CORNERSTONE MACRO

A BIPARTISAN INFRASTRUCTURE DEAL?

Democratic leaders have announced they plan to seek a major bipartisan infrastructure deal with Republicans. While there could be some common ground on the size and scope of a major infrastructure bill, paying for it in a way both sides can agree to is likely to be an insurmountable obstacle. Instead, we expect a modest bipartisan surface transportation bill to pass this summer and for Democrats to include roughly $1 trillion in infrastructure spending (loosely defined) in a broader reconciliation package that includes tax hikes this fall.

On Friday, Speaker Pelosi announced she had "called upon the chairs of the committees of jurisdiction to work with their Republican counterparts to craft a big, bold and transformational infrastructure package." Such a package would not only include transportation spending but also "critical needs in energy and broadband, education and housing, water systems and other priorities." Pelosi acknowledged the plan would need to be "partially paid for." Democrats seem to prefer offsets be included in a separate reconciliation bill, but no decisions have been made about how much needs to be offset and in what legislation those offsets might be inserted.

There are several reasons why we think Democrats have chosen to attempt a major bipartisan deal. First, Democrats need to make an overture to Republicans not only because moderates like Sen. Manchin demand it, but so they have political license to pursue a partisan package if negotiations fail. Second, it's possible the second reconciliation bill of the year is too crowded with other priorities, so passing a separate infrastructure bill might make the broader bill easier to pass (especially since Democrats know they can add whatever was left out into the second bill). And third, some Democrats including Transportation & Infrastructure Committee Chairman DeFazio have acknowledged important elements of the bill would likely be struck down by the Senate's Byrd rule (this likely includes earmarks but also the regulatory provisions that would have no effect on the budget).

Key Republicans on committees with jurisdiction over infrastructure spending such as ranking members Rep. Graves and Sen. Capito are on board for a bipartisan deal but have a few stipulations: it can't grow into a multitrillion dollar package, it should be paid for (but not with contentious offsets like a higher corporate rate), it has to be predominantly about transportation rather than climate change, and it needs to maintain a focus on rural America and offer states flexibility with federal dollars. In addition, Republicans are likely to insist on budget offsets being included in the infrastructure bill (rather than punting the issue to Democrats in the reconciliation bill, thereby having no input into those offsets).

There is probably room for bipartisan compromise on the size and scope of a package. Republicans could probably agree to a trillion or less in infrastructure spending and perhaps even tolerate a hundred billion

Andy Laperriere, CFA
(202) 888-1151
alaperriere@cormacteam.com

Melissa Turner, CFA
(202) 888-1153
mturner@cormacteam.com

Don Schneider
(202) 888-1154
dschneider@cormacteam.com

or so in climate-related provisions (such as spending on a clean energy grid, electric vehicle charging stations, and climate resiliency). That would be a win for Democrats and still gives them room to do the rest of what they want in reconciliation.

However, paying for a package of this size either in whole or in part is likely too much to ask. Republicans aren't likely to back down on concerns about the deficit and will not accept tax hikes that reverse the 2017 reforms. The only other revenue options large enough are major increases in fuel taxes, a vehicle miles traveled (VMT) tax, or a carbon tax. Despite what some press reports have suggested, we strongly doubt Republicans will back any of these measures. Out of the three options, a VMT is the most likely to be considered but the tax is still controversial and in the experimental phase (some states are conducting pilot projects). Importantly, Biden has said he would not raise taxes on Americans earning less than $400,000, which makes any of these ideas problematic. It probably goes without saying Democrats aren't going to accept spending cuts to offset the cost of the package.

So how will this all play out? We expect the committees of jurisdiction to begin holding hearings (Ways and Means has scheduled one on March 23 and Transportation & Infrastructure on April 14). Lawmakers in charge of the surface transportation process are intending to report legislation by Memorial Day (well ahead of the September 30 deadline which is when the spending authorization expires) so that's a fair timeline to expect some action. We expect talks on a broad bipartisan deal to break down by that time. If we're right, Congress will operate on two tracks: a narrow bipartisan surface transportation bill and a more ambitious infrastructure package that would be included in a broader economic package that would pass under reconciliation. The process on the second package is not likely to begin until July, which is when Congress will take up a budget with reconciliation instructions.

In order to get a better sense of what a surface transportation bill and partisan infrastructure package might look like, we illustrate the main approaches in the table on the next page. The three most prominent proposals include: The Moving Forward Act (H.R. 2) advanced by House Democrats, the American Transportation Infrastructure Act (S. 2302) which cleared the Senate Environment and Public Works Committee on a bipartisan basis, and Biden's infrastructure **plan** developed for the campaign trail. Over a 10-year period they total roughly $1.5 trillion, $300 billion, and $2.1 trillion, respectively. Of all of these bills, H.R. 2 is the most important because it will serve as the starting point for negotiations with Republicans and will ultimately be the backbone of whatever partisan law Democrats pass.

