Testimony of

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Mr. Chairman,

I want to thank you and this committee for your invitation to testify today on the financing of infrastructure investments. I speak from the perspective of having served as the Executive Director of the CSIS Commission on Public Infrastructure, which was co-chaired by Ambassador Felix Rohatyn and Senator Warren Rudman. Mr. Bernard Schwartz was also a leading member of our panel. Much of the direction of our report has been captured by a bill submitted by Senators Dodd and Hagel, and Representatives Ellison and Frank, that creates a National Infrastructure Bank.

In my testimony, I want to touch on three realities regarding current infrastructure policy and briefly explore their implications for infrastructure finance – specifically, why they lead you to the idea of a national infrastructure financing facility of some sort. The issues are:

- **the growing unsuitability of the existing "modal" programs to their tasks;**
- **the inescapability of using tolls and other user charges as a method of managing infrastructure assets; and**
- **the difficulty of turning good business deals into good infrastructure policy.**

The Failure of the Modal Programs

It is widely understood that the so-called modal programs – the programs that govern highways, airports, water projects, and the like – are good at building things and not good at managing and maintaining them. The Minneapolis bridge event is a dramatic example, but more generally, we are letting our infrastructure assets depreciate by spending less than the replacement level or the level associated with the highest economic returns.

But we pay even less attention to a different and, to me, more important problem – we are choosing the wrong projects to build. At the highest level, dedicated trust funds or financing facilities for highways, navigation, water, and the like mean that those projects do not compete with each other in the budget process. Nor do we evaluate those projects using standardized criteria for the cost of capital, the value of time or life, or the benefits of expanded economic activity. The programs are too prone to political guidance – the term "earmark" would not be in the public vocabulary today were it not for the last transportation bill and its bridge to nowhere. And the largest program – highways – turns money over to states and tells them that whatever they pick will be funded by the feds using a predetermined percentage. Mr. Chairman, that is not infrastructure policy. That is revenue sharing.

That was a good system for building the national highway system. But that job was effectively done over thirty years ago. Today, the same selection process means that we favor new road construction over non-structural solutions, whether they mean variable speed limits, flexible traffic flow patterns, or congestion fees. They mean that new road segments are being built to encourage growth in some areas while decaying segments retard growth in others. They mean that if a flood control project doesn't get federal funding this year, the best thing for a locality to do is wait until next year, as if policy were a merry-go-round with a brass ring attached.

And, of course, in times of budgetary stringency, those programs mean that federal dollars are spent through formula grants or project approval lists without a primary focus on getting the best return for our dollars. Is the last road we built more important than the last water treatment plant we funded? We have absolutely no way of knowing the answer and, therefore, no way of knowing how far we are from getting the most out of our resources,

These realities tell us that we need to find a way to finance infrastructure that compares funding new projects to managing the old ones, that allows nonstructural alternatives – from urban congestion fees to wetlands preservation for flood control – to be considered, and that uses the same criteria to evaluate the impact of every federal dollar.

Tolls

In a world in which people empty bedpans and mop floors for an unlivable minimum wage and working families face four dollar gas and forty thousand dollar college, we are hesitant to think about raising the price of *anything*. But tolls are inescapable. There are no new places to build roads to solve downtown rush hour congestion. There are no new ways to expand dramatically the capacity of airports. We have two alternatives – we can impose congestion charges for peak uses, as we do for electricity use, or we can resolve the issue by having people sit in their cars or on airport tarmacs and waste their time. Those are our options.

Moreover, tolls are a possible new source of funds for transportation solutions – low-cost surface rail, intelligent sensors to change traffic flow controls on the fly, improvements in the technology of the air traffic control system, and the like.

Governments are too often hesitant to impose or raise user charges for understandable political reasons. But when they fail to do so, they ration congestion through delay or, more recently, they sell the asset to private parties who will raise the tolls for them. In other words, one bad decision leads to another.

Mayor Bloomberg attempted to break this cycle with his visionary program to accommodate a million new New Yorkers by 2025, a program that included downtown access fees, such as those used successfully in London. But the political opposition he faced shows us that we need to turn dramatically the issue. A national infrastructure financing facility would help change this dynamic by rewarding localities or states that used tolls correctly with targeted federal financing, and by requiring that peak-time management policies were in place before new capital expenditures were made.

Public-Private Partnerships

I confess that I dislike intensely the term public-private partnerships. I have worked in a large corporation, and I have been involved in private-private partnerships, or as we called them, business deals.

