills do not even raise investment in this sector from previous, insufficient levels. Nor do they address the biggest long-term problem for transportation—inadequate funding from the Highway Trust Fund. Since the mid-1950s, federal gas tax revenues have been deposited into the Highway Trust Fund and then allocated to states for transportation improvements. But the gas tax is not tied to inflation and has not been raised since 1993. At current spending and revenue levels, the trust fund will be insolvent within two years. Raising the gas tax would alleviate the funding problem, but both parties consider that and other new taxes to be political nonstarters.

UNLOCKING PROGRESS

There is no shortage of good proposals to encourage infrastructure investment. For example, President Obama has endorsed the idea of creating a national infrastructure bank to leverage federal funds and encourage PPPs. Bipartisan negotiations in the Senate produced a bill for a scaled-down version of the bank, focused on low-cost federal loans to supplement state financing and private capital. The bill is not supported by House Republican leaders, however, and is unlikely to pass this year. There are also important transportation reforms in both pending highway bills where Republicans and Democrats are on common ground: expanding the popular Transportation Infrastructure Finance and Innovation Act (TIFIA) loan program, streamlining the Department of Transportation bureaucracy to speed approval of new projects, and eliminating congressional earmarks—a huge step toward smarter project selection based on merit rather than political interests. But if the highway bill does not pass, none of these reforms will happen.

States are already looking at new ways to finance infrastructure as federal funding becomes uncertain and their own budgets are strained. More states rely on PPPs to share the costs and risks of new projects, and they are finding new sources of nontax revenues to fund investments, like tolling and higher utility rates. But at the same time, federal regulations and tax laws often prevent states from taking advantage of creative methods to finance projects. Federal programs designed to facilitate innovative state financing are underfunded, backlogged, or saddled with dysfunctional application processes. Many of these obstacles can be removed by adjusting regulations and tax rules to empower states to use the tools already available to them, and by better managing federal credit programs that have become so popular with states and private investors.

In cases where modest reforms can make more financing solutions possible, good ideas should not be held hostage to "grand bargains" on big legislation like the highway bill or the failed 2010 energy bill. Congress should take up smaller proposals that stand a chance of passing both houses this year—incremental steps that can unlock billions of dollars in additional investments without large federal costs. Any proposals hoping to win Republican support in the House need to have a limited impact on the federal deficit and focus on reducing, rather than expanding, federal regulations and bureaucracy. Some progress can also be achieved by circumventing Congress entirely with executive branch action.

VIABLE NEAR-TERM ACTION ITEMS

Congress can unlock state and private investment by reducing state borrowing costs and allowing flexibility for alternative revenue sources and private capital for financing solutions. Specifically, federal policymakers should:

- ***Give states the flexibility to use alternative capital and revenue sources.*** Billions of dollars to finance new infrastructure could be raised every year from private-sector capital and untapped revenue sources like tolls and user fees. Neither is a free lunch, but they are potential alternatives to a federal tax increase or deficit spending.

New tolls are banned on interstates, except for a federal pilot program that allows only three states to use tolling to replace worn-out roads. Congress should eliminate this cap and make tolling options available for any interstate improvement project. In addition, Congress should promote PPPs by loosening rules on government contracting and concessions and provide grants and other assistance to develop state PPP programs. Congress should also help states attract private capital by allowing broader use of tax-favored structures preferred by many investors for other types of investments, like master limited partnerships (MLPs) and real estate investment trusts (REITs).

– *Help reduce states' borrowing costs.* Municipal bonds are exempted from federal taxation, lowering interest rates on state debt by making them more attractive investments. But federal tax exemptions are more restricted for state private activity bonds (PABs), which pass along low state borrowing rates to private companies and independent authorities investing in projects with public benefits, such as water treatment facilities and airports. Congress should provide long-term certainty by eliminating limits on the amount of PABs states can issue and permanently exempting PABs from the federal Alternative Minimum Tax (AMT) to increase buyer demand. The federal cost of the AMT exemption is around $20 million per year in lost revenues—a modest amount that will result in tens of billions of dollars in low-cost financing for urgently needed projects.

Streamlining regulatory reviews and financing approval processes and improving program management can speed project delivery and reduce regulatory uncertainty for project sponsors. Specifically, federal policymakers should:

– *Coordinate and enhance existing finance programs.* A modest but viable alternative to an infrastructure bank is coordinating the many loan programs for infrastructure that are already spread across various federal agencies and departments. There is bipartisan agreement that these programs need improvement—for example, TIFIA needs more credit experts to keep up with its growing workload, and the Department of Energy's loan program needs better oversight and transparency. Congress should modernize the outdated Federal Financing Bank (FFB), a nearly dormant government corporation now controlled by the Treasury Department, and convert it into an independent credit review and oversight office. The new, more active FFB could perform technical, "back office" functions like risk assessments and loan tracking for agency credit programs. Using a central team of experts would avoid duplicative staff across programs, speed approvals, and minimize taxpayer exposure to unforeseen loan risks.

– *Cut red tape for new projects.* On March 22, 2012, President Obama issued a new executive order to "improve performance of federal permitting and review of infrastructure projects." But the order is short on substance and long on studies and steering committees. A bolder step would be eliminating duplicative reviews by merging them into single-track proceedings wherever possible. The approval process for natural gas pipelines is a model; an interagency agreement established a "one-stop" review conducted by the Federal Energy Regulatory Commission (FERC) with input from other government agencies. President Obama could order similar streamlining without congressional approval and without waiting months for a steering committee plan.

CONCLUSION

None of these steps is a silver bullet for fulfilling the United States' infrastructure needs. But big successes may be hard to come by before the 2012 election. In the meantime, small victories are better than none. The modest steps offered here could unlock hundreds of billions of dollars in new investment over the next decade. With pragmatic solutions that do not carry big federal price tags, Congress and President Obama can offer some relief to the states and local governments who know firsthand that the country cannot afford to wait any longer to make these investments.

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