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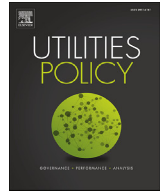

The favourability of U.S. PPP enabling legislation and private investment in transportation infrastructure

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The capacity of individual U.S. states to utilize public-private partnerships (PPPs) is influenced by the existence and nature of PPP enabling laws. We examine the nature of PPP enabling legislation and how it varies across states. Although commentators stress the importance of enabling laws, the relationship between the favourability of legislation and the transportation PPPs completed in each state remains unclear. We study three states where substantial PPP investment has occurred. That experience sheds light on the type of legislation required to remove obstacles to PPP investment but also the constraints remaining in each state. We uncover a relatively weak connection between enabling laws and PPP investment activity. We conclude that the existence of enabling legislation is a helpful but not necessarily sufficient condition for PPP investment.

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1. Introduction

Governments around the world are compelled to address gaps in infrastructure funding and financing. Many are turning to greater private-sector participation and new procurement approaches, including public-private partnerships (PPPs). “PPP” is a broad term referring to a long-term contract to provide the design, construction, operation, and (sometimes) finance of infrastructure assets and ancillary services.

In a PPP, the private sector plays a greater role in infrastructure delivery relative to traditional public-sector procurement and service delivery. PPPs bundle different elements of the project life cycle into a single contract. That generates greater scope for risk sharing between the public-sector project sponsor and private contractors. For example, the private sector may assume construction and operational risks, thereby incentivising timely and cost-efficient delivery of critical infrastructure. PPPs also leverage private resources for the purpose of financing new infrastructure's up-front design and construction cost. For a dollar of anticipated infrastructure funding, PPP financing generates greater initial *financing*.

PPP use has been embraced in Europe as well as many parts of Africa and Asia. The United States, however, has been relatively slow to adopt this procurement model. Although there were 498 PPP projects, with a value of $116.5 billion, closed in the United States during the period 1985–2016 (PWF, March 2017) this lags considerably behind the PPP investment levels recorded in Europe.

A number of factors help explain the relatively small U.S. PPP market. Those include the national economic climate in the wake of the global financial crisis, apprehension over PPP transactions given a relatively mixed track record, abundant low-cost tax exempt municipal debt, and concerns about robust public-interest protections in PPP arrangements (Garvin, 2010).

There are compelling reasons to expect U.S. PPP investment to grow despite a relatively limited experience. Commentators stress that the U.S. infrastructural deficit extends across many sectors including transportation, flood defences, water services, and schools. The American Society of Engineers estimated that $3.6 trillion must be invested by 2020 if the existing quality of U.S. infrastructure is to be maintained (Infradeals, 2015). Moreover, fiscal constraints at the federal and state levels provide incentives for policy makers to explore alternative procurement approaches, especially privately financed PPPs.

An important element of the governance of the U.S. PPP market is the state-level legal framework. Many aspects of PPP procurement can be completed without the involvement of state legislatures. However, “a strong legal basis is a necessary precondition for a successful partnership” (Sabol and Puentes, 2014: 13).

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Consequently, over time an increasing number of U.S. states have passed laws to facilitate PPP utilization.

State-level enabling laws provide the institutional foundation for PPPs. Although an enabling statute can contribute to the creation of a supportive environment for PPP procurement, it may also discourage PPP investment. The complex nature of PPP procurement regarding finance, expertise and public-interest protections means that PPP enabling statutes must “preserve a delicate balance between program flexibility and public-interest concerns” (Gifford and Transue, 2016: 266). Whether or not PPP legislation ultimately encourages or discourages PPP investment (especially privately financed investment) is thus an important empirical question, that we seek to address.

The main purpose of this paper is to examine how the usage of PPP for transportation infrastructure in the U.S. has developed as enabling legislation evolves. Insofar as we are aware, this question has not been addressed in the PPP literature to date. Our paper specifically focuses on privately financed PPPs. Although there is extensive experience in the U.S. with using PPPs to design and build infrastructure projects there is a growing trend towards using PPPs to provide the up-front finance for infrastructure investment. In that regard our paper makes a novel contribution to the literature on the PPP experience in the U.S. where enabling laws are widely regarded as an important part of the institutional framework around PPP procurement.

We examine the content of state-level enabling legislation in detail. We study three states with the most developed PPP programs and conduct a case-based analysis of how enabling legislation has evolved and has removed obstacles to PPP investment to date. Our principal focus is on privately financed PPPs in the transportation sector and we examine the experience with such procurement as legislation has evolved in each state.

