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How Not to Rebuild an Interstate with Toll Finance

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Regular readers know I have long argued that the best way to pay for the enormous cost of reconstructing and modernizing this country's aging Interstate highway system is via what I call "value-added tolling." That means only instituting tolling where doing so provides significant new value for those now being asked to pay tolls—such as for a brand new toll road, new toll lanes, or replacing an aging and obsolete non-tolled highway with a state-of-the-art all-electronic toll road.

Unfortunately, the first of three states in the federal pilot program to reconstruct an Interstate via toll finance—Virginia—is going about it all wrong. The original plan was to create only two tolling points along the 179 miles of I-95 from the North Carolina border to the Capital Beltway near Washington, DC. That was bad enough, but this month the state scaled the plans back even further, to a single tolling point near the North Carolina border. The rationale for both plans was to hit through traffic with tolls while letting most Virginia residents avoid paying.

That approach is wrong in principle, and it is proving to be a disaster in practice, arousing even more opposition than the original plan. It's wrong in principle because if the idea is to reconstruct and modernize I-95, that's a benefit for everyone who uses it, not just out-of-staters. Virginia DOT estimates that I-95 needs \$12.2 billion worth of reconstruction and widening over the next 25 years, but likely federal and state fuel tax funds will cover only about \$2.1 billion, leaving a gap of over \$10 billion. Who, if not the users, should be paying for that?

And by scaling back to a single tolling point, which happens to be in an economically depressed portion of the state, VDOT is further shooting itself in the foot. Besides foregoing most of the potential revenue, it has aroused a firestorm of opposition from local residents as well as from

Republican Senate candidate (and former governor) George Allen.

VDOT has also been losing the rhetorical battle. Nearly every news story I've seen over the past year has adopted the trucking industry's terminology, characterizing the state's proposal as "installing a tolling facility on I-95 near the NC border"—rather than as a plan to pay for the otherwise unaffordable \$12 billion replacement and modernization of I-95. VDOT has not set forth and publicized a complete 25-year plan to reconstruct and widen I-95, but has only provided examples of possible near-term improvements, such as rebuilding the interchange with I-85 and US 460 in Petersburg.

By contrast, the other two pilot program states have far better plans. As I've written before, Missouri--along with three other states--has developed a comprehensive plan to rebuild I-70 all the way from Kansas City to eastern Ohio with added truck-only lanes. And North Carolina has developed a \$4.4 billion plan to widen all of I-95 there, tolling it from border to border, with electronic toll collection points every 20 miles. By contrast, two states that did not get approved for the pilot program—Connecticut and Rhode Island—seemed likely to go with border-tolling on the same politically motivated basis as Virginia.

Frankly, with the rapid emergence of all-electronic tolling, the simplest and fairest way to implement tolling to finance Interstate reconstruction and modernization is to equip only the on-ramps and off-ramps. That way, customers of the Interstate would pay for exactly the number of miles they drive—no more and no less. That model was first introduced way back in 1997 on Highway 407 ETR near Toronto, and has worked well ever since. This would be a great way to pioneer mileage-based user fees on America's most important highway system.

Let me close by quoting a few sentences of commentary from TOLLROADSnews Editor Peter Samuel about VDOT's revised plan:

"You have to think the Feds will be wondering whether this plan from Virginia is a serious proposal; tolls play such a small role. Since this is the last 'slot' in the Interstate System Reconstruction & Rehabilitation Pilot Program, they'll have to be asking if this isn't a waste of a scarce slot. Little Rhode Island's plans for their segment of I-95 are way more serious than this proposal from Virginia. Connecticut and South Carolina, too, would make better use of the opportunity to toll I-95. And it bears no comparison with North Carolina's plans. Sheer fantasy is their notion that a 'gap' of \$9 billion 2015 to 2049 is going to be filled with new tax money. Fuel taxes are in decline so there will be less tax money, not more . . . let alone a huge amount more as VDOT's application suggests." (www.tollroadsnews.com/node/6172) n

Infrastructure concessions are all the rage in some quarters. Yet, conclusive empirical evidence of their profitability over lengthy periods of time is missing. Nevertheless, we know a lot about the nature of risk and return for infrastructure concessions. There are countries like France where concessions are a way of doing things. Clearly, there is a sustainable level of business at some level—just like for utilities. After all there is no real difference between a full concession, a utility business, or a UK-style privatization of an infrastructure business. The words vary, the substance is very similar. The periodic enthusiasm for any form of PPP (including concessions) is not always

matched by results. But then that is not only the case for concessions and the like.

By nature the business is a "limited upside-limited downside" proposition when it is run sustainably—like utilities. Limited upside, because the natural monopoly features of the business restrict the scope for effective competition except during initial bidding and invite regulatory limits on returns or prices. Limited downside, because the public authorities need to assure some basic return absent the expectation of extraordinary upside.

Business needs to embrace that reality. The countries where private participation in infrastructure (PPI) has been successful have been those where business itself supported limits on upside in return for limits on downside. Examples include: ATT in the U.S. under Theodore Vail, China/Light and Power (CLP) in Hong Kong, and RWE in Germany. ATT and CLP helped launch rate-of-return regulation schemes. RWE shared returns via a 50% government ownership share.

One should not trash modest, but sound returns. In the end PPPs can be a sound business if business and government find an accommodation around a mutually acceptable "return equation". After all the experiments of recent decades with innovative schemes, U.S.-style rate of return regulation comes out reasonably well. It turns out to be very similar to return regulation for French-style concessions. Of course, the French have a different name for it, calling it the "équilibre économique et financier," the economic and financial equilibrium of the concession.