

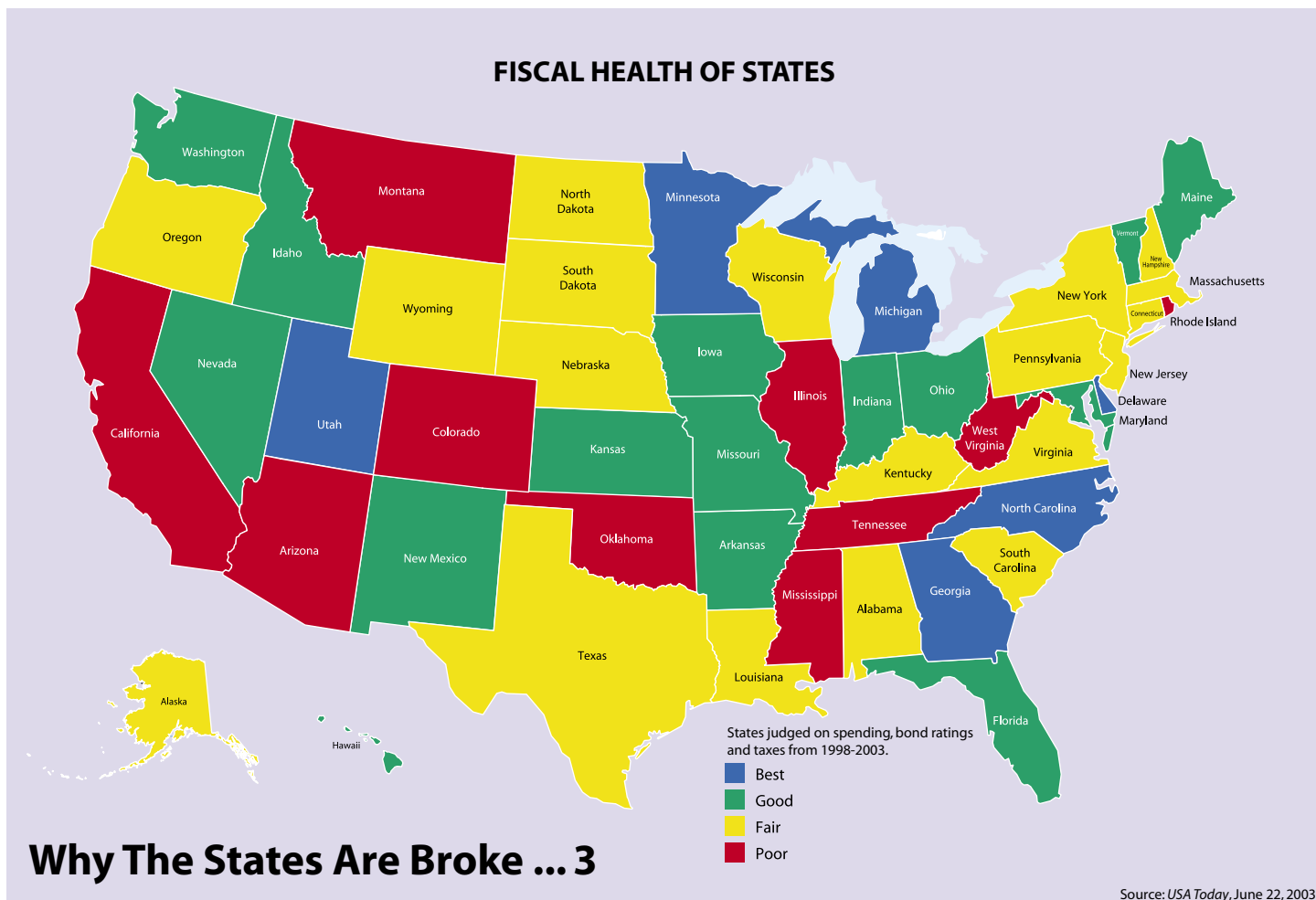


# Privatization Watch

Analyzing privatization developments since 1976

No. 323

A Project of the Reason Public Policy Institute, the World Leader in Privatization



**States Look to Tolling ... 2**

**Unions vs. Volunteers ... 9**

**Privatizing Child Support ... 4**

**Canada on Pension Funds ... 10**

**Arnold Targets the Budget Crisis ... 5**

**OMB Tracks Competitive Sourcing ... 11**

**Searching for Good News ... 6**

**In-house Bids Win Competitions ... 14**

**Ending Spam and Other Annoyances ... 7**

**Privatization Briefs ... 15**

**Remembering Arnold's Mandate ... 8**

**Who, What, Where ... 16**

## Privatization Watch

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## Published by Reason Foundation

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www.privatization.org ■  
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## With Budgets Cut, States Look to Tolling

By Robert W. Poole, Jr.



Legislatures in California and Wisconsin, facing severe budget pressures, have borrowed from their highway trust funds to make ends meet in their general funds. The lack of funding to do more than just maintain existing highways is leading to calls for toll-funded projects in both states.

The Southern California Association of Governments has unveiled the draft of its long-range (20-year) transportation plan, which will rely on tolls for most large new projects. The centerpiece of the plan is a \$16.5 billion system of toll truckways, to be added to the set of freeways leading from the ports of Los Angeles and Long Beach to the east: I-710, SR-60, and I-15. The plan would add two heavy-duty truck lanes in each direction over 142 miles. To make it worth trucking companies' while to pay tolls, they would be permitted to haul triple-trailer rigs on these new lanes, separated by concrete barriers from the cars in the regular lanes (as proposed in 2002 by Reason Foundation). Other toll projects in the draft plan include tolled express or HOT (high occupancy toll) lanes on U.S. 101 through the San Fernando Valley, a new tolled expressway linking Riverside and Orange Counties and a toll tunnel to complete the long-stalled missing link on I-710 through South Pasadena.

Nothing that specific is yet on the table in Wisconsin. In August, WisDOT Secretary Frank Busalacchi suggested the state should consider tolls as it struggles to finance a proposed \$6.25 billion modernization of the Milwaukee-area freeway system in the face of a huge budget deficit. Gov. Jim Doyle quickly tried to squelch the idea, saying there would be no toll roads in Wisconsin on his watch. But six weeks later the head of the state's Transportation Development Association said that toll financing simply had to be considered. "The results of the past two-year budget process have exceeded our worst expectations," he told a Chamber of Commerce meeting on October 2nd. So introducing highway tolls, "while unpopular, is an alternative that should be seriously considered."

Both states may want to look carefully at steps recently taken in Texas. That state already has functioning toll road systems in Dallas and Houston, both of which are being expanded to meet demand. And a new one is just getting under way in San Antonio. But Gov. Rick Perry is not stopping there. His

See TOLL PROJECTS on Page 15

# Why the States Are Broke

Bloated governments, budget gaps, and Parkinson's laws

By John Hood



By most accounts, the recession that began in 2001 is one of the mildest on record. Yet also by most accounts, state governments since 2001 have experienced one of the most severe fiscal emergencies since the Great Depression. Is something unique and inexorable going on here?

