

A Public Infrastructure–Led Economic Recovery Program

By Bernard L. Schwartz and Sherle R. Schwenninger

December 4, 2008

Executive Summary

Public spending on infrastructure is the best way to stimulate the economy at the lowest cost with the greatest long–term economic gain. Making long–term investments in public infrastructure creates jobs, crowds in private investment, makes the economy more productive, and generates a multiplier of growth in other sectors of the economy. We therefore recommend strengthening the public infrastructure component of the President–Elect’s economy recovery program. This paper proposes a three–phase program of public infrastructure investment that could begin implementation within months of the new administration taking office and that could sustain economic growth over a longer period of economic recovery.



Rationale for Strengthening the Public Infrastructure Component of the Economic Recovery Program

The economic recovery program the President–elect outlined in late November is a clear improvement over the first stimulus program that relied heavily on tax rebates to consumers. Yet in our opinion the program still falls short of what is needed to ensure a sustainable recovery. The goal of the recovery program should not just be to stimulate a short–term bounce–back in economic growth but to create a stronger more productive economy that is less dependent on debt–financed consumption to drive growth in the future.

The severity of the economic crisis is attributable to two reinforcing developments. The first was the collapse of our banking and financial system. The second is the downward spiral of global business activity that has caused a global recession whose length and the depth is difficult to predict but which is likely to be worse than most people have expected. What should be recognized is that each of these developments requires different remedies despite the fact that each interacts with the other, thereby exacerbating the problem. We should also recognize that past attempts to stimulate the economy, such as the most recent 2008 tax rebates, do not work under these complex economic conditions. The economic recovery program must find a new, big source of growth that can replace personal consumption as the main driver of economic growth and job creation. The most promising new source of growth of that magnitude is the pent–up demand, in the U.S. and globally, for public infrastructure improvements in everything from roads and bridges to broadband and air traffic control systems to new energy infrastructure and transportation. This program, entailing one trillion dollars of new government spending over the next ten years, will generate comparable levels of private investment, provide millions of new jobs for American workers, improve our productivity and competitiveness, and increase national security.

Three essential elements of this infrastructure investment proposal are a phased investment program, a National Investment Bank, and partnering.

A Three-Phase Infrastructure Investment Program This paper proposes a three-phase investment program for public infrastructure that allows for immediate implementation of the current backlog of projects and the planning for and start-up of the intermediate and long-term projects to be carried out over the next five to ten years. It is important that the three phases are seamless, overlapping one another so that there will be no discontinuation of funding or delays in project schedules.

Phase One: Allocate funds immediately to the infrastructure programs in the pipeline that have already been planned and, in most cases, are authorized by local and state legislatures. This phase can start immediately. It is estimated that there are at least \$75 billion dollars of "shovel-ready" projects waiting for funding.

Phase Two: Address medium-term infrastructure requirements by starting the planning process immediately. Actual implementation would begin within the next two years. This second phase, involving for example, the repair and upgrade of the nation's water and wastewater systems, would require at least \$400 billion dollars.

Phase Three: In parallel with the first two phases, begin planning for major long-term projects such as new ports and airports, high-speed rail lines, and, in particular, a national power grid and a national broadband network. The cost of this phase is estimated to exceed \$500 billion dollars.

National Infrastructure Bank (NIB) This proposal also recommends the formation of a National Infrastructure Bank (NIB) to fund and oversee this program. This structure suggested here is consistent with that proposed by the President-elect during the primary campaign as well as by Senators Christopher Dodd and Chuck Hagel, and Representatives Barney Frank, Keith Ellison and Rosa DeLauro.

