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Political Change, Budget Tightening Pose Risks for Infrastructure Funding, Projects

NEW YORK—The recent decision by New Jersey Gov. Chris Christie (R) to terminate work on a megaproject that would have resulted in a passenger rail tunnel between New Jersey and New York highlights how quickly political uncertainty and budget woes can put a wrench in infrastructure deals, even after contracts have been issued and construction is underway, according to industry and policy analysts.

The Nov. 2 election results, which gave Republicans control of the House of Representatives and ushered new Republican governors into scores of state houses across the country, paired with the ongoing need by state officials to cut expenses, are expected to bring new announcements of scaled back, delayed, and even cancelled infrastructure and transportation projects in the coming year.

''There is no doubt we're going to see more states tightening their belts,'' said Robert Puentes, a senior fellow at the Washington, D.C.-based Brookings Institution, who studies transportation and infrastructure issues.

''This election is going to usher in a whole new era of austerity,'' Puentes continued. ''The message has been sent loud and clear . . . and a lot of these guys are going to come in with a cut, cut, cut mentality.''

The public and private sectors together spend more than $500 billion a year on infrastructure projects including roadways, sewer and water, airport, schools, and hospital projects. In 2007, federal spending on infrastructure totaled $68 billion, or about one-eighth of all capital expenditures on infrastructure in the United States, according to the Congressional Budget Office.

Infrastructure projects and the jobs they create are seen by many in Washington as a way to grow the economy and the Obama administration supports continued infrastructure spending.

''America has always prospered and grown when its infrastructure has expanded not contracted,'' said Barry LePatner, a lawyer who specializes in construction and infrastructure projects.

State Budget Woes to Continue. But declining state revenue and budget shortfalls are presenting problems for states across the country, with many responding by ushering in broad efforts to streamline government. States have taken ''record measures to downsize and redesign state governments during the 2009 and 2010 state fiscal years,'' according to a recent report from the National Governor's Association on state belt-tightening.

John Thomasian, the director of the NGA Center for Best Practices, said he does not expect states to recover to 2008 pre-recession revenue levels until the close of 2013 in real terms, or today's dollars. ''In a number of instances, states may not recover until the end of the decade,'' he said.

Cities similarly are expected to face a combined fiscal shortfall of between $56 billion and $83 billion over the next three years, according to the National League of Cities. In 2008, local governments spent $93 billion on water and sewer services and infrastructure alone, according to the U.S. Conference of Mayors. These costs are projected to rise in the coming years and decades and cities are expected to struggle to find the capital to undertake these projects.

City finance officers recently surveyed by the National League of Cities said the ''fiscal condition of the nation's cities continues to weaken in 2010'' amid the ongoing economic downturn, according to a report released in October.

A report released Nov. 1 by the ratings agency Standard & Poor's confirmed the difficulty that state and local officials will face amid the ''trend of growing budget gaps'' and ''the declining availability of federal stimulus funds,'' though the ratings agency is optimistic that most can weather the financial storm.

''[W]e believe that most municipalities and state governments will likely be able to continue to make the tough fiscal choices to see them through this challenging economic climate while meeting their debt service obligations and covenants,'' the report said. ''However, adding to the difficulty of managing through this climate are, in our view, indications that the economic recovery will continue to be tepid.''

Infrastructure Funding Challenges. To address budget shortfalls, plenty of local officials are eying costly infrastructure projects and the savings that can be achieved by halting projects in the near-term, according a report from the National League of Cities released in October.

''To cover budget shortfalls and balance annual budgets, cities are making a variety of personnel cuts, delaying or cancelling infrastructure projects, and cutting basic city services,'' the report said.

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Of the financial officials surveyed who are facing ''prospective shortfalls'' this year, 69 percent said delaying or cancelling capital infrastructure projects is one of the most common ways to address this problem, according to the report. Similarly, 73 percent of those surveyed said infrastructure costs are having a negative impact on city finances in 2010.

State officials understand the need to focus on long-term funding of infrastructure projects that may take more than a decade to plan and build even if the political and economic environments make it difficult to obtain funds. In a recent speech, California Gov. Arnold Schwarzenegger highlighted the outlook that state officials must take to address infrastructure needs saying, ''If you do water infrastructure, you look 20 years ahead, 30 years out. If you build roads, if you build more schools, university buildings, if you fix the levees—it's all not about now, it is about the future.''

But actually coming up with the funds for transit, road, port, and water systems amid the current economic conditions is expected to become more challenging in the next year.

In mid-October, Mississippi Gov. Haley Barbour (R) informed state agency of an expected $600 million budget shortfall for the state in 2011, saying agencies will face a 10 to 15 percent reduction in funding compared to current levels, with some seeing even larger cuts.

Virginia Gov. Robert McDonnell (R) similarly asked state agencies to suggest budget cuts of up to 6 percent by Nov. 5, with such cuts making it more likely the state will be able to fund economic development, higher education, and transportation programs without raising taxes.

Pennsylvania Gov. Ed Rendell (D) has asked the state legislature to increase the so-called gas tax, along with fees for driver's licenses, registrations, and vehicles to address the state's $3 billion funding gap for much-needed infrastructure improvements across the state, but the proposals have not gained traction. In October, Rendell and Philadelphia Mayer Michael Nutter (D) met with Obama administration officials to ask for additional federal funds for transportation and infrastructure projects.