Many alleged experts on government finance say so. Writing from academic roosts or from policy groups such as the Brookings Institution or the Center for Budget and Policy Priorities, these experts blame the current crisis on "structural problems" in state tax codes created by the technology-driven New Economy, uncontrollable inflation in education and health costs, excessive tax cutting by the surging Republicans during the 1990s, and international trade policy. Supposedly non-ideological groups such as the National Governors' Association (NGA) and the National Conference of State Legislatures (NCSL) repeat and amplify these messages to a broader audience, as do gullible or ax-grinding reporters.

States are having trouble, NGA Executive Director Ray Scheppach declared on New Hampshire Public Radio earlier this year, because of "a perfect storm" of long-term fiscal trends. "Most states have systems sort of built for a manufacturing economy of the 1950s," he said, rather than for "a high-service high technology international economy of the 21st century. There's a deteriorating tax base. We don't tax services, and that's where growth is."

The reality is more prosaic. What we have seen in various states is little more than the confirmation of old maxims about how and why governments grow and what, if anything, can be done to arrest that growth. One useful way of thinking about this is to recognize that state lawmakers are obeying Parkinson's laws.

C. Northcote Parkinson, an oddball with an odd name, was a British novelist and historian whose output ranged from Napoleonic-era military fiction to a history of sea-borne trade. But his major claim to fame was Parkinson's Law (1957),

which began a delightful series of books about how organizations make decisions, particularly bad ones. Here are some of Parkinson's best-known laws and how states are illustrating them:

### 1. "Expenditure rises to meet income."

In his 1960 book *The Law and the Profits*, Parkinson noted that bureaucracies, public and private, will usually find ways to spend pretty much whatever money comes in. That is, they don't build their annual budgets from the ground up. They discover the level of expenditure they can finance without breaking too much of a sweat, then work backward to justify that level as "essential" to meet the institution's "needs."

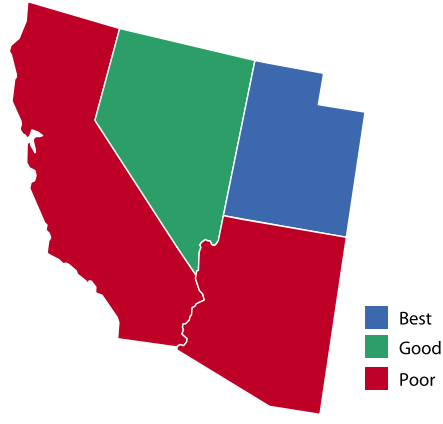
The problem is exacerbated in governmental settings because there is no search for profit and few competitive pressures to tame the natural appetite for spending.

Among the states, it is notable that most of the governments with the biggest fiscal problems during the last two years don't fit the profile suggested by superficial media reports. Since 2001, reports the Rockefeller Institute of Government, 20 of the 50 states have enacted "significant" tax increases (amounting to at least 1 percent of general fund revenue), with 10 of those raising broadly applied tax rates on items such as individual income or retail sales. (The rest have mainly fiddled around with excises on cigarettes.)

If the NGA/NCSL establishment is correct, then the states with the lowest rates of taxation to start with or the highest rates of expenditure growth over time, or both, would be the most likely to resort to tax hikes to bail themselves out of fiscal fixes. But no such pattern exists. About as many of these tax-raising states have fallen below the national average in spending growth in recent years as have exceeded it. Similarly, a slight majority of the tax-raising states were above average in tax burdens before the recent recessionary budgets, so it would be hard to argue that their resort to tax increases was due to some sort of basic inadequacy or to excessive tax cuts in the past.

The fiscal data offer even worse news for those who believe the states need to rely less on the archaic and regressive sales tax and more on progressive income taxes. This policy pre-

See STATES on Page 12



## Two Birds, One Stone

Privatizing child support enforcements can please customers and the feds

By Adrian T. Moore



As states grapple with budget deficits, many also struggle to meet federal performance mandates for their child support enforcement programs. Failure to meet mandates can cost states hundreds of millions in federal funding at a time they can ill afford such penalties. Some states use privatization to kill two birds with one stone—they avoid federal funding penalties and deliver a better, less costly service.

The Family Support Act of 1988 requires states to establish statewide, automated child support enforcement systems. Although failure to complete a system can trigger federal penalties, some states like California have struggled with the mandate. California botched two attempts to implement new child support enforcement systems over 10 years and now suffers federal financial penalties that will total \$1.2 billion by 2006. But the state appears to have finally got it right with a much-audited \$801 million contract with IBM to design, develop and implement the major component of a new child support enforcement system. (See the latest audit of the contract at [www.bsa.ca.gov/bsa/pdfs/99028.2.pdf](http://www.bsa.ca.gov/bsa/pdfs/99028.2.pdf))

Apart from updating systems, child support agencies are increasingly turning to private sector firms for help with improving operations and performance. In some cases, agencies don't have sufficient staff to keep up with growing caseloads. As well, existing staff simply may not have the expertise to perform new or highly technical functions, such as genetic screening.

In 1997, Robert Melia at the Pioneer Institute for Public Policy Research examined child support enforcement privatization in five states and found that privatized services are on average 35 percent more cost effective than government services, costing 15 cents per dollar collected compared to 23 cents per dollar collected for government agencies ([www.pioneerinstitute.org/research/whitepapers/wp03full.cfm](http://www.pioneerinstitute.org/research/whitepapers/wp03full.cfm)). That same year the General Accounting Office examined the quality of privatized child support collection around the nation and found that “fully privatized offices performed at least as well as or, in some instances better than, public child support programs in locating noncustodial parents, establishing paternity and support orders, and collecting support owed.” ([www.gao.gov/archive/1997/he97004.pdf](http://www.gao.gov/archive/1997/he97004.pdf)) Moreover, the GAO only examined fully privatized child support services, and not savings from many support and ancillary services of child support collection that

are often privatized in order to reduce costs.

A good example of privatized child support enforcement comes from Nebraska, where one third of the child support caseload is concentrated in Douglas County. In 1993, a private contractor took over responsibility for daily operations, while the state retained oversight management. A 1998 audit by the U.S. Department of Health and Human Services found that the privatization brought substantial benefits, including:

- Increasing collections by 81 percent.
- Improving cost effectiveness by 56 percent, while dropping caseloads by 16 percent.
- Making the paternity establishment caseload current. The rate of paternity establishment has increased by more than four and one-half times and the rate of support order establishment by more than two and one-half times since privatization.
- Increasing enforcement productivity, with the office executing almost 10,000 income-withholding orders and initiating more than 4,400 contempt hearings in 1997.
- Resolving outstanding audit issues.
- Enhancing customer service. The office is accessible, the waiting area is pleasant and comfortable, and customer concerns are promptly addressed.
- Meeting federal performance standards. The proportion of cases under order increased from 39 percent to 60 percent and are on track to reach 80 percent. (See the entire audit here: [www.acf.dhhs.gov/programs/cse/new/csr9806.htm#9806d](http://www.acf.dhhs.gov/programs/cse/new/csr9806.htm#9806d)) ■



## Arnold Targets the Budget Crisis

By George Passantino



Gov. Arnold Schwarzenegger is pressing forward with an ambitious “100-day plan” to reform California state government, and it’s clear that the state’s lingering budget crisis is at the top of his to-do list.

