

COUNCIL *on*
FOREIGN
RELATIONS

 **Renewing America**
Progress Report and Scorecard

 **Road to Nowhere**

Federal Transportation Infrastructure Policy

May 2012

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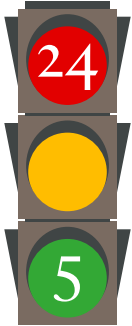
Road to Nowhere



Renewing America Scorecard:
Failing U.S. Transportation Infrastructure

FALLING BEHIND

OUTPACED



2011 RANKING OF U.S. INFRASTRUCTURE QUALITY, WORLDWIDE

U.S. LAPPED BY 13 COUNTRIES IN THE PAST DECADE:

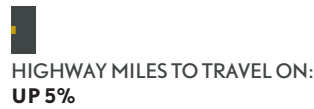
Bahrain, Barbados, Canada, Japan, Luxembourg, Malaysia, Netherlands, Oman, Portugal, South Korea, Spain, Sweden, and United Arab Emirates

2002 RANKING OF U.S. INFRASTRUCTURE QUALITY, WORLDWIDE

RUNNING OUT OF ROAD



HIGHWAY MILES TRAVELED BY U.S. DRIVERS:
UP 100%



HIGHWAY MILES TO TRAVEL ON:
UP 5%

1980
TO
2006

OUT OF GAS

ANNUAL FEDERAL SURFACE TRANSPORTATION SPENDING



ACTUAL CURRENT SPENDING, IN BILLIONS



RECOMMENDED SPENDING, MAINTENANCE



RECOMMENDED SPENDING, MAINTENANCE AND IMPROVEMENT

TRANSPORTATION INFRASTRUCTURE SPENDING

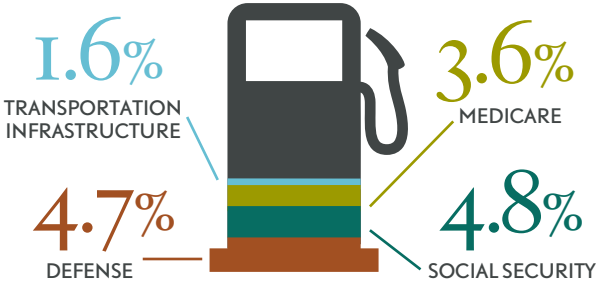


U.S. vs. THE WORLD

The rest of the developed world spends, on average, 52.7% more of its GDP on transportation infrastructure than the United States.

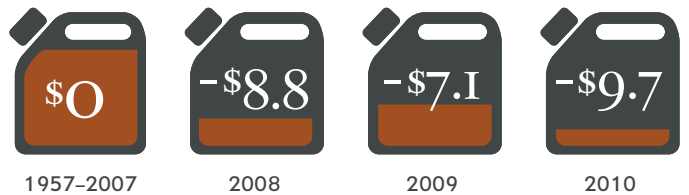
FILLING THE TANK

U.S. SPENDING, AS A PERCENTAGE OF GDP



SUDDEN SHORTFALL

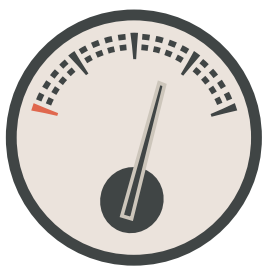
DEFICIT IN THE HIGHWAY TRUST FUND, IN BILLIONS



In 2008, the trust fund stopped covering U.S. highway transportation infrastructure costs.

CATCHING UP

HITTING THE GAS



66%

American voters say fully funding transportation infrastructure is either extremely (27%) or very (39%) important ...

TAPPING THE BRAKES

...but voters oppose typical options for funding it.



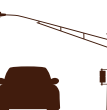
NEW GAS TAXES



NEW TOLLS



REPLACING GAS TAX WITH A MILEAGE FEE



INTRODUCTION

Concerns over the state of U.S. transportation infrastructure are higher on the federal policy agenda than at any time since President Dwight D. Eisenhower championed the creation of the interstate highway system in the 1950s. A generation of U.S. infrastructure built fifty years ago is reaching the end of its lifecycle, and new construction has not kept pace with population growth. Meanwhile, international competitors, particularly China, are making massive investments in state-of-the-art transportation systems.

