When the State Partners with Business, the Devil's in the Details

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President Trump has reportedly expressed reservations about public-private partnerships, but White House economic advisor Gary Cohn is still enthusiastic about building the administration's fabled infrastructure plan around them. Not everyone realizes, however, that there are two very distinct kinds of public-private partnerships, which I call the good kind and the bad kind. I'd like to believe that it is the bad kind that worries Trump while it is the good kind that encourages Cohn.

Two Kinds of Partnerships

The good kind of public-private partnership is more formally known as a *demand risk* partnership. In this case, the public partner essentially gives the private partner a franchise to build a road or some other infrastructure. The private partner is allowed to collect tolls or other revenues from the infrastructure for a fixed period of time, usually three or four decades, after which ownership and management of the infrastructure are turned over to the public partner (who may contract it out again). The key is that the private partner accepts the risk that revenues may not cover the costs. For example, the I-495 Capital Beltway express lanes are a demand risk partnership.

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The bad kind of public-private partnership is more formally known as an *availability payment* partnership. As with the good kind, the public partner designs the project while the private partner builds and, usually, operates it. Unlike the good kind, the private partner takes no risk that the project might not pay its way. Instead, the public partner contracts to pay the private partner enough money over several decades to completely repay the private partner's costs regardless of whether anyone is actually using the infrastructure.

Availability payment partnerships might make sense in the case of infrastructures that no one expects to earn user fees, such as common schools. But, in most cases, such partnerships are formed mainly to allow the public partner to sidestep legal debt limits. For example, euro nations are supposed to limit their debts to a fixed percentage of GDP. Some nations, such as Italy, have built high-speed rail and other infrastructures using availability payment partnerships so that the debts appear on the books of the private partners, not the government.

For the same reason, Denver’s Regional Transit District (RTD) formed a public-private partnership to build a billion-dollar rail line to the airport. Voters had approved a sales tax increase for the rail line but set a debt limit. When cost overruns made it impossible to build the line without exceeding the debt limit, RTD entered into an availability payment partnership so the debt wouldn’t appear on its books. Of course, it was still contractually obligated to pay the private partner enough to repay its debt.

If We're Going to Have Them, Have the Good Kind

We should favor the demand risk kind to protect taxpayers.

Demand risk partnerships are good because the need to cover costs out of user fees creates a discipline that ensures that projects are worthwhile and costs do not get out of control. User-fee funded projects are also better maintained because managers know users will stop paying if the project becomes dangerous or unreliable.

Availability payment partnerships are bad because they offer little incentive to control costs or ensure that projects are worthwhile. Denver’s airport rail line was originally projected to cost $315 million and ended up costing over a billion dollars. That billion dollars didn't even buy a quality product: more than a year after it opened, the builder still has not gotten the automatic grade crossing gates working, a technological problem that the private railroads solved more than 80 years ago.

Until the Trump administration releases its infrastructure plan, we won’t know if it will make a distinction between demand risk and availability payment partnerships. It should, however, favor the former over the latter to protect taxpayers and ensure that the infrastructure we build is both worth having and well maintained.

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