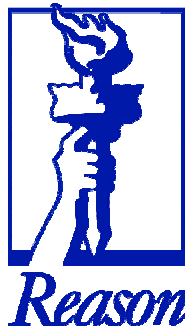


Leasing the Pennsylvania Turnpike: A Response to Critics of Gov. Rendell's Plan

By Peter Samuel and Geoffrey F. Segal



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Introduction

Last November, the Pennsylvania Transportation Funding and Reform Commission identified a \$1.7 billion annual shortfall in funding for the commonwealth's transportation infrastructure and mass transit services. The Commission concluded that, in order to sufficiently fund Pennsylvania's transportation needs, an additional \$900 million is needed for state highways and bridges, \$65 million for local highways and bridges, and \$700 million for mass transit, on an annual basis.

Given this reality Pennsylvania is left with few choices. First, the state could do nothing and live with ever declining conditions of its roads and increasing congestion that drains taxpayers and businesses. Second, Pennsylvania could follow the commission's recommendations: several new taxes and fee hikes to pay for infrastructure. Or, third, the state could take an innovative approach, championed by Gov. Ed Rendell—leasing the Pennsylvania Turnpike to raise significant capital that will allow for significant investment without raising taxes or fees.

This third option is part of a new paradigm for how infrastructure is built, maintained, funded and operated. While the vast majority of transportation projects around the country continue to be funded from traditional sources—gas and vehicle taxes—state and local transportation agencies are increasingly looking to supplement these sources with private investment.

The old way, the way “it's always been done” is no longer the model. Pennsylvania taxpayers don't have to see higher taxes and fees. That path, while new to Pennsylvania, is not new to other states. Recently, some two dozen states have passed legislation enabling public-private partnerships, whereby governments partner with private sector companies to provide public goods and services. States like Indiana, Georgia, and Texas have largely centered their transportation policy on the utilization of these partnerships.

In just the last two years, the use of public-private partnerships has provided other states and cities with additional private capital to help solve their transportation funding problems.

In 2005, two high profile partnership leases—the 99-year lease of the 7.8-mile Chicago Skyway and the 75-year lease of the 157-mile Indiana Toll Road—garnered the City of Chicago nearly \$2 billion and the State of Indiana more than \$3.8 billion respectively. Recent concessions in Virginia and Colorado further demonstrate the viability and growth of this trend.

The 530-mile Pennsylvania Turnpike could likewise be leveraged through a long-term

lease agreement to generate billions of dollars to help meet the state's transportation needs. Indeed, a recent analysis by Morgan Stanley found that a long-term concession has the highest potential for up-front proceeds to the state. Without a real market test it is impossible to determine if Pennsylvania could meet all their transportation needs with a concession—the initial analysis suggests they might be able to.

However, Gov. Rendell's proposal to lease the Pennsylvania Turnpike in a long-term concession has run into strong opposition, not least from the Turnpike Commission which presently controls it. Timothy J. Carson, Vice Chairman of the Pennsylvania Turnpike Commission, made the commission's most comprehensive case against a private concession in the paper "The Pennsylvania Turnpike: a Golden Goose in the Brave New P3 World."

Carson's paper captures most of the points made by critics, so the following point-by-point critique is an effort to assemble an exhaustive counter-counter argument.

Part I: Carson's Critique of Private Concessions

1. Portraying Concessions as "Brave" and "New"

Carson's very title conveys a misconception. Private toll concessions are neither brave nor new. On a global basis, they are commonplace. Entire toll motorway systems in countries like France, Italy, Spain, Portugal, Greece, and Ireland are operated with concessions or public-private partnerships (PPPs) as they are sometimes called. They have also become commonplace in Australia, Canada, Brazil, Chile, China, Hungary, India, Mexico, South Korea, Taiwan, Thailand, and many other countries.

In the United States they are less common but not unknown. In Detroit, the Ambassador Bridge was built and has been operated under a concession by different private companies for 80 years. The Dulles Greenway in Northern Virginia, 91 Express Lanes and South Bay Expressway in Southern California, and the Camino Columbia Toll Road in Laredo, Texas were developed under toll concessions. In Virginia, the Pocahontas Parkway in Richmond was leased under a long-term concession in 2006, and a similar leasing is under way for the Northwest Parkway in Colorado. These are all in addition to the much-discussed long-term leases of the Chicago Skyway and Indiana Toll Road. Over 20 states now have legislation encouraging concessions for toll roads, and many are actively considering proposals.

