INNOVATION BRIEFS

COMMENTARY

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The Transportation Policy Commission Gets Down to Business

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After two meetings filled with tutorials on various aspects of the federal surface transportation program, the National Surface Transportation Policy and Revenue Commission finally got down to the business of examining substantive policy issues. At its October 18-19 meeting, with newly confirmed Transportation Secretary Mary Peters in the chair, the Commission focused on three related topics: tolling, congestion pricing and the role of the private sector in transportation infrastructure. All three issues are of considerable relevance to the transportation community and are likely to influence the development of any future national transportation policy. They also are still capable of raising questions in the minds of the Commissioners, as became evident during the meeting.

To brief the Commission, the staff invited an impressive roster of experts from the public and private sectors. Offering an overview of the economics of congestion pricing at the Wednesday public session was Don Pickrell, Chief Economist at U.S. DOT's Volpe National Transportation Systems Center. Introducing the Thursday public session on the private sector's role in financing and operation of transportation infrastructure was Robert Poole, transportation director at the Reason Foundation. Each lead presentation was followed by a panel of experts. The Wednesday panel discussed the practical experience and policy issues surrounding the practice of tolling and road pricing. The Thursday panel dealt with private infrastructure transactions, focusing on the Chicago Skyway and the Indiana Toll Road lease concessions. (For a listing of panel memebers, see below. Panel presentations, including that of your editor, will be posted on the Commission's website, www.surfacecommission.gov/commissionmeetings.htm). Following the public sessions, the Commissioners met privately with Chris Leslie, CEO of Macquarie Infrastructures Partners and Robert Dove, Co-Managing Director of the Carlyle Infrastructure Fund for a discussion of infrastructure financing as seen from the perspective of private equity investors.

In our May 2006 report on the inaugural meeting of the Commission, we observed that there seemed to be no immediate prospect for a Commission consensus concerning the future role of private sector financing. ("The Congressional Transportation Commission Gets Underway," May 25, 2006). Our impression was confirmed at the October meeting. A number of the Commissioners were plainly not convinced that highway concessions, at least of the Chicago Skyway and Indiana Toll Road type, represent sound public policy.

The criticisms posed by the Commissioners and the ensuing debate (shown in italics) can be summarized as follows:

What do these deals accomplish that the public toll authorities could not do by themselves? *By having access to private equity capital and bank loans, private concessionaires can raise more capital than public toll authorities. The latter are limited by state law to traditional bond financing and constrained by stringent debt coverage ratios. In other words, a debt-equity financing model allows a private concessionaire to pay more for a given asset than the traditional municipal bond financing approach. As Indiana Governor Mitch Daniels stated, thanks to the up-front lump sum payment received from the private concessionaire, Indiana is the only state in the nation with a fully funded 10-year capital program of highway construction. Few projects in this program would be constructed had Indiana continued to rely on traditional funding mechanisms.*

Private concession agreements also have other advantages. The risk of cost overruns and over-optimistic traffic forecasts is borne by the concessionaire and the taxpayer is held harmless. Under private management, toll rates can be raised to control demand or fund needed improvements without the fear of political interference. Finally, private toll operators have shown themselves to be more entrepreneurial, innovative and customer-oriented by introducing new technology, innovative design and construction approaches and novel operating practices such as variable pricing and advanced traveler information systems. That is not to say that all toll facilities should be candidates for private concessions. There are many well-run toll properties that will remain in public hands indefinitely.

Aren't we creating value out of thin air? *Hernando de Soto, in his book "The Mystery of Capital," explained how inadequate markets and legal systems can lock up certain public assets as "dead capital" and prohibit them from being used as productive capital. Highway infrastructure in the United States represents such "dead capital." The Chicago and Indiana transactions have shown that captive capital invested in these assets can be freed and redeployed to a higher and better use. A state study found that the toll road authority could have raised $1.8 billion through additional bonding. The private concession, on the other hand, was able to offer $3.8 billion, thus freeing $2 billion in captive capital. It was a demonstration of the well known fact that changing the property rights structure can unlock additional asset value.*

Isn't the benefit from this transaction rather transient? What will happen in Indiana in ten years, after all the money has been spent? *There will be a permanent legacy of new assets in the form of some 200 new highway infrastructure projects across the state. In addition, $500 million has been placed in a dedicated "Next Generation Fund" which will generate interest income for infrastructure projects for the next 75 year (along with income and other taxes that will now be paid by the concessionaire).*

Is it fair to require users of the Indiana toll road (including users from out of state) to pay for transportation improvements unrelated to the facility itself? (Under

Governor Daniel’s "Major Moves" program, most of the $3.8 billion proceeds from the Indiana toll road concession will be spent on projects throughout the state.) *Cross-subsidies are common in highway finance. They are inherent in the mechanism of the gas tax whose proceeds are spent on road improvements throughout the state. They are present at the national level, with donor states subsidizing donee states. They are also common within multi-modal toll agencies at the regional level. For example, tolls collected by the New York Port Authority on its bridges and tunnels support the cost of transit operations elsewhere in the region.*

Commentary

Forgotten in the discussion were two important factors. First, private lease concessions involving existing toll facilities, as exemplified by the Chicago and Indiana transactions, are likely not to be the only, or even the most prevalent type of private sector involvement. While there are good prospects for more private concessions involving existing toll roads (e.g., Pennsylvania Turnpike, New Jersey toll facilities, Illinois Tollway, several New York State toll facilities), of greater long-run significance will be public-private financing of new, "greenfield projects" such as express toll lanes, new stand-alone toll roads (as in Texas) and multi-state corridor truckways.

Second, despite the attention given to it at the Commission meeting, private leasing of existing toll facilities has few implications for federal policy. States alone will determine whether these kinds of transactions make good sense and whether they are of financial benefit. Congress and the federal government will not be involved in these transactions and will have little to say in deciding their fate. We hope that the Commission will judge the promise of private financing by examining a wider range of public-private transportation partnerships, notably those that are now in the process of implementation in Texas, Virginia, Maryland, Florida and California.

We commend the Commissioners for coming to grips with one of the most consequential issues facing the Congress at the expiration of the current federal surface transportation program in 2009. That issue is whether the nation’s surface transportation program should continue relying exclusively on the traditional sources of transportation financing or whether it should begin a transition to a more market-oriented approach—an approach in which tolls, demand-based variable pricing, private capital and public-private partnerships are allowed to play an integral role.

For our part, we believe that maintaining the status quo is no longer tenable. The forces of change and the need to respond to them are compelling. They include the urgency to address the alarming levels of congestion on the nation’s highways, the eroding value of the Highway Trust Fund revenue, and the growing desire and determination of the states to solve their transportation funding problems in novel ways, without raising taxes.

We hope the Commission will rise to the occasion and become an agent of change rather than a ratifier and endorser of the status quo. The nation’s transportation program deserves nothing less.

Wednesday panel: Patrick DeCorla Souza, FHWA; Lee Munnich, Univ. of Minnesota; Naveen Lamba, IBM; Sec. Robert Flanagan, Maryland DOT; Michael Replogle, Environmental Defense, Ken Orski, Innovation Briefs; Brian Taylor, UCLA Institute of Transportation Studies.

Thursday panel: Dana Levenson, City of Chicago; Chuck Schalliol, State of Indiana; Mark Florian, Goldman Sachs; John Schmidt, Mayer, Brown, Rowe and Maw, LLP; Gerald Pfeffer, Kiewit Corporation.

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