Of the plan’s ten points (see below), nine have direct implications on the state budget. Only the successful effort to repeal driver’s licenses for illegal immigrants is not budget-centered.

California’s budget has been plagued with legal challenges and criticized by Republicans and Democrats alike. It was only able to clear a polarized legislature after most of the shortfall was made up through borrowing (more than \$16 billion) and another \$7 billion in accounting maneuvers, deferrals and unfunded mandates.

Some key pieces of the current budget are in jeopardy, including \$500 million in deferred payments to the state teacher retirement system (which faces pending litigation). And Schwarzenegger has already made good on his promise to roll back the tripling of the vehicle license fee.

In September, the delicately balanced document suffered a major legal setback when a Sacramento Superior Court Judge sided with the Howard Jarvis Taxpayer’s Association and ruled that it was unconstitutional for the state to borrow \$2 billion to cover its pension obligations. The court found that the bond never received a vote of the people, as Article XVI of the California State

Constitution requires. While the state has appealed the decision, it is unclear if the new governor will support the appeal.

The most formidable challenge of all may still emerge. If the courts apply the same legal argument to the state’s \$10.7 billion “deficit bond” that they applied to the pension obligation bond, the deficit bond may be struck down as well. Even if courts uphold the various bond issues that undergird the 2003-2004 budget, a projected \$8 billion deficit looms over next year’s budget. Some budget experts estimate that by January, the new governor may confront a combined deficit of more than \$20 billion.

What may be most intriguing about the Schwarzenegger plan is how boldly it confronts many different politically powerful forces, from Indian tribes to the legislature itself. Legislators will likely be unhappy by Schwarzenegger’s plans to bring the legislature back for a special session to remedy the current year’s budget.

Issues that were considered “resolved” this year—such as previously rejected spending reductions and tax increases—might well land back on the negotiation table.

Schwarzenegger also plans to go beyond the legislature to confront one of the most politically powerful institutions in Sacramento, public employee unions. While the current budget anticipated more than \$1 billion in personnel savings through layoffs or contract renegotiations, the Davis administration has had difficulty achieving savings thus far. Efforts by Schwarzenegger to increase the amount of savings through renegotiation will run into stiff resistance from state employee unions and their supporters in the legislature.

The big unknown seems to be what influence Schwarzenegger’s ability to communicate with the public will have on the budget debate. Whereas Governor Davis had difficulties connecting with the public and effectively leveraging public support to achieve his policy goals, Schwarzenegger possesses both the resources and persona to wage policy debates in the court of public opinion or at the ballot box if necessary. This will mark a significant shift in leadership style and one that may well carry his policy agenda over the finish line.

“The fact that he has said he will go around legislators directly to the people gives him a great amount of clout,” said Elizabeth Garrett, a political science professor at the University of Southern California, quoted in the *Los Angeles Times* on October 14th. “It takes more time, but it’s a useful threat and fulfills his promise of governing for the people.”

For updates on this topic, go to [rppi.org/outofcontrol](http://rppi.org/outofcontrol) and click the category “State.”

*George Passantino is Reason’s director of government affairs.* ■

### Arnold’s Plan

- Step 1:** Repeal tripling of car tax
- Step 2:** Freeze spending and audit state budget
- Step 3:** Call special session on spending cuts to address current imbalance
- Step 4:** Get fair share of Indian gambling revenue
- Step 5:** Renegotiate state employee union contracts
- Step 6:** Pass jobs package with real workers’ compensation reform
- Step 7:** Submit ‘04-05 budget that closes deficit and restructures inherited debt.
- Step 8:** Streamline bureaucracy and send more money to the classrooms
- Step 9:** Repeal SB 60, which gives driver’s licenses to illegal immigrants
- Step 10:** Pass open government amendment and limit fund-raising during budget process

## Searching for Good News

Is there not one fiscally responsible state?

Interview by Ted Balaker



There's so much talk of so many states in such awful fiscal predicaments. But we all know how the media operate—they focus on bad news and ignore good news. Certainly there must be some good news somewhere. There must be some states that stay in the black while keeping spending and taxes under control. There must be some model of fiscal responsibility, at least one state that all the others should emulate.

Not exactly, says Chris Atkins director of the Tax and Fiscal Policy Task Force at the American Legislative Exchange Council. Atkins works with state legislators nationwide to implement fiscal policies that combat ever-swelling deficits and tax burdens, and is editor of *Crisis in State Spending: A Guide for State Legislators* (available at [alec.org](http://alec.org)).



After speaking with Atkins, it quickly became apparent that my quest for good news was somewhat naïve. When examining the fiscal health of states, it's not so much a case of separating the good from the bad, but rather separating the bad from the less bad.

**Which state has done the best job of keeping taxes, spending, and its deficit under control?**

No single state has truly distinguished itself in terms of its general response to the budget deficit crisis. States like Texas, Florida, Colorado, and New Hampshire have done a decent job of seriously addressing their budget crisis without adding to the burden of taxpayers.

**What was the most effective method of cutting or at least slowing spending?**

Texas probably had the single most innovative approach to spending cuts: lawmakers approved a plan to consolidate the state's health care agencies to save the state \$1 billion a year without a substantial reduction in health care service delivery.

**It can be politically difficult for legislators to keep spending under control. What was it about Texas's political climate that allowed this program to work?**

Texas is, of course, traditionally conservative and has low per capita spending compared to other states. Texas also has more of a culture of governmental efficiency than other states, due largely to the existence of the e-Texas program, which is designed to examine state government operations

annually and recommend savings. It's administered by the Texas Comptroller, and it has saved the state of Texas billions of dollars over the past several years. It works because e-Texas has clout in the legislature. In fact, it has worked so well that the legislature wants to bring it under legislative control.

**Is this political climate an anomaly or something that could be replicated by other states?**

I don't think the political climate has mattered that much when it comes to state budget deficits. We would traditionally expect Republicans to cut spending and Democrats to raise taxes, but the opposite has occurred in many states. Republicans Bob Taft (Ohio), Dirk Kempthorne (Idaho), Bob Riley (Alabama), Kenny Guinn (Nevada) and Sonny Perdue (Georgia) all signed or advocated tax increases in 2003, while Democrats Jim Doyle (Wisconsin), Phil Bredesen (Tennessee), and Mark Warner (Virginia) all advocated spending cuts.

**Is there any reason to be optimistic about the future or do you think we'll see ever escalating spending, taxes, and deficits?**

No, because human nature is not going to change. The founders of this nation understood this and that is why they sought to limit government's power over the people.

