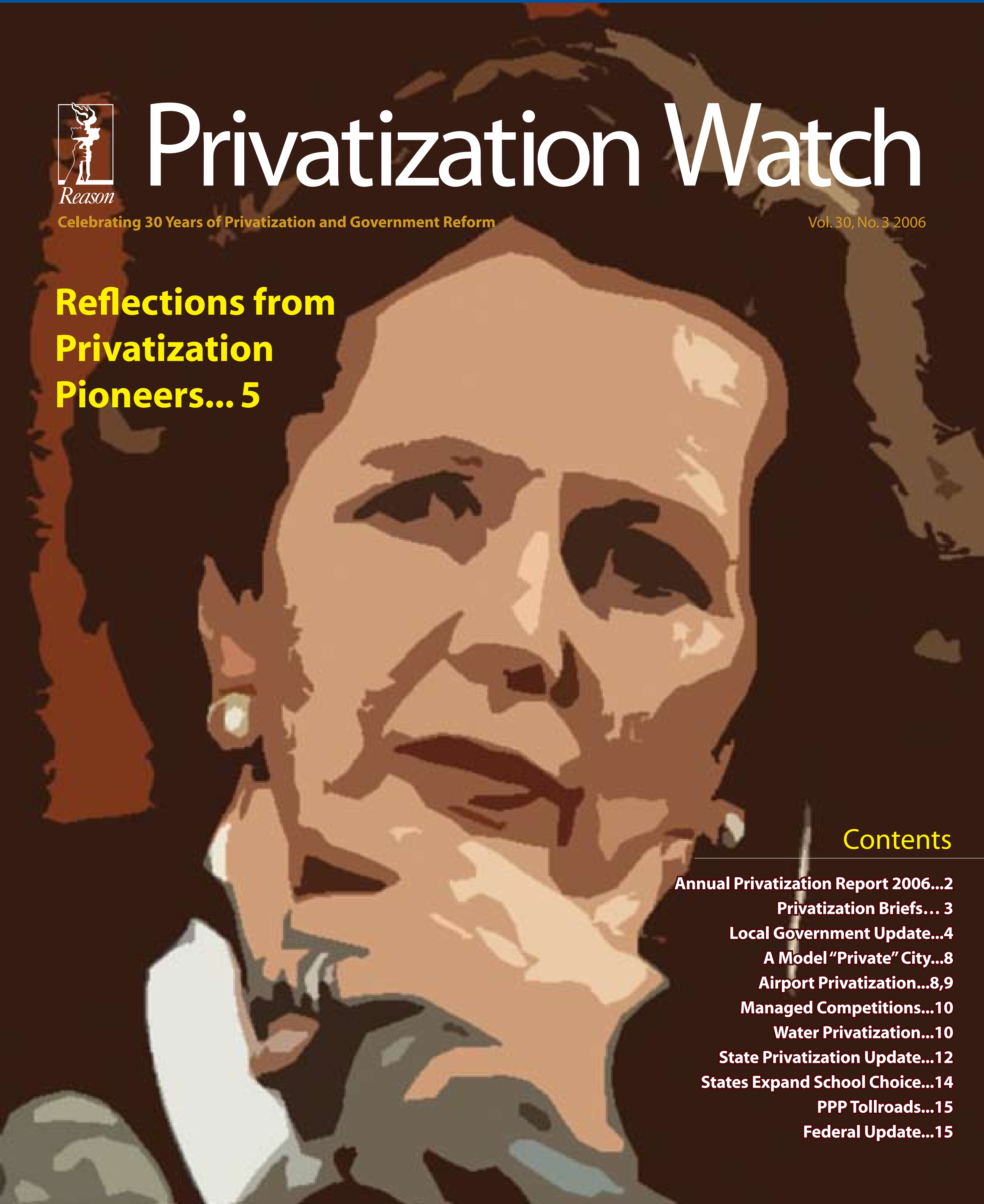

Reason

Privatization Watch

Celebrating 30 Years of Privatization and Government Reform

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Privatization Watch

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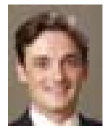
Annual Privatization Report 2006

By Leonard Gilroy



Reason's privatization efforts have reached two significant milestones. This year *Privatization Watch* turns 30 and *Annual Privatization Report* (*APR*) turns 20. This issue of *PW* highlights this year's 20th anniversary edition of *APR*.

Like all issues of *APR*, this year's focuses on trends in privatization and government reform. But this time around, *APR* also reflects on how privatization has developed in recent decades. In recent decades, governments of all political complexions have increasingly embraced privatization as a strategy to lower the costs of service delivery and achieve higher performance and better results. Once considered a radical concept, privatization has largely shifted from an ideological concept to a well-established, proven policy management tool.

Virtually every government service—from local services like road maintenance, public safety, and water to national services like passenger rail, energy production, and social security systems—has been successfully privatized somewhere in the world. Decades of successful privatization policies have proven that private sector innovation and initiative can do certain things better than the public sector.

This year's 20th anniversary edition of *APR* recognizes the tremendous advances in government reform over the last two decades and features special contributions by several pioneering policymakers and researchers at the forefront of privatization and government reform, including Margaret Thatcher, Indiana Governor Mitch Daniels, South Carolina Governor Mark Sanford, former Indianapolis Mayor Stephen Goldsmith, E.S. Savas, and Reason founder and transportation director Robert Poole, Jr. This issue of *PW* includes summaries of their reflections on privatization.

This year's report also addresses issues ranging from federal program performance, state and local policy innovations, and surface and air transportation, to telecommunications, property rights, school choice, and much more.

This issue of *Privatization Watch* is meant to give our readers a sample of what's available inside *Annual Privatization Report 2006*. If you like what you see here and want more, you can access the entire report online: reason.org/apr2006/

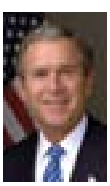
Leonard Gilroy, Editor, *Annual Privatization Report*, Managing Editor, *Privatization Watch*. ■

Privatization Briefs

Presidents Who Privatize

Republican and Democratic administrations alike have taken the idea of privatization seriously. During his term, Ronald Reagan changed the nature of the debate over the size and scope of the federal government, leading to the establishment of President's Commission on Privatization, the privatization of Conrail, and the divestiture of the two Washington, DC airports to a new local airport authority. Upon Reagan's departure from office, privatization was a low priority in George H.W. Bush's administration, but was subsequently embraced by the Clinton administration.