Starting with the multiyear surface transportation reauthorization bill, we expect a bipartisan deal that is roughly a midpoint between the red underlined portions in the table on the next page. This implies a five-year package totaling about $400 billion focused on highways, public transit, and rail.

Both of the congressional proposals contain a five-year reauthorization of federal highway spending that are broadly similar ($319 billion in the House Democrat proposal and $287 billion for the bipartisan Senate bill). However, because these are reauthorizations of existing spending, the increase relative to the spending baseline is much smaller. Current highway spending is $46 billion per year (or $232 billion over the next five years), so the actual increase in new outlays would be $87 billion and $55 billion, respectively. This is a critical distinction that can often get lost in the discussion of infrastructure spending. Investors should know the likely increase in transportation spending, while potentially significant in percentage terms, is likely to have a tiny impact on GDP.

It is possible lawmakers could agree to boost highway spending even further but there isn't a sound policy rationale to do so. According to CBO, if another $36 billion or $68 billion cumulatively were added to the proposals, respectively, it would provide enough funding to ensure that all projects for which the net benefits meet or exceed the costs get funding. In other words, if Congress wants to spend a lot more on highways than the key leaders have proposed, it would have to do it on projects with low or even negative returns.

BUDGETARY COMPOSITION OF MAJOR INFRASTRUCTURE PROPOSALS ($BN)

	House Dems (H.R. 2)	Senate EPW (S. 2302)	Biden
Traditional Infrastructure			
Highway Reauthorization	319	287	
Public Transportation	105		
Rail	60		
Other / Unallocated Transportation	10	4	900
Covid Related Transit $	83		
Broadband	100		20
Water Infrastructure	65		50
Airports	38		
Infrastructure Financing Bonds	84		
SUBTOTAL	**$863**	**$291**	**$970**
Clean Energy Infrastructure & Incentives			
Clean Grid & Power Transmission	70		105
Other	14		335
Clean Cars & Fuels	18		200
Green Energy & Efficiency Incentives for Individuals	24		50
Renewable Electricity Investment & Carbon Reduction Incentives	87		144
SUBTOTAL	**$214**	**$0**	**$834**
Non-Traditional Infrastructure			
Schools	130		138
Child Care	10		
Housing	189		124
Hospitals	30		
Postal	25		
All Other	25		41
SUBTOTAL	**$407**	**$0**	**$303**
TOTAL	**$1,486**	**$291**	**$2,106**

Source: CBO, JCT, Moody's, Biden Campaign, NACO, and Cornerstone Macro.

Notes: Red underlined text reflects the components of surface transportation legislation that can move as a standalone bill.

As for a second more ambitious infrastructure package that would pass with only Democratic support, its size and composition depend in part on how much is included in the surface transportation bill. Assuming there is bipartisan agreement for about $300 billion for highways, this leaves about $1.1 or $1.2 trillion as a starting target (the $83 billion in the table above for COVID-related transit funds is likely unnecessary now given infrastructure aid passed in the American Rescue Plan Act). Press reports have said the administration is targeting spending between $1 and $2 trillion so that loosely corroborates this spending target as a starting point.

The second bill could look broadly similar to the rest of what is shown in the table above for H.R. 2. However, there is room for upside for spending on clean energy because President Biden made this a high priority on the campaign trail. One of the largest beneficiaries will likely be electric vehicles as Biden is embracing a slimmed down version of Sen. Schumer's $454 billion electric vehicle plan which would "provide consumers rebates to swap old, less-efficient vehicles for these newer American vehicles built from materials and parts sourced in the United States. These rebates will be accompanied by significant new targeted incentives for manufacturers to build or retool factories to assemble zero-emission vehicles, parts, and associated infrastructure here at home." This trade-in program, coupled with an expanded EV credit, funds for charging stations, and subsidies for manufacturers could total about $200 billion. All in, this means Democrats might aim to pass an infrastructure bill totaling around $1.5 trillion.

However, it's important to note that infrastructure spending will have to compete with other priorities likely to be included in a broader Biden agenda in the FY22 budget reconciliation package. Some of the other possible priorities include: expanding health care coverage, manufacturing and onshoring incentives, job training and education, universal pre-K, child and elder care subsidies, making the child tax credit expansion permanent (a cost upwards of $1 trillion), student debt relief, paid leave, etc. Even if only a few of these policies were included, they could easily bring the total cost of the package closer to $3 trillion.

As we outlined in a **recent piece** on how Democrats are approaching tax increases, there's probably an upper bound of $1.6 trillion in new revenues. There is also a limit on how much Democrats can increase the deficit without losing votes on the Democratic side. Given these other priorities, the limited revenues available to finance them, and even modest constraints on deficit spending, the upper bound for infrastructure spending is roughly $1.5 trillion (over the next decade) and it is very possible Congress ends up spending considerably less.