

Testimony by

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to the

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of the
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Transactions—The Future of Infrastructure Finance

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Good morning Mr. Chairman and members of the Subcommittee, and thank you for the opportunity to testify about the sale of the concession rights for existing publicly-owned highways to private investors. There have been two such transactions in the last year, the Chicago Skyway and the Indiana Tollroad, and both have generated a great deal of interest from the press, the financial community and, most importantly, state and local governments across the country. Public officials are looking at these concessions as a way to raise significant amounts of money without raising taxes or issuing bonds. In fact, the *New York Times* in an article in January titled “Turning Asphalt to Gold” (a) predicted that the sale of public assets might become the next big thing in this country.

Over the last year, as a senior fellow at the Kennedy School of Government and after fifteen years as an executive in a company serving the toll road industry, I have been looking at these transactions through a public policy lens. In keeping with this, my role today is not to explain how these deals work or to recap the financial benefits that may accrue to the various parties. Instead it is to lay out a framework to examine the public policy aspects of these sales. In other words, to answer the question, are these concession sales in the public interest?

At this point everyone in this room is familiar with the first of these concession sales—the Chicago Skyway. The winners in this deal are:

- The taxpayers of the City of Chicago who received a windfall equal to about one-third of the total size of the City’s annual operating budget;
- The Mayor and City Council who were able to solve an immediate budget crisis without resorting to tax increases; and
- The private investors who have what they hope will be an attractive investment.

It is also supposed that the people who use the Skyway are winners because the private owner will provide better service than the City, such as the introduction of electronic toll collection. While it is true that the long-awaited electronic tolling was implemented by the private owner, this service enhancement could have been implemented by the City as has been the case with dozens of publicly-owned toll roads in the United States. There are many examples of public toll roads being operated efficiently and with an eye to service. Better service is not a good reason, in most cases, to privatize our highways.

While there are winners, there are also losers. In the case of the Skyway, the losers are the Skyway users who will be paying significantly higher tolls than they would have paid under City ownership. The other loser is the region.

First, the Skyway users: Under private ownership and with the agreement of the City, tolls on the Skyway will more than double in the next twelve years and continue to increase through the term of the concession. The increased revenues resulting from these

toll increases will be used by the private owner to service the debt and equity that financed the \$1.8 billion purchase price. In effect, the future tolls collected on the Skyway have been monetized to fund the operating budget of the City of Chicago.

Further, the toll proposition is based on the users' willingness to pay a toll in return for receiving a service. In this case, users will see ever increasing tolls and ever increasing revenues being banked by the private investor, with, at best, only modest improvements in service. Interestingly, the City has required the private investor to file annual financial reports for Skyway—we can only conjecture about public's reaction in ten years when the sale proceeds have been spent but the earnings of the private investor continue to increase in step with higher tolls.

The other loser is the region. First, not one dollar of the sale proceeds realized by the Chicago was earmarked for investment in transportation projects, despite the fact that Chicago is one the country's most congested urban areas.

The City also has abdicated the control of a major transportation artery and along with it the ability to manage the regional transportation network in a coordinated fashion. To see how this might adversely impact the public interest, it is important to recognize that the private investor's sole motive is profit maximization. That is not a bad thing, but it does color how the toll road will be managed. Let me cite two illustrations of this point: Under the concession agreement, the private owner has the ability to use time of day pricing to discourage trucks from using the Skyway during day time hours. One possible consequence of this is to force trucks onto neighboring roads, generating externalities—traffic, congestion and pollution—for which the private owner is not accountable and does not have to concern itself.

Second, the alternative routes for drivers who do not want to use the Skyway are non-tolled limited access roads that are operating currently at or near capacity, thus allowing Skyway to operate, in effect, as a monopoly. Even if it was believed that lower tolls on the Skyway would lessen congestion on the alternative routes, the private investor, again, is motivated only by maximizing revenues on its road.

