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Public-Private Partnerships

Chairman DeFazio, Ranking Member Duncan, and Members of the Subcommittee:

I greatly appreciate the opportunity to appear before you today to talk about one of the most important trends in transportation, Public-Private Partnerships. Under the leadership of Secretary Peters and Secretary Mineta before her, the U.S. Department of Transportation (USDOT) has made the expansion of public-private partnership a key component in the Department's on-going initiatives to reduce the high and growing costs of congestion and improve transportation system performance.

The combined public and private sector interest in forming various transportation-infrastructure-related partnerships is growing every year. Based on a recent internal Federal Highway Administration survey, the majority of States are either participating in —or exploring the creation of — a public-private program. Currently, 23 States have some form of legislation that authorizes public-private partnerships in transportation. The 2005 Safe, Accountable, Flexible, Efficient Transportation Equity Act – a Legacy for Users (SAFETEA-LU) also took important steps to further encourage development of public-private partnerships by expanding state tolling flexibilities, allowing up to $15 billion in private activity bonds to be issued outside state volume caps for highways and intermodal freight facilities, and directing USDOT to streamline design-build regulations.

While the private sector is keenly interested in investing in a broad range of infrastructure systems in the U.S., my testimony will focus on highways and public transportation facilities with an emphasis on four areas: 1) why have public-private partnerships become an attractive financing option; 2) what are the various forms that public private partnerships can take; 3) what are the public policy implications; and 4) the Federal government's role.

WHY HAVE PUBLIC-PRIVATE PARTNERSHIPS BECOME AN ATTRACTIVE FINANCING OPTION?

The Demand for Private Sector Finance

As with any major economic trend, there are a variety of factors that have come together at the same time to propel us to this point. The willingness of public authorities to go beyond the traditional government approach to providing highways and public transportation systems has been driven largely by four distinct, but related trends: 1) growing resource scarcity; 2)

declining system performance; 3) emergence of contract mechanisms to reduce government risk; and 4) growing public acceptability of direct user fees.

Growing Resource Scarcity

Governments today (Federal, State, and local) are experiencing financial difficulty in keeping up with the demand for transportation investment. Transportation-related taxes are being increasingly absorbed by rising costs and the need to dedicate ever more resources to system preservation and maintenance.

Over time, the growth in gasoline consumption has been and will continue to be limited by increases in fuel economy for cars. In this year's State of the Union address, the President called for reducing gasoline consumption by an additional twenty percent in the next ten years by expanding alternative fuel production and increasing the average fuel economy of new cars and light trucks. In addition, vehicle miles traveled trends in the U.S. appear to have flattened out in recent years after tracking closely

Political resistance to fuel tax increases has grown at both the state and federal levels. Results of a recent survey by Washington State's DOT indicate 58 percent prefer the collection of tolls to fund future transportation improvements. Only 26 percent would rather see an increase in the gasoline tax.

At the same time, the costs of highway construction and rehabilitation have been growing faster than prices generally. As construction activity has taken off in China and India, competition for scarce construction materials has caused materials costs to explode, rising 8.5 percent in 2004 and 12.6 percent in 2005. Overall, construction costs since 1998 have risen 35 percent, more than twice as much as the GDP deflator.

Construction costs are particularly high in urban areas where congestion is most severe. Even without land acquisition costs, building a lane-mile of uncomplicated new highway in an urban area now costs about $11.2 million – adding land acquisition brings it to $15 million. But often there are complications that add to the costs, such as tunneling and overpasses, and these can push the cost of building a lane-mile of new highway to anywhere between $40 million and $300 million. Environmental mitigation is also a growing portion of project costs, amounting to between 5 and 27 percent of project costs.

Declining System Performance

Deteriorating performance in the Nation's surface transportation infrastructure is acute and widespread, and it affects both passenger travel and freight movement. For many years, the U.S. enjoyed substantial amounts of excess capacity along many sections of our transportation systems. Quite clearly, that era is over. In the past 20 years, hours of delay and wasted fuel have each increased by more than four times. The cost of wasted time and fuel for travelers in 2003 was over $60 billion, about 5 times the level in 1982. If we add the extra time people must allow in planning for congestion delay and the lost productivity associated with it, the annual costs rise to roughly $170 billion. These costs have been growing at about 8 percent per year – almost triple the rate of growth of the economy. The extent, duration, and intensity of delay associated with these costs have all skyrocketed over the past two decades.

