

Commission Briefing Paper 5A-14

Evaluation of Tax-Preferred Investment Products as a Transportation Financing Mechanism

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Date: January 10, 2007

Introduction

This paper is part of a series of briefing papers prepared for the National Surface Transportation Policy and Revenue Study Commission authorized in Section 1909 of SAFETEA-LU. The papers are intended to synthesize the state-of-the-practice consensus on the issues that are relevant to the Commission's charge outlined in Section 1909, and will serve as background material in developing the analyses to be presented in the final report of the Commission.

This paper presents information on the contribution that federally tax-preferred debt and equity investment products can make in stimulating capital investment in surface transportation. The three investment products summarized are (1) tax-exempt private activity bonds, (2) tax credit bonds, and (3) investment tax credits. A separate research paper (Task 1-14) evaluates the potential contribution of other innovative finance tools (GARVEE Bonds, State Infrastructure banks, federal credit programs, etc.)

Background and Key Findings

- Federal tax incentives can provide a substantial subsidy to capital investment in long-lived assets such as transportation projects, by providing a portion of the investor's return through tax benefits rather than project cash flow. Tax Code measures may be especially suitable for encouraging investment in sectors that are not otherwise eligible to receive federal assistance, such as freight rail.
- SAFETEA-LU established a new class of "private activity" tax-free bonds with a volume cap of \$15 billion. The provision is intended to encourage private participation in the delivery, operation and ownership of highway, freight transfer and other surface transportation projects. Tax exemption generally provides a 15-20 percent present value subsidy on long-term borrowing.
- To date, USDOT has authorized one state (Texas) to pursue plans to issue up to \$1.86 billion of **private activity bonds** for a highway project. As with the TIFIA program (described in Briefing Paper 1-14), use of this financing tool likely will be limited to the relatively small number of eligible projects that can generate sufficient revenue to repay project debt. Other factors that may limit the use of these private activity bonds include: (i) narrow yield spreads between taxable and tax-exempt debt; (ii) limitations in the tax code on how private activity bonds may be structured; and (iii) the apparent willingness of commercial banks to accept credit risk on project debt lacking an investment grade rating.

This paper represents draft briefing material; any views expressed are those of the authors and do not represent the position of either the Section 1909 Commission or the U.S. Department of Transportation.

- A deeper form of federal subsidy can be conferred by **tax credit bonds**, in which the borrower pays no cash interest. Instead, the lender receives its annual return in the form of federal tax credits. Depending on the term of the bond, this can subsidize 50-75 percent of the cost of borrowing, in present value terms.
- To date, Congress has enacted three separate tax credit bond programs totaling over \$5 billion in volume – for school modernization, renewable energy projects and Hurricane Katrina assistance. Several tax credit bond proposals for surface transportation have been introduced in recent years (e.g., Build America Bonds, Amtrak, other rail infrastructure), but none has yet been enacted.
- Another form of credit can be used in connection with direct equity participation, through **investment tax credits** (ITCs). There presently are ITCs in sectors such as energy, low-income housing and historic preservation that produce present value benefits in the 20-40 percent range, depending on the terms of the specific programs. Because ITCs are less liquid and require direct ownership of the asset, the market for investors is much narrower. This approach is seen as requiring higher yields to investors, and being less cost-effective from a federal perspective.
- Of the three tax-preferred investment products, tax credit bonds are potentially the most effective at encouraging private investment in certain facilities, due to the depth of the subsidy and the potential for developing a broad investor market. However, their deeper subsidy means a higher cost to the federal government, requiring strong justification that targeting investment to that activity will clearly benefit the public.
- Regardless of the tax-preferred product, it is important to recognize that financing tools still generate only a partial subsidy. Each assisted project will require identifying a predictable long-term revenue stream. Accordingly, tax-preferred products should not be viewed as an “investment gap-closer” in the way that revenue-raising policies such as increasing or forward-indexing of fuel excise taxes would be.