Pennsylvania is not the only state looking for additional federal aid to complete infrastructure projects. The Department of Transportation, in late October, announced that 75 highway, bridge, transit, rail, and ports projects in 40 states would share roughly $600 million in Transportation Investment Generating Economic Recovery (TIGER) funds (1 IIPR 5, 10/25/10). The agency received close to 1,000 grant applications requesting more than $19 billion in funding.

In its first round of funding, announced in 2009, the TIGER grant program, which was created by the American Recovery and Reinvestment Act of 2009, received applications for nearly $57 billion worth of projects (1 IIPR 12, 9/28/09).

Additional Federal Funds Unlikely. In this economic environment, states will ''continue to muddle through'' when it comes to funding transportation and infrastructure projects, according to Joseph Giglio, executive professor of strategy at the College of Business at Northeastern University. Giglio previously chaired the U.S. Senate Budget Commission on Innovative Financing of Infrastructure and is a past chairman of the Public-Private Division of the American Road and Transportation Builders Association.

The Obama administration supports increased spending and investment in transportation infrastructure as a way to grow the economy and create jobs, a position that was reiterated by Transportation Secretary Ray LaHood in his efforts to convince New Jersey officials to revive the proposed $9 billion tunnel project despite concerns about cost overruns and the state's budget shortfall (1 IIPR 17, 11/1/10). In September, President Obama called for a $50 billion stimulus package specifically targeted to infrastructure projects (1 IIPR 5, 9/13/10).

But there is little optimism that a new Republican majority in the House and a slim Democratic majority in the Senate will have an appetite for a large, new spending package.

''There's not going to be more money coming from the federal government,'' said Thomasian. ''I don't see how we can expect any additional transportation funds.''

''Do I think infrastructure and transportation funding is important? Yes,'' Giglio said. ''But it's certainly not urgent,'' he added, pointing to a host of other issues that are higher priorities for most Americans today.

''What I think you are going to get is more flexibility [from Congress] rather than [more] funding,'' said Giglio. By flexibility, Giglio means support from congressional leadership for a move toward market pricing and more public-private partnerships for transportation and infrastructure projects.

''We need to get people to think about the users of the system as customers,'' Giglio said.

But he also warned that ''If you're going to ask people to pay more taxes or user fees'' to access transportation infrastructure, states will need to raise the level of accountability of their transportation agencies and ''start guaranteeing a minimum level of performance'' for users.

States Face Different Decisions. LePatner said New Jersey Gov. Chris Christie's decision to abandon the tunnel project is understandable given New Jersey's limited pocketbook and the open-ended construction contracts that could easily have turned the tunnel project into a boondoggle that left taxpayers on the hook.

''Gov. Christie is correct in saying there will be cost overruns,'' LePatner said. ''Rarely, rarely, rarely does a megaproject not go wildly over budget.''

But LePatner also said the country's roads, bridges, dams, and levees need to be repaired and maintained. LePatner thinks part of the solution is making the construction industry take on the risk for getting projects done on time and on budget. With open-ended contracts, ''the construction industry will dictate the cost'' of the project, LePatner said.

''We know the costs are going to be underreported to the public'' when big transportation and infrastructure projects are proposed, Giglio said.

Puentes does not see any other obvious big-ticket infrastructure projects like the New Jersey to New York tunnel likely to be cancelled, and suggested that the New Jersey project may have been an outlier due to its size and a host of state-specific issues New Jersey faces when it comes to financing infrastructure that factored into the state's decision to nix the project.

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"Decisions in Michigan won't be the same as decision in Tennessee," Puentes said. "There are not a whole lot of projects like [the Hudson tunnel]," he added.

Giglio similarly highlighted the state's underfunded pensions and other financial obligations the state is grappling with. "If you are Gov. Christie you say, on balance, this is not the time for me to be doing this," he said.

"You are not going to see [something like] that in Texas," Giglio said, referring to the decision to cancel the New Jersey project. The increases in the population in Texas and the subsequent need for additional infrastructure capacity make it unlikely transit projects will be curtailed.

Far more likely is continued efforts to scale back funding for infrastructure projects in states that have budget problems similar to New Jersey and where officials want to be "conservative and prudent" and mitigate their costs when they don't have access to a steady stream of transportation funding, Giglio said.

"The way they do it in infrastructure is you just don't see new projects" getting funded, Thomasian said.

In order to give more funding to transportation and infrastructure projects, states would need to lower liabilities elsewhere, Thomasian said. But states have already been doing this for years to fund health care and a host of other existing obligations, he said.

"It's going to be tough to keep up with transportation projects," Thomasian said. "I just don't see major projects getting funded unless it comes from" the private sector.

Austerity Versus Infrastructure. Whether some states could try to impose so-called austerity cuts to most areas of government yet sustain or increase money to infrastructure and transportation projects remains unclear.

"There are going to be cuts, but I think the smart ones will be the ones with the austerity cuts but they will be coupled with long-term infrastructure spending," Puentes said.

This approach has been taken more recently by British Prime Minister David Cameron, who announced steep austerity cuts in most areas of government combined with a new national infrastructure plan for long-term investments in projects aimed at bringing growth and jobs to the economy (1 IIPR 23, 10/25/10).

By Stephanie I. Cohen

The National Governor's Association Report, "State Government Redesign Effort in 2009 and 2010, is available at http://www.nga.org/Files/pdf/1010STATEGOVTREDESIGN.PDF. The National League of Cities Report/Survey of city financial officials on City Fiscal Conditions in 2010 is available at http://www.nlc.org/ASSETS/AE26793318A645C795C9CD11DAB3B39B/RB_CityFiscalConditions2010.pdf.