For example, between 1982 and 2003 U.S. highway congestion:

- Increased from affecting 33 percent of travel in 1982 to 67 percent of travel in 2003;
- Increased in duration from 4.5 hours per day in 1982 to 7 hours per day in 2003; and
- Tripled the delay for the average rush hour driver's trip from 13 percent of normal trip time in 1982 to 37 percent in 2003.

For the trucking industry, the increases in delay time, wasted fuel, and other increased operating costs that congestion imposes costs them about $10.7 billion annually. The cost to shippers of delays in deliveries of shipments has been estimated at another $9.4 billion, so the total costs to truckers and their customers is about $20 billion per year. Productivity losses and costs of unreliability are in addition to those costs.

Emergence of Contract Mechanisms to Reduce Government Risk

Over the past decade, states and the private sector have gained valuable experience with new contractual mechanisms, including various types of design-build contracts, long-term management contracts and concession arrangements. These new contractual structures allow the government to efficiently manage the various risks associated with infrastructure development and operation without compromising other policy objectives. Because of these successful experiences, state legislators have given state transportation authorities broader leeway to experiment with ever more sophisticated arrangements.

Growing Public Acceptability of Direct User Fees

The introduction of the first motor vehicle fuel tax in the U.S. was in Oregon in 1918, however, that was not the preferred option. As transportation expert Martin Wachs, now with the Rand Corporation wrote in 2003 for the Report of the Committee for the International Symposium on Road Pricing, "The legislature had preferred a toll-based system of finance, but at the time it was rejected because of the cost of constructing toll booths and collecting tolls. So a practical limitation, rather than a policy-based one, dictated the starting point for our system of paying for road infrastructure." Similarly, when President Eisenhower created the Interstate Highway System in 1956, he had originally preferred a toll-based system, but reluctantly agreed to go along with the recommendation of the Clay Commission to use fuel taxes as the financing mechanism instead.

By the 1960s, some visionaries were already anticipating a time when administrative costs would no longer force us to rely only on indirect charges such as the fuel tax. In 1963 the economist William Vickrey, who later won the Nobel Prize, wrote:

> "Talk of direct and specific charges for roadway use conjures up visions of a clutter of toll booths, an army of toll collectors, and traffic endlessly tangled up in queues. . . . However, with a little ingenuity, it is possible to devise methods of charging for the use of city streets that are relatively inexpensive, produce no interference with the free flow

> of traffic, and are capable of adjusting the charge in close conformity with variations in costs and traffic conditions. My own fairly elaborate scheme involves equipping all cars with an electronic identifier which hopefully can be produced on a large-scale basis for about $20 each. These blocks would be scanned by roadside equipment at a fairly dense network of cordon points, making a record of the identity of the car; these records would then be taken to a central processing point once a month and the records assembled on electronic digital computers and bills sent out. . . . Cameras can be arranged at some locations to take pictures of cars not producing a valid response signal."[1]

Twenty-five years before E-ZPass, and 40 years before the London and Stockholm congestion pricing systems, Vickrey had anticipated exactly how congestion charging would be carried out and enforced. Needless to say, with technology reducing the costs of electronic toll collection to a fraction of what it would have been in the 1960's, administrative feasibility is no longer a problem.

Public opinion has also turned around. The American Automobile Association recently published a national opinion poll that found that 52 percent of respondents favored tolls as a revenue source for expanded highway investment, while only 21 percent favored an increase in fuel taxes. A survey by the Colorado DOT found 66 percent in favor of tolls as a way of financing new highway capacity, while only 16 percent favored fuel taxes. A 2005 Washington Post survey for the D.C. area similarly found 60 percent in favor of tolls, compared with 30 percent in favor of fuel taxes. A 2004 poll by the Minneapolis Star Tribune found 69 percent in favor of express toll lanes, but only 23 percent in favor of increases in fuel taxes. A 2006 poll for the Richmond-Times Dispatch found that 59 opposed an increase in fuel taxes, while tolls were supported by a 49-45 margin.