I. Background

Federal policy makers have four general types of policy tools they can use to stimulate capital investment in surface transportation projects: direct grants; credit assistance (loans and loan guarantees); regulatory reforms; and tax code incentives. Historically, Federal-aid reimbursement grants have been the principal tool used by the federal government, with credit assistance (TIFIA, RRIF) and regulatory reforms (design-build contracting, environmental streamlining) playing supplemental roles. The final category—tax incentives—has played only a minimal role in surface transportation investment policy to date. For example, while transportation spending consumes about 3 percent of the federal budget, tax expenditures

(representing the fiscal cost of tax incentives) for transportation purposes amount to only about 0.4 percent of the total estimated tax expenditures in coming years.”¹

However, with continued constraints on federal spending and the need for deeper subsidies than provided by credit and regulatory tools, policy makers are focusing increasingly on how the Internal Revenue Code (the “Tax Code”) may be used to stimulate capital investment. Providing a portion of the return on capital investment in the form of federal tax benefits reduces the level of cash flow the project must generate. Unlike grants, tax incentives do not get fully “expensed” at the outset for budgetary accounting purposes. Rather, the tax expenditures are recognized over a multi-year period, more closely matching the fiscal impact of the derived benefits. In addition, tax-preferred investments are subject to market discipline, since private investor capital is placed at risk (unlike grants).

This briefing paper examines three forms of tax-preferred financing. One tax incentive for highways and intermodal facilities—tax-exempt Private Activity Bonds—was enacted as part of SAFETEA-LU. Two other forms of tax incentives—Tax Credit Bonds and Investment Tax Credits—have been used in other sectors and are being considered for the transportation sector. Freight infrastructure, in particular, is seen by some as a potential candidate for subsidized investment through tax credits since it is a largely private sector function providing significant benefits to the general public.

II. Private Activity Bonds

A. Tax Treatment of Transportation Bonds. Generally, states and their political subdivisions may issue debt on a tax-exempt basis to fund new facilities for public use without federal limitation.² The ability of the investor to exclude the bonds’ interest from federal income taxation—and state and local income taxation within the issuer’s jurisdiction—enables the issuer to borrow at lower rates. In present value terms, the tax-exemption subsidy today is worth approximately 15-20 percent of the face amount borrowed.³

Under the Tax Code, if more than 10 percent of bond proceeds are used directly or indirectly by a private business *and* more than 10 percent of the debt service is secured by payments from a private business, the bonds are deemed private activity bonds (“PABs”). This is the case even where the private activity is incidental to a public use and benefit, such as a public toll road that

¹ The FY 2007 Budget of the U.S. Government estimated 2007 transportation function current services outlays of \$77 billion out of total federal outlays of \$2.7 trillion. In its *Estimates of Federal Tax Expenditures for Fiscal Years 2006-2010*, the Joint Committee on Taxation estimated average annual transportation function tax expenditures of under \$5 billion out of total federal tax expenditures of nearly \$1.1 trillion. Virtually all of these tax expenditures are associated with the exclusion of employer-paid transportation benefits (parking and transit passes). This figure does not include the tax expenditures associated with the issuance of tax-exempt governmental purpose bonds for highway and transit purposes. The estimated tax expenditure for the newly authorized highway and intermodal private activity bonds is negligible (less than \$50 million per year).

² Certain overarching federal rules apply to the use of proceeds within prescribed periods, reinvestment provisions, etc. Governmental issuers may face separate constitutional or statutory debt limitations at the state or municipal level.

³ The estimate of the present value benefit attributable to borrowing at tax-exempt rates is calculated by comparing the level debt service requirements for mid-investment grade 30-year bonds issued at 4.75% (tax-free) and 6.25% (taxable) yields, and discounting the annual savings at the tax-exempt yield.

is privately operated, or a freeway maintained under a long-term, private management contract.⁴ Thus, the Tax Code generally prohibits tax-exempt financing of facilities owned or operated by private, for-profit entities through a long-term lease or concession.

