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In 1995, California granted a private company the right to construct express toll lanes along the State Route 91 freeway in Orange County, a region inhabited by millions, with some of the heaviest traffic flows in the nation. This was the first modern privatized highway in the United States. The California Private Transportation Company (CPTC), a partnership of three corporations—Level 3 Communications, Granite Construction, Inc., and the French toll operator Cofiroute SA—completed the project with \$130 million in mostly privately sourced money. To recoup this expense, and to make a profit, CPTC was given a 35-year concession to operate the toll route. State leaders promised that the private company would provide greater efficiency and savings, and that the public would benefit from clear and safe roads, even during a time of government budget constraints.

It did not take long for things to unravel. The SR-91 toll lanes did not unclog what local traffic reporters referred to as the “Corona Crawl,” so state and local officials sought to expand nearby highways to ease worsening congestion and improve safety. When transportation offices announced the improvement plans, CPTC unexpectedly filed a lawsuit, citing a non-compete clause in their contract to build and operate the toll lanes. The people of California were legally blocked from improving their highways because it could reduce private profits. In 2003, the Orange County Transportation Authority was forced to purchase the SR-91 toll lanes for \$208 million to put an end to the fiasco.

In 2004, California’s state legislature halted the experiment in privatizing highways. But that did not stop other states from pushing forward with privatization. In Virginia and Texas, several major privatized freeways were built in the 2000s. Then, in 2009, things came full circle. California once again authorized so-called public-private partnerships to procure highways and other public goods. Although privatization of transportation projects has a tarnished record, owing much to California’s costly experiments over a decade ago, all across the United States major highway and other infrastructure upgrades are once again being handed over to private investors, now under the moniker of “public-private partnerships,” or P3.

P3 is at least three things:

It is a rebranding of privatization. The phrase purposefully evokes a win-win scenario involving equal “partners” working toward a common goal. Government leaders have been sold this new kind of privatization as a solution to declining tax revenues and borrowing capacity, while private companies claim to be offering their expertise and capital in a spirit of public service.

It is the result of a long ideological campaign against public-sector unions and “big government,” which conservative think tanks, pundits, and politicians blame for growing deficits and crumbling infrastructure. This worldview, meanwhile, hails private companies and the private profit motive as the bearers of efficiency and fiscal discipline.

Finally, P3 is obviously a money-making opportunity. It is propelled by an infrastructure-industrial complex composed of global construction corporations, investment banks, private-equity firms, and elite law firms organized as vertically integrated consortiums. Allied through their own trade associations, they are actively pressing for new laws to expand the types of public infrastructure from which they can extract profits, and in recent years they have been quietly succeeding.

A New Kind of Privatization

To understand the P3 privatization model, it is best to start with the basics of the traditional public model of infrastructure development. In the United States, this is known as the “design-bid-build” process. Take, for example, a state highway. State engineers usually design a project, sometimes by contracting out work to engineering firms. With blueprints ready, the state department of transportation allows companies to bid against one another for the construction contract. Meanwhile, the state borrows money by selling bonds, usually at low cost, because banks compete to serve as underwriters. The state then uses the bond proceeds to pay the lowest-bidding construction company to build the project. Bond holders are paid back over a longer period, usually from gasoline taxes or other tax revenues dedicated to infrastructure funding. The entire process is characterized by the monopoly power of the state (assumed to be acting in the public interest) forcing private companies to compete against one another, and so to drive down costs.

Privatization of transportation infrastructure under the P3 model is different from what we usually think of as privatization. Most people define privatization as the actual private ownership of roads, bridges, ports and other goods used by the public. The P3 version of privatization stops short of allowing investors to legally own a highway, instead offering private companies varying degrees of monopoly control (depending on the deal) over different parts of a project. Under the P3 model, investors can exercise greater control over the design, financing, construction, and maintenance of a public good, allowing them to extract profits from public infrastructure, without actually needing to literally own the asset.

Extracting Profits

P3 legislation reorganizes the infrastructure- procurement process to allow private investors to extract profits from various phases of a project.

A major source of profit is the suppression of market competition. The typical bidders on a P3 project are consortiums that include global construction companies, investment banks, private-equity firms, and engineering firms. Together, they can fulfill the design, finance, construction, operations, and maintenance obligations that P3 contracts require. Unlike the traditional infrastructure procurement process, the P3 model eliminates competitive bidding from later phases of a project. The consortiums only have to compete against a handful of other multi-billion dollar construction firms and investment banks to secure the initial contract for the entire project. The size and complexity of P3 contracts means that many smaller, more specialized companies are eliminated from bidding. P3 contracts therefore usually have few bidders and, as a result, a higher price tag.

