LEGISLATIVE FACT SHEET

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The Transportation Infrastructure Funding Flexibility Act: H 4033

The House recently passed legislation, the Transportation Infrastructure Funding Flexibility Act, authorizing the creation of public-private partnerships (PPP) that can be used to build roads in South Carolina. In theory, the legislation should provide for a more efficient mechanism for building and maintaining roadways – provided that such reforms are carried out in a transparent manner that gives key stakeholders – rather than the Budget & Control Board – oversight over PPP projects.

What does this bill do?

H 4033 creates a mechanism for tapping new sources of private funding to build public roads in South Carolina. The bill would do the following:

- Create a process for private entities to apply for and receive the rights to build toll roads.
- Establish guidelines for partnership agreements between the state and private entities.
- Authorize the ability to set rates for tolls and related fees.

What is the current status of transportation funding in South Carolina?

While creating a public network of roads has long been a core government function, the state is failing in its duty to build and maintain roads. In part, this is because South Carolina is spending billions on nonessential activities like economic development. Additionally, education and health care (other functions that would also be served by expanded public-private partnerships) are driving up state spending and crowding out other priorities.

According to the South Carolina Department of Transportation (SCDOT), the state is responsible for more than 41,500 miles of roadway. That amounts to the 4th largest network in the country – in a state ranked 24th in terms of population and 40th in overall area. For FY08-2009, SCDOT's expenditures were $1.18 billion – up from $892 million 10 years ago. According to the agency's latest comprehensive transportation plan, state highway and mass transit needs will run $48.3 billion over the next 20 years. Anticipated funding during the same period is $19 billion, thus creating a $29.3 billion shortfall. In the absence of a unified prioritization plan (see below), it is difficult to determine which projects should be funded first, or at all. One benefit of using PPPs to build roads, however, is that the free market can help determine which projects are likely to be of greatest public benefit.

How is road construction funded now?

Federal funding currently accounts for 55 percent ($800 million) of transportation spending ($1.4 billion for FY09-2010) in South Carolina. This number is about 80 percent higher than usual, owing to temporary federal stimulus funds. The state's share of transportation funding is primarily derived from a 16 cent-per-gallon motor fuels tax. The tax is distributed into four major categories: 65 percent to SCDOT; 17 percent to the counties; 1 percent to the Department of Natural Resources; and the remaining 17 percent to the State Highway Fund. However, various statutory provisions – for example, $18 million is dedicated to the Coordinating Council for Economic Development – permit highway funding to be used for other activities.

While South Carolina has the 5th lowest gas tax in the country, such taxes are an inefficient and unfair approach to funding roads. Both government and private sector studies have thus recommended reducing reliance on the tax. According to the nonprofit Reason Foundation:

> Fuel taxes generate revenue based on the energy source for the vehicle, not the wear and tear on the road, bridge, or other facility. We need to shift to a direct mileage charge, where we pay for how much we drive and which roads we drive on. This kind of pricing will give transportation system users participation in the funding process in a meaningful way.

Privatizing road construction and maintenance could ultimately lead to a reduction, or elimination, of the gas tax by creating efficient mechanisms for making road consumers pay their own way instead of shifting costs to other users.

What is a public-private-partnership?

Public-private partnerships are contracts between the government and private companies that allow the private sector greater participation in the creation and delivery of some public function – in this case, the construction and maintenance of roads. Public-private partnerships offer a better way to leverage private capital in order to finance the public service of building roads and infrastructure.

The thinking behind public-private partnerships is that the government does not possess the expertise and incentives necessary to deliver certain core services. Thus these functions should be delegated to private contractors operating under careful oversight. In doing so, the state saves taxpayer money and also invites an additional level of public oversight.

As far as roads go, South Carolina's current model for building roads is not only outdated, it is archaic. Whereas governments were once the only entities capable of carrying out long-term road projects (think: Rome), advances in technology have made it possible for private contractors to build roads more easily and efficiently. Likewise, new technology makes it possible to bill consumers of roads at the point of consumption – namely, the toll booth.

The primary benefit of public-private initiatives for road construction is the building of new roads at a reduced cost to taxpayers. By accomplishing this goal, PPPs can bring about a reduction in spending on core services, as well as facilitate the completion of projects that would otherwise be left undone – such as the Storm Evacuation Life Line route (SELL). Accordingly, the U.S. Department of Transportation strongly supports public-private partnerships as a way of "generating substantial benefits for public agencies interested in encouraging innovation and saving time and money on projects."

