Financing the Productive Economy: The Heartland Development Bank

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September 12, 2008

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Infrastructure and Economic Opportunity

Throughout American history, infrastructure investment has played a critical role in economic development. As the nation moved west, the building of canals and turnpikes, followed by construction of railroads, expanded the field of economic opportunity. Later, investment in electricity and telephone networks facilitated the development of vast expanses of the American landscape that had previously been left behind. More recently, the national interstate highway system and now the continuing build-out of broadband telecommunications networks have enabled the de-clustering of many business endeavors that were once confined to large central cities.

Infrastructure is one of the basic building blocks of economic opportunity, as illustrated in Figure 1. The standard infrastructure package of the economy includes highways, airports, harbors, utility distribution systems, railways, water and sewer systems, and communications networks.

In today's network-centric, innovation driven economy infrastructure also includes university and lab facilities, technology and training centers, export processing facilities, and research parks. (see Table 1). These infrasystems – integrations of facilities, technology and advanced socio-technical capabilities – have emerged as key drivers of innovation and the locus of future higher-value industries and higher-paying jobs.

Figure 1:

Infrastructure and Economic Opportunity

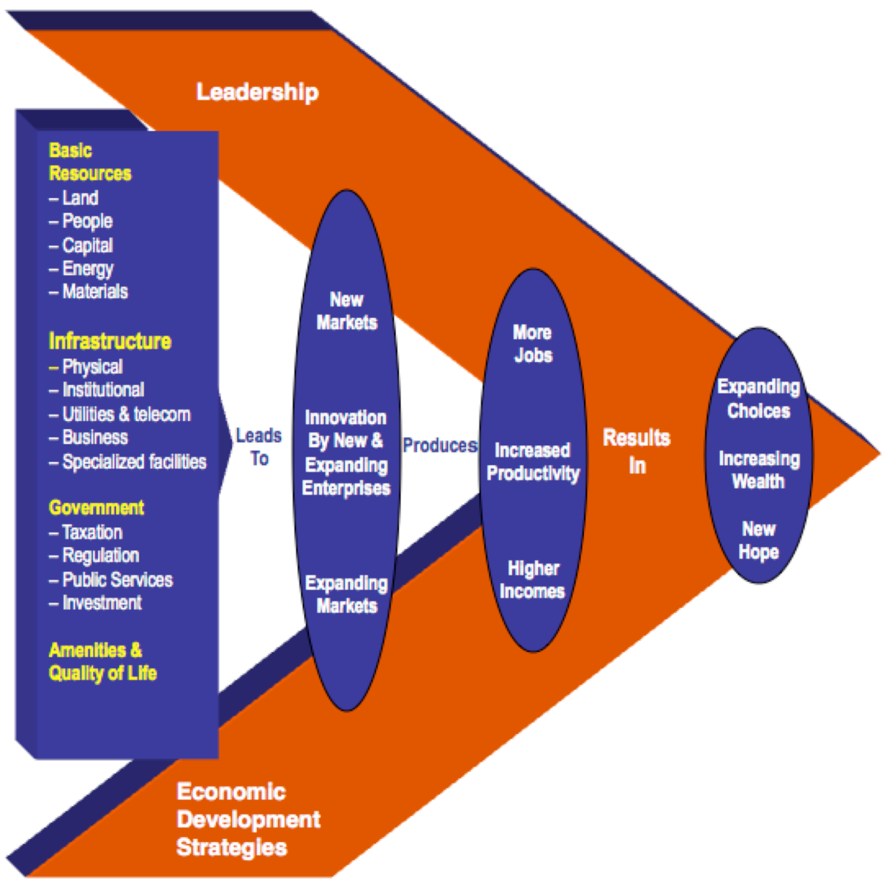

Table 1: Infrastructure: The Total Picture in Today's Economy

Public Service	Interoperability	Transactional	Innovation
Water Waste treatment Roads Open space	Connectivity -> telecom Mobility -> transit, transport, shipping Distribution -> water and energy	Export processing zones Logistics centers Multi-modal shipping	Specialized facilities -> R&D labs, tech parks, skills training centers Advanced services for connectivity, energy, environmental