By unifying a project under a single contract, moreover, P3 also provides significant authority to the private consortium to cut its own costs. P3 contractors can squeeze higher profits out of a project by altering its design, by using non-union subcontractors, or by paying lower wages.

Another source of profits derives from the byzantine financial arrangements at the heart of a typical P3 contract. Unlike traditional infrastructure projects, P3s involve the use of private equity and debt, along with public loan subsidies, to construct a highway. P3 projects depend on several sources of private financing. The so-called “equity” investment, usually drawn from the consortium partners’ own internal operating funds, gives them a small stake in a project’s construction phase. P3 proponents say that, with their own money at risk, the private partners have an incentive to deliver a project on time and below cost.

The main source of project financing, however, comes from investment banks that lend to the consortium partners. P3 proponents claim that this private financing source is a solution to the budgetary constraints of governments that face huge backlogs of deferred infrastructure investment. A recent Congressional Budget Office (CBO) report, however, shows the flaw in this argument: “The case is sometimes made that using funds from private capital markets to finance roads can increase the resources available to build, operate and maintain roads,” the report notes. “But the sources of revenues available to pay for the cost of a highway project —

whether it uses the traditional financing approach or a public-private partnership—are the same: specifically, tolls paid by users or taxes collected by either the federal government or by state and local governments.”

The ultimate source of project financing, then, is always the public, either through tolls or taxes. Why then allow private banks, drawing from private capital markets, to serve as intermediaries? Private financing simply permits the insertion of the financial interests of investment banks and private-equity funds into the long-term wealth-producing potential of public infrastructure. By allowing private investors to fund the construction of a project, the state allows these parties to impose their monopolistic claims on future flows of tax or toll revenues.

Public Risks, Private Profits

Because privately financing and operating public infrastructure is actually more expensive than doing so through a public authority, the concept of risk becomes central to how P3 proponents justify infrastructure privatization. P3 advocates argue that the traditional design-bid-build model including public ownership, operation, and maintenance of a highway, exposes the state to risks that threaten to inflate the cost of a project.

Sources of risk include everything from changes in interest rates to labor strikes, and they can (and occasionally do) conspire to drive up a project’s cost. Proponents of the P3 model claim that, by handing a project’s finance, construction, and other phases over to a private consortium for a pre-determined price, the public transfers over these risks as well. The extra money the state must pay the P3 consortium—the private investors’ profits—are therefore justified because the private investors are now shouldering these risks. The state is said to obtain “value for money,” the value being less risk for an extra sum.

The P3 industry, however, has worked hard in recent years to make sure its members are, in fact, exposed to very little risk. For P3 projects built in California, Texas, Virginia, and Florida in the 1990s and early 2000s, industry profits were largely extracted from the public through tolls. Tolls, however, did not always produce the revenue necessary for the private companies to turn a profit. Several early P3 toll highways failed miserably after assumptions about traffic flows failed to pan out, causing bankruptcies, and leaving the public to foot much of the bill.

The South Bay Expressway in California, a private toll highway owned by the Australian investment bank Macquarie Capital, went bankrupt in 2010. A bankruptcy judge forced U.S. taxpayers who had subsidized the project with federal loans to take a 42% loss. The Camino Colombia Toll Road in Texas also went bankrupt after lower-than-expected traffic flows failed to produce toll revenues to repay investors. Camino Colombia was auctioned off in 2004. The road’s main creditor, John Hancock Life Insurance, purchased Camino Colombia for \$12 million and then turned around and resold it to the Texas Department of Transportation the next year for \$20 million.

Even though the public ended up footing much of the bill for failed toll-funded projects, the P3 industry’s lobbyists have pushed for a new, sure-thing revenue system. They have rewritten state laws in Alabama, Arizona, California, Florida, Georgia, Illinois, Louisiana, Oregon, and Texas to shift toward an “availability payment” model. Availability payments are akin to lease payments, whereby the state pays the private developer of a highway to maintain the road for public use. Rather than collecting tolls from drivers who use the route, the state pays the private developer directly from general state revenues collected through a gasoline tax or other taxes. Availability payments protect P3 developers against the risks associated with toll-road financing because the road’s owners no longer have to estimate future traffic flows, or rely on macro-economic trends beyond their control, like regional housing bubbles. They simply are guaranteed payments directly from the state over a span of several decades.