The interest income on PABs is taxable unless the financed project falls into one of several “exempt facility” categories enumerated in section 142 of the Tax Code. One of the exempt facility classes authorized by Congress in the 1980s is governmentally owned “mass commuting facilities,” defined as the infrastructure and systems (*excluding* rolling stock such as buses and rail cars) of a privately operated transit project. Mass commuting bonds, however, must receive an allocation by the state from its annual PAB “volume cap” — the maximum amount of tax-exempt private activity bonds that may be used in a state in a given year. The volume cap for each state in 2006 is the greater of \$80 per capita and \$246.6 million. Because this volume cap also applies to other PAB purposes (single and multi-family housing, student loans, manufacturing, etc.), there is considerable competition for allocations. In fact, there have been very few PABs issued for mass commuting facilities.⁵ Tax-exempt private activity bonds for financing of airports, ports, and governmentally owned high-speed intercity rail facilities are not subject to these volume limits. The table on the following page summarizes the use of private activity bonds by category in 2004.

Section 11143 of SAFETEA-LU provided for a new class of PABs—highways, rail-truck freight transfer facilities, and any other transportation project receiving title 23 assistance. These bonds are *not* subject to the annual state volume caps, but *are* subject to a nationwide limitation of \$15 billion, to be allocated by the USDOT Secretary. A *Federal Register* notice published January 5, 2006 (Vol. 71, No. 3, 642-644) sets forth the application process. As of December 31, 2006, only one application has been approved. The Texas Department of Transportation was given permission to apply for \$1.86 billion of funding on behalf of prospective private investors developing a new toll road, under the proviso that the private companies become the ultimate borrowers and arrange to repay the PABs with toll revenues. The state expects to seek final approval from the Secretary in the fall of 2007 after negotiating a comprehensive development agreement with a private consortium to design and build the toll facility.

Long-Term Tax-Exempt Private Activity Bonds by Category, 2004 *

Purpose Of Bond	Number Of Issues	Amount (Billions)	Share Of Total
Airport	37	\$ 2.5	5.2 %
Docks and Wharves	13	\$ 0.3	0.6 %
<i>Mass Commuting</i>	0	\$ 0.0	0.0 %
Solid Waste Disposal	67	\$ 1.4	2.8 %
Residential Rental	477	\$ 5.6	11.6 %
Liberty (New York City)	8	\$ 1.2	2.5 %
Mortgage	146	\$ 5.1	10.6 %

⁴ The Tax Code does allow private sector management of a facility to a limited extent, without it being deemed a “private activity.” But the management contract rules circumscribe volume-related compensation and effectively prohibit incentive-based compensation to the manager. The permitted term of the contract is limited to a much shorter term (5-15 years) than that of a typical bond.

⁵ PAB mass commuting facilities financed to date include ancillary retail uses and parking garages at commuter rail stations and Amtrak-owned power supply equipment jointly used by commuter agencies.

Small Issue	399	\$ 0.7	1.4 %
Student Loan	35	\$ 4.0	8.3 %
Section 501(c)(3) Hospital	298	\$ 1.1	23.1 %
Other Section 501(c)(3)	1,050	\$ 15.7	32.7 %
All Other	14	\$ 0.3	0.7 %
Total	2,544	\$ 47.9	100 %

* Source: *Tax-Exempt Bonds, 2003-2004*, by Cynthia Belmonte, Special Projects Section, Statistics of Income, Internal Revenue Service, Table 7. Excludes refunding issues.