In fact, the Clinton administration's privatization successes exceeded those of Reagan. Under Clinton, the federal government sold the Elk Hills Naval Petroleum Reserves ($3.6 billion), the U.S. Enrichment Corporation ($3.1 billion), and many billions of dollars worth of electromagnetic spectrum, as well as the competitive contracting of more than 100 airport control towers and numerous military base functions. Further, a 1994 plan by Vice President Al Gore called for air traffic to be converted into a self-supporting government corporation, though the administration's 1995 proposal to create the U.S. Air Traffic Services Corp. failed to get congressional support.



In 2001, the Bush administration adopted the President's Management Agenda, and one of its elements—competitive sourcing—has had a significant impact. Since 2003, agencies have conducted almost 1,100 public-private competitions for about 41,000 federal positions, generating $5.6 billion in cost savings over the next few years. Fixed costs and expenses to provide central direction and oversight between 2003 and 2005 totaled $211 million—better than a 27 to 1 return on investment; i.e., for every dollar spent on competitive sourcing, 27 were saved.

The Thatcher Revolution

When Margaret Thatcher was first elected prime minister in 1979, the British government still owned the coal, steel, oil, and electricity industries, several auto companies, the telephone system, and a major airline, among other holdings. By the time of her resignation in 1990, all had been privatized by Thatcher. Under her leadership, the United Kingdom rose from 19th to second in the OECD rankings. Further, between 1979 and 1997, stock ownership among the British population had increased from 7 to 23 percent, the middle class increased from 33 to 50 percent of the population, and the homeownership rate increased from 53 to 71 percent.

Privatization Cities

When it was incorporated in 1954 Lakewood, California resolved to contract out for major municipal services. Since then, dozens of other contract cities have emerged, including Sandy Springs, Georgia, which incorporated just last year. The city has contracted out nearly all government services and other nearby communities are following its lead. According to the National Council for Public-Private Partnerships, the average American city contracts out 23 of its 65 basic municipal services—such as road maintenance, solid waste collection, and water/wastewater—to the private sector, and states contract out approximately 14 percent of their activities. Further, a 1997 survey of 1,400 cities and counties by the International City/County Management Association found that more than 90 percent were contracting out services that had been done in-house just five years earlier. ■

THE ROAD MORE TRAVELED

The Road More Traveled provides a thoughtful analysis on the causes of congestion and offers detailed suggestions for relieving it in America's cities. Balaker and Staley clearly debunk the myth that there is nothing we can do about congestion."

—Mary E. Peters, Secretary of U.S. Department of Transportation

bright and readable

"*The Road More Traveled* should be required reading not only for planners and their students, but for anyone who loves cities and wants them to thrive as real places, not merely as museums, in the 21st century."

—Joel Kotkin, Irvine Senior Fellow, New America Foundation, and author of *The City: A Global History*

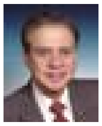
"Buy their book, read it, and then send it on to your favorite political representative."

—Peter Gordon, School of Policy, Planning and Development, University of Southern California ■

persuasive

Local Government Update

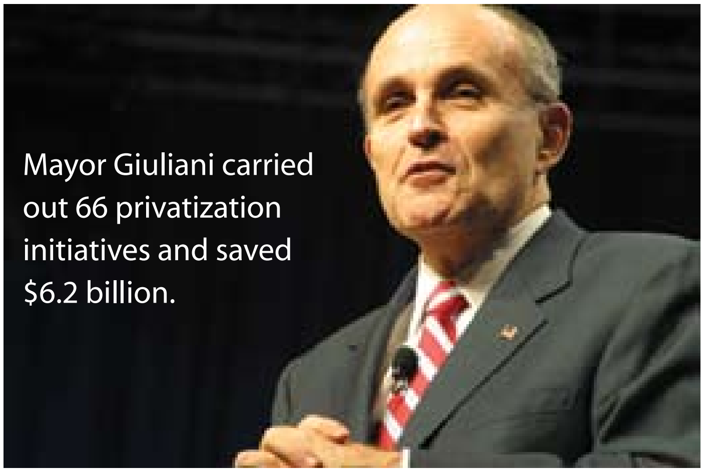
By E.S. Savas



Local government privatization seems to be reaching a plateau in terms of outsourcing. The average city contracts out about a third of the 70 common city services and growth is tapering off. In many cases the engineering services like public works have already been extensively outsourced; those are services for which it is easy to write good contract specifications and to monitor and measure contractor performance. But other services are also outsourced, such as emergency ambulances and social services. The latter are often contracted to nonprofit agencies although these services pose more difficult problems of assuring competition, specifying desired outcomes, and monitoring performance.

Municipal services are frequently dominated by strong public-employee unions; therefore stronger political will—so often in scarce supply—is needed if further progress is to be made. Those unions are getting very sophisticated in their opposition, for example, pressuring public-employee retirement systems to disinvest in firms that provide privatized services.

There is still ample opportunity in city, county, and state governments, however, to divest government-owned buildings and land and to form public-private partnerships to finance, design, build, operate, and maintain needed infrastructure such as high-occupancy toll lanes, roads, bridges, tunnels, airports, water systems, and government buildings.

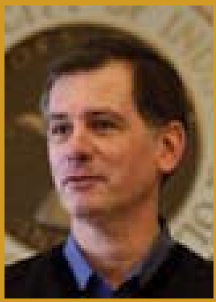


Mayor Giuliani carried out 66 privatization initiatives and saved $6.2 billion.

Mayor Rudolph W. Giuliani demonstrated that there are many other ways to introduce privatization even in a liberal bastion like New York. An examination of his accomplishments shows, besides outsourcing and divestments, numerous small privatizations carried out by a combination of methods including municipal withdrawal or default and voluntary organizations stepping in to take over and provide, in whole or in part, city services the groups found wanting. For example, what is perhaps the world's most famous urban park, Central Park, was judged by nearby (wealthy) residents to be poorly maintained and managed, an example of municipal default. They formed the Central Park Conservancy, raised funds for the Park, and soon entered into a contract with the City to manage the Park; the City pays the contractor, but the latter raises four times that amount of private money and maintains a much higher standard than the City ever achieved. In effect, the City outsources to a philanthropic organization.

