



# Why do U.S. states adopt public–private partnership enabling legislation?



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## ABSTRACT

Public–private partnerships, or PPPs, have the potential to address a range of urban economic issues. As of late 2012, thirty-two U.S. states and Puerto Rico had enacted legislation enabling the use of PPPs. PPP enabling laws address such issues as the treatment of unsolicited PPP proposals, prior legislative approval of PPP contracts, and the mixing of public and private funds. We utilize 13 key elements of PPP enabling laws to develop an index reflecting the degree to which a state's law is encouraging or discouraging of private infrastructure investment. We examine why states pass such laws, and why some states pass legislation that is relatively more favorable to private investment. We consider demand side, supply side, and political/institutional drivers of passage. Vehicle registration growth and greater traffic congestion both increase the likelihood of passage, as does political agreement between a state's executive and legislative branches. Traffic congestion, growth in per-capita income, and the percent of Republicans in the state's House of Representatives all increase a law's favorability to private investment. There is little indication that traditional public finance variables, such as federal highway aid, affect the likelihood of passage or the favorability of a state's PPP enabling law.

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## 1. Introduction

U.S. Interstate highways, state roads, local streets, bridges, underpasses, and tunnels form the core of the nation's surface transportation system. The 4-million-mile system was recently valued by the Bureau of Economic Analysis at almost \$3 trillion (Winston, 2013). Most of the nation's traffic is carried by the 46,000 miles of Interstate highways which, together with another 117,000 miles of major roads, comprise the National Highway System.

Those valuable transportation assets are beset by several seemingly intractable problems. Between 1980 and 2008 vehicle miles traveled (VMT) in the United States increased 96%, while highway-lane miles rose only 7.5% (Fischer, 2005). Unsurprisingly, traffic congestion worsened during that time. The demand for new transportation infrastructure – and the maintenance and renovation of existing aging infrastructure – is burdening traditional

transportation financing sources at a time when significant additional investment is needed (Hagquist, 2008). According to a 2013 report from the American Society of Civil Engineers, about 32% of America's major roads are in poor or mediocre condition. Poor road quality costs motorists about \$67 billion a year, or \$324 per motorist, in additional repairs and operating costs (American Society of Civil Engineers, 2013).<sup>1</sup>

Many states and localities are considering non-traditional approaches to renovating, maintaining, and financing transportation infrastructure. This includes a greater role for private firms in such activities though public–private partnerships, or PPPs. Although meanings vary across countries, in the United States the term “PPP” has evolved to encompass a range of contractual relationships between a public project sponsor and a private partner that facilitate a larger private role.

One recent step taken by states to facilitate private participation is the passage of laws that enable PPP use. Commentators suggest

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<sup>1</sup> However, some parts of the nation's highway and tunnel system improved between 1997 and 2006 due to rising nominal investment (U.S. Department of Transportation, 2008).

**Table 1**  
Survey-weighted enabling scores for key provisions of PPP laws.

Number	Provision	Survey-weighted enabling score	Standard deviation of responses
1A	The law allows multiple modes of transportation and types of transportation facilities to be eligible for a PPP	0.80	0.74
1B	Roads and highways are not eligible for PPPs under the statute	−0.84	0.72
2	The law allows existing transportation facilities, as well as new transportation facilities, to be PPP-eligible	0.77	0.64
3	The law allows the responsible public entity to receive both solicited and unsolicited proposals	0.54	1.16
4	The statute exempts PPPs from the state's procurement laws	0.61	1.05
5A	The law explicitly permits revenue sharing in PPP agreements	0.60	0.77
5B	The law does not allow revenue sharing in PPP agreements	−0.57	0.66
6	The law explicitly permits the state to make payments to the private entity in lieu of direct user fees (e.g. availability payments)	0.82	0.50
7	The law explicitly grants authority to entities other than the primary public sponsor (i.e. counties, municipalities) to enter into PPP agreements	0.67	0.62
8	The law exempts the private entity from paying property taxes on the land required to operate the facility	0.47	1.03
9A	The law explicitly allows PPP agreements to contain non-compete clauses or compensation clauses	0.57	1.06
9B	The law explicitly prohibits the PPP agreement from containing non-compete clauses or requires the state to maintain a free, alternative route	−0.47	0.47
10A	The law allows both public and private sector money to be combined in the financing of a PPP project	0.90	0.41
10B	The law requires the private sector to put up all of the financing for a PPP project (i.e. no public sector funds allowed)	−0.64	0.46
11	The law protects the confidentiality of proprietary information contained in a private entity's proposal	0.79	0.51
12A	The law includes a provision that allows the state legislature (or another public body) to reject a PPP agreement	−0.90	0.43
12B	The law does not include a provision that allows the state legislature (or another public body) to reject a PPP agreement	0.77	0.66
13A	The law puts a limit on the number of projects that can be developed under the PPP approach	−0.54	0.83
13B	The law does not put a limit on the number of projects that can be developed under the PPP approach	0.79	0.51