Although indirect taxes on gasoline, diesel, general sales, motor vehicles, property and income still dominate the transportation revenue landscape, it is important to observe the trends closely. From 2000 to 2004, toll revenues grew 21.1% in the U.S. compared to 2.5% and 0.1% for fuel and vehicle taxes, respectively. The majority of new highway projects over $500 million that are currently in the development phase in the U.S. will be toll roads. In many cases, they will be toll roads constructed using some form of public-private partnership and whose prices will vary based on congestion levels.

The Supply of Private Sector Finance

From a supply standpoint, the surge in private sector interest in investing in U.S. highways and public transportation systems is driven by four entirely different factors: 1) investment returns at rates higher than long-term government debt with risks lower than real estate; 2) confidence in the stability and predictability of U.S. legal systems; 3) a belief that the U.S. economy will continue to grow as quickly as any industrialized economy in the world; and 4) increased facility operating and management expertise.

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[1] William S. Vickrey, "Pricing and Resource Allocation in Transportation and Public Utilities: Pricing in Urban and Suburban Transport," *American Economic Review*, v. 53, no. 2 (May 1963), pp. 457-459.

Investment Returns

In order to fully understand current infrastructure trends both in the U.S. and around the globe, one must have some appreciation for the current forces at work in international capital markets. With long-term interest rates continuing to hover near record lows, a substantial amount of savings has been organized to invest in low to medium risk assets with low to medium returns.

As then Federal Reserve Governor Ben Bernanke said in April 2005,

> "One well-understood source of the saving glut is the strong saving motive of rich countries with aging populations, which must make provision for an impending sharp increase in the number of retirees relative to the number of workers. With slowly growing or declining workforces, as well as high capital-labor ratios, many advanced economies outside the United States also face an apparent dearth of domestic investment opportunities. As a consequence of high desired saving and the low prospective returns to domestic investment, the mature industrial economies as a group seek to run current account surpluses and thus to lend abroad."

Many of the same forces that have driven international managers of large pools of savings to seek new investment opportunities are now driving U.S. fund managers to do the same. The California Public Employees' Retirement System, for example, is now the majority investor in a major intermodal transportation facility developer. More than 50 percent of the investors in Macquarie Infrastructure Partners, a recently formed infrastructure fund, are Americans, including substantial commitments from the retirement funds of several labor unions. Various other financial services firms in the U.S. have reported the speedy formation of large investment funds with an infrastructure focus. Private-sector infrastructure investments globally have grown from $52 billion in 2000 to $145 billion in 2006.

Confidence in U.S. Legal System, Economy, and Demographics

Growing interest in U.S. infrastructure reflects not only a large pool of long-term lenders, but also great confidence in the U.S. legal system. Public-private partnerships have been commonplace in the developing world for many years, but the recent emergence of infrastructure investment funds in the developed world that allow the diversification of infrastructure investment portfolios has greatly reduced investment risk. As a result, investors are willing to tolerate significantly lower returns, which lower the costs born by the public sector in connection with the execution of a public-private agreement.

Given the scope of our infrastructure networks, our demographic advantage over most of the industrialized world, and our economic growth potential, there is little question that a substantial wave of investment in U.S. infrastructure across multiple sectors is possible. A 2004 survey by the Global Business Council ranked the United States as the second leading destination country for foreign direct investment.

Increased Expertise

At the same time that macroeconomic and external forces are driving private investors to the U.S. transportation system, private toll road operators have gained valuable operating

experience in the U.S. and around the world. Several European firms each operate more than 2,000 miles of toll roads. France, Spain, Portugal, Italy and Australia have all moved extensively to private operators to run large parts of their national motorways. Through efficient capital investments and a strong focus on throughput and operational performance, these companies generate higher operating margins than their public sector counterparts. This trend is a throwback to the 19th century in which over 2,000 private companies operated toll roads in the U.S.

WHAT FORMS DO PUBLIC-PRIVATE PARTNERSHIP TAKE?

There has been a great deal of discussion and interest in the lease transactions that took place in Chicago and Indiana, but it is important to bear in mind that the opportunities for public-private partnerships extend well beyond long-term lease agreements. The basic opportunity for the public sector is to allocate various project risks to private sector entities that may be in a better position to efficiently manage and reduce those risks. Those include design risk, financial risk, construction risk, operations and maintenance risk, and revenue collection risk, among others. The ability to shift these various risks to private investors increases the public sector's ability to manage a large number of projects, while also reducing strains on government budgets and the taxpayer.

