

Statement of
The Associated General Contractors of America
to the
Committee on Ways and Means
U.S. House of Representatives

For a hearing on
“Tax Reform and Tax Provisions Affecting State and Local Governments”

March 19, 2013



Building Your Quality of Life

AGC is the leading association in the construction industry. Founded in 1918 at the express request of President Woodrow Wilson, AGC now represents more than 33,000 firms in nearly 100 chapters throughout the United States. Among the association's members are approximately 7,500 of the nation's leading general contractors, more than 12,500 specialty contractors, and more than 13,000 material suppliers and service providers to the construction industry. These firms engage in the construction of buildings, shopping centers, factories, industrial facilities, warehouses, highways, bridges, tunnels, airports, waterworks facilities, waste treatment facilities, dams, hospitals, water conservation projects, defense facilities, multi-family housing projects, municipal utilities and other improvements to real property.

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The Associated General Contractors of America (AGC) is pleased to write today to explain the many Federal tax provisions that affect State and local governments and form the tools that could and should be active in the infrastructure financing toolbox.

Founded in 1918 at the express request of President Woodrow Wilson, AGC is the leading association in the construction industry representing more than 30,000 firms in nearly 100 chapters throughout the United States. Among the association's members are approximately 7,500 of the nation's leading general contractors, more than 12,500 specialty contractors, and more than 13,000 material suppliers and service providers to the construction industry. These firms engage in the construction of buildings, shopping centers, factories, industrial facilities, warehouses, highways, bridges, tunnels, airports, waterworks facilities, waste treatment facilities, dams, hospitals, water conservation projects, defense facilities, multi-family housing projects, municipal utilities and other improvements to real property. Many of these firms are small and closely-held businesses.

While private construction is finally recovering from the recession, public construction markets like transportation, water and wastewater have been shrinking. Federal funding cuts in the recently enacted sequestration and appropriations bills, along with tight local government budgets, mean public construction is poised to decline further in 2013 and beyond. These decreases threaten to worsen the already high unemployment rate in the construction industry, which stood at 15.7 percent in February, roughly double the rate for the overall economy. Volatile prices for materials and diesel fuel have cut into the already slim margins most firms are working on and jeopardized the solvency of some.

Even before the current economic downturn, many of our cities and towns, which include everything from large urban to small rural communities, had experienced substantial challenges in finding money to repair and replace infrastructure that is quickly reaching the end of its useful life. Many communities do not currently have the financial resources to make the necessary investments to meet growing infrastructure needs.

For transportation infrastructure, the Federal Highway Administration (FHWA) estimates in its 2010 Conditions and Performance Report that to eliminate the nation's bridge backlog by 2028, we would need to invest \$20.5 billion annually, while only \$12.8 billion is currently being spent. The challenge for federal, state, and local governments is to increase bridge investments by \$8 billion annually to address the identified \$76 billion in needs for deficient bridges across the United States. Additionally, 42 percent of America's major urban highways remain congested, costing the economy an estimated \$101 billion in wasted time and fuel annually. While the conditions have improved in the near term, and federal, state, and local capital investments increased to \$91 billion annually, that level of investment is insufficient and still projected to result in a decline in conditions and performance in the long term. Currently, the Federal

Highway Administration estimates that \$170 billion in capital investment would be needed on an annual basis to significantly improve conditions and performance. Ridership on America's public transit infrastructure has increased 9.1 percent in the past decade while conditions on these systems have deteriorated. Deficient and deteriorating transit systems cost the U.S. economy \$90 billion in 2010, as many transit agencies are struggling to maintain aging and obsolete fleets and facilities.

In the case of water and wastewater infrastructure, needs continue to multiply as age and chronic underinvestment in federal water infrastructure financing programs (like the EPA's State Revolving Loan Fund Program) are compounded by an evolving and expanding regulatory landscape. State and local governments will continue to bear the brunt of this double-edged problem and many face significant practical and political challenges to enacting rate structures to raise adequate capital and make the improvements that are needed. EPA projects that more than \$600 billion is needed in infrastructure improvements over the next 20 years simply to keep pace, yet consistent dwindling of federal commitment to water infrastructure programs has resulted in a gap in funding of more than \$20 billion annually.

