20th Anniversary Edition

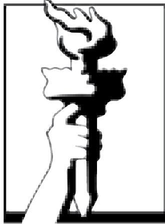
Annual Privatization Report 2006

Transforming Government Through Privatization

Reflections from Pioneers in Government Reform

Prime Minister Margaret Thatcher
Governor Mitch Daniels
Governor Mark Sanford
Robert W. Poole, Jr.

Reason Foundation



Reason Foundation's mission is to advance a free society by developing, applying, and promoting libertarian principles, including individual liberty, free markets, and the rule of law. We use journalism and public policy research to influence the frameworks and actions of policymakers, journalists, and opinion leaders.

Reason Foundation's nonpartisan public policy research promotes choice, competition, and a dynamic market economy as the foundation for human dignity and progress. Reason produces rigorous, peer-reviewed research and directly engages the policy process, seeking strategies that emphasize cooperation, flexibility, local knowledge, and results. Through practical and innovative approaches to complex problems, Reason seeks to change the way people think about issues, and promote policies that allow and encourage individuals and voluntary institutions to flourish.

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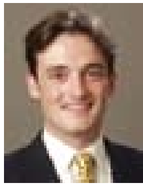
Letter from the Editor

Leonard C. Gilroy



Welcome to Reason Foundation's *Annual Privatization Report 2006*. Now in its 20th year of publication, *APR* is the world's longest running and most comprehensive report on privatization news, developments, and trends. Since the first *APR* was published two decades ago, privatization has continued its evolution from novel concept to a proven policy management tool that delivers higher quality services at lower costs and more efficient, effective government.

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, South Carolina Governor Mark Sanford, Indiana Governor Mitch Daniels, former Indianapolis Mayor Stephen Goldsmith, and Reason founder and transportation director Robert Poole, Jr. We are honored to have them share their expertise and insights on privatization, competition, and government reform in this *APR*.

APR 2006 also details the latest on President Bush's efforts to bring more competition to federal programs, saving billions of taxpayer dollars in the process. The "Federal Update" also includes the latest news on federal program performance, military postal privatization, and a major government reform bill.

The "Local and State Update" section highlights two key projects in which Reason assisted local officials in developing plans to streamline government and save taxpayer dollars: the incorporation of Georgia's first contract city (Sandy Springs) and the launch of a county-wide managed competition program in Hamilton County, Ohio.

This issue also includes an expanded section on tax and expenditure limitations (TELs). Dr. Barry Poulson, distinguished scholar at Americans for Prosperity, offers an update about the progress that states and local governments have made toward constraining the growth of government by enacting TELs similar to Colorado's Taxpayer Bill of Rights (TABOR).

This year's *APR* provides a comprehensive overview of domestic and international developments in air and surface transportation, including the significant growth in highway tolling and the increasing use of public-private partnerships for toll projects. The "Surface Transportation" section includes a profile of Reason's groundbreaking Mobility Project, our long-term, nationwide effort to help stimulate urban economies by improving mobility and reducing congestion.

Reason played a key role in the debate over California's Proposition 82—the universal preschool initiative defeated at the polls in June—through an extensive research and public

outreach program. The "Education" section includes a review of continuing state efforts to adopt universal preschool programs, as well as articles on school choice, the benefits of shared services, and child welfare privatization.

For the first time, *APR* includes a section on the fast-moving arena of telecommunications policy, featuring articles on the deployment of municipal broadband services, network neutrality, and video franchise reform.

Our "Emerging Issues" section includes articles on policy strategies to speed hurricane recovery, foreign management of domestic infrastructure, the government pension crisis, government offshoring, and free-market alternatives to occupational licensing.

The protection of private property rights continues to be a hot button issue a year after the U.S. Supreme Court's 2005 decision in *Kelo vs. City of New London*. This *APR* features an update on eminent domain reform in the states, as well as state-level efforts to replicate Oregon's Measure 37, a voter-passed initiative designed to protect property owners from regulatory takings via land use regulation.

Your comments on the 20th *Annual Privatization Report* are important to us. Please feel free to contact us with questions, suggestions, or for more information. For more privatization news, check out *Privatization Watch* (www.reason.org/pw.shtml), now in its 30th year of publication. For the most up-to-date information on the rapidly changing privatization world, please visit our Privatization Center (www.reason.org/privatization/) and our weblog, Out of Control (www.reason.org/outofcontrol/).

Leonard C. Gilroy, Editor

Annual Privatization Report 2006

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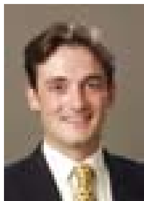
Introduction

By Leonard Gilroy, Editor, Annual Privatization Report 2006



In the two decades since the publication of Reason's first *Annual Privatization Report*, governments of all political complexions have increasingly embraced privatization—shifting the production of a good or the provision of a service from the government to the private sector—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. Policymakers from Phoenix to Prague, China to Chile, and North America to the Middle East have used privatization to better the lives of citizens by offering them higher quality services at lower costs, delivering greater choice and more efficient, effective government. 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.

For much of the 20th century, the trend was clearly in the opposite direction. This period saw the rapid expansion of state control over the lives of citizens. Prominent political ideologies like socialism and communism spread the belief that society's needs and problems are best addressed through government intervention. Statism even spread to capitalist economies; for example, the British government nationalized its coal, gas, rail, shipbuilding, and steel industries, and the United States nationalized the facilities of the Tennessee Electric Power Company into the Tennessee Valley Authority and adopted a number of government-run social welfare programs (such as Social Security, Medicare, and Medicaid) under the New Deal and Great Society programs. As governments grew, they increasingly constrained commerce and free enterprise, consumed an ever greater share of personal and business income, and restricted private property rights and personal freedoms.

The tide began to turn in the latter half of the century as the folly of this approach became apparent through bloated bureaucracies, sluggish economies, stifling taxes, and failing government programs. Intellectuals, policymakers, and citizens became increasingly interested in market-based policy solutions to improve the efficiency and performance of government. It is in this context that the concept of privatization began to flourish.

Reason's Annual Privatization Report:

Twenty Years at the Cutting Edge of Privatization and Government Reform

For almost four decades, Reason Foundation has worked to advance a free society by developing, applying, and promoting the principles of individual liberty, free markets, and the rule of law. In steadfast pursuit of this mission, Reason works at the forefront of privatization policy through its research, outreach, and publications like the *Annual Privatization Report* (*APR*).

Now in its 20th year of publication, *APR* has become the world's longest running and most comprehensive annual report on news, developments, and trends in privatization, competition, and government reform. *APR* helps policymakers and leaders at all levels of government understand this fast-moving policy arena, highlighting tools and trends to help them improve the efficiency and performance of government and emphasizing best practices, cooperative problem-solving, and structural reform.

APR is the brainchild of Reason Foundation Trustee David Koch, executive vice president of the nation's largest privately owned company, Koch Industries, Inc. During a 1986 visit from Robert W. Poole, Jr., founder of Reason Foundation, Messrs. Poole and Koch engaged in a wide-ranging discussion on how privatization had grown to become a global issue, largely due to the innovative, market-based policy programs developed under the aegis of U.S. President Ronald Reagan and U.K. Prime Minister Margaret Thatcher. In that conversation, Mr. Koch proposed the idea of an annual report on the status and progress of privatization efforts around the globe, with a particular emphasis on privatization's impact on U.S. public policy.

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

What emerged in early 1987 was *Privatization 1986*, a report on the status of privatization to date and important developments of that year. The publication garnered enough attention from policymakers that Messrs. Koch and Poole determined that it was worth continuing. For subsequent editions, the report was re-titled *Annual Privatization Report*.

Reason owes a debt of gratitude to David Koch, and *APR* would not have flourished without his commitment to market-based tools that enable individuals, institutions, and societies to survive and prosper. It is thanks to Mr. Koch's vision and support that the *Annual Privatization Report* has become the nation's foremost publication on privatization, outsourcing, and government reform.

In addition, the organization that has evolved into Reason Foundation would not exist without the dedication and vision of Robert Poole. In 1978, Robert launched Reason Foundation to advance the values of individual freedom and choice, limited government, and market-friendly policies. He popularized the term "privatization" to refer to contracting-out public services, and his book *Cutting Back City Hall* (Universe Books, 1980) was the first book-length examination of the subject.

Privatization in Perspective

Over the years, privatization has taken many meanings. In its purest form, the term refers to the divestiture of government-owned assets like airports, rail systems, real estate holdings, and oil production facilities. As the concept has evolved, privatization has grown to resemble more of an umbrella term to account for greater private sector participation in the delivery of services. For example, over 1,000 local governments in the United States—including Indianapolis, Seattle, and Beverly Hills—have entered into public-private partnerships for water services, contracting out the operations and maintenance of water systems to private companies. Similarly, multi-billion dollar public-private highway, bridge, and tunnel projects are operating or under construction across the United States, in Australia, Canada, Italy, France, and other countries.

Regardless of the specific form it takes, privatization introduces market-based competition into government where it otherwise does not exist. Competition benefits the public by offering expanded choices, higher quality services, and lower costs. Adrian Moore, Vice President of Reason, offers a concise articulation of the benefits of privatization:

Privatization exposes things we otherwise would not see—ideas, processes, innovations in service delivery. Within government rarely is success adequately rewarded, and innovation and new ideas are often quashed. But when privatization brings competition, accountability, and a chance for customers to have a say, then excellence and innovation are rewarded, and mediocrity and failure are penalized.

Since the first *APR* was published two decades ago, privatization has continued its evolution from novel concept to mainstream idea, both in the United States and internationally. Some examples illustrate this point:

- In 1986, air traffic control (ATC) services were exclusively the province of national governments. Today, over 40 countries have "commercialized" their ATC systems since New Zealand launched this trend in 1987, shifting the responsibility for providing ATC services from the national government to an independent corporation supported by user fees instead of government appropriations. Benefits of ATC commercialization include improved safety, improvements in service quality through increased flight

Privatization as Societal Transformation

In 1969, famed management guru Peter Drucker published *The Age of Discontinuity*, in which he foresaw the transition from the industrial age to the information age. According to Drucker, this transition would be accompanied by profound, transformative change in society, business, and government. One of Drucker's predictions was that governments would eventually "reprivatize" the state-owned industries in Europe, moving them back into the private marketplace. The term reprivatize resonated so strongly with Reason Foundation founder Robert Poole that when he began writing about outsourcing municipal services in the early 1970s, he popularized the term "privatization" to describe the concept.

efficiency and delay mitigation, and lower costs relative to the United States' government-run FAA.

