Research

Infrastructure Spending Proposals

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Summary

- American infrastructure needs are significant, and require an efficient funding strategy.
- Hillary Clinton proposes spending $275 billion over a 5-year period to address infrastructure needs including $25 billion to create an infrastructure bank. Donald Trump proposes spending $500 billion.
- An effective federal policy on infrastructure spending will focus primarily on projects with a clear economic growth impact and a significant benefit-cost ratio.

Introduction

Infrastructure spending is a hot topic in the lead up to the 2016 election. Transportation infrastructure is a vital part of an efficient economy. Effective infrastructure spending can promote economic growth by lowering transportation time and costs, improving access to valued services (health care, education, etc.), and reducing the environmental impacts of transportation. Both presidential candidates have a proposal for the best approach to funding transportation needs.

While America's infrastructure has been viewed by many as deficient and some have claimed a drop in financing of such projects, earlier research by AAF found that federal infrastructure spending is consistent with spending patterns of the last two decades. Federal infrastructure investment carries a low return relative to private-sector investment. The Congressional Budget Office (CBO) estimates that the average return on federal investment is one-half of the average return from private-sector investment.[1] In light of the disparity between consistent infrastructure spending and infrastructure deterioration, it is essential to pinpoint the infrastructure areas that provide the best benefit for the cost. AAF released earlier research with recommendations for maximizing net benefits with emphasis on requiring implementing agencies to conduct transparent economic analyses to facilitate the prioritization process.

Presidential Proposals

Donald Trump's $500 billion infrastructure proposal leaves much to the imagination since the only detail available is that he will not increase taxes and the entire proposal will be paid for using infrastructure bonds. Without any further information on how Trump will tackle this issue, it is difficult to assess his plan in detail.

Hillary Clinton plans to spend $275 billion on infrastructure, $25 billion of which would be used over a 5-year period to set up an infrastructure bank. The additional $250 billion in funds would go directly towards public investment.[2] Since Secretary Clinton's infrastructure proposal is more detailed, the remainder of this paper will be devoted to what we know, what we don't know, and recommendations that would improve the plan.

What We Know— Clinton proposes that the infrastructure bank be an independent, government-owned entity with a bipartisan board of directors. The purpose of the bank is to serve as a one-stop-shop for states, municipalities, and project sponsors seeking federal resources for the development of infrastructure projects that

are significant on a regional or national scale. The infrastructure bank will emphasize investments in freight and port improvements, as well as projects to modernize the energy, water, broadband, and transportation systems in urban and rural communities.

The infrastructure bank will have the ability to provide loans, loan guarantees, and other forms of credit enhancement. Furthermore, the infrastructure bank will revive the Build America Bonds (BABs), the subsidized taxable municipal bonds of Obama's American Recovery and Reinvestment Act. BABs were appealing to investors and issuers alike because the interest was heavily subsidized (35 percent) by the federal government. The end result was a yield comparable to corporate bonds but with much less risk. The BABs proposed by Secretary Clinton will be subsidized at a lower rate of 28 percent.

It is important to note that the Transportation Infrastructure Finance and Innovation Act (TIFIA) is an instrument already in place providing credit assistance for regionally and nationally significant projects. The TIFIA credit program is designed to fill markets gaps and leverage substantial private co-investment which is the designed function of the infrastructure bank. Rather than create a new government entity, it is a better idea to modify the mechanisms already in place.

That being said, an infrastructure bank is intended to be different from the way government currently funds infrastructure in three ways: volume of suitable projects, funding, and project selection.

The number of projects that will qualify under an infrastructure bank is considerably smaller since a project will be required to have a dedicated revenue stream through tolls or availability payments, monthly payments received from the public partner based on the public asset being available at a certain performance level. While this is not a requirement for the formula grant projects, some do have dedicated revenue streams.

The funding for an infrastructure bank is repaid using these direct fees from end users or other dedicated taxes. By charging users for the benefits received, the majority of the costs for the project are absorbed by the individuals that use the highway or bridge. On the contrary, the Federal Highway Administration (FHWA) is largely funded by a gasoline excise tax and other general taxes that charge drivers broadly even if they do not see the benefit of some of the FHWA projects.

The infrastructure bank will also differ by the appropriation of funds. In a typical surface transportation program, the budget authority is mandatory so there will be a steady stream of funding for the budget. On the other hand, the outlays are discretionary and need to be appropriated for these funds to be used. The independent infrastructure bank differs from this since the budget will be set by the funds available and the usage will not be under direct federal control.

