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The Limited Benefits of a National Infrastructure Bank

Testimony before
The Subcommittee on Highways and Transit
The Committee on Transportation and Infrastructure
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My name is Ronald. D. Utt. I am the Herbert and Joyce Morgan Senior Research Fellow at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

Until recently, federal interest in infrastructure banks has been limited to legislation focusing on the creation and funding of *state* infrastructure banks, several of which were created in the 1990s and are still in operation. Recently, congressional focus has shifted to a federal infrastructure bank or a related financing facility, and several bills have been introduced in Congress to create such an entity. Added to the many congressional initiatives are the several plans that President Barack Obama has proposed since taking office.

What these federal-level proposals all have in common is the goal of attempting to muster a greater volume of financial resources for various types of infrastructure, but beyond that they all differ significantly in how they would operate, who would run them, the volume and source of funds, what they can invest in, and what types of infrastructure would be eligible for support.

Some would be limited to just transportation infrastructure; others would allow investments also in water supply and treatment, housing, energy, and environment; and still others would focus on infrastructure with a social welfare intent. Some would be funded by appropriations only, while others would have a mix of appropriations and debt. In some, this debt would be guaranteed by the federal government; in others, it would not. Some would provide loans, loan guarantees, and grants, while others would provide only loans and loan guarantees.

Some of the bills have changed significantly from session to session. The White House has offered at least three different proposals, the most recent being the American Infrastructure Financing Authority included in the American Jobs Act proposal.

I have read the legislative language (or discussion drafts) that would create these banks and finance facilities and have concluded that there is little added value from any of them beyond what could be achieved by modest alteration in existing transportation programs. What value there is could be more than offset by the problems that could emerge from such entities. The reasons for this skepticism are as follows.

The Checkered History of Federal Finance Facilities

Beginning in the 1930s, the federal government created a number of bank-like entities and credit insurance facilities, and every one of them has been challenged by serious, if not catastrophic, financial failure that often involved costly taxpayer bailouts. They include the Federal Land Banks, Farm Credit Administration, Federal Housing Administration, Federal Deposit Insurance Corporation, Federal Savings and Loan Insurance Corporation, Federal Home Loan Banks, and Fannie Mae and Freddie Mac. The latter two are perhaps the most catastrophic of all, with the taxpayer bailout cost totaling about $150 billion so far.

In every case, these entities were believed to have been soundly organized and operated, and they provided loans and guarantees and insurance on products or entities that were also believed to be financially sound. Importantly, these loans and investments also provided a reliable stream of income to fund the federal entity, service its debt, and provide it with the necessary reserves and contingency funds.

In short, they were all deemed to be commercially viable, as were their clients. Yet they all failed in one way or the other despite the top-notch talent thought to be running them.

Could the Bank Avoid These Risks?

In this regard, what is noteworthy about the typical infrastructure bank proposals is that all will begin with risks and deficiencies that significantly exceed those confronting the federal finance entities cited above. Fannie Mae, for example, was supposed to be investing only in conforming mortgages, thought by most to be a safe, conservative investment providing a steady stream of interest and principal repayment.

In contrast, and with the exception of some well-established toll roads, bridges, and tunnels, most transportation infrastructure earns no revenue and must be supported entirely through taxes or related user fees. Most roads are still "free" to users and likely will remain so, while fares earned on even the best-run transit systems cover none of their debt service and only about half of their operating costs.

While a growing share of new transportation capacity underway will be tolled and thus will yield a stream of revenues, "freeways" will likely continue to be the norm. However, even the act of tolling is no assurance that the necessary and sufficient revenues will be there to cover debt service: Over the past decade or so, a number of new toll roads in Virginia, California, South Carolina, and Texas have suffered revenue shortfalls of some significant magnitude. Obviously, a revenue-generating environment of this degree of uncertainty seems likely to impose important challenges to any transportation infrastructure bank attempting to maintain a sound financial footing.

Moreover, those banks that would also make grants would lose money on every grant made, effectively losing both interest and principal the minute the grant is made. This has led one critic to observe that "institutions that give away money without requiring repayment are properly called 'foundations' not 'banks.'"[1] Senator James Inhofe, ranking member on the Senate's Environment and Public Works Committee, likewise noted that:

> Banks don't give out grants; they give out loans. There is also currently a mechanism for giving out federal transportation grants—it is called the highway bill. I don't believe an infrastructure bank will increase total transportation investment—it will only take money away from what would otherwise go through the existing highway and transit programs.[2]

Would It Improve Overall Federal Transportation Policy?