B. Potential Use of PABs. There has been a growing trend for state/local governments to enter into public-private partnerships to develop and manage major transportation facilities such as toll roads. In prior years, some project sponsors have created special-purpose non-profit (“63-20”) corporations to issue tax-exempt debt to finance the projects. However, private sector participants are not permitted to make equity investments under those arrangements, and contracts for operation and maintenance of the financed facility must comply with IRS “management contract” rules that restrict the term of the agreement and the compensation provisions. SAFETEA-LU enables greater private sector investment and participation in public infrastructure projects, through an amendment to Section 142 of the Tax Code adding highway and freight transfer projects as PAB-eligible exempt facilities.

Given the growing number of highway concession proposals nationwide, proponents of the highway/intermodal PAB provisions anticipated that there would be a substantial demand by concessionaires for the \$15 billion volume cap. Few of the projects in the pipeline however are ready to be financed. In addition to a lack of ready candidates, the limited use of this new policy tool may reflect other factors, such as:

- *Restrictions on Acquisitions.* The Tax Code generally limits PABs to new construction, and not more than 25 percent of proceeds may be used to acquire land.⁶ Thus, much of the leasing of existing highway facilities to private investors / operators (e.g., Indiana Toll Road, Chicago Skyway) may not be eligible for PAB financing.
- *Limited Structuring Flexibility.* Many start-up toll roads do not generate sufficient revenue during the ramp-up period to fully cover interest expense on borrowed funds. The Tax Code effectively prohibits the accretion of interest on PABs (negative amortization of principal), which is deemed to be working capital – a prohibited use of proceeds. This restriction limits the usefulness of PABs in project financings that require back-loaded repayment structures, where interest is deferred to accommodate the revenue profile.
- *Straight-line Depreciation.* Under Section 168(g) of the Code, PAB-financed property may only be depreciated on a straight-line basis over the defined class life of the asset. In contrast, “owners” of facilities financed with taxable debt may be able to claim

⁶ The purchase of existing property (other than buildings and related structures) may only be financed with PABs if capital expenditures for rehabilitation equal 100 percent of the acquisition cost. It is unclear how assets like roadways would be treated.

accelerated depreciation of the asset, which might represent a 5-10 percent differential in present value terms.⁷

- *Narrow Yield Spread.* Under current market conditions with prevailing yields at relatively low levels, project sponsors can arrange loans from foreign commercial banks at rates approaching tax-exempt levels. Foreign lending institutions are more accustomed to privately-operated toll roads, and appear willing to accept greater credit risk than the tax-exempt buyers, most of whom require investment-grade ratings (“BBB-minus” or higher) on the bonds.

C. Contribution to Closing the Investment Gap. It is difficult to gauge the net effect of PABs in generating incremental highway/intermodal investment. In theory, such bonds can help attract greater private participation in project development and operations, thereby facilitating investment that otherwise might occur more slowly or less efficiently. The potential investment effect of PABs will depend on the following factors:

- *The forward supply of privately-managed toll and intermodal facilities.* The “pipeline” for such projects may be growing but the projects tend to have long developmental phases. In recent years, sponsors of start-up toll roads have issued on average less than \$1 billion of debt per year. Some observers predict this volume of highway project financing will double or even triple in coming years, as more project sponsors take advantage of liberalized federal tolling provisions. Even so, the pace of new investment likely will be driven more by factors such as planning priorities, environmental approvals and traffic assessments than by the relative cost of debt capital.
- *The ability of PABs to satisfy project funding profiles.* Clearly, some projects will continue to be financed “conventionally” by governmental operators through toll revenue or other tax-exempt bonds. Other projects may require the flexibility offered by taxable debt and private equity. Tax-exempt PABs likely will find a niche in the capital structures of certain privately sponsored projects, but the size of that niche is uncertain.
- *The relative yield advantage of PABs.* The bond ratings on most start-up toll projects are borderline investment-grade. Even with tax-free status, the risk-averse municipal bond market may not offer a substantial rate advantage relative to bank debt provided by overseas lenders, who may be more comfortable absorbing the credit risk.

