# NATIONAL INFRASTRUCTURE BANK:

## *A PILOT PROJECT PROPOSAL*

***Summary.*** There is a growing consensus that infrastructure investment should be part of any broad-based recovery plan to address the current U.S. economic downturn. If done strategically, infrastructure investment can create and retain good-paying jobs right away while laying the foundation for achieving long-term national goals – economic competitiveness, energy independence and reducing carbon emissions.

The National Governors Association (NGA) currently estimates that at least $136 billion in transportation, water and school projects could go to construction in the next 24 months, putting hundreds of thousands of Americans to work. Adding energy and other investment categories yields an even larger number.

However, to ensure the highest short- and long-term return on our investment, we must begin now to implement necessary reforms to our national infrastructure policy. The U.S. can no longer afford to funnel scarce public dollars through the same old programs which lack innovation, accountability, market discipline and a coherent national purpose.

Furthermore there is a growing federal deficit and a Highway Trust Fund that has run out of money, and as a result, there is an immediate need for new and creative approaches to financing infrastructure. At the same time, it may take as long as two years to complete the next surface transportation bill. As such, Building America's Future believes that a national infrastructure bank should be piloted as part of the economic recovery proposal likely to pass in early 2009.

The proposed economic stimulus legislation provides an ideal opportunity to start reforming the existing infrastructure programs by keeping our system in a state of good repair and investing in projects that foster energy independence and economic growth, reducing red tape and bureaucratic delays, and strengthening accountability at the state and local level.

But there are significant hurdles to those reforms. In federal surface transportation policy there is a lack of performance goals, transparency and accountability, and often a failure to promote projects that offer the best solutions to meeting broad national transportation goals, as well as extensive earmarking of projects of little or no merit. The U.S. also lags behind many other countries in its use of pricing and tolling mechanisms to manage demand and generate revenue. And our national infrastructure policy overall is stovepiped and incoherent, funneling funds to each program separately – highways, transit, wastewater, energy, housing – when a cross-cutting approach is needed to solve some of our nation's more difficult challenges.

While there is a broad coalition of groups such as Building America's Future that are committed to reforming our nation's infrastructure policy, part of the solution is to "think outside the box" of existing failed programs and seize opportunities such as the economic recovery bill to try creative approaches, such as a national infrastructure bank, as proposed by the incoming Obama Administration and Members of Congress, including Senators Chris Dodd, Chuck Hagel, Congressman Keith Ellison and others.

Rather than create a full-fledged bank, the economic recovery package could instead propose a more limited pilot version of the concept, identifying the core powers the bank will need, setting basic policy goals, and providing an initial *tranche* of funding. The process of setting up such a pilot project will naturally identify the technical and policy issues that will need resolution before a final structure is adopted, and these issues can be addressed legislatively at the appropriate time. But starting now allows these issues to be identified even as projects are funded and work gets underway. If necessary, a two-year limit on this pilot project phase could be adopted to assure that the core issues will be revisited before anything is set in stone.

Starting the bank with such a pilot project phase can be the venue for our nation to make a clear commitment to new, creative thinking in infrastructure policy right away. This effort could kick off with as little as $5 - $15 billion.

***Background.*** The concept of a national infrastructure bank first surfaced in the 1980s as a means of lowering barriers that prevented private capital from investing in infrastructure. The original vision was that targeted public support for financial tools such as loan guarantees, bond insurance, low interest loans and other credit enhancements, would leverage significant private investment. This in turn would expand the number of projects that could be built and use a more traditional project finance model, which would consider return on investment while insulating the project evaluation process from political interference.

Recent developments have shown both the strengths and weaknesses of this framework. As envisioned, private capital is now moving to the infrastructure market (Indiana Toll Road, Midway Airport, etc) in the U.S., but mainly to projects with reliable streams of revenue, especially toll roads, and therefore in least need of public investment. And, in truth, this market has grown without most of the financial tools described above.

This clarifies a key limitation of the early model: many vital infrastructure projects will not have sufficient revenue streams to entice private capital unless a new model is developed. For example, there is a huge backlog of road and bridge reconstruction projects where it has not been politically feasible to impose tolls or congestion pricing to cover project costs. Likewise, there are a number of transit, rail, water and energy projects where there is a gap between what users are able or willing to pay and the societal benefits – be they economic or environmental – that the projects will yield upon completion.

A national infrastructure bank could play a key role in financing those types of projects, including providing financial "carrots and sticks" for states and localities to use pricing and tolls to generate additional revenue.

