

GUEST SPEAKER

Enrique DIAZ-RATO, Chief Executive Officer- CINTRA-FERROVIAL- BAA

Good morning, Ladies and Gentlemen, it is my pleasure and privilege to join this select number of policy makers today.

My name is Enrique Diaz-Rato. I am Chief Executive Officer of Cintra, a leading transportation infrastructure developer. We own and operate 25 toll roads in 8 different countries in Europe and the Americas. We started in this business with our first toll road almost 40 years ago. That first development was handed back to the Authority in 2003, after 35 years of successful operation. One of our toll road contracts in North America extends its term well into the 22nd Century.

Our parent company, Ferrovial, is also an active investor in the airports sector, having recently acquired BAA, the world's largest private airports operator.

We have therefore a track record of successfully co-operating with Governments in many different countries in the provision and operation of transportation infrastructure. My speech will try to convey to you our views, based on our experience, on how to cope with congestion and provision of new transportation capacity and on the ways in which the private sector can efficiently contribute to that effort.

On dealing with the issue of congestion, the first question is to what extent is it efficient to invest in new capacity. While this question has to be answered by policy makers, our experience in providing mobility in congested environments (for example: 407ETR highway in Toronto or Chicago Skyway) suggests that there is a strong case for substantially investing in new capacity. On the one hand, the cost of congestion increases exponentially the higher the congestion level, not only due to the loss of productivity that derives from growing number of hours spent by users and goods waiting in congested roads, but also by the increasing environmental costs of the inefficient use of fuel that results from it (the lower the average speed, the increasingly higher the fuel cost per vehicle per kilometer). On the other hand, anybody that travels today around major European cities can realize that over-investment is far from being the problem: there is a real need and social demand to improve capacity.

The second question is how that investment in new capacity should be paid for. In this respect, the question should be whether the users of the infrastructure should directly contribute to its cost via pricing of its utilization, rather than discussing how complex contractual structures can result in minimizing the impact in the Government Budget of publicly funded infrastructure.

We believe that the 100% Government funded approach that has been traditional for the road sector is a sensible tool to promote economic growth in underdeveloped areas (the Government subsidizes mobility by not transferring its full cost to users in order to promote economic growth). However, as economy develops a number of factors result in this approach becoming increasingly inefficient, as the gap between the cost and the value of additional capacity increases:

- There is an increased demand for mobility which, when coupled with a free pricing and a growing motorization rate, results in traffic growth rates that turn the avoidance of congestion in a moving target which is impossible to reach.
- As users become wealthier they are not only able to assume the cost of their transportation needs, but, as the value of their time increases, they are willing to pay for additional capacity and an improved service.
- As urban areas grow in population and affluence, new residential and business areas are developed in the surroundings making the acquisition of land for the addition of new capacity, both more expensive and unpopular.

At the end of the day, the question is whether it makes sense to maintain a system in which all the taxpayers subsidise the usage of transportation infrastructure in a context in which the addition of new capacity is increasingly more expensive and the users of the infrastructure have the capacity and the willingness to pay for the extra capacity they need to receive a better service.

The above factors strongly support the implementation of user paid funding, in particular in economically developed and densely populated corridors. In this context, the Government would provide a free minimum public service in which a certain degree of congestion would be assumed and users willing to receive an improved service would pay for the additional capacity required for it. This approach is common in other infrastructure related services such as telecoms in which it is generally assumed that the users have to pay a price that reflects both the cost and quality of the service they are receiving.

Furthermore, user paid pricing schemes that would reflect the value and quality of the transportation have two additional and particularly relevant side effects:

- It helps to internalize the environmental costs of transportation, charging the user a price that more accurately reflects the impact of building new infrastructure and reduces the current gap between the price of mobility and its costs.

- It allows, when coupled with private provision of infrastructure, to implement pricing mechanisms that incentivise the addition of new capacity and the provision of a quality service by the private developer. We will come back to this point later on.

The efficiency of these pricing schemes to achieve these goals, however, depend on similar criteria being applied to competing transportation modes. It may not make sense to implement a road pricing scheme that reflects the value of the service provided to the user and the cost of the capacity required and make it compete with a government subsidized railway project. If, after all, we believe that the goal is to internalize the costs associated with mobility in different transportation modes so that the market can then efficiently balance the choice between them, then particular attention should be given to avoid this type of cross subsidies.

Having, hopefully, made a strong case in favour of investing in new capacity and in relying on user paid schemes to pay for at least part of such investment, the third question is how that additional investment should be financed. We strongly believe that a sizeable part of this effort should be assumed by the private sector. Of course, you can think that, myself being the CEO of one of the world's largest private infrastructure developers, I could not argue otherwise. There are, however, objective arguments that support this view:

First, there is a growing private sector appetite to contribute to the financing and development of transportation infrastructure. Infrastructure assets, with its relatively low risk and safe, moderate returns, are increasingly perceived as an attractive asset category by a growing number of investors. This appetite, matched with the need of public authorities to promote new projects and investment opportunities is not only creating new project development capacity but also tapping capital markets in more varied forms. The financial markets have fostered the participation of these suppliers of financing in the development of new projects either through the investment in the equity of existing developers and operators or by creating new specialized funds to invest in the equity of infrastructure projects.

