

For the Public Good

When is privatizing infrastructure a wise solution?

BY KATE SHIRLEY

With many infrastructure projects in North America, the looming question is: how is this going to be funded? The answer is becoming increasingly less certain. With budget cuts, cash-flow challenges, a declining tax base and rising pension costs, some cities and states are increasingly exploring privatization as a means to building and funding much-needed transportation infrastructure assets.

The American Society for Civil Engineers (ASCE) estimated in its 2013 Infrastructure Report Card that by 2020, the United States must invest \$3.6 trillion to meet future infrastructure needs. And while currently some 85% of critical infrastructure in the U.S. is privately owned, these are primarily in the areas of telecommunications, power generation, railways and pipelines. The nation still depends almost exclusively on the government for its public transportation infrastructure.

Is privatization a viable solution for constructing and maintaining surface transportation assets that have historically been financed by the government? And if so, what are the trade-offs?

There are two main ways a local government can bring in money through infrastructure privatization. One is to sell assets that have already been built, as Indiana did in 2006, when it leased its 157-mile Indiana East-West Toll Road for \$3.8 billion. In this situation, a group of international companies agreed to maintain the road for 75 years, and in exchange, are allowed to increase the tolls each year by either 2% or the rate of inflation, whichever is higher. While Indiana gave up the long-term revenue source from the tolls, the influx of cash allowed it to take care of other pressing issues.

The other way to enact privatization is for an organization to bid on a project such as a new bridge, road or transit line. If it wins the bid, the company would take charge of design and construction from

the very beginning. This option is popular with local governments, as it is perceived that a private company engaged in such an arrangement will have a more personal stake in the success of the project, leading to more positive outcomes for the public.

Some project successes have demonstrated that private companies can more easily cut through red tape. And because they can often come up with more cash to fund projects, this gives companies more freedom to innovate. Another key benefit of public-private partnerships (P3) involves government accounting processes. In some cases when a private company handles paying for a project, a government agency can simply pay the company a yearly lease payment. Instead of parting with a large lump sum up front, they can record a lesser payment their books. This is an attractive proposition for a cash-strapped city or state.

But despite the numerous benefits to infrastructure privatization, there are just as many downfalls. For example, imagine a scenario in which a city auctions off its bus routes to private bidders. Some peripheral routes that provide little opportunity for profit but which are essential to user mobility could be shut down for not yielding large enough returns. In the end, companies aren't buying up these assets as a form of charity; they do it with the desire to profit financially. Such arrangements could also hamper other public projects, as private companies usually have non-compete clauses written into the contracts, which might cause nearby transportation needs to go unmet. In 1995, Caltrans entered into a 35-year agreement with a private company to fund a ten-mile electronically tolled express lanes corridor on SR91 in Orange County, CA. But by 1999, the need for additional free lanes on the highway went unmet because a non-compete clause in the lease prevented capacity increase within 1.5 miles of the toll lanes. The adverse impact of this agreement was severe enough to

cause the Orange County Transportation Authority to buy back the lease at a public cost of \$207.5 million.

In 2008, Chicago leased its parking meters to a consortium of investors led by Morgan Stanley. The city received a lump sum of \$1.15 billion, and in exchange the consortium won the right to operate the meters and collect fees for 75 years. However, the private companies raised rates almost immediately, to the point where the meters couldn't handle the number of quarters necessary to pay for extended parking. Citizens began a boycott and meters were vandalized. According to a 2011 report by Chicago's Office of the Inspector General, this scheme ended up costing the city \$974 million in lost revenue, not to mention untold amounts of bad press. Long-term public interest issues must not be overshadowed by the desire for a large up-front payment.

One thing that is certain is the complexity of the P3 agreements. If this funding method becomes pervasive, local governments will need to be cautious when executing agreements to ensure the protection of the community. After all, if we don't like how our government leaders are serving our needs, we can vote them out of office, but a private company isn't so beholden to the general public. Cancelling services or insisting on non-compete clauses that compromise the public good could be a large sticking point.

Even though asset privatization might seem like a handy solution for local governments struggling to make ends meet while serving public infrastructure needs, detractors caution that there may be unintended consequences to entering into a hasty P3 arrangement. In the end, the public good must always be the first priority. ♣

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