Senator Inhofe makes a very good point by wondering about what the value added would be of creating another federal transportation program (independent of the current one under some proposals) when you already have one that has been up and running for more than half a century

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[1] Ken Orski, "The Transportation Community Braces for Continued Uncertainty and Improvisation," *Innovation NewsBriefs*, Vol. 21, No. 3 (February 1, 2010), p. 2, at *http://www.innobriefs.com/*.

[2] Senator James M. Inhofe, statement before the Committee on Environment and Public Works, U.S. Senate, September 28, 2010, at *http://epw.senate.gov/public/index.cfm?FuseAction=Hearings.Statement&Statement_ID=8cee4317-6930-454a-8ad4-39395bf7cb7e&IsPrint=True*.

and, for the most part, has served the nation well. More specific to some of the infrastructure bank proposals is the emphasis on loans and loan guarantees as opposed to grants, suggesting that the bank will somehow be paid back—a notion about which, as we have seen, we have reason to be skeptical.

Nonetheless, if credit availability is at issue, then a quick review of existing transportation infrastructure federal credit programs reveals that there are plenty of attractive credit programs including the U.S. Department of Transportation (USDOT) Transportation Infrastructure Finance and Innovation loan program (TIFIA), Private Activity Bonds, and State/Municipal/public authority Revenue Bonds.[3] For passenger and freight rail projects, there is also the USDOT's Rail Rehabilitation and Improvement Financing (RFFI) program.

For these concerns, there are questions but not yet any answers.

- If grants were to be provided by the new bank, how would they be different from—or better than—those already provided through the existing mechanisms in USDOT and the highway program?
- If current levels of credit availability for existing federal transportation credit programs are deemed to be insufficient by some, why not propose that these existing channels be improved and/or expanded?
- If spending is thought to be deficient, why not simply provide more grants through the existing mechanism rather than going through the costly and complicated process of setting up and operating a new federal transportation entity, which President Obama's budget estimates would cost upwards of $270 million to create and staff?[4]
- In this era of fiscal austerity and yawning budget deficits, wouldn't there be better uses for this money than a redundant bureaucracy?
- Are the banks' independent status, separate board, funding, and approval process designed to circumvent the existing role that state DOTs and governors have in the allocation of transportation resources?
- Would its independent status and separate board of directors thwart congressional oversight?

I don't think a satisfactory answer has been provided to any of these questions, and certainly none of the existing proposals have addressed them. But they are certainly valid concerns, and Congress should seek answers to them as Members contemplate these many infrastructure bank proposals.

[3] Note that several of these credit mechanisms have been used to considerable success in recent years to fund very large and ambitious transportation infrastructure projects. To finance the new Beltway HOT lanes project, Virginia is providing a grant of $409 million; the U.S. Department of Transportation is providing a "TIFIA" loan of $589 million; another $589 million will be borrowed by issuing private activity bonds (PABs); and the remaining $350 million is an equity investment provided by the joint venture partners. Net revenues earned through variable-rate tolls will be applied first to the PABs and then to the TIFIA loan, and any residual will accrue as profit to the private, joint venture partners.

[4] U.S. Department of Transportation, "Fiscal Year 2012 Budget Highlights," February 2011, p. 22.

Management and Operational Concerns

Previous sections have already touched on the management challenges confronting any of these banks. If these banks are allowed to borrow on their own, or if they are funded by a large, one-time appropriation that can be leveraged into more debt and loan guarantees, it seems that Congress and the President would have little say in what they did and how they did it. Indeed, the nation has already experienced a couple of such incidents, and they are commonly referred to as Fannie Mae and Freddie Mac.

All of the bills to create infrastructure banks include many pages of exhaustive detail on the prospective management structure, a pseudo-corporate board, and its duties. Degrees of independence vary from one proposal to another, but the greater the independence, the more likely it is that the bank may wander away from the changed priorities of future Congresses and Presidents and instead pursue opportunities that are not necessarily in the public interest. In a democratic society where voters periodically get to pick the people and policies that govern them, it might not be appropriate to have entities supported by taxpayers that are not responsive to the voters.

