First Trust ECONOMIC RESEARCH REPORT

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Dep. Chief Economist*
Bryce Gill – *Economic Analyst*

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Let the Private Sector Take the Reins on Infrastructure

The Trump administration took its first steps to address infrastructure Tuesday, with the president signing an executive order aiming to expedite environmental review and permitting processes. Some will decry the fact that these actions weren't accompanied by a multi trillion-dollar spending bill. With treasury yields so low, the narrative goes, we can borrow massively to finance new bridges and airports, repair crumbling highways, create jobs, and boost economic growth, all while locking in rates that make doing so very affordable. Further, this idea seems to enjoy bi-partisan support. However, government infrastructure spending is far from the panacea it is being made out to be, all too often resulting in money flowing to political allies and massive cost overruns.

First, it is important to note that the largest barrier to infrastructure development is not an unwillingness to invest from the private sector. Instead, the biggest roadblock is a combination of environmental regulations, NIMBY-ism, and local permitting that can drag projects out for years and significantly increase building costs. The president's executive order is a concrete step toward solving this.

These exact issues have been a major impediment to much needed upgrades to commercial rail, seaport, bridge, and water infrastructure nationwide. With the opening of the recently widened Panama Canal, seaports and their private sector partners estimate they will need to spend $155 Billion on upgrades to accommodate larger ships and cargo volumes. However, the opposition from local communities, competing industries, and air regulators has been fierce. In the LA area, BNSF looks ready to abandon its major project following 10 years and $50 million in costs. Similarly, Union Pacific claims it has been in "environmental review purgatory" for nearly a decade in LA and Long Beach, while CSX has stated publicly that the permitting process alone can take double the time of actual construction for its port projects.

And these challenges aren't just confined to the private sector. Gone are the days of the New Deal when much of the country was still undeveloped and the federal government could undertake major projects with minimal opposition. Last year, it was announced that the California high speed rail project that was partly financed by President Obama's 2009 stimulus bill would be delayed another four years. In fact, the Associated Press reported that, as of March, no track had yet been laid. Many of these delays have been attributed to lawsuits, opposition by local farmers, and bureaucratic red tape. As a result, the new estimated cost for the project has now risen to $64 Billion, nearly double the original $33 billion estimate.

But how about state and local government infrastructure projects? Surely they can undertake these projects more efficiently than Washington.

As of June, Census Bureau numbers show that roughly 92% of all public construction was undertaken by states and local municipalities. The problem is that the American infrastructure system is set up in a way that funnels a large portion of federal funding to states on an "equality" basis that isn't adjusted for population or density. This led to Alaska receiving about 8 times more money per head than New York for highways in 2015. Further, state DOTs have remarkably bad track records at utilizing this money effectively. All too often the result is politically motivated highway mega-projects like the infamous Boston "Big Dig", or more recently, Milwaukee's Marquette Interchange taking priority over routine maintenance. In their most recent annual report, Smart Growth America calculated that from 2009-2011, the most recent data available, state DOTs spent 55% of their funds annually to construct or expand only 1% of all roads.

On top of this, cost overruns are commonplace when it comes to public works megaprojects. One driver of these inflated costs is federal "prevailing-wage" requirements that force government projects to pay union style wages despite an abundance of labor at lower market rates. It's no surprise then that one comprehensive study from the Journal of the American Planning Association found that nine out of ten of these projects come in over budget, illustrating the dangers of simply throwing money at the problem.

When it was passed in 2009, President Obama called his stimulus bill "the largest new investment in our nation's infrastructure since Eisenhower built an interstate highway system in the 1950s." Despite this, only $48 Billion of the original $787 Billion total was earmarked for transportation infrastructure. Oftentimes, money earmarked for "stimulus" becomes another way to grow budgets for the general bureaucracy.

For the record, we aren't saying that upgrading infrastructure can't be beneficial, the construction of Denver's airport comes to mind as a crucial driver of the city's recent prosperity. And as we wrote last year, we also agree that the US would benefit from sensible debt financing. However, we think the country would be better served by locking in low rates to help service our debt not only today but in the future. This would give us time to catch our breath and fix our long-term fiscal problems, like Medicare, Medicaid, and Social Security.

As for infrastructure, if we really want to unlock investment potential in the US, the best way to do that is to reduce the regulatory and financial burdens that continue to dissuade private companies from pulling the trigger on big budget infrastructure projects. On this, the Trump administration's actions were right on the money. Not only is this cheaper for the tax payer, but it will also increase the odds that resources are allocated where they are most needed. When money is doled out politically it means resources are being shifted away from more productive uses, which hurts economic growth. We already know Government is bad at picking winners and losers, so why not give the private sector – and free markets - the incentive to lead the charge?