And what happens if the decision is made in the next several years to toll these alternative free roads in order to manage congestion? To do this effectively requires a coherent and coordinated regional toll policy. With Skyway out of the public's control, this is no longer possible. Further the imposition of tolls on these free roads will likely increase the revenues to be realized by the private owner with no subsidiary benefit to the region.

I have not tried to mask my opinion that the Chicago Skyway sale scores poorly in terms of the public interest. This low score is not because the Skyway is now in private hands, but because of the particular motivation for the sale and the intrinsic nature of the Skyway. In contrast with the Skyway, the Indiana Tollroad situation has significantly different characteristics that, in my view, change the balance. First, all of the sale proceeds will be reinvested by the State to improve its transportation infrastructure. True, these new roads will be paid for, in effect, by the people who use the Indiana Tollroad,

but these users as well as the taxpayers of Indiana should benefit from an enhanced statewide transportation system.

Second, given where the Tollroad is situated and its relationship with other roads, it is my opinion that there is not much opportunity for the private owner's actions to impose costs on the surrounding communities. Eighty percent of the trucks that currently use the Indiana Tollroad are traveling inter-state and are not likely to use local roads to avoid tolls. Also, unlike the Skyway, the Indiana Tollroad is not part of a network of roads that would benefit from being managed in a coordinated fashion. For all of these reasons, the Indiana Tollroad concession tilts in favor of the public interest.

The last point I want to make is that it is important for all of us to understand why investors are willing to pay large sums for these concessions. The reason is simply that these investors have been granted a franchise to increase tolls—an action that state and local governments are reluctant to take. The last toll increase on the Skyway was in 1993 and on the Indiana Tollroad in 1986. In both cases, the new owners, pursuant to agreements with the City and the State, will increase tolls immediately upon signing the concession agreements and every year thereafter for the term of the concessions. These increases are not to be subject to voter approval, and are the consequence of what has been tagged, the outsourcing of political will.

I am not arguing against the involvement of the private sector in the provision of public services such as transportation. The sale of existing roads should meet, however, three tests:

- First, a significant portion of the proceeds of the sale should be reinvested in improving and enlarging the particular region's transportation infrastructure;
- Second, the private owner should be held accountable for the externalities—the non-cash costs—of operating the road; and finally
- If the road is part of a regional network, the toll regulation needs to accommodate regional solutions.

Applying these tests may reduce the amount of money that can be raised by state and local governments through these sales, but maximizing the dollars should not be the sole objective. Improving the mobility of our citizens should be the overriding goal.

Source:

(a) *New York Times*, "Turning Asphalt to Gold", January 20, 2006.

Attachment

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Professional Background

- 2005 to present Senior Fellow—Mossavar-Rahmani Center for Business & Government at Harvard’s Kennedy School of Government
Guest Lecturer—Cornell University, College of Engineering
- 1995 to 2005 Co-Founder and Executive Vice President—TransCore, Inc. (and predecessor companies) (Boston)
Involved in wide range of management activities, including project implementation, research and development, business development, and strategic planning; member of executive management team. Note: TransCore is a transportation engineering company specializing in “intelligent transportation systems and services”, e.g. FAST LANE™ /E-ZPass.
- 1988 to 1995 Managing Partner—Lewis, Foote & Company (Philadelphia)
Responsible for day to day operations of private investment partnership, including oversight of portfolio companies; president and CEO of TST International Pty. Ltd. (Brisbane, Australia; a toll systems integration company)—1991 to1995.
- 1985 to 1987 Managing Director—Chase Manhattan Asia Ltd. (Hong Kong)
Managed the Bank’s capital markets group focused on corporate and sovereign entities throughout the Pacific Rim.
- 1976 to 1985 Senior Vice President—Butcher & Singer Inc. (Philadelphia)
Managed the firm’s public finance group, working with state and local governments to raise capital for infrastructure needs.

Education

- 1974 to 1976 The Wharton School of the University of Pennsylvania—
Master of Public Administration
- 1970 to 1974 Cornell University—B.S. Engineering (College Program, combining Civil Engineering-Public System, Planning and Analysis with Government and Economics)