- According to a 2005 World Bank report, 120 developing countries carried out 7,860 privatization transactions between 1990 and 2003, generating close to $410 billion in privatization proceeds.
- 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 2nd 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.

Congress passed the Federal Activities Inventory Reform (FAIR) Act in 1998.

- Congress passed the Federal Activities Inventory Reform (FAIR) Act in 1998, which classifies every federal job into categories, the most basic being "inherently governmental" (activities that can only be provided by government employees) and "commercial in nature" (activities that can and are provided by the private sector). FAIR facilitated the adoption of "competitive sourcing"—a process for determining whether the private sector or government is the most efficient and effective source for performing specific functions. President Bush's competitive sourcing effort is saving taxpayers money; competitions over the last three years alone are expected to save approximately $5.6 billion over the next few years.
- The FAIR Act inspired similar legislation in Virginia, and other states use it as a baseline for determining which services are commercial and which should be contracted out.
- In the last seven years, Florida state government has launched more than 130 government reform and privatization initiatives saving more than $550 million. That focus on management excellence has also enabled more than $20 billion in tax cuts during that same time, and the number of state jobs has fallen from 127,000 to 113,000, an impressive feat that would have been much larger if not for the addition of workers in education and public safety.
- According to the National Solid Wastes Management Association, the percentage of contracted solid waste collection and disposal services increased from 30 percent in 1987 to 54 percent by 2000.
- 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 of the governments surveyed said they were contracting out services that had been

done in-house just five years earlier.

- Contract cities—cities that contract with outside public or private sector providers for major municipal services, such as police and fire services, public works, and building and safety—have continued to grow in number since Lakewood, California—a pioneer contract city—was incorporated in 1954. Sandy Springs, Georgia, incorporated in late 2005, is the latest contract city and the first new city in Georgia in 50 years. Instead of creating a new municipal bureaucracy, the city opted to contract out nearly all government services. Inspired by Sandy Springs and impressed by its cost savings achieved by contracting, citizens in four nearby Fulton County communities will hold elections in the near future on cityhood, and feasibility studies for at least three more new Georgia cities are currently underway.
- A LexisNexis search of the keyword "privatization" showed that the term appeared in 957 articles in major U.S. periodicals in 1986. In 2005, the term appeared in over 20,000 articles, suggesting a significantly increased media focus on privatization.

Privatization is not the domain of any one political party or ideology. In the United States, privatization is used by leaders of both major political parties, and they have demonstrated that not only can politicians at all levels successfully privatize public services, but they can get re-elected after doing so. For example:

- Under the Democratic administration of Pres. Bill 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. It also conducted competitions for the operation of more than 100 airport control towers and numerous military base functions. It was also Clinton's Environmental Protection Agency that declared public-private partnerships for water and sewer systems a "classic win-win."
- Florida Gov. Jeb Bush's Republican administration has opened more than 138 public services to competition, generating cost savings of at least $550 million and improved service delivery. Governor Bush also created the state's Center for Efficient Government, which has developed a centralized process for evaluating when and where competition is appropriate, as well as assessing the competitions.
- 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. The list of services privatized

included golf courses, print shops, parking garages, and prisons.

Looking abroad to number, size, and type of privatizations being done in other countries, it is clear that we have barely scratched the surface in the United States. Many federal government services and agencies that are being privatized routinely in other countries are still firmly in government hands, such as Amtrak, the Social Security system, the Tennessee Valley Authority, the U.S. Postal Service, the air traffic control system, and the nation's power marketing authorities.

At the state and local level, there is also tremendous potential for saving taxpayers money and improving the delivery of services. More than half of the U.S. population still gets its drinking water from government agencies and then gets its wastewater treated by government agencies. There are still large numbers of municipal electric and gas utilities. And the United States has only just begun to tap the private sector for airports and highways, where dozens of other countries are already enjoying the savings and improvements.

In short, the ideas of privatization and competition have advanced a long way since *Privatization 1986*, yet there is still a long way to go.

Reflections from Privatization Pioneers

In this 20th issue of *APR*, we present a series of exclusive articles by the world's leaders in privatization. Our contributors include pioneering policymakers and researchers at the forefront of privatization and government reform, including:

- Margaret Thatcher, prime minister of the United Kingdom from 1979-1990;
- Mitch Daniels, governor of Indiana;
- Mark Sanford, governor of South Carolina;
- Stephen Goldsmith, former mayor of Indianapolis;
- Robert Poole, Jr., founder and transportation studies director of Reason Foundation;
- Professor E.S. Savas, former assistant secretary of the U.S. Department of Housing and Urban Development and former first deputy city administrator of New York City;
- Ronald Utt, senior research fellow at the Heritage Foundation;
- John Blundell, director general of the Institute of Economic Affairs in London;
- William Eggers, formerly with Reason, now global director for Deloitte Research—Public Sector;
- Roger D. Feldman, partner at Bingham McCutchen LLP and former Chair of the National Council for Public-Private Partnerships;
- Dr. Lawrence Martin, director of the Center for Community Partnerships at the University of Central Florida; and
- Grover Norquist, president of Americans for Tax Reform.

It is impossible to look back on the last 20 years of privatization without acknowledging the leadership and dedication of these individuals in advancing the idea of competition in government. Reason Foundation is honored to have them share their expertise and insights on privatization, competition, and government reform in the 20th anniversary edition of our *Annual Privatization Report*.

Rebuilding an Enterprise Society through Privatisation

By Margaret Thatcher, former Prime Minister of the United Kingdom

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.

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.

For Britain, the 1970s was a decade of decline: even worse than that, our people seemed to accept it. Our nationalised industries were inefficient, overmanned and weakened by restrictive practices. Government had no business being in business.

We tackled privatisation in the way which best suited us.

First, we had to put the balances of the industries we wanted to sell in good order. Where redundancies had to be made because of overmanning we were determined to

“We showed that privatisation worked.”

ensure that those who lost their jobs would receive a capital sum related to the length of their service. For the first time in their lives this put capital into their hands and each industry helped them to find other jobs or to set up businesses of their own. Thus we made clear our concern to look after those who were losing their livelihoods as well as those who were staying on.

Second, I saw it as part of my purpose to have a policy which extended ownership of capital more widely. It is most people's ambition to have something to pass on to their children. In doing so, we link the generations and create a deep and abiding interest in the future. I have already outlined how we achieved this goal for those leaving an industry, but we also wanted those remaining in the newly privatised industries to have a greater stake. So we reserved a block of shares for employees which they could purchase at a discount.

Third, those companies which could not be floated on the stock market were sold to companies who were willing to buy them at the best possible price.

Fourth, some industries were so thoroughly outdated that they would have cost too much money to modernize. Others such as shipbuilding had lost their markets as business had moved to the Asia Pacific. The subsidies required by our shipyards each year were equal to their entire wage bill, and we were told that we could not stop them because people would lose their jobs. Clearly we could not go on that way. Some shipyards had to be closed, others were offered for "sale".

It was an unusual type of sale, buyers were not asked to pay anything for the land or for the plant. They were even offered substantial capital sums to cover the necessary redundancies and to help build a modern effective industry in the private sector. This recipe, also applied to other industries, offered a way forward in the worst cases.

We faced vociferous opposition, particularly when we came to privatise the public utilities, but the facts show that they too are much more efficient in private hands and that they have become some of our most successful businesses.

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.

Indeed as the *Economist* put it:

Nationalisation, once all the rage, is out; privatisation is in. And the followers of the new fashion are of the left, the right and all hues in between.

Baroness Margaret Thatcher, LG, OM, PC, FRS was Prime Minister of the United Kingdom from 1979 to 1990. Baroness Thatcher is widely credited with reviving the British economy, reforming outdated government institutions, and reinvigorating the nation's foreign policy during her term of office. By successfully shifting British economic and foreign policy in a free-market direction, her governments helped to encourage wider international trends which broadened and deepened during the 1980s and 1990s, as the end of the Cold War, the spread of democracy, and the growth of free markets strengthened political and economic freedom in every continent.

Reforming Government Through Competition

By Mitchell E. Daniels, Governor of Indiana

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.

More than ineptitude was at work; shrewd politics was a central factor. On arrival, we found dozens of state employees spending 100% of their time on public employee union business, zero for the taxpayer. By gubernatorial executive order, 25,000 state employees were paying compulsory union dues of almost 2% of their pay, money faithfully recycled into political campaigns of the staunch union allies running state government.

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.

The case for judicious private contracting rests, of course, not just on superior efficiency but also on grounds of sound philosophy: anything that strengthens the private sector vs. the state is protective of personal freedom. And in an economically struggling state like ours, channeling more public dollars to private businesses can make a modest contribution

to a stronger economy. We couple our privatization initiatives, and all government procurement, with strong and unapologetic preferences for Indiana firms.

But basically our choices are driven by the duty of stewardship. We approach each activity with the question, "Assuming this service is proper for government at all, what is the best way to deliver it?" Personally, I never use the word "privatization", because it connotes an orthodoxy of its own, a preconception that things should be done privately as a matter of doctrine, not practicality.

Applying these approaches first at the federal level, as Director of OMB, and now as governor, I've labeled our policy "Competitive Sourcing," to indicate that it is the cost-reducing, service-enhancing power of competition that we seek to capture for government's customer, the taxpayer. Wherever possible, we encourage and assist incumbent public employees to submit their own bids, and I confess to a special gratification when any such bid is the winner.

Specializing in delivering a given product or service and spurred to constant improvement by competition and the profit motive, people can achieve their goal better than the best-intentioned administrators of the best-organized government bureaucracies.

Shortly after taking office, our new Corrections Commissioner asked me "Did you know we're cooking our own food in 26 separate kitchens, and we're paying $1.41 a meal to feed the offenders?" "No," I answered, "is that a lot?" "It only cost us 95 cents where I worked last" he said, so I authorized an immediate competition.

A well-established food service company won most of the business, at a cost of 98 cents per meal (nutritional quality and consistency improved, by the way, by the terms of the contract). But, in one delightful outcome, the employees of one facility trimmed middle management, reorganized their processes, and won the right to continue while cutting a minimum of 30% from the previous costs. At this writing, they are doing even better than that, and seem sure to qualify for substantial bonus checks at the end of the fiscal year.