No two projects are identical and, as a result, the scope of risk transfer can vary substantially from transaction to transaction. At one end of the risk transfer spectrum is the basic design-build contract, whereby the public agency transfers various cost and design risks to the private sector, but retains virtually all other risks. At the other end of the risk transfer spectrum are contracts to build/re-build, own, and operate. In these agreements, the public sector can insist on various performance requirements and rate schedules, but provides the private sector with broad discretion to operate and invest in the facility in the most cost-effective manner.

In the middle of this spectrum are variations on these contracts, including contracts to build, operate, and transfer, as well as long-term concession/franchise agreements. In both of these arrangements, the private sector bears virtually all the operating and maintenance risk. In the concession arrangement, the private sector also bears financing and revenue risk for the term of the contract.

While relatively new to the United States, particularly in the post-interstate highway era, these various arrangements have become commonplace around the world. According to a 2005 Federal Highway Administration synthesis that relied on information from Public Works Financing, there were 1,121 public-private infrastructure partnerships completed around the world between 1985 and 2004. Eighty percent of these projects were in the transport sector, representing a value in excess of $360 billion.

In a recently released design-build study, FHWA found that, among responding agencies that had design-build programs, more than a quarter of total project costs were incurred in connection with design-build contracts. For large-scale highway projects, particularly bridges and tunnels, design-build has become a standardized procurement technique in many states. Some of the most comprehensive analysis of the benefits of public-private partnerships has

been conducted by the United Kingdom's Treasury department. Among other findings, the UK found that 88 percent of ppp projects were delivered on time or early, and with no cost overruns on construction born by the public sector while non-ppp projects were delivered late 70 percent of the time and over budget 73 percent of the time.

Intermodal freight facilities are an emerging area of public-private partnership interest. The Alameda Corridor project in Southern California was one of the earliest examples of a successful public-private partnership. With the passage of the intermodal freight transfer private activity bond provision in SAFETEA-LU, USDOT is expecting several large intermodal facility developments to proceed as public-private partnerships in the next two years. While such projects often have a freight transportation focus, they often have spillover benefits for passenger transportation as well.

As the country's public-private partnership experiences grow, we can expect that our public transportation systems will increasingly explore creative partnerships with the private sector. The majority of empirical studies in both the U.S. and abroad find that the private operation of public transportation lowers costs, increases operational efficiency, produces a more efficient allocation of resources, and enhances innovation in comparison with the public sector.[2]

According to a comprehensive analysis of data from all major UK bus companies, private firms are technically and organizationally more efficient than public companies.[3] Evidence indicates that bus deregulation in the UK decreased operating costs by 30 percent, largely due to productivity and efficiency improvements.[4] Similarly, in Sweden, competitive tendering led to cost savings of 8 -15 percent.[5] In Greece, controlled competition led to 40 percent reduction in total costs and a 15 percent increase in ridership and productivity; and in Spain private firms provided public transportation at a cost 42 percent lower than that of public providers.[6]

Although public transportation agencies in the U.S. have far less experience with private involvement in recent decades than their European counterparts, these agencies have experienced similar reductions in cost through private sector involvement. In Indianapolis, for example, cost efficiency increased by 15 percent over a five-year period after its transit agency contracted all bus routes to private operators.[7] Researchers indicate that U.S. public

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[2] Matthew G. Karlaftis, Ph.D., *Privatisation and Regulation of Urban Transit Systems—Privatization, Regulation and Competition: A Thirty-year Retrospective on Transit Efficiency*, European Conference of Ministers of Transport Joint OECD/ECMT Transport Research Centre, at 35 (January 30, 2007).

[3] J. Cowie and D. Asenova, *Organizational Form, Scale Effects and Efficiency in the British Bus Industry*, Transportation, 26, 231-248 (1999).

[4] A. Nolan, *Urban Bus Deregulation: A Review of the UK Experience*, Published Commissioned Research Report, Dublin Corporation, Trinity College, Dublin, Ireland (1999).

[5] B. Anderson, *Factors Affecting European Privatization and Deregulation Policies in Local Public Transport: The Evidence from Scandinavia*, Transportation Research A, 26A (2), 179-191 (1992).