Privately financed turnpikes go far back in U.S. history. One of the first companies listed on the Philadelphia Stock Exchange was the Philadelphia and Lancaster Turnpike Company, incorporated in 1792, which successfully built and operated the first engineered highway in America (on the route now followed by U.S. 30). It opened in 1794 and operated successfully as a privately chartered toll road until early in the 20th century, when it was bought by the state. State-chartered private turnpikes allowed wheeled vehicles to first traverse the Alleghenies and by 1804 extended to Pittsburgh.

The early turnpikes cooperated with one another to create an efficient network. Historians Daniel Klein and John Majewski note that Pennsylvania's early 19th century private turnpike system was "far better" than the government-planned National Road through Maryland and West Virginia, costing less and being better maintained.¹

Some 199 turnpike companies were incorporated in Pennsylvania from 1800 to 1830, and the money raised from investors to build roads during that period amounted to over 6 percent of the state's GDP.² Additionally, unknown hundreds of toll bridges were built by sole proprietorships and family companies, under state charters.

Charter, concession, long-term lease, build-operate-transfer, public-private partnership - the terms have changed but the essence is the same: toll roads run as an investor-owned business, supervised by government under the terms of a long-term contract.

¹ Daniel Klein and John Majewski, "America's Toll Road Heritage," in Gabriel Roth (ed.), *Street Smarts*, Oakland, CA: Independent Institute, 2006.

² *Ibid*, p. 281.

2. Misrepresenting the Term of Concessions

"The terms of long-term concessions outside the United States have generally not exceeded 35 years," Carson writes. That is not true. Although the plain-vanilla rural toll roads of France and Spain in the 1960s and 1970s used mostly 35-year terms, much longer concessions have emerged in recent years, for urban toll roads and more-costly projects:

- 407ETR toll road in Toronto: 99 years
- M6 Toll England: 53 years
- A86 West tunnel near Paris: 70 years
- Millau Viaduct, France: 78 years
- A28, France 62 years
- A41, France 55 years.

Carson also considers long terms as inherently bad. "As many as four generations of Pennsylvanians could be subject to any concession agreement that might be entered into today," he writes. Precisely because the future is hard to predict, all concession agreements provide a process for:

- Amendment of the provisions, based on the principle that neither party should be financially disadvantaged by the changes;
- Early termination of the concession at the convenience of either party, also based on compensation for the fair market value of the remaining term.

3. Sale versus Lease

The distinction between sale and long-term lease is "largely illusory," Carson writes. But this, too, is incorrect. Sale involves transfer of ownership (title) in perpetuity and usually without conditions. Under the long-term leasing of a toll road the state maintains ownership of the road; the lease is for a finite specified term; and the contract involves whatever set of conditions and controls that the state chooses to put in the concession agreement. The distinction is very real.

4. The Need for Planning

Pennsylvania needs a "road map" and "comprehensive Pennsylvania transportation policy guidelines and principles" before considering a concession, Carson maintains.

Documents such as Carson mentions are like election manifestos - heavy on rhetoric and quickly forgotten. In practice, transportation infrastructure develops by a process of pragmatic adaptation and seizing opportunities as they arise. The notion that everything can be planned for decades ahead is unrealistic.

For the next decade or so, the Turnpike's needs are well known - completing the

reconstruction of the original pavement, third-laning, and modernization of interchanges and toll systems. A concessionaire can be required to deliver these improvements and then to provide as much additional capacity as is needed to maintain specified levels of service (e.g., uncongested flow at Level of Service C or D, as in the Indiana Toll Road concession agreement). Trigger points can be set which require extra lanes and higher-capacity interchanges.

In order to accommodate unforeseen changes, the concession agreement will provide procedures to allow the state and the concessionaire to negotiate those. Most improvements will be in the interest of the concessionaire to undertake anyway. If changes cannot be negotiated to mutual satisfaction the state can reserve the right to provide extra facilities at its own cost.

