Republicans Plan Bait and Switch on Infrastructure

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The Trump administration wants better infrastructure, but doesn't want to pay for it. Instead, the administration's long-awaited plan is expected to shift responsibility for infrastructure onto the private sector and cash-strapped state and local governments.[1]

The administration plans to move funding away from successful existing programs, resulting in no net increase in federal infrastructure investment.[2] In addition, its blueprint reportedly does nothing to shore up the Highway Trust Fund, which funds highways and public transit projects across the country and is running an annual deficit of $15 billion.[3] President Trump's FY 2018 budget charted a similar path, cutting more in infrastructure spending than it added, and eliminating critical infrastructure programs including TIGER and New Starts.[4]

There is near universal agreement that the nation needs a major investment in upgrading and maintaining our infrastructure, and that current funding levels are not sufficient to meet the need. Simply hoping that states, localities, and the private sector will close this gap is unrealistic.

By contrast, Senate Democrats have proposed $1 trillion in new federal investment to modernize the nation's infrastructure.[5] The Democratic plan calls for rebuilding and maintaining roads, bridges, ports, water systems, rail transit and airports, making investments in 21st Century clean energy, expanding access to broadband internet, modernizing public schools and VA hospitals, and investing in public lands and tribal infrastructure.

It is Unrealistic to Expect States and Cities to Foot the Bill

The Trump administration is reportedly looking to shift the burden of investing in and maintaining infrastructure onto state and local governments, requiring them to shoulder 80 percent of the cost of infrastructure investments.[6]

State and local governments are resource-constrained

State and local governments will be hard pressed to take on more infrastructure responsibilities. Already, state and local governments account for more than three-fourths of all infrastructure spending.[7] And states are not awash in cash. Twenty-two states faced revenues shortfalls in 2017, partly a result of declining oil prices in energy-producing states and tax cuts in others.[8]

States also face about $1.1 trillion in unfunded pension liabilities, including three states with net liabilities exceeding $100 billion. This gap between assets in state pension funds and benefits owed to workers is expected to increase by $350 billion over two years.[9] States which face growing pension funding gaps may find it harder to issue debt to finance a range of projects, including infrastructure.[10]

The Republican tax bill adds new fiscal pressures

The Republican tax legislation will present new fiscal challenges for states in 2018, as deductions for state and local sales, income and property taxes are capped at $10,000 in the new tax law. This will make it difficult for states to levy new taxes for increased infrastructure investments.

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In addition, the Republican legislation increases the costs on states and municipalities of raising money for infrastructure through tax-free municipal bonds. By lowering the tax rate for wealthy individuals and corporations, both of whom are large investors in municipal bonds used to finance infrastructure projects, the legislation reduces the value of these tax-free bonds. States will have to pay higher rates to attract the same investment.[11]

Federal investment is key to modernizing infrastructure

Some states and communities are still recovering from the recent recession and are not well-positioned, by themselves, to make needed infrastructure investments. This is especially true in rural, less populated regions.[12] As the economic gap between large and small communities continues to widen, relying on state and local governments to fund the overwhelming majority of infrastructure may contribute to these communities falling further behind.

At the same time, all states face difficulties funding infrastructure during economic downturns because of balanced budget requirements and other fiscal constraints. Even if a state is able to increase funding for infrastructure when the economy is going well, this funding is often at risk during recessions when tax revenues fall and spending needs, such as unemployment insurance, increase.[13]

Revenue fluctuations are especially challenging for the 22 states that fund infrastructure on a pay-as-you go basis rather than using a separate capital account that is exempt from balanced budget requirements.[14] If the federal government were capped at contributing 20 percent of a project's funding, as proposed in the leaked administration plan, federal funding would decline as states balance budgets and cut investment in future recessions. This would compound states' challenges during difficult economic times and feed into recessions.

States and localities would underinvest because they do not capture all infrastructure benefits

Relying on state and local governments to drive investment could result in fewer interstate projects and investments that have broad regional benefits. The positive effects of an infrastructure project, including less congestion, more economic development and higher tax revenues, often extend beyond municipal and state lines. One study found that only 20 percent of the total effects of public investment in U.S. highways occur in the state where the highway is located.[15] States and municipalities may be unwilling to foot the majority of the bill on a project where the benefits accrue mostly to other areas' residents, leaving many important projects unfunded in the Trump plan.