And that is what selling a turnpike or a toll road is – it's a business deal. It is *not* a partnership, nor a transportation policy, or sometimes even a budget policy. It's a bad business deal from our perspective as policy makers if a government sells a road and then uses some of the proceeds for a "rainy day" fund that substitutes for missing revenues. It's a bad deal if the government agrees that no new roads will compete with the one, or if it makes a 99 year deal for a road that will only last 40 or 50 years. It's a bad deal if the government could have simply securitized its future tolls receipts instead of selling the right to impose them.

Those are important concerns, but the reality is that private money is itching to enter this area, and lots of it. Infrastructure is the flavor of the month in asset markets. The point is not to keep private money out, but to guide it in the right directions.

This is an important prospective function for a national infrastructure financing facility. A Bank could guide private money – and state policy regarding asset sales – to the right purposes. For example, private money has eagerly pursued existing assets, but has no appetite for building new ones, at least in the United States. A Bank could change that focus by being a lending partner for new projects in which private investors played a leading role, or could provide credit guarantees or other enhancements that lowered their cost of capital. A Bank could require or encourage states to have a pre-announced, competitive, and comprehensive evaluation policy before selecting private bids for assets. It could help finance the rehabilitation of old roads if private parties agreed to impose congestion pricing and share the road's monopoly profits with the public sector.

In short, a Bank could provide a framework within which private money could best enter the infrastructure area and support long-term public policy goals, while having enhanced access to credit markets through the Bank's active support. This "partnership" would still be a business deal, but it would be a better deal for all concerned.

A National Infrastructure Bank

The facility our Commission imagined would be similar to the World Bank, a private investment bank, or any other entity that evaluates candidate projects and assembles a portfolio of them. State, localities, or other government entities would come to it with proposals that explained the benefits of specific projects that had a proposed federal exposure above some threshold in value. Those project proposals would outline the stakes that state and local governments would be willing to take, what users would be expected to pay, the funds that were available and on what terms from private sources, and what the national benefits would be. If it found the national benefits compelling, the Bank would then have the ability to use a variety of tools to involve itself. It could buy credit guarantees or enhancements for the project's financing: it could provide interest rate subsidies or otherwise reduce the borrower's cost of capital; it could lend directly; or it could finance sinking funds, underwrite an offering, or take any other steps. The point is that such a facility could go project-by-project, and dollar-by-dollar, to find the best use of federal support.

The bank would have two windows. One would provide direct subsidies, when appropriate, through a variety of mechanisms. It would require appropriations and be subject to credit scoring when appropriate. For investments above some threshold, it would replace the existing modal programs. Any and all federal subsidies to any project would be delivered through this "subsidy window."

The second window would be a credit window, in which projects with Bank participation were refinanced on a break-even basis. If the "credit window" were to lose money, it would be because it had made bad decisions, and the Bank's management would be obliged to correct them, or it itself would be corrected. Perhaps these projects would be pooled and resold to investors, which would facilitate the Bank's balance sheet leverage. Perhaps the bank would issue covered bonds, as has been proposed by the New America Foundation, in which the Bank promises to give to borrowers what state and local governments and users have promised to give the Bank, and make good what is not.. Perhaps the Bank would issue preferred stock that would finance a revolving pool of activities. These details are in fact secondary, and the "best" combination of them would change as do capital markets, economic conditions, the Bank's credibility, and other factors. For example, investors light feel more comfortable at first with covered bonds, then, as the Bank gains experience and credibility, with pooled securities, and then, when it is mature, with preferred stock.

This choice is not as crucial as having a central facility that picks projects coherently and independently, that gives out subsidies transparently, and that then must face a market test. Whatever the financing mechanism, the Bank would have to convince investors that its projects were tenable and their benefits compelling – in short, its project selections would face a market test every day, as a deep and liquid market for its securities was formed. Let me also add that we do not think the bank's securities, whatever they may be, should receive tax-free returns, nor do we think there should be a promise of the government's full-faith and credit beyond whatever project-by-project guarantees the Bank makes. If the Bank wishes to make a subsidy, let it be a conscious and targeted one, and let investors be compelled to then evaluate the assets they buy.

Conclusion

We know that the resources our economy devotes to infrastructure are inadequate to meet our best engineering estimates of needs. But we do not have a system for testing the economic validity of those needs, nor of making sure the best projects are funded first. A National Infrastructure Bank is attractive not just because it would better lever federal resources, but also because it would allow us to put in place a project selection process that evaluated our investment opportunities coherently and set priorities based on those evaluations.