There is also the question of the extent to which some of these infrastructure bank proposals may be designed also to circumvent existing budget controls and spending caps, as well as ongoing oversight. How each of these proposals might be scored is beyond the scope of this testimony, but it is certainly an issue that Congress should carefully review.

Would an Infrastructure Bank Contribute to Jobs and Stimulate the Economy?

For some advocates—especially the President—these banks are seen as mechanisms to propel the economy forward out of the lingering recession into an era of greater prosperity and more jobs. Sadly, all evidence indicates that this just isn't so. As far back as 1983, the General Accounting Office (now the Government Accountability Office) reviewed an earlier infrastructure-based stimulus program and observed that although the program was enacted during the worst of the recession, "implementation of the act was not effective and timely in relieving the high unemployment caused by the recession." Specifically, the GAO found that:

> Funds were spent slowly and relatively few jobs were created when most needed in the economy. Also, from its review of projects and available data, the GAO found that (1) unemployed persons received a relatively small proportion of the jobs provided, and (2) project officials' efforts to provide employment opportunities to the unemployed ranged from no effort being made to working closely with state employment agencies to locate unemployed persons.[5]

Infrastructure-based stimulus programs have been a disappointment, in large part because of time delays in getting programs underway, projects identified and approved, and money spent. More recently, supporters of the American Recovery and Reinvestment Act (ARRA) claimed that it would focus on shovel-ready projects, but USDOT recently reported to this committee that as of July 2011—two and a half years after the enactment of the ARRA—just 61 percent of the

[5] U.S. General Accounting Office, *Emergency Jobs Act of 1983: Funds Spent Slowly, Few Jobs Created*, GAO/HRD-87-1, December 1986, p. 3, at *static/reportimages/3EBDD12EC030CC2F58506D309FCA2E69.pdf*.

authorized transportation funds had been spent. Perhaps contributing to this is the fact that the Federal Railroad Administration required 12 months to set up a mechanism to receive, review, and approve rail infrastructure projects authorized by the ARRA.

In both of these cases, the stimulus funds were being spent through existing federal, state, and local channels by departments, managers, and employees with many years of experience in the project approval business. In large part, these delays are not due to any particular institutional failing but simply to the time it takes to establish guidelines and rules for project submission, for outside parties to complete the request, and for USDOT to review the many requests submitted and pick the most promising, perhaps with modifications, and fulfill the contractual details of awarding the contract. Once the award is made to state and local entities, they in turn must draw up the RFP (and perhaps produce detailed engineering plans as appropriate), put the contract out for bid, allow sufficient time for contractors to prepare bids, review submitted bids, and finally accept the winning contract. It is at this point that money can be spent on the project, and the time that elapses from the beginning to the end of the beginning can easily exceed a year or more.

In the case of an infrastructure bank, such delays will be much longer—perhaps even double that described above. In the case of the above example, the assumption is that the newly authorized stimulus money would flow through an institutional "infrastructure" of well-established channels staffed by experienced people. In the case of the proposed infrastructure banks, no such administrative structure exists, and one will have to be created from scratch once the enabling legislation is enacted.

In the case of some of the proposals, this creation process could take a while. President Obama's most recent plan, for example, first requires the selection, recommendation, and Senate confirmation of a seven-person bipartisan board appointed by the President. The President will also appoint, and the Senate confirm, a Chief Executive Officer who in turn will select the bank's senior officers—Chief Financial Officer, Chief Risk Officer, Chief Compliance Officer, General Counsel, Chief Operation Officer, and Chief Lending Officer—subject to board approval.

The Chief Lending Officer will be responsible "for all functions relating to the development of project pipelines, the financial structuring of projects, the selection of infrastructure projects to be reviewed by the board, and related functions." So once all of this administrative effort is completed and the bank is ready to go, then the process of fulfillment, as described in the paragraph just prior to the preceding paragraph, would then be in effect.

As is obvious, dependence upon this prospective bank will further delay the time in which the project money would be spent, but in the process, it would also incur substantial administrative expenses that might better be used for actual infrastructure repair and investment.

Would State Infrastructure Banks Be a Better Bet?

