



The Capacity of States to Oversee Privatization Deals

Investors and operators of private toll roads in the United States have focused most of their attention on state governments. Road privatization deals give responsibility to companies to maintain and invest in roads, while typically granting the private companies the right to collect increasing tolls for themselves for fifty or more years or more. In order to protect the public, states must have the capacity to evaluate contracts up-front. And if a deal is signed, the state must also have the capacity to independently monitor and enforce compliance. Adequate capacity to oversee these deals is particularly important because the companies themselves have a financial incentive to invest less in the roadways, to raise tolls as high as possible, and to sue the state whenever its actions diminish toll revenue.

In order to protect the public, governments must take a number of steps. Analysis by the federal General Accountability Office shows that states must develop systematic approaches to identifying and evaluating the public interest as governments have done in many other countries. These protections are especially important when projects do not use federal funds, and therefore would otherwise typically lack the standard transparency rules and public interest considerations that major transportation project would otherwise meet.

States have not developed systematic approaches to identifying and evaluating the public interest

Before signing a private road contract, up-front public interest analysis tools are important to evaluate the expected costs and benefits of a private operator, as well as the most appropriate means to deliver the project. The failure to use such tools can lead to certain aspects of the public interest being overlooked, such as environmental standards and equity concerns.¹

Governments in other countries, such as Australia and the United Kingdom, have developed systematic approaches to identifying and evaluating the public interest before entering into privatization agreements. Typically, these governments identify important elements of the public interest and develop criteria for how they should be considered. In Australia, for example, the state of Victoria requires all privatization agreements to be judged according to eight specific public interests tests, including whether the rights and views of affected communities have been heard and protected, whether community health and safety is ensured, and that there are sufficient safeguards to ensure public access to the infrastructure.² These public interest³ evaluations are conducted often during the negotiations to adequately protect the public.⁴

Unfortunately, these kinds of safeguards have been used much less in the United States. In a recent report titled, *Highway Public-Private Partnerships: More Rigorous Up-front Analysis Could Better Secure Potential Benefits and Protect the Public Interest*, the U.S. Governmental Accountability Office notes that neither Chicago nor Indiana employed public interest tests prior to the leasing of the Chicago Skyway or the Indiana Toll Road, such as ensuring transparency of negotiations and examining effects on regional mobility. They also failed to use comparisons with the public sector to examine the long-term costs of a project and the value of transferring risk to the private sector. In fact, Governor Daniels did not even commission an independent financial analysis of the concession until the deal was almost complete.⁴ Similarly, transportation officials in other states, such as New Jersey, Pennsylvania, and Illinois,⁵ admit that they have not developed a systematic approach to assessing public interest concerns.⁻

The failure to use formal public interest tests may result in certain aspects of the public interest being overlooked, such as the value of foregone toll revenue. When states have decided mid-course to conduct thorough analysis, it has often changed their decisions. In Texas, for example, Harris County conducted a study in 2006 to examine the value of a long-term concession compared to retaining public control. The County determined that they would gain little through the concession, and that by implementing more aggressive tolling they could realize⁶ similar or greater financial gains. Thus, Harris County opted to retain control of the toll roads.⁻ Similarly, when Oregon hired a consultant to compare the estimated costs of private versus public sector financing, they concluded that the cost of the privately financed project was not justified given the limited value of risk transfer. Unfortunately, the study was not conducted until after the private partners had already done substantial early development work.⁷⁻

Additionally, many states lack legislation requiring transparency in private road projects, such as making proposals available to affected communities. These rules may be justified on the basis that private road builder and operators regard their own analysis and proposals as “proprietary” business secrets. But such rules prevent full public review of the process and undermine both transparency and the opportunity for full public participation.⁸⁻

Lack of federal involvement considerably reduces consideration of public interests

While the federal government in recent years has aggressively promoted road privatization through new laws, it has done little to develop or disseminate public interest protections for such deals. This has particularly profound consequences when private funding replaces federal grants that require public interest safeguards and reviews.