5. Where Does the Value Come From?

Carson purports to debunk the "myth of the free lunch" and the "magical unlocking of trapped value," which he says is nothing more than the ability of the concessionaire to charge higher tolls to motorists who have no choice but to pay. Carson says the ultimate source of revenue - tolls - is exactly the same whether a private concession is negotiated or the public authority "monetizes" the asset.

It is true that private toll road companies typically increase toll rates to keep pace with inflation or economic growth with regular small increases. This allows the toll operator to plan staffing and improvements better. It also allows motorists to adapt to changing costs far better than under the typical public toll authority practice of allowing many years to go by with toll rates frozen, and then, when finally the political stars are in alignment, to impose monster toll increases of 40 percent or 50 percent in one big hit. In a long-term concession agreement, this right to make modest annual increases is locked into the initial contract. This gives the financial markets confidence in the long-term revenue stream. Proposals for a public toll authority to do similar frequent small adjustments to tolls are unrealistic. Public authorities are inherently political creatures, and with elections always looming, they are under constant pressure to avoid any toll increases until the financial condition of the toll road has become a financial crisis.

Only a toll concession contract enforceable in the courts can provide guarantees against the arbitrary political interference in toll rates and other aspects of management that afflict public authorities. It is this high political risk environment that causes investors in the bonds of public toll authorities to demand high "coverage ratios" that limit their ability to raise capital as compared to private concessionaires

Contrary to Carson's claims, the value of a toll road comes not from toll revenues, as such, but from the surplus - if any - of revenues over costs. When costs consume most of the revenues of the Turnpike, there is little left to invest in new projects or provide a return on investment. The trapped value of public authority toll roads - the value that is unlocked in going to a concession - lies in the ability of the private sector to operate the roads more efficiently and to provide better service at lower cost. The private sector has

the advantage of being focused single-mindedly on customer service and containing costs.

Moreover, as a state agency, the Turnpike is unable to operate across state lines. Private companies achieve major efficiencies through operating nationally and internationally.

Private toll companies are able to hire and retain experienced management talent, whereas in a public authority the chief executive is likely to change with every change in political administration. Many chief executives of public toll authorities come to the job with no toll road experience at all. Not only are they forced to make decisions in ignorance of the industry, but they find it difficult to retain experienced people. If the top position is virtually guaranteed to a politician, the managers immediately below lack an incentive to make a career of toll road management.

6. Sky-High Toll Rates

"That'll be \$533, Ma'am." Carson quotes an unnamed consultant as calculating that applying the terms of the toll road cap from the Chicago Skyway and the Indiana Toll Road concessions to the Pennsylvania Turnpike since the year it opened, the toll for a car going the length of the Turnpike would be \$533 now instead of the actual \$22.75.

This is ridiculous. Initial tolls on the Pennsylvania Turnpike, in 1940, were set high relative to the prices and income levels of the time because they assumed a volume of traffic about a tenth of that which eventuated. By contrast, when it was decided to lease the Chicago Skyway and Indiana Toll Road, those were long-established toll facilities with absurdly low toll rates. Even if a toll road were allowed to charge a several-hundred-dollar toll today, it wouldn't - because it would get no traffic. People will only pay a toll that is less than the value they get from using the toll road (generally based on time savings and other aspects of service quality).

Critics of concessions, like the one Carson cites, play a deceptive game, taking advantage of compound interest over a long period of time. For example, they will take a starting-year toll of 15 cents a mile, increase it by an assumed Consumer Price Index (CPI) of 3.5 percent per year and come up with a shocking toll of 81.5 cents per mile by the 50th year of the lease. That sounds like an outrageous amount—until you realize that wages and salaries generally increase faster than the CPI (so the year-50 toll will be more affordable than the starting-year toll), and that a cup of Starbucks, a movie ticket, a plane flight, or a house purchase will likely also increase by the same percentage.

7. Is Profit Incompatible with Providing Transportation?

Leasing the Turnpike to a private toll company would involve a "metamorphosis" of its mission from mobility to profit, leading to adverse consequences, says Carson.

This is a false dichotomy. All organizations exhibit self-interested behavior, whether they are for-profit, not-for-profit, employee-owned or government-owned like the Turnpike.

