The Market Oracle

Trump's America, Front and Center

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Public infrastructure in the U.S. is in bad shape and has been so for many years. Washington has fingered the importance of doing something about the decrepit state of America's infrastructure for decades. It's the bipartisan thing to do.

President Obama's Council of Economic Advisers devoted a lengthy chapter in its 2016 Annual Report to the Nation's infrastructure problems. Enter President Trump in 2017. The first thing out of his box was infrastructure. But, the "i" word faded away as rapidly as it entered President Trump's lexicon. There was a little problem: the White House didn't really have a fully developed infrastructure plan and most certainly had no legislative action plan. With last week's elections, President Trump once again trotted out infrastructure, as did Nancy Pelosi—the most likely Speaker of the House, which will be controlled by the Democrats in the 116th Congress.

Before I proceed with a proposal that might receive bipartisan congressional support, allow me to address two obvious questions. Just why is public infrastructure in such a sad state? And, why is the stock of America's infrastructure capital consumed but not accumulated? It's all about politicians and their time preferences. After all, it's politicians who control the investment and maintenance decisions related to publicly-owned infrastructure.

Politicians have very high time preferences: what counts is "today," not "tomorrow." Indeed, politicians' discount rates are very high. This means infrastructure investments that have long lives and produce benefits for many years receive short shrift from politicians. The average tenure for a U.S. Congressman is 9.4 years. This implies that project benefits accruing in year 10 are worth nothing for the average member of the U.S. Congress. So, the implied discount rate for the average Congressman would be approximately 100%. With discount rates that high, it is easy to see why most long-lived projects have trouble passing the congressional "smell test." Mega white elephants are perhaps the only exception. They seem to generate huge immediate political benefits at ribbon cutting time.

So, what type of infrastructure program might overcome the political time preference bias and win bipartisan support in the divided government that will commence with the 116th Congress? Sale-and-leaseback arrangements (SLBs) might provide a silver bullet. That's what Steve Walters, a fellow at the Johns Hopkins Institute for Applied Economics, Global Health, and the Study of Business Enterprise, and I concluded. Most governmental entities have vast holdings of poorly maintained infrastructure on their balance sheets. These assets could be monetized via SLBs and “temporarily” put into private hands for maintenance, additions, and improvements.

With a SLB, a government sells its real assets to a private entity and leases them back. This enables government entities to sell their property and receive an immediate cash infusion in exchange for an annual rental payment. There are many variations, but, generally, ownership of the property reverts to its original owners at the end of the lease period. During the lease period, control and management of the property remains with the lessee.

Just how significant might the cash infusions from SLBs be? One high-profile use of SLBs involved the state government of Arizona. It employed such contracts to cope with a 34% plunge in revenue and heightened demand for services arising from the Great Recession of 2007-09. In January 2010, the state raised $735.4 million by selling 14 state buildings via “certificates of participation” that promised institutional and individual buyers annual returns of 4.57% over 20 years and stipulated that the properties would be returned to state ownership at the end of the lease if all lease payments were made. The sale was so successful that the state raised another $300 million with a similar offering six months later. Thus, SLBs helped the state close a $2.6 billion budget deficit in 2010 with an immediate $1 billion cash infusion, though it took on about $76 million in annual lease payments over the following 20 years.

However, sale-and-leaseback instruments should not be seen merely as a means for governments to raise revenues. SLBs can yield tax advantages that enhance their appeal for both buyers and sellers. Because governments are tax-exempt property owners themselves, they cannot benefit from tax depreciation allowances. For this reason alone, government should be asset-lite (read: infrastructure-lite).

Private entities that buy government assets and then lease them back to the government can depreciate the assets purchased for tax purposes. In consequence, the private owners can maintain and upgrade infrastructure at lower net (after-tax) cost than if the government retained the asset ownership.

Instead of being asset-lite, government entities hold huge inventories of real assets, including infrastructure. For example, according to its most recent accounting statements, the government of Baltimore City owns approximately $4.4 billion worth of property that is potentially available for SLB contracts. Most cities and towns of any size similarly maintain holdings of physical assets that would carry depreciation allowance-related tax benefits if held in the for-profit sector. Therefore, the potential demand for SLB contracts is great. So, a key component of any federal initiatives on infrastructure must be the clarification and enhancement of existing depreciation provisions allowed for in SLB arrangements.

The up-front cash infusions from monetizing the infrastructure components of governmental balance sheets that are now essentially “dead” would provide cash strapped governments with funds that could be earmarked, in part, to invest in new infrastructure. But more importantly, SLBs would put the care, maintenance, and augmentation of infrastructure in private hands. Indeed, the most important part of all SLB arrangements are their provisions that dictate exactly how the private lessee must care for and augment the infrastructure projects in a cost-effective manner.

If the encouragement of sale-and-leaseback arrangements isn't a big part of bipartisan infrastructure initiatives, assets on governmental balance sheets will remain "dead" and infrastructure will remain dead in the water, too.

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