The Bush Administration and the U.S. Department of Transportation have actively promoted privatization agreements through various policies and practices, including programs that waive certain federal regulations or grant tax-free bond subsidies. For example, the federal government has waived regulations for projects in Texas and Oregon that prevent private investors from being involved in a highway project until the federally mandated environmental review process has been completed. USDOT and the Federal Highway Administration have also developed

publications that promote privatization agreements to state officials through activities such as drafting model legislation and creating an promotional websites and newsletter. —

Despite these efforts at promotion, the federal government has not been directly involved in regulating privatization agreements, even when national interests may be affected. When federal funds are used in highway construction, the projects are constrained by numerous federal regulations. These regulations relate to issues such as prevailing wages (Davis-Bacon), assistance for small and minority-owned businesses (disadvantaged business enterprises), environmental review (NEPA), air quality improvement (clean air conformity), environmental mitigation (wetlands), resource conservation (4(f) endangered species), domestic job and industrial base protection (Buy America), and accommodation for the disabled (ADA). — Transportation plans must also be developed in a transparent manner and reflect the collective views of the community. — However, when federal funds are not used, no federal guideline exists to regulate the projects. States can even avoid federal protections for the public by segmenting their projects and funding selected portions that would not pass federal muster with private financing. —

Even when federal funds are used, the federal government has exhibited an inability or unwillingness to become actively involved in the projects. The Federal Highway Administration has yet to develop a federal definition of the “public interest”, and officials have not provided any guidance on identifying and evaluating the public interest. — This creates the potential for national public interest concerns, such as interstate commerce issues, to be ignored. For example, federal officials did not review the terms of the concession agreement for the Indiana Toll Road, even though 60 percent of the traffic is interstate in nature. — Such review was not required, according to federal officials, because the \$1.9 million in earlier federal funds had been repaid. — Similarly, because the lease of the Chicago Skyway did not include any new expenditure of federal funds, there was no requirement that the Federal Highway Administration approve the lease. The law did require the FHWA to ensure that the toll rates under the agreement represented a reasonable rate of return. However, because federal officials had no standard definition of a ‘reasonable rate of return’, they deferred to the state’s discretion. —

Furthermore, though the federal government has the authority to oversee any project receiving federal aid, it does so only rarely. Following the passage of the Intermodal Surface Transportation Equity Act in 1991, the federal government has increasingly delegated oversight responsibility to state Departments of Transportations. — Unfortunately, many states lack the ability to properly oversee projects.

Lack of a comprehensive planning process also means that the choice of which roads get built can be determined by profitability instead of overall effect on the road network. As any driver knows, changes on one roadway seriously affect traffic flow on other connected roads. Transportation planners therefore evaluate potential road projects on a wide range of criterion, including effects that extend beyond the roads themselves. New roads can create traffic bottlenecks or can create new problems with concentrated air pollution, for instance. New roads create new land-use patterns that may require costly future public infrastructure investments. The planning process makes sure that such interrelated effects are considered and ensure that

alternatives are evaluated according to what fits best into long-term regional plans. Limiting the process to bidding and profitability over a single road leaves much unconsidered.

Some states have enacted, and others are considering, laws that will permit the submission of unsolicited proposals by private firms for transportation projects. These laws would require public transportation agencies to review the proposals within specified timeframes, and to go forward if the proposed projects are determined feasible – even if the roadway is not a priority or conflicts with other plans.¹⁸ In the Texas SH 130 project, this reversal of traditional planning has gone so far¹⁹ that the private encourage toll traffic, such as lowering the speed limit on competing roadways.[—]

Ultimately, a lack of federal involvement in transportation projects can be detrimental to interstate transportation concerns. States may agree to long-term concessions that include non-compete or concession clauses which may hamper the nation's ability to properly respond to new transportation needs. Additionally, many of the transportation projects being considered include facilities in more than one state, or projects that are located in one area but benefit larger regions. If these states act in complete independence of each other, without federal oversight,²⁰ they are likely to produce an uncoordinated and inefficient state transportation system.[—] Thus it is essential for the federal government to take a more active role in privatization agreements to ensure that national public interests are not supplanted by short-term considerations of state governments.

Lack of capacity forces states to rely on private companies and their partners for oversight, creating serious conflicts of interest

Private contractors have a monetary incentive to under-invest in projects and to finish them quickly. For this reason, public oversight of transportation projects is essential to ensure that safety standards are maintained. Paradoxically though, while the budgets for transportation departments have increased over the past five years,²¹ staffing levels have either declined or remained stagnant.[—] This has resulted in an unprecedented level of 'contracting-out' by state agencies, leading to a decline in oversight.