America has abundant and affordable airline service, freight railroads, and trucking companies, all operated by for-profit companies. Major roads, bridges, and tunnels in numerous other countries are operated by for-profit companies, under long-term concession agreements. Mobility is being well-served in all of these cases.

The Turnpike as presently constituted is not single-mindedly focused on mobility the way Carson implies. It is a naïve, idealized view of government agencies that they are solely concerned with the public interest and with their customers. They are also concerned with the careers, incomes, and power of their managers and staff. In the particular case of the Turnpike, there is a long and well-known history of using that power to reward friends and allies with jobs and contracts at the expense of merit-based selection.

Private concessionaires must certainly look to their self-interest, too. A business must generate enough revenues to recover its costs and earn a return on investment, since it doesn't have the power to tax the citizenry to make up for a shortfall. For a business to be profitable operating a toll road, it must focus on providing superior mobility services. That's where its revenue comes from.

Given that maximum toll rates will be set by formula in the concession contract, the toll road company will earn a profit based on its ability to improve service, attract additional traffic and its ability to contain costs.

8. High Tolls Leading to Diversion of Traffic

Any level of toll will be “too high” for some people, and hence will generate some economizing behavior, and depending on alternatives, diversion. But Carson wants to have it both ways. When talking of the prospect of motorists getting "gored" he says motorists have no choices but to use the Turnpike, whatever the toll rates. However when it comes to the prospect of "diversion" and his need to scare people with images of tractor-trailers departing the Turnpike to rumble through all the main streets of state routes, he does a logical U-turn. Suddenly drivers DO have choices after all and he has them exercising that choice to jam local roads.

In truth, the situation varies from section to section and depends on the origins and destinations of different travelers. The Turnpike mainline is roughly paralleled by U.S. 30, the old Lincoln Highway. For some trips, and in some stretches, U.S. 30 provides a good alternative; in other stretches less good; in still others, bad. It has steeper grades through the mountains and in many places goes through main streets; in other towns, it bypasses. It has little grade separation or access control. Still it will get you there toll-free.

Toll rates on the Turnpike will have some impact on traffic on U.S. 30 - regardless of who operates the Turnpike. A toll road company depending on toll revenues will have no incentive to drive traffic away. On the contrary since they earn their income from traffic ON the Turnpike, they will have every incentive to minimize diversion.

9. Mobility Only for the Wealthy?

Carson asks "at what toll level will we find that Pennsylvania transportation mobility has been rationed just to the well-to-do"?

The answer is: at toll levels much higher than any concessionaire is likely to find profitable. It is a longstanding populist jibe at capitalists that they make their money by selling to the rich. In truth they mostly make their money by selling to the masses, as capitalists from Henry Ford to Sam Walton and Bill Gates have demonstrated. Great companies have been built on turning luxuries of the rich into staples of the masses by driving down costs and prices. There may be some niche markets serving the rich - such as express routes to airports - but the Pennsylvania Turnpike is destined to remain a highway for everyone.

10. Cooperation in Emergencies

"A Valentine's Day Case Study" is the heading for another call by Carson for a "cohesive, integrated system." During a winter storm in mid-February 2007 (Valentine's Day), the tax-supported Interstates through Pennsylvania's Appalachian Mountains (I-81, I-80 and I-78) were closed for several days by ice. The Turnpike, with its superior snow-plowing capacity, kept open the Northeast Extension (I-476) and the mainline (I-76/I-70). The Turnpike's two highways acted as emergency alternative routes for the closed Interstates, and the Turnpike loaned some snow-plow teams to the state Department of Transportation.

Carson doesn't state, but implies, this kind of cooperation would be more difficult under a concession agreement than with the status quo. As it happens, the Turnpike only agreed to eliminate its tolls for the period of the emergency based on a commitment from the state to reimburse it. Toll tickets continued to be used and E-ZPass transactions were recorded to estimate the traffic. There is no reason why a toll company would behave differently from the Turnpike Commission in such a case, though a concession agreement could spell out the rules ahead of time - eliminating uncertainty and the need for negotiations at the time.

