Testimony
Of
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Aspects of Highway Public-Private Partnerships
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Mr. Chairman and Members of the Committee:

Thank you for the invitation to be with you today. I was asked to provide a brief overview of the state of our national infrastructure and the growing role of the private sector in the financing and operation of our national highway infrastructure. While these comments are generally about highways, most are equally applicable to America's other domestic civil works.

Declining National Effort

The infrastructure – that is, the domestic civil works such as roads, bridges, water systems, levees and wastewater treatment facilities -- of the United States is decaying faster than it is being built, replaced, repaired and maintained. It is inadequate for today's needs, let alone tomorrow's. This is a direct consequence of a declining public effort relative to both our needs and our fiscal capacity. The arithmetic of this diminishing public effort is documented in the attached Table 1.

While in the 1960s, the U.S. public sector devoted almost 5.3 percent of its Gross Domestic Product (GDP) to fixed capital investments (domestic plus national security); the level of effort has declined steadily over the intervening five decades.

When defense expenditures are removed from these calculations and consumption of that fixed public capital (depreciation) is factored into the equation (producing the net investment), we can see that such expenditures fell from 2 percent of the GDP in 1960 to 1.14 percent in 2006, a decline of 43 percent. If this declining effort continues, we will have fewer public facilities, producing lower levels of service, at the end of the next decade than we do today.

Table 1

Government Investment in Fixed Capital
(1960-2006)

	1960	1970	1980	1990	2000	2006
GDP (billions $)	526	1,038	2,789	5,803	9,817	13,914
U.S. Population (millions)	180	205	227	249	281	300
Gross Govt. Investment (billions $)	28.3	43.6	100.3	215.7	304.5	433.8
Gross Investment as percent of GDP	5.3%	4.2%	3.6%	3.7%	3.1%	3.1%
Net Investment Less Consumption (billions $) (All units of Govt. minus defense)	10.7	19.5	37.5	71.3	119.0	158.8
Net Domestic Investment as percent of GDP	2.0%	1.87%	1.34%	1.22%	1.21%	1.14%

Source: Population estimates are from the U.S. Census Bureau. Government investment data is from "Table 5.2.5 Gross and Net Domestic Investment by Major Type, National Income and Product Accounts, Bureau of Economic Analysis, (July 2008). Consumption of fixed capital are estimates by the BEA. Per capital calculations are by the author.

As this table also documents, the U.S. population expanded by more than 120 million people in the same period – a growth of 66 percent.

The fact is the U.S. population increased by two-thirds since 1960 and our net relative effort, as a part of the GDP, decreased by more than 40 percent.

In major part, highway financing has not kept pace with demands for investment because the fuel taxes have not been indexed for inflation. If they were, the current 18.3 cents per gallon devoted to the Highway Trust Fund would be 27 cents. A 9-cent increase in the price of $4 gasoline does not seem much of a burden.

The importance of not indexing for inflation is found in what happened between 1993, the last time Congress adjusted those taxes, and today. What $1,000 bought in 1993 now costs $1,460 because of inflation. Put another way, what government could buy for $1,000 in 1993 now only gets $703 of goods.

As we look to the next 50 years, the Federal Highway Administration projects that the highway vehicle miles of travel will increase from 3 to 7 trillion, a 133 percent increase.

The nation's other public capital will face similar demands. The U.S. Census Bureau, for example, reports that the U.S. population will increase to 419 million by 2050 from its present 303 million.

Yet, the nation is unprepared to meet the demand placed on our public infrastructure. Most significantly, the U.S. lacks a long-term strategy for such public investment, especially as articulated in a national capital budget. A systematic and orderly approach to public capital investment by the federal government would provide the context for state and local investments. Because the national government makes roughly 40 percent of the overall public infrastructure investments, chaos at the federal level is automatically transferred to state and local decision makers.

How can one rationally explain this steadily diminishing effort in the face of a growing population and obvious national needs?

I conclude that three factors are at play, which in combination are creating the almost perfect storm that brings us to this hearing.

(1) Anti-Government Ideology

In the middle of this four-decade plus era since 1960, the prevailing governing ethos became "The government is the problem, not the solution." The implied assumption is the private sector can virtually always perform work better than the public sector can. For more than a decade, the presumption has been transformed into the massive outsourcing of public activities to the private sector. This privatization is increasing in the building and operation of our public infrastructure, notably highways.

The issue is not whether the administrators, engineers, accountants, lawyers and others working in the U.S. Department of Transportation and in the State and local highway departments are generally less skilled, competent, productive and efficient than their private counterparts. They are not.

Indeed, other nations come to the United States to learn from these public servants.

Moreover, the United States has put into place over many decades various oversight mechanisms that generally ensure that such work done by the public sector is free from massive corruption, waste and gouging of the public. The recent experiences of the U.S. in its extensive use of private contractors to provide defense infrastructure both here and abroad are just the opposite.