The top six private road operators listed in European markets have an aggregated capitalization of 60 billion euro, and they own and operate worldwide roads which are worth around 200 billion euro.

According to Standard and Poors, ten new infrastructure funds were raised in 2006 - with a further 17 to be raised. There were at the end of last year 120 billion euro of funds raised and waiting to be placed in equity for infrastructure projects, and it is expected that this figure could soon reach 400 billion €.

The possibilities opened by these trends should, I believe, be of great interest to policy makers charged with delivering transport improvements, but also to those charged with responding to broader questions concerning savings and pension policy, and regional economic development. Pension policies in countries such as Chile, Australia or Canada are one of the key reasons for the sharp development of these funds.

These trends – which are also reducing the relative cost of capital which funds transportation assets - seem set to endure. And they are ones that both finance ministries and transport ministries should in my view seek to analyse, facilitate and exploit. They embody a unique opportunity for developing today the infrastructure of tomorrow in an efficient and socially responsible way.

Second, there is growing pressure on the limitation of Government spending which should promote that, when it can be done efficiently, authorities should seek the involvement of private financing in the provision of infrastructure.

Third, the involvement of the private sector in the development and operation of infrastructure assets does not only provide funding, it also brings in many other operational advantages, a concept commonly defined as “Value for Money”. Essentially appropriately structured PPPs will deliver value for money because they have a number of attributes:

- They de-risk taxpayer exposure to the construction phase of major transport improvements, effectively transferring all construction risk to the private sector and avoiding the usual delays and cost overruns associated with classic government contracting formulae: according to comprehensive academic analysis on capital cost overruns in traditionally funded transport projects across the OECD1, cost escalation between the original public sector decision to proceed and the serviced infrastructure coming into use was 28%.
- They link private profit to timely provision of the infrastructure, efficient operation and quality of service, resulting in long run social benefits.
- They introduce innovation in the provision and operation of infrastructures as private operators are not bound by the rigidities of public entities and are able to promote and value, for example, the provision of ancillary services associated with the usage of the infrastructure (i.e.: shopping, catering, electronic tolling) that may cross subsidise the construction and operation and reduce its costs

¹ Brent Flyborg at Aalborg University, originally published in the Journal of the American Planning Association in 2002

Fourth: getting the private sector involved in the development of infrastructure rationalizes transportation policies in an environment where planning is not always driven by true needs.

This is because the process that leads to the commitment of private debt and equity funding for infrastructure assets involve extensive scrutiny of the soundness of the project by financiers, investors and contractors backed by technical experts. These scrutiny will ensure that the risks of the project are adequately assessed and compared with its returns, ensuring that only feasible and necessary projects will effectively be implemented.

Summarising, we believe:

- That the problem of congestion requires investment in new capacity,
- That part of that new capacity can and should be paid by users, reflecting their increasing willingness to pay for an improved service and the inconsistency that taxpayers continue subsidizing growing transportation infrastructure usage
- That there is a growing amount of money ready to be invested by the private sector in the funding of such new capacity and that the involvement of the private sector does not only provide affordable funding but brings in substantial efficiency in the construction and operation and rationality in the planning.

All the advantages that the private sector can provide to the provision of infrastructure, however, will only emerge if the private operator is correctly incentivised to deliver additional capacity and quality of service.

Let me briefly compare two relevant examples of how the pricing of the infrastructure results in different incentives for the private operator and, therefore, in different outputs:

On one side, let's look at UK airports, where pricing is based on limited yield: in Heathrow, runways operate at 98.5% of maximum capacity and terminal buildings at 150% of design capacity –though with the lower passenger fee of comparable airports-.

On the other side, let's look at the toll ring road of Toronto in Canada, highway 407, where pricing is based on performance, with an obligation by the private developer to sustain continuous growth and manage to alleviate congestion in the network. It operates with spare capacity, and expansions are regularly in place well in advance of strict contract requirements, although yes, it charges relevant toll levels.

Accordingly, if the problem we are faced with is congestion (US DOT, estimated that congestion in the US costs 168 billion dollars a year), the focus when involving the private sector in the provision of infrastructure should be to create incentives for solving the problem and not merely to try to limit the yield of its investment.

We can and should learn from our past mistakes. What is clear however is that the PPP Transport track record is now sufficiently developed for governments to be able to use this tool with greater dexterity and a higher degree of confidence. Continual sharing of best practice can assist in ensuring that at both the political and the administrative level both the will and the skill are put in place for this to happen – and at the broader European level this will be invaluable if we are to be able to meet current transport sector challenges in a timely fashion.

Ladies and Gentlemen, a whole lot of investors are now prepared to fiercely compete to provide equity and debt, at historically low conditions, for transport infrastructure PPP projects.

It would be a pity not to attract such investors in EMCT Countries on ambitious PPP programs.

Thank you very much for your time and patience.