Although P3s are advertised as tapping the power of private capital markets to invest in public infrastructure, the reality is that P3 investors enjoy large public subsidies. For example, private companies building P3 highway projects now routinely expect states to grant them authority to issue qualified private activity bonds (PABs). Unlike most lending in private capital markets, interest payments on PABs are exempt from federal taxes (because the cash proceeds are expected to be put to use building goods with broad public utility, rather

than projects that solely benefit private parties). Since the bonds are not taxed, they allow the borrower to obtain cash at less cost. This form of financing, then, is essentially a tax cut for the investment banks and corporations with the P3 contract. The U.S. Department of Transportation also routinely grants Transportation Infrastructure Finance and Innovation Act (TIFIA) loans to P3 developers. TIFIA loans provide companies with much cheaper interest rates and more flexible terms than anything available in the private capital markets—again because the public subsidizes them.

P3 companies, in short, are now virtually guaranteed returns on their investments. The shift away from tolls and the growing use of availability payments means P3 investors no longer need worry about traffic flows. Guaranteed lease payments, together with the low interest rates of federally subsidized loans and tax-exempt bonds they use to pay for construction, mean sure profits.

Meanwhile, P3 arrangements create a whole new set of risks for governments and the public. Complex contractual obligations, designed to protect private profits, hand over discretionary power to private companies while tying the hands of state officials. A recent report on P3s from the California Legislative Analyst Office notes that, by allowing private corporations to possess a financial interest in public infrastructure, the government incurs the “greater possibility for unforeseen challenges,” while its “flexibility” to respond to these challenges is limited.

The Infrastructure Industrial Complex

Given the magnitude of profits to be made, powerful companies have invested considerable time and resources to push P3-authorization laws through more than 30 state legislatures. The handful of global construction companies, investment banks, and private equity firms that dominate the P3 market today spend millions each year lobbying lawmakers in key U.S. states. Besides shopping around bills to authorize highway privatization, they are now expanding into the privatization of public-building projects (like court buildings), parking garages and metering systems, and other so-called “social infrastructure.”

Elite law firms shop around legislation for P3 authorization in numerous state capitals. For example, the Los Angeles law firm Nossaman, LLP, straightforwardly explains on its web site that, “our PPP model legislation offers local, regional, and state lawmakers a valuable blueprint for authorizing legislation.” A big slice of Nossaman’s income comes from advising private investors and construction companies bidding on P3 contracts, so the firm has a lucrative material stake in passing P3 laws in as many states as possible. With support from major P3 contractors, the American Legislative Exchange Council (ALEC), a conservative, pro-corporate organization focused on pushing “model legislation” in statehouses nationwide, is now backing public-private partnerships. The group has endorsed a model state law, the “Establishing A Public-Private Partnership (PPP) Authority Act,” introduced by a vice president of the Australian investment bank Macquarie Capital. Macquarie is a corporate member of ALEC.

Some current government officials speak frequently at industry conferences to promote P3. For example, in October 2012, José Luís Moscovich of the San Francisco Transportation Authority lectured attendees of the Bond Buyer’s West Coast Finance Conference about the Presidio Parkway road, privatized under a 30-year contract with the German construction company Hochtief and French investment bank Meridiam. Former government officials are also involved in P3 promotion, both working for private companies and think tanks. For example, Dale Bonner, head of the state Business, Transportation, and Housing Agency under ex-California governor Arnold Schwarzenegger, now works as the principal partner of Cal-Infra Advisers, Inc., a lobbyist and consultancy that works with P3 developers seeking contracts. Bonner also promotes P3 policy from his position as a senior advisor at the Milken Institute. The Reason Foundation, arguably the intellectual home of P3 privatization, helped write California’s first P3 law in 1989. Since 2009, its vice president for policy has sat on California’s Public Infrastructure Advisory Commission, the state board tasked with identifying highway projects to privatize. The Reason Foundation has also been a corporate member of ALEC.

P3 investors have even created their own national trade association, the National Council for Public Private Partnerships (NCP3P), which has developed “tool kits” for state legislators. The NCP3P also circulates a press

kit that attempts to dissuade reporters from thinking that “when the private sector is involved... citizens will eventually have to pay more for services” or from asking whether “private companies take short cuts in providing services in order to increase profits.” Existing trade groups like the American Road and Transportation Builders Association have supported P3 privatization by hosting events such as the annual Public-Private Partnerships in Transportation Conference, a national gathering of major contractors, law firms, banks, and lawmakers.

