

THE CASE FOR A MULTI-YEAR INFRASTRUCTURE INVESTMENT PLAN

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The US is suffering from the worst labor market crisis since the Great Depression. After hitting a high of 10.1% in October of last year, the unemployment rate has stalled at 9.6%, more than double what it was in 2007 before the Great Recession gripped the economy. The primary culprit behind today's high unemployment rate is inadequate demand. In the wake of the financial shocks at the end of 2008, spending by US households and US businesses plummeted, and companies responded by curbing production, shedding workers, and in many cases closing down altogether. By late 2009, fueled by unprecedented fiscal and monetary stimulus, household and business spending began to recover, but the pace of recovery has been weak, leaving a substantial gap between the supply of goods and services the economy is capable of producing and the demand for them. This gap manifests itself in the 23 million Americans currently seeking full-time jobs and the millions more who have left the workforce because they could not find one.

The remedy for unemployment caused by inadequate private spending is fiscal stimulus (monetary stimulus is also warranted, but that is not the focus of this piece). The 2009 fiscal stimulus package is working: it has added around 3% to the level of GDP and about 3 million jobs relative to what would have been the case otherwise, and there is more to come since about 36% of the stimulus is yet to be spent. But the package ends next year at a time when the unemployment rate will still be well above 9%. So there is a strong economic argument for additional fiscal measures targeted at job creation.

A significant and sustained increase in infrastructure investment by federal, state and local governments should be a priority. Unlike most other forms of stimulus, spending on infrastructure both increases demand when the spending occurs and increases the supply and growth potential of the economy over time. The demand-side case for infrastructure investment is well documented. According to the Congressional Budget Office, infrastructure spending is a cost-effective demand stimulus as measured by the number of jobs created per dollar of budgetary cost. Moody's Economy.com estimates that \$1 of infrastructure spending increases demand and the level of GDP by about \$1.59.

The supply-side or growth case for a significant increase in infrastructure investment is also compelling. Real infrastructure spending is about the same today as it was in 1968 when the economy was a third smaller. The inadequacies of the country's current infrastructure are displayed every day in freight bottlenecks, road congestion and airport delays, all of which reduce business productivity and make the US a less attractive location for business activity. Documenting these inadequacies, the American Society of Civil Engineers gave America's infrastructure a failing grade of D in its 2009 report and has identified

more than \$2.2 trillion in outstanding infrastructure needs. And using a narrower cost-benefit approach, a 2008 CBO study concluded that a 74% increase in annual spending on transportation infrastructure alone is economically justifiable.

Over the next five years, the federal government should work with state and local governments and the private sector to finance \$1 trillion of additional investment in infrastructure. The successful Build America Bonds (BABs) program included in the current stimulus package should be extended to support this goal. Under this program, state and local governments issue federally taxable bonds to investors to finance infrastructure projects, and the federal government pays a subsidy of 35% of the interest costs of the bond issuer. BABs have grown rapidly and now account for about 21% of the municipal bond market. Rather than displacing traditional tax-exempt municipal bonds, BABs have expanded the funds available for infrastructure investment by appealing to large investors like pension funds, life insurance companies, and foreign investors for whom tax-exempt munis have limited attraction. BABs have helped state and local governments finance an additional \$120 billion in infrastructure investment during the last year. After the current stimulus ends, the federal government should maintain the 35% subsidy on BABs and broaden the range of projects for which they can be issued.

As part of its commitment to a multi-year infrastructure plan, the federal government should also establish and provide the capital for a National Infrastructure Bank. President Obama's 2010 budget proposed the creation of such a bank with a \$25 billion capital contribution from the federal government over a 5 year period, but Congress failed to act on the President's request in 2009. This was an ill-advised decision that should be reversed. An appropriately designed and governed national infrastructure bank would both address gaps and shortcomings in the current system for selecting and funding infrastructure projects and attract private investment funds for such projects. The bank would focus on transformative projects of national significance, like the creation of a national high-speed rail system or the modernization of the air traffic control system, that require the participation and coordination of many states. Such projects are neglected by the formula-driven processes now used to allocate federal infrastructure funds among states and regions. The bank would provide both coordination among diverse actors and certainty about the level of federal funding for such multi-year projects by removing funding decisions from the politically volatile annual appropriations process. Moreover, the bank would select projects for funding, not on political and earmarking considerations that too often influence project selection in the current system, but on independent and transparent cost-benefit analysis by objective experts.

Armed with a flexible set of financing tools, including direct loans, loan guarantees, grants, and interest subsidies for BABs, the bank could provide the most appropriate forms of financing for each project. The bank should be granted the authority to create partnerships with private investors on individual projects. Public-private partnerships would both increase the total amount of funding for infrastructure investments and foster efficiency in project selection, operation and maintenance. Such partnerships are becoming common in infrastructure financing around the world and many nations are using them to attract private capital, but to date they account for a miniscule share of infrastructure financing in the US. A national infrastructure bank could tap into the significant pools of long-term private capital in pension funds and dedicated infrastructure equity funds looking for infrastructure investment opportunities.

The federal government can afford a capital commitment of at least \$25 billion to establish a national infrastructure bank as an additional stimulus measure immediately. Given the significant excess capacity in the economy and the very low interest rates at which the US government can borrow funds, there is no danger that an additional stimulus of this size will trigger a crisis of

confidence in the US government's creditworthiness. Nor is there any danger that infrastructure investment financed by the bank will crowd-out private investment—it fact, it is likely to encourage or “crowd-in” such investment.

As the economy recovers, however, the federal government must embark on a multi-year plan to reduce the deficit and stabilize the debt to GDP ratio. To ease capital market anxiety about the government's future borrowing needs, such a plan should be developed and passed by the Congress now. The plan should include permanent funding mechanisms for the national infrastructure bank. These mechanisms could include a small share of funds from a new multi-year transportation bill, a small share of revenues from the gasoline tax or from a new carbon tax, and user fees. Whenever appropriate and feasible, user fees should be linked to the projects financed by the bank. Such fees would not only raise revenues but would also encourage the efficient use of infrastructure assets and provide financing for their maintenance.

There is no doubt that the country needs to invest significantly more in its infrastructure to secure its competitiveness and deliver rising living standards to its citizens. And there is no better time to begin that investment than now when millions of Americans can be put to work in meaningful jobs to help build the infrastructure we need.



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