E.S. (Steve) Savas is a professor of public affairs at Baruch College in the City University of New York and author of Privatization in the City *(CQ Press).* ■

Not Just Rudy:
Big City Mayors from Both Parties Embrace Privatization



- During his term as mayor of Indianapolis, Stephen Goldsmith, a Republican, identified $400 million in savings and opened up over 80 city services—including trash collection, pothole repair, and sewer services—to competitive bidding. As a result of Goldsmith's leadership, Indianapolis is considered the municipal leader in competition and privatization.
- Chicago's Democratic Mayor Richard Daley has privatized more than 40 services. In fact, he was so satisfied with the $1.8 billion privatization of the Chicago Skyway—one of Chicago's major highways—that he is lobbying for similar deals for city-owned parking lots and the Midway airport.
- When Democrat Ed Rendell, governor of Pennsylvania, was mayor of Philadelphia, he privatized 49 city services, saving $275 million.

Reflections from Privatization Pioneers

MARGARET THATCHER

All too often the state is tempted into activities to which it is either ill-suited or which are beyond its capabilities. Perhaps the greatest of these temptations is government's desire to concentrate economic power in its own hands. It begins to believe that it knows how to manage business. But let me tell you, it doesn't—as we discovered in Britain in the 1970s when nationalisation and prices and incomes policy together deprived management of the ability to manage. And when we came to privatise and deregulate in the 1980s it took some time before these skills returned.

A system of state control can't be made good merely because it is run by "clever" people who make the arrogant assertion that they "know best" and that they are serving the "public interest"—an interest which of course is determined by them. State control is fundamentally bad because it denies people the power to choose and the opportunity to bear responsibility for their own actions. Conversely, privatisation shrinks the power of the state and free enterprise enlarges the power of the people.

To create a genuine market in a state you have to take the state out of the market.

The policies we introduced in the 1980s were fiercely opposed. Too many people and industries preferred to rely on easy subsidies rather than apply the financial discipline necessary to cut their costs and become competitive. Others preferred the captive customers that a monopoly can command or the secure job in an overmanned industry, rather than the strenuous life of liberty and enterprise. But we understood that a system of free enterprise has a universal truth at its heart: to create a genuine market in a state you have to take the state out of the market.

Altogether, through our programme, we demonstrated that we could rebuild an enterprise society and we showed that privatisation worked. It was better for the consumer, better for the taxpayer and better for the health of an industrial and commercial country. Many others followed our example.

Baroness Margaret Thatcher was Prime Minister of Great Britain and the United Kingdom from 1979-1990.

"We demonstrated that privatisation worked. It was better for the consumer, better for the taxpayer and better for the health of an industrial and commercial country."

Reason Founder Robert W. Poole, Jr. with Margaret Thatcher

GOV. MITCH DANIELS

In a moment of apparent epiphany, Mario Cuomo is recorded as having said "It is not government's obligation to provide services, but to see they're provided." However sensible and straightforward this notion seems, it remains heresy in much of American public administration. The Indiana state government our crew inherited a year ago was still doggedly cooking its own food, cleaning its own buildings, and running its own power plants. Six departmental print shops sat side by side a few blocks from the nearest Kinko's; the state owned one motor vehicle for every three employees. Predictably, dysfunction and inefficiency were rampant.

The orthodoxy of Big Government was so rigid that it produced some true absurdities. Having built a $135 million prison, our bankrupt state government found it could not afford to open the facility at the state's cost of nearly $60/inmate/day. Rather than accept private service provision within our state, Indiana left its white elephant vacant and shipped hundreds of prisoners to a private prison in Kentucky. When our administration took the obvious step of inviting private management to run our paid-for prison, our state reaped multiple pluses: we "brought our boys home" and began using the empty facility; 300 Hoosiers were hired to replace the Kentuckians guarding our offenders; and the taxpayers saved $2 million per year.

I often advocate policies of competitive sourcing as "antitrust for government," appealing to Americans' natural suspicion of bigness, whether in business, labor, or government. But the very best arguments are usually pragmatic: which approach will get the food cooked, the offices cleaned, or the roads built in the most effective way, at the least cost to taxpayers?

The Honorable Mitchell E. Daniels is the governor of Indiana.

GOV. MARK SANFORD

In attempting to advance limited government, personal freedom and free markets over government fiat, here are a few things we have found in South Carolina:

Friedman, not freedom, sells: So much of why we should limit government is tied to freedom, but sadly we have found greater leverage in talking about how Thomas Friedman's new-found and so-called Flat World necessitates limits to government. The point we have made continually over the past three-plus years is that for our state to survive and thrive in this new competition of 6.5 billion people across planet earth, we must make changes to our government cost structure.

Business principles trump ideology in advancing limited government: As an example, many of the successes that were built into the $100 million in last year's budget savings in South Carolina were sold by talking about business principles. We argued that in the world of business, when your business model changes, you change with it.

Similarly, in the business world, you constantly reshuffle the cards, from low performers to high performers. Government doesn't. The case in point for us was the port in Port Royal, which does less volume in a year than the Port of Charleston does in a week. We said let's reshuffle the cards and after a fair amount of consternation, the sale is now in motion. That's been matched by our efforts to maximize return on investment to taxpayers through privatization of things as wide ranging as the state-owned car fleet, golf courses and even bait and tackle shops once run by state government prior to this administration's arrival!

The Honorable Mark Sanford is the governor of South Carolina.

STEPHEN GOLDSMITH

Thirty years ago, in the wake of the Thatcher initiatives, privatization often dealt with the ownership of a public asset. In my tenure as mayor of Indianapolis, though, I found that framing the choices was more a matter of inducing competition for the delivery of services than simply implementing privatization. Thus, the choices seemed more varied: Should I sell the wastewater plants, contract out the operation of them, or keep the ownership and management inside government?