When the federal government began mandating quality standards for drinking water and wastewater discharge through legislation like the Clean Water Act and Safe Drinking Water Act, it also recognized that forcing local governments to spend billions of dollars to upgrade facilities and equipment to comply with regulatory burdens was impractical. The EPA's SRF program is the vehicle the government uses to avoid foisting the burden of maintaining national water standards onto local ratepayers alone. Given that it is in the federal interest to set water quality standards, then so too must it be in the federal interest to provide financing and flexibility to help operators so they can meet those standards. This is even more salient now with the sharp drop-off in State revenues and lack of budgetary flexibility most states have due to balanced budget requirements.

Public investments in infrastructure also are often the best way to ensure the health, safety and economic vitality of sparsely populated rural communities. Many rural communities, indeed many rural states, lack the resources needed to finance the construction of major infrastructure projects like interstate highways, advanced wastewater treatment plants, or safe drinking water filtration systems. The federal government is uniquely suited to supporting infrastructure investments in these rural communities, especially when so much of our nation depends on the commercial traffic that travels through them and the agricultural products that come from them. In fact, 27 states rely on federal funds for 25 to 40 percent of their state highway capital investments annually and 14 states rely on federal funds for over 40 percent of their annual highway capital investments, of which 10 are over 65 percent.

Economic Advantages

Spending on construction creates jobs. We at the Associated General Contractors of America found that for every \$1 billion in spending on infrastructure, 28,500 jobs are created in construction and construction-related activities which includes 9,700 (34%) direct construction jobs; 4,600 (16%) indirect jobs in supplier industries (mining, manufacturing and services); and 14,300 (50%) induced jobs resulting from purchases out of the additional income of workers and

owners in the directly and indirectly supported industries. The U.S. Conference of Mayors found that every job created in water and sewer infrastructure creates over three additional jobs in the national economy to support that job.

Federal support for drinking and wastewater systems also delivers a tremendous return for taxpayers by lowering healthcare costs, reducing the cost of cleaning up polluted waterways, and contributing to increased economic vitality. Robust water infrastructure provides a solid foundation for business that wells and septic systems simply cannot. Regular federal investments in infrastructure also save taxpayers money as it costs a lot less to maintain infrastructure than it does to repair it. The cost of replacing water pipes through routine maintenance is typically between \$100 and \$300 per linear foot. The cost to repair a water main break is approximately \$1,500 per linear foot, not including the costs of flooding damage, closures of businesses, and health hazards to those in the area.

Tools in the Toolbox

There are several infrastructure financing options that have been suggested or have been in use at one time, but none that have remained consistent or expanded over the last several decades. There needs to be stability and predictability for state and local governments, which would allow them to create long-term construction plans, which in turn give stability and predictability in the water and wastewater construction markets. Giving municipalities and their contractor partners access to all the tools in the infrastructure financing toolbox will help achieve this.

Transportation

Two national policy commissions established by SAFETEA-LU, the U.S. DOT, AASHTO and other groups have reached the same conclusion – “Without changes to current policy and accompanying revenue enhancements, it is estimated that revenues raised by all levels of government for capital investment will total only about one-third of the roughly \$200 billion necessary each year to maintain and improve the nation’s highways and transit systems.” The purchasing power of the federal highway revenues has decreases nearly 50 percent since the last gas tax increase in 1993, further contributing to the backlog of needs.

To address these increasing transportation infrastructure needs both National, Bipartisan Commissions established in SAFTEA-LU, as well as the Simpson-Bowles Deficit reduction committee recommended increasing the federal motor fuels tax. The recommendations range from a minimum increase of 15 cents per gallon up to 40 cents per gallon.