**If you had the ear of all our nations' governors and you could suggest one reform that offers the best mix of impact and political feasibility, what would it be?**

It's clear that the politicians cannot resist the urge to raise taxes and spending, so controls must be built into each state's constitution. Tax and expenditure limitations—like those in Colorado that limit tax revenue growth to the increase in population and inflation—are the best chance the people have to take back control over their own checkbook and the state's. ■

**Out of Control ...**



**and into competition.**



**Check out Reason's privatization weblog at  
[www.rppi.org/outofcontrol/](http://www.rppi.org/outofcontrol/)**

## Ending Spam and Other Annoyances

State and federal politicians want new laws, but is there a better way?

Commentary by Dave Schrader



Life is filled with little annoyances, like the kid with the headset who sings along to his music on the subway. Or the woman at the conference who refuses to put her cell phone on vibrate instead of beep mode. But technology might also help you avoid other irritations, like the junk mail awaiting you when you log into a slow line at a hotel. Or those relentless TV ads for belly busters and thigh slimmers.

It costs businesses a lot of money to generate those pitches. Last year the United States spent about \$236 billion on advertising. While TV receives the bulk of the dollars, significant portions also go to print and an increasing amount to the Internet and e-mail. The fourth quarter 2003 *McKinsey Quarterly* newsletter on “Better Branding” reports that a typical consumer will see 5,000 advertising impressions a day, up from 3,000 in 1990. Marketers’ abuse of the e-mail and telephone channels has led to more government legislation, including the Do Not Call FTC Registry in the United States. About 53 million households have registered—2,300 per minute in the first week alone.

Consumers also face numerous proposals to restrict unsolicited commercial e-mail, which now comprises 30 to 40 percent of a typical inbox. However, these “solutions” seem rather crude because they shut down those channels completely, making an irritation into an illegality, and also choke off communication channels use by good marketers.

Despite what you read, most marketers are responsible and don’t spam their customers or prospects. They strive to improve the relevance, timing, and frequency of messages across all channels. While the most exciting developments are in personalized TV ads, it’s still “push marketing.”

### Engaging the Consumer

In 1981, futurist Faith Popcorn highlighted a trend called “cocooning” which she later publicized in her books. She described cocooning in a recent interview with mochasofa.com: “The most interesting thing that has happened in the cocooning trend is that the home has become an armoured cocoon, so you see alarm systems, and gated communities, and people really hiding at home. The other thing is that they don’t even

want to work outside the home, so a lot of them are working at home, especially women.”

So why not apply this trend to the world of advertising? Why not let consumers use technology to build cocoons around themselves, letting in only those ads that are relevant to them, and screening out the junk?

How might this work? Perhaps once a week, or once a month, you would turn on the TV or PC and update your personal or household cocoon. This might involve simple yes/no answers to questions like:

- Are you in the market for a new car or truck?
- Planning any vacation trips?
- Interested in hearing about upcoming special events in your community?
- Need any medical advice?
- How about weekend getaways?

Your answers would create a “permeable cocoon” that describes your interests and the kinds of advertising you value. Periodically, you could update your cocoon. For example, the day after you buy a new car you are probably no longer in the car market.

### What Would Your Cocoon Look Like?

I tried this idea out on a few seat companions on my recent flights. I asked them: If you could see only three or four ads per TV show, which ones would you value?

Rick, a high-tech product manager, would like:

1. Lower-cost, better performing financial suggestions for his retirement portfolio,
2. A lower-maintenance, longer-lasting gas BBQ, and
3. A better broadband bundle.

Lisa, a legal assistant, thought she’d like to see:

1. Special weekend getaway deals to places like Whistler,
2. Promos for TV shows on Tuesday and Thursday nights—her “free” nights, and
3. Latest updates on skin care, low cholesterol, and vitamins.

My own answers would include:

1. Any information about new Jimmy Buffett CDs or concerts in my area,
2. Details on trips to Chile or South Africa,
3. Local real estate ads—time to buy instead of rent, and
4. Information about specials on refrigerators or mattresses—time to replace both.

See COCOONING on Page 14

## Remembering Arnold's Mandate

Commentary by George Passantino



As the post-inauguration battleground grows fierce, it's worth remembering that Governor Schwarzenegger received a surprisingly strong mandate in November. When California's legislators refuse to cooperate, Schwarzenegger will find support at the source of that mandate—the public.

As Matt Fong, California's former elected state treasurer and current member of the Schwarzenegger transition team recently wrote in a Los Angeles *Daily News* opinion piece, "The recall isn't a circus. It is part of a pattern—taxpayers are demanding transparency and accountability from corporate America and their government." Now California is waiting to see how this call for accountability and transparency will manifest itself in the new Schwarzenegger administration and his efforts to "give California back its future."

Chief among the challenges the new executive will face is a current-year budget that is hemorrhaging red ink (See "Arnold Targets the Budget Crisis," page 5). Former State Controller Kathleen Connell referred to the recently passed budget as a "Band-Aid on a broken leg." Others have roundly criticized the legislature and Governor Davis for willingly putting off the difficult decisions year after year—behavior that has only made the current crisis worse. When all is said and done, Schwarzenegger may face a current year deficit as high as \$20 billion, along with a projected \$8 billion shortfall in next year's budget.

Recall opponents warned that a new governor could be elected with as little as 15 percent of the vote, yet Schwarzenegger received nearly 49 percent of the vote in the crowded race and beat his closest pursuer by roughly 17 percent. Based on the latest figures from the California Secretary of State, it appears that more voters have cast their ballots for Schwarzenegger than to retain Governor Davis (approximately 4.20 million vs. 4.00 million). Also, Schwarzenegger received more votes than Governor Davis did in the 2002 general election (3.53 million)—something astonishing since turnout is typically lower for special elections.

Voters galvanized around fiscal concerns and gave the governor-elect a more straightforward show of support than many expected. But what about California's political class? How will it react?

Two days after the historic election, I participated in a panel discussion comprised of a politically diverse group of highly



respected government officials, legal experts and academics to discuss the challenges the new administration will confront. With both Republicans and Democrats in the room, I anticipated a vocal joust over the propriety of the election and what it really meant. Only the joust never materialized.

Instead, there seemed a general consensus that Schwarzenegger had a clear mandate to fundamentally reform the way government operates. There was also a shared view that Schwarzenegger's rapport with the public is something that he can and will use if the legislature resists his reform agenda.

Even panelist Scott Rafferty, a vocal opponent of the recall and a lead attorney in lawsuits against the election, expressed his desire that this historic opportunity be seized upon to consolidate state departments, restructure duplicate government programs, and reduce the number of state personnel. This is a shocking departure from the divisiveness of the recall and the sense that it would carry on beyond October 7th.

California indeed faces monumental challenges. But if anything can offer hope in the wake of the election, it is this apparent shift in public attitudes as well as an emerging sense that Schwarzenegger is well-positioned to leverage these forces to create a new political will among lawmakers.

Even in times of political turbulence, both Schwarzenegger and the legislature remain mindful of the governor's strong public support—and this may be the force that finally reforms California's lingering problems.

*George Passantino is Reason's director of government affairs.* ■



## Unions Vs. Volunteers

Commentary by Lisa Snell



Like other area schools, district employee layoffs left the campus of Marvin Elementary overgrown. So parents whose children attend the San Diego school recently volunteered to pull weeds and remove trash from the grounds. Public schools often urge parents to get involved with their children's education, but sadly such acts of voluntarism can violate union labor laws.