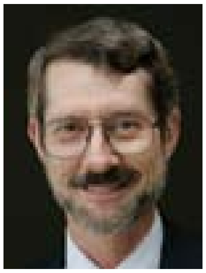
Today, however, a mixture of private, not-for-profit, and government employees works together to produce almost every complex government service. The right and left continue to frame the public/private choice as a bilateral one, pitting private profiteers against lazy bureaucrats, but these opponents miss the point entirely. Whether the issue involves welfare-to-work, roads, defense, or health, the solution requires sectors working together. Government monopolies cannot measure up;

nor does the private sector provide optimum value without the oversight of talented public employees.

Neither critics nor advocates should evaluate success based on how much privatization has occurred; success should be determined by how well government performs as a result. The real test for those who advocate this process must not be whether government is smaller but whether outsourcing furthers better government, enhancing the quality of life and providing the foundation for a robust economy. The defenders of privatization must argue in units of public value: the more units of public value produced per dollar spent, the more successful the trend.

The Honorable Stephen Goldsmith is the former mayor of Indianapolis, Indiana and a professor of government at Harvard University's Kennedy School of Government.

ROBERT W. POOLE, JR.



After having done a few consulting assignments for people in the White House Office of Policy Development, I finally made a persuasive case that the second-term Reagan administration should at least try to develop a Thatcher-type privatization agenda. So Reason Foundation helped to organize a White House seminar on privatization. It took place in late July of 1985, and it laid the groundwork for the creation of the President's Commission on Privatization. And during the second term, DOT Secretary Elizabeth Dole managed an all-out effort that privatized Conrail (the northeastern freight railroad that the government had nationalized some years previously) and divested the two Washington, DC airports from the federal government to a newly created local airport authority.

Unfortunately, the federal government moves very slowly, so the President's Commission was not appointed until 1987, which meant that its report appeared in 1988, at the end of Reagan's second term. The many recommendations in the report were not embraced by the new Bush administration. Ironically, after languishing for more than four years, some of them were picked up by the new Clinton administration, especially due to the work of Vice President Gore's National Performance Review. Hence, the Clinton years saw the privatization of the Naval Petroleum Reserve and the Helium Reserve, the U.S. Enrichment Corporation, the Alaska Power Marketing Administration, and Sallie Mae, extensive spectrum auctions, and a serious effort to create a nonprofit corporation to take over air traffic control.

Robert W. Poole Jr. is director of transportation studies and founder of Reason Foundation. Poole's Cutting Back City Hall *(Universe Books, 1980) was the first book-length examination of the subject of privatization.*

E.S. SAVAS

Schopenhauer once said, "All great ideas go through three stages: In the first stage, they are ridiculed. In the second stage, they are strongly opposed. And in the third stage, they are considered to be self-evident." Privatization has reached the third stage. It is now a worldwide practice, adopted in democracies and dictatorships, developed and developing nations, and communist, socialist, and capitalist countries. In the United States it is a routine management tool, employed at all levels of government by Democrats and Republicans.

The bipartisan nature of privatization is illustrated by President Reagan's sale of Conrail, the government-owned freight railroad, and President Clinton's sale of Teapot Dome, the U.S. Enrichment Corporation, and a dairy farm owned by the U.S. Naval Academy. Vice President Gore headed the National Performance Review, in which privatization was prominently featured.

President George W. Bush aggressively pursued A-76 competitions, that is, classifying government jobs as either commercial in nature, and therefore slated for competitive sourcing, or inherently governmental and exempt from competition. The Office of Management and Budget conducted an inventory of 173,000 jobs in 35 federal agencies in 2003 and found that 51 percent (88,000) were commercial. One wishes that more details about individual A-76 competitions were readily available, but raw statistics show that 879 competitions were conducted in FY 2003–04. They covered 30,168 full-time positions and resulted in estimated net savings of $2.5 billion over three to five years.

E. S. (Steve) Savas is a professor of public affairs in Baruch College of the City University of New York. He served under President Reagan as assistant secretary of the U.S. Department of Housing and Urban Development, and was first deputy city administrator of New York. He started writing on privatization in 1969 and is called "the father of privatization."

The preceding reflections were abbreviated from their original forms. Read these and other reflections in their entirety at: reason.org/apr2006/apr2006_specialexcerpt.pdf. ■

Sandy Springs: A Model "Private" City

By Geoffrey F. Segal

Fed up with high taxes and poor service delivery, residents of Georgia's Fulton County voted in 2005 to incorporate the city of Sandy Springs, earning 94.6 percent of the vote. What makes Sandy Springs interesting however, is that instead of creating a new municipal bureaucracy, the city opted to contract out nearly all government services.

Indeed, moments after taking the oath of office for the first time, Mayor Eva Galambos, a PhD economist said:

> *We have harnessed the energy of the private sector to organize the major functions of city government instead of assembling our own bureaucracy. This we have done because we are convinced that the competitive model is what has made America so successful. And we are here to demonstrate that this same competitive model will lead to an efficient and effective local government.*

City leaders started with a blank slate, enabling them to ask the fundamental questions about what role government should play. Taking a page from management guru Peter Drucker, every "traditional" service or function needed to prove its worthiness and proper role and place within government. Absent any program history, bias or general government inertia, city officials were able to apply Drucker's test for business, "if we weren't doing this yesterday, would we do it today," to the operation of municipal government.

Every "traditional" service or function needed to prove its worthiness and proper role and place within government. Officials had to decide whether to "make or buy" public services. Ultimately they decided to "buy" most services from the private sector.

Officials had to decide whether to "make or buy" public services. Ultimately they decided to "buy" most services from the private sector. A contract was signed with CH2M-Hill to oversee and manage the day-to-day operations of the city. The contract, worth $32 million, was nearly half what the city traditionally was charged in taxes by Fulton County (approximately $60 million). Oliver Porter, the chairman of the commission set up to establish the city said "that's more service for less cost than anything we could have hoped for." ■

Airport Privatization Update

By Robert Poole, Jr.

The biggest news in U.S. airport privatization over the last year is the possibility that Midway Airport in Chicago might be leased. Following on the successful 99-year lease of the Chicago Skyway in January 2005, Mayor Richard Daley has turned to Midway as a possible further privatization candidate. The city government has supported legislation in the state Senate to exempt from property taxes, if they were leased, a number of city-owned facilities—including parking lots, waste treatment plants—and Midway (but not O'Hare). The only significant hurdle such a deal would have to surmount would be to gain the support of airlines representing 60 percent of the annual landed weight at the airport. Southwest is currently the largest carrier at Midway.

