The President's Economic Recovery Advisory Board

MEMORANDUM FROM THE PERAB
DATE: December 4, 2009
SUBJECT: Infrastructure Investment and the Creation of a National Infrastructure Bank

I. Introduction

1. Infrastructure Spending, the Economic Recovery and Jobs

Many economists believe that as our economy begins to recover from its deep recession, economic growth will be slow and employment growth even slower, extending over years. The unemployment rate will remain high and many workers will be forced to accept part-time work because full-time work is not available. The construction sector will be the hardest hit as the overhang of residential and commercial property continues to discourage new private-sector construction projects.

The PERAB believes that infrastructure spending by the federal government can boost the growth of output and employment during the extended recovery period. There are several reasons for this belief.

First, macroeconomic models indicate that $1 of infrastructure spending boosts GDP by $1.59. A dollar of government spending on infrastructure has a larger effect on GDP and employment than many other kinds of government spending. Many of the jobs created through infrastructure spending are in the construction industry and related sectors that have sustained the largest job losses (about 25% of the total).

Second, as a result of severe budgetary constraints on state and local governments, there will continue to be a large backlog of economically justifiable infrastructure projects that can be quickly mobilized to employ workers if federal funding is available. State and local governments account for 75% of public infrastructure spending and many of these governments are under severe fiscal strain. Projects involving substantial public benefits that cannot be fully captured through user fees or that cross state boundaries are particularly unlikely to be funded by state and local governments in this economic climate. If the federal government does not provide adequate funding, we will forego the opportunity to build important infrastructure projects while spurring economic recovery and creating jobs.

Third, infrastructure projects often take well over two years to complete, so federally funded projects initiated in 2010 will provide ongoing fiscal support during the multi-year recovery period.

Fourth, federal spending on economically justifiable infrastructure projects will strengthen the foundation for future growth once the economy has recovered. The PERAB believes that the boost in employment that will accompany increased infrastructure spending is only one part of the equation—equally important is the quality of jobs created. As we build new institutions to compete in a 21st century economy, we need to ensure that we create the kind of well-paying jobs with excellent benefits that will rebuild our middle class.

2. Infrastructure Spending, Productivity and the Economy's Long-run Growth

There is broad agreement among experts and business leaders that spending on physical infrastructure—primarily transportation, water and sewage, and energy—is not sufficient to meet the nation's long-term needs. Infrastructure spending in real inflation adjusted dollars and adjusting for the depreciation of existing assets is about the same level now as it was in 1968 when the economy was one-third smaller.

- Congestion and traffic delays wasted over 2.8 billion gallons of fuel and cost an estimated $87 billion in 2007.
- Freight bottlenecks cost about $200 billion or 1.6% of GDP per year.
- In a recent assessment, the American Society of Civil Engineers (ASCE) gave the United States a grade of "D" on its transportation infrastructure.
- Lagging infrastructure saps the productivity of American companies competing with foreign companies operating in emerging nations with lower costs and newer infrastructure.

Expert assessments differ on the size of the shortfall in spending on physical infrastructure, but there is widespread agreement that the current level of spending is far below what is necessary to meet the nation's long-term needs. The ASCE estimates that infrastructure investment has to double to $2.2 trillion over the next five years to bring the quality of the nation's infrastructure to good condition. Even a 2008 CBO study based on conservative economic assumptions identifies about $185 billion a year of real government spending on transportation infrastructure alone that is justifiable on economic grounds—a 75% increase over current spending levels. Finally, the nation would benefit from more rigorous, transparent and consistent project selection methods than those currently used by both state and local governments and the federal government.

The PERAB believes that the current level of infrastructure spending is insufficient to meet the nation's growing infrastructure needs and supports a sustained and significant increase in infrastructure spending to boost future economic growth and competitiveness. For the reasons discussed below, the PERAB believes that the creation of a National Infrastructure Bank would help achieve important efficiency and funding objectives. The goal of the Bank is not to displace existing infrastructure spending. It is to help garner additional funding for worthy projects that would not otherwise be undertaken. We recognize that a NIB will not be able to fully close this country's infrastructure spending gap. Other initiatives will still be necessary to complete this important task.

