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Risks of Relying on Private Sector to Address America's Infrastructure Needs

President Trump told the nation's governors last month that "we're going to start spending on infrastructure, big."[1] But so far, the Trump Administration's only action has been to release a budget that slashes funds for roads and bridges, train service, airports and water systems.

The White House FY 2018 budget eliminates several critical infrastructure programs and makes deep cuts in others. It eliminates USDA's Water and Waste Disposal Loan and Grant program which funds clean and reliable drinking water systems and sanitary sewage disposal in rural areas; DOT's TIGER grant program which supports local transportation projects including bridge replacements and rail upgrades; HUD's Community Development Block Grant program which helps communities address a range of needs including infrastructure; and the Essential Air Service program which guarantees air service to small communities. In addition, the Trump budget ends funding for Amtrak's long distance train service and cuts the Army Corps of Engineers Civil Works Program by $1 billion.[2]

As it cuts investments that states and communities need, the Trump Administration still has not offered a blueprint that would make good on its promises to rebuild the nation's infrastructure. In the absence of an actual plan from the Trump Administration or Congressional Republicans to invest in infrastructure, JEC Democrats have examined Trump's campaign proposal to understand who would benefit, who would be harmed and how it would address – or fail to address – America's infrastructure needs.

From candidate Trump's infrastructure proposal as well as recent media reports, we know Republicans are toying with schemes to leverage private equity investors through the use of tax credits to finance infrastructure investment.[3] These schemes would enrich investors and developers, but would not meet the nation's infrastructure needs.

The key takeaway

Trump's proposal ignores critical areas of infrastructure need, costs more, delivers fewer jobs, neglects rural areas and wastes taxpayers' money by handing out tax breaks to finance projects that would have happened anyway.

Trump's proposal fails to meet America's infrastructure needs

- The proposal's sole reliance on an investor tax credit will not support the kinds of projects that are needed most, such as urgent road and bridge repairs and upgrades of failing water systems. Rural areas will be neglected.
- Wall Street equity investors will get a generous tax break to finance projects already planned or underway – and middle-class Americans will get stuck paying the bill.
- JEC calculations show that Trump's proposal could cost **nearly 55 percent more** than traditional infrastructure financing.
- Fewer good-paying jobs will be created under Trump's proposal than with traditional infrastructure financing.
- Individuals will face high user fees, including new tolls.

Trump's proposal to provide tax credits for private infrastructure investment would turn all infrastructure project financing into public-private partnerships (P3s). In a P3, a private firm could be enlisted to handle select or even all aspects of the project – ranging from finance, design, construction, operation or maintenance – and shares the risks and benefits with the public entity.[4]

P3s may help finance infrastructure projects that the federal government or state and local governments may not have the resources to fund or finance and to protect against unanticipated costs.[5] In addition to about 60 P3 transportation projects underway in the United States in 2015, P3s have supported recent port expansions, such as the addition of a 50-foot-deep berth at the Port of Baltimore to accommodate larger ships.[6] But the potential financial returns to different infrastructure projects vary greatly. Relying exclusively on private investors to address all of the nation's growing infrastructure needs means that many important projects which do not deliver returns attractive to investors simply would not happen. Rural areas in particular, with small populations to support the costs of infrastructure projects, would be overlooked.

An analysis of Trump's proposal finds that it:

Ignores critical areas of infrastructure need. Many urgently needed projects, such as maintenance of roads and bridges, construction of new transit lines or upgrades of existing ones, and overhauls of failing, dangerous water systems, are unlikely to satisfy private equity investors' demands for high profits, and therefore will not be funded.

Costs more by handing windfall profits to private equity. The $1 trillion of infrastructure investment through Trump's tax credit proposal could cost Americans *nearly 55 percent* more than financing the same amount of investment through traditional measures.[7] This is because the rates of return that private equity demands – about 14 percent annually – are substantially higher than for private capital raised in bond markets for public infrastructure investment.[8] (*See Box 1 below for illustrative example).*

Leaves rural areas behind. Public-private partnerships are likely to fund projects in more densely-populated urban areas where there are more drivers to pay a toll on a heavily-trafficked road or bridge. Investors know that fixed costs of a project cannot be spread easily over sparse populations and low traffic volume, making it more difficult to deliver the rates of return demanded by private equity. Rural areas cannot offer the economies of scale to push up financial returns. In addition, the longer distances between rural communities add to the construction and maintenance costs of roads and other infrastructure.[9] Environment & Public Works Committee Chairman John Barrasso explained at a recent hearing that public-private partnerships "do not work for rural areas."[10]

Levies new tolls and fees on consumers. In order to generate the profits private equity demands, new tolls will spring up, increasing commuting and other travel costs. Many states, including New Mexico, Arizona and Wyoming have no tolls roads.[11] Adding tolls may require federal authorization and may also encounter consumer backlash.[12] Once tolls are established, private operators will be highly motivated to raise rates. 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.[13]

Wastes taxpayers' money by doling out tax breaks to finance infrastructure projects already planned or underway. Investors could play a variety of games to repackage existing projects in order to claim tax subsidies on projects which would have been done without the credit. Even conservative policy experts who support additional privatizing of infrastructure acknowledge this challenge. Randal O'Toole, a transportation analyst at the Cato Institute, observed: "He [Trump] would be giving tax breaks to private owners who would be investing in that infrastructure anyway."[14]