that U.S. transportation PPPs are hindered by a lack of state-level enabling legislation (Fishman, 2009; Reinhardt, 2011). The preambles of enabling laws declare that their intent is to attract private infrastructure investment to the state. The laws create an institutional framework for the conduct of PPPs. They address such issues as the treatment of unsolicited PPP proposals, whether a PPP may be used on existing as well as on new transportation facilities, whether agreements may include revenue sharing with the public sponsor, and whether non-compete clauses may be included in the agreement, among many other key concerns. We provide a list of the thirteen main provisions in Table 1.

Appropriate institutional frameworks are critical for PPP success. From the private sector's perspective, it is risky to expend substantial time, money, and effort in developing infrastructure projects that may ultimately fail to receive authorization. Moreover, the large investment required is usually long lived, specific to that use, and irreversible. It is irrational to incur such investment unless returns are assured over its useful life, which depends heavily on the institutional environment. In addition to reducing the uncertainty of returns, PPP enabling legislation provides a framework for contracting, signals a general willingness to engage in PPPs, and more clearly defines the allocation of risk between the public-sector project sponsor and the private partner (Iseki et al., 2009).

However, private investment in infrastructure remains low in the United States by global standards, and controversy surrounding PPP use remains intense (Istrate and Puentes, 2011). Critics argue that PPPs do not create net social value, but instead conceal public liabilities by removing debt from the government's books, by raising the social cost of capital, and by protecting the interests of private partners at the public's expense (Roin, 2011; Dannin, 2011; Quiggin, 2004). One implication of that position is that states pass PPP enabling laws out of fiscal necessity rather than a desire for social welfare improvements.

Others argue that PPPs generate social value by providing sharper incentives to innovate and properly allocate investment, through greater access to equity capital, through greater

contractual transparency, and by better linking compensation to performance, suggesting that states pass PPP laws to capture such benefits. The two perspectives are not mutually exclusive and we cannot disentangle them here.

We do not attempt to directly address debate regarding the social value of PPPs. We instead contribute to understanding why states pass laws that explicitly invite private investment in transportation infrastructure, and the degree to which fiscal exigencies cause states to pass PPP laws (and to pass more favorable laws). We also develop the first numerical index of relative enabling law favorability to private investment.

Despite their growing importance there has been little detailed empirical examination of U.S. PPP enabling laws.<sup>2</sup> We examine the underlying drivers of state enactment of such legislation and, of those states passing laws, how favorable they are to private participation. We catalog thirteen main elements of each law to develop a PPP enabling law "favorability index."<sup>3</sup> However, it is unlikely that each element of the index is equally important in attracting private investment. We contacted numerous PPP experts in the United States to solicit their views on enabling law provisions, which allowed us to assign weights to various provisions based on how important experts believe they are in attracting private investment.

We consider alternative theories of the enactment and content of PPP enabling laws. One view suggests that states are responding to the needs of motorists who use transportation facilities. States and localities are here understood to be using PPPs to increase the provision of a public good in response to customers' demand

<sup>2</sup> There are, however, attempts to understand the determinants of public-private partnerships globally. Hammami et al. (2006) examine international data and find that effective rule of law is associated with more PPP projects, while Istrate and Puentes (2011) discuss the importance of various provisions of state PPP enabling laws.

<sup>3</sup> We recognize that enabling laws most favorable to private investment may not best protect the public interest. This raises the separate research question of which laws best control market power, ensure stewardship of public assets, and guarantee service quality, for example.

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