COUNCIL on FOREIGN RELATIONS

Renewing America

POLICY INNOVATION MEMORANDUM NO. 44

Date:	March 19, 2014
From:	Heidi Crebo-Rediker
Re:	Infrastructure Finance in America—How We Get Smarter

The United States has an infrastructure investment problem. A generation of roads, bridges, airports, and water and sewer pipes built half a century ago is nearing the end of its useful life. Yet traditional public resources are no longer substantial enough to foot the bill. Investors from the United States and around the world are eager to invest in infrastructure projects that can provide stable, long-term returns, through public-private partnerships (PPPs) or other innovative investments. But it takes expertise to channel this investment in a way that protects taxpayers and provides value for money—expertise that many state and local policymakers lack. The federal government should close this knowledge gap by creating a new advisory unit under the auspices of the Treasury Department called "Infrastructure USA." This unit would support state and local governments in deciding how best to use private investment to plug the infrastructure spending gap. Other countries have created special entities within, or working closely with, finance ministries or treasuries that share technical expertise and best practices with local decision-makers. A good model already exists within the federal government: a small unit in the U.S. Treasury Department advises foreign governments on how to use private investment for infrastructure projects in their own countries. This program can be replicated easily and inexpensively to encourage infrastructure investment in the United States.

THE PROBLEM

The American Society of Civil Engineers estimates that the United States needs to invest $3.6 trillion by 2020 to maintain its current infrastructure in a state of good repair. But such a large expansion in direct appropriations is completely unrealistic at a time when government coffers are already stretched or otherwise spoken for. The most common way states and local governments fund infrastructure projects—through municipal bonds—works well for many infrastructure projects. But municipal bond issuers are not able to take advantage of large global pools of capital looking to make infrastructure investments, due to lack of bond liquidity, bond issue size, and return for investors who do not benefit from the tax exemption. With infrastructure spending as a percentage of gross domestic product (GDP) at its lowest level in over twenty years, these traditional funding sources alone are unlikely to cover the country's mounting infrastructure needs.

Using more private capital could play a large part in solving this issue. Pension fund, insurance fund, and sovereign wealth fund managers would like to invest in projects—like infrastructure—that guarantee stable, long-term returns. Their money can be channeled into infrastructure projects through innovative financing structures, including collaborative public-private partnerships. In addition to using private funds, PPPs often come together with private expertise that use creative ways to stretch infrastructure dollars further. PPPs are not always the best option. But when they are a good fit, well-designed PPPs have a better track record internationally than do publicly run projects of being completed on time and under budget. Ultimately, PPPs and other innovative financing structures that use private capital can help governments meet public needs with fewer public dollars. Yet in the United States, too few of these projects get off the ground.

One barrier is the lack of basic knowledge among state and local officials about project finance and PPPs. These financing structures are often complicated and require a thorough understanding of who bears what risk, who receives what benefit, and how to weigh public and private funding options. Private investors seek a return on their investments, which often means private capital appears more costly than using municipal market finance. But for the right project, PPPs may prove to be better value for taxpayers and the public at large. The challenge is knowing how to measure their value. Some U.S. state and local officials are very adept at using innovative financing, and a few states, like Virginia, have their own PPP units that build up expertise. But most state and local officials lack the necessary skill to value, negotiate, and implement innovative financing structures in ways that maximize benefits to taxpayers. And these same officials make the lion's share of decisions on which projects move forward and how they are funded.

EXISTING MODELS

The federal government already offers this vital capacity-building and advisory service at the Treasury Department—but only for foreign countries. The Infrastructure Finance Unit, which is housed in the Treasury's Office of Technical Assistance (OTA), is a small team of experts that travels to foreign countries and gives hands-on technical and managerial assistance. The team advises on the entire process of infrastructure project development: project feasibility and design, risk assessment, financial structuring, tendering, fiscal oversight, debt management, and handling of long-term contracts. They even work with countries to attract project investors. But OTA is not allowed to provide this same advice and analysis to assist U.S. state and local governments, which are confronted with the same opportunities and challenges.