Long-term concession deals are extremely complex, and state DOTs are unlikely to have the in-house expertise needed to plan, conduct and execute privatization agreements. In 2006, the Federal Highway Administration found²² that several state projects had been delayed due to inadequate staff capacity and expertise.[—] In Georgia, the DOT's new commissioner even decided to end all privatization agreements due to her staff's lack of experience.²³ In order to manage these projects, state DOTs are increasingly outsourcing various aspects of their projects to private contractors and consultants, including engineering and inspections. Unfortunately, this outsourcing further erodes in-house expertise, which will further diminish the ability to oversee projects in the future.²⁴[—]

Private toll road concessions are a more extreme form of out-sourcing, and historical trends indicate that state DOTs will be unable to adequately monitor these projects. The supervision and performance assessment functions performed by the departments are often understaffed and under-budgeted. Even though concession agreements may require the private entity to maintain a certain level of investment in the road, if the state does not properly monitor these agreements then the investments are likely to be substandard. In fact, a series of Federal Highway Administration reviews of quality assurance activities found numerous deficiencies in state oversight of consultants, “such as a lack of independent sampling of highway materials for verifications tests; inadequate statistical comparisons of the tests results; and insufficient state control of test samples, sampling locations, and testing data.” The FHWA further found that pavement on highways is deteriorating faster than expected, which they attribute in part to the weaknesses in oversight.²⁵—

Furthermore, a reliance on outside contractors increases the potential for conflicts of interest that may be detrimental to the public. With the growing interest in privatization agreements among investment banking firms, there is a possibility that a firm may provide financial advice to a state while simultaneously engaging in investment banking for the same deal.²⁶— For example, Goldman Sachs was an advisor to Indiana on the concession of its toll road, but failed to mention that it was also creating a fund whose sole purpose was to invest in infrastructure. In fact, while it was supposedly advising Indiana on how to get the best return, its Australian subsidiary’s mutual funds were investing in MIG (the concessionaire), becoming de facto investors in the deal. These potential conflicts of interest, coupled with the lack of oversight by state officials, will likely result in states receiving an unfair deal.²⁷— Even if a conflict of interest does not exist, private advisors may still fail to adequately represent the interests of the state. They may, for²⁸ example, not wish to alienate private-sector firms that may want to use them in a future deal.—

¹ Hecker, JayEtta Z. “Highway Public Private Partnerships: Securing Potential Benefits and Protecting the Public Interest Could Result from More Rigorous Up-Front Analysis,” Testimony before the Subcommittee on Energy, Natural Resources, and Infrastructure, Committee on Finance, US Senate, pg 3.

² U.S. Government Accountability Office. “Highway Public Private Partnerships: More Rigorous Up-Front Analysis Could Better Secure Potential Benefits and Protect the Public Interest,” *Report to Congressional Requesters*, February 2008, p 52.

³ GAO – Highway, p 53

⁴ Schulman, Daniel and James Ridgway. “The Highwaymen,” *Mother Jones*, January/February 2007, <http://www.motherjones.com/news/feature/2007/01/highwaymen.html>

⁵ GAO – Highway, p 57

⁶ GAO – Highway, p 57

⁷ Hecker, p. 9

⁸ Oberstar, James L and Peter A DeFazio. “Public Interest Concerns of Public-Private Partnerships,” Position Paper by the Chairmen of the House Committee on Transportation and Infrastructure and the Subcommittee on Highways and Transit, June 4, 2007, <http://Transportation.house.gov/Media/File/press/ppp%20guidelines%20veritas.pdf>. P. 7

⁹ Hecker, p. 10

¹⁰ Oberstar, p. 6

¹¹ Oberstar, p. 7

- [12](#) Oberstar, p. 6
- [13](#) Hecker, p. 10-11
- [14](#) GAO – Highway, p 9
- [15](#) GAO – Highway, p 59-60
- [16](#) GAO – Highway, p 61
- [17](#) U.S. Government Accountability Office. “Federal-Aid Highways: Increased Reliance on Contractors Can Pose Oversight Challenges for Federal and State Officials,” *Report to the Chairman, Committee on Transportation and Infrastructure, House of Representatives*, January 2008, p 10.
- [18](#) Oberstar, p. 7
- [19](#) "Toll Road Contract Includes Reward for Lowering I-35 Speed Limit," *The Associated Press*, November 5, 2007.
- [20](#) Oberstar, p. 9
- [21](#) GAO – Federal, p 5
- [22](#) GAO – Highway, p 34
- [23](#) Hart, Ariel. “New DOT Chief May Scrap All Toll Road Projects,” *Atlanta Journal-Constitution*, January 10, 2008.
- [24](#) GAO – Federal, p 6
- [25](#) GAO – Federal, p 39
- [26](#) Oberstar, p. 5
- [27](#) Schulman
- [28](#) Oberstar, p. 5