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TRUMP'S STATE OF THE UNION – ECONOMIC TAKEAWAYS ON INFRASTRUCTURE INITIATIVE

*__*Trump's first State of the Union (SOTU) address__ included comments on infrastructure spending, trade, and tax reform and its expected benefits to the economy.*

**In keeping with all State of the Union speeches, only a few details were provided on the closely-watched infrastructure initiative: (1) $1.5 trillion infrastructure package to be financed by federal, state and local governments and private businesses and (2) streamlined permitting process for infrastructure projects.*

**Trump's comments on trade policy were less stridently protectionist than some of his prior statements, with trade negotiations in progress. But, it is clear the Administration's objective is to renegotiate existing agreements with an objective of opening overseas markets and protecting U.S. workers.*

The U.S.'s basic infrastructure--roads, bridges and public venues, schools, etc.--are in desperate need of upgrading, but a well-rounded modern infrastructure plan must include upgrading the electrical grid, air traffic control systems, green energy, national security, disease control, cyber security and technology, and repairing and upgrading oil and gas pipelines (see "US infrastructure spending--a roadmap for thinking broadly", October 24, 2016). This obviously includes a wide array of options for infrastructure projects. Members of both sides of the political aisle will have personal preferences. The development of an infrastructure package likely will involve input from a number of congressional committees involving commerce, transportation, energy, national security and others. The degree of coordination suggests a lively debate on what is included in the final infrastructure legislation.

How the infrastructure initiative will be financed, how the individual projects will be chosen and how the overall program will be administered are important issues that must be worked out. In general, the Trump Administration proposes that federal spending be leveraged with significantly large financial burden placed on state and local governments. The Administration will also be proposing public-private partnerships with various incentive schemes.

The proposed federal government spending has been mentioned to be approximately $200 billion over 10 years. In reality, this is a very small amount *(the federal government is constrained by the renewed focus and concern on higher budget spending after tax reform).* Other financing from state and local governments and private businesses, are expected to lift the total infrastructure spending package to $1.5 trillion. The proposed higher financial burdens on state and local governments will face varying degrees of political opposition. Some financially-strapped states will balk at the proposals.

The specifications of how public-private partnerships and related incentives would work and be financed are unclear. We note that some infrastructure projects may provide particular benefits to specific companies and industries, such that they would be willing to contribute to the infrastructure financing. However, some of the infrastructure initiative will involve purely "public goods" that should be financed by the government, not the private sector.

Economic impact - Increased infrastructure spending is measured as government purchases and counted directly as an addition to GDP and would also increase jobs.

31 January 2018

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The economic impact of the infrastructure project depends on how they are financed and whether the projects add to productivity capacity and economic efficiencies. These outcomes depend critically on whether the right projects are chosen and how they are administered.

Bipartisan support. There is very strong support to upgrade America's infrastructure on both sides of the political aisle, but amid the rancorous political environment in Washington D.C. the infrastructure spending and finance proposal is likely to generate a heated debate. And while the debate may not be as strictly partisan as was the debate on tax reform, in part because of political pressures imposed on members of Congress with the midterm elections looming in the not too distant future, there remains a wide gap between Democrats' and Republicans' visions on proper infrastructure and how to finance it. Because the infrastructure legislation will involve many different committees in Congress and is not simply a piece of budget legislation, it is unlikely that Congress can use the budget reconciliation process that would allow the legislation to pass with a simple majority.

Election year. A midterm election year complicates Congress' legislative agenda. The midterm elections are set for November 6th, all seats in the House and 1/3 of the seats in the Senate are up for election. A sizable share of the Congress up for elections this year would probably like to have a significant infrastructure package to deliver to their constituents. But given the extremely polarized political climate, members of each party may be hesitant to collaborate. Timing is a key issue in an election year – with the full focus of Washington on primaries and campaigning, there is little space left for the legislative agenda.

Near term issues need to be handled first. In the near term, the Congress has many unsettled issues that will distract from infrastructure developments. The latest stopgap spending bill expires on February 8th, and parties are apart on key issues – (1) Republicans want to ensure funding for higher defense caps for defense and military readiness, and (2) DACA and broader immigration reform. The deadline for the debt limit likely has to be reinstated sometime in March. The longer these spending negotiations are extended, the lower the chance of any infrastructure spending package this year. Negotiating these contentious budget issues clog up the legislative agenda and constrain necessary debate on infrastructure.

Timeline: Details of the infrastructure spending plan are likely to be released in coming weeks and reactions from Congress will be important. Developing a well-reasoned and financially sound piece of infrastructure spending and financing legislation will be a daunting task. This is particularly true since it will involve so many different committees in Congress in contrast to tax reform that was driven by the House Ways and Means and Senate Finance Committees. On the other hand, President Trump and his Administration will be aggressive dealmakers, even if the final deal involves a lot of compromises. We do not expect any quick enactment of an infrastructure legislation.

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