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The right way to invest in infrastructure

New thinking is needed to deliver the benefits of public-works spending and eliminate the waste.

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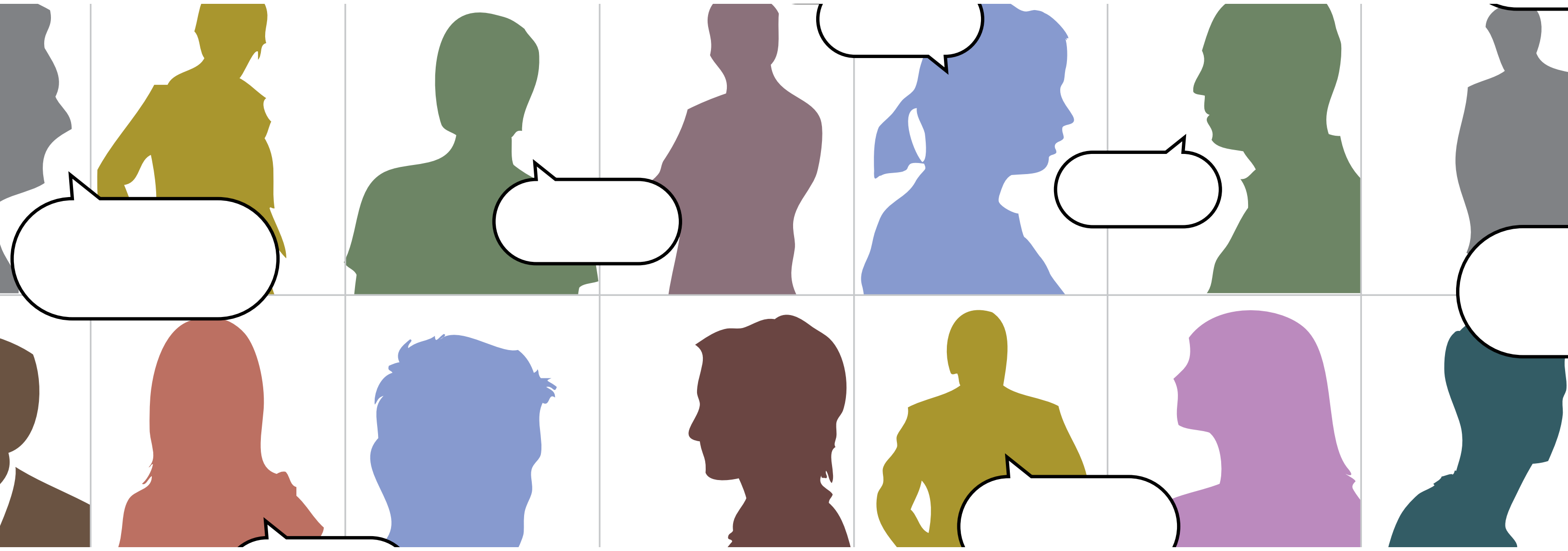

In the current debate about how to build a durable economic recovery, it's welcome news that infrastructure spending is gaining attention. In a December 8 speech on jobs and economic growth, President Obama called for a boost in public investment in infrastructure—beyond what his earlier stimulus package included—to modernize the US transportation and communications networks. The president's proposal reflects a consensus among economists that investment in infrastructure is one of the most effective ways to use government spending to promote economic activity. The bad news is that when it comes to implementation, many of the methods revolve largely around the kind of short-term stimulus and Congressional earmarking that are making citizens increasingly impatient and distrustful. If America is really interested in fixing both its unemployment and infrastructure messes over the long term, then it should invest in infrastructure in a different way.

Infrastructure investment is an often-overlooked but crucial way to generate growth and jobs in the United States, even in a global economy with overcapacity in conventional manufacturing. Investing in infrastructure is the ideal way to shift resources and labor from the bubble sectors of housing, finance, and luxury services and into areas that have the potential to boost the long-run rate of American economic growth. Public investment in infrastructure "crowds in" private investment: every dollar spent on infrastructure has a multiplier effect of $1.59, according to a widely-accepted estimate by Mark Zandi, the chief economist at Moody's Economy.com. In addition, businesses in general benefit from reduced costs for transportation, communications, and reliable energy and water services. And while some inputs can be imported, most infrastructure activity can be performed only in the United States—creating jobs and strengthening industries at a time when the country and its politicians are struggling to find solutions.