The Chicago metro area is also the site of another form of airport privatization—developing a new airport as a public-private partnership. The proposed Lincoln National Airport would be located in Peotone, 40 miles south of downtown Chicago. State transportation officials submitted the required "concept alternative analysis" to the FAA in April 2005 for what is expected to be an 18-month review of the airport's feasibility. Private companies have pledged some $200 million in funding for the airport, which would begin with a single, 10,000 ft. runway and a 12-gate terminal building.

Despite the relative lack of airport privatization activity in the United States, it continues to be a robust phenomenon worldwide. More than 100 large and medium-size airports worldwide are either investor-owned or operating under some kind of long-term lease or concession contract.

For more on air transportation trends, visit: reason.org/apr2006/air_transportation.pdf. ■

Speaking of *PW*

"[I]n 1976, Bob Poole, the founder of Reason Foundation, started an invaluable newsletter—still published [regularly]—that keeps readers abreast of privatization happenings."

***Privatization pioneer E.S. Savas, writing in* Annual Privatization Report 2006.**

Airport Privatization Takes Off Overseas

By Robert Poole, Jr.

Among the recent developments in global airport privatization:

- BAA, the first major airport grouping to be privatized in 1987, was the winning bidder in a hard-fought competition for a 75-year, $2.15 billion concession to run the fast-growing Budapest Airport. Several weeks after the selection, in December 2005, losing bidder Hochtief challenged the award, claiming that BAA failed to meet some of the bid requirements.
- The German federal government in October 2006 sold its remaining 18.2 percent stake in Fraport (whose largest airport is Frankfurt) for $772 million. The state of Hesse still owns 31.8 percent and the city of Frankfurt owns 20.3 percent. The federal government is also looking for a buyer for its 26 percent stake in Munich Airport. Another German airport privatization took place when New Zealand's Infratil purchased 90 percent of Luebeck Airport from the city government.
- Copenhagen was one of the first European airports to be privatized (after BAA), but its majority ownership changed hands in December 2005. Macquarie Airports bought 52.4 percent of the shares in December 2005, a major increase from its previous 14.7 percent stake. The government retains its 39.2 percent holding, leaving less than 10 percent still trading on the stock market. Macquarie already owns major stakes in Brussels, Rome, Birmingham, and Bristol Airports in Europe and Sydney in its home country of Australia.
- One of the last major European airports still in state hands is Amsterdam's Schiphol Group. The Dutch Parliament passed legislation in June 2005 allowing a minority stake to be sold, and the finance minister in September decided that its preferred method would be a stock market offering of up to 49 percent of the company. No date for the sale has been announced.
- Mexico held an initial stock offering for the government's remaining stake in the second of three privatized airport companies in February 2006. The offering of shares in Grupo Aeroportuario del Pacifico (GAP) brought in $609 million at the initial offering price of $21 per share; by the end of the day, the price had exceeded $28. ■
- Colombia is offering a 17-year concession to manage and modernize the main facilities at Bogota's Eldorado Airport. The concession excludes the two main runways, since they are already privately managed under a previous concession agreement.
- Hong Kong's government announced a four-year delay in the planned privatization of its Airport Authority, during which time it will invest about $580 million to add capacity for both passengers and cargo. It will sell a minority stake, at a date yet to be announced.
- India completed the privatization process for the Mumbai and New Delhi airports in early 2006. The government selected Fraport teamed with India's GMR Infrastructure for New Delhi and Airports Co. of South Africa teamed with India's GVK Industries for Mumbai. ■

The Hong Kong Airport Authority will invest about $580 million to add passenger and cargo capacity.

Managed Competition Comes to Ohio

By Geoffrey F. Segal

Faced with declining revenues and ever increasing costs, the Hamilton County (Ohio) Board of County Commissioners adopted a resolution establishing a citizen-led task force charged with developing recommendations on cost-saving initiatives through managed competition.

The task force, called the Hamilton County Competition and Efficiency Committee (CEC) was, charged with six initial tasks:

1. Recommend cost-saving initiatives though managed competition, service consolidations and program eliminations.
2. Review county services with an eye toward cost savings through managed competition.
3. Work with the county administration to develop a fair competition process.
4. Assist the county administration in developing bid specifications.
5. Assist the county in evaluating bid responses.
6. Set specific cost-savings goals and monitor the results.

The scope has been expanded a bit to include all efficiency efforts.

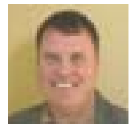
The third task was proving to be most difficult. Task force members had a good idea of services that could be subjected to competition and they certainly knew that savings could be found, however, there was not any policy or guidelines for undertaking an initiative like this.

CEC chair, Tony Condia, called in Reason Foundation staff to assist in the development of their overarching policy and process that would be used to manage initiatives. Over several months of collaboration, the CEC agreed on a modified version of the Florida GATE Management Process (see discussion in last year's *APR*: www.reason.org/apr2005/state_update.pdf). It was chosen because it was considered cutting edge with an eye toward transparency and accountability of an initiative. The performance-based model was first adopted by the Governor's Center for Efficient Government in Florida. It has served as the starting point for several competition efforts throughout the country.

With an initial goal of finding $25 million in immediate savings, the CEC hopes to cut cost in many areas, including fire hydrant repair and maintenance, fleet maintenance, facilities management, and IT services. ■

Water Privatization Update

By Adrian T. Moore



Water and wastewater services continued on their path of expansion, reports the 10th annual water report from *Public Works Financing*. The survey is based on a review of the eight largest water utility operators.

The market has grown steadily by 7 to 12 percent a year in total contract dollar value since 2000. A total of 1,337 municipal, state or federal government agencies contract out at least one part of their water utility—a 10 percent increase over 2004. The industry's contract renewal rate remained high—averaging 96 percent over the past four years.

