

BROOKINGS

FRIDAY MAY 27, 2011

The Private Sector Can Improve Infrastructure with Privatization not a Bank

Infrastructure, U.S. Economy, U.S. Department of Transportation, Transportation

Clifford Winston, Senior Fellow, Economic Studies

e21

SEPTEMBER 29, 2010 —

The notion of an “infrastructure bank” seems to be gathering steam among the cognoscenti as an effective way to put our long-term economic recovery back on track. Creating an infrastructure bank would be a nice coup for the Obama administration because it would reinforce its strategy of massive spending to solve the nation’s economic ills while simultaneously enlisting the participation of Wall Street and the business community. Unfortunately, an infrastructure bank would be compromised by the same political pressures that our current transportation system faces, and it would also fail to address the most glaring problems with the nation’s infrastructure.

The Administration could improve the nation’s infrastructure—and also improve its standing with Wall Street and the business community—by selling some roads and airports outright to the private sector. Privatizing infrastructure would also help cut the federal deficit by raising revenues and reducing expenditures.

The bank’s funds would consist of private capital and general funds, which would allegedly be allocated by an appointed Board to projects that meet national economic objectives instead of local political objectives. Really? Why would state and local sponsors bring candidate projects to the bank unless they thought they could apply political pressure to get their projects approved? Would Florida stand by while California got funding for a large project and it got nothing? And is it plausible to believe that states and cities would support allocating public funds primarily on the basis of maximizing private investors’ returns? Do governments often think that way?

Moreover, even if an infrastructure bank existed, it would not address the public sector’s inefficient pricing, investment, and production policies.

Consider highways, airports, and urban transit. Motorists and truckers pay a gasoline tax but they are not charged for delaying other vehicles on the road; truckers are not charged for damaging pavement and stressing bridges; aircrafts pay a weight-based landing fee but they are not charged for delaying other planes that want to takeoff or land; and bus and rail transit users pay fares that only cover a modest fraction of operating costs and no capital costs—in fact, some, like federal employees, obtain subsidies to ride completely free. Prices that are set below costs send the wrong signals for investment by justifying expenditures to expand a crowded road when the problem would be fixed by simply charging peak-period tolls. The bank may try to force states and cities to consider pricing options but politicians have made it clear that they prefer to spend money on their constituents, not to charge them a user fee.

The way we waste money on our transportation infrastructure is appalling. Road pavement is not built thickly enough to minimize the sum of maintenance and up-front capital costs. The cost of highway projects is inflated by Davis-Bacon regulations that require labor to be paid at the prevailing union wage rate in a metropolitan area, and by cost overruns that occur because the bidding process selects the firm that is the lowest-cost bidder even though those costs do not tend to end at the bid thanks to renegotiable (mutable-cost) clauses in the contract for underestimated project expenses. Boston's Big Dig, which came in at a large multiple of the bid price, comes to mind.

Airports are a nightmare because they take several years to add runways thanks to opposition from local residents, environmental groups, and regulatory hurdles such as EPA environmental impact standards. And building a new large airport from scratch is basically impossible for the same reasons. Only one has been built over the last 35 years.

Mass transit—busses, subways and trains—run too many schedules that make little sense, which is why on average, most buses and subways fill roughly 20% of their seats—and routes don't change even if population centers shift. At the same time, the cost of providing transit service is inflated by regulations such as "buy American" provisions that mandate that transit agencies first offer contracts to domestic producers instead of seeking the most efficient suppliers of capital equipment. Other perverse incentives include giving extra federal dollars to transit agencies to replace their capital stock prematurely rather than maintaining it efficiently. And it is basically impossible to lay-off or fire a transit employee because to do so could result in severance packages that approach \$400,000 per worker.

An infrastructure bank would do nothing to address those inefficiencies. And if an infrastructure bank is going to be funded by outside institutional investors, why not allow the private sector to have a greater stake in infrastructure performance by selling them ownership?

Privatization of the system would have at least three positive effects. First, private operators would have the incentive to minimize the costs of providing transportation service and can begin the long process of ridding the system of the inefficiencies that have developed from decades of misguided policies. Second, private operators would introduce services and make investments that are responsive to travelers' preferences. Third, private operators would develop new innovations and expedite implementation of current advances in technology, including on-board computers that can improve highway travel by giving drivers real-time road conditions, satellite-provided information to better inform transit riders and drivers of traffic conditions, and a satellite-based air traffic control system to reduce air travel time and carrier operating costs and improve safety. The technology is there. But it hasn't been deployed in a timely fashion because government operators have no incentive to do so. The private sector does.

The major and legitimate concern with privatization is that private firms would be able to set excessive prices and drastically cut service because they face little competition or that they might experience serious financial difficulties. Thus, experiments are needed to provide evidence on the intensity of various potential sources of competition, firms' financial performance, and the evolution of capital markets to fund a privatized system. Congressional legislation for airports and highways has included funding and tax breaks to explore privatization, so the idea of experiments is not new (nor is the idea of private infrastructure in most parts of the world).

Supporters of an infrastructure bank claim it would treat infrastructure like a long-term investment, not an expense. Yet, unlike privatization, a bank would do little to curb wasteful expenses. The case is not difficult to make: the country would clearly benefit from a policy that has great potential to spur innovation and growth and has the added bonus of budgetary relief. Privatization, instead of a bank, is the real long-term solution to the nation's transportation infrastructure problems.