2. Institutions, enabling laws and PPPs

PPPs involve the transfer of certain infrastructure-related responsibilities to a private entity. This raises important questions and challenges for governance. Greve and Hodge (2010) and Skelcher (2010) view PPP for infrastructure projects as a form of governance that involve varying challenges at different stages of long-term PPP contracts. Those include: (i) handling the complexity of PPP contracts; (ii) appraising alternative procurement approaches; (iii) justifying the use of PPP over other alternatives; (iv) managing partners at all stages of the project life-cycle, including contract negotiation; (v) contract execution; and (vi) the post-contractual stage when management involves monitoring, performance measurement, and contract enforcement. Appropriate governance therefore requires the design of mechanisms that protect the public interest when authority is delegated to private business concerns.[1]

Appropriate governance, as part of the wider institutional framework, is essential for the development of PPP markets (OECD, 2010). Such institutions can reduce transaction costs, which are significant when infrastructure contracts involve large investments in specific assets that have little or no value in alternative uses (Williamson, 1985). Infrastructure investment tends to be characterized by complexity, uncertainty, and high bargaining costs (Boardman and Hewitt, 2004). Potential investors generally require the public-sector project sponsor to ensure fair competition for contracts, competitive risk-adjusted returns on investment, and an efficient allocation of project risks across the public and private sectors. According to the European Commission (EC), this can be supported by clear and “sustained political and public sector support to the strategic decisions around the PPP [and] a conducive legal, regulatory and financial framework supporting the development and implementation of PPPs” (European Commission, 2004: 5).

Laws that are specific to PPP use, commonly referred to as PPP enabling laws, and general procurement laws that may impact a PPP project together, create the institutional framework surrounding PPP procurement. Those laws (both specific and general) are numerous due to the complexity and size of PPP projects (Queiroz and Lopez Martinez, 2013).

A country's legal tradition is also important. In countries that legal scholars categorize as civil law jurisdictions, PPP projects rely mainly on legislation and on express legal authority (European Investment Bank (EIB), 2011: 23). The enactment of specific PPP laws is therefore observed in civil law jurisdictions, such as France, Poland and Mexico. In common law systems such as Canada, Ireland and the United Kingdom (UK), PPPs are regulated via contract on a project-by-project basis.[2] England, for example, does not have a specific PPP law and “certainty and clarity of intention of the contracting parties is achieved by the presence of clear and comprehensive contracts written under a legal system that is permissive and not prescriptive” (EIB, 2011: 22). In addition, the UK has developed a stable institutional framework aimed at supporting PPP procurement. Over time, government departments have published specific guidance on procurement. A specialist private finance unit was established in Her Majesty's Treasury that has since been re-structured and currently operates as *Infrastructure and Projects Authority*. It has standardised PPP/PFI contracts and provides advice to procuring authorities as well as being instrumental in setting up specialist units supporting PFI procurement in specific sectors such as health and education.

The link between legal institutions and success or failure in undertaking PPP procurement is open to debate (Menard, 2013). A well-defined legal system and powerful judiciary may lend credibility, thus facilitating long-term commitments by contracting parties. Alternatively:

> Legal support might turn into legal impediments, since it introduces rigidities in the negotiation, costly procedural obligations ex ante as well as ex post… The success of PPP therefore depends on a delicate equilibrium between the need for legal support and a judiciary that make commitments credible; and the risks of a system that is either incompetent, imposing arbitrariness on parties, or powerful enough to engage parties in highly procedural and costly relationships” (Menard, 2013: 166).

Whether specific enabling laws or general procurement laws encourage greater levels of PPP investment remains unclear. The European Investment Bank (EIB), for example, asserts that

[1] Skelcher (2010) states that appropriate PPP governance structures create: “constraints on the agency of private actors, reducing possibilities for self-interested behaviour on the state's expense. And in contradistinction to the first point, governance structures act as a constraint on the state, enabling private actors to realise the innovative potential that PPPs are intended to promote by virtue of not being part of the state's bureaucracy (2010:292).

[2] Typically, however, specific PPP-enabling legislation is not in place in Canadian jurisdictions except to the extent required to establish the agencies that are responsible for project delivery and procurement. As a result, there are generally no legal requirements with respect to mandatory contract terms, value thresholds for using PPPs, or evaluation criteria that must be considered before selecting a PPP as a project delivery vehicle. However, policies and procedures may be in place governing certain aspects of PPP procurement, either through internal policies and procedures of an agency such as IO or PBC or through publication of general guidelines by a governmental ministry (Shkordoff et al., 2015: 48).

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