In other developed countries with strong PPP track records, governments offer these services domestically. "PPP Canada" provides expertise and standardizes documentation and procedures for Canadian officials on the frontlines of negotiating PPPs. Canada topped the list in a May 2012 Deloitte / PPP Bulletin International survey assessing recent and expected levels of PPP activity and quality of its infrastructure financing model. The number of infrastructure projects in Canada has surged over the past five years, due in part to the work of PPP Canada. The United Kingdom also has its own "Infrastructure UK" unit operating within the UK Treasury that supports private investment in UK infrastructure.

RECOMMENDATION

President Barack Obama should establish an Infrastructure USA unit, which potentially could be done through executive order, to address the PPP and infrastructure-finance knowledge gap among state and local government officials. This unit should be housed within, or be closely affiliated with, the Treasury Department, which has experience with evaluating risk, financial structuring, and public debt management. It should also build on existing expertise from in-house and outsourced experts in the foreign-focused Infrastructure Finance Unit of OTA. As a central repository for this expertise, Infrastructure

USA should coordinate closely with other agencies involved in a broad cross section of infrastructure, especially ones with federal grant or lending authority for projects, such as the Department of Transportation.

Infrastructure USA could start small and with a relatively modest budget. The fully functioning PPP Canada cost approximately $12.5 million in Canadian dollars ($11.4 million in U.S.) to operate in 2013. The entire OTA, which primarily runs non-infrastructure-related advisory programs, received an annual appropriation in 2013 of approximately $27 million. By starting small and leveraging existing expertise within the U.S. government, Infrastructure USA could provide immediate value. It is reasonable to assume that ongoing operating costs will not exceed those of PPP Canada.

State and local governments could go to Infrastructure USA on an as-needed basis for specific project support—for example, consulting on whether PPPs are the best option, and if so, how they should be custom-tailored. Additionally, Infrastructure USA could offer the following services:

- *Standardize template documentation for different types of PPP agreements.* Well-vetted base templates allow state and local governments to know what to expect when exploring opportunities for private investment in infrastructure. This could maximize efficiency and minimize legal fees, as well as provide a neutral starting point for discussions with private investors.

- *Assess and collate best practices.* Across the world and within the United States, there is ongoing innovation in PPP best practices, from financing structures to budget management and risk sharing. The unit should conduct research on what works, collaborating with the OTA's team, the European Investment Bank, World Bank, and International Finance Corporation, as well as other development banks that have significant expertise.

- *Host experience-sharing meetings.* The unit should provide a convening space for state and local governments to share practical experience and expertise on structuring, negotiating, and implementing PPPs, particularly in collaboration with any state PPP units. This experience varies widely around the United States.

- *Advise on existing federal funding opportunities.* There are many federal grant, loan, and loan-guarantee programs currently available for infrastructure projects designed to complement other means of financing or encourage private investment, but local governments may be unaware of these resources or how best to navigate them.

FEASIBILITY

The politics of creating Infrastructure USA should be easy. Democrats and Republicans agree that U.S. infrastructure needs more investment, and both parties support using more private money to make that happen. President Obama could potentially create Infrastructure USA without legislation in the initial stage to get it up and running immediately. The cost would be minimal, but the impact could be large if PPP Canada is any guide. The federal government is also well positioned to pool expertise that can then be shared broadly. An agency like the Small Business Administration is a good domestic example; it has provided advice, training, support, and capacity-building to entrepreneurs and small businesses for years. Infrastructure USA would not impose federal guidelines or priorities. Its services would be voluntary for state and local governments and by request. They could reject any recommendations to counter any fear of overreach by the federal government or political interference. Ultimately, the purpose of Infrastructure USA would be to ensure that taxpayers at all levels of government can make well-informed investment decisions and receive better value for money, and that quality infrastructure gets built.

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The Renewing America initiative is supported in part by a generous grant from the Bernard and Irene Schwartz Foundation.