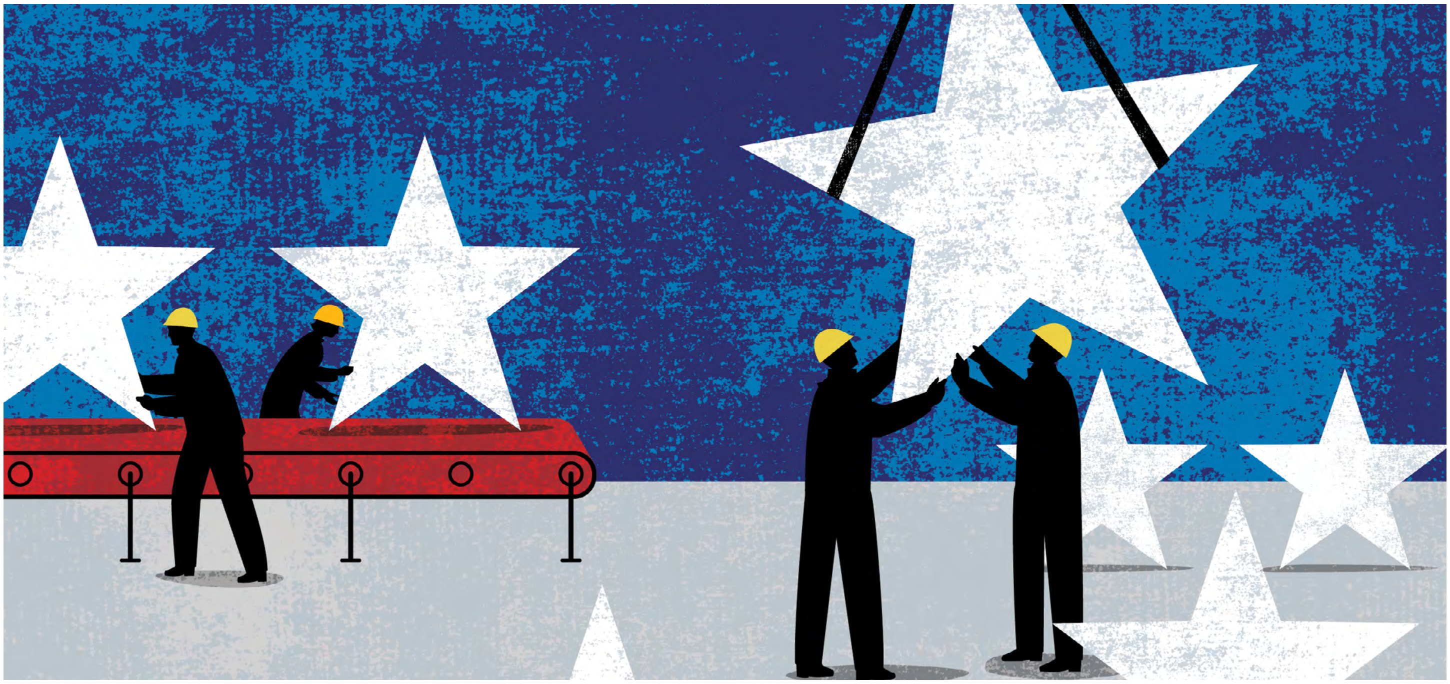

The New Federal Infrastructure: Are States and Localities Up to the Task?

Justin Marlowe

We now have President Biden's long-awaited infrastructure plan, dubbed the American Jobs Plan (AJP). He talked often on the campaign trail about a bold new vision for infrastructure. The AJP is certainly bold. It includes nearly $2 trillion in spending over the next 15 years on a mix of traditional infrastructure like highways, water and sewer systems, and railroads, but also for "new" infrastructure like affordable housing, broadband, and electric vehicles. For infrastructure wonks, there's much to like.

Yet the AJP doesn't stop there. In a bold stroke of infrastructure policy intrigue, its largest spending item is $400 billion to broaden access to home healthcare. If the point of infrastructure is to support economic growth, proponents say, then in a post-COVID economy, services like home healthcare are as essential as roads and bridges. Add to this the nearly $600 billion for community college, childcare, and paid family leave in Biden's American Families Plan, and it's clear that he's forcing us to rethink the notion of "infrastructure."