We have applied the "Yellow Pages" test (if you can find a service there, maybe government should not try to do it itself) to a host of activities, ranging from janitorial service (annual savings = $500,000) to debt collection of delinquent taxes (achieving a return of 16:1). Next, we hope to contract for the more accurate adjudication of entitlement claims—Medicaid, food stamps, welfare, and so forth—to improve on a system where error rates average 25%, and administrative costs are exorbitant while deserving citizens are left stranded in long waiting lists.

Again and again these reforms demonstrate that people specializing in delivering a given product or service, and spurred to constant improvement by competition and the profit motive, can achieve their goal better than the best-intentioned administrators of the best-organized government bureaucracies.

To date, the most noteworthy of Indiana's new initiatives involved our approach to transportation infrastructure. In a problem almost universal among the states, we faced a shortfall of some $3 billion, equal to ten years of new road

construction at the current level, between road-building needs and projected revenues.

Meanwhile, a 40-year-old Indiana Toll Road across the northern part of our state continued losing money and deferring maintenance and expansion, while charging the lowest tolls of any comparable highway. Tolls had not been raised in twenty years; at some booths the charge was 15 cents. (As the new governor, I innocently inquired what it cost us to collect each toll. This being government, no one knew, but after a few days of study the answer came back: "34 cents. We think." I replied, only half in jest, that we'd be better off going to the honor system.) With politicians in charge, neither sensible pricing nor businesslike operational practices were likely, ever.

As a faithful *Reason* subscriber, I was well aware of the growing role around the world of private capital in financing public infrastructure.

As a faithful *Reason* subscriber, I was well aware of the growing role around the world of private capital in financing public infrastructure. Without knowing what level of interest to expect, we offered to lease our toll road long-term to any interested operator willing to pay for the privilege.

Independent estimates of the road's net present value in state hands ranged from $1.1 billion to $1.6 billion, the latter figure aggressively presuming that all future politicians, unlike all their predecessors, would raise tolls at least in line with inflation. I had resolved that only a bid far in excess of that range would be worth advocating to my fellow citizens.

In the event, we received a best bid of $3.8 billion. Upon closing, we will cash a check in this amount and commence the largest building program in our state's history, while transferring the burden and the risk of running the toll road to the private firm. At one stroke our seemingly insurmountable transportation gap will be closed. Needed projects that have sat around in blueprint stage for years will now become reality. The jobs generated by the construction alone will be measured in the tens of thousands, and the permanent payoff in incremental economic activity should far exceed that.

Any businessperson will recognize our decision here as the freeing of trapped value from an underperforming asset, to be redeployed into a better use with higher

Source: Gregg Gearhart / The Times of Northwest Indiana

Indiana Toll Road looking west in LaPorte County.

Source: Christopher Smith / The Times of Northwest Indiana

Toll booth on the Chicago Skyway.

returns. We viewed it as critical that the dollars liberated from one capital asset must all be reinvested into long-term capital uses, and not dribbled away on any short-term operating purpose.

However obvious from a business and economic standpoint, this proposal touched off enormous controversy and opposition when proposed in the political realm. Many citizens, with a sincere sense of responsibility, misperceived that value was simply being pulled forward from future years. Many have not yet understood that the state is being paid more than $2 billion more than the road conceivably would have been worth in public hands. Far from "stealing from our children," we have acted to leave our children billions in new public assets—roads, bridges, airports—that they would otherwise not have enjoyed. Turning down this deal would have been the real theft from the future.

But we almost did turn it down. The fact that the winning bidder was an Australian-Spanish joint venture struck many of my fellow citizens negatively, and this reaction emboldened a partisan opposition that united to almost defeat the necessary enabling legislation. The irony of this "anti-foreigner" argument in an export-dependent state that is home to hundreds of foreign-owned firms was lost on many Hoosiers. Over time, one hopes that a modernized, more customer-friendly toll road, coupled with the highly tangible benefits to our state as the proceeds are reinvested, will overcome misplaced patriotism.

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?

However strong the philosophical case for freedom and a limited state, it is the relentless march of the evidence, through statism's many spectacular failures, that has discredited Big Government in the minds of our ever-practical fellow Americans.

More than a decade has passed since a president who had just attempted the biggest expansion of American government ever proclaimed "The era of Big Government is over." However strong the philosophical case for freedom and a limited state, it is the relentless march of the evidence, through statism's many spectacular failures, that has discredited Big Government in the minds of our ever-practical fellow Americans, and that furnishes the template for progressive proposals of better ways forward against our common challenges.

The Honorable Mitchell E. Daniels is the governor of Indiana. He previously served as the director of the federal Office of Management and Budget from 2001 to 2003.

Advancing Limited Government, Freedom, and Markets

By Mark Sanford, Governor of South Carolina

Any read through history demonstrates how essential limited government is to preserving freedom and individual liberty. What life experience shows us is that limited government is equally important in both making your economy flourish and in enabling citizens to get the most for their investment in government.

Let me be clear up front that in the long run the only way to make government truly efficient is to make it smaller, and this seems to me to be the real clarion call in highlighting the importance of privatization efforts. Efficiency and government are mutually exclusive in our system, and if our Founding Fathers had wanted efficiency I suppose they would have looked more closely at totalitarian systems. They wanted not efficiency, but checks on power in our republic.

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. South Carolina used to institutionalize every mental health patient in the state on a single piece of property, but then the business model changed and the number of patients our state institutionalized dropped from several thousand to fewer than 200. Despite the change, we continued to hold on to the $50 million piece of property. We made the business case, and pointed out that if the

vastly underutilized property were sold, there would be three dividends: one to mental health patients, another to taxpayers and a third to children in the local school district because the property would be back on the property tax rolls.

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!

There is no substitute for time and focus: Milton Friedman once said the ultimate measure of government is what it spends. This is certainly not the only measure—but it is a very good place to start. As a consequence, we have spent a lot of time digging into the budget—in fact, ours is the first administration in South Carolina history to have ever produced an operational executive branch budget. It is said in Washington that Presidents often get diverted and focused on foreign policy because it is seemingly a loftier issue. At the state level, there are a wide variety of things to take a chief executive's eye off budget matters, but I think we all need to remember the first real barometer on whether we are advancing the conservative cause of limited government is the budget. It was Paul Kennedy is his book *The Rise and Fall of the Great Powers* who talked about how not foreign policy but, ultimately, economic might was the driver of a nation's viability in the long run.

Finally, you can go back to the Ten Commandments to see warnings on envy—on coveting what someone else has. Tragically, envy is part of human nature and in some cases it can be used as a tool in attempts to limit government. We frequently make the point that government shouldn't grow faster than the people's pocketbooks and wallets—and what we've found is people, when they compare their wallets with the growth of government, nearly always agree!

Long story short is that it occasionally gets lonely holding our position in the struggle between the growth of government and freedom—and in advancing market-based solutions in areas such as education or health care. And, as a consequence, I've grown to that much more appreciate fellow soldiers in this greater battle for freedom.

On this front, Reason Foundation has been a great partner in our efforts to infuse a business mindset in government through competition and free market principles, to improve services and reduce costs—and in our greater efforts to bring change to South Carolina. Congratulations to Reason on 20 years of privatization success. The 20th anniversary edition of the *Annual Privatization Report* clearly establishes Reason's role as the world leader in privatization and government reform ideas.

The Honorable Mark Sanford is the governor of South Carolina. He previously represented South Carolina's 1st Congressional District in the U.S. House of Representatives from 1995 to 2001.

Privatizing to Improve Government

By Steven Goldsmith, Kennedy School of Government, Harvard University

The conditions facing the privatization movement today differ fundamentally from conditions 30 years ago, when Reason Foundation first began documenting and analyzing this important shift in government management and policy. In the United States, local, state, and federal government all deliver ever-increasing high-quality government services through third-party providers. The continuously declining ratio of government employees to contractors provides evidence of the momentum of this trend. At the same time, the public continues to witness all too frequent headlines touting examples of poor services, corrupt or flawed processes, and personal abuses resulting from contractual services.

This article looks at not only the inevitable future growth of privatization but also why the term "privatization" is less relevant today and how success should be measured and ensured. 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?

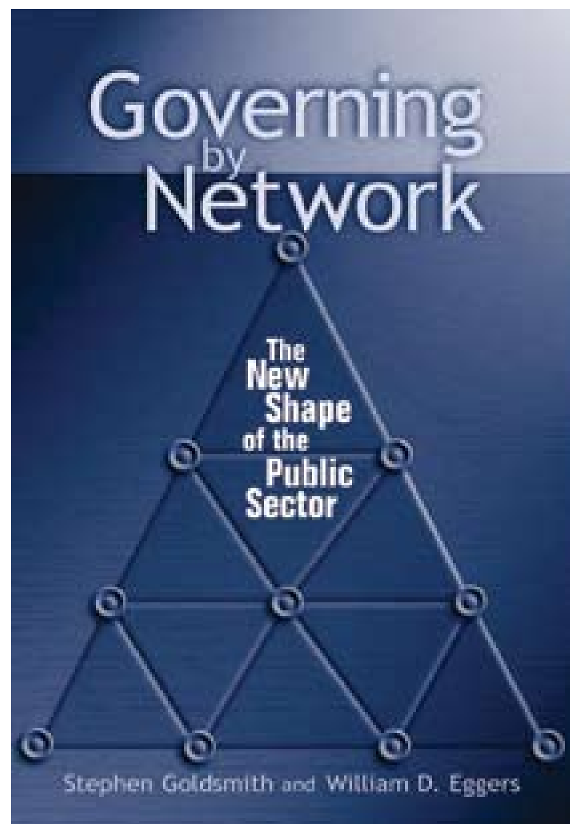
Today, however, a mixture of private, not-for-profit, and government employees works together to produce almost every complex government service. The right and left continue to frame the public/private choice as a bilateral one, pitting private profiteers against lazy bureaucrats, but these opponents 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.

Governments of developed countries face hugely complex problems, from providing homeland security to mitigating social ills, and must utilize delivery systems that do more than efficiently deliver antiquated processes. For government to move forward, private and not-for-profit providers need to contribute public value by providing solutions. For example, Mayor Anthony Williams of Washington, D.C. did not privatize the operation of an obsolete public hospital to reduce losses; rather, he worked with private and not-for-profit community health partners in order to achieve the true goal of "making better health" for citizens (*Governing by Network*, p.58).