Even though the gap-closing potential of PABs is indirect and hard to quantify, private participation may produce significant benefits (e.g., project acceleration, operating efficiencies, management innovations, and risk transfer). And the use of PABs *in conjunction with* private equity could help advance certain riskier projects that otherwise might not be able to arrange financing relying exclusively upon debt issuance.

⁷ In the case of a concession involving a long-term lease of a highway facility, the “owner” claiming depreciation benefits would have to demonstrate that the terms of its leasehold interest satisfy the conditions for establishing ownership of the asset for federal tax purposes.

III. Tax Credits

In recent years, Congress has enacted several new tax incentives for infrastructure investment designed to provide a deeper subsidy than the 15-20 percent present value benefit of private activity bonds. These approaches involve the use of *tax credits* rather than *tax exemption*. Tax exemption reduces the federal tax on interest income to the extent of the marginal tax bracket of the investor (e.g., a 35% tax savings on interest income for a corporate investor). A tax credit, in contrast, provides a dollar-for-dollar (100%) reduction in the investor's tax liability, depending upon the tax treatment of the credit itself. Tax credits may be applied to both debt capital (tax credit bonds) and equity capital (investment tax credits).

A. Tax Credit Bonds. A tax credit bond is a hybrid debt instrument where the lender receives an annual return in the form of federal tax credits, in lieu of cash interest payments, plus return of principal at bond maturity. The borrower is responsible for repaying the principal from local revenue sources. The investor can apply the tax credits against its other federal tax liability. Since interest expense on long-term bonds may constitute as much as 75 percent of the financial cost of debt service in today's market environment, tax credit bonds provide the borrower (project sponsor) with a much deeper subsidy than do tax-exempt bonds.

Tax credit bonds are a relatively novel security. They were first authorized by Congress in 1997 for a school modernization program known as Qualified Zone Academy Bonds ("QZABs") with a nationwide formula allocation of \$400 million/year for two years. Congress has subsequently extended QZABs on several occasions, most recently with the passage of the Tax Relief and Health Care Act of 2006. The cumulative QZAB volume authorization now totals \$4.0 billion through December 31, 2007.⁸ In the same bill, Congress expanded and extended a second tax credit bond program enacted in 2005 for "Clean Renewable Energy Bonds." Under this program, the Department of the Treasury is authorized to allocate \$1.2 billion of tax credit bonds through 2008 to sponsors of energy-generating projects utilizing hydroelectric, solar, biomass and other renewable resources. A third tax credit bond authorization was included as part of the Hurricane Katrina recovery package, and authorized a total of \$350 million of short-term tax credit bonds to be issued by Louisiana, Mississippi and Alabama.⁹ In each case, the tax credit is treated as taxable investment income to the holder, similar to conventional interest-bearing taxable corporate bonds.

Policy makers increasingly are examining the potential of this technique. In the last Congress, over a dozen tax credit bond proposals were introduced, including the \$30 billion Build America Bonds program for surface transportation and the \$12 billion ARRIVE-21 program for rail infrastructure. None of these tax credit bond measures were enacted, however.

Advocates of tax credit bonds believe this potential tool offers several advantages over other federal policy mechanisms such as direct grants or credit assistance:

⁸ Section 107 of the Tax Relief and Health Care Act of 2006 (H.R. 6111). Although no reliable data are maintained on the actual issuance of QZABs, it is estimated that perhaps half of the authorized volume has been issued to date.

⁹ The Clean Renewable Energy Bond (CREB) program was authorized in section 1303 of the Energy Tax Incentives Act of 2005 (Public Law 109-58); the Gulf Tax Credit Bond program was authorized in section 101 of the Gulf Opportunity Zone Act of 2005 (Public Law 109-135).