We'll watch this summer as Congress debates that vision. But regardless of how that debate unfolds, it is refreshing to see an actual infrastructure spending plan, complete with transparent priorities and a clear legislative timeline. "Infrastructure Week" has been a punchline in Washington for almost two decades, as Presidents Bush, Obama, and Trump all struggled to move a comprehensive infrastructure package. Biden seems intent on not repeating his predecessors' mistakes. By redefining "infrastructure," he's guaranteed a robust debate, if nothing else.

With so much attention focused on what Washington thinks of Biden's vision, it's easy to overlook a key question: What does this new notion of "infrastructure" mean for states and localities? Will they be a partner, a roadblock, or something else? As is often the case in public finance, the answer depends. In particular, it depends on three key factors.

The first is funding. The central problem with federal infrastructure today is the lack of a reliable funding mechanism. The federal gas tax has not kept pace with inflation or with federal highway spending needs for decades. The Highway Trust Fund is virtually insolvent as a result, and much of the spending in the AJP is meant to catch up on unfunded maintenance. The president has proposed to pay for that spending with higher federal income taxes on the wealthy, mostly through higher statutory rates on corporate and individual income taxes; ending some federal tax preferences; and stronger audit enforcement of wealthy individuals' tax returns.

Whether higher income taxes on the wealthy is good tax policy is a question for another time. But what is clear is that they might not be a reliable long-term infrastructure funding source. Income tax collections can be volatile and unpredictable, especially in today's global macroeconomy. States and localities will be reluctant to take on their own projects if more federal spending on new projects today means more state and local spending on maintenance later. Higher federal gas taxes, or an increase in some other federal excise tax, might be politically unpopular but would offer more assurance.

A second factor is whether states and localities have the right tools. Recent experience tells us that many of the new infrastructure areas President Biden is targeting might not lend themselves to traditional tax-exempt financing. Take broadband access, as an example. Broadband is an expensive, difficult, and uncertain business. It takes time to build a customer base, the technology changes rapidly, and you need economies of scope (as in the ability to serve retail customers as well as businesses, utilities, and others). There are examples of municipal bonds having helped make broadband projects pencil out. Utah's UTOPIA project is a good example. But there are many other examples, like the "Kentucky Wired" program, where projects have struggled even with cheap, tax-exempt capital.

The same is true for affordable housing, where the problem is often local zoning rules that make it difficult for developers to build new units. Or for stormwater management, where the challenge is building and monitoring the thousands of individual rain gardens, bioswales, and other small projects that make up contemporary water reclamation systems.

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Success in these "new infrastructure" areas often comes from leveraging private-sector investment, expertise, and risk sharing. Federal money will help, but many state and municipal officials will argue that the federal government could do a lot by giving them the tools to get the job done locally. This includes loosening rules on how states and localities can deploy tax-exempt capital, restoring municipal bond advanced refundings, broadening access to federal tax credit bonds, and offering other types of federal regulatory relief, among other measures.

A third factor is whether the federal government is willing to respect the distinction between operating expenditures and capital expenditures. The federal government has never had a capital budget. The AJP further muddies these waters by packaging spending on programs like home healthcare as infrastructure.

Many state and local officials will enthusiastically support broader access to home healthcare—but they won't support it as "infrastructure." States and localities develop capital budgets precisely because infrastructure spending is a long-term commitment that requires careful attention to both upfront and long-term costs. They take the capital-spending-versus-operating-spending distinction seriously, and they are understandably hesitant when the federal government does not because it's often left them with the bill. For instance, the Community Oriented Policing Services (COPS) program, established during the Clinton era, expanded community policing in cities all over the United States with broadly accessible federal grants. When the federal funding waned in the following years, local police departments faced the difficult challenge of finding new resources, diverting resources, competing for a shrinking pool of federal money, or ending this otherwise popular program. The same is true for many other areas where well-intentioned federal spending became a long-term local financial challenge.

President Biden deserves credit for putting forward an aggressive, forward-looking infrastructure plan. As he and Congress fine-tune that plan, they should remember that its long-term success will depend on states and localities.

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