Financing Urban Highways and Transit

Clifford Winston
Brookings Institution
Public Sector Problem, Private Sector Perspective

- Discussions of financing arise for the public sector
- More precisely, the discussion is concerned with how to fund public deficits—for example, introduce a new tax or find another source of funds
- Private sector firms finance their operations from revenues from the sale of products and services and from capital markets
Efficient Financing

- Private firms efficiently finance their operations or they fail. Efficiency encompasses:
  - Pricing
  - Production
  - Maintenance
  - Investment

- How has the public sector performed?
- Is privatization the answer?
Pricing

- Public enterprises are justified on the basis of social desirability: compare consumer surplus with deficits
- Value considerations: the service should provide sufficient value so that users’ willingness to pay generates sufficient surplus and revenues so the service is socially desirable
- Prices should cover enough of the relevant costs so that the service is socially desirable
Pricing in Practice

- Highway and transit prices are far below private and social costs
- Highways provide sufficient value such that prices could be raised to reduce deficits and the social costs of congestion and road damage. This may not be true for transit.
- Raising prices faces political obstacles
- Cost reduction is thus critical to improve financing.
Cost Reduction in Practice

- Costs can be reduced by reducing production, maintenance, and investment costs but, in practice, this has proved difficult.
- Production costs are inflated by regulations (e.g., buy-American provisions, Davis Bacon Act).
- Maintenance costs are also inflated (capital subsidies in transit, suboptimal highway design).
Cost Reduction (continued)

- Investments are not based on cost-benefit analysis. Costs are often underestimated and benefits overestimated.

- Some investments are earmarked expenditures that elected officials provide to constituents—"bridges to nowhere."

- In sum, US urban bus and rail transit systems run large deficits and highways are now running a deficit.
Public Sector Solutions

- Public sector solutions call for more funding for transit and highways—alternatives include VMT taxes, an infrastructure bank, and public-private partnerships.

- But those approaches ignore the inefficiencies in pricing and production, maintenance, and investment—inefficiencies that won’t be addressed.
Privatization

- Privatization of urban highways and transit may provide incentives to improve pricing to respond to users’ preferences and to improve the efficiency of operations and investments.

- Privatization may also lead to innovations and more technological advance.

- Experiments are essential to see how privatization would perform in practice.