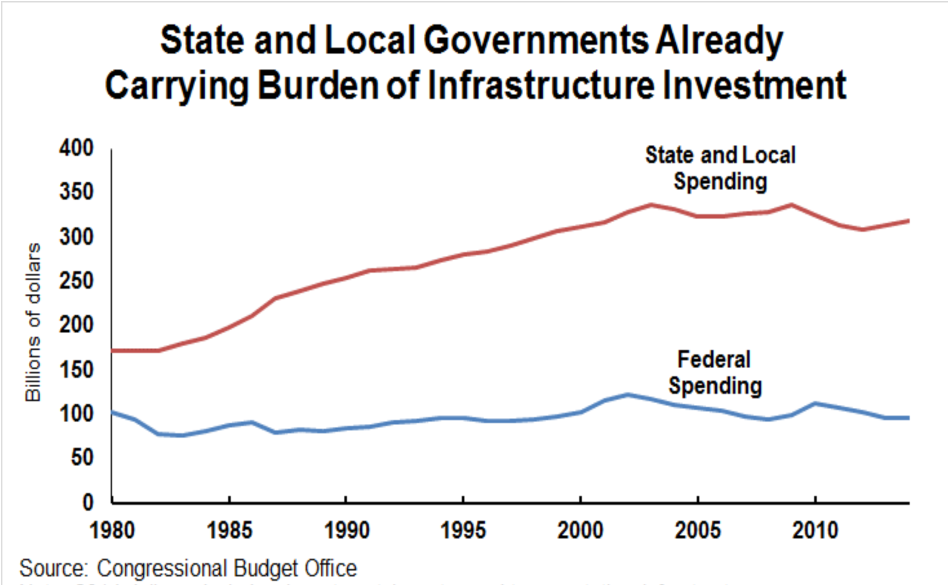
States and local governments are already investing heavily in infrastructure

State and local governments accounted for 77 percent of spending on transportation and water infrastructure in 2014, with the federal government's share of spending at 23 percent. State and local governments fund the overwhelming majority of operations and maintenance – 88 percent in 2014 – and their operations/maintenance spending was almost twice as great as their capital spending – $208 billion vs. $112 billion.[16]

The federal government's investments are concentrated in capital investments (investment in new equipment and structures or rehabilitation of existing structures/equipment). In 2014, the federal government spent more than twice as much on capital expenditures ($69 billion) as it did on operations and maintenance ($27 billion). Overall, the federal government accounted for 38 percent of capital investment in infrastructure in 2014.[17]

As infrastructure needs have grown over the past 35 years, federal investment in infrastructure has barely budged while state and local spending has nearly doubled. If the federal government invested the same amount as a share of GDP in 2014 as it did in 1980, it would have invested an additional $158 billion.[18]

Spending on infrastructure has also started to decline at the state and local levels over the past decade. From 2003 to 2014, state and local spending on infrastructure, after adjusting for inflation, declined by 5 percent and federal investment fell by 19 percent.[19] Reversing the federal decline, rather than asking the states to do more, should be a top priority.



Source: Congressional Budget Office
Note: 2014 dollars. Includes investment in water and transportation infrastructure

Public-Private Partnerships

Press reports about the Trump infrastructure plan also indicate that the administration will rely heavily on public-private partnerships (P3s).[20] P3s have played only a limited role to date in transportation infrastructure in the United States. Relying on a massive influx of new P3s is risky and ignores the significant gap between investors' motivations in financing infrastructure projects and the public interest. Even President Trump recently expressed reservations about relying on P3s according to a White House official who said, "He doesn't think they will work."[21]

P3s can make available additional resources to finance infrastructure, which is especially important when state and local budgets are strained. But there is a tension between the government's interests and those of private investors or operators. The government wants to provide good transportation options, reduce congestion, and ensure that its infrastructure supports economic development, among other objectives. The private entity wants to maximize its profit. These interests sometimes overlap, but not always. And, often, as seen in examples below, it is taxpayers who end up squeezed, paying new tolls, higher fees, and other charges levied by private companies.

There has been limited P3 success in United States

Only 14 highway projects were completed using public-private partnerships between 1990 and 2014, according to the Congressional Budget Office. Three of the 14 declared bankruptcy.[22] One of the other completed projects, the Dulles Greenway, failed to meet revenue projections, when fewer cars used the new road than had been projected. The contract had to be renegotiated.[23] Including all P3 highway projects either completed or underway during the past 25 years accounts for less than one percent spent on highways during this period, according to CBO.[24]

Previous analysis by JEC Democrats shows that financing infrastructure through tax credits to private investors can also cost nearly 55 percent more than traditional infrastructure financing.[25] In fact, because states are able to finance infrastructure projects relatively inexpensively through tax-exempt municipal bonds, the P3 market has been slower to develop in the United States than in other countries.

