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RESEARCH SUMMARY

How to Fund Our Highways: Making Public-Private Partnerships Work

Many states are considering public-private partnerships (PPPs) as a way to build new highways or improve existing ones. PPPs may be able to manage highway projects more efficiently than government transportation departments can. However, while some partnerships have been successful, others have ended in the bankruptcy of the private partner and the failure of the project.

Tracy C. Miller examines the advantages and challenges of a successful PPP in "Role of the Private Sector in the Management of Highways: A Primer on Public-Private Partnerships." Potential advantages include accelerated project delivery and increased availability of funds for highways.

According to Miller, PPPs may improve on government management of highways because of private-sector efficiencies. PPPs may also improve on fully privatized management because profit-maximizing firms are not responsible for the rest of the highway network.

These "network effects" are key. A private, profit-making firm that is managing a particular highway need not consider how its actions affect users of parallel roads that are not tolled but instead are funded by taxes. Governments, on the other hand, must consider such effects. A PPP may be able to strike a better balance between the interests of one highway project and the interests of the highway network, including the difficult question of promoting efficiency and cost effectiveness at the network level.

When it comes to the success of a PPP, much depends on how the government structures its contracts with private partners. This often involves a balancing act in a number of areas:

- *Alignment of incentives*. The transportation department must offer the right incentives to the highway management firm. Usually this involves granting the firm a share in toll revenue or granting it compensation for vehicular traffic.

- *Adequate risk management*. Highway managers will make cost-effective decisions if they have skin in the game; therefore, PPPs should assume some of the financing and operating risk. However, contracts should also include arrangements to limit that risk, such as minimum revenue guarantees.

- *Transparency*. Some PPPs have drawn public opposition. For that reason, transparency is another important consideration for the success of a PPP. The goals of the project, how it is to be paid for, and the tradeoffs involved should all be clearly communicated to the public. This is vital to ensure accountability to voters and their elected representatives—and to show how PPPs can provide better value for money than can public provision alone.

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