Fundamentally, privatization will increase because government simply cannot successfully discharge all of its current and future responsibilities by itself. The stark reality, for better or worse, is that bureaucratic, "progressive" government can no longer produce enough good government and meet citizen demands with the money available. Progressive government (now a misnomer) started 75 years ago as local and national reformers imposed bureaucratic "command-and-control" procedures in an attempt to reduce corrupt or patronage-infested governments. Progressives did indeed reduce corruption and abuse of discretion, but they did so by *eliminating discretion*. This arrangement ensures that as problems become complicated, government cannot keep up. In fact, traditional government processes struggle to solve complex horizontal problems with vertical solutions. Inherently, public officials cannot run fast enough in their assigned places to deal with these problems.



Governments of developed countries face hugely complex problems, from providing homeland security to mitigating social ills.

In addition to the increasing complexity of public problems, a rising imbalance between citizen demands and available resources will strain even the best-run operations. An aging population will demand health, pension, and nursing home services that will exceed the most optimistic projections of tax revenues.

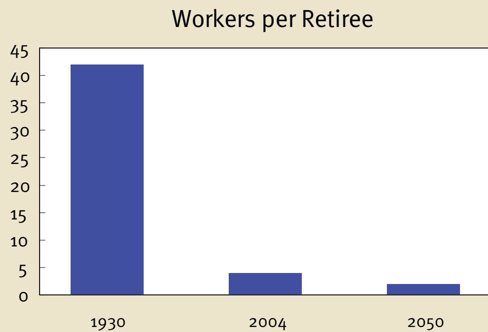
Faced with complexity and service demand growth, government officials must figure out how to better manage a government whose role is transforming from that of service provider to that of

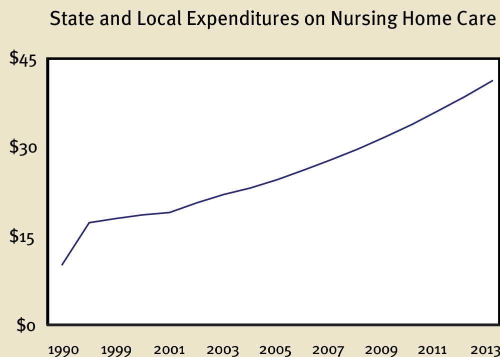
network facilitator; government is doing less itself and more through third parties. Until government officials adapt and respond to this transformation, taxpayers will not get the results they deserve. As suggested in *Governing by Network*, this new generation of issues requires more than "privatization to save money," which is worthwhile but not enough. It demands "outsourcing as part of government transformation." Outsourcing an antiquated system in order to more efficiently deliver an outdated process skips the threshold question: What is the public value I am trying to add?

With the goal of adding public value in mind, what rules should government officials apply in order to produce positive results? Of course, external factors can provide momentum or create obstacles, but, after competing-out 80 public services (and observing or advising dozens of officials engaged in privatization), I highlight six issues that if managed well will dramatically increase the chances of success. Despite a relatively strong foundation, the future of the privatization movement depends on getting these issues right.

An Ominous Future?

An aging population will demand health, pension, and nursing home services that will exceed the most optimistic projections of tax revenues.





1. Control Results, not Processes

Officials worry about the wrong things when they focus on control. Public officials stay wary of surrendering control of service delivery to nongovernmental agents and employees because they are painfully aware of the ultimate responsibility they have for meeting public expectations. However, this reasonable anxiety should take officials down another track, one in which they allow processes to be flexible but retain control over quality outcomes. Put another way, it is not so important whose uniform the meter reader wears, but whether clean drinking water—a public value—can be secured in all parts of town for an affordable price. The private sector produces, in a generally agnostic way, what it commits to, so it is the public sector that must impose the values. For example, how can both fairness and efficiency be achieved? How can access and equity be enhanced? And, how can privacy and transparency be protected? Safeguarding these values is the responsibility of public officials and requires scrutiny and rule-making at every stage of the process, from initiation to management. Governments that insist on spending all their management talent on the delivery system and not on larger values often get both wrong.

2. Manage the Flexibility/ Accountability Tension

The new shape of government by network requires the management of both flexibility and accountability. Not-for-profit and for-profit partners produce better results when they are free to use their talents to deliver services. These private partners should be given substantial discretion because they are closest to the problem or client. Micromanaging slows down the provider's ability to be responsive. However, private providers must remain accountable when they use public dollars. Clearly, too little oversight can also lead to problems, namely, cost overruns, services failures, and even scandal. Public officials must allow flexibility in what is delivered and how it is delivered, but accountability in terms of performance outputs and outcomes.

> Fundamentally, privatization will increase because government simply cannot successfully discharge all of its current and future responsibilities by itself.

I have observed this tension in my own work as chairman of the Corporation for National and Community Service, the quasi-government parent of AmeriCorps and other programs. When one organization out of thousands does something wrong, the natural tendency is to enact new regulations that burden thousands of high-performing grantees. Government agencies all too frequently act similarly—rather than targeting the response to the individuals or vendors in the wrong, they place new requirements on all partners, thereby restricting flexibility. The innovative public manager must be on-guard against using extreme amounts of authority and control and mindful of how they are deployed.

3. Articulate the Case for Privatization

Strangely, often even bold public officials do not spend enough time making the case for change. A full list of stakeholders, including the inchoate ones that will benefit from change but do not yet know or believe it, provides a starting point. Usually, the immediate benefits fail to inspire, but the immediate risks, including employee displacement, energize opposition. In these situations, taxpayer savings alone usually do not carry the day. Documenting poor customer service and weak infrastructure that will be improved will help garner the support necessary for privatization.

We based the Indianapolis privatization/managed-competition strategy on a pro-growth agenda that was necessary to generate private-sector jobs. City employees and citizens came to understand that making public units competitive with their private counterparts was the only way to decrease taxes and still offer better services.

4. Establish Benchmarks Early

Privatization initiatives often stir controversy. Even if the status quo is mediocre, change produces the prospect or perception of loss—job layoffs, less human interaction with providers (more automated services), or cutbacks in service—and often attracts strident critics. A favored media technique involves finding something wrong with an outsourcing, even a highly personal anecdote, and promoting it through headlines as an example of failure. While no approach will inoculate the

innovator against this attack, an important mitigation strategy involves carefully and accurately benchmarking the process before outsourcing: i.e., how long do people wait in line to get their welfare checks? How many trips to the motor vehicles registration department are unnecessary? How much does it cost to fill the (proverbial) pothole?

These metrics help both the public relations aspect of an outsourcing and the eventual contract monitoring, as the government must ensure that the private provider is meeting the specified service requirements. In addition, having accurate cost and performance data is crucial, not only to guard against low bidding by vendors who later wish to modify their contracts for greater profit but also to counter understated or overstated in-house cost estimates. Finally, benchmarking helps foster realistic expectations about what the vendor can actually deliver.

5. Implement Successful Contract Monitoring

High-quality contract monitoring enables both good vendors and the public at large to benefit from privatization. In order to carry out this type of monitoring, officials must overcome a number of serious obstacles: inadequate knowledge management tools that restrict information from passing easily from one sector to another, poorly conceived quality or service-level agreements, too much prescriptive input oversight, too little output oversight, and the inability to capture dynamic changes. Technological tools allow private and government organizations to be merged and managed as a seamless delivery system. The challenge lies in balancing the burden of risk placed on each party. Managing public services through private-sector agents requires some degree of aptitude in negotiation, mediation, risk analysis, trust building, collaboration, and project management. Considering these factors in advance will go a long way in ensuring that privatization results in public value.

6. Treat Public Employees Fairly

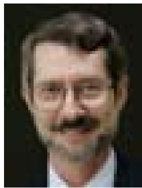
An official interested in government by network can assume that a large percentage of government workers will respond well to appropriate incentives and good management. Indeed, many of these workers operate in very difficult environments with mediocre management, unclear performance standards, and no reward for productivity. In a privatization initiative, communication must happen early and frequently, and affected unions and public employees have a right to understand the rationale, direction, and range of possible outcomes. Clearly explaining options to existing employees, reassuring good employees about their futures, and encouraging vendors to be open to continuity of employment will help to ensure success.

Over the last two decades, privatization has grown into a well-respected aspect of government at all levels. But, as outsourcings attempt to solve more complex problems and become more complicated to manage, the stakes will increase. Officials who pay attention to these six issues will increase their chances of adding public value and garnering public support.

Stephen Goldsmith is the Daniel Paul Professor of Government and director of the Innovations in American Government Program at Harvard University's Kennedy School of Government. He also served as the two-term mayor of Indianapolis, Indiana from 1992 to 1999.

Reflections on 30 Years of Promoting Privatization

By Robert W. Poole, Jr., Founder and Transportation Director, Reason Foundation



In the early 1970s I read two books that would have a profound effect on my career in public policy. In his 1969 book, *The Age of Discontinuity*, Peter F. Drucker used the term "re-privatization" to refer to the eventual return of nationalized industries to the private sector. It was an electrifying thought to a young libertarian, eager to shrink the state. And then I discovered William C. Wooldridge's 1970 book, *Uncle Sam, the Monopoly Man*. Here was a series of chronicles of entrepreneurs who had developed private-sector alternatives to government services, some unsuccessful (e.g., Lysander Spooner's private mail company) and others that were great successes.

In those (pre-Reason Foundation) years, I was working for a consulting firm in Santa Barbara that worked with city and state governments. On assignment in Phoenix, I realized that right next door was Scottsdale, the largest client of one of the successful privatized services profiled in Wooldridge's book: Rural/Metro Corporation, a for-profit fire department company. How could I not pay them a visit?

In the course of that visit, I got to know founder and CEO Louis A. Witzeman, who became a good friend over the years. My 1976 *Reason* article about fire privatization's success would lead to a very positive "60 Minutes" story two years later, the first time Reason hit the major networks.

In the course of my work with cities and states, I encountered case after case of privatized (or as we say today, "outsourced") public services, mostly in fast-growing Sunbelt states. A few political scientists had noticed the phenomenon, and I eagerly snapped up UCLA and Indiana University papers on the California contract-cities phenomenon—newly incorporated cities set up without service-delivery departments, relying largely or entirely on contracts with private firms and larger nearby governments (e.g., the county sheriff's department) for their public services.