Moving people and goods efficiently matters for the U.S. economy. The economic cost of traffic congestion alone in wasted time and fuel was estimated at \$101 billion, or \$713 per commuter, in 2010.¹ According to one estimate, the country's economic growth would have been 0.2 percentage points higher in 2011 if necessary transportation infrastructure maintenance and improvements had been made.² If current spending levels persist, by 2020 the drag on growth could be 1.2 percentage points. With interest rates remaining at historic lows and unemployment near double-digit highs, an opportunity exists to marry shorter-term job creation with investments that will pay longer-term benefits to U.S. economic competitiveness.

Transportation infrastructure includes everything from roads and airports to ports and water navigation systems. "Surface" transportation—or roads, bridges, highways, transit, and rail—is by far the largest component of federal capital infrastructure spending, at 77 percent, and is also the locus of the major transportation policy debates.³

President Barack Obama has made infrastructure investment a top priority. Infrastructure expenditures were the second-largest component of his 2009 stimulus package, in which he laid out the nation's most ambitious transportation vision—building a high-speed rail system from scratch—since Eisenhower. He is also the first president to propose legislation creating an independent "infrastructure bank" to help funnel private investment into public projects. Republicans have been cautious about increasing public spending without offsets, but House Speaker John Boehner (R-OH) has said that Republicans are "not opposed to responsible spending to repair and improve infrastructure."⁴

Yet pending federal legislation would do little to address the country's transportation infrastructure problem. Overall investment would be kept at current and inadequate levels, and spending priorities would also remain unchanged. State and local governments, in partnership with the private sector, will be forced to take the lead to find innovative ways to meet the country's infrastructure needs.

TRANSPORTATION INFRASTRUCTURE INVESTMENT NEEDS

The United States is struggling just to maintain the roads, bridges, and rail lines it built decades ago. According to two federal transportation commissions, maintenance on the nation's highways and transit systems would require increasing the \$48 billion the federal government currently spends annually on capital investments to \$78 billion or \$87 billion, respectively—an increase of at least 60 percent.⁵ And the longer the country waits to start repairs, the more costly the repairs will become.

Now add new construction and improvements. From 1980 to 2006, the total number of miles traveled by cars and trucks nearly doubled, while the number of new highway miles grew by less than 5 percent.⁶ Per mile traveled, real highway spending has declined by nearly 50 percent since the late

1950s. Recommended highway and transit capacity expansions would bring the annual cost to \$96 million or \$118 million—an increase in current federal spending levels of at least 100 percent.

INTERNATIONAL COMPARISONS

Expenditures

The United States spends just 1.6 percent of its GDP on transportation infrastructure—a fraction of what it spends on Medicare (3.6 percent), Social Security (4.8 percent), and defense (4.7 percent).⁷ Among countries in the Organization for Economic Cooperation and Development (OECD), the United States consistently ranks last or second-to-last in transportation infrastructure spending as a percentage of GDP. Since 1970, OECD countries have, on average, spent 52.7 percent more of their GDP on transportation infrastructure than the United States.⁸ China's total infrastructure spending may be as high as 9 percent of its GDP, though available data sources are unreliable, making international comparisons difficult.⁹

Quality

The World Economic Forum ranked the overall quality of U.S. infrastructure at twenty-fourth globally in 2011.¹⁰ As recently as 2002, it was fifth. Since then, several economic competitors moved in front of the United States in the rankings, including Japan, South Korea, Canada, and Spain. China is still far behind in the rankings at sixty-ninth. But China is likely to move up, and move up fast. It built a highway system equivalent in size to the U.S. interstate highway system in fifteen years. The United States took thirty-five years. By 2015, China intends to build roughly fifty new airports. Infrastructure takes years, if not decades, to plan, build, and deliver payoffs. Current rankings reflect past investment decisions. Given the United States' level of investment, its relative decline in overall quality of infrastructure will likely continue.

POLICY CHALLENGES

The federal government is poorly designed for a coordinated infrastructure policy. Responsibility for highway and transit policy alone is split among seven congressional committees. The closest the country has come to a coordinated national infrastructure plan was the National Transportation Plan in the 1970s, and the idea sank fast.

Washington shoulders a minority share of the nation's transportation costs, or about 25 percent of total transportation costs and 40 percent of capital transportation costs.¹¹ Infrastructure in the United States has traditionally been a state and local affair.