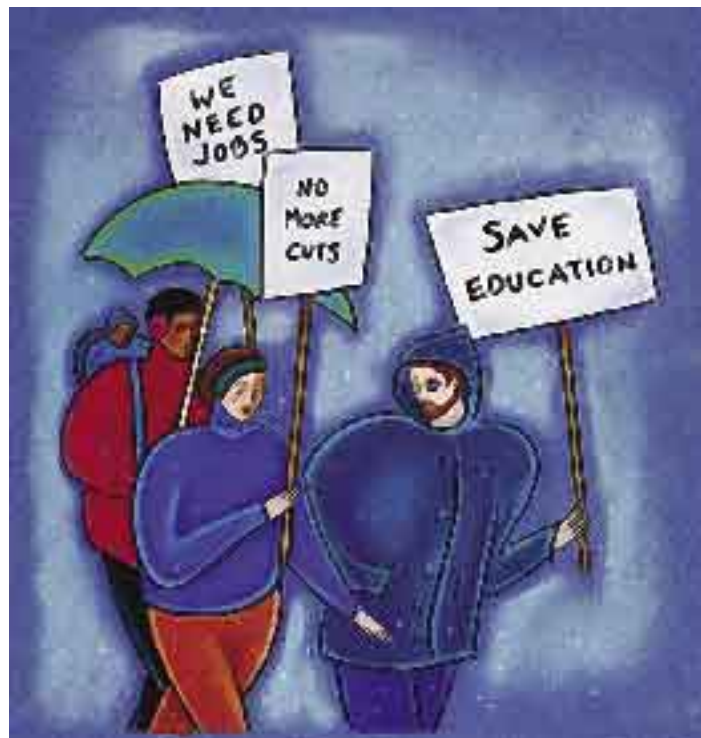
The union that represents landscapers cried foul saying that schools are prohibited from giving district work to anyone but employees. The district even circulated a memo telling administrators what to do in the event this "problem" of volunteers arose. Now the principal of one school says it was wrong to ask for volunteers.

Marvin Elementary Principal E. Jay Derwae is one of the few sticking up for the volunteers. "Our nondistrict school foundation decided it wanted to spruce up the school because of budget cuts and because the weeds were five feet tall," he said. "The union told us we were to cease and desist. But I'm not going to tell my parents and neighbors who live in houses with impeccable yards they can't clean up the school."

San Diego is not the only school district to claim that volunteers violated union rules. Perhaps the most notorious example occurred last year, when two Brooklyn school janitors demanded to be paid time-and-a-half (\$37 dollars an hour) for two weekends that community members worked on school landscaping as a memorial in honor of a second-grade boy who had recently died. Never mind that the janitors did not even participate in the work—the grieving community members violated their labor contract.

Using union reasoning, any job done by a school volunteer is a job that could be completed by hiring another school employee. In effect, the very spirit of volunteerism violates union rules. But volunteers serve a critical school function, allowing parents and the community to be engaged in their schools while allowing principals and school superintendents to focus resources into the classroom. Perhaps a better question would be: should school districts be forced to pay union employees for work that volunteers would be willing to complete for free?

Ironically, the San Diego school district's layoffs may be partially blamed on a new union-supported anti-privatization law that took effect January 1, 2003. The law effectively prevented school districts from outsourcing any classified jobs to



private companies during the recent budget crunch. The law says that districts must prove cost-savings from outsourcing while requiring that contractors' wages not undercut school district pay rates or lay off any district personnel. Outsourcing would have given district administrators more flexible cost-cutting choices—instead, they simply eliminated classified jobs. In fact, some districts across California that might have considered outsourcing tasks like bus service or school landscaping have simply discontinued the services. Fortunately, Governor Schwarzenegger has made repealing the anti-privatization law a top priority for his administration.

California has other volunteer clean-up programs that work very well. For example, Caltrans' adopt-a-highway program allows volunteers to "adopt" a stretch of highway and keep it clean. It would cost California millions more in road maintenance dollars if the public employees union prevented volunteers from tending to highway clean up.

The San Diego unions have thwarted a community effort to clean up a school, and helped ensure that education continues to have higher than necessary costs for local families.

We must decide if public education is a general purpose jobs program or if its mission is to teach kids. If we decide its mission is to teach kids, we should outsource as much as possible (e.g. food services, administration, buses and maintenance) and use the money saved to attract top-notch teachers, reduce class size and purchase better instructional materials. ■

## Canada Has a Different Take

Union pension funds often invest in privatized companies.

By Robert W. Poole, Jr.



Since 2001, three major pension funds have adopted policies that forbid investments in privatized companies. The New York City Employees' Retirement System, the Ohio Public Employees Retirement System and the Los Angeles County Employees Retirement Association will not invest in companies that compete with government employees—such as school bus companies, charter school companies, and private corrections firms. *The Wall Street Journal* recently spotlighted this previously behind-the-scenes union tactic to pressure public employee pension funds to adopt anti-privatization policies.

The WSJ article (Sept 23) chronicled recent union efforts to persuade the board of the \$145 billion California Public Employees Retirement System (CalPERS) to do likewise. In recent years unions have helped elect several anti-privatization members to the CalPERS board. The article also detailed efforts by the Service Employees International Union (SEIU) to derail the transaction in which Edison Schools is seeking to go private; the major planned buyer is a firm that manages funds of the Florida Retirement System. Other unions involved in similar efforts include the California School Employees Association and the American Federation of State, County and Municipal Employees (AFSCME).

Similar pressures exist in Canada, where privatization generally goes by the name public/private partnerships, abbreviated P3s. The Canadian Union of Public Employees has the same objective of preventing public pension fund money from being tainted by P3s. But that has not stopped several such pension funds from being active players in this growing field. The Ontario Municipal Employee Retirement System (OMERS) runs its own infrastructure investment fund called Borealis. It's an active investor in privatization, having recently bought a 34 percent stake in Strait Crossing Development, Inc., the company that owns and operates Canada's first major priva-

tized toll bridge. Borealis is also bidding on several hospital P3 projects, and is involved with a proposed private truck tollway between Windsor and Detroit. The Laborers International Union of North America's pension fund is part owner of Hamilton, Ontario's successful private airport, Tradeport International. And the public sector pension funds of British Columbia and New Brunswick are initial investors in a new infrastructure fund investing in electric and gas transmission systems.

The WSJ article pointed out that blanket policies against investing in privatization may breach pension funds' fiduciary duty to their pensioners. It quoted former Labor Department official Ian Lanoff advising that "You can't do this just because you like the idea or because the union likes the idea," or to "advanc[e] particular political or social agendas." There's a burden of proof that expanded privatization would actually have large enough consequences (e.g. layoffs leading to reduced pension fund contributions) to cause harm to the fund, he said. ■

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## OMB Details Competitive Sourcing Efforts

By Geoffrey F. Segal



The competitive sourcing pillar of the President’s Management Agenda (PMA) has come under attack during the appropriations process this fall, prompting the OMB to change its policy and eliminate the government-wide goal for competitive sourcing. While the Senate has moved slowly on appropriations, and has added fewer anti-competitive sourcing amendments, the House has added amendments that will stall, hinder or prevent agencies from undertaking competitive sourcing to nearly every house appropriations bill, most notably Interior, Agriculture, and FAA reauthorization. Essentially, the future of competitive sourcing hinges on the conference committees since the bills from the two houses will be different. The new policy will center on competition plans that agencies have customized to reflect their own mission and workforce needs and goals. The Office of Management and Budget (OMB) recently detailed federal agencies’ progress in identifying and initiating competitions.