Yet the world at large seemed almost entirely unaware of this phenomenon, and I was itching to make it better known. So when my friend and colleague Mark Frazier in 1976 challenged me to document privatization of municipal services, and provided a publishing opportunity, I researched and wrote a 46-page handbook, "Cut Local Taxes—without Reducing Essential Services." It was widely distributed by the National Taxpayers Union (on

whose board Mark sat) in hopes of giving credibility to the budding grassroots tax revolt movement around the country. The booklet created enough interest that it led to a contract with Universe Books in New York for what became the first-ever book on privatization, my *Cutting Back City Hall*, published in 1980.

Mark also made a deal with NTU to distribute a monthly column by me on these ideas to local newspapers around the country. Beginning in autumn 1976, it was called "Fiscal Watchdog." It eventually evolved into the Reason Foundation's *Privatization Watch* newsletter. But even in its fledgling days as a newspaper column, "Fiscal Watchdog" (and the "Cut Local Taxes" handbook) had a much wider impact than I imagined. At some point in the late 1970s, I was contacted by a young Conservative Party local council member in England, John Blundell. He'd heard about municipal privatization in the United States and wanted some details. So I sent him the assembled "Fiscal Watchdog" columns and the handbook, and wished him well. Only many years later did I learn that the booklet he co-authored on the subject, "Reservicing Britain," had helped to introduce Margaret Thatcher to the concept of privatization.

Needless to say, watching the Thatcher revolution of the 1980s dismantle the edifice of state-owned industries and utilities in the United Kingdom was breathtaking—not only the traditional targets of British Coal, Britoil, British Steel, British Airways, and British Leyland (autos), but also the airports, seaports, electricity, gas, water, and telephone monopolies. As this grand strategy was put into action, and with great political success, I was increasingly frustrated that no comparable privatization agenda emerged from the Reagan White House. To be sure, there was much talk of privatization in Reagan's first term, but it never seemed to lead to any serious policy proposals.

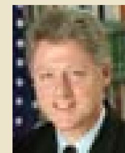
Robert W. Poole, Jr. testifies at the United States House of Representatives.

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, D.C. airports from the federal government to a newly created local airport authority.

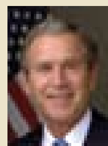
Unfortunately, the federal government moves very slowly, so the President's Commission was not appointed until 1987, which meant that its report appeared in 1988, at the end of Reagan's second

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.

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, Sallie Mae, extensive spectrum auctions, and a serious effort to create a nonprofit corporation to take over air traffic control.

Despite the fact that we still have government-owned electric utilities (TVA, Bonneville, and the rest), a government-monopoly post office, and a whole raft of other government corporations, the worldwide embrace of privatization by governments of all stripes over the past 20 years has been exhilarating to me. If Canada can privatize its air traffic control system, France its major highways, and China its banks and countless other state-owned enterprises, I still have hope for privatization of the many remaining federal enterprises in the USA.

Robert W. Poole, Jr. is director of transportation studies and founder of Reason Foundation.

Privatization: Past, Present, Future

By E. S. Savas, City University of New York

Privatization means relying more on the private institutions of society—the market, the family, and voluntary groups—and less on government to satisfy people's needs. Privatization ultimately led to the founding of the United States inasmuch as Queen Isabella hired a private Italian contractor to explore the western ocean instead of relying on the Spanish navy. But privatization almost thwarted American independence: the British hired contract troops, Hessians, to prevent the colonies from breaking away. History is rich with such examples, but a significant change in privatization took place in the last third of the Twentieth Century.

The Past

Governments have always used the private sector for public purposes. They bought supplies from private firms: horses and trucks, desks and books, food for prisoners, uniforms for soldiers. Public infrastructure was also constructed by private firms: roads, schools, courthouses, city halls. All this long preceded the concept of privatization. The word "reprivatize" was introduced in 1969 by the management guru Peter Drucker, referring to the need to have the private sector resume many functions that had been ceded to big government a generation or more earlier. Robert Poole, Jr. seized the term and coined "privatization," which first appeared in a dictionary in 1983. The profound change from the past role of the private sector in public services was the deliberate use of privatization to improve the performance of government and, indeed, of society by introducing competition and alternatives in the delivery of public services.

The first media notice of the idea of which I'm aware was in 1970, when the *New York Times* featured a front-page story about my plan, as First Deputy City Administrator of New York, for an experiment in which private firms would compete against the city agency for garbage and trash collection. In 1971 *Harper's Magazine* published my article, "Municipal Monopoly," and in 1977 the first two books on the subject (both by this author) were published. One of those books and several research articles showed unambiguously that public garbage collection was 30 percent more costly on average than collection by private contractors. The National Solid Wastes Management Association picked up these research findings and heralded them to virtually every city, town, and village in America in the late 1970s; it played a vital role in arousing interest in privatization by disseminating the information to decision-making public officials that books and journals did not reach. In the meantime, in 1976, Bob Poole, the founder of Reason Foundation, started

an invaluable newsletter—still published monthly—that keeps readers abreast of privatization happenings. He authored the first solo-written book on privatization, *Cutting Back City Hall*, in 1980. After that came a deluge of books and articles about this new concept for improving government.

The Present

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, liberals and conservatives, and black, white, and Latino officials.

The changed nature of public administration is called "the New Public Management," which recognizes a large role for civil society and for market principles: privatization, public-private partnerships, choice, competition, deregulation, user charges, and pricing strategies. They are all of a piece: less reliance on conventional government tools.

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. As is generally the case, competition forces the in-house unit to improve its performance or see its jobs outsourced. In fact the government agency won 90 percent of the competitions but only after it made large efficiency improvements under the threat of outsourcing. Contractor associations complain that in-house costs are not calculated properly.

A different kind of privatization has emerged at the local level: the private community. More and more of these private, voluntary, self-governing units are springing up, appealing to those who like the features of such neighborhoods. In the meantime, some newly chartered cities are adopting the Lakewood Plan: private and intergovernmental contracts for most of their services and only a skeleton workforce.

The difficulties of contracting under emergency conditions were highlighted by the experiences in Louisiana after Hurricane Katrina and in Iraq. Large-scale fraud is easy in hectic circumstances and honest costs are inevitably high because many layers of subcontractors are necessarily involved.

Private security firms in the United States perform expedited screening of trusted travelers, and other kinds of security firms provide security for individuals and offices

in dangerous areas, including Iraq. Overall, in the 1990 Gulf War there was one contract employee for every 50–100 soldiers; in the Iraq War there are 10 for every 100.

One can list the imaginative ways that innovators are privatizing a vast array of public activities, but space does not permit that luxury. One can however, look ahead.

The Future

With respect to social security reform, President Bush's plan did not gain enough legislative support and neither did Governor Schwarzenegger's plan for the California retirement system. Nevertheless, I have enormous confidence that government will make the right decision—but only after it has exhausted every other conceivable alternative. After trying higher social security taxes, later retirement, reduced benefits, and increased taxes of all kinds, a future administration must ultimately produce a more privatized system. Deferred tax plans are already proliferating; what remains is to make them available to all workers and to displace much of the current social security system.

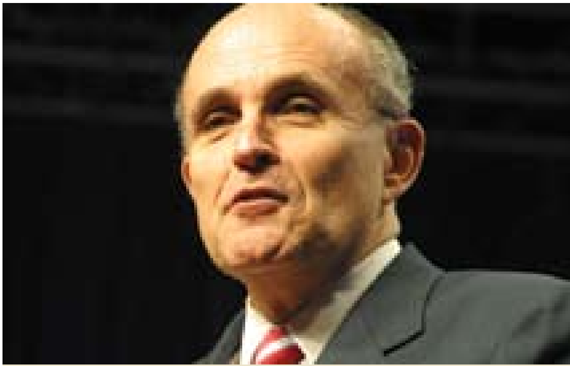
Costs are rising for all medical services in today's malfunctioning health-care system except one: cosmetic surgery—which is the only part that is based purely on market forces with no insurance or government subsidies. Therefore I see a more privatized health care system unfolding in the United States, with medical savings plans, health-insurance vouchers for low-income families, and a variation of Governor Romney's compulsory health-insurance plan for Massachusetts. Countries proud of their socialized health care are quietly allowing private medicine to return as their citizens complain about long delays and rationing of medical care.

Recent opinion surveys show that the African-American community has shifted decisively in favor of school choice, diverging from its "leaders" who reflexively support teachers' unions that vigorously oppose it. This augers well for continued growth in charter schools and vouchers, as well as tax credits for private-school tuition and even home schooling. Mayor Anthony Williams of Washington, D.C., in desperation, provided the breakthrough by endorsing a Republican voucher plan for his city, saying that any change had to be better than the status quo.

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


Even in liberal bastions like New York, Mayor Rudolph W. Giuliani outsourced, divested, and privatized several municipal services.

needed infrastructure such as high-occupancy toll lanes, roads, bridges, tunnels, airports, water systems, and government buildings.

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. This model has been adopted for other selected sites.

Another well-known example is the Business Improvement District (BID). Property owners, typically in commercial areas, form a corporation and levy a special property tax on all properties (collected by the state on their behalf) in their defined geographic area. The BIDs provide extra security and cleaning, and beautification through fancy street lighting, well-designed street signs and newspaper vending boxes, trees, and plantings. They realize higher sales in their stores and increased property values.

Adopt-a-highway, adopt-a-library, and adopt-a-school programs attract private sponsors who improve services that suffer from government default. Cultural institutions were successfully encouraged, through a matching grant program, to seek more funds from donors and accept less from the city; that is, the city partially withdrew from providing its costly support.

These examples from New York might profitably be emulated elsewhere. They represent an expanded pattern of municipal privatization that goes beyond conventional outsourcing and divestment.

At the federal level, the greatest opportunities lie in continuing the A-76 competitions for activities deemed commercial, and, even more important, privatizing the numerous federal corporations: Amtrak, the United States Postal Service, the Tennessee Valley Authority (TVA), and the power marketing administrations (PMAs) are the most attractive candidates.