- *Depth of Subsidy.* Long-term tax credit bonds can provide a present value financial subsidy of as much as 75 percent, which is much deeper than other tax incentives and approaches that of traditional highway and transit grant programs.
- *Efficiency of Subsidy.* As a technical matter, taxable tax credits are more economically efficient than other forms of tax incentives because the project sponsor (borrower) receives 100 percent of the financial subsidy.¹⁰
- *Market Discipline.* Tax credit bonds will only be issued for projects with dependable repayment streams, subjecting the investment to a degree of financial discipline. Unlike federal loan and loan guarantee programs, tax credit bonds do not expose the government to credit risk of the project.
- *Less Administration.* Similar to tax-exempt bonds, the issuance of tax credit bonds by state and local governments should not require the same level of federal management or oversight of the program as direct grant or federal loan programs.
- *Budget Leveraging.* Tax credits do not require discretionary budget resources; their fiscal effect is calculated annually in the form of tax expenditures (affecting the “mandatory” side of the budget). Therefore, the scored 10-year budgetary cost of a tax credit bond program may equal 25-50 percent of the face amount of bonds issued, as opposed to 100 percent scoring of discretionary grants. Effectively, the budget cost of tax credits is amortized over the term of the bonds rather than scored up-front or over the construction period as is the case with grants.

Although tax credit bonds are highly advantageous to project sponsors as zero-percent financing, they do present significant tax policy issues. Their deeper level of subsidy produces greater tax expenditures than tax-exempt bonds. In addition, the few small, specialized programs enacted to date have not adopted uniform rules and reporting requirements. Because of their higher fiscal cost and specialized nature, tax credit bonds require thorough policy analysis to ensure that the public benefits justify the use of this tool.¹¹

¹⁰ See for example: *CBO Testimony: Economic Issues in the Use of Tax-Preferred Bond Financing*, Statement of Donald B. Marron, Acting Director, Congressional Budget Office, before the Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives, March 16, 2006; and *Funding School Infrastructure Investment: Tax-exempt Bonds and Qualified Zone Academy Bonds*, Statement of Dr. Steven Maguire, Congressional Research Service, Submitted for the Hearing Record, Senate Finance Committee, February 14, 2001.

¹¹ A good overview of federal tax incentives and policy issues is provided in the Statement of Eric Solomon, Acting Deputy Assistant Secretary for Tax Policy, U.S. Department of the Treasury, *Testimony before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means*, March 16, 2006. An important aspect of any tax credit bond program is that it not be viewed as a federal agency borrowing, which would raise issues about both budgetary treatment (on-budget vs. off-budget) and implied federal liability. The Dept. of the Treasury has opposed previous tax-credit bond proposals contemplating the establishment of a Congressionally-authorized central issuer. This policy concern can be avoided by conforming to the QZAB and CREB programs, where tax credit bonds are issued at the state and local level.

B. Investment Tax Credits. An alternative way of using federal tax credits pertains to equity capital rather than debt capital, in the form of a federal investment tax credit (“ITC”). ITCs have been used as a federal policy tool to stimulate economic activity in various sectors for several decades. Among the current capital investments eligible for ITCs are energy projects, low-income housing and historic building renovation. In the surface transportation sector, Congress has enacted (as part of the American Jobs Creation Act of 2004) a railroad track maintenance tax credit for expenditures on roadbeds, bridges, trackage and signaling equipment by regional and short-line railroads, shippers and contractors. The program, available through 2007, provides a tax credit of 50 cents for every dollar invested in track rehabilitation or maintenance, up to \$3,500/mile. The government has estimated that approximately \$400 million in tax credits will be claimed under the program through 2010.¹²