Finally, the selection process of an infrastructure bank can differ greatly since it could use a competitive process to weigh the costs and benefits to pick the most suitable projects. Formula grant projects have broad federal guidelines to determine qualification and an infrastructure bank has the ability to have strict cost-benefit requirements. The infrastructure bank could also fund projects that face barriers through the current grant funding system such as projects involving multiple modes of transportation or multiple government jurisdictions.

What We Don't Know— Aside from the note that the funding for her proposal will be achieved through business tax reform, specific information on how the infrastructure spending will be funded is lacking. According to the Tax Policy Center, the total estimated effects of Clinton tax proposals on the corporate income tax amount to only $196 billion over a 10-year period.[3] This increase in revenue covers less than 3/4th of the $275 billion the

proposal is projected to spend over a 5-year period. This does not include other proposals by Secretary Clinton that have very high price tags.

Another vague area in Clinton's proposal is how an infrastructure project will qualify for federal funding. There are many areas that desperately need infrastructure spending and it is essential that this proposal targets the most qualified projects.

Recommendations— Any federal infrastructure proposal needs to focus on economically justifiable projects with a high benefit-cost ratio. The FHWA regularly measures cost-benefit ratios for various infrastructure projects, and this analysis could easily be used to determine a project effectiveness standard for any proposals submitted for infrastructure bank funding. The cost-benefit analysis is seldom used by the federal government to determine if a project is a good investment and decisions are made based on immediate needs and political considerations. To optimize the fund usage, a specific benefit-cost threshold for a project should be considered. For example, using FHWA information, requiring a minimum benefit-cost ratio of 1.5:1 would cover roughly 94 percent of the economic benefits for only 76 percent of the total costs.[4]

Another criterion that a federal project should be required to meet is a national or regional benefit. If most or all of the benefits of a project are local, then it is in the best interest of the state and local governments to manage and fund the project, not the federal government. Secretary Clinton does note the importance of the national and regional benefits but without a requirement to promote national connectivity, it is hard to keep the program accountable.

A cause for concern in Secretary Clinton's proposal is that the overall economic impact is not as advertised. Clinton's campaign claims that for "every dollar of infrastructure investment leads to an estimated $1.60 increase in GDP the following year and twice that over the subsequent 20 years."[5] This estimate is moderately greater than the CBO's $1.30 midpoint estimate of short-term output.[6] The inflated estimate used by Secretary Clinton will result in a much lower short-term economic impact than projected.

Another issue to consider is the use of federal funds for transportation projects in general. Research from AAF dives into the issue of the unpredictable future of federal transportation funding. One alternative to federal funding is replacing it with more private sector involvement. The government can facilitate private sector activity through already existent mechanisms such as increasing funding provided under TIFIA, increasing the cap on the amount of tax-exempt private activity bonds that can be issued to finance highways, and authorizing tax preferred bonds for public-private partnerships for specific projects.

Conclusion

Concerns about U.S. infrastructure deficiencies have prompted policymakers from both parties to focus attention to funding proposals. This year's presidential campaign is no exception. An effective policy on infrastructure spending will focus only on projects with a clear economic growth impact and a significant benefit-cost ratio. It will place a priority on successful public-private partnership models, and fund only targeted efforts that either significantly benefit economic activity or have a clear federal role. A more detailed guideline on the selection process for plans is necessary for proper evaluation, and to understand how an infrastructure bank proposal is not ultimately a new version of big government, tax and spend politics.

[1] “The Macroeconomic and Budgetary Effects of Federal Investment,” https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51628-Federal_Investment-OneCol.pdf

[2] “Hillary Clinton’s Infrastructure Plan: Building Tomorrow’s Economy Today,” https://www.hillaryclinton.com/briefing/factsheets/2015/11/30/clinton-infrastructure-plan-builds-tomorrows-economy-today/

[3] Auxier, Richard; Burman, Leonard; Nunns, James; & Rohaly Jeffrey, “An Analysis of Hillary Clinton’s Tax Proposals,” http://www.taxpolicycenter.org/publications/analysis-hillary-clintons-tax-proposals/full

[4] “Approaches to Make Federal Highway Spending More Productive,” https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/50150-Federal_Highway_Spending-OneCol.pdf

[5] “Hillary Clinton’s Infrastructure Plan: Building Tomorrow’s Economy Today”

[6] “Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output in 2014,” https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/49958-ARRA.pdf