The large, continuing, and widely deplored drain on the public purse by Amtrak suggests that this might be the first to go. New Zealand, Germany, The Netherlands, France, and Denmark are well along on privatizing their postal services. In the United States postal services are partly

privatized: Federal Express, UPS, and DHL (which is majority owned by Germany's Deutsche Post) provide private mail services, but more privatization can bring large efficiency improvements. TVA and the PMAs have long outgrown their special status as government corporations; they can and should be set free to make their way in the marketplace.

The welfare states of Western Europe are stumbling toward liberalization, but backward-looking economic chauvinism remains a force that weak politicians have not tackled. Unless the move to free markets is accelerated and the remaining state-owned enterprises are privatized, the countries are doomed to continued economic stagnation as well as demographic decline. The post-socialist states of Eastern Europe, on the other hand, emerging from the bleak past to which they were consigned for four decades and hardened by that involuntary experience, are determined to avoid the errors of their western neighbors.

Free-market environmentalism can also be expected to grow. It is the proven private alternative to costly and ineffective command-and-control schemes for protecting endangered species and habitats. To avoid the tragedy of the commons, one can look to the creation of more private, voluntary arrangements for "property rights" over animals, fish, and ecologically sensitive lands—via auctions of cleverly designed contracts to limit kills and catches and via binding covenants to preserve natural lands in perpetuity. Conservation banks, first created in 1995, now number 70 and represent another approach to environmental protection for endangered birds and animals.

Stephen Goldsmith and Bill Eggers offer a compelling, expanded view of privatization. The role of government has evolved from a hierarchical producer of services to a partner with private organizations—outsourcing, public-private partnerships, "third-party government"—and is now becoming a facilitator, convener, and broker engaging the talents of all sectors of society and often multiple government levels. That is, government now addresses many of its policy objectives by involving and managing external partners. The authors call this governing by network, because problems transcend organizational boundaries.

One can look ahead with hope to the gradual acceptance of Charles Murray's revolutionary proposal to transform entitlements. It is breathtaking in its simplicity. Instead of politicians gaining votes by dispensing largess through a multitude of particular benefits going to selected segments of the population, an annual payment would go to every adult. This would be funded by eliminating all current transfer payments. Neither tax revenue nor total government spending would decline, but government would be far less powerful in this better-balanced society, and the benefits would be enormous: a civil society in which individuals live meaningful and secure lives in an age of plenty.

Both the Goldsmith-Eggers insight and Murray's vision fit the definition of privatization cited at the beginning of this essay: Relying more on the private institutions of society and less on government to satisfy people's needs.

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.

Privatization: Are We Finally Turning the Corner?

By Ronald Utt, Senior Research Fellow, The Heritage Foundation

How odd it is that the United States continues to lag most other nations in privatization of government activities—the process of shifting commercial activities from government ownership and operation to private sector providers. With government involvement in our economy lower than most other advanced nations (36 percent of GDP in U.S. compared to 55 percent in France and 45 percent in the United Kingdom in 2005), and where the virtues of capitalism and competitive markets are openly endorsed by both political parties, the U.S. has yet to embrace the concept to the extent that other nations have.

Where Britain, Canada and 38 other countries have privatized or commercialized their air traffic control systems, the U.S. maintains an inefficient and high cost government monopoly, whose overpaid worker force is now lobbying Congress for a compensation package that would average more than $200,000 per year per controller. Even worse is our warm and generous embrace of a socialist passenger rail system (Amtrak) whose losses nearly match the revenues it earns from ticket sales. Whereas Argentina, Japan, Britain, Australia, and others have all turned—with great success—to the private sector to own, operate or manage their passenger rail systems, the U.S. remains committed to the kind of socialist business model that Russia and other former communist countries have been abandoning since 1990.

Although the reasons for America's slow progress in shifting government commercial operations to the private sector are many and varied, chief among them is America's comparatively greater wealth and prosperity that has allowed us to avoid making tough financial choices for the sake of budgetary savings that many other countries have had to adopt and endure. So what if Amtrak loses $1.2 billion per year serving a tiny fraction of the traveling public? Unlimited access to global capital markets allows us to borrow the money to pay the subsidy and avoid a rate hike for passengers, thereby burdening future generations with the irresponsible self-indulgence of those now in power.

But are things changing for the better? Twenty years ago I had the good fortune to be appointed by OMB Director Jim Miller

to be the federal government's first (and last!) director of privatization at the U. S. Office of Management and Budget. With the full support of President Ronald Reagan, we proposed a bold agenda that included the privatization of federal lands, Coast Guard rescue responsibilities, adjudication of federal tax disputes, the U.S. Postal Service, the Naval Petroleum Reserves, the U.S. Helium Reserves, the uranium enrichment program, and many others. I would like to say that but for an obstinate, left-wing Congress we would have quickly prevailed and put the nation on a course of money-saving, service-enhancing privatization; in point of fact, the most serious opposition to our bold privatization agenda mostly came from the people President Reagan appointed to run the many departments that comprise the federal government.

Worried about congressional reaction and opposition from the civil servants who were opposed to any change in their jobs, and who saw privatization as a threat to their power and status, many of the president's political appointees opted to protect their workforce from the competitive pressures that President Reagan wanted to incorporate into the federal bureaucracy. Indeed, had it not been for OMB Director Jim Miller's success in getting the president to agree to devote time at one of his cabinet meetings to review each agency's progress on privatization—thereby forcing action to avoid embarrassment—the outcome would have been even less impressive. Despite this clever gambit, agency opposition and foot dragging persisted and limited our progress, and much of what was accomplished during the 1980s was undone during the subsequent Bush I administration, whose enthusiasm for privatization was markedly less than Reagan's. Nonetheless, a few of the Reagan ideas quietly progressed—the Naval Petroleum Reserve and the uranium enrichment program—and these were ultimately privatized during the Clinton Administration.

But with the exception of a renewed commitment to competitive contracting within the federal bureaucracy (and some notable achievements including the contracting out of FAA's flight service stations), the Bush II administration has not pursued the kind of privatization opportunities that have been proven successes in other advanced countries, particularly in air and surface transportation programs. Nor has the president revived the position that I held—OMB Associate Director of Privatization—to ensure that at least one federal official has full time responsibility for the program. Instead, responsibility is diffused throughout the government, and privatization becomes everybody's secondary concern, and not much happens.

> Indiana's $3.8 billion windfall got the nation's attention, and many states are now looking for ways to cash-in on the bonanza.

Although federal enthusiasm for privatization has waxed and waned over the past 25 years, support for the concept has been picking up steam at the state level—especially in highways where a number of states have embarked on ambitious programs in partnership with private sector investors, builders and operators. Virginia, Georgia and Texas have enacted legislation to encourage private contractors and investors to build new roads in their states in partnership with the state's department of

Texas has already received an offer of about $7 billion for a new toll road.

transportation. Virginia's program has been in operation for more than a decade, and in recent years the state has received proposals from major corporations that, combined, would provide more than $10 billion in private money for new roads in the state. Texas enacted a similar law a few years ago, and it has already received an offer of about $7 billion for a new toll road, while another group of investors has proposed a billion dollars for a new road in Georgia.

Once some states became comfortable working with private investors to fund and operate new roads, the selling or leasing of existing roads to private investors was less controversial than would have been the case had these transfers occurred in isolation. Thanks to this growing acceptance, both the city of Chicago and the state of Indiana were able to lease existing toll roads to private investor/operators for a combined sum in excess of $5 billion. As a result of these successes, a number of other states with potentially valuable toll facilities are taking a closer look at converting their roads to cash to fund other public needs.

One reason these recent road privatizations and partnerships have succeeded where others have failed has been the financial necessity of such transactions. Because the user fees/taxes that fund most state transportation programs have been growing slowly in recent years, and voters and motorists have been reluctant to support an increase in taxes, many state (and federal) transportation programs have been experiencing funding shortfalls in comparison to their building and maintenance needs. With their traditional options for new revenues shrinking or closing, more and more state transportation programs are adopting, or seriously considering, different forms of privatization as a substitute for traditional construction and public finance.

Whether the growing interest in privatized roads will spill over into other public programs and infrastructure remains to be seen. State transportation systems are generally self-funded with dedicated taxes and operate independent of a state's overall budget. As a result, financial shortfalls confronting the transportation sector may extend no further, in which case the pressure to privatize may be isolated just on roads.

Still, some of the recent successes are hard to ignore, and more and more states will likely begin looking to convert other tangible assets to cash that can be redeployed to meet public needs. Indiana's $3.8 billion windfall got the nation's attention, and many states are now looking for ways to cash-in on the bonanza. Advocates of privatization should be prepared to help them meet that goal.

Ronald Utt is a senior research fellow for the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation. Utt also served as former associate director of the U.S. Office of Management and Budget during the Reagan administration.

"Q" Privatised? James Bond More Efficient?

By John Blundell, Director General, Institute of Economic Affairs

Given the British Labour Party was the primary architect of the nationalisation of so much of the UK economy, it is worth remarking how the tide of privatisation has risen so high the reinvented New Labour Party has not blocked further privatisations and indeed has gone to areas where others feared to tread. It has been bold where the Tories were diffident. It has also adapted regulatory regimes to open previously closed markets.

The UK Air Traffic Controllers were an agency of the state that the Conservatives had funked reforming. Where Ronald Reagan had had in 1981 one of his greatest victories, Mrs. Thatcher and her team were reluctant to privatise these functions. I think they were intimidated by the synthetic but real fears that air safety might be compromised or even perhaps sabotaged by militant trade unionists. Prime Minister Blair insisted that the tentative proposals were conducted through to full privatisation.

Another remarkable New Labour sell off was the diverse Research and Development laboratories of the UK Ministry of Defence. These were the "Q" figures familiar to fans of the James Bond books and movies. Nobody doubted the scientific ingenuity of these units but it had not occurred to any Tory Minister they could be brought to the market. Given a radical overhaul, Quiniteq plc was floated on the stock market to acclaim.

As I write Mr. Blair is in a tussle with the producer groups to open up the state's near monopoly of hospitals and schools. New Labour is trying to devolve decision-taking down to local clinicians and break the hierarchical system of the National Health Service. The Government is bringing in private companies to supplement or displace NHS units now deemed expensive and slothful. The arrival of alternatives is impressive in its ability to confound long-standing assumptions.

By a subtle process the dental profession has been discreetly privatised by changing the contract of dentists with the NHS. Most British dentists are ceasing to be civil servants and becoming private practitioners, both screening services and specialist operations. I think it fair to say this is something Mrs. Thatcher would not have dared to attempt—nor John Major.