**The future of competitive sourcing hinges on the conference committees since the bills from the two houses will be different.**

The report, “Reasoned and Responsible Public-Private Competitions,” comes as Congress continues to consider the Bush administration agenda to bring efficiency and effectiveness to the delivery of government services. The OMB report documents the number of activities that each agency can compete, as well how many jobs will likely face competition. The agencies under review had a combined workforce of 1,636,000, of which 880,600 (54 percent) were listed as



### Agencies with Lowest Total Number of Activities Available for Competition

Smithsonian	0
National Science Foundation	200
Agency for International Development	300
Environmental Protection Agency	400

### Agencies with Largest Total Number of Positions in Competition Plan

Department of Defense	67,800
USDA	5,822
Army Corps of Engineers	5,711
Department of Interior	3,041
Department of Treasury	3,029

commercial. The report identified 434,800 (49.4 percent) of the commercial positions as available for competition.

The number of planned competitions varies widely, with agencies planning to compete anywhere from zero to 36 percent of commercial jobs. The Environmental Protection Agency plans to compete roughly 36 percent (215 positions) of its commercial functions. The Department of Defense (DOD) had the largest number of commercial activities at 410,700. Of those, 270,600 are considered ready for competition and the DOD plans to subject nearly 68,000 to competition.

Although the Veterans Affairs Department has designated 190,500 positions as commercial, it identified only 7,600 as ready for competition. Of those, it will subject only 1 percent (2,500 positions) to competition. Out of 1,300 commercial activities available, the Smithsonian did not identify a single one for competition. ■

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Continued from Page 3  
States

scription is intended to head off future fiscal crises by allowing state revenues to track more closely the dynamics of our service-driven economy. Since a sales tax is essentially limited to physical goods, it is argued, it will inevitably fail to keep up with an economy increasingly composed of service industries that aren't taxed at retail. Income taxes pay no attention to whether goods or services are being sold and are thus supposed to be a more robust revenue source in the New Economy.

But seven of the 10 states that have been "forced" to raise broadly applied taxes in the last two years were already more heavily reliant on the income tax than the average state. And the only two states to have raised these taxes in both 2001 and 2002, New Jersey and North Carolina, already had the sharply progressive income tax systems that allegedly would be best. New Jersey had six rates that topped out at 6.37 percent for single taxpayers making more than \$75,000. North Carolina's top rate was even higher: 7.75 percent for those making at least \$60,000. (A 2001 tax bill added yet another rate of 8.25 percent for income above \$120,000.)

Heavy reliance on progressive income taxes is actually a recipe for more budget woes. Other things being equal, it gets states into trouble because of what might be called fiscal turbulence. Rising incomes, supercharged in the 1990s by big capital gains, push more taxpayers into higher tax brackets. This accelerates the growth of tax revenues above the rate of overall growth in incomes and the economy. Flush with cash, state lawmakers create new programs to satisfy various "unmet needs": class size reduction, infrastructure construction, health care, and the like.

Of course, what quickly goes up can quickly come down. When boom yields to bust, and especially when capital gains booms yield to stock market busts, states dependent on progressive income taxes see their projected revenues fall faster than average as households and businesses shift to lower brackets. The result is a large, unforeseen hole in the budget.

Parkinson's insight here is that it's not really projected budget deficits or the perceived need for more spending that guides fiscal decision-making. It's a breeze for politicians to justify new government expenditures, at least to themselves. What they struggle with is how to justify higher levels of taxation. They see recession-driven drops in revenue growth as prime opportunities to sell higher taxes.

2. "Work expands so as to fill the time available for its completion."

This is the most famous of Parkinson's laws. Anyone familiar with elastic deadlines can immediately grasp it.

In the state government context, the implications are subtle but critical. Most state legislatures operate under time constraints. They begin their regular sessions in January and end on a fixed date, often in March or April. But 10 states extend their regular sessions beyond four months a year, and another 10 operate without any meaningful restriction on how long they can meet in regular session. Interestingly, 13 of these 20 states are also among the 20 that have raised taxes during the last two years. Three additional states with lengthy legislative sessions—New York, Missouri, and South Carolina—may enact tax increases in 2003.

Why do legislatures that meet longer tend to end up with larger fiscal problems and a greater recourse to hiking taxes? Because the Parkinsonian "work" lawmakers do to fill the time allotted to them consists to a large extent of sitting in committee meetings at which a parade of government managers, state employees, and special interest lobbyists make the case for how much their pet program is "needed" and would be "sliced to the bone" unless the state raises taxes. Other "work" involves dreaming up new programs or pork barrel projects to attract media attention.

Furthermore, the longer a politician is parked in this big-government echo chamber, the more he or she forgets any previous convictions about limited government or the need for frugality. Average taxpayers, after all, don't spend much time lobbying and cajoling politicians in the often distant state capital. Studies from the Competitive Enterprise Institute, the National Taxpayers Union, and my own organization, the John Locke Foundation, have confirmed a version of this effect for long-serving members of Congress and state legislatures. The more years a politician spends in office, the more he or she votes for bigger government. It's no great stretch to expect a similar effect based on how much time state legislatures spend in session each year.

3. "The matters most debated in a deliberative body tend to be the minor ones where everybody understands the issues."

Whenever you hear state lawmakers waxing eloquently about how they are "cutting spending to the bone" by shuttering state aquariums, turning down the thermostat in state buildings, or sending state employees to fewer out-of-town conferences, you can see one of Parkinson's lesser-known laws in force. It is easy for politicians, the news media, and the general public to sink their teeth into these sorts of savings. You can gain a lot of rhetorical mileage out of anecdotes that involve relatively small

amounts of money and evoke emotional reactions.

Still, bureaucrats misusing state vehicles to visit girlfriends and construction offices peddling contracts to pay off political contributors aren't the cause of growing governments and rising taxes. The real causes of burgeoning state governments are large, sprawling, lobby-infused programs, such as Medicaid and public universities, that too few lawmakers fully comprehend or are willing to take on.

Medicaid, the joint state/federal health care program for the disabled and the poor, is eating up an ever-increasing share of state general fund money. Expenditures grew by an average of 12.5 percent in 2002 alone, representing tens of billions of dollars in new spending. (Washington is paying 57 percent, while the states pick up 43 percent.) There is no shortage of sound explanations for why Medicaid is such a mess. Basically free to its beneficiaries, the program offers more benefits than the average private health plan does and thus encourages wasteful consumption of care. And as both Congress and the states expanded eligibility and the benefits package of Medicaid in the 1980s and 1990s, it became increasingly attractive for low-income persons, sometimes far above the federal poverty line, to adjust their finances (or at least what they reported their finances to be), drop their private coverage, and sign up for free health care.