Unlike tax credit bonds, which may be held by a wide array of financial investors with no direct business interest in the project, the investment tax credits typically are claimed by the entity that is making the capital investment in the asset. Generally, ITCs are illiquid investments that are not readily marketable to other taxpayers should the tax position of the initial investor change. In contrast, a bond is a negotiable instrument that is more easily transferable to another fixed-income investor. As a result, the marketplace for ITCs differs markedly from that for tax credit bonds. ITCs are sold as tax-oriented equity investments to corporations seeking to shelter taxable income, similar to the lessor market for tax-oriented leveraged leases. The universe of buyers for “tax-oriented equity” is much narrower and less efficient than the taxable fixed-income markets, which in 2005 saw \$3.7 trillion in taxable-rate new issues come to market¹³. As a result, the required yield typically is substantially higher (e.g., 10%+ pre-tax) than that for tax credit bonds (6-7% pre-tax). Although a substantial portion of the taxable bond market consists of non-taxable investors such as pension funds and foreign entities that would not be purchasers of tax credit bonds, there still is a much broader potential investor pool among bond investors.

Generally, ITCs are not treated as taxable income to the claimant, but do reduce the cost basis in the asset. This has the effect of reducing depreciation expense and potentially increasing capital gains if the asset is sold. In addition, it is unclear to what extent the project sponsor receives the financial benefit of the subsidy, as opposed to tax credit bonds, where 100 percent of the federal tax subsidy goes to the project sponsor since the investor’s tax credit is treated as taxable income.

Finally, an equity-style ITC program may not be as readily adaptable as a tax credit bond program to the highway and transit sector, where project ownership often is retained by the public sector. ITC programs generally require private ownership of the financed asset.

For these reasons, it appears that it may be more effective to stimulate capital investment in the surface transportation sector if the federal tax credits are used in connection with tax credit *bonds* rather than ITC *equity*.

¹² *Estimates of Federal Tax Expenditures for Fiscal Years 2006-2010*, Joint Committee on Taxation, April 25, 2006.

¹³ *U.S. Credit Market Outlook*, The Bond Market Association, January, 2006.

C. Financing Freight Infrastructure. Increasingly, federal policy makers are seeking ways to encourage private investment in goods movement projects. Improving the nation's freight infrastructure for shipments by rail and truck has broad policy implications: reducing economic friction, alleviating metropolitan congestion, enhancing automobile safety, conserving the environment, and promoting energy independence.

Historically much of the investment in goods movement has been provided by the private sector. In the case of freight rail, for example, there is no existing program through which the government provides significant grant assistance, as is the case with other transportation modes. And the private rail carriers have been reluctant to seek traditional federal grants because of the concern about bureaucratic interference and other federal requirements that accompany direct government grants. Instead, they seek indirect assistance that would subsidize their high cost of capital investment.

Some observers believe that stimulating private investment in freight infrastructure presents the right circumstances for a major federal tax initiative. For freight and intermodal projects generating substantial public benefits, a tax-preferred product such as tax credit bonds could stimulate more investment with less federal intrusion than outright grants. The tax credit bonds could be used in connection with either constructing new publicly-owned projects (Alameda Corridor), or improving existing privately-owned facilities (Chicago CREATE). The challenge faced by policy makers is to design a program that effectively targets the subsidized investment to those projects where the quantifiable benefits to the public are greater than the fiscal cost of the subsidy.

CONSOLIDATED COMMENTS FROM MEMBERS OF THE BLUE RIBBON PANEL OF TRANSPORTATION EXPERTS – PAPER 5A-14

One reviewer commented as follows:

On page 10, the paper states: “Historically much of the investment in goods movement has been provided by the private sector.” This statement does not properly differentiate the case of freight rail. It would be more appropriate to say, “Historically, much of the investment in goods movement has been provided by government, except for freight rail.”

Also on page 10, the paper states: “And the private rail carriers have been reluctant to seek traditional federal grants because of the concern about bureaucratic interference and other federal requirements that accompany direct government grants. Instead, they seek indirect assistance that would subsidize their high cost of capital investment.” This is true, but another key reason is that federal funding provides a means for projects to go forward that are economically justified because the net social benefits are large, but the net private benefits to railroads are insufficient to induce the railroad to make such an investment. The Congressional Budget Office made this point in a recent report.