The Bank would have a variety of funding mechanisms at its disposal: direct subsidies, the issuance of general-purpose and project-specific bonds, low interest loans, and loan guarantees for state and local government bonds. If properly capitalized at \$200 billion over five years, and if given the explicit authority to pool, package and sell existing and future infrastructure securities in the capital markets, the Bank could fund up to \$1 trillion in new infrastructure projects by using a relatively conservative five times leverage thereby increasing the program's scope without further burdening the Treasury or the taxpayers. The program also will open access to new sources of capital, such as overseas investors and US pension funds, neither of which now benefit from the tax subsidies of tax-exempt bonds. The combination of financial products, including partial use of U.S. guarantees, secures the lowest financing costs. Further, the NIB would eliminate the standard political objections to federal infrastructure spending. It would have an independent bi-partisan board that would be appointed by the president and confirmed by the Senate. It would have a professional staff to carry out a thorough review of projects based on return on investment and their contribution to the public good.

Partnerships The use of a National Infrastructure Bank structure is based on a tried and tested concept. It allows for partnerships among the federal, local, state and regional governments, commercial banks, investment banks, private investors, and private industry. A variation of this structure historically funded American growth, from the Louisiana Purchase, the transcontinental railroad, the Erie Canal, and the great water dam systems of

the 1930's, to rural electrification and innumerable other regional and local projects throughout our history.

The Benefits of Public Infrastructure Investment

1. Job Creation. Public infrastructure investment would generate more high-wage, skilled, domestic jobs, and thus would help counter the negative employment effects of the collapsing housing bubble, as well as the economic downturn. Using a composite of data from the U.S. Department of Transportation and the State of California, it is estimated that 32,000 jobs would be created for every one billion dollars of spending on infrastructure.

2. A Healthy Multiplier Effect. Public infrastructure investment not only creates jobs but generates a healthy multiplier effect throughout the economy by creating demand for materials and services. The U.S. Department of Transportation estimates that for every \$1 billion invested in federal highways more than \$6.2 billion in economic activity would be generated. Mark Zandi, chief economist at Moody's Economy.com, offers a more conservative but still impressive estimate of the multiplier effect of infrastructure spending, calculating that every dollar of increased infrastructure spending would generate a \$1.59 increase in GDP. By comparison, a combination of tax cuts and tax rebates is estimated to produce only 67 cents in demand for every dollar of lower taxes. Thus, by Zandi's conservative estimates, \$1 trillion in infrastructure spending would generate a nearly \$1.6 trillion increase (or around a 10 percent increase) in GDP over five years.

3. A More Productive Economy. Public infrastructure investment would not only help stimulate the economy in the short term but help make it more competitive over the long term. America's current economic structure — relying heavily on financial services, entertainment, and certain tech industries — reflects our low investment in public infrastructure over the past two decades. However, many of the potential new growth sectors of the economy in agriculture, energy, and clean technology will require major infrastructure improvements or new public infrastructure: new transmission grids to tap the potential of wind and solar power in the Southwest and the Great Plains, better broadband access and new airports to support the growth of agribusiness and new tech companies in the lower-cost areas of the American heartland, and a new generation of information technology to reduce traffic congestion and speed up all sorts of transactions.

4. Needed Investments that Will Pay for Themselves. The spending for public infrastructure investment we recommend for inclusion in the President-elect's economic recovery program would represent investments that we need to make in any case. Two decades of underinvestment in public infrastructure has created a backlog of public infrastructure needs that is undermining our economy's efficiency and costing us billions in lost income and economic growth. By making these investments now, we would eliminate costly bottlenecks and make the economy more efficient, thereby allowing us to recoup the cost of the investment through stronger growth and higher tax revenues. Indeed, if done properly, a public infrastructure program will pay for itself and more over time by increasing productivity.

Conclusion

By making public infrastructure spending the centerpiece of its economic recovery program, the incoming administration would be able to accomplish several urgent public policy goals simultaneously. It would close the public infrastructure gap at a time of low borrowing costs; it would provide the economy a significant boost in investment and job creation that is

needed to put the economy on a new growth path that is less dependent on debt-financed consumption; and it would make the economy more productive and efficient over the longer term by eliminating costly bottlenecks and by crowding in new private investment. Indeed, if done correctly, a public infrastructure program ought to more than pay for itself – in the form of stronger economic growth, more good jobs, more tax revenues, and thus lower borrowing costs and lower tax burdens in the future.