[6] G. De Rus and G. Nombela, *Privatization of Urban Bus Services in Spain*, Journal of Transport Economics and Policy, 31(1), 115-129 (1997)

[7] M.G. Karlaftis, J.S. Wasson and E.S. Steadham, *Impacts of Privatization on the Performance of Urban Transit Systems* Transportation Quarterly, 51(3), 67-79 (1997).

transportation agencies with competitive contracting regimes experience cost savings between 5.5 and 14 percent.[8]

A small but growing number of Federally-supported public transportation projects have experienced reduced costs, shortened project delivery, improved project quality, or enhanced revenues by transferring risks and responsibilities to private partners. The Federal Transit Administration hopes to demonstrate the advantages of PPPs for new fixed guideway capital projects through its newly created Public-Private Partnership Pilot Program, which was formally established on January 19, 2007.[9]

Although no transaction has taken place to date, the Department also expects that creative arrangements involving multiple facilities, including highway and public transportation systems will emerge. Multiple facility transactions would permit the pooling of low and high risk facilities, as well as revenue positive and revenue negative facilities.

PUBLIC POLICY ISSUES

Any analysis of the policy merits or pitfalls of public-private transportation partnerships is only appropriately discussed in comparison with the predominant approach of sole government provision. In other words, the burden on proponents of the public-private model is to articulate how such a model improves on our current policy framework. In that regard, I believe there are five critical (and related) policy failures that have emerged.

First and foremost, as discussed earlier, we are suffering an intolerable decline in system performance in the form of travel delays and unreliability. Sadly, we are far too tolerant of this obvious deterioration, choosing to assume that there are few, if any, solutions. Transportation system decline poses a threat to our continued economic prosperity, to our quality of life, and to our environment. An increased private sector role can help reverse these trends. Because congestion is an internal cost to a private operator, there are powerful incentives for the private entity to take aggressive steps to reduce it. A decline in vehicle throughput caused by congestion or an inability to effectively operate and manage a facility will reduce revenues and encourage customers to seek alternate routes.

Second, current planning and project selection processes are not adequately investing in projects that generate high returns. According to Clifford Winston from the Brookings Institution, "It would be expected that as the road system matures, the payoff from investments would decline, but inefficient highway policies also appear to have significantly reduced the rate of return from highway infrastructure investments. Shirley and Winston found that during the 1970's annual returns exceeded 15 percent, but that returns have fallen to less than 5 percent during the 1980's and 1990's." FHWA is working with states to develop mechanisms to analyze the economic costs and benefits of major investments; however, substantial work remains. Because private investors have little interest in investing in low return projects, resources are far more likely to flow where they are most critical. Most often, these will be

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[8] Matthew G. Karlaftis, *Privatisation and Regulation of Urban Transit Systems—Privatization, Regulation and Competition: A Thirty-year Retrospective on Transit Efficiency*, European Conference of Ministers of Transport Joint OECD/ECMT Transport Research Centre, at 25 (January 30, 2007).

[9] 72 Federal Register 2583.

major congestion relief projects in some of our largest metropolitan areas. In turn, this frees up public resources to invest in socially desirable transportation projects that would not rate highly on purely economic grounds.

Third, due to various budget and political constraints, highway capitalization has been sub-optimal. The majority of pavements in the U.S. interstate and primary systems were designed on the basis of a 20-25 year initial service life. The original design life of many of these assets is now over, and a growing percentage of Federal and state resources are being directed to preservation and maintenance activities. Current materials and technologies are widely available in the U.S. and around the world for much longer lasting pavement. Improved management practices, using timely preservation actions, can also significantly extend the life of existing infrastructure. In addition to providing substantial amounts of new investment resources, a long-term contract with the private sector can reverse some of the incentive challenges inherent in the current approach to government budgeting. As with congestion, an under-capitalized asset is an internal cost to a private concessionaire and its lenders. Over time, the operating and maintenance costs of such an asset will grow at rates far faster than would have been the case with a larger up-front investment. Equally important, more efficient investment schedules will lower the costs to users.

Fourth, as with any asset or service provided solely by government agencies, the current policy framework provides weak incentives for innovation and competition. Because the rewards of a given advancement – for example, in extended life pavements or more sophisticated traveler information systems – accrue broadly and not to specific creative individual firms or individuals, the current approach is unlikely to deliver the pace of breakthroughs that we are seeing in other critical infrastructure sectors like telecommunications and energy. Public-private partnerships can greatly improve the incentives to innovate, as well as the level of competition in the highway and public transportation sectors.