Rather, the real issue, often coyly stated, is not about the competence of our transportation agencies; it is about the political courage of our elected officials; they are afraid to ask voters to pay for what the public wants and needs. In searching various studies for this testimony, I was struck by how many times the argument is made that a private corporation, shielded from real public oversight, can make the tough decisions and raise the transport taxes that elected officials would never consider.

(2) The Politics of Taxes

In major part, those political fears are very real. Our contemporary politics are dominated by an aversion to the pay-as-you-go principles that long guided U.S. fiscal policies. In part, this is an extension of the anti-government ideology. I have some personal knowledge of how this works. In 1984, the Reagan Administration invited me to serve on a small Commission that was charged with devising domestic policy recommendations for the President's second term. The work became entangled in whether to adopt a "starve the beast" strategy advocated by several fellow commissioners. They wanted to borrow and spend massively and by that expand the national debt and deplete the government's capacity to borrow to the point that future Presidents and Congress would be forced to cut or privatize programs such as Social Security and Medicare, which they strongly opposed.

That strategy, though seldom stated as such, was reversed in the 1990s by the end of which time the federal government was operating at a surplus, actually paying down the debt. I think history will judge this to be President Clinton's single greatest policy and political achievement.

In this decade, however, "no new taxes" and "cut the taxes" are the political mantras, even as national borrowing, increasingly from the central banks of China, Japan, South Korea and Taiwan, has raised the national debt from $5.7 billion at the end of 2000 to more than $9.5 billion today. Whether by design or accident, we have returned to a "starve the beast" policy.

These deficits and the inability of our government to finance and operate domestic civil facilities are no accident. The power of no new tax politics is found in the vast number of public figures who have signed and posted on the Internet a solemn "no tax pledge." As of May 2008, that list included President Bush, 192 U.S. Representatives and 41 U.S. Senators. Moreover, the list includes 240 challengers for House seats in the 2008 election, as well as 32 U.S. Senate challengers.

No similar concern is exhibited for deficit spending.

Significantly, "no tax" politics extend deeply into state governments, which provide up to 60 percent of all U.S. infrastructure investments. As of April 2008, 1219 incumbent state legislators had taken the "no tax pledge," as had 8 Governors, 7 Lt. Governors, 3 Attorneys General, 3 Secretaries of State, 3 Treasurers, and 1 Controller. An equally large list of challengers for state office has also made and posted similar pledges.

(3) Vested Interests

Beyond ideology, the privatization of here-to-fore public functions has many direct beneficiaries. Investment banks, wealthy private investors, specialized law firms, contractors, engineers, and speculators all seem to do very well – at least as measured by some of the Public-Private Partnerships that have already been put into place.

As the principal corporations from Europe and Australia who lead many such projects note on their web sites, these types of investments are highly profitable. One billionaire tells me that he is being offered 18 percent returns for such investments.

Such privatization gives the corporate operators enormous control over the setting of transport taxes (tolls). These contracts often have no-compete provisions that require the state or local government to compensate them for any improvements on public roads that drive traffic away from the toll road. Indeed, as traffic seeks alternative routes and diminishes service on free roads, the pressure to use the toll way intensifies.

Ironically, one of the principal vested interests are the state and local officials who impose increased transport taxes, via private corporations, onto their citizens. The State of Indiana, for instance, sold the operation of the Indiana Toll Road to an Australian/Spanish consortium for $3.85 billion. This allows the Governor to keep his no new tax pledge, earn $500,000 per day in interest

for the state, distribute $250 million to the counties surrounding the toll road, and fund dozens of other projects throughout the state.

As part of the deal, the Governor agreed to double the tolls before turning over control. The private corporation will be able to raise the tolls after 2010 at a rate greater than 2 percent of an amount equal to an increase in the consumer price index or the nominal gross domestic product per capital growth. The tolls are likely to rise by at least 4 percent annually and much more if inflation increases.

Because the lease is for more than 55 years, the IRS will treat the consortium as the owners, allowing them to depreciate their investment at an accelerated rate over 15 years. This is worth several hundred million dollars. If at the end of 15 years, the lease is sold, the profits will be taxed at a low capital gains rate and the new owners can begin the depreciation process over for another 15 years. I look forward to testimony by fellow panelists today as to the costs of these arrangements to U.S. taxpayers.

In Chicago, the sale of the Skyway lease for 99 years for $1.82 billion provided monies to a city government that was in deficit by $200 million. Those monies have been used for many purposes, many of which are non-transport related.

In Texas, their PPP arrangements have been structured in a way to provide both upfront monies to the state for the long-term lease of public highways and the construction of new roads, plus a percent of the revenues. The Texas Governor is already financing much of state government through transport taxes and he intends to increase that source of revenue. Between the mid-1990s and today, some $15 billion has been diverted from the Texas Department of Transportation to the general fund where the monies are used to finance education and other programs. Simply put, Texas is not financing needed road investments because it is using its highway monies to finance non-transport functions.

