Motivation

- Performance of most public infrastructure—airports, highways, waterways, and public railways—has been declining—symptoms are deficits, delays, safety issues.

- The US cannot spend its way out of the problems

- Inefficient public policies and lack of innovation are at the heart of the problem and reform is intractable

- Glimpses of private sector involvement in infrastructure throughout the world.

- More guidance and motivation to spur privatization
Inefficient Pricing: Unrelated to Costs

- Airports: weight-based landing fees
- Roads: gasoline tax for cars and trucks
- Ports: fees often unrelated to congestion
- Deficits financed by taxpayers

Inefficient Investment and Production: Costs are Inflated

- Airports: runway costs and delays
- Roads: suboptimal capacity and durability
- Ports: excess capacity
- Generally, there is X-inefficiency from regulations that inflate labor and capital costs
Inefficient Spending: Funds are Wasted

- Public funds are not allocated on the basis of cost benefit analysis
- Airports: Misallocation of funds in Airport Improvement Program
- Roads: Misallocation of Highway Trust Fund
- Earmarked funds

Lack of Innovation and Technical Advance: We are not at the Frontier

- Roads
  - Improved navigational aids and signals
  - Improved methods of construction
  - Automated highways
- Airports
  - Slow adoption of satellite-based ATC technology
Why Do All the Inefficiencies Exist?

- Agency limitations—slow and bureaucratic
- Engineering (spending) mentality
- Regulations
- Political forces and status quo bias
- Government accomplishes reform by exiting

Privatization: Theory

- Incentives for cost reduction
- Incentives for innovation to reduce dynamic X-inefficiency that has developed
- Engagement with customers
- Market power and associated inefficiencies
Privatization: Evidence from Deregulation and Simulations

- Deregulation
  - Bequeathed inefficiencies
  - Contract equilibria
- International Evidence: US behind
- Highway simulations
- Airport Simulations
- Expected effects: accurate predictions are difficult, otherwise they could possibly be obtained by regulation

Privatization In Practice

- Very long term process of adjustment
- New private firms must overcome inefficiencies built up for decades by public sector providers while having little experience competing intensely
- Mistakes will be made by privatized firms and the public will be inconvenienced
- The longer term gains will come from reducing the dynamic X-inefficiencies that have built up under public ownership.
- The gains will also come from innovations spurred by “young firms.” Such firms are often the main sources of growth.
Experiments

- Conduct carefully planned privatization experiments for selected cities
- Obtain evidence of benefits to strengthen case to the public
- Government must not undermine the process of adjustment
- Constructive interventions should not be opposed on ideological grounds