With national leaders framing infrastructure as a larger national problem, it would appear that the federal government is gearing up for a greater role. But those ambitions are hitting up against the wall of fiscal austerity. Given political realities, the best outcome could be a continuation of present transportation spending levels. Deep cuts in spending are a possibility with a Republican-controlled House opposed to either additional taxes or increased debt. Advocates of infrastructure investment are faced with squaring the circle, of doing more with less.

WHAT HAS BEEN DONE?

The Stimulus Bill

Obama's 2009 American Recovery and Reinvestment Act (ARRA) produced an immediate one-time increase in federal infrastructure spending of roughly \$100 billion spread out over several years. The largest amount, \$49 billion, went toward transportation. But the stimulus did not go nearly far enough in scale or timeframe to make a serious dent in the nation's infrastructure problem. It will have raised federal highway and transit capital spending by at most 30 percent and for only two years.¹²

Critics argue the stimulus has been money poorly spent, because it favored shovel-ready projects to maximize job creation over more cost-effective investments.¹³ Obama's ambitious and hugely expensive high-speed rail program has also been a disappointment. High-speed intercity link projects were rejected in Florida, Ohio, and Wisconsin, even though Washington had offered to pay 80 percent of the cost. California is considering rerouting and scaling back its Los Angeles-to-San Francisco rail link in the face of ballooning cost estimates. Nevertheless, ARRA did contain some notable policy innovations:

- The Department of Transportation's TIGER competitive grant program has awarded approximately \$2.6 billion distributed on merit instead of automatic grants based on formulas or congressional earmarks for favored projects. Congress appropriated a further \$500 million for the program in 2012.
- Build America Bonds (BABs), a new financing tool, raised \$181 billion for state and local capital projects from April 2009 until the program expired in December 2010. BABs are federal tax-credit bonds for which Washington pays a generous 35 percent subsidy on interest payments. The tax subsidy also attracted a new kind of investor—tax-exempt pension, insurance, and sovereign wealth funds. There is some discussion of bringing BABs back, but with a lower federal subsidy in the range of 25 to 28 percent.

Federal Loan Programs

Federal transportation loan programs are growing in popularity, though they remain small. The largest program, the Transportation Infrastructure Finance and Innovation Act (TIFIA), provides federal credit assistance (e.g., direct loans, loan guarantees, flexible terms, and low interest rates) totaling \$120 million a year to leverage private capital and finance large-scale surface transportation projects undertaken by public or private entities. Since the program's inception in 1998, twenty-three projects have participated, with only one bankruptcy. For every dollar contributed by the federal government, thirty dollars have been raised from the private sector and state and local governments. Both the Democratic and Republican versions of the pending Surface Transportation Reauthorization Bill would expand federal funding of TIFIA by nearly tenfold, to \$1 billion. Other existing loan programs for different modes of transportation (e.g., rail, transit, and highways) will probably see their allocations increase as well.

The trend in federal infrastructure policy—which increasingly favors competitive grants, bond and loan programs, and the private sector—fits with the tight fiscal environment. Federal money is

awarded more carefully and with more strings attached. Loans and BABs engage private capital and entities to fund and manage public works projects, reducing the burden on public budgets.

NEW FEDERAL INITIATIVES

The president, most Democratic members of Congress, and some Republicans favor a new infrastructure bank. Like TIFIA, it would supply federal credit assistance and loan guarantees to help finance large-scale, interstate, and multimodal projects with leveraged private capital. An initial federal infusion of \$10 billion could raise \$100 billion to \$200 billion from capital markets. Unlike TIFIA, the bank would finance all infrastructure projects, including transportation, water, energy, and technology. It would be an independent entity with an independent board.

The advantages are many, proponents argue. The bank would correct a market failure, meeting public infrastructure financing needs with the private capital market. Private investors would be guaranteed a conservative, long-term spread of returns. Public infrastructure would be paid for with fewer tax dollars. And the bank's independence would free it from the political grip of Congress and the Department of Transportation.

But skeptics, who tend to be Republicans, question whether the solution to the country's infrastructure woes is another government institution. It could take years to get up and running. If the bank would be a purely lending institution, they argue, why not instead expand existing federal lending programs like TIFIA?

Republicans appear to be winning the debate. As of now, prospects for the new bank are dim. Obama's Jobs Act, which included the proposal, was rejected by the Senate in October 2011. Both House and Senate versions of transportation authorization bills do not include provisions for an infrastructure bank.