11. Poor Integration with Other Highways?

Under the heading "No slip ramp for you," Carson argues that the private operator will be driven by one factor only - profit maximization - and that this may result in a "non-collaborative disconnect" between state economic development initiatives and the toll road company.

First, Carson exaggerates the disconnect between the company's interest and the state's interest. Businesses value goodwill and do not apply a rigid test of cold profitability to everything they do. Interconnections with other roads and new developments usually promise new traffic so the company will want to make the connections. Slip ramps, especially, are cheap to build, and the problem for slip ramps is not usually financial cost

but local opposition, as the Turnpike Commission has found with many of its new slip ramp proposals.

Full-scale interchanges, it is true, can be uneconomic to build in that their capital cost may be greater than the present value of additional toll revenues likely to be generated. It is standard practice in toll concession agreements to provide that in cases like this if the state wants an uneconomic improvement then it pays for the difference between the cost and the estimated present value of future tolls deriving from the facility. Sometimes a toll company can get a local developer to foot some of the bill for connections that enhance the value of the proposed development. That way a mix of funding is possible.

The Turnpike Commission itself has been unable to build many desirable interconnections for political, as well as financial reasons. Fifty years after construction of the Turnpike Mainline to the Delaware River, it has still not been able to build an interchange with I-95 at the river (although an environmental impact study and design is now complete). There are also interconnections that would hugely benefit motorists - and for which they would gladly pay - that are still lacking because special interests have used their political connections at the Turnpike Commission to prevent them being built. The Turnpike's I-70 interchange in Breezewood is the poster child for Turnpike politics causing a "non-collaborative disconnect," to use Carson's term. Local merchants on U.S. 30 in Breezewood have successfully prevented construction of simple ramps between the Turnpike and I-70, thanks to political influence. For 40 years similar conditions prevailed at I-79 in the west of the state.

12. Running Down the Asset Value?

Carson speaks of a concession "cannibalizing" the state's infrastructure. This is emotional and misleading political imagery. Nothing is being cannibalized, which means eaten up. A concession agreement would be based on continued and, hopefully, accelerated improvements to the infrastructure of the Turnpike and more efficient operations of it. Only toward the very end of a concession term does the toll road company have a possible self-interest in no longer properly maintaining it (cannibalizing it). Strong provisions are required in the contract to ensure that the road is turned over in good condition. Long concession terms minimize the end-of-concession problem of perverse incentives.

13. Long-Term Value of the Deal

Carson criticizes the proposed lease on financial grounds, writing that "the greatly diminishing effective real purchasing power of the income of the concession payment principal in the later years of the concession agreement term calls into serious question the viability of Gov. Rendell's proposed financial model."

He further writes that, "As we cede control of a vital public asset to a private operator . . . surely we can do better than bequeath to our grandchildren's grandchildren a transportation funding inheritance of something less than 2c or 5c in the dollar."

First of all, a concession agreement does not "cede control." If it were a one-page document saying in legalese "It's yours, go toll," then indeed it would be ceding control. But concession agreements are not written like that. They contain potentially hundreds of pages of carefully crafted, legally binding requirements whose function is precisely to retain public control of those aspects of toll road operations deemed important to the state, leaving the company to operate within that legally binding framework. Departure from that framework is a default and threatens the company with termination of the concession, and the toll road's reversion to the state.

On the financial structure, Gov. Rendell did tentatively propose a lease with all financial proceeds provided to the state as one-time up-front payment, to be invested in an annuity for transportation. The return on the investment should be able to cover inflation, so it is pure rhetoric to suggest future generations will be left with cents on the dollar. Inflation in construction costs is a problem, but it erodes the value of all sources of funding for future construction - gas taxes, public authority revenues, federal grants, sales taxes. The problem it creates is not peculiar to a concession's income stream.

Although Gov. Rendell has spoken of the annuity model attacked by Carson, he has shown he is open to different models and has asked the state's advisers (J. P. Morgan) to do comparisons. Concession agreements can be written in many different ways. Some provide for a mix of upfront payments, annual lease payments, and sharing of profits.

14. New Toll Roads versus Existing Toll Roads

Under a heading "Higher hanging fruit," Carson argues there are greater benefits in using concessions for "green-field" toll road projects because, there is more risk transfer. A brand new toll road runs the risk of cost over-runs, late opening, and below-forecast traffic and revenues. Those risks can generally be transferred to the toll company, under a long-term concession agreement. And it is true that those risks are smaller with an existing toll road, with well-established traffic history and less need for construction.