II. Recommendations for a National Infrastructure Bank

The President's FY 2010 budget includes funding of $25 billion over the next five years to capitalize a National Infrastructure Bank to invest in large infrastructure projects that promise significant national or regional economic benefits. The PERAB supports the NIB idea, and recommends a higher initial capital base. We believe that an appropriately designed, governed and funded NIB would address several shortcomings and gaps in current federal, state and local government processes for funding infrastructure investment. Addressing these shortcomings and gaps would both improve the efficiency with which public infrastructure funds are allocated and increase available infrastructure funding by enabling public infrastructure projects to tap a broad pool of capital in a cost-effective manner for projects that would not otherwise be funded.

1. Despite the efforts of Congressional leaders committed to addressing the infrastructure gap, federal infrastructure funding is subject to volatility based on legislative timetables and shifting fiscal priorities. A multi-year commitment of funds to capitalize the NIB would provide greater certainty to the selection, planning and funding of large, long-term projects that often involve the deployment of complex technologies.

2. Existing federal infrastructure programs are not well-suited to funding regional or cross-state projects of national significance. The NIB would play an important coordinating role among the various state, local, Congressional and private sector actors that participate in such projects.

3. Infrastructure projects are typically long-lived public goods with significant positive externalities, but current federal programs and project selection processes sometimes overlook the effects of infrastructure decisions on broader policy goals. The NIB would consider related policy goals in its assessment and selection of projects. Allocation of infrastructure funds should strive for the maximum impact both on the nation's infrastructure needs and on the nation's need for middle class jobs. In this context, it is essential that the financing of infrastructure projects be designed to tap the highest-value capital available for a given project.

4. The NIB would choose projects based on transparent and fact-based selection processes supported by consistent cost/benefit analyses. These analyses would account for the range of externalities associated with transformative projects—including requirements for quality construction and maintenance, and the larger economic benefits that flow from well-designed infrastructure projects.

5. The NIB should consider a range of funding and project delivery alternatives—including private sector co-investment—and select the alternative that delivers the highest-value financing available to meet the NIB's objectives. A goal would be to leverage private lending with public financing on a project-level basis. Where this is not possible, the NIB board could consider private sector co-investment in public infrastructure where it could convincingly increase the overall availability of capital for a given project, improve the quality of services delivered, and appropriately share the returns and risks between the public and private sectors.

The NIB should supplement, not supplant, other infrastructure funding sources such as municipal bonds, sector specific programs (e.g. Transportation Infrastructure Finance and Innovation Act) and the Green Bank (CEDA). All of these sources should provide adequate public funding to support economically justifiable projects. Tapping into multiple funding pools targeted at different kinds of projects with varying risk and returns would likely expand the overall pool of capital available for infrastructure. In addition to the NIB, the Administration and Congress should explore steps to repair the market for tax-exempt state and local bonds.

Finally, the PERAB recognizes that the jobs impact of infrastructure spending is heavily dependent on the extent to which the supply chain for infrastructure spending also generates jobs. As such, some members have called for a larger national strategy for developing industrial capacity in areas such as high speed rail components and specialty steel to leverage the impact of infrastructure spending both on job creation and on long-term national competitiveness and industrial recovery. Others are convinced the supply base needed to support more infrastructure spending will develop naturally once businesses become confident the financial support for such spending is in place.

III. Guidelines for the design, governance and funding of the NIB.

1. **Structure**: The NIB should be structured as a wholly-owned government corporation or independent federal agency. Financing costs will be lower and management incentives more closely aligned with public interests if the NIB is a government-owned entity, operated as an independent agency. This structure avoids the conflicting incentives of quasi-government agencies like the GSEs. The NIB would have no private sector shareholders and would not use private sector compensation models.

The NIB's independence is critical since it allows for fast, transparent, and fact-based project selection supported by conventional and consistent cost-benefit analysis. The governance structure of the NIB should reflect the broad range of constituents involved, including private sector representatives, labor officials, environmental representatives, and representatives of various levels of government. The NIB needs to operate with stakeholder input, public transparency and accountability.