STATE AND INTERNATIONAL INNOVATIONS

Another option would be for the federal government to provide more support for existing state infrastructure banks. Thirty-two states plus Puerto Rico already have banks that qualify for federal transportation funding. But only a handful have fully functioning banks with mature lending ability, and two of the most active banks—in California and Ohio—have opted out of federal funding.

Since its creation in 1999, California's bank has funded \$32 billion in public works projects ranging from wastewater plant upgrades to police stations and road improvements. Like a model private bank, its operations are fully funded by fees, interest earnings, and loan repayments. Its bond portfolio, though small compared to its loans, has an excellent credit rating of AA+ from Standard & Poor's, on par with U.S. Treasury bonds.

States have also been experimenting with public-private partnerships (P3s). Twenty-nine states have P3 legislation on the books. Yet there are few large-scale P3 projects. The Indiana Toll Road and Chicago Skyway are notable examples, both of which were "concession" agreements through which the state sold ownership for a lump-sum payment. A more promising and popular model is an "availability payment" agreement currently being used for two projects in Florida. A private developer finances the capital and operating costs of the facility, but the government retains ownership and pays the developer an annual fee. With deep budget cuts and a favorable political climate, more P3s are likely.

In establishing P3s, the United States is catching up with the rest of the developed world. P3s are widespread in countries such as France, Spain, the United Kingdom, Australia, and Canada. Public-private consortiums, for example, manage most highways in France and Spain.

FEDERAL APPROPRIATIONS

Clever financing tools, however, are unlikely to fill the huge transportation funding gap. Few projects can deliver a high-enough rate of return to qualify for TIFIA. Rural roads, for example, and other less-used but still-necessary infrastructure would never be built. TIFIA's combined public and private contribution to the nation's transportation infrastructure is small, amounting to only about \$3 billion annually. Competitive grant programs cannot hope to fill the gap either. The entire TIGER program is less than 2 percent of the Department of Transportation's annual expenditure budget.

The scale of the infrastructure shortfall demands more appropriations—but legislative attempts at increasing funding are foundering. Obama's Jobs Act called for roughly doubling appropriations for surface transportation, as did his FY 2013 budget. Neither bill made it through Congress.

The saga over the surface and air transportation reauthorizations shows how hard the congressional funding environment has become. The bills, which authorize spending on highways, transit, airports, and ports, should ideally set funding levels for several years. State departments of transportation and federal agencies can then plan with more certainty. But the last multiyear surface transportation authorization expired in 2009. Since then, the best Congress has been able to muster is *multi-month* extensions of previous policies, the most recent a three-month extension from March 30 to June 30, 2012. It was the ninth extension of the bill.

Spending authorized by the bills is mostly funded from user-fee revenues. Drivers pay a gas tax, airline passengers pay an aviation tax, and shippers pay a harbor tax.

The Aviation and Harbor Maintenance Trust funds have been running surpluses. But the Highway Trust Fund is another matter. Revenues from gas taxes have been declining for six straight years. The gas tax has not been raised since 1993 and is not indexed to inflation. Cars are becoming more fuel efficient and Americans are driving less. Even with real expenditure levels frozen in place, the highway fund has not been able to meet its spending obligations since 2008. For the past three years, Congress has appropriated general funds to make up the difference. By 2021 and assuming current real expenditure levels, the Congressional Budget Office estimates the highway fund will face annual deficits of about \$17 billion and a cumulative deficit of \$169 billion.¹⁴

WHAT THE PUBLIC WANTS

Though Americans share Obama's enthusiasm for making infrastructure improvement a priority, nationwide opinion polls suggest they oppose typical options for funding it. A 2011 Rockefeller Foundation poll found that nearly 80 percent of voters agree that "in order for the United States to remain the world's top economic superpower we need to modernize our transportation infrastructure and keep it up to date."¹⁵ Two out of three voters believed improving the country's transportation infrastructure is "highly important." Yet similar margins do not want to have to pay for it: 71 percent oppose increasing the gas tax, 64 percent oppose new tolls on existing roads and bridges, and 58 percent oppose paying more for each mile driven.

