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House Corporations Committee,
Honorable Joseph J. Solomon, Jr., chair
State House
Providence, RI 02903

RE: Testimony in support of H-5666

Honorable Committee Members:

During 2015 and 2016, I served as Senior Policy Advisor to General Treasurer Seth Magaziner. One of the primary projects I took on was to help design and write legislation for the new Rhode Island Infrastructure Bank (RIIB). The legislation passed in 2015, and it has already become a vital institution and has grown to do things we did not imagine. Its benefit to the state, in terms of roads (re)built and clean energy projects underway, is already substantial and in the future will only increase.

To create RIIB, we built on the Clean Water Finance Agency, so essentially the task was only to add some more flexible lending programs to an already-existing, well-run, agency. The old agency was well used to doing bond finance, and bond finance was envisioned for the new programs. There was substantial demand from the state's municipalities for the new programs, for roads and bridges, and for energy finance. In fact, the demand was far greater than the capacity from the beginning.

Sole reliance on the bond market was problematic for a few reasons. The first is that trying to corral a dozen municipal projects into a bond issue is a long and tedious process. More than a few of the projects in that first bond issue could have been completed months, possibly years, sooner but for financing delays caused by wrangling all the other municipalities into the same pool. Second, because we sought a rating for the bond, not the lending program or the institution, we were unable to concentrate the lending in the communities that need it the most. The logic of sharing risk as expressed in bond documents meant that our bonds would involve lending in rich communities, as well as poor ones to keep the rating high: two Barringtons for each Central Falls. This is not a bad thing in some respects—rich communities also have legitimate need for attention from the state—but the aid we can deliver this way is out of proportion to the needs.

The bond market is also inflexible. Programs must be envisioned completely enough to be thoroughly described in bond documents. A thorough airing of public policies is always a good thing, but it is not unknown for conditions to change, and bond terms can last decades. Once a bond is sold, the terms are immutable, and this can deprive the borrower any possibility of adapting to unforeseen market developments and municipal needs.

Finally, the bond market has some well known inequities. In 2011, in response to the Central Falls bankruptcy, this body made municipal default a virtual impossibility. Despite that action, Providence debt, rated BBB+ by S&P sells at a significant premium over Middletown, rated Aa1 by Moody's.[1] As a result of the 2011 legislation, there is no practical difference in the default risk, but Providence and other less affluent communities pay a "risk premium" nonetheless.

This also highlights the fact that borrowing through the bond market can never be a good way to seek redress for historic injustices. Historically poor cities and towns tend to have bad bond ratings. The ratings agencies have no brief to change that, and bond investors have no motive to look beyond the ratings. In other words, the bond market is an excellent way to perpetuate the status quo, but it can never be a source of change, even for things that richly deserve to be changed.

By contrast, an infrastructure bank is ideally positioned to overcome each of these issues. By having what amounts to a loan officer willing to serve his or her clients, the bank can be far more flexible in terms, expanding a successful program or contracting a troubled one on the fly. It can be empowered to put its aid where it will do the most good, and it can also be less expensive than the bond market, by simply reducing the number of gatekeepers and their opportunities to extract funds from the issuance process.

Because I was involved in the creation of our own infrastructure bank, it seems worth addressing the question of whether a national version would be duplicative of our own. This is far from the case. RIIB does not have its own capital to lend. Though it has done a lot (more than many other states I should add) to leverage available capital, RIIB is fundamentally just a conduit for finance. It seeks financing from the bond market and others in order to extend that financing to the cities and towns that it serves. A NIB would not end that service, just provide another option for funding RIIB loans. I have little doubt that RIIB would be perfectly suited to serve as a local agent for some NIB lending, leveraging the national dollars on behalf of local governments just as it already does with bond market funding.

There is also a potential for impact on the bond market itself. This might be separated into the possible impacts on bonds already issued and on bonds not yet issued. As far as the bonds already out there in the market, a NIB could hardly affect their value, except to lower the likelihood of default by a city that sees its other borrowing costs and risks reduced. To the extent it reduces the supply of new bonds coming into the marketplace, the likely consequence seems as if it would be an appreciation in price, largely a benefit to issuers.

For bonds not yet issued, a NIB obviously would provide competition to the traditional bond underwriters, like Goldman Sachs or Morgan Stanley. It does not seem like a primary responsibility of this body to favor those bond market players over the Woonsockets and Newports of the world. Again, buyers of municipal bonds might see a rise in prices as the supply drops,

[1] See 2021 bond sales for Providence https://emma.msrb.org/IssueView/Details/P1408105 and Middletown https://emma.msrb.org/IssueView/Details/P2408745.

but this would be to the benefit of issuers, as they would see their interest costs decrease as a result.

Any proposal as ambitious as a National Infrastructure Bank will have detractors, many of whom will defend the existing bond market by pointing to its unparalleled supply of funds. But given the risk and delays created by the bond market's inflexibility, the inequities built into the process, the cost imposed by the many gatekeepers, and the ratings fiction, it is far from clear that the bond markeet can achieve anything close to the optimum efficiency in the use of public dollars. An alternative source of infrastructure finance is sorely needed and the NIB seems like an excellent way to do it.

It would be wrong to say that I have only a critique of the bond market to offer in support of the NIB proposal. A national investment bank like NIB can also be an important locus of coordination among states, counties, and municipalities, as well as the promulgation of best practices and even coordinated purchasing. Many of us here can recall the period before the dramatic evolution of several Asian countries from third-world status to economic powerhouses. Those transformations—of Singapore, then Taiwan, even South Korea, and then China—were astonishingly rapid. Those giant steps did not happen by accident, but because there was a shared vision and unity of purpose among the people making basic decisions about investment and infrastructure in those countries. The NIB can be a vehicle toward moving in that direction, much as the Reconstruction Finance Corporation provided that kind of coordination during the Great Depression.

This is all to say that I am very excited by the proposal for a National Infrastructure Bank and hope that you are too, for the sake of our nation's continued prominent standing in the world. The NIB cannot fix everything. It is not a magic bullet, only a superior source of credit. But by reducing the cost and risk of state and municipal borrowing, it can go a long way to creating the conditions to rebuild our nation's crumbling infrastructure. It's something our children deserve to have us create and I urge this committee to approve this resolution and send it to the floor for a vote.

Sincerely,

Tom Sgouros