Eventually the nation must shift to a more sustainable funding mechanism for surface transportation. AGC recommends maintaining a user fee-based system for transportation investment. The user fee should be increased and supported by including an inflation index. Additional user fees such as a sales tax, oil exploration fee, registration fees, customs fees on imported freight and others should be considered. Establishing user fees tied directly to miles driven has many long term benefits. The mileage-based fee is a fair and equitable in that all can be charged the same amount based on actual usage regardless of the type of fuel used in the vehicle and the efficiency of the vehicle. This method also has the benefit of being relatively

easy to administer. It also meets other national policy objectives by offering a means to alleviate congestion and promote economic development, environmental sustainability, equity, and quality of life.

Water and Wastewater

While increased appropriations would go a long way toward alleviating the short-term problem, they would not solve the long-term problems of market instability and unpredictability. With the volatility inherent in the annual appropriations process, a sustainable, long-term funding mechanism is needed to provide market certainty for construction firms and local water authorities. This new long-term funding mechanism should be multi-year and utilize the existing successful SRF framework to move funds from the federal to state and local levels. This long-term mechanism should also embrace the “user pays” concept that other infrastructure funding mechanisms have implemented with success to create a budget-neutral, user-fee financed, clean water trust fund. The best long-term solution would be to establish this national clean water trust fund, to be financed by a wide array of small broad-based user fees.

There is ample precedent for dedicated federal trust funds to tackle problems too big for states to handle alone. The GAO has identified more than 120 federal trust funds in operation. These trust funds help ensure funding for other critical projects, including highways, airports, harbor maintenance, and inland waterways. But in this case we can use the model of the highway trust fund that has been extremely successful to build a dedicated long-term, sustainable, off-budget source of funding for water infrastructure such as a trust fund, which would create market certainty in the water and wastewater markets.

Polling has shown that people believe that the government has a responsibility to provide clean water. In fact, 86 percent of Americans support legislation by the U.S. Congress that would create a long-term, sustainable, and reliable federal trust fund for clean and safe drinking water infrastructure. The Government Accountability Office (GAO) in 2009 released a report entitled “Options for a Clean Water Trust Fund” which acknowledges that our nation faces tremendous challenges in replacing and rehabilitating our water infrastructure. As the GAO’s report states, a trust fund for water infrastructure may not be the only solution to our water infrastructure needs in America but it would establish a multi-year commitment to address the nation’s pressing water needs.

While a trust fund would be the best solution, it is still only one tool in the toolbox of financing and funding mechanisms that Congress should make available for use by state and local governments. Alternative and creative methods of financing water infrastructure must be embraced in these tough times. As traditional methods of funding fall out of favor, it is important to seek fresh and creative approaches. However, it is crucial to note that these creative and alternative mechanisms should supplement, rather than replace, the traditional financing mechanisms, such as the SRF, which are already proven to work.

Bonds

One such creative mechanism is the highly successful, but short lived, Build America Bonds

(BAB) program in the Recovery Act. BABs are taxable bonds for which the U.S. Treasury Department pays a 35 percent direct subsidy to the issuer to offset borrowing costs. The program financed nearly \$38 billion in water, sewer, and utility infrastructure projects and over \$46 billion in transportation projects over the two years it was active. This popular program could be resurrected, perhaps with a lower direct subsidy to reduce upfront costs to the federal government.

Another method of directing funds to infrastructure would be to secure access to private investment in water infrastructure. Private activity bonds (PABs) can be an important tool for financing infrastructure investments in our communities by providing long-term financing for capital-intensive infrastructure projects. PABs are a form of tax-exempt financing available to entities like state or municipal governments that want to partner with a private party to meet a public need. Interest paid on bonds issued by State and local governments generally is excluded from gross income for Federal income tax purposes, which allows the interest rates on such bonds to be lower. This, in turn, lowers the borrowing costs for the beneficiaries of such financing.