The Public Interest

Despite the P3 industry’s influence, privatization of public infrastructure is anything but assured in the United States. The numerous problems with, and sordid history of privatization undermines public acceptance and official support. P3 procurement costs more. It generates as many new risks for the public as it supposedly eliminates. Additionally there is the matter of institutional inertia; state and local transportation agencies have procured infrastructure through the public design-bid-build method for over a century now. Shifting to the P3 model requires complex changes in the law and transformations of government procedures, as well as whole new skill sets for state officials, none of which simply happens without enormous time and effort to change the culture of government. P3 faces resistance for these and other reasons.

In spite of these barriers, privatization’s advocates have scored significant victories in Texas, Virginia, Florida, Illinois, and most recently California. In California, the Professional Engineers in California Government, a union of state engineers, sued to block conversion of the half-billion dollar Presidio Parkway into a billion-plus dollar P3 project. Even though the union’s legal argument was echoed by two state agencies, which doubted that California’s 2009 P3 law authorizes the use of availability payments, a judge ruled against the union, and allowed the project to proceed.

California’s Legislative Analyst Office (LAO) criticized transportation officials who approved Presidio Parkway’s P3 conversion, saying in a November 2012 report that privatization of the road likely cost taxpayers an extra \$140 million, but this analysis went virtually unreported in regional newspapers. Besides the union and the largely toothless LAO, there has been no other opposition from the public or watchdog groups. As California officials plan to privatize as many as four more freeways in the Los Angeles area, there is little sign of organized resistance to these plans.

The Ohio Public Interest Research Group (PIRG) recently issued a study critical of plans to privatize the Ohio Turnpike, a 241-mile publicly owned and operated toll road, debunking the rationale that doing so would generate dollars to immediately invest in other state roadways. PIRG researchers are posing questions that similarly confront privatization plans in other states: If cost-savings measures can generate savings, why can’t the state introduce the same measures a private operator would? How might a contract with a private operator constrain the state’s ability improve parallel public roadways? What downsides might there be if motorists seeking to avoid the increased tolls end up crowding onto nearby roadways?

For whatever reason, though, organized opposition to public-private partnerships across state lines and on a national level, confronting the national infrastructure-industrial complex that P3 proponents have assembled, does not exist today. Opposition to privatization of infrastructure in the United States is piecemeal and inconsistent, so that P3 projects often proceed without any critical analysis.

Perhaps this is because of the relatively early and small scale of P3 projects, with only an estimated 377 ever completed in the United States, compared to tens of thousands of traditionally financed roads. Only a tiny fraction of transportation infrastructure in the U.S. has ever been handed over to private investors. The complexity of P3 deals may also explain the relative lack of opposition: contracts involve multiple bank creditors, private-equity investors, multiple legal and technical advisers, hundreds of pages of binding obligations, and strange formulas determining payments due over the term of a concession.

Finally, many officials and the public may be sold, at least partially, on the notion that the solution to government budget shortfalls is to tap private capital to build infrastructure. Whatever the reason may be, as

various states move ahead with privatization plans for highways and other infrastructure, controversies are likely to erupt over the financial terms, new risks to the public, and the fact that P3s do not actually alleviate budget constraints, and may indeed exacerbate them.

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SOURCES: California Department of Transportation, "State Route 91 (91 Express Lanes)" (dot.ca.gov); Jennifer Gress, "Public-private partnerships (PPPs): just compensation," Analysis of SB 528, California State Senate Transportation and Housing Committee, May 12, 2009; Congressional Budget Office, "Using Public-Private Partnerships to Carry Out Highway Projects," January 9, 2012 (cbo.gov); California Legislative Analyst Office, "Maximizing State Benefits from Public Private Partnerships," November 8, 2012 (lao.ca.gov); "Relating to Public-Private Partnerships for Public Infrastructure," model legislation, Nossaman LLP, 2009 (nossaman.com); Reason Foundation, "Reason Foundation Experts: Adrian Moore" (reason.org); National Council for Public Private Partnerships, "A Resource on Public Private Partnerships: Press Kit for the National Council for Public Private Partnerships" (ncppp.org); Darwin BondGraham, "Global Corporate Powerhouses Ramp Up to Privatize California's Roadways," *Sacramento News & Review*, November 8, 2012 (newsreview.com); Istrate, Emilia and Robert Puentes, "Moving Forward on Public Private Partnerships," Brookings-Rockefeller Project on State and Metropolitan Innovation, December, 2012.