Perhaps most important is that PPPs inject the power and knowledge of the free market into the execution of road projects. By necessity, PPPs must take into account the needs of consumers – as drivers – so that these needs take priority over bureaucratic preferences, backdoor deals, or misplaced federal funding allocations. In doing so, PPPs can result in a more efficient distribution of taxpayer dollars, such that these funds gravitate toward high-priority projects consumers are willing to pay a premium to use.

Questions regarding public-private partnerships

> **Does this legislation implement tolls on existing roadways?** Section 57-3-910 (as amended) of H 4033 states that no toll may be imposed on a federal interstate in existence as of January 1, 1997 – unless the toll is authorized by the General Assembly in separate legislation. Likewise, § 57-3-330(C) states that an existing "transportation facility may not be the subject of a public-private initiative." However, if additional lanes are added to an existing highway, a toll may be imposed on the new capacity if the extension is conducted under the rules of a public-private partnership. The bill also provides that once the toll road is paid for, toll charges shall cease.
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> **Will private companies be able to exercise eminent domain?** The Supreme Court case, *Kelo v. New London (2005)*, has raised public awareness regarding property rights and eminent domain takings on behalf of private entities. Wording in § 57-3-450 explicitly requires that SCDOT retain eminent domain authority. Moreover, homeowners will likely be better off owing to private participation. According to Len Gilroy, director of government reform with the Reason Foundation, private firms tend to compensate owners at higher prices than do government agencies.
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> **Aren't tolls a form of double taxation?** In South Carolina, roads are currently paid for through state and federal taxes. So isn't imposing a toll on top of that creating a double tax? This would be the case if a toll were imposed on a roadway built with tax dollars, but would not apply to new roadways or expansions of existing roadways built through PPPs.

In addition, gas tax rebates (see below) can be provided to drivers that frequently use toll roads.

Should roads be built at a profit? Private investors already profit from a number of core government services via the process of issuing state and local bonds to support capital and other projects. The profit that comes from building roads is fair compensation for taking on the risk of privately funding such ventures. More important, though, is that the ability to profit from roads aligns investor incentives with what is best for state taxpayers and consumers. Private investors, for instance, will have a greater incentive to build and maintain high-quality roads because using (and thus paying for) these roads will be a voluntary transaction. Moreover, H 4033 includes several consumer/taxpayer protections. These include: permitting road construction contracts to include a maximum rate of return on investment (§ 57-3-400(e)); requiring that tolls only be used to pay for costs associated with the toll road (§ 57-3-930); and requiring that tolls cease after financial obligations related to financing the road have been satisfied (although, given the need for ongoing maintenance, it is unclear if such tolls would ever entirely disappear). The state likewise retains title to any roads should the PPP default on its agreement (§ 57-3-420).

How do other states do it?

Public-private partnerships dedicated to road building are not a new concept. Twenty-six states and numerous countries already rely on such partnerships for extensive road projects. Major cities like Paris, Sydney and Toronto have undertaken projects in excess of $1 billion. Even developing countries in Latin America have found public-private partnerships effective in securing funding for new roads.

Here are a few examples of how states have used PPPs to save money, reduce time and cost overruns, and complete previously undone projects.

Florida

- According to the Florida Department of Transportation, public-private partnerships have generated cost savings of between 15 and 20 percent. Additionally, they have created a 300 percent reduction in cost overruns and a 400 percent savings in time overruns.

- In Fort Lauderdale, the I-595 highway has been consistently congested. But the state has had trouble funding such a project through conventional financing. A new $1.8 billion public-private partnership has allowed construction to begin and is expected to be completed by 2014.

- Another undone project involves two tunnels that have been on the Florida transportation plan for years. Recently, the state entered into a $1 billion public-private partnership that will start construction to connect the Port of Miami to I-395 and I-95.

Virginia

- In Virginia, a DOT plan to build new lanes on I-495 was estimated to cost $3 billion. As in South Carolina, Virginia's transportation funding was overdrawn. But Virginia law allows for public-private partnerships, and a private firm bid to do the project for $1.8 billion. With traditional funding, the project would likely not have been undertaken.