Water/Wastewater PPP Contract Renewal Rate

	1999	2000	2001	2002	2003	2004	2005
Industry Renewal Rate (%)	88	95	87	97	96	97	93
Renewed by Incumbent (%)	83	91	81	94	94	95	92
Reverted to Competitor (%)	4	4	7	3	2	2	1
Reverted to Muni (%)	11	5	13	3	4	3	7

Source: *Public Works Financing*

A joint study from the American Enterprise Institute and Brookings Institution looked at the effects of ownership on water system regulatory compliance and household cost. After controlling for local conditions and some additional factors, the authors concluded that "there is little difference between public and private systems."

Public systems were more likely to violate the maximum levels of health-based contaminants allowed under the Safe Drinking Water Act. Private systems performed as well, and in many cases better than publicly owned systems. In fact, privately owned systems outperformed public systems, on average, in every category except in very large (100,001 + customers) systems.

While private systems were somewhat more likely to violate monitoring and reporting regulations, the authors note that other forms of private management may produce different results, especially in this arena. Contract operations typically have more stringent reporting requirements and additional levels of scrutiny that can be enforced with the contract. These additional levels are an added benefit.

Perhaps most powerful was the finding that "household expenditures on water at the county level decrease slightly as the share of private ownership increases, contradicting fears that private ownership brings higher prices." Given that private water utilities are regulated utilities and typically are limited in what they can charge, this is especially powerful. In fact, rates are generally set by a Public Utilities Commission or an equivalent agency, limiting profits and forcing private utilities to keep costs down.

Overall, the report concludes that, absent competition, water systems typically don't differ much regardless of ownership or operation. Ownership type does not suggest ultimate superiority—either way—dispelling many of the fears that privatization will lead to poor quality water and high rates.

A new Water Partnership Council survey of representatives from 31 communities engaged in a public-private partnership for the day-to-day management, operation, and maintenance of facilities shows high rates of success and satisfaction.

The water industry's contract renewal rate remained high—averaging 96 percent over the past four years.

Partnership Satisfaction

Half of the respondents rated their overall satisfaction as "extremely satisfied," the highest ranking (a corresponding value of 5). No one ranked his partnership below "satisfied" (a corresponding value of 3) and the average score was 4.5. When asked about whether they would continue with the partnership model once the contract expired, 76 percent of the respondents said "likely," a score of 5. Only one respondent noted he would not continue with the partnership model, and the average score was 4.6.

In addition, the incumbent provider was retained outright (without a competition) 62 percent of the time once a contract expired. Incumbents won an additional 24 percent of competitions while the remaining 14 percent were won by other firms.

Environmental Impact

Many of the respondents reported that the partnership was central in bringing the municipality back into regulatory compliance. In fact, 74 percent of the public officials rate regulatory compliance as better under the partnership than before it. Furthermore, in many cases the private partner performs at a higher standard than what regulations require.

Impact on Customers, Municipalities, and Employees

Thirty-seven percent of respondents noted that customer complaints decreased under the partnership. However, in most cases the number of customer complaints remained the same.

While water and sewer rates are not controlled by the private provider, the relative cost of providing a service does directly impact the rates. In some cases, the municipality can keep the rates down because of cost savings when compared to previous operations. Most respondents, however, thought their partnerships did not have an impact on rates. Seventy-six percent of respondents reported that rate increases would be the same regardless of public or private operation. Just under a fifth said that potential rate increases would be smaller under a partnership arrangement.

Unfortunately only just under half of the respondents actually documented projected cost savings—shrinking the small sample size even more. Of those, however, 92 percent reported that those projections were achieved. The remaining 8 percent noted that it was too early in the contract to determine. Savings ranged from 5 to 25 percent.

In terms of employees, respondents noted that employees are generally very satisfied with their partnerships. In nearly a third of partnerships, the municipality required the private partner to increase or maintain salary and benefit levels contractually. Sixty-four percent of respondents noted that employee grievances were below pre-partnership levels. In addition, 93 percent of respondents reported that education and training opportunities, as well as professional development and advancement opportunities, had increased under private operations.

For more water privatization trends, visit: reason.org/apr2006/environmental.pdf. ■

State Privatization Update

Spotlight Florida

During Governor Bush's tenure the state of Florida has saved taxpayers nearly $600 million through public-private partnerships. Indeed, at the beginning of his second term Bush talked about privatizing government functions so that "these buildings around us [are] empty of workers; silent monuments to the time when government played a larger role than it deserved or could adequately fill." His administration has established a remarkable track record and progress toward achieving these goals.

Since Bush took office the size of state government has shrunk, with the number of state jobs falling from 127,363 to 113,202. This impressive feat would have been much larger if not for gains in education and public safety. Further, appropriated dollars for salaries and benefits has dropped from $6.8 billion to $6.4 billion—even with rising costs and inflation.

In addition, Bush has offered another $1.5 billion in tax cuts this year, bringing his eight-year total to $20.3 billion in state and local tax relief since taking office. In addition, the governor has been able to rein in the growth of government so that it doesn't grow faster than the private sector. In his last biennial budget, state funds increased by 4.4 and 6.8 percent respectively, compared to an estimated personal income growth of 6.8 percent. Much of this success can be attributed to a focus on performance and results. The Bush administration has used competition and privatization as a cornerstone of its management philosophy.

As previously reported in *APR*, Bush had initiated a review of the state's privatization process, with an eye toward establishing firm guidelines that would create more transparency, consistency in contracting, and high performance. The end result was the creation of the GATE management process, as established by the Governor's Center for Efficient Government.

In June 2006, Bush signed SB2518—known as the "Florida Efficient Government Act"—into law, which codified the GATE process. In adopting the process, the legislation requires that a business case be developed for each initiative. It must then be evaluated for feasibility, cost-effectiveness, and efficiency before an agency can sign a contract. Further, the legislation establishes a Council for Efficient Government that will play an advisory role and provide additional oversight of privatization initiatives. Many aspects of this bill are identical to the original proposal from the Center for Efficient Government as discussed in last year's *APR*.

Besides codifying the GATE process into law, the bill also provides some guidance for privatization policy in general. It establishes legislative intent to direct state agencies to focus only on their core missions and to deliver services efficiently and effectively, and requires them to leverage the private sector whenever they can reduce the costs of government.

Spotlight Indiana

Perhaps one of the most privatization-active states this past year was Indiana. The legislature heard several bills—some that allowed more privatization, and some that would have restricted privatization.

