The Infrastructure Investment Decline

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In this edition of State Fiscal Affairs, Fisher and Wassmer discuss government infrastructure spending, which has declined significantly in the past decade. The authors also compare infrastructure spending in different areas of the nation and conclude that state and local governments are not sufficiently investing in maintaining our nation's infrastructure.

A term once reserved for policy wonks, "infrastructure" now is at the forefront of broad policy and political discussions. State and local governments are at the front- lines of addressing the issue, especially because Congress has been in an extended period of inaction.

This topic even has made its way into the presidential election, despite everything else going on. In *The Atlantic*, Derek Thompson noted: "It is one of the few things that Donald Trump and Hillary Clinton agree on: The U.S. needs to spend more money on itself."[1] Democratic presidential nominee Hillary Clinton offered a plan called "Fixing America's Infrastructure,"[2] which is a $275 billion, five-year plan. In a September talk to the New York Economic Club,[3] Clinton's Republican counterpart Donald Trump said that "crumbling roads and bridges can become gleaming new infrastructure," although he has offered little detail on how this would be accomplished.

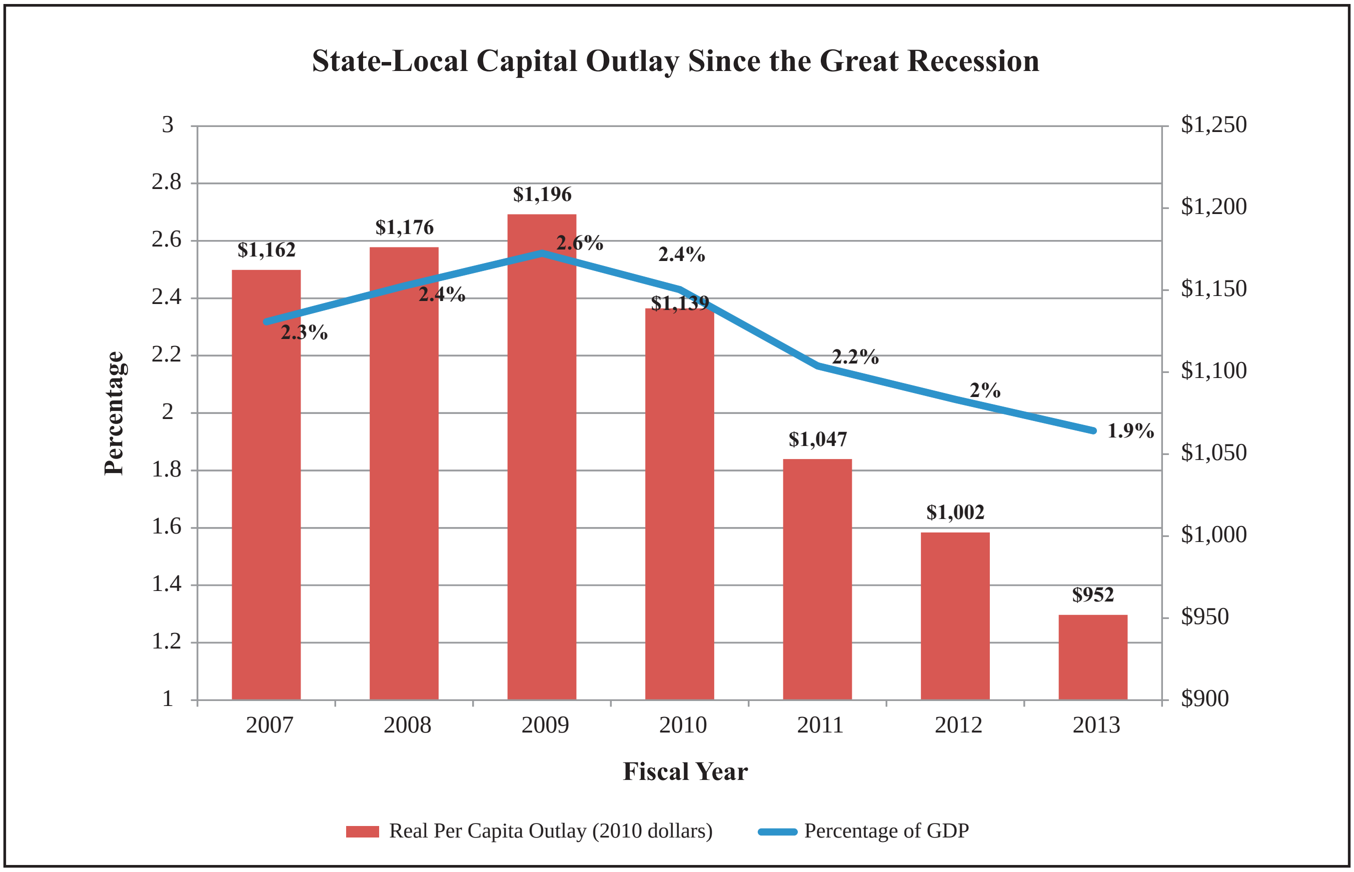
In contrast to a federal government focus, the great bulk of spending on public infrastructure — roads, bridges, airports, ports, schools, parks, water and sewer systems, and so on — is made by state and local governments (in some cases with the assistance of federal government financial support). In fiscal 2013, state and local governments spent more than $323 billion on public capital investment, which corresponds to nearly 2 percent of GDP, more than $1,000 per person, and 10 percent of total state and local government expenditure.