FUTURE PROSPECTS

Congress has four broad options: continue transfers from the general fund, increase gas taxes, find other revenue sources, or spend less. Republican leaders oppose tax increases or higher deficits. The Republican House version of the highway bill proposes using alternative revenue streams, such as new offshore gas and oil exploration royalties, to fill the highway fund gap and keep transportation spending at current levels, adjusted for inflation, for five years. The Democratic Senate version would authorize roughly two years of spending at current levels, adjusted for inflation, borrowing from the general fund and other smaller funds (e.g., for pensions and for repairing leaking underground tanks). Negotiations for a long-term highway bill have collapsed, however. Few policymakers expect passage of a long-term bill before the 2012 election. Good ideas contained in both the Republican and Democratic bills—including the tenfold increase in TIFIA federal funding to leverage more private capital—will remain on the backburner until then.

But even if some combination of the two pending highway bills had passed, the fundamental problems of U.S. transportation policy would have remained unresolved.

Neither bill offers a long-term revenue solution to the highway fund shortfall. It is unlikely the Republicans' scheme of using energy exploration royalties would cover the gap. The Democrats' scheme is hardly better, diverting precious federal dollars from other programs.

Neither bill increases real spending levels. The status quo is the best option on the table—levels at which the United States will struggle simply to maintain, much less improve, its transportation infrastructure.

And neither bill sets a clear strategic plan about what the country's transportation infrastructure priorities should be.¹⁶ Federal funding allocation decisions continue to follow the same formulas that have been in place for decades, which favor highway and road projects spread evenly across the country. To be sure, programs like TIGER, which distribute funds based on merit, or TIFIA, which distribute funds based on financial viability, are welcome, albeit small and limited, steps in the right direction, as is giving the private sector a larger role in transportation project finance, especially with an estimated \$500 to \$600 billion in private equity waiting in the wings ripe for such investments.¹⁷ Private money could inject greater accountability and sensitivity to shifting consumer demand. But a more thoughtful federal funding plan would set strategic long-term goals to better target appropriations, gauge project merit, and guide private investment decisions. If the country is serious about energy independence, for example, more resources could be devoted to mass transit and rail. Or, with economic growth now more dependent on a robust export economy, more resources could be devoted to shoring up some regional corridors over others.

With or without a set of national transportation strategic priorities, more responsibility is set to devolve to state and local municipalities and the private sector. There is some indication that local municipalities are stepping up to the challenge, with the support of voters who appear more willing to pay for improving their own local infrastructure. Since 2000, 71 percent of state and local transportation ballot initiatives have passed.¹⁸ In several western cities—Los Angeles, Denver, Phoenix, Las Vegas, and Salt Lake City—voters agreed to raise their own sales tax to finance specific local infrastructure projects. Without using any federal funds, Chicago is embarking on an ambitious multi-billion-dollar, multiyear infrastructure improvement plan, complete with an infrastructure fund to leverage private capital.¹⁹

But Washington needs to meet this challenge with positive initiatives. Infrastructure can still be a priority in tight fiscal times. It was for the United Kingdom in 2010: when the Conservative government enacted painful austerity measures that cut 20 percent of government agencies' funding, it also committed the country to a \$320 billion, five-year national infrastructure plan.²⁰ Today's favorable environment of low long-term interest rates and depressed construction costs will not last indefinitely. Stronger U.S. economic growth in the future will depend heavily on the decisions made today.

Endnotes

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7. Transportation infrastructure spending figure is the 1970–2006 average and also includes communications infrastructure spending. *Economic Policy Reforms 2009: Going for Growth* (Paris: OECD, 2009), chapter 6, figure 6.1. The transportation spending figure is consistent with Congressional Budget Office figures. Total combined transportation and water spending is estimated to be 2.4 percent of GDP (table A-1, p. 22) with the breakdown roughly one-third for water and two-thirds for transportation (table A-7, p. 34): "Public Spending on Transportation and Water Infrastructure," Congressional Budget Office, November 2010, <http://www.cbo.gov/ftpdocs/119xx/doc11940/11-17-Infrastructure.pdf>. Medicare, Social Security, and U.S. defense spending for 2010: *The Budget and Economic Outlook: Fiscal Years 2011 to 2021* (Washington, DC: Congressional Budget Office, 2011), http://www.cbo.gov/ftpdocs/120xx/doc12039/01-26_fy2011outlook.pdf.
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This report was prepared by Rebecca Strauss, associate director of Renewing America Publications at the Council on Foreign Relations.

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