Mr. Blair is in a tussle with the producer groups to open up the state's near monopoly of hospitals and schools.

Tony Blair is investing much of his political capital in creating a network of semi-private schools which will be no part of the local authority schools, which seem to be as flawed as U.S. public schools. This is inviting the vehement hostility from the National Union of Teachers but the schools that have opted out of municipal control seem to be prospering. Parents are clear—they value them. We are still however far short of creating a true schools market.

The very first act of the new government in 1997 was not quite to privatise the Bank of England but to instruct it to act autonomously. This was as bold and radical as Mrs. Thatcher's very early decision to abolish exchange controls. The setting of interest rates and other policy matters are no longer done on command from the UK Treasury.

Technical innovations have changed much of the British commercial landscape. The British Broadcasting Corporation, a state body often "lovingly" called Big Bunch of Communists, has seen its superior status challenged and dissolved as first satellite then broadband and other "platforms" were allowed to transmit. The BBC still exists, cozy in its protective cocoons, but it is now just another broadcaster amongst many albeit tax financed.

There is no shortage of candidates for market principles to be applied afresh in Britain. The brilliant Macquarie Infrastructure Group of Australia constructed and now runs a significant chunk of the M6 Motorway, a prime British trunk route. The road system of the UK is run by the state and impervious to price information...or rather pricing and timing. The nominally hard Leftist regional regime in London, led by Mr. Ken Livingstone has imposed a "Congestion Charge" in Central London. This is a relatively crude innovation but it has shown that something rare and precious—road space—can be priced. Central London's roads flow much more freely and as soon as you leave the zone the difference is startling. The Conservatives, for rather short-sighted tactical reason opposed road pricing throughout its birth but have suddenly welcomed it on environmental grounds. In my view it will be applied extensively after the next election. How odd that we should be told to "Vote Green Vote Conservative" while "Red" Ken delivers road pricing.

The Labour Government has not sold off the Royal Mail, the state's delivery system akin to the U.S. Mail. It has not been privatised but its privileges have been lifted. Rival postal services are entering a market

Source: HM Treasury

Gordon Brown is particularly clear about the need for free trade and is an unyielding critic of the European Commission with its protectionist and interventionist instincts.

from which they have been barred since 1660. My assumption is that a slimmed-down Post Office will be converted to a limited liability company before the decade is out with a heavy bias towards shares being given or sold at knock down prices to their staff. It is about the last place we ever see strikes and they too will disappear. We will be a no-strike country soon.

The British State is still a holder of a vast portfolio of land. The Ministry of Defence is the single biggest landowner followed by the Forestry Commission. In addition the Crown Estate, nominally the property portfolio of the Royal Family, owns all the marine foreshore and estuarial acres of the country. The pace is slow but Defence, Forestry Commission, and Crown Estate are selling off or leasing their vast estates.

It would be false to depict New Labour as disciples of Mrs. Thatcher. Yet they do invoke the mantra word "reform." Tony Blair seems to regard the public services as slothful and expensive and slow to experiment. For three successive elections, the once emboldened Conservatives have been as frozen as a popsicle when it comes to innovation.

Perhaps a significant sign is the acclaim and respect afforded to Adam Smith by the heir apparent to Mr. Blair, the Chancellor of the Exchequer, Mr. Gordon Brown. He is particularly clear about the need for free trade and is an unyielding critic of the European Commission with its protectionist and interventionist instincts.

In a sense I fear more for the British Conservative Party's attachment to liberal economics. Its new leader has spoken out against "Big Business," whatever that is. He is adopting all the nostrums of Global Warming and prescriptions that I fear will handicap the market's price signaling. He has an uncanny ability to latch onto every crazy green notion and bit of junk science going. Perhaps an occasional appointment with reality is the best ploy to teach politicians what their options truly are.

There is no shortage of opportunities for liberalising British institutions but the pace of reform since 1979 has created a phenomenon that seems unstoppable and other nations are now following.

John Blundell is the director general of the Institute of Economic Affairs. He is a former president of the Atlas Economic Research Foundation and the Institute for Humane Studies.

The New Public-Private Landscape

By William D. Eggers, Global Director, Deloitte Research, Public Sector

I can't say I was around for the *Annual Privatization Report's* inaugural issue but I had the opportunity to help pull together the third one—and many more after that. The world has changed dramatically since those early issues—the fall of the Berlin Wall, end of the Cold War, rise of China and India—and so not surprisingly has the privatization landscape. Four trends in particular define the new environment.

Dramatic Growth in Public-Private Partnerships

When Tony Blair first became prime minister, many analysts wondered whether or not the first Labor party prime minister since the 1970s would undo much of the Thatcher reforms. Speculation was rampant that many of the newly privatized enterprises would be renationalized. These fears thankfully proved unfounded.

Prime Minister Blair surprised many by building upon the Thatcher successes to bring—for the first time really—private-sector finance and innovation to bear on the core businesses of government. Over the past decade, the United Kingdom has become the world's undisputed leader in using public-private partnerships (PPPs) to develop and deliver all manner of infrastructure, from schools and hospitals to roads and defense facilities. More than 100 new schools and 130 new hospital projects have been developed using private finance since the mid-1990s.

The United Kingdom's creative use of PPPs has produced a bevy of benefits: faster construction, big gains in on-time and on-budget delivery, reduced lifecycle costs, better value for money, and a vastly improved overall investment climate for infrastructure.

Prior to the PPP push, decades of neglect had resulted in deteriorated schools, hospitals and other public assets. The introduction of private finance reversed this trend, with £50B invested in capital infrastructure projects over the last decade, and a £26B expansion of Private Finance Initiative (PFI) deals pledged this year. Moreover, a 2002 U.K. audit office survey found that 78 percent of PPP projects were delivered on budget (compared to 27 percent of public projects), and cost overruns were far less frequent.

To be sure, there have been failures—both big and small—over the course of the hundreds of PPP projects delivered in the

United Kingdom. In the face of these, many governments would have backtracked or abandoned the enterprise completely. The Blair/Brown government, however, didn't "go wobbly." They instead learned from each failure and used them as an opportunity to continually innovate in the PPP models employed, developing more creative and flexible approaches.

	Traditional	PFI
Projects over budget	73%	20%
Projects late	70%	24%

Just as the Thatcher privatization program stirred governments around the world to sell off state-owned enterprises, the success of the Blair PPP program has inspired imitators the world over. In India, for example, the once-socialist Congress party government has targeted $30 billion in new infrastructure to be done through PPPs over the next five years. In Europe, the volume of PPP deals is doubling, tripling and even quadrupling year to year in many countries. One hotbed is Ireland where over 100 water and wastewater PPP projects are either operational or in construction and planning.

Meanwhile in the emerging democracies of Central Europe, public-private partnerships are becoming the delivery model of choice for new infrastructure, with governments viewing PPPs both as a way to complete projects on time and on budget, and as a means to attract foreign investment. Explains Czech Republic Prime Minister Jiri Paroubek: "Just like any other market economy, we are trying to multiply the economic potential of the Czech Republic and implement projects for which the public sector alone has neither the strength nor the resources. We are striving to make services accessible to taxpayers that we would otherwise be unable to offer."

Across the pond, in British Columbia, 20 percent of all new infrastructure is now designed, built and operated by the private sector. The United States has been slower to this party. However, with about half the states passing PPP-enabling legislation in recent years and huge PPP projects underway or planned in Texas, Florida, and elsewhere, some analysts predict the states could soon become the world's largest market for PPPs.

Post Ideological

Back in the mid-1980s when the *APR* was first published, the concept of turning over public services or infrastructure to the private sector was strongly associated with center-right parties and politicians like Ronald Reagan and Margaret Thatcher.

Center-right parties and politicians like Ronald Reagan led the charge for greater private sector provision of government services.

Not anymore. Since then center-left (often Labor) governments in Australia, New Zealand and the United Kingdom have championed far-reaching PPP and privatization programs. Meanwhile, in the United States, Democratic politicians such as former Virginia Gov. Mark Warner and Chicago Mayor Richard Daley outsourced major areas of government and pioneered partnership approaches for infrastructure. All in all, private provision of public services has been increasing relative to government delivery for decades in every region of the world regardless of which party is in charge at the time.

The result: a far more pragmatic and sophisticated view of private involvement in public services has come to the fore. The polarized and simplistic debates about the pros and cons of privatization or contracting out government services haven't completely gone away, but thankfully they're becoming increasingly rare.

Emergence of "Governing by Network"

The post-ideological phase we've entered means that the important question is no longer whether a service should be delivered by a private or a public player. The question now is how the sectors, including nonprofit groups, should be arrayed and managed to produce the best public services. In a book I co-authored in 2004 with Stephen Goldsmith, we term this development "Governing by Network."

In this model, government executives redefine their core responsibilities from managing people to coordinating resources for producing public value. Government agencies, bureaus, divisions, units and offices become less important as direct service providers and more important as levers of public value inside the web of multi-organizational, multi-governmental and multi-sectoral relationships that now constitute modern government. The issue is how to conceptualize, configure, and manage a network of public, private and nonprofit providers in a way that produces more value for citizens for each dollar spent.

Government by network has become a fixture at every level of government in nearly every area of the public sector, from Kansas—where a network of nonprofit and for-profit providers delivers all foster care and adoption services—to the battlefield in Iraq—where the U.S. military relied on thousands of contractors to do everything from maintain computer systems to set up base camps.

The U.S. Department of Interior's new partnership model illustrates the networked governance trend. Deputy Secretary Lynn Scarlett, a former Reason Foundation president, has spearheaded a major transformation in the agency toward a heavy reliance on partnerships, a philosophy of leveraging non-governmental organizations to enhance public value, and varied and innovative business relationships. At the 76,000-acre Golden Gate National Recreational Area (GGNRA), for example, partnerships are so extensive that National Park Service employees constitute only 18 percent of the workforce; partners, concessionaires, contractors, cooperative associations, and volunteers compose the other 82 percent. GGNRA's partners have contributed more than $100 million in capital improvements to the park.