Several bills were introduced under the moniker of transparency that would have established cumbersome guidelines for privatization that were nothing more than a set of bureaucratic hurdles that state agencies would have to jump through before privatizing functions. The legislation was an attempt to stall, restrict, and limit the power of the executive from privatization. Perhaps most troubling would have been the creation of an additional layer of legislative oversight and review. If these bills would have passed, any privatization plan would be subject to hearings from the budget committee just 30 days before project implementation. The committee would also submit a recommendation to the governor, highly politicizing a pure management decision.

Companion bills, HB1006 and SB323, allowed explicit authority for school districts to engage in shared services contracts (see discussion of the benefits of shared services in the Education chapter of this year's *APR*). In an effort to find efficiencies and drive more money into classrooms, this common-sense legislation was signed into law.

Gov. Mitch Daniels, known as "the knife" during his days at the federal Office of Management and Budget, has employed his strategies for cost savings and efficiency inside Indiana's government. In just two years in office Daniels has cut 3,000 state jobs and eliminated seven departments.

The governor has also launched an aggressive review of the size, scope, functions, and budget of each agency. The review dubbed PROBE—Program Results: an Outcome Based Evaluation (see text box)—is similar to the federal PART analysis that was established under Daniels' leadership as federal OMB director.

Under the PROBE review each program will be asked to justify its work but also that the program is making an impact. Each program is systematically reviewed according to key characteristics:

Program Measurement: Of the programs evaluated only 38 percent have performance measures in place. "Because most programs lack long-term, results-based performance measures, these programs are unable to demonstrate adequate progress."

Program Overlap and Duplication: Evaluations have found many areas where services can be "shared" rather than "owned"—print, copy, and mail services are prime examples.

Relevance: If nothing else, this hopes to eliminate traditional government inertia and resistance to change. "The way we've always done it" will not pass this review. Programs will have to demonstrate a clear need for them to exist.

Financial: Over time government financial management has failed. This review exposes financial management problems as a first step to fixing them.

The PROBE process will identify programs that should have their budgets reduced or eliminated—again similar to the federal PART. Reports will include recommendations for better linking of performance to priorities, as well as be used to coordinate statewide initiatives like strategic sourcing to tackle program overlap.

PROBE seeks long-term savings—not just one-time efficiencies. In order to help with this goal the evaluations will be ongoing and used in future budget cycles to determine funding levels for programs and activities. Further, an inventory of program duplication, cost-reduction opportunities and enhanced cross-agency cooperation will be developed to help foster additional opportunities.

Indiana's department of corrections fully embraced privatization, launching three major initiatives last year. First, the department signed a deal with Aramark to privatize food service in the state's prisons. The deal will save the state $12 million a year. Second, the DOC renegotiated a contract for medical services for additional savings, but more importantly higher performance levels. Finally, the corrections department put an entire facility out to bid and ultimately privatized the operations of the New Castle Correctional Facility. All three deals combined with save the state $67.8 million over four years according to Commissioner David Donahue.

The Family and Social Services Administration also launched a major initiative to look into the administration of state welfare programs and health care services. Several proposals have been submitted for what could be a 10-year contract worth more than $1 billion.

As reported in *APR* last year and in this year's transportation section, Indiana passed HB1008 giving the governor authority to enter into a concession agreement for the 157-mile Indiana Toll Road. Other partnerships are to be examined as part of the governor's transportation plan unfolds.

For more state updates, visit http://www.reason.org/apr2006/local_state_update.pdf. ■

Quick Shots: Some Key Developments

Connecticut: Governor Rell vetoed HB5684, which would have placed overly burdensome restrictions and regulations on contracting.

Hawaii: Efforts to place restrictions on privatization went nowhere and were carried over to the next legislative session.

Massachusetts: H1333 would have prevented local governments from privatizing water or sewer services, but it was killed in committee. S1742 would require any privatized work be completed inside the United States. After an initial hearing, the bill was reported out of committee favorably, however it has not been acted on since.

New Jersey: S1777 was introduced, which would allow up to 49 percent of the New Jersey turnpike to be "corporatized." Governor Corzine is intrigued by the concept, however, has not actively supported the measure yet. Companion bills were introduced in both the Assembly and the Senate (A2210/S1600) that would establish new guidelines and requirements for privatization. If enacted, they would severely restrict privatization opportunities.

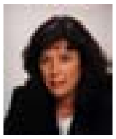
Pennsylvania: HB2572 would prohibit government agencies from competing with the private sector for goods and services. The bill has been assigned to committee but has not been heard.

Utah: SB 74 would have created a privatization task force to identify functions suitable for public-private competition and privatization. The bill failed in the Senate and no action was taken in the House. The passage of SB80 enabled "concession" model deals for the state's highways, making Utah the 23rd state with specific privatization-enabling legislation.

Virginia: HB1122 was left in committee. It would have required the state to define activities as either commercial or inherently governmental and justify why functions should not be privatized.

States Continue to Expand School Choice

By Lisa Snell



According to the Alliance for School Choice, so far in 2006, 13 legislative houses in seven states—Arizona, Florida, New Hampshire, Ohio, Utah, Virginia, and Wisconsin—have passed school choice bills. Four states—Arizona, Ohio, Utah, and Wisconsin—have passed bills creating or expanding choice programs.

In 2006 the Arizona legislature enacted three new school choice programs. Thousands of economically disadvantaged families will benefit from a new corporate scholarship tax credit program. The corporate tax credit program builds upon the success of Arizona's Individual Scholarship Tax Credit, which became law in 1997 and grants a credit against Arizona's individual income tax for donations to nonprofit scholarship tuition organizations (STOs). Likewise, the new corporate scholarship tax credit program provides a dollar-for-dollar credit for corporate donations to STOs. The scholarships are limited to low-income K-12 children who transfer from public to private schools.

Under the new law, the cap is set at $10 million a year, with vouchers worth up to $4,200 for K-8 students and $5,500 for high school. The law will include automatic 20 percent annual increases until 2010 when it will total nearly $21 million and over 6,000 students. In addition, Arizona's individual tax credit program gives 21,000 students scholarships worth more than $28 million.