Finally, accountability to customers in transportation lags other infrastructure sectors. The current policy framework largely disconnects highway users from the ownership, operation and management of highway assets despite the fact that users depend on these facilities and indirectly finance their existence. This disconnect weakens the facility owner's incentive to provide superior customer service, as well as reduces opportunities for customers to voice complaints. Because the health of transit systems is in part dependent on satisfied customers, customer interaction tends to be much more frequent and sustained than can be observed with highway systems.

Public Policy Risks

Despite the clear opportunities that PPPs present to address some of the most pressing policy failures, it is also critical that public authorities, policymakers, and elected officials protect the public interest by fully understanding and analyzing the risks to the general taxpayer and transportation system user that can arise in connection with these transactions. The most important risks are: monopoly pricing risk, corruption risk, thin market risk, system distortion risk, financial risk, and inexperience risk.

Monopoly Pricing Risk

To the extent that the government views the leasing of existing transportation assets as a potential income source, there is an inherent tension that must be addressed. Contractual terms that provide substantial degrees of pricing power and protection from competition can substantially increase the discounted present value of the revenue stream associated with the asset. Obviously, there are other critical assumptions that go into asset valuations, such as traffic growth projections, the ability to control costs, and the cost of long term borrowing. However, there is little question that pricing flexibility in a potentially constrained market will be a major driver of facility value.

As a result, it is important that public agencies analyze closely the potential for prices that do not bear a close relationship to costs plus some reasonable return commensurate with the level of risk being assumed. Around the world, we have witnessed a trend in utility infrastructure toward price cap regulations that provide the regulated entity the authority to increase prices at a rate not to exceed the consumer price index plus or minus some X factor related to productivity improvements and changes in costs.

Another form of economic regulation is rate of return regulation. Rate of return regulation was the traditional form of economic regulation in the U.S. for many years. It has increasingly fallen out of favor because it provides perverse cost incentives and encourages overcapitalization. Given the complexity of these matters, it is important that public sector officials without regulatory experience gain a better understanding of the various penalties and incentives that are unlocked in connection with any economic regulatory decision.

A related issue is the treatment of competing facilities in the concession agreement. Contract provisions that limit the prospect of competition will increase the up front lease value of a highway, but may run counter to the public interest if such a provision is not commensurate with the private sector's risk. The emerging trend in this area appears to be the inclusion of either a limited provision or no protection at all. As with economic regulations, public sector officials must fully understand the implications of the various forms that these provisions can take prior to entering into any agreement.

Despite the monopoly risks, economists ask the more salient question: how do inefficiencies in a privatization compare to the inefficiencies of sole government provision? As Nobel Prize winning economist Gary Becker wrote recently on his internet site, in the context of a discussion about highways:

> "Still, I generally strongly support privatization, even when privatized companies have monopoly power in setting prices and other conditions of the sale. The reason is that other companies are more likely to find ways to compete against private monopolies than against government ones. A very important part of this argument is that technological progress is faster with private monopolies than with public monopolies. For example, ATT was a private regulated monopoly before the breakup of the Bells in the early 1980's into competing entities. The breakup was desirable, but still ATT was much more efficient than were the government run companies that dominated the telephone industry in the rest of the world."

Facility characteristics differ greatly across the country, and a uniform pricing policy at the national level is not appropriate. The Department hopes to conduct research into this economic regulatory question so that we can provide helpful guidance to State and local governments considering these transactions.

Corruption Risk

In any public-private contractual arrangement, there is always a risk of corruption, and the risks must be particularly managed when the agreement is for a large amount of money and for a lengthy period of time. An open and transparent process is the single most effective means to combat corruption. It is important that clear selection criteria are established, and that the qualifications of the various competitors are fully disclosed. Rarely, even with such transparency, an inappropriate concession award may be made. In these cases, public authorities should protect themselves and their constituents with provisions that allow a contract award to be cancelled if it can be proven that the award was corruptly made.

