Financing Infrastructure with Inattentive Investors

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Hutchins Center on Fiscal & Monetary Policy at Brookings



## Summary of Main Findings

Tax-exempt securities are primarily attractive to retail investors who are "inattentive"

Therefore, "attentive" mutual fund conduits for retail initially purchase new issues before redistributing them over time to retail investors

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In periods of reduced retail demand and/or mutual fund outflows, the cost and availability of capital for infrastructure investment is impeded

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This retail demand dynamic is a primary reason for the poor state of U.S. public infrastructure

The Federal Reserve should intervene during periods of mutual fund outflows to support state and local infrastructure investment





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## Retail Investors are "Inattentive"

- Low sales commissions relative to other investment products
- Timing/size of retail demand vs. issuer supply
- Maturity mis-match of retail demand vs. issuer supply

"Attentive" mutual funds buy municipal issues upfront

- Entire par amount of bond issue must clear the market at one price
- Mutual funds provide "synthetic" demand for longer term maturities
- Non-exempt "cross-over" buyers support periods of weak demand

Absence of retail demand inhibits state/local infrastructure investment

- Impact on cost vs. availability of infrastructure investment capital
- State/local debt capacity limitations: affordability and politics
- Mutual fund redemptions: COVID Mar/Apr 2020 vs. recent 2022-23 experience
- Taxable investor alternatives: 2009-10 BABs and 2020-21 issuance surge





Role of mutual fund "principal reinvestment" vs retail inflows

Differing impacts of separating out new money vs. refunding issuances

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Increasing importance of SMAs and other non-mutual fund conduits

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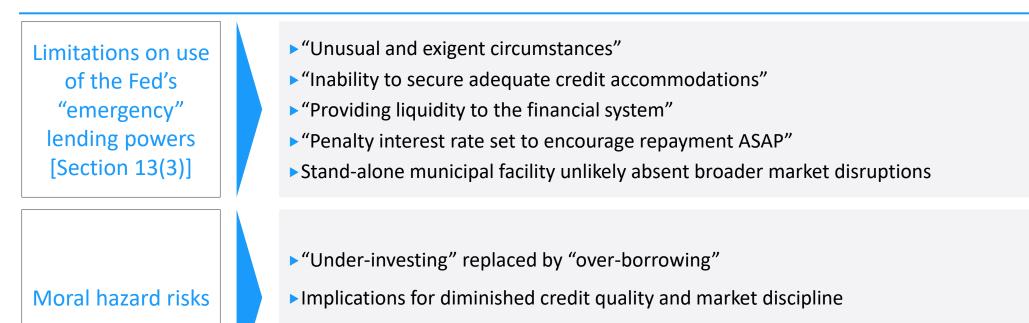
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Impact on conclusions if large/repeat issuers selected vs only counties





## **Comments on Policy Recommendations**



Implied federal guaranty

Funding vs. financing dilemma

- ► U.S. capital markets are largest and most liquid in the world
- Access to capital vs capacity for repayment
- Absence of debt capacity and political support for repayment taxes, user fees or other revenue streams
- Alternative delivery mechanisms (P3s) can enhance DBOM but don't change debt capacity challenge



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