Facilities ••••••••••••••••••••••••••••••••••• Infrasystems

The Heartland Opportunity

Long written off by much of the national media the American Heartland of America has been displaying new signs of life.   Made up of thousands of rural small towns and hundreds of second and third tier cities scattered across America, the Heartland represents the vast regions outside the metropolitan areas. Many retain strong ties to agriculture, forestry, mining or fishing but many also have made a steady and successful diversification to globally competitive manufacturing, energy information and other service industries.

Heartland communities outside the major metropolitan areas possess many underutilized assets. These include, in many places, relatively low housing costs and a good business climate, quality schools, a reasonably educated and productive workforce, and available land and other resources for expansion. Recently the resurgence of the Heartland has also been bolstered by strengths in both energy and agriculture.

Infrastructure bottlenecks, however, are putting a damper on the Heartland's forward economic motion. Surging agricultural exports are exposing inadequacies in the country's railways, highways and waterways that carry grain to feed the world. Those bottlenecks are costing farmers, shippers and consumers millions of dollars.

This dire situation is mirrored in the energy sector. Much ballyhooed plans to harness wind and solar power face severe limitations due to a power grid that cannot bring renewable energy from its sources to potential customers. Many transmission lines are simply inadequate for the amount of power companies would like to push through them. As a result many of the windiest places, particularly in the Great Plains, cannot move their energy to the more populated cities where the demand lies.

Rural regions and second and third tier cities in the Heartland cannot bear the financial weight of these investments themselves because they are often financially stressed due to a limited tax base, the high costs associated with size and scale, and difficulties of a population that is in many areas is aging and in others being rapidly increased due to in-migration.

America, the world's most advanced continental nation, could be on the verge of a great resurgence, much of it based in regions largely unacknowledged by many pundits, academics and the media. What is needed now is an infrastructure strategy to make it happen.

Infrastructure Investment Key to the Heartland's Growth

Of course, the Heartland's infrastructure problems are not unique. According to the American Society of Civil Engineers, the United States needs to invest $1.6 trillion in infrastructure improvements in the next few years. There is a need for a greater national commitment to meet these needs. Yet often in the debates about infrastructure, the needs of the heartland --- so out of sight and mind to policy makers and pundits alike --- are often ignored.

Spurred in part by the increase in calls for action on infrastructure investment, Congress has begun to propose new funding structures and agencies to deal with the perceived shortfalls in funding. Senators Dodd and Hagel have introduced bipartisan legislation (S. 1926) calling for the creation of a National Infrastructure Bank. (NIB) The NIB would be an independent government agency modeled after the FDIC, with an initial endorsement to issue bonds totaling up to 60 billion dollars. Focusing on transportation infrastructure, Sen. Wyden or Oregon has introduced legislation (S. 2021) that calls for 50 billion dollars in infrastructure bonding through the issue of "Build America Bonds." In the House, there have also been moves towards proposing new solutions, including the introduction of the National Infrastructure Development Act of 2007 (H.R. 3896) that calls for creating an infrastructure development corporation capable of using leverage to make loans and to issue and sell debt securities.

Federal resources alone are not going to meet the nation's infrastructure needs. For that reason, here and elsewhere around the world, cash-strapped governments are viewing private investment as an increasingly important piece of the infrastructure investment puzzle. Concurrently, banks, pension funds and other private investors are considering infrastructure as a new, long-term asset class that offers a combination of hard assets and visible long-term earning streams.

