PERSPECTIVE

Deferred Maintenance and Pensions—Is One Like the Other?

BY JUSTIN MARLOWE

A few weeks ago, Washington, D.C. delivered the long-awaited Infrastructure Investment and Jobs Act (IIJA). It promises $550 billion of new infrastructure spending—beyond previous spending commitments—over the next decade. Proponents say it ushers in a new era of federal infrastructure investment. And they're right. Many of its headline-grabbing spending items are for "new era" infrastructure like broadband access ($65 billion), pollution mitigation ($21 billion), electric buses ($7.5 billion), and electric vehicle charging stations ($7.5 billion), among many others.

IIJA also ushers out the old federal-state-local infrastructure partnership. Only $165 billion—about 30 percent of IIJA's total spending—is for traditional localized projects like roads, bridges, and water supply systems. This solidifies a trend that's emerged over the past few years.

For instance, according to the U.S. Census, the federal government covered only 41 percent of new investments in transportation and water infrastructure in 2017, while states and localities picked up the remaining 59 percent. For operations and maintenance on existing infrastructure, that split was 90 percent state and local, and only 10 percent federal. That's a big shift from the 50/50 split of the past.

Some believe this shift from national to local funding is long overdue. After all, localized projects produce mostly localized benefits, so why not pay for them with local dollars? Others worry that states and localities don't have the right taxes and fees to cover large-scale infrastructure projects, which is why federal help was vital. But either way, IIJA's broader message is clear: State and local infrastructure will now be paid for mostly or entirely with state and local dollars.

States and localities can employ a variety of design approaches, technological solutions, and asset management strategies to address infrastructure maintenance concerns.

In that case, we're forced to confront some important follow-up questions. If "traditional" infrastructure is now a state/local obligation, is their failure to maintain it a liability? If it is, should we estimate and report the size of it, just like we do with pensions, other post-employment benefits liabilities (OPEB) like retiree healthcare obligations, and other measurable long-term liabilities? In other words, should we treat deferred maintenance like pensions?

There are good arguments on both sides.

One can make the case that there's no reliable, agreed-upon way to think about "infrastructure maintenance." Estimates of the backlog of deferred maintenance, like those reported by the American Society for Civil Engineers' Report Card for America's Infrastructure, are based on analysis of what it would cost to bring all our existing infrastructure up to today's design standards. Much of our infrastructure is hundreds of years old, so it's no surprise that ASCE's 2021 maintenance backlog price tag for surface transportation alone was $1.2 trillion.

But at the same time, some engineers prefer to talk about how much it would cost to keep roads and bridges in safe, reliable, usable condition, regardless of when they were built. A bridge designed 50 years ago might look different than a bridge designed today but can work just fine if it's well-maintained. The cost to repair and refurbish infrastructure is considerably less than the cost to redesign and rebuild it. If the engineers can't agree on a good estimate of the deferred maintenance liability, that liability should not appear on a state or local government's statement of net position. That's quite different from pensions or OPEB, where actuaries might disagree on key technical assumptions but ultimately arrive at qualitatively the same estimate of future benefit costs and plan assets.

There are also concerns about "sticker shock." When pension and OPEB liabilities first hit state and local balance sheets, elected officials reacted with predictable fear and panic. Some viewed those liabilities as a real threat to solvency and responded with drastic policy proposals to close plans and slash benefits. Few of those proposals went forward, but the political tension and animosity toward public-sector workers remains in many communities. New disclosures of massive infrastructure maintenance liabilities could lead to hasty decisions to decommission, privatize, or sell key pieces of infrastructure.

But on the other hand, many states and localities have a strong incentive to bring infrastructure maintenance to the forefront. Why? Because they have a good story to tell.

Recall that GASB Statement 34 requires states and localities to capitalize and report the value of their infrastructure assets. They can do this by estimating historical cost, depreciating, and reporting depreciation expense. Or, they can specify the desired condition and performance of their infrastructure and report what they spend to maintain it to that effect. The latter, or "modified approach," is designed to offer more detail on the relationship between spending and infrastructure condition.

The City of Lake Worth, Texas—a solidly middle-class community of a little more than 5,000 people at the edge of the Metroplex—is one of the few local governments that's adopted the modified approach. It applies that approach mainly to its roadways. According to its recent annual comprehensive financial reports, it has maintained all those roadways at well above its stated condition level, and has consistently spent more than expected to maintain them. Lake Worth's story, and that of many other small to medium-sized local governments, cuts against the narrative of crumbling, unsafe roads.

The same applies to the states. At the moment, roughly half the states use or are considering using the modified approach. For most of them, actual maintenance spending exceeds estimated maintenance spending in most years. Moreover, most have kept infrastructure at or even above expected condition for several years. A recent paper by Ryan McDonough and Claire Yan, researchers at Rutgers University, shows that states that adopt the modified approach spend more on maintenance and keep their infrastructure in better condition, in part because they are less likely to cut maintenance spending during budget downturns.

These stories suggest that infrastructure maintenance is a concern, but not the massive, catastrophic liability that some have suggested. And perhaps more importantly, states and localities can employ a wide variety of design approaches, technological solutions, and asset management strategies to address infrastructure maintenance concerns. For these and other reasons, disclosing infrastructure liabilities might draw attention to capital budgeting and finance staff's good work in keeping budgets moving forward, and it might help generate the political momentum to sustain and expand their efforts.

Is deferred maintenance the new pensions? The debate will continue, as will our thinking about the new era of infrastructure investment.

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