Although these numbers suggest the substantial magnitude of public capital investment by states and localities, it is also true that state and local governments are not investing to the same degree as in the past. State and local government spending on infrastructure has declined substantially in the last several years and is now less than before the Great Recession, as shown in the figure. State and local capital spending was 2.3 percent of GDP in 2007 but only 1.9 percent in 2013. Adjusting for changes in population and prices, real per capita state and local capital spending declined from $1,162 in 2007 to $952 in 2013.

Part of the reason for the decline in public capital investment is that state and local governments are spending less overall, but it is also because capital investment has become relatively less important in state and local government budgets. State and local governments in aggregate spent more than 12 percent of total expenditure on capital investment in 2007 but only about 10 percent in 2013.

Taking a much longer perspective, the gap in infrastructure investment is even more apparent. Much of the current state and local infrastructure originated in the post-World War II construction boom — new housing, new subdivisions, and new communities led to construction of schools, water and sewer systems, and roads. Interstate highway construction began in the 1950s, and during the 1957 to 1967 period, state and local government capital spending was consistently greater than 3.5 percent of personal income. Since 2011 state and local government capital spending has been less than 2.5 percent of personal income. Similarly, during the period 1952 to 1967, capital spending

[1]Thompson, "One Issue Trump and Clinton Agree On," *The Atlantic*, Aug. 16, 2016.
[2]Hillary Clinton campaign website, "Fixing America's Infrastructure," *available at* http://hrc.io/29Jc86d.
[3]Press Release, "Trump Delivers Speech on Jobs at New York Economic Club," Sept. 15, 2016, *available at* http://bit.ly/2ch6N61.



accounted for more than 20 percent of total state and local government expenditure compared with 10 percent recently.[4]

Regional experience supports the perspective that state and local governments may want to increase infrastructure investment. For example, New England state and local governments spend relatively less on capital projects than other states, as shown in the report Fisher coauthored for the New England Public Policy Center at the Federal Reserve Bank of Boston.[5] Census data show that state and local capital spending in all six New England states was well below the national average between 2000 and 2012, whether measured on a per capita basis, as a share of personal income, or as a share of state and local government spending.

In the case of New England, the relatively low levels of state and local government capital expenditure for that region relative to the national average do not seem to be explained by traditional economic and social characteristics. The existing public capital stock in the New England states does not seem to be of such high quantity or quality that additional investment is unwarranted. It also does not seem to be the result of a different organization of higher education or public utilities in the New England states than nationally.

On the other hand, a political focus on lowering state government debt may have contributed substantially to the New England states' relatively low investment in public capital. If attaining low debt levels is the focus of policy attention and debt and capital investment are considered jointly, attempts to lower state government debt may contribute to a lessened degree of investment in public capital.

The experience in New England applies to other states and regions as well. In Michigan, state and local government capital spending was between 25 and 20 percent of total spending in the 1950s and 1960s, 8 to 9 percent before the Great Recession, but only about 6 percent today.

The state government in California exhibited similar spending priorities in fiscal 2015 to 2016, with about 20 percent of state spending to education, 15 percent to healthcare, 10 percent to pension obligations, 10 percent to welfare, 9 percent to protection, and only 8 percent (or $34.4 billion) to transportation. Democratic Gov. Jerry Brown's

[4]Authors' calculations based on Census Bureau reports.

[5]Darcy Rollins Saas, "Why Is State and Local Government Capital Spending Lower in the New England States Than in Other U.S. States?" Federal Reserve Bank of Boston (July 30, 2016).

2015 five-year infrastructure plan[6] calls for the state to spend $57 billion in infrastructure investment before 2020. According to Brown, nine out of 10 of these new dollars needs to be spent on California's transportation system, which, according to the governor's infrastructure plan, has about $59 billion in deferred maintenance.

Therefore, a reasonable conclusion is that state and local governments are not spending sufficiently today to maintain the substantial public infrastructure that was built initially in the 1950s and 1960s. Much of the existing infrastructure has lasted 50-plus years and is now in need of repair, if not outright replacement. Of course, spending to expand infrastructure — such as for new transportation facilities — also may be warranted. Taking the 1950 to 1970 period as a guide, a decade of capital spending amounting to 3.5 or 4 percent of personal income may be necessary. That would mean increasing infrastructure investment spending to about $575 billion annually compared with the $320 billion in 2013. And certainly there is a substantial role for the federal government in such investment given the national importance of these public facilities. ■

[6]Gov. Edmund G. Brown Jr., "2015 California's Five-Year Infrastructure Plan," *available at* http://bit.ly/2eB3KYd.