This committee's draft proposal for reauthorization of the federal highway program includes a section whose purpose is to enhance and expand the role of state infrastructure banks in transportation funding. Although the legislative language has not yet been made available, the draft proposal says that the new approach:

> will reward states that create and capitalize state Infrastructure Banks to provide loans for transportation projects.... The percentage of federal funding that a state can dedicate to a state infrastructure bank will be increased from 10 percent to 15 percent and states will receive a specific amount of funding that can only be used to fund State Infrastructure Banks.

At present, there are several state infrastructure banks (SIBs) in operation, and their existence, or lack thereof, reflects a series of past federal SIB legislative initiatives enacted in 1991, 1995, 1997, and 1998. Today, several SIBs are in active operation, some very much so, and some illustrate the concerns discussed earlier in discussing a federal bank. A quick review of some of these SIBs suggests that few of the projects they fund return a stream of income (if any) sufficient to cover debt service and operating expenses and that state and local tax revenues account for much of the revenues supporting these banks. This suggests that they may not be materially different from the workings of the state DOT and are not banks in the normal use of the term.

Some Final Thoughts

As this testimony has argued, at the end of the day, a real bank needs a reliable stream of revenues to thrive and survive, yet many of the transportation projects now underway and contemplated do not provide a reliable stream of revenues—beyond state or local taxes—that can meet the debt service payments for infrastructure bank loans provided or guaranteed.

Beyond more taxes, the only other obvious option is to "commercialize" infrastructure in ways that more closely connect use of infrastructure with fees paid by users. Tolls, of course, are the most obvious fee and were essential in creating a precursor of the interstate highway system running west from Boston to Chicago and south to Washington, D.C. In recent years, the advent of public–private partnerships (P3s) in several states has worked to boost infrastructure spending that creates projects providing new capacity that are expected to pay for themselves through tolls charged on new lanes offering premium service.

While P3s could offer a promising supplement to the traditional highway program and could be important customers of an infrastructure bank, their existence is dependent on accommodative state legislation, and not all states have enacted such legislation. Virginia has done so and at the moment is the beneficiary of approximately $4 billion in additional road spending by way of three P3s now underway or soon to be started.

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Committee on Transportation and Infrastructure

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(1) Name: Ronald D. Utt

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Have received no federal grants or funds over period in question

Ronald D Utt — 10-12-2011

Signature — Date

Ronald Utt is the Herbert and Joyce Morgan Senior Research Fellow for the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation. At Heritage, Utt conducts research on housing, transportation, and the federal budget. He also specializes in the application of privatization, restructuring, decentralization and devolution of government programs, and works in cooperation with scholars across the United States to evaluate the success and failure of policies for urban revitalization, land use and growth management.

Utt is a veteran of budgetary politics in Washington. In the 1970s, he served as Director of the Housing Finance Division at the Department of Housing and Urban Development, and was Senior Economist at the Office of Management and Budget. In 1977, he became Director of Economic Research at the National Association of Real Estate Investment Trusts. From 1980-87, he served as Associate Chief Economist of the U.S. Chamber of Commerce.

In 1987, President Ronald Reagan appointed Utt to lead his Administration's efforts to promote the transfer of some federal government functions to the private sector. Utt's work helped Reagan present a variety of privatization proposals in his fiscal 1988 budget, including selling the Northeast corridor of Amtrak rail passenger service, some naval petroleum reserves and the Bonneville Power Administration.

From 1989-1990, Utt served as Heritage's Senior Fellow in Political Economy before being named Executive Vice President of the National Chamber Foundation, the research and education division of the U.S. Chamber of Commerce. There, he created and edited the *Journal of Economic Growth*, a scholarly publication focusing on free market solutions to economic development and the *Journal of Regulation and Social Costs*, which investigated the economic costs of government's social regulations. Utt returned to Heritage in 1994.

Utt is the founder and President of Potomac Renovations, Ltd., a Northern Virginia real estate and residential renovation firm. Prior to forming the firm, he served as Managing Director for Novecon Ltd., a Washington, D.C.-based company focusing on trade and business development with East Europe and the former Soviet Union. In that capacity, he served as the exclusive L.A. Gear distributor for Bulgaria, Romania, and Macedonia. He also has served as an economic and privatization consultant to government officials in Russia, Bulgaria, Romania, Latvia, Lithuanian, Estonia and Slovakia. Utt holds a doctorate in economics from Indiana University and a bachelor's degree in business administration from Penn State University.