Wisely chosen infrastructure projects that generate benefits to the economy over decades and generations represent the best uses of borrowed money, but the political attention they get usually takes the wrong shape. Much of the public discussion on infrastructure has focused on passenger mass-transit investments that are intended to reduce urban congestion costs, make American cities more pedestrian friendly, and decrease greenhouse gas emissions from automobiles. But if the goal is contributing to long-term economic growth, the focus of infrastructure spending should be on the movement of freight and on information technology, not commuters.

Along with advanced telecommunications, the low cost and reliability of freight transportation in the United States have been critical to the country's economic success. But America's failure to modernize its overloaded freight transportation infrastructure—chiefly the railroad network and highways used by trucks, but also inland waterways, ports, and airports—is imposing costs on American efficiency. As a result of congestion (highway delays, for instance), the penalty on American growth exacted by logistics costs rose from 8.6 percent of GDP in 2003 to 10.1 percent in 2007, even before the crisis. Meanwhile, emerging economic powers in Asia, such as China, are devoting vast resources to creating world-class transportation and information infrastructures.

To keep up, the United States needs to invest in new infrastructure of all kinds, from universal high-speed broadband to the modernization of transportation and energy systems. And it needs to make existing infrastructure far more efficient by using information technology to create "smart" grids and highways. We should think of different kinds of infrastructure as parts of a coherent system—synergies among different transportation modes, such as rail, trucking, and water, should be exploited, and rights-of-way for roads and rail should be used for new communications and power grids.

And even as infrastructure-related industries rebuild America for a new era of economic growth, they can contribute to rebuilding America's exports. In the next half century, the poorest nations in the world will add between two billion and three billion people, who will need roads, utilities, and communications grids that could be built by US-based multinationals, with materials and technology sourced partly from the United States. Even larger foreign markets for US infrastructure industries might be found in developing giants such as Brazil, China, and India as these countries shift from a one-sided export promotion strategy to greater investments in growth led by domestic demand.

But to support such an infrastructure modernization in the United States and to strengthen its infrastructure industries enough that they might ultimately generate revenue beyond its borders, funding needs to be not only substantial but also sustainable. According to the American Society of Civil Engineers, the United States needs to spend at least $2.2 trillion over five years for deferred maintenance of existing infrastructure and investment in new infrastructure. Infrastructure is the kind of public capital asset—with high up-front costs and long-term, continuing benefits—that justifies public borrowing within the limits of a capital budget distinct from ordinary appropriations. For this reason, Congress's short-term investment proposals deflate the important role infrastructure could play in a long-term recovery. The more effective solution would be to establish a national infrastructure bank, modeled on the European Investment Bank and some state-level economic-development banks.

A national infrastructure bank would serve two purposes. First, it would remove decisions about federally funded infrastructure projects from the pork barrel politics of congressional earmarking—a process that currently inhibits the United States from developing transparent, economically effective infrastructure priorities. Second, a federal

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infrastructure bank would be able to fund infrastructure in a massive and sustainable way by issuing federal debt, within limits, to fund infrastructure projects of national significance. By contributing to a higher rate of economic growth, infrastructure investment financed by government borrowing could make it easier to reduce the national debt and deficit over time. It would also spur long-term job creation in industries such as manufacturing and construction, currently two of the worst hit by unemployment.

But the hard facts in favor of a national infrastructure bank have led to an even harder political reality. Although President Obama indicated support for such a bank during his campaign, Congress so far has been unwilling to relinquish control of decision making over individual infrastructure projects to an independent agency—and isn't going to do so anytime soon. And the creation of an infrastructure bank that would be a mere pass-through vehicle for Congressional appropriations would be pointless. So in the absence of firm plans for a national infrastructure bank, we must at least proceed with alternate forms of infrastructure investment.

One important vehicle for greater investment is the multiyear highway-spending bill that Congress is likely to pass in 2010. Other sources of spending are state and local infrastructure bonds that receive favorable tax treatment. As part of the stimulus package, the American Recovery and Reinvestment Act earlier this year included a new class of federally subsidized state and local tax-credit bonds called Build America Bonds, which should generate as much as $50 billion of new infrastructure spending this year. While an important start, programs like these remain a second-best alternative to federal funding and federal choice of projects of regional and national significance.

From the earliest years of the republic, the United States has undertaken massive infrastructure projects—in canals, in railroads, in interstate highways, and in electric grids—that have accelerated economic growth even as they created new industries and new communities. At a time when the country is looking to rebuild business and tackle the highest unemployment figures in decades, we have to turn to public infrastructure investment as one solid solution. Like previous generations, today's Americans in the aftermath of the bubble economy must lay a foundation for sustained prosperity by creating the infrastructure a 21st-century economy needs.

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