Real-world bids will show where the greatest benefits to the state are. Risk transfer is not the only argument for concessions. More businesslike and less-political management and consequently greater efficiency of operations is another reason to privatize, especially when the state can share in the benefits via profit sharing.

A concession for an existing toll road may start off with less construction needs than a new or green-field toll road, but over the longer term it will involve major reconstruction and expansion. There will be many of the design and construction challenges involved in a new toll road and similar risks. Carson draws a distinction that is not much of a difference.

15. Riskier Capital Structure

"Working without a (safety) net: private partners bring riskier capital structure," says

Carson. And he's right. Private toll companies can raise their funds without the very conservative leveraging rules and high debt coverage ratios required of public toll agencies like the Turnpike Commission because of its political handicaps. Those who purchase tax-exempt toll revenue bonds are conservative, and insist on investment-grade ratings from agencies like Moody's and Standard & Poors. But toll road companies are able to raise funds using greater leverage and without needing bond ratings as high as public agencies. One reason for that is that toll road companies tend to have operations spread over a number of states and nations, a geographic spread that reduces the risks of any one toll road.

A weakness of the state public toll authority model is that the agency is only able to operate within a single jurisdiction. All its eggs are in one basket, so to speak. A toll road company that leased the Pennsylvania Turnpike might have a portfolio of toll roads, with others perhaps in Texas, Virginia, Florida, Spain or Australia. A downturn in the Pennsylvania economy would most likely be offset by stronger economic conditions in their other locations, allowing them to carry the Pennsylvania operation through several bad years without the large reserves or coverage ratios required by the public authority's rating agencies and bondholders.

The bottom-line question concerning a "riskier" capital structure is who bears the risk. To the extent that the Pennsylvania Turnpike is a government agency, its bondholders are at risk (and in some cases, to the extent that taxpayers' money is used for some of its project, the taxpayers of Pennsylvania, as well). If the Turnpike is leased, and the toll company uses more-aggressive financing, only its presumably sophisticated investors will be at risk. Should worse come to worst and the company enter bankruptcy, standard provisions in the concession agreement would cause the Turnpike to revert to state control, unencumbered by the company's debts.

16. Higher Cost of Capital

"Pay now - and more later: hidden increased future capital costs," Carson asserts. Future improvements will have to be paid for at "high taxable borrowing rates or even higher equity return rates."

It is not at all clear that the capital costs of private toll companies are higher. Yes, the interest rate on a taxable toll revenue bond is slightly higher than that on an equivalent (same amount, same term, etc.) tax-exempt toll revenue bond. But that is not the relevant comparison. What counts is the overall "weighted average cost of capital—or WACC."

While companies negotiating toll road concession agreements are not required to disclose the details of their capital structure, there are indications that their WACC may be about the same as that of state toll agencies. One indication of this is the fact that, since the enactment of SAFETEA-LU in 2005, companies involved in long-term public-private partnership toll road deals can gain access to tax-exempt Private Activity Bonds. Yet concession deals in Texas, with the tax-exempt bonds pre-approved, thus far have not made use of public activity bonds. Operating on a global scale, these concession

companies can raise capital at very competitive cost.

Secondly, private toll companies are very likely to have significantly lower operating and maintenance costs than public toll authorities, as previously discussed. Whether such a company is operating efficiently and cost-effectively depends on all its costs, not just its financing costs.

Third, if this situation changes in the future, and public authority financing proves less costly, there is nothing to prevent Pennsylvania using that model for projects outside the concession. Public toll authorities should be allowed to bid competitively with private concessionaires. Ireland, which makes extensive use of concessions, has also used the public toll authority model recently when a concession was judged inappropriate (Dublin Port Tunnel).

Part II: The Turnpike's Six Proposed Strategic Initiatives

As an alternative to competing with the private sector in bids for a concession from the state, the Turnpike Commission proposes six “strategic initiatives” which Carson discusses under headings A through F.