- State engineers estimated it would cost $283 million to complete Route 288 near Richmond. But as built under a PPP, the project ended up costing $236 million – for a savings of $47 million.

- Another Va. highway project – the Pocahontas Parkway – was completed via a public-private partnership saving $10 million from initial estimates.

Texas

- Two projects in Dallas have been agreed upon that will bring $6 billion in new roads. The first, a $4 billion, 52-year contract, will rehab I-635 and is expected to be completed in 2016. The state is kicking in a mere $445 million for the project.

- Another Texas project underway is the North Tarrant Express – a $2 billion project that will be undertaken with a combination of private investment and $570 million in taxpayer funds.

How to make PPPs work for South Carolina

Take the Budget & Control Board out of it. Contrary to the model proposed in H 4033 (cf. § 57-3-340 and following), the Budget & Control Board (BCB) should not have direct oversight over PPPs. In no other state does any such entity exercise control over the approval of transportation projects. Rather, the Department of Transportation (specifically, via the SCDOT Commission) should exercise oversight over contracts and proposals, but with additional safeguards such as a public review process and a PPP oversight committee. After all, if private companies are submitting bids and contracts for transportation projects, it would seem appropriate that the public sector agency – Department of Transportation – that has the greatest knowledge in this area should make approval decisions. Leaving such decisions to the BCB politicizes the road building process even more, leading to increased costs and a lack of accountability and transparency.

Allow for longer contracts. H 4033 outlines a timeline for contracts and procedures for any extensions. Section 57-3-380(B) limits the timeframe to 30 years – subject to extension by the BCB. But this limit is too strict and will discourage competitive private bids. As evidenced by best practices in other states – most contracts have been at least 50 years in length in Texas – longer terms provide more time for private firms to adequately recoup costs and maintain roads. According to the Reason Foundation, the best model is a long-term concession agreement as the basis for protecting the interests of both parties in the partnership. Additionally, SCDOT or another oversight body with transportation expertise (see below), rather than the BCB, should be responsible for approving contract extensions.

Prioritize road projects. As indicated above, one of the key benefits of PPPs is that they necessarily lead to the prioritization of road projects according to consumer needs – proportionately depoliticizing the road building process. A good complement to this reform would be to encourage SCDOT to develop a unified prioritization plan based on objective metrics and subject to public review. As things now stand, DOT has several such planning documents, but no unified project list. (Granted, federal funding restrictions often make it difficult to fund the most important projects first.) Each project should also include a cost-benefit analysis using metrics equivalent to those used by the private investors the state hopes to attract.

Allow for public review and independent oversight. As amended by the House, H 4033 requires a 30-day public review period for proposed PPPs (§ 57-3-360). Another improvement could be the addition (as has been done in Indiana) of an oversight board for each project that would monitor contract compliance. An even better option might be to establish a separate PPP oversight board (as recently instituted in California) that would provide additional expertise and review over SCDOT Commission decisions. Whatever mechanism is chosen, though, must be streamlined so as not to increase compliance costs for private investors.

Provide for a gas tax rebate. As previously mentioned, the gas tax is an inefficient means of paying for roads. In Arizona, concerns over double taxation resulted in a reform measure that specifically detailed a process for taxpayers to apply for gas tax rebates in an amount equal to the time driven on toll roads. The legislation reads:

> *"A person who pays a toll to operate a motor vehicle on a roadway project that is constructed or operated pursuant to this article is entitled to and may apply for a refund or credit from the state for motor vehicle fuel license taxes, use fuel taxes, or motor carrier fees paid while operating the motor vehicle on the roadway project."*

Adding a similar safeguard to H 4033 would protect taxpayers – particularly businesses with high transportation costs – from double taxation.

Conclusion

Public-private partnerships are a tool that can help bring better roads to South Carolina. But another benefit offered by PPPs is that they give private investors and consumers essential input (via the free market) into setting road construction priorities – thus helping to ensure taxpayer dollars are used in the most efficient manner possible.

As with any government endeavor, though, the key to making PPPs work requires transparency and accountability. Instead of entrusting such oversight to BCB or, even DOT bureaucrats, the public should be invited to take an active role in monitoring and reviewing the process by which roads are built. Strong reporting, evaluation, and auditing measures are also necessary to making PPPs a success in South Carolina.

Nothing in the foregoing should be construed as an attempt to aid or hinder passage of any legislation.

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