This confluence of circumstances has given rise to a new set of private infrastructure funds that have attracted billions of dollars and Euros from individual and institutional investors alike . In an 18-month period leading up to 2007, nearly 160 billion dollars was directed for infrastructure investment funds, including 120 billion dollars in newly created funds. This trend has continued into 2008, with investment banks and institutional mangers now able to leverage somewhere between $400 and $500 billion in buying power.

A key question is whether the new private infrastructure investment vehicles or the assets of a federally sponsored bank will find their way to the Heartland. There is a danger that these funds will remain concentrated in the large metropolitan areas like their private venture capital and federal urban development program counterparts.

The Heartland Development Bank[1]

In order to capitalize on emerging economic opportunities and to rebuild America's productive capacity in energy, agriculture and manufacturing enterprises we propose the creation of the Heartland Development Bank. The Bank is envisioned as a $10 to $25 billion source of financing for infrastructure development projects. The Bank would serve as a lead lender on projects of economic significance in the Heartland and leverage considerable co-investment from the private and public sectors.

Comparable models include the Inter-American Development Bank (IDB) and California's Infrastructure and Economic Development Bank (I-Bank). The IDB is the oldest and largest regional development bank which now serves as the main source of multilateral financing for economic, social and institutional development projects as well as trade and regional integration programs in Latin America and the Caribbean. California's Infrastructure and Economic Development Bank (I-Bank) finances public infrastructure and private investments that promote economic growth, revitalization of communities and the enhancement of the quality of life throughout California.

Following the IDB model, the Heartland Development Bank's capital would be subscribed by ainvestors including states and the federal government, banks, private investment funds, local and regional development organizations, corporations, and other development-interested groups. Non-Heartland members outside the region could subscribe to the fund and benefit by having preferred status as suppliers of goods and services for HDB-financed projects.

The Bank's resources would include callable capital, and paid-in capital from HDB members, as well as reserves and funds borrowed in international markets. The Bank could be structured so that only 5% percent of the $10 billion is paid-in. The remaining 95% is callable capital to be based on the implementation of approved projects in need of financing.

Unlike earlier periods of infrastructure expansion, which were often uniformly national or regional in scope, today's infrastructure --- and more particularly infrasystems --- needs related to economic development are often closely tied to the specific circumstances pertaining to a particular local or regional economy. Since federal resources alone will most certainly be unable to meet the entire need, local and private resources must be mobilized to the greatest extent possible. For these reasons, the investment strategy of the Heartland Development Bank may be most successful if it focuses on the many thriving regional growth centers in manufacturing, agriculture, energy and advanced services that have emerged across the country.

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[1] The Heartland Development Bank was first developed as part of *Rebuilding America's Productive Economy: A Heartland Development Strategy* for the New America Foundation in Washington, DC authored by Joel Kotkin and Delore Zimmerman. 2006.

Public Private Investment in the Heartland Development Bank

Infrastructure provision and development in America is poised to jump to the front of the policy agenda over the next several years. With the election of a new President, new priorities and objectives are sure to be set regarding infrastructure investment. In addition, a major new transportation funding bill will be introduced in the coming year, to be accompanied by a major push for all kinds of infrastructure, at the congressional level.

While the rest of the world has been expanding the use of private finance through public private partnerships (PPP) for decades, the United States has remained somewhat behind the curve. Limited use of such PPPs has a long history in the United States, going back to the canals and railroads, but new and useful models need to be developed. Faced with numerous challenges, including a soft economic outlook, and a downturn in property values, governments require innovative new options for the provision of infrastructure vital for economic growth. In many cases, the most viable option for such communities will be to draw upon public-private financing partnerships for new projects.

Infrastructure has been aptly characterized as the new competitive imperative. The full competitive potential of the Heartland cannot be fully realized, unless there is intelligent public policy and public and private investment to catalyze it and make it happen. By investing in a vital heartland, America help develop the kind of productive economy necessary to improve the lives and prospects of a rapidly expanding population.

This work is supported by the Small Business Innovation Research program of the U.S. Department of Agriculture.