In 2007, the Governor of Texas went a step further; He announced that Texas would not construct any new roads unless they were tolled. He also asked the President and Congress to allow Texas to reimburse the federal government for the monies it had invested in federal interstate roads in Texas. Texas could then lease its portion of the Interstate Highways to private operators for 50 years or more, collect the upfront concession fees and receive part of the revenues. The Texas PPP is as much about financing state government through transport taxes as it is about providing good transportation.

Looking Forward

Attached is a Federal Highway Administration projection of U.S. highway congestion by the year 2020. If the present pro-transport tax policy of the U.S. Government is continued, it is also likely to be a map of future toll roads in the United States.

Governors and mayors are under extreme pressures to maintain even present levels of transport services. Thus, imposing a transport tax by outsourcing the political risk to a private corporation, which is often located in Australia or Europe, is increasingly attractive.

The U.S. Department of Transportation is aggressively pushing the use of transport taxes imposed and administered by such private corporations. The Department has prepared a detailed legal analysis for each state as to what changes in its constitution and state laws are required to undertake these projects. And it offers low cost loans and tax-free bonds for financing these deals. Such projects are now on the planning boards in 25 states.

Various studies estimate that about 20 percent of the nation's future highway needs can be financed through private arrangements, of which there are many variants. Most of those are in areas with high-volume congestion, such as the I-495 Hot Lanes deal the State of Virginia has made with a private corporation but 80 percent financed with Federal and State monies.

When the Interstate System was first conceived in the late 1930s, a fundamental question was whether to build the system as freeways or toll ways. President Roosevelt's advisors concluded after much study that the nation was so vast and that in many areas the traffic would be so light that transport taxes would be insufficient to build a true national system. What would emerge is a hodge-podge of good roads in some areas and bad or no roads in others.

As the congestion map also reveals, about 80 percent of the roads in the National Highway System are probably too unattractive for a transport tax approach today or in the foreseeable future. Inevitably, those states with large stretches of such roads will be shortchanged under existing policies.

The policy behind U.S. highway construction during the Eisenhower era was to build a truly national system that would provide unimpeded transport to all parts of the nation at the lowest possible cost to users. The market pricing approach now being advocated would limit transport to those able to

pay. It would seek to maximize revenues on toll roads, even if that meant forcing traffic to side roads.

Conclusion

The present transport policies of the Government of the United States will put into private hands control of key parts of our national highway infrastructure for a half century or longer. It will significantly raise the costs of transport over what it is now and, more important, what it could be if the public sector followed the pay-as-you go public approach devised by the Eisenhower Administration and championed in the Congress by Senator Prescott Bush of Connecticut.

While many argue that tolling of existing or new roads is really a matter for state and local governments to decide, the whole of the nation has a direct interest because all taxpayers are involved when their national government finances many of these projects and when all taxpayers are required to make-up the costs of 15 year accelerated depreciation on these projects.

Several recent studies from the GAO on this subject are particularly informative about key policy questions involved with privately administered transport taxes. Having examined several of these PPP deals, notably those in Texas and Indiana, I strongly agree with the GAO that much stronger analysis is required on the economic and social impacts before these deals are made. Governors and mayors are swayed by the prospect of upfront cash they can use, while leaving any problems in the deals to their successors.

While the private corporations surely have a strong analysis of the fundamentals of those deals, the voting public does not. Notably, the Texas and Indiana projects were done with much secrecy, the corporate and Wall Street lobbyists were involved inappropriately, and the details of the deals given the public were often false.

I am also concerned that the U.S. Department of Transportation so strongly favors the wider use of privately administered transport taxes that other alternatives are not being adequately considered. The public would benefit from an independent, third party economic analysis of these new policies v. the traditional pay-we-go approach long used in the United States. A beginning premise should be there are public officials who are unafraid to ask voters to pay for what they want done.

Finally, our future demands for infrastructure investment are so great that a coherent federal approach is required as embodied in a national capital budget. Indeed, it is long overdue.

Thank you.

Pat Choate is co-author of **America in Ruins, Financing U.S. Public Infrastructure**, "The Magic Highway" and the forthcoming **Dangerous Business: The Risks of Globalization for America** (Alfred A. Knopf, Inc – August 2008). He has authored six other books on contemporary economics and served on several national commissions. He was Director of Research at the Oklahoma Department of Industrial Development, Commissioner of Economic Development for the State of Tennessee, and Administrator of the Department of Commerce's Economic Development Administration - Southern Region. In the 1980s, he was VP of Public Policy at TRW Inc. Since 1992, he has been Director of the Manufacturing Policy Project, an independent non-profit, educational research organization.