

PRIVATE *INFRASTRUCTURE* PROVISION— THE EASY, THE HARD, THE IMPOSSIBLE



By **Edward Glaeser**¹

There are many things to like about President-elect Trump's plan to encourage the private provision of infrastructure. Private firms have incentives to keep costs down. If the costs need to be covered by tolls and ticket fees, no one would build bridges to nowhere or empty monorails. If investors reap returns only over time, they have the right incentives to invest in maintenance.

But private provision is no panacea. In some cases, such as airports, privatization can be swift and relatively painless. Yet generous tax credits for privately built infrastructure—as proposed by Wilbur Ross, Mr. Trump's nominee for secretary of commerce—leave real potential for abuse: when the users don't need to cover costs, it is far easier to waste billions on unwise projects. Better to make tax credits dependent on project performance, as measured by property-value increases.

Unfortunately, privatization is unlikely to be the right recipe for America's most important infrastructure investments: maintaining its existing stock. A better approach would have the federal government monitor infrastructure quality and tie federal support to maintenance.

1. ***The Easy: Airports and New Technologies***
2. ***The Hard: Getting Subsidies Right***
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1.

The Easy: Airports and New Technologies

The world has plenty of well-run privately owned and operated airports, such as London's Heathrow. Yet New York City groans with the service provided by La Guardia Airport and JFK,

which are part of the publicly owned and operated Port Authority. President-elect Trump should follow Prime Minister Thatcher's lead and push to privatize airports that function poorly.

Airports are easy targets: they don't need subsidies, and there are many global models for airport privatization. Air passengers generally have above-average incomes and can readily

¹For further discussion, see Edward L. Glaeser, "If You Build It... Myths and Realities About America's Infrastructure Spending," *City Journal*, Summer 2016.

pay landing fees sufficient to cover the costs of the airport. JFK could certainly survive as a stand-alone business.

Indeed, metropolitan New York is a natural place to start with airport privatization: the current service level is low, and the region's three major airports make the market naturally competitive. This competition should act to keep service level high and prices low. (Where only one airport serves a region, there is a better case for some regulation of landing fees.)

Airports still need regulation. We want the TSA to continue screening—

although it would be best if passengers fully pay for its costs. Ordinary taxpayers in Nebraska should not pay for the security costs of highfliers in New York.

In addition to privatizing airports, there may be other easy wins for the new administration that leverage America's edge in new technology. Taking advantage of new transportation technologies often requires new infrastructure. The full advantage of steam engines wasn't reached until we had built thousands of miles of rail lines. Cars needed the highway system.

Mr. Trump should convene a high-level Transportation Technology Council to discuss how the federal government can—ideally, without subsidies—enable the proliferation of new transport options. Do we need help coordinating electronic charging stations? Do we need new rules about vertical takeoff and landing planes in cities? Do we need separate lanes on highways for autonomous vehicles? The president-elect should embrace the possibilities and start a planning process for the future.

2.

The Hard: Getting Subsidies Right

Mr. Trump has expressed admiration for Peter Navarro and Wilbur Ross's plan to subsidize privately delivered infrastructure. The Navarro and Ross plan imagines that private infrastructure investment would be supported by public tax credits, like the Low Income Housing Tax Credit, which subsidizes affordable housing.

Private Activity Bonds provide an alternative model, one that subsidizes transportation construction by allowing private companies to issue tax-exempt securities. These bonds are allocated by the Department of Transportation to projects like I-495 Capital Beltway High Occupancy Toll lanes.

Yet public subsidies for private investment create new perils for waste

and abuse. The Navarro and Ross plan assumes that the "government will provide a tax credit equal to 82 percent of the equity amount" of investment in new infrastructure. They correctly say that this still "leaves the investor with skin in the game"—though not a lot. Moreover, whenever there are generous subsidies available for private businesses, those businesses have strong incentives to invest in gaming the political process.

While the Navarro and Ross plan avoids technical jargon, their basic economic argument is not specious. New infrastructure can create "externalities"—benefits that are not reaped by the investors themselves. Consequently, the socially desirable amount of infrastructure is greater than the amount of

infrastructure that private investors will produce on their own. Navarro and Ross focus on the benefits that infrastructure creates through added property- and income-tax revenues.

Still, countless wasteful public investments were based on the alleged externalities from new building. Detroit's infamous People Mover Monorail, for instance, was supposed to work magic in the city. It didn't.

Equity investors are sure to love a system where the government pays 82% of their costs while investors get the upside. This is the kind of heads-I-win, tails-the-government-loses scenario that made such mischief in the mortgage-backed securities market before the Great Recession.

The downsides of the Navarro and Ross scheme could be reduced by making tax credits contingent upon performance. If the justification for these subsidies is that infrastructure projects will generate property-tax increases, the credits should be contingent upon increases in property values.

For every new project, define a catchment area that will potentially benefit from the new infrastructure; then define a comparable control region that is not likely to benefit from the project. The increase in property-tax revenues for the catchment relative to the control area provides the natural measure of the size of the external benefit from the project.

If the tax credit is proportionate to the increase in property-tax revenues and is doled out over time, the potential for abuse is significantly reduced. Savvy investors will invest only in projects that are likely to lead to large increases in local property values, and those are the new projects that make the most sense.

A further check on tax-credit abuse is to share the cost among states, localities, and the federal government. Most of the benefits of new infrastructure projects lie within a single state. Federal support should be a fraction of the total tax credit and should flow only when states are also willing to pony up cash.

The federal government can further support local projects by helping states

and localities to evaluate regulations, including land-use laws that can prevent new infrastructure from being built. The Federal Office of Information and Regulatory Affairs provides cost-benefit analysis for executive-branch regulations; but states and localities are too small to have their own cost-benefit analysis shops.

The federal government could help by providing cost-benefit analysis for state and local regulators—and tie tax credits to the use of federal cost-benefit analyses. If the states want the money, they need to submit to an analysis that will ensure that local regulations aren't increasing costs excessively.

3.

The Impossible: Private Maintenance of Existing Infrastructure

For decades, transportation economists have emphasized that the highest returns come from investing in existing infrastructure. In some cases, this means repairing potholes and ensuring the structural integrity of a bridge. In other cases, this means imposing smarter tolls that vary by time of day to ensure more efficient usage.

In theory, privatizing some roads, bridges, and tunnels will solve these problems. A private provider will have incentives to ensure that the road doesn't become unusable. A private toll company will be happy to impose time-varying tolls to make a road more attractive and profitable.

Yet throughout much of America, privatization is politically unlikely and tolling

is deeply unpopular. Like government, private providers may skimp on safety, especially when the benefits from spending on maintenance are not always immediately obvious to drivers. Still, the federal government can help with the repair of existing infrastructure. It can regularly monitor road quality and bridge safety. Improvements in technology have made this easier than ever. It is possible to use drones to photograph roads, and computer vision can now spot potholes from pictures. Bridge and tunnel safety are a little harder to assess, but doable.

In addition to carrots, there are sticks. For example, if a state's infrastructure is in poor shape, the federal government can refuse to support building new infrastructure until the

existing infrastructure is brought up to snuff. Or it can withhold tax credits and require federal highway funds to be used only for maintenance. Or if current tolls are too low to pay for maintenance, it can insist on higher user fees.

When existing infrastructure quality rises above a threshold, some new infrastructure support is feasible; but still, the lion's share of state spending needs to go for maintenance to be eligible for federal support. The key is that the federal government transforms itself from an uncritical funder of new projects to a watchdog that insists that states maintain their existing infrastructure stock.