***What To Fund.*** As it evolves, the bank should allocate funds using a merit-based assessment of individual projects, without favoring one mode or method over another. The bank should also be scrupulously free of political pressure in its project selection process, along the lines of the Base Closure and Realignment Commission (BRAC) model. This would create a healthy level of competition among states, cities and other projects sponsors to develop projects that achieve the best results and take a major step toward discarding our current system of outmoded formula allocations and earmarking, all while assuring that existing national standards – labor, environmental, etc. – are met.

To make the process clear, performance should be assessed against criteria that relate directly to important national goals and specifically accelerate the transition to a 21st century clean, green economy. This will be necessary to prevent funds from being spent on projects that have strong local support but few broader benefits. To keep things simple, in the interim eligibility would be limited to projects that meet at least one of the following criteria:

1. bring existing assets to a state of good repair;
2. improve the sustainability of the economy, measured by reduced energy consumption or reduced carbon emissions;
3. improve our economic competitive position in the world.

These simple criteria could encourage some projects and discourage others: upkeep of existing assets would be preferred over new construction except where national economic interests are at stake. Projects that support smart growth, freight rail and energy efficiency could take precedence over projects that perpetuate the cycle of more roads, more sprawl, more driving and more carbon emissions.

***More Than A Bank.*** Ideally the national infrastructure bank would have some access to the tools described above – loan guarantees, low interest loans, and bond insurance. This would allow it to participate in public-purpose projects that use market mechanisms like tolling and pricing to raise revenue and manage demand.

But to be fully effective it will also need the ability to fund projects where direct returns are not possible, where the payback is the economic growth that smart infrastructure investment enables. Even so, there could still be a strong role for private capital in such projects. Under one possible model, this could come in three areas.

- *First* are public-private partnership (PPP) projects like the lease of the Chicago Skyway or Indiana Toll Road where there is a revenue stream suitable to spur private investment. Given the strong private market for these projects the bank may not need to make major interventions. This would be determined by the dynamics of individual projects.

- *Second*, the bank could attract private capital where the return on investment comes through federal tax credits when project revenues are either insufficient or absent. This structure could have advantages related to earmarks and scoring. Using private capital creates a barrier to congressional earmarking not present when appropriated funds are used. And using tax credits rather than appropriations to support the bank opens the door to capital budget-style scoring, i.e., scoring long term capital investments one year at a time rather than at the full cost up front.

– *Third*, deriving funding from private sources even for projects without their own revenue streams opens the door to non-traditional projects that blur the line between private investment and public infrastructure. In addition to the much needed investments in basic infrastructure – roads and bridges, water systems, etc – the public-private model can include a wide variety of more innovative projects that have both public and private benefits but have been tough to fund with purely public dollars. Exactly how and where the bank's participation in projects of this kind is appropriate would be worked out in the bank's pilot phase.

***How To Pay For It***. A key to funding a national infrastructure bank is capital budgeting, where the costs of a valuable asset are accounted for over its useful life of 20 or 30 years instead of all up front. Applying this principle to an infrastructure bank pilot project will allow it to get started without a dramatic effect on the Federal deficit in the short term. New spending would have to be paid for eventually, but even this could be blunted if the bank is allowed to invest the proceeds of its borrowings in market instruments at market rates without regard to Federal tax code restrictions on arbitrage.

Granting the bank preferred status in these two areas – capital budgeting and arbitrage rules – could allow it to become nearly self-sustaining. This will take time so an upfront cash infusion would be required even if these tools are applied. The specifics of how to actually structure a bank that takes advantage of these powers is too complex to describe in this short summary, but much preparatory work has been done and a more detailed proposal can be provided as desired.

***Conclusion.*** An infrastructure bank pilot project could be quickly established with the power to raise funds from the private sector, pledge Federal tax credits to bondholders, and finance public and public-private ventures. Its chartered purpose would be to bring existing infrastructure assets up to a state of good repair and invest in new assets that increase sustainability and improve economic competitiveness, and promote a more market-driven and less political approach to project selection, pricing and investment.

The core of this entity could be created as a pilot project in the economic recovery bill and given two years to begin working before a fuller debate is held over its exact needs, powers and duties. Funding for the pilot phase would be a mix of direct appropriations and the authority to pledge Federal tax credits and could range from $5 to $15 billion.

Building America's Future believes that a national infrastructure bank could be a creative solution to some of our nation's most pressing infrastructure challenges and that the current economic crisis presents a unique opportunity to jump start its establishment. We hope to work further with the Administration and Congress to craft such legislation for inclusion in the next economic recovery package.