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While there may be room to increase the usage of P3s in the United States, it is unrealistic to expect a large enough increase in projects to account for the level of investment that the economy needs or the administration is promising. It takes time for state and local agencies to develop expertise and processes for bidding out, selecting, implementing, and operating a partnership.[26] As past projects have demonstrated, they are only successful in particular circumstances, as well.

Many important projects would be ignored by the private sector

Relying on private investors to address the nation's growing infrastructure needs means that many important projects that do not deliver returns attractive to investors simply would not happen. For example, a highway serving rural areas with little traffic would not be able to generate the toll revenue needed to attract private investment. Urgent repairs and maintenance are also unlikely to satisfy investors' demand for high returns and would go unfunded. In fact, it is estimated that close to $200 billion annually is needed just to maintain the nation's road and bridges.[27] Adding tolls to existing roads in order to draw in private entities willing to repair and maintain them would be an unpopular approach.

P3s are often anti-competitive

The long terms of some P3 agreements, sometimes up to 99 years, can limit the options of policymakers well into the future. These agreements may include non-compete clauses which limit improvements to existing infrastructure near a P3-operated road or prohibit the construction of additional transportation options.[28] The lack of competition allows the operating company to raise toll rates substantially once the project is up and running. This has already played out in the relatively limited U.S. experience with P3s. For example, costs on the Indiana Toll Road, operated under a P3 agreement, jumped from $4.65 to $8 for a car travelling the whole road.[29] Federal taxpayers can also be exposed to risk. Since many P3s receive federal loans through the Transportation Infrastructure Finance and Innovation Act (TIFIA), federal taxpayers can be on the hook if the private entity is unable to service the loans.[30]

Examples of challenges with P3s

Despite the limited experience with P3s, challenges already encountered are instructive. To minimize risks, investors often negotiate deals that leave the public exposed to the costs of any hiccups, involve punitive non-compete clauses, or constrain the decision making of future elected officials.

- Users of the Chicago Skyway faced toll increases when ownership moved to a private operator. When it was publically operated, tolls decreased by about 25 percent in real terms between 1989 and 2004. In contrast, under private control, tolls increased by nearly 60 percent in real terms from 2005-2012.[31]
- State Route 91 in southern California provides another cautionary tale. A P3 was created to reduce congestion on State Route 91. It carved out a 4-lane toll road within the highway that allowed drivers to pay for a faster road and included congestion pricing, where rates would vary with traffic. However, the lease agreement to provide the toll road blocked the state from making repairs, adding a lane or improving public transit—actions that could have reduced traffic volume and revenues on the toll road. After

spending years in court, the Orange County Transportation Authority ended up having to buy the toll lanes for $208 million in 2003 to move forward with a highway overhaul.[32]

- In Virginia, a non-compete agreement means that taxpayers could be on the hook for up to $774 million. The public-private partnership to fund the Norfolk Midtown Tunnel in Virginia conferred a monopoly position to the private investor, with a non-compete clause allowing the company to receive payments from the Virginia Department of Transportation (VDOT) if they make improvements to “alternative facilities” or infrastructure options that would cut into the profits of the Midtown Tunnel. One estimate places these payments between $269 million and $774 million over the life of the contract.[33]
- The state of Indiana helped people escape flooding on a privately operated road and ended up owing the private toll operator. The state (i.e. taxpayers) had to pay a private toll road operator nearly $450,000 in 2008 because it waived tolls to help residents escape during a flood emergency.[34]
- In 2017, the state of Indiana stepped in at additional taxpayer expense to take over a failing P3 that had been formed in 2014 by then-Governor Mike Pence to build a highway connecting Bloomington and Martinsville. The scheduled completion of the I-69 extension was pushed back to August 2018, nearly two years after the original completion date. Costs are expected to increase by an estimated $164 million. The Indiana Finance Authority took over control of the project, issuing debt to finish it. Taxpayers were responsible for the costs of both creating and ending the P3.[35]

These examples offer reason for caution when determining the appropriate role of P3s in rebuilding and modernizing the nation’s infrastructure. It is not clear when the Trump administration’s infrastructure plan will be released or the exact policy proposals it will include. Some reports suggest that the administration plans federal investments in rural America. Such investments are badly needed and would likely receive bipartisan support. But the scope of investment contemplated by the administration would not meet the need in rural areas across the country. Connecting rural communities to broadband, upgrading water and sewer systems, and modernizing schools requires a significant federal investment. Based on what is known at this point, the administration’s plan falls short.

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