Thin Market Risk

In the past, the number of investors capable of bidding on major infrastructure projects was limited, and this raised the risk that the market for investors in such projects was so thin that the public authority could not be assured that fair value for the public was being received. In a thin market, and with a public agency focused on short-term returns, an agency might fail to receive returns commensurate with the long-term value of an asset. To a large extent, this risk has now receded, as the capital funding available to invest in such projects has multiplied several-fold over the past few years. With multiple U.S. investment firms entering this market, and foreign investment funds expanding their capacity, the risk that a thin market will fail to provide fair market value to the public is lessening year by year.

System Distortion Risk

The national highway system is a well-developed network, and we want to ensure that the system continues to work efficiently even when some parts of the system have been privatized. Of course, we already have substantial experience with operating a system that has multiple owners – the current national highway system is owned by 50 different states and numerous other highway, bridge, and tunnel authorities. For the most part, this multiple ownership of the system has not been a problem, and we do not expect that private ownership of part of the system would present an operational problem. Private owners have a financial incentive to maintain their facilities to a high standard and to ensure that construction activities, inclement weather, and other potential service disruptions do not interfere with continuous operations. The fact that part of the system is subject to tolls and part is not is an issue that has been with us for many years. This creates a distortion primarily when the prices charged do not reflect the real value of the facility to the user (as when prices do not reflect levels of congestion). Public authorities should ensure that the pricing structure established by private operators reflects congestion and other characteristics affecting the value that the user receives, so that traffic is not inappropriately diverted from one part of the system to another.

Financial Bailout Risk

Public authorities that use private sector finance will want to ensure that, if a private sector project encounters financial difficulties, the operations of the project will not be interrupted and that unforeseen financial liability does not transfer to the public sector. The public partner will also want to ensure that control of operations on the facility will not be tied up in bankruptcy proceedings. We have extensive experience in private sector ownership of essential facilities, such as railroads and power plants, so these issues are not novel and the means to ensure uninterrupted service are well-established.

Inexperience Risk

Finally, given the novelty of some of these concepts, there is risk that public agencies will lack the capability to successfully administer public-private programs in the public's interest. An inexperienced public agency, for example, might underestimate the value of an asset and lease it for too little. As a result, it will often be necessary for these agencies to procure legal and financial expertise to assist them. As experience grows across the country, the sharing of best practices and lessons learned from state to state will also grow, thereby helping to minimize some of these risks. In addition, it will be necessary for States to acquire different types of in-house skills.

WHAT IS THE FEDERAL ROLE?

The approach to federalism that we have historically adopted in highways and transit delegates most of the responsibilities to the states. The federal government sets certain kinds of performance standards for highway and transit facilities, but leaves most of the decisionmaking to the states and their agencies. We see no reason to alter that fundamental division of responsibility. The federal government must focus more closely on ensuring that national transportation objectives are being achieved. This includes ensuring that freight and passenger traffic can flow easily across state and international boundaries, and that the national connectivity of the highway system is maintained. We believe that public-private partnerships, by bringing more market-oriented perspectives into transportation planning, will help to ensure that both private and public transportation dollars are allocated more efficiently. And our top priority, as always, is safety. As an integral part of the roadway network, it is essential that privately financed and operated highways be a full partner in the goal of improving safety, through being engaged as part of the Strategic Highway Safety Planning process being led by State DOTs and other means.

In general, the advent of privately operated highway and transit infrastructure does not alter that division of responsibilities. Privately operated highways that are part of the Interstate system must still meet Interstate standards set by the Federal Highway Administration. Buses used in a privately operated transit system must still meet federally established standards for access by people with disabilities. Privately operated highways will still be subject to patrol by state police forces. Highways built with private sector financing should still be included on state transportation plans.

The fact that public financing is not at risk in a privately financed project will alter the nature of the planning process somewhat, because the public partner does not need to do the same kind of assessment of costs and benefits that it would do if it were committing its own funds to the project. It still needs to ensure that the project will be, on balance, beneficial to the public, including effects on land use and the environment, but this analysis will be somewhat simplified as compared with the analysis required for a publicly financed project.

In general, we believe that the planning and regulatory framework in place now is sufficient to protect the public interest as it is affected by public-private partnerships. But we welcome review by advocates of various kinds of public sector concerns, and we will all need to be sensitive to cases in which important public sector concerns may not be adequately protected. As those cases come to light, we can make adjustments in our regulatory and planning processes to take account of them.

I appreciate your attention to my testimony, and I would be happy to answer any questions that you may have.