Delivers fewer jobs and less bang for the buck than public financing. Since the tax credit will likely finance projects that had already been planned or would have happened without the credit, few new jobs will be created. The additional economic activity generated through infrastructure investment – the multiplier effect – also will be much smaller with Trump's approach. Additionally, private investors will tend to shun infrastructure repair and maintenance projects, which economists understand deliver some of the highest returns to society since the deteriorating infrastructure tends to be frequently used or exceedingly old.[15]

Incentivizes investors to engage in a range of monopolistic behaviors that harm consumers. Investors may try to inflate profits by seeking sweetheart deals in contracting to supply private infrastructure, underinvesting in the upkeep of infrastructure as it depreciates over time, cheating sub-contractors and workers out of payments owed to them for their work or gauging users with monopoly fees for accessing what traditionally was public infrastructure.[16] Harvard economist and former Treasury Secretary Larry Summers notes, "The private sector often demands rates of return far greater than public sector borrowing costs, especially in the current low interest rate environment. Insisting on private participation could well substantially raise costs without addressing major problems."[17]

Fails to provide a regulatory framework that would allow innovative infrastructure financing while protecting taxpayers and consumers. Few states currently have the capacity to design and provide independent oversight and enforcement of public-private partnership contracts.[18] In the absence of strong regulatory protections, taxpayers are put at risk.

Puts investors – not taxpayers – in driver's seat in contract negotiations. To minimize risks, private investors often negotiate deals that leave the public on the hook for any hiccups, involve punitive non-compete clauses or constrain the decision making of future elected officials. For example, 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 through 2070.[19]

Box 1

	Trump-Republican Scheme			(Billions $)		
	Private Share		**Principle**	**Interest or Rate of Return**		**30-year Cost**
(1)	Private Equity	$	30	14.00%	$	1,528.5
	Public Share					
(2)	Trump Tax Credit (Federal tax expenditure)	$	137	3.10%	$	342
(3)	State & Local PAYGO	$	133	3.10%	$	332.36
(4)	State & Local PABs*	$	367	3.35%	$	1,078
(5)	Federal Credit Facilities (e.g. TIFIA)	$	333	3.10%	$	832.15
(6)	**Total**	$	1,000		$	4,113
	Conventional Financing					
	Public Share					
(7)	State & Local PAYGO	$	333	3.10%	$	832
(8)	State & Local Municipal Bonds*	$	334	3.35%	$	982
(9)	Federal Funding	$	333	3.10%	$	832
(10)	**Total**	$	1,000		$	2,646

*Cost also includes estimated federal tax credits paid to private bond investors.

Consider a stylized example comparing the total cost to taxpayers from financing infrastructure completely through P3s—as President Trump and Speaker Ryan would like to do—with conventional infrastructure financing. JEC calculations assume that $1 trillion dollars of infrastructure investment will be undertaken in the first year—an unrealistic assumption, but sufficient for illustrating the difference in costs between the approach Republicans would like to take and conventional infrastructure financing. Furthermore, this example assumes interest compounds annually over a 30-year term.

Trump-Republican Scheme Financing

The table's top panel describes P3 projects financed with a capital structure comprised of 70 percent debt and 30 percent equity. The plan envisions raising $167 billion of private equity, on which investors would receive an 82 percent tax credit, meaning equity investors contribute $30 billion for which they require a 14 percent annual rate of return (Line 1). They

receive a tax credit offsetting $137 billion of their investment, which taxpayers finance by selling a 30-year Treasury bond (Line 2).[20] The contribution of $167 billion from private equity amounts to 17 percent share for private equity contributed to a total investment of $1 trillion.

We assume the project's remaining 13 percent equity share will be met with some combination of new, dedicated state and local tax revenues or from fees levied on use of the new infrastructure amounting to $133 billion that taxpayers pay as they go (PAYGO, Line 3). Forgoing this current income carries an opportunity cost equivalent to the 30-year Treasury rate. The remaining 70 percent of debt capital is raised through federal credit facilities, such as TIFIA—on which taxpayers pay the U.S. Treasury interest rate—and with state and local private activity bonds (PABs)—on which taxpayers pay the municipal bond rate *plus* a federal tax credit to bond investors amounting to 25 percent of the borrowed principle (Lines 4 and 5).[21]

In total, financing under such a scheme will cost taxpayers $4.113 trillion, of which $1.529 trillion is paid to private equity for contributing just 3 percent to the overall price of the project.

Conventional Financing

Financing infrastructure under conventional methods is much simpler and less costly than the Trump-Republican scheme, by combining federal, state, and local debt financing and current PAYGO revenues raised from new, dedicated state and local tax revenues or from fees levied on use of the new infrastructure. PAYGO and federal resources carry an opportunity cost equal to the 30-year Treasury rate. Taxpayers pay municipal bond investors the current municipal bond interest rate *plus* a federal tax expenditure on the tax exempt municipal bond interest, assuming a 15 percent effective income tax rate paid by bond investors.

The total cost for financing $1 trillion in infrastructure under the conventional example amounts to $2.646 trillion, or $1.467 trillion less than under the Trump-Republican scheme. The additional cost is explained almost entirely by the extra payments made to private equity investors.

Sources

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