In addition, the unpredictability of the appropriations process is not well suited to long-term infrastructure projects that need coordination across states or regions or across different types of infrastructure like highways, bridges, rail and air transit. Given the size and time horizons of infrastructure projects of national significance, the safety factors involved, and the complexity of the technologies, a specialized agency with enduring and independent guidance is warranted. After the initial infusion of capital from the Treasury, the NIB should be self-sustaining to provide for long-term continuity, independent of the appropriations process.

2. **Equity Capital Financing**: The Administration proposed, and the PERAB recommends, providing federal funds for the NIB's initial capital base. A flexible set of financing tools, including direct loans, loan guarantees and grants would allow the NIB to use its capital to provide the most appropriate forms of financing to a given project.

The PERAB benefited from examining a wide range of other models for capitalizing the NIB, including the National Infrastructure Development Bank Act supported by Congresswoman Rosa DeLauro and the European Investment Bank. The PERAB discussed whether the NIB should be allowed to leverage its initial capital injection from the Treasury through the provision of additional callable Treasury capital. Additional callable capital—to be paid only if needed—would increase the funds available for NIB projects. Since paid-in and callable capital would both properly be thought of as contingent obligations of the federal government, we recommend that the NIB capital base not include callable capital and instead be funded directly with a transparent outlay.

3. **Debt Issuance:** The PERAB debated whether the NIB should issue debt on its own in addition to project-level borrowing. Given concerns that the market would perceive an implicit government guarantee behind NIB bonds, the PERAB recommends that the NIB not have the authority to issue general debt.

4. **Private Sector Co-Investment and Public-Private Partnerships:** The NIB should focus on projects with substantial public benefits and should seek to finance these projects with the lowest-cost, highest-value capital available for that project. Projects should access private capital

primarily through fixed income vehicles. Going beyond that to actually shared equity, there should be clear processes and procedures to ensure that any project with substantial private ownership has been shown to produce benefits to the public, as well as clear mechanisms for public oversight of the project throughout the project's life.

Some members of the Board believe that a substantial number of investors would be interested in providing co-financing for NIB projects. In addition to the $180 billion in infrastructure equity funds raised to date, U.S. pension funds have an estimated $49 billion allocated to infrastructure investments.

5. **Scope:** The PERAB believes that the NIB should focus on projects of national or regional significance. Often, such projects will be regional or cross-state projects that are neglected by current allocation processes and that involve complex coordination among many public and private actors. The NIB should choose projects on the basis of transparent and fact-based selection processes and cost-benefit analysis. The breadth and depth of a project's impact should be evaluated comprehensively. The PERAB recommends interpreting the mandate of what constitutes an infrastructure project broadly to include a broad spectrum beyond one specific category such as transportation.

6. **Revenue model:** The PERAB recognizes that a variety of circumstances go into the mix of user fees and general tax revenues that fund infrastructure projects. Some types of projects, like high speed passenger rail, will be more highly reliant on user fees than others. While user fees can encourage the more efficient use of infrastructure projects by ensuring that users pay for projects, some members observe that they also result in a more regressive method of funding projects from the perspective of income distribution. In extreme cases this can lead to infrastructure that is only useable by the affluent. Given these considerations, NIB projects should generate returns from user fees (e.g., tolls on roads and bridges and fares from high speed trains) where feasible. For projects that do not fit the user-fee model, or where user fees are insufficient, the NIB should consider "availability payments" from states and local municipalities willing to co-fund or provide revenue guarantees on projects to make them feasible for the NIB. Grants made by the NIB would be limited to funding pre-development costs (e.g., environmental and feasibility studies) where private financing would otherwise be unavailable.

The PERAB recognizes that the NIB will not be sufficient to meet our nation's infrastructure needs on its own. This proposal should not be seen as a substitute for general federal funding of infrastructure development.

7. **Labor Standards:** Given the ongoing economic crisis and forecasts of an extended period of high unemployment, a National Infrastructure Bank should have an explicit goal related to job creation included in its charter. To this end, we recommend that the NIB take a leadership position with respect to wages and benefits for the jobs created with its financing. Some members of the Board insist that all projects supported in any manner by the NIB should be subject to the Davis-Bacon Act in the construction phase, and subject to responsible employment standards and contracting procedures in the operations phase. Other members feel that such a requirement would prohibit developers from undertaking important projects and recommend omitting the requirement from the NIB guidelines.