A. “Public-Public” Partnerships

The Commission proposes “public-public” partnerships, a play on the term public-private partnerships. As Carson describes it, this might involve cooperative projects between the Turnpike and the state DOT or between the Turnpike and a regional authority.

This is perfectly reasonable. State agencies should work collaboratively with one another and with local government. It is odd that the Turnpike Commission sees this as a “strategic initiative.” There is no legal obstacle to such cooperation now. If there are benefits, one has to wonder why the Turnpike isn’t already engaged in such partnerships.

B. Tolling Non-Tolled Interstates

Under the rubric of “Strategic expansion of toll facilities,” the Turnpike proposes that tolling be imposed to finance the rehabilitation and selective expansion of I-80, I-81, I-83, I-79, I-78, I-76 (Schuylkill Expressway) and I-95. Carson also suggests adding elevated toll express lanes on I-76 and I-95 in Philadelphia, like those recently added to the Crosstown Expressway in Tampa.

These are all ideas worth exploring but they would require extensive study, public outreach, alternatives analysis, traffic forecasts, and environmental impact review. There is generally strong opposition to imposing tolls on existing non-tolled roads, and there are also legal obstacles. SAFETEA-LU includes a pilot program under which three states may rebuild an Interstate using tolls, if it can show that doing so is the only realistic way to do so. Getting federal permission to do this for *seven* Interstates in Pennsylvania is a very long shot, even if there were a critical mass of support for doing so within the state. And it is not clear why the Turnpike Commission would be the most appropriate party to carry out these toll-financed reconstruction projects, when these are the kinds of things long-term toll concessions are good for. Alternatives could include:

- A regional Southeast Pennsylvania agency to do the urban toll projects mentioned including the Schuylkill Expressway and I-95 toll express lanes;
- The Southeast Pennsylvania agency inviting private sector bids to build these toll express lanes in return for a toll concession;
- Asking trucking interests to build improvements to the main Interstates with special truck-only toll lanes;
- Seeking separate private sector concession bids for each of the Interstate

upgrades.

These proposals are quite unrelated to the issue of whether the existing Turnpike Commission is the best kind of organization to run the existing Turnpike. The Governor has identified a need to fill major gaps in the state transportation budget, and none of these projects addresses that issue.

C. More State Debt Issuance

The Turnpike's third point is "Prudent use of debt" based on revenues like motor license fees. What this initiative seems to be about is for the state to borrow more based on the future revenue stream of various state taxes and charges (like license and registration fees) to support non-tolled roads and mass transit. Greater reliance on borrowing always entails risk. Carson says the borrowing would not be backed by the Commonwealth's general fund yet still, he opines, it "would likely" gain a high rating in the bond markets.

The real trouble with borrowing for works that generate no revenue stream is that they require ever increasing taxes and charges to support the debt service. License fees imposed annually regardless of road use are a deadweight cost to those people and businesses that use their vehicle little, and make few demands on the road system and the environment. They are exactly the wrong way to support borrowing for given-away transportation services.

We need to move away from indirect charges like this and to bring transportation more into the regular market economy in which users pay in proportion to what they use, and if they decline to pay, then in deference to customers the service is trimmed. Otherwise we create a bottomless pit devouring taxes and charges to no good purpose.

D. A New Toll for Mass Transit

The Turnpike Commission proposes generating around \$150 million a year for mass transit via a new \$1 toll levied at entry and exit in urban areas. This toll is intended "to encourage use of mass transit" in Carson's words.

There is often a case for variable tolls in urban areas both to manage traffic flow (so as to prevent the overloading that causes the breakdown in flow) and to help fund increased roadway capacity. The siren song of getting commuters out of their cars onto mass transit is old and is discredited by the continued shift away from transit to roads. Cars and buses, with the roads they operate on, are America's mass transportation system. The use of rail transit has steadily diminished as a percentage of both commuting trips and of all urban trips—despite huge continuing subsidies. Rail now serves two or three percent of person-trips within Pennsylvania metro areas and virtually none of the freight and service trips.

Any toll revenues levied on urban motorists should be channeled back into road improvements which benefit car drivers, freight, and road-based transit – i.e., buses. Carson's plan amounts to a tax on road users to further subsidize rail transit.