Arizona's legislature also passed school choice legislation that would expand the state's education options and allow children in foster care to apply for an education grant to attend private schools. The displaced pupils choice grants program provides grants of $5,000 or tuition and fees, whichever is less, to the first 500 applicants each year. The program will last for five years.

Finally, Arizona also enacted Scholarships for Pupils with Disabilities Program and will provide up to $2.5 million in scholarships for children with special needs to attend the private school of their parents' choice. It will be the nation's fourth school choice program for special needs students, following the popular and effective McKay program in Florida (now enrolling more than 16,000 students), Utah's Carson Smith program, and scholarships for autistic children in Ohio.

In Ohio and Utah, lawmakers also gave more students access to school choice. Thousands more students in Ohio

and Utah will be eligible to receive more educational opportunities through the expansion of the states' current choice programs.

The Ohio legislature passed the expansion of the Ohio Edchoice program, which increases the number of students eligible for the scholarship program from 20,000 to 50,000. The existing program had limited eligibility to students attending schools that have been in "academic emergency"—the lowest performance grade—for three consecutive years. Now, students in approximately 50 schools in "academic watch"—the second-lowest grade—could apply for the scholarships.

The Utah legislature passed an expansion of the Carson Smith Scholarship Program earlier this month, increasing the number of schools eligible to participate and the number of children likely to benefit. The language previously requiring private schools to have "specialized" in serving children with special needs was changed to a requirement that the private schools had served students with special needs in the past. The bill also requires that parents receive notification of the availability of the scholarships.

The May 2006 issue of *School Reform News* reports that on March 10, 2006, Wisconsin Gov. Jim Doyle (D) signed legislation expanding Milwaukee's school voucher program. Doyle, a Democrat, reached a compromise with the state legislature to raise the cap on the total number of students eligible to receive vouchers from approximately 14,500 to 22,500 students. Without an increase in the cap, vouchers would have been rationed, potentially forcing some students currently using vouchers to lose them. The bill included new accountability measures for schools educating voucher students, as well as increased funding for smaller class sizes in Wisconsin's government schools.

For more education trends, visit: reason.org/apr2006/education.pdf. ■

PPP Toll Roads on the Drawing Board

By Robert Poole, Jr.

Texas continues to lead the nation in public-private partnership (PPP) toll road projects under development. TxDOT has made clear that it plans to pursue its second major Trans-Texas Corridor, TTC-69, as a PPP toll project, like it is doing with the $7.2 billion TTC-35. Among the other projects that are under way as PPPs are:

- Adding managed lanes, some of them in tunnels, to the LBJ Freeway (I-635) as part of a $3 billion reconstruction of that major corridor in Dallas;
- Adding 42 miles of toll lanes on Loop 1604 and US 281 on the north side of San Antonio;
- Developing SH 121 as a new 24-mile toll road on the north side of Dallas;
- Developing the proposed $500 million SH 161 in Ft. Worth as a toll road.

Virginia is another high-profile practitioner of PPP toll roads. The state's first HOT lanes project, awaiting final environmental clearance, is a $900 million Fluor/Transurban project that will add two new HOT lanes in each direction to the southwest quadrant of the traffic-choked Washington Beltway (I-495). The same team was selected in October 2005 as the preferred bidder to add HOT lanes on a long stretch of I-95 and I-395 approaching Washington, DC, a total length of 56 miles. In February 2006, VDOT announced that it was seeking a PPP deal to develop a new, 55-mile toll road from Norfolk to the west, as part of a revamped US 460. Less further along is a possible tolled PPP approach for a Third Hampton Roads Crossing, with competing unsolicited proposals from Fluor and Skanska.

Georgia's revised PPP toll roads law has led to two proposals being accepted by the State Transportation Board. The first, by a Bechtel/Kiewit team, would add HOT lanes (and possibly also toll truck lanes) to I-75 and I-575 in the northwest corridor suburbs of Atlanta. The second, by Washington Group International, would add HOT lanes on Georgia 400, part of which is already an Atlanta toll road. And Florida is now seeking proposals for the first PPP toll road under its revised enabling law. The Tampa-Hillsborough County Expressway Authority got a standing room only crowd at its initial bidder's conference, in March 2006, for the $150 million East-West Road. Although Florida has numerous public-sector toll roads, East-West would be its first PPP concession project.

For more on surface transportation trends, visit: reason.org/apr2006/surface_transportation.pdf. ■

Federal Government Update:

Competitive Sourcing Continues to Expand

By Geoffrey F. Segal

President Bush's plan to bring more competition to federal programs—competitive sourcing—continued to expand in 2005, though competitive sourcing was used less often than in the previous two years. Making government jobs that are considered "commercial in nature" compete with the private sector, thereby forcing them to be efficient to survive, has resulted in taxpayer savings of billions of dollars so far, and promises to save billions more in the coming years.

In FY 2005 federal agencies completed 181 public-private competitions for a total of 9,979 positions. In addition, competitions for nearly 5,000 other positions have already been announced and are working through the process. While agencies used competitions for a wide range of services, they focused on logistics, maintenance and property management, and information technology.

Collectively the competitions are estimated to generate net savings, or cost avoidance, of approximately $3.1 billion over five to ten years. Fixed costs and expenses to provide central direction and oversight between 2003 and 2005 totaled $211 million—better than a 27 to 1 return on investment, i.e., for every dollar spent on competitive sourcing, 27 were saved.

Savings from 2005 total $3.1 billion over the next three to five years. When combined with the previous years' savings, competitive sourcing is estimated to save taxpayers $5.6 billion, with annualized savings expected to approach $1 billion. Competitions resulted in savings of $23,000 per position studied when analyzed on a cost basis alone, yielding a 29 percent savings (a slight increase over 2004). When best value is considered, involving a mix of cost and quality, savings jump to $68,000 per position—three times the average expected net savings.

To date agencies have conducted almost 1,100 competitions or about 41,000 positions, representing approximately 11 percent of the commercial activities identified as suitable for competition. This falls far short of the president's goal of submitting half the federal workforce to competition.

There are plans to rapidly expand the program. While 5,000 positions have already been slated for competition, officials estimate that up to 21,500 more positions could be put up for public-private competition in this fiscal year. ■

Who, What, Where

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Privatization Watch Back Issues available at reason.org/pw.shtml

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