And we shouldn't assume lawmakers have a deep knowledge of the program and its wacky finances in the first place. "The information deficit is huge," says Michael Greve, a scholar at the American Enterprise Institute. "Medicaid is intentionally and deliberately complicated. And when something goes wrong, [lawmakers] don't have anyone local to yell at. State officials point to D.C. and say, 'They did it.'"

Research by Greve and his colleagues shows clearly that recent Medicaid growth doesn't reflect the "we couldn't help it" line peddled by politicians and their handlers. States such as Florida and Arizona that attract high proportions of retirees "should be a basket case" when it comes to Medicaid inflation, Greve says, but the reality is that they have controlled costs better than most. Moreover, Medicaid spending has grown rapidly during boom years, not simply during recessions, when people lose their jobs and work-based health insurance.

### Why the Laws Are Bronze

The performance of both governors and legislatures in some states is proof that Parkinson's laws aren't forged in cast iron. They're made of wrought iron, or perhaps even bronze, and thus do have some room to give.

One fiscal strategy that sounds like a gimmick—pushing candidates to take a no-new-tax pledge, a core mission of the group Americans for Tax Reform—has turned out to be surprisingly useful. Lingering pressure from their campaign stances has encouraged not only Illinois's Blagojevich but also new Democratic governors in Michigan, Oklahoma, Kansas, Virginia, and Arizona to resist hikes in broad-based taxes.

On an institutional level, tax or expenditure limitations (TEs) have been valuable tools in the fiscal restraint arsenal. But not all TEs are created equal. A 2001 Cato Institute study found that measures placed into state constitutions or law by citizen referendum and requirements that taxes and spending rise no faster than inflation plus population growth have had large and beneficial effects on state budgets. But when legislatures pass mild revenue or expenditure caps, easy to evade and largely unenforceable in the breach, the result can be more spending from lawmakers who think they're behind political cover.

Setting up political or institutional counterweights to the public choice dynamics that drive government growth in state capitals can yield some fascinating and hopeful outcomes. For the first time in decades, for example, governors and legislators under fiscal pressure are rethinking their slavish devotion to pouring massive funds into state university systems. Colorado, with both a political tailwind and a strong TE, is considering a voucher system for higher education to replace its current set of institutions and subsidies. College administrators themselves are proposing more privatization measures for state systems in Massachusetts, South Carolina, and Wisconsin. On the Medicaid front, Florida and a handful of other states are experimenting with a defined-contribution approach that gives patients more financial incentives to shop wisely and more choices about where and what to buy. The early results look encouraging.

No reforms or political victories, however promising, can repeal the basic laws of government finance. Politicians will continue to tax. They will continue to spend. And they will continue to spin, holding endless conferences and issuing countless reports to justify their actions. Parkinson got that one exactly right when he reportedly told a lecture audience: "Government's handling of a difficult matter by appointing a commission...is just like a person going to the toilet. There is a sitting, a report, and then the matter is dropped."

*John Hood is president of the John Locke Foundation, a state policy think tank in North Carolina. A longer version of this article appeared in Reason magazine and is available online: [reason.com/0310/fe.jh.why.shtml](http://reason.com/0310/fe.jh.why.shtml). ■*

## In-house Bids Win Competitions

By Geoffrey F. Segal



Several recent competitions yielded results bound to please taxpayers as well as federal employees. From Agriculture to Interior, competitions have cut costs and stayed in-house.

The Forest Service, which is part of the Department of the Interior, has used competitive sourcing extensively—competing over 2,600 positions or 10 percent of the agency (DOI competitions not including Forest Service or other related agencies). With not a single involuntary reduction, DOI employees have fared very well with competitions. Moreover, DOI has already realized over \$2.4 million in annual savings.

Based on a first round of competitive sourcing studies, the Forest Service determined that several types of maintenance jobs should continue to be done by federal employees. The agency studied whether private contractors could provide better services for fleet, roads, building and grounds maintenance, as well as trails maintenance work. Of the 969 positions that were studied, all but 47 will remain in-house. Even though much of the work will remain in-house, agency officials have stated that the process has helped the agency identify areas where it could save money—an often-touted benefit of competition.

### The process has helped the agency identify areas where it could save money.

Federal employees have also won several other small competitions:

- The National Institutes of Health won its first large competition for administrative and secretarial support for its \$18 billion grants program. The restructuring plan submitted by employees will produce annual savings of \$15 million and 58 vacant positions will be eliminated.
- The Park Service reorganized 45 archeologists, eliminated 17 positions and trimmed \$850,000 in annual personnel costs to retain the work. The competition will save \$4.2 million over the next five years.
- The Agriculture Department's Natural Resource Conservation Service employees won three competitions involving mail, clerical and soil-mapping work.
- The Centers for Medicare and Medicaid Services employees won all 17 competitions involving 309 accountants, IT specialists and project managers. ■

Continued from Page 7

## Cocooning

### Why Cocooning Pays Off

What was interesting about this survey was the breadth of what people want, and the degree of detail. By putting consumers in control of their own cocoons, a wealth of information about their desires could flow back to the distributors (in the case of the Web, an ISP). They can then “market” those customers much more effectively to vendors with products and services that these people actually want to hear about.

### This ability to “let in” certain kinds of marketing messages should benefit consumers and marketers alike.

This ability to “let in” certain kinds of marketing messages should benefit consumers and marketers alike. For consumers, it's telling marketers what kinds of messages they want to receive, and for marketers, using database technology to generate and deliver cost-effective campaigns can result in higher profits through better customer service.

Who says the business model for TV or Web advertising can't be broken? For TV, we have an old system invented around 1948, based on interruptive advertising to pay for the content. George McDonald of Zenith detested that model, and invented the remote control to “wreck it”. But what if we allow for more flexibility? On Tuesday, when you want to watch “your shows” without any commercials, you would pay a small fee, but on Wednesday, let the advertising roll.

This approach would give you the ability to time-shift the programming content (via the VCR as well as TiVo), and control the amount of advertising. Varying advertising business models would certainly break open new, more consumer-friendly approaches. Some consumers might be willing to watch more ads, and provide instant feedback—think online focus groups—in exchange for some payment defrayments on their next cable bill.

Consumers demand change and soon cocooning innovations will be technologically feasible. Marketers of all stripes will have more successful campaigns if they allow consumers to take control of the media messages that make their way through their “cocoons.” Who knows, if this works, in the future people might find advertising so good, so relevant, so timely—that they go the washroom during the show, not the commercials.

*Dr. Dave Schrader is director of strategy and marketing at Teradata Applications Solutions, a division of NCR Corporation. ■*

## Privatization Briefs

### Military Base Privatizes Water

In one of the latest contracts under a Defense Department initiative to privatize utilities at military bases, Ft. Sill Oklahoma signed a 50-year, \$179 million contract with American Water Services to operate and maintain the base's water and wastewater treatment and distribution facilities. American Water will be responsible for system capital investment, regulatory and environmental compliance, planning, asset recapitalization and long-term operations and maintenance.

