National Security and the Infrastructure America Needs

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Up until the release of the Trump administration's National Security Strategy in December 2017, the prevailing view in Washington policy circles was that economic security and national security were unrelated. This was the case despite the obvious observation that the underlying economy dictates how much a nation can spend on defense, not to mention the associated industrial base which sustains the integrity of that defense. Thankfully it appears that policy makers are beginning to pay attention and recognize that economic security is vital to a strong national defense.

Unfortunately we are now faced with a two-part problem. First, we have neglected our critical infrastructure since the end of the Cold War. And second, our defense budget is incapable of sustaining the needed investments in infrastructure and the defense industrial base because of the accumulated effect of two decades of inadequate investment on the readiness of our military forces.

This leaves us in a quandary. Our economy needs these investments to sustain economic growth beyond the tax and deregulation stimulus, but there appears to be no hope of passing an infrastructure bill in Congress that relies on Federal funding.

The need is clear. The American Society of Civil Engineers estimates that $5.1 trillion is required through 2040 to close the investment gap. If we fail to rebuild our infrastructure, we cannot achieve economic security. Consequently, the US could become a vassal state of China, providing raw materials and agricultural products, while China leads the world in manufacturing and high tech, which is the goal of "Made in China 2025".

The desire is bipartisan. President Donald Trump pledged to "build the next generation of roads, bridges, railways, tunnels, sea ports, and airports," and Peter DeFazio, chair of the House Transportation and Infrastructure Committee, previously proposed a $500 billion infrastructure bill.

Fortunately, there is a historical analog that provides a template for success - a federally chartered "non-bank bank." The Federal Home Loan Bank System (FHLB), chartered during the great depression, runs so well that even with about $1 trillion in assets, you rarely hear about it. While it is federally chartered, the FHLB is privately owned, privately managed, profitable, and traditionally free from political interference.

An Infrastructure Bank for America could be patterned on the FHLB, established in 1932 to assist in the economic recovery. Like the FHLB, this new infrastructure bank would be funded by issuing equity and debt securities through the private capital markets. Any investor could participate, including trade unions, corporations, financial institutions, and sovereign wealth funds of foreign nations. Bondholders would get interest payments, and equity holders would get dividends and the opportunity for capital gains.

The federal government could encourage investment in the bank in two ways. First, the Treasury would provide a tax break on repatriated earnings if the money is invested in special infrastructure bonds for 10 years. Second, equity investors in the bank would get a federal tax credit similar to tax credits that investors earned for financing wind farms. These incentives would encourage investment in America, which is important in a globalized world that continues to support democratic principles.

China has been able to capture investment capital by similarly aligning its private sector investment incentives with their national interests. In other words, not only would this bank strengthen the American economy, it would align American private sector investment capital with America's national security strategy. When coupled with increased domestic investment in basic research and STEM education, the outcome is sustained economic growth for America.

Just like the FHLB, the bank would be supervised by a federal regulator. It could be designated a SIFI, or systemically important financial institution (like any large commercial bank) and required to maintain sufficient levels of capital. The bank's directors would be private citizens, chosen by equity holders, not Congress or the White House. There would be clear regional parameters and guiding principles on directing funds to worthwhile endeavors. The long-term goal is to establish regional infrastructure banks -- again similar to the FHLB system -- and to reinvigorate current state infrastructure banks, most of which are dormant or underdeveloped.

This is an infrastructure plan that promotes America's national interest. Government plays a key role by providing incentives, but the bank is structured so that capital will flow to its best uses through economic, not political dynamics. It's a truly non-partisan, market-based, American solution. More importantly, it recognizes that in the 21st Century national security is about more than bombs and bullets.

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