Congress controls the total volume of tax-exempt bonds by limiting issuance in each state with an annual cap – for example, in 2011 the volume cap for a state was the greater of either \$95 per resident, or \$277.8 million. Construction projects should be removed from this annual volume cap, allowing those projects to no longer have to compete with the dozens of other categories of public spending these bonds finance. Exceptions from the volume cap are currently provided for other governmentally owned facilities such as airports, ports, high-speed intercity rail, and solid waste disposal sites.

PABs employ the best features of successful public-private partnerships, spreading risk and encouraging innovation. By reducing a government's project management burdens and its risk (with PABs, the private entity assumes much of the financial risk and administrative responsibility), multi-year projects and a broader project load become more feasible as the government has more resources to allocate. Also, PABs do not affect the municipality's bond rating, as the private entity retains the financial risk, an important benefit of PABs for municipalities.

Amid all these new ideas and methods for financing the nation's infrastructure, we must not forget one of the oldest and most popular methods of financing infrastructure at the state and local level, the tax exempt municipal bond. AGC believes that it is crucial that these bonds remain tax exempt and that Congress reject proposals to cap or remove this tax exemption.

Under the federal tax code, investors do not pay federal income tax on interest earned from most bonds issued by state and local governments. This tax exemption for municipal bond interest has been in law since the federal income tax was promulgated 100 years ago, and these tax-exempt bonds have resulted in trillions of dollars of infrastructure investment since as state and local governments receive a lower interest rate on their borrowing than they would if their interest was taxable to investors.

A recent report by the National Association of Counties, National League of Cities, and National Conference of Mayors concludes that tax-exempt municipal bonds are the most important tool in the U.S. for financing investment in schools, roads, water and sewer systems, airports, bridges and other vital infrastructure. State and local governments financed more than \$1.65 trillion of infrastructure investment over the last decade (2003–2012) through the tax-exempt bond market. In 2012 alone, more than 6,600 tax-exempt municipal bonds financed over \$179 billion worth of infrastructure projects. In typical market conditions, the tax exemption can save states and localities up to two percentage points on their borrowing rates.

The study goes on to explain that for the proposal to enact a tax-benefit cap of 28 percent for certain taxpayers on many itemized deductions and exclusions, including tax exempt interest, the effect would be a partial tax on interest that would otherwise be exempt from income tax. In effect, the tax-exempt bond market would no longer be entirely tax-exempt. If this proposal to impose a 28-percent benefit cap on tax exempt interest had been in effect during the last decade, it is estimated that this would have cost states and localities an additional \$173 billion in interest expense for infrastructure projects financed over the past ten year period. For a complete removal of the tax-exempt status the impact would be even worse, accruing an additional \$495 billion of interest expense on state and local governments. These proposals are absolutely inconsistent with the dire infrastructure needs problem and ever-shrinking pool of federal support. Given the tremendous economic, environmental, and public health benefits of infrastructure construction and grim situation that our current infrastructure backlog represents, why enact such self-punishing policies?

Concluding Remarks

AGC thanks the Committee for the opportunity to submit this statement for the record. There is a menu of financing tools available to Congress that is as wide in variety as it is deep in financial potential. However, it is critical to remember that infrastructure financing is not, and should not be, a zero-sum operation. None of these options is mutually exclusive with the others, and indeed many would work better when combined. AGC believes that all should be available to spread the financing burden among as strong a foundation as possible to help these critical sectors of our nation's infrastructure.

AGC of America believes the approach outlined above must be taken to give every locality – from the smallest rural towns to the biggest urban centers – the widest range of possible mechanisms to fund construction. These ideas range from new programs to be created and old programs that should come back to existing ones that could be modified and existing programs that should remain untouched. Many of these options have been sporadically available in the past and remain good ideas waiting to come off the shelf. A true solution to the infrastructure financing crisis would include making all of these options available all the time. Permanent long-term solutions are the only way to avert further crisis, let municipalities and contractors plan for the future, and truly safeguard our economy, environment and health.