Robert Schalkenbach Foundation
Briefing on Infrastructure

Wheels of Fortune

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1. The $1.6 Trillion Challenge

IF THE United States had followed the example set by one of its mayors a century ago, it might not now be saddled with a $1.6 trillion challenge. That is the sum that needs to be spent over the five years to 2010, according to the American Society of Civil Engineers (ASCE), to upgrade the nation's infrastructure. Bottle necks in the transport system, overcrowded schools and dangerous bridges are just some of the consequences of the failure to maintain investment at appropriate levels to meet the needs of an expanding population and growing economy.

Investment in infrastructure ought to be on a continuous basis. But governments persistently claim that a shortage of capital means that tough choices have to be made – and that some needs would have to go unmet. But is this correct?

When he was Mayor of Cleveland (between 1903 and 1909) Tom Johnson – *pictured above* – campaigned for a policy which would have ensured that "public goods" would be renewed through a self-funding system. In essence, as he proposed for the funding of the tram system in his city, capital costs would be defrayed out of a charge on the value of land. This would be matched by lower transit fares to maximise the number of passengers travelling on the trams. But why the public charge on land values? Because, as Johnson stressed, the net gains from productivity delivered by mass transit systems surfaced as an increase in the value of land. That value, if it were recycled back into the funding of transportation, would reduce the need to tax people's wages and savings. As a US Congressman in the 1890s, Johnson was one of a number of statesmen who sought to enshrine that policy in the nation's system of public finance.

Johnson and others helped to include land rents in an income tax act. The policy reform was inspired by Henry George's *Progress and Poverty* (1879). But the US Supreme Court threw out this refinement of the income tax act in 1894. The result was a shift in the structure of public finance away from the value that was created by investment in infrastructure and on to wages and salaries. As a result, politics came to play a role in the determination of where and when money would be spent on the nation's infrastructure.

2. Railway Bottlenecks

FOR THE first time since World War II, the US economy is suffering from bottlenecks in the rail network. The freight railroad industry alone needs to spend $175-195bn over the next 20 years just to maintain existing infrastructure. Intercity corridor passenger rail service needs another $60bn over 20 years. Annually investment needs to be $12-13bn if the railway network is to meet demand. Total transport expenditure ought to be increased by $94bn a year to meet the nation's needs, according to the ASCE.

But the funding system is so inefficient that many transit operators are borrowing to maintain operations, raising fees and cutting back the services they provide for customers. This is not a sustainable financial formula.

- Since deregulation, railroads have spent $349bn on capital improvements. This was insufficient for the Class 1 railroads to retain market share. The revenues being generated are insufficient to fund investment in tracks and equipment.
- Small railroads are particularly vulnerable. Without additional taxpayer-funded subsidies from government they will be unable to upgrade the infrastructure and may therefore cease to exist.

The ASCE proposes the establishment of a federal capital budget as a mechanism that would help to reduce the funding problems. Current federal budgetary policy fails to differentiate between expenditures for current consumption and long-term investment. The outcome is political horse trading which leaves the economy at the mercy of deals in the corridors of power which may have nothing to do with maintaining the efficiency of the nation's need for mobility.

3. The Costs of Motoring

UNDER-INVESTMENT in highways is imposing enormous costs on motorists. Total spending of nearly $60bn annually falls short of the $94bn needed to improve the nation's highway network.

- Poor roads cost motorists an estimated $54bn every year in avoidable repairs and operating costs – about $275 per motorist.
- Highway congestion increases travel time at a cost of an estimated $67bn in lost productivity and wasted fuel.

- Sub-standard roads create safety and health hazards. Automobile accidents costs US citizens $230bn a year in medical costs, lost productivity and workplace, legal and insurance costs.

According to the American Association of State Highway and Transportation Officials (AASHTO) capital outlay by all levels of government would have to increase by 42% to reach the projected $92bn just to maintain existing levels of service, and by 94% to reach the $125bn that is needed to improve standards to the desired levels of efficiency.

4. Sub-standard Schools

THE Federal government has not assessed the condition of schools since 1999. But in that year, a Department of Education report revealed that $127bn was needed to raise the quality of the nation's school facilities. In 2000, the National Education Association reported that the need was even greater – more than $268bn ought to be spent.

But the politics of taxation make it difficult to ensure sufficient funds for education. In New York City, for example, a court-appointed panel found that $9.2bn in new amenities like classrooms and libraries were needed to relieve crowding and provide adequate facilities for 1.1m public school students.

But in Arizona, a state court ruled that funding school construction and repair through local property taxes was unconstitutional. This obliged the state to shift hundreds of millions of dollars from other sources to fund school facilities.

The ASCE is lobbying the Federal government for increased grants for high-poverty school districts. But is this really the satisfactory solution for a funding crisis in which the nation's wealth and welfare is at stake?

A new fiscal approach may yield the desired results, which ties public goods such as roads and schools to the value which they create. These, as Tom Johnson noted a century ago, increase the productivity of a community and, in doing so, increase land values. The principles of both economic efficiency and justice require that this land value be used to fund infrastructure.

Take the case of schools. Families locate themselves in homes close to those schools where they know their children will receive a good education. Competition for residential properties within the catchment area of the schools is raised as a result. Families are willing to pay a premium in order to gain access to the schools. In fairness, shouldn't that premium be channelled to the amenity that creates the value in the first place – the school?

The way to solve the intricate issues is to reform the property tax. If public goods were funded out of land values, this would be no more than another example of people paying for the benefits which they received. And by funding infrastructure out of land values, it would be possible for all tiers of government to reduce the burden of those taxes that currently inflict damage on the wealth of the nation and the welfare of US citizens.

Tom Johnson believed that this strategy would make it possible to enable people to travel without paying for their rides on street cars (trams). Sufficient revenue could be raised out of locally generated land rents to fund mass transit systems. Economically speaking, he was correct. In subsequent decades, distinguished US economists were awarded Nobel prizes for their contributions to the economics of public goods. One of them, the late William Vickrey of Columbia University, explained that landlords would actually gain as a result of their agreeing to fund transit systems out of land values.

A century ago the power of landowners was too great. They thwarted the mayor's plans for reforming Cleveland's approach to paying for public services. Johnson's biography contains an introduction by his editor, Elizabeth Hauser, who explained how the real estate interests ganged up against the Mayor's plans to slash transit fees and raise additional revenue from the value of land.

> …there was organised as if by instinct a sympathetic, political-financial-social group whose power and influence made itself known the moment it was touched. Banks that did not sympathise with this conspiracy were coerced by fear into compliance with the will of the stronger institutions. Through the banks, manufacturers, wholesale and retail merchants were reached. Business men who openly sympathised with the low-fare movement were called to the directors' rooms in the banks and advised, sometimes in guarded language, that their loans might be called or their credit contracted…at one time 14 of the leading law firms of the City were employed against the movement.

Against such a ferocious coalition, the mayor's plans were defeated. Other congressmen and civic leaders echoed the views of Tom Johnson, but their wisdom was not allowed to influence governance in the 20th century. One result was that nation's infrastructure will decay deeper into crisis unless effective reforms are instituted to the property tax.

Sources:

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