Ft. Sill's utilities serve a total population of about 51,500 personnel and the system includes 550,000 linear feet of pipe, four pump stations, six storage towers, a booster pumping station and numerous fire hydrants. The wastewater utility includes a tertiary treatment facility that processes 4.3 million gallons of water a day.

### Careful What You Wish for

No one has fought harder to resist air traffic control outsourcing than the National Air Traffic Controllers Association. Earlier this year NATCA's president asked the Department of Transportation's Inspector General to review cost and safety issues associated with the Contract Tower Program. The report was released in September, and it found that contract towers had significantly lower error rates than similar union-staffed FAA towers (0.49 errors per million operations versus 2.03). The contract towers also cost one-third as much to operate as comparable FAA-run towers, saving taxpayers \$917,000 per tower.

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Contract towers had significantly lower error rates.

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### County Renews and Expands Private Prison Contract

In Pennsylvania, the Delaware County Board of Prison Inspectors confirmed the success of the local privatized prison by deciding in October to sign a new contract with Wackenhut Corrections to continue to operate the prison for another three years, and to expand the partnership with a new 206-bed general population unit and a 46-bed expansion to the special care medical unit to be added over the next year by Wackenhut. After the expansions the contract will run about \$32 million per year.

Delaware County was the first Pennsylvania County to

privatize prison management. The partnership included private construction of the new prison, which saved \$37 million in construction costs, and has saved the county over \$10 million per year in operating costs. Under public management 12 percent of the prison budget was absorbed by overtime costs, but Wackenhut cut that figure to below 1 percent. Labor costs can often comprise up to two-thirds of a prison's operating costs.

Quality also improved. Reduced prisoner assaults and new prisoner education programs helped the facility earn "excellent" ratings from the Pennsylvania Department of Corrections. Of the 250 former public employees, all but two were offered jobs, and all employees received a 3 to 5 percent salary increase. ■

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### Continued from Page 2 Toll Projects

administration this year got several bills through the legislature to make it easier to use tolls and public-private partnerships to meet highway needs. HB 3588 provides the framework for the governor's ambitious Trans-Texas Corridor program, whose aim is to add several thousand miles of new toll road and rail corridors across the state, bypassing congested urban areas. The first such project is already under way, thanks to the submission of an unsolicited proposal by Fluor Corporation last winter. Under the state's public-private partnership rules, competing proposals are now being solicited. HB 3588 also delegates to regional mobility authorities (RMAs) the power to carry out privatized tollway projects, enabling them to become "localized DOTs." Another provision would ease the way for right-of-way acquisition, by allowing landowners to receive a portion of the revenue generated by tollway projects.

Finally, Uncle Sam may make it easier for states to launch such projects on existing Interstate highways (where tolling has long been prohibited by federal law). Under the FAST Act, cosponsored by Reps. Mark Kennedy (R, MN) and Adam Smith (D, WA) and Sen. Wayne Allard (R, CO), new electronically tolled lanes could be added to any and all congested Interstates. This would permit tolled express lanes for commuters, HOT lanes, or toll truckways. In early September, Rep. Kennedy unveiled an analysis I did for the Fluor Corporation. It estimated that some \$50 billion in new investment might be generated by such a measure, if every state with severely congested Interstates took advantage of its provisions (see [www.fluor.com/fastlanes](http://www.fluor.com/fastlanes)). ■



## Who, What, Where

### Reason Studies

**Roadmap to Reform: A Commission and Seven Principles for Fundamentally Reforming California State Government**, Project Directors: Carl DeMaio and George Passantino Reason Public Policy Institute and The Performance Institute: [rppi.org/roadmap.pdf](http://rppi.org/roadmap.pdf)

**Citizens' Budget 2003-2005: A 10-Point Plan to Balance the California Budget and Protect Quality-of-Life Priorities**, Carl DeMaio, Adrian Moore, Adam Summers, Geoffrey Segal, Lisa Snell, Vincent Badolato, and George Passantino: [rppi.org/calstatebudgetproposal.pdf](http://rppi.org/calstatebudgetproposal.pdf)

**Privatization Opportunities for States**, William D. Eggers. Policy Study No. 154: [rppi.org/ps154.html](http://rppi.org/ps154.html)

**Mining the Government Balance Sheet: What Cities and States Have to Sell**, Robert W. Poole, Jr., Ed. Policy Study No. 139: [rppi.org/ps139.html](http://rppi.org/ps139.html)

**Frequently Asked Questions About Water/Wastewater Privatization**, Geoffrey F. Segal and Adrian T. Moore. Policy Brief No. 26: [rppi.org/pb26.pdf](http://rppi.org/pb26.pdf)

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**Privatization Watch Back Issues** available at [rppi.org/privwatch.html](http://rppi.org/privwatch.html)

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**State Business Tax Climate Index**, Scott A. Hodge, J. Scott Moody and Wendy P. Warcholik. The Tax Foundation: [taxfoundation.org](http://taxfoundation.org)

**Federal Taxing and Spending Benefit Some States, Leave Others Footing the Bill**, Scott Moody. The Tax Foundation: [taxfoundation.org](http://taxfoundation.org)

**The Case for a Tax and Expenditure Limitation**, Grant Gulibon and Thomas Armstrong. The Commonwealth Foundation for Public Policy Alternatives: [commonwealthfoundation.org](http://commonwealthfoundation.org)

**Health Insurance Spending Growth: How Does Medicare Compare?** Joint Economic Committee, United States Congress: [jec.senate.gov](http://jec.senate.gov)

**Facilitating Privatization: Virginia's Commonwealth Competition Council**, Phil K. Bomerheim. Pioneer Institute: [pioneerinstitute.org](http://pioneerinstitute.org)

**Why Wisconsin Has High Taxes**, Dale Knapp and Todd Berry. The Wisconsin Policy Research Institute: [wpri.org](http://wpri.org)

**Mandate for Leadership: A Public Policy Agenda for South Carolina**, Daniel Varat. The South Carolina Policy Council: [scpolycouncil.com](http://scpolycouncil.com)

**railway.com**, Robert C.B. Miller. The Institute for Economic Affairs: [iea.org.uk](http://iea.org.uk)

**When Schools Compete: The Effects of Vouchers on Florida Public School Achievement**, Jay Greene and Marcus Winters. The Manhattan Institute: [manhattan-institute.org](http://manhattan-institute.org)

### Conferences

**Transportation Finance Summit**, March 3-4, 2004, Washington D.C. The International Bridge, Tunnel & Turnpike Association. Contact Neil Gray at [neil.gray@ibtta.org](mailto:neil.gray@ibtta.org)

**The 2004 Preserving the American Dream Conference**, April 16-18. Portland, OR. The Thoreau Institute: [ti.org](http://ti.org)

**4th Annual Liberty Forum**, April 28. Chicago, IL. Atlas Economic Research Foundation: [atlasusa.org](http://atlasusa.org)

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