The Case for Establishing Federal "Qualified Municipal Infrastructure Bonds" (QMIBs)

Robert P. Strauss and Kenneth P. Kramer[1]

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1.0 Introduction: The Problem of Fixing our Public Infrastructure

Current TV ads which promise free replacement of pizzas damaged by jostling due to potholes, AND the free private repair of offending potholes that caused damage to said pizzas underline just how dire the US infrastructure problem is. Equally worrisome is the deficit position of the federal government and many states and their localities. What to do if current federal budgetary resources are unavailable or insufficient to enable states and localities to do what they should be doing?

2.0 The First Step towards Solving our Public Infrastructure Problems: Qualified Municipal Infrastructure Bonds (QMIBs)

We believe that part of the infrastructure problem can be solved by reorganizing and clarifying the current, highly diverse and complex municipal bond market. Some years ago the Hamilton Project endorsed the notion of a system of uniform municipal bonds to improve state and local access to capital markets. Under the Hamilton plan, an independent, private agency would advise state and local governments about infrastructure borrowing, and develop a common bond contract.

Instead, we propose that the federal government establish, through changes to federal tax and banking law, a new class of state and local tax-exempt borrowing for well-defined state and local infrastructure purposes. The Secretary of the Treasury and his delegate, the Commissioner of the Internal Revenue Service, would determine within 60 business days whether or not a proposed QMIB would meet the following requirements:

1. Issued only by state and local governments with the authority to levy taxes;
2. The proceeds of QMIBs would be only for purely public, enumerated purposes: the construction, maintenance, and repair of:
   a. Public roads and bridges and related public capital facilities
   b. Public airports and related public capital facilities
   c. Public ports and public water ways and related public capital facilities
   d. Public buildings for public use (school buildings, municipal buildings)
   e. Public housing for low and moderate-income renters
   f. Public sewer, storm water and water systems
   g. Public mass transportation systems and related capital facilities
   h. Public energy production and distribution systems
3. Annual public financial and project reporting throughout the life of QMIB financed projects would be required of successful QMIB issuers to the Secretary of the Treasury and his delegate, the Commissioner of IRS, e.g. the purpose, location, useful life and term of the QMIB bond[s], status of toll, tax, and sinking fund finances, use of project upon completion, and scheduled and actual maintenance;

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[1] Respectively, Professor of Economics and Public Policy, Carnegie Mellon University, and Managing Director, Rushton Atlantic, LLC.. The views in this document are those of the authors and do not represent Carnegie Mellon University or Rushton Atlantic.

4. The maturity of any QMIB must equal the economic life of the assets/repairs financed by the sale of QMIBs;
5. All QMIBs must be issued with sinking funds for 80% or more amortization of principal and interest;
6. Sinking fund arbitrage investments would be limited to safe public securities, and net profits would be required to be put into the funded projects.
7. At least ½ of any governmental unit's QMIBs would have to be revenue bonds, e.g. interest and principal to be paid off by earmarked taxes as well as earmarked user charges;
8. A QMIB would be countable in the denominator of bank "stress tests" , e.g. for Section 2A purposes;

3.0 Discussion

Bonds that meet the above requirements would be high-grade, and should attract the interest of municipal bond funds as well as individual investors. The independent determination of promised qualified status and ongoing compliance with these requirements would ensure lower borrowing risk, attending lower interest rates, and continuing investor interest. The Internal Revenue Service has had considerable expertise in performing these administrative functions through its historic responsibilities administering state by state caps on other kinds of qualified state and local bonds, and also has been responsible for administering rules governing various kinds of taxable and tax-exempt sinking funds.

Over time, as the market for QMIBs matures and broadens, it is imaginable that state and local governments will prefer to issue QMIBs rather than their historical heterogeneous portfolio of federally tax-exempt borrowing instruments, because fulfilling the above requirements will materially improve the *management* of public assets. Elected officials will begin to think more clearly, not only about the replace vs. repair decision, but also engage in more thoughtful dialogues with their electorates about the cost vs. benefits of building infrastructure for now and in the future, with the result that that beneficiaries over time will pay their fair share of the costs of public capital assets. The enhanced reporting requirements in conjunction with their ongoing public disclosure are designed to improve public confidence and support in long-term state and local public infrastructure projects.

Some have suggested that QMIB status be accorded to consortia of state and local governments in order to accomplish regional solutions to public infrastructure needs. Whether individual, governments with the power to tax can accomplish this can easily become a complicated constitutional state by state question. From our point of view, if an area is represented by elected (not appointed officials) officials, and the resulting government has the authority to tax and impose/collect fees, then we are comfortable that the democratic process and political competition can find responsible, regional solutions to regional infrastructure problems.