E. Increased Fuel Taxes and License Fees

Carson's fifth proposed strategic initiative is to "revisit" the funding recommendations of the Transportation Funding and Reform Commission, at least its recommendations on raising the gas tax by 12.5c/gallon and increasing the surplus from license fees by \$150 million.

Carson seems to have forgotten that the Funding and Reform Commission also suggested that the state should aggressively explore a concession/long-term lease of the Pennsylvania Turnpike.

There are major problems with the higher gas tax and license fees. License fees should cover the costs of administering the licensing system, the purpose of which is to keep unsafe drivers and unsafe vehicles off the roads. The licensing system should not be diverted from this important mission by being made a profit center to fund projects that people are unwilling to pay for directly. Using the licensing system as a cash cow only encourages the funding of boondoggles at the expense of the proverbial little old lady who has a car to drive to the supermarket once a week.

Fuel taxes at least bear some relationship to miles traveled on the roads and the demands motorists are making. They are a crude proxy for direct road charges. They have these shortcomings:

1. With the vehicle fleet moving to more fuel efficient and "green" vehicles, the revenue yield of fuel taxes is in decline.
2. Fuel taxes do not help with management of traffic in urban areas and fall unfairly on off-peak and rural travelers whose use of uncongested roads does not generate the need for extra roadway capacity.
3. Fuel tax increases are not supported by the public.

F. "Monetization" of the Turnpike

Instead of being leased under a long-term concession, Carson wants the Turnpike "monetized" or used as the basis for extra borrowing. He argues that if the state decides as a matter of public policy that there should be "greatly increased future tolls" then they should be paid to the Turnpike, because the revenues will flow back into "badly needed infrastructure" providing a "public ownership dividend" rather than going to private profits.

First it isn't clear that greatly increased tolls would be feasible in Pennsylvania under a private concession or the Turnpike Commission. Tolls on the Pennsylvania Turnpike are already quite high, at least relative to tolls on the Indiana Toll Road – where large increases were probably justified, concession or no concession.

Second, tolls paid to the Turnpike Commission will likely flow more into the bloated costs of this political machine than into badly needed infrastructure. Under a competitively bid concession, a base toll rate and controlled increases can be set. This would force the concessionaire to focus on customer service to attract more traffic and on smart, economical operations to save on costs.

If Carson's formulation (that the state can run key businesses better than the private sector) were realistic, then all the utilities of the state – electricity, telecommunications, gas, railroads – would be run by state owned authorities rather than by for-profit businesses. Companies bring managerial expertise, an interstate and international range of abilities, the potential to raise equity capital as well as debt, and a set of internal incentives that makes for better service at lower cost than a government authority despite paying profits to shareholders.

Part C: Conclusion

Carson is correct that a private concession for the Pennsylvania Turnpike is not a “magic bullet.” However, properly structured and competitively bid, it might offer substantial advantages to the people and economy of the state. That is sufficient reason to justify the Governor’s plan to formally seek proposals. If those private sector proposals don’t measure up, by all means let the Commission work to get its act together with other state agencies, as Carson suggests.

Unfortunately the Turnpike seems desperate to avoid competition and does not want the state to get competitive proposals. However the Commission is a political entity. The Turnpike belongs not to the Commission but to the people of Pennsylvania who would be wise to explore whether private enterprise could offer them a better deal under a long-term concession.

About the Authors

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Segal recently served as an advisor to Florida Gov. Jeb Bush's Center for Efficient Government. In addition, his counsel has recently been sought out by Gov. Mark Sanford and Indiana Gov. Mitch Daniels, where he is working with the Government Efficiency and Financial Planning group inside the Office of Management and Budget. Segal is also an advisor to the Cost Cutting Caucus in the Virginia House of Delegates.

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Segal has testified to the United States Senate and numerous state legislatures and agencies. He has written dozens of articles for leading publications including Investor's Business Daily, Atlanta Journal-Constitution, Indianapolis Star, Orange County Register, Los Angeles Daily News, and New York Sun. Segal is also a contributing editor to Budget & Tax News. A frequent guest on television and radio, he has appeared on Fox News Channel's "Your World with Neil Cavuto" as well as CNBC's "Closing Bell with Maria Bartiromo" and "Power Lunch."

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