Choice Movement

Governing by network represents the confluence of several important trends; one is the growing number of governments that

are injecting choice into public services. The provincial government in Alberta, Canada now offers parents a wide range of publicly funded schooling options including online, public, charter, and private. Meanwhile, state governments in the United States are beginning to shift job training, elder care, mental health, education, and other services to choice-based approaches. South Carolina's new Personal Choice proposal establishes personal health accounts for most of the state's 850,000 Medicaid recipients, allowing beneficiaries to customize the healthcare they receive to suit their individual health needs. Across the pond, the U.K. National Health Service, public schools and social services are offering increased consumer choice, along with more diversity and competition among service providers. Propelling these initiatives forward is the belief that letting people choose encourages a greater diversity of providers, which in turn allows for a better match between citizen preferences and the services received. Choice can also help improve service quality by weeding out poor performers and driving competitors to deliver a consistently higher standard of care.

The choice movement builds on a steadily emerging post-World War II trend: government funds and sets the rules for safety nets while injecting market-based creativity and freedom into the delivery of those services. Instead of inputs and processes, government focuses on accountability, rule setting, and outcomes, such as a quality education. Watch for continued growth and innovation in this area.

Lastly, a Cautionary Note

Reformers need to acknowledge that greater private provision of government services by itself is no panacea. Newspaper headlines reveal the serious difficulties governments often have getting this right. In Iraq, private-sector involvement has been critical but also at times controversial. Atlanta's effort to outsource wastewater treatment failed miserably. And in Kansas, two large, venerable nonprofits went bankrupt as a result of too much risk-shifting in the state's child welfare privatization.

Figuring out how to avoid such failures and better manage a government to do less of the work itself has become one of the central public management issues of our time. Management must move to center stage. Holding providers accountable and measuring and tracking their performance has to become a core government responsibility that is as, or perhaps even more, important than managing public employees.

The government's ability to meet its obligations depends on both sides understanding that a profound change is occurring in how governments fulfill policy goals. If this change is managed well, we'll have a new model of government that protects the public better but produces less itself, focuses on goals instead of processes, and harnesses the dynamism, efficiency, and flexibility of the private sector. And that, ultimately, can only lead to greater public good.

William D. Eggers is the global director for Deloitte Research—Public Sector. He is the author of *Governing by Network: The New Shape of the Public Sector* (Brookings, 2004) and *Government 2.0: Using Technology to Improve Education, Cut Red Tape, Reduce Gridlock, and Enhance Democracy* (Rowman and Littlefield, 2005).

The New Privatization: Applying Old Lessons to New Problems

By Roger D. Feldman, Partner, Bingham McCutchen LLP

Privatization's most important future role is in the national energy and security fields. The basis of this New Privatization challenge lies in its evolution over the past two decades.

Twenty years ago, "privatization" was about dismantling or "reinventing" government, depending on whom you asked. In either case, it involved letting privately performed personnel or businesses relieve government of its growing pseudo-commercial role, in such key agencies as national defense. Privatization was philosophically linked with deregulation: it too involved removal of "unnatural" government constraints on the operation of markets in areas like energy. The resulting "city on a hill" would be better, because whatever was done by it would be operated more efficiently and its resources would be more productively allocated.

Privatization then moved into a "public-private partnership" phase, particularly in the infrastructure development and operation sphere. This has proved to involve an on-going struggle to entice private developers to accept the carrot of government-compensated concessions in exchange for finely tuned governmentally negotiated project acceptance and performance risks.

Privatization/public-private partnerships continue to emerge throughout the infrastructure world, albeit glacially. The rearguard defensive action of public employees has been supplemented by the determined defense of the public treasury and dogged efforts to shift public risk to the private sector through the efforts of public officials guided by very diligent counsel. Some efforts to achieve public/private partnerships expired or lumbered into limbo. We are now seeing a resurgence in fields like transportation where project costs exceed public budgets and the will to tax directly.

Today, the national challenge has shifted: in a physical security sense and in terms of the sustainability of our energy resources, we are a nation at risk. We are all suddenly in a maelstrom together. And when that happens, throughout history, there is always a cry for stronger central government. Confidence in private marketplace solutions to serve the commonweal, as opposed to private providers' interests, tends to wane

When systems fail, if only because of the technical complexity involved, and the eggshell is broken, the yolk is on us. Only Katrina isn't laughing.

rapidly. The need for dramatic innovation seems to cry out for the risk-taker or regulator who will go where no single profit-driven enterprise can independently take financial risk. The significant unremarked problem is created of the headstrong "public entrepreneur" who sees insufficient longer-term danger in the suspension of markets.

Therefore now, more than ever, in the nation's most critical areas—security and energy—we need public-private partnerships that link the capabilities of government to affirmatively provide governance effectively and of private entities to achieve the performance levels identified by government. Nowhere is the need for effective collaboration clearer than in the areas of introduction of "distributed generation" and "renewable resources."

The nervous system of our nation is made up of many "critical nodes" that flip on and off in response to predefined decision roles and user commands. It is ultimately energy-driven. Not only do we have massive national grid and pipeline networks, we have hyper-reliability-sensitive computers and communications switches. That system in America is to a large extent serviced, at the macro level, by our oldest public-private partnership, "public" utilities regulated by

"public service commissions" and our newest federal effort of regionalizing electric system operations, so-called "Regional Transmission Organizations." In the event of natural or man-made emergencies, all the king's horses and men cannot hold this thin-shelled system together. And when systems fail, if only because of the technical complexity involved, and the eggshell is broken, the yolk is on us. Only Katrina isn't laughing.

The technology to enhance operating energy security exists. It needs to be established on a distributed basis that corresponds to our modern telecommunications-linked (and vulnerable) society. Government needs to respond to this fact by finding ways to tap from the private sector the new technologies (some of which, happily, can also be lower polluting and many of which do not use foreign fuels) to deal with this problem.

In addition to taking up this physical vulnerability challenge, government needs help to reduce reliance on insecure fuel supplies. Under the Energy Policy Act, Congress sought to direct public capital and resources to stimulate private solutions to public problems through use of bio- and coal-based fuels. Less emphasized was the need to open up regulatory bottlenecks and private inertial resistance to the national distribution and consumption of these fuels. New public-private interstate networks vital to the American future need to be fostered.

In short, new public-private partnership formats to foster distributed power and domestic renewable energy use are needed. Policy innovations can draw from the lessons learned—some better from the trying experience over the last 20 years—both as they relate to the question of who should do things and how performance goals (taking into account national policy requirements) can be set. Private action, overseen by enlightened public regulation and an emphasis on civic cooperation, is the necessary combination to perpetuate these aspects of American security.

So looking back at privatization over the past 20 years, I come to the following conclusions:

- It was good the battle was fought; it broke the ground for ideas for future action;
- We face a new and stronger struggle with a higher ticket: national survival (perhaps the way Margaret Thatcher saw privatization in the 1980s for the U.K.);
- To fight that struggle requires learning from our recent history, saving the best of government but making sure it guides private innovation into new markets, thereby reducing the vulnerability of our systems or making possible needed changes and improvements to national fuel consumption patterns.

In short, the privatization we helped build over the past 20 years will have earned its place in American history if it provides the foundation for an enlightened New Privatization effort which responsively blends public and private initiatives. That, I believe, is the challenge for those of us who were present at the first "birth" of privatization.

Roger D. Feldman, a partner in the law firm of Bingham McCutchen LLP in Washington, D.C., was one of the founders of The Privatization Council and long time Chair of its successor, The National Council for Public-Private Partnerships.

Privatization: Looking Backward, Looking Forward

By Lawrence L. Martin, Ph.D., University of Central Florida

Can this really be the 20th anniversary of Reason Foundation's *Annual Privatization Report?* It seems like only yesterday that Reason Foundation began its quest to bring research and policy analysis to bear on the then still relatively new phenomenon of privatization. Twenty years ago was also just about the time the term "privatization" first entered the popular lexicon. While the concept of privatization had bounced around for a few years, it was the increased public attention created first by Prime Minister Margaret Thatcher (1979-1990) in the United Kingdom and then by President Ronald Reagan (1981-1989) that put it firmly on the public policy agenda.

In the same year (1986) that Reason Foundation published its first *Annual Privatization Report*, I defended my doctoral dissertation on privatization. Since that time, I have continued to observe with keen interest the progress of both privatization and Reason Foundation. This 20th anniversary provides an opportunity as well as the motivation to pause and reflect on the past and future of privatization. Realizing that others are also contributing to this special 20th anniversary issue and that privatization will be addressed from a number of perspectives, I would like to focus my comments around three specific areas. First is the general acceptance of privatization by public managers today. Second is the continued equivocation of academics and scholars on the question: Does privatization work? And third is the issue of privatization and partnerships.

The General Acceptance of Privatization by Public Managers

Two indicators of the general acceptance of privatization by public managers today are the decline in anti-privatization rhetoric and the actual use of privatization at the federal, state and local government levels.

How the term "privatization" has been viewed over the last 20 years tells us much about its growing acceptance. In 1989, the National Academy of Public Administration (NAPA) released a report entitled, *Privatization: The Challenge to Public Management*. The report could just as easily have been called, Privatization: the Challenge for Public Management. Perhaps

At the federal level, an estimated $400 billion is now being spent annually on the purchase of goods and services from the private sector.

never in the history of public management has a preposition contained more policy significance. The general view 20 years ago was that privatization constituted an assault on public management, an assault that had to be repulsed. A few enlightened individuals, primarily at the state and local government levels, recognized that privatization was actually a new tool that public managers needed to master, but this view was in the minority.

Fast forwarding to the present day... Lester Salamon, of Johns Hopkins University and one of the principal authors of the 1989 NAPA report, now sees privatization in its many forms (e. g., contracting, vouchers, public-private competition, public-private partnerships) as part of the basic tools of government. Much of the literature on privatization today is no longer ideologically driven, but rather seeks to better understand this tool, its uses and limitations. Of course there are exceptions to this statement. The American Federation of State, County and Municipal Employees (AFSCME), for example, continues to publish anti-privatization studies, but it is unclear that anyone today take this research seriously.

Additional evidence of the general acceptance of privatization by public managers today is provided by the International City/County Managers Association (ICMA). In a series of five studies conducted between the years 1982 and 2003, the ICMA documents the increase in the number, as well as the proportion, of local governments utilizing privatization strategies. For some specific services (e. g., solid waste collection), the most recent ICMA data suggest that some slowing down may be occurring. However, this leveling off is more in keeping with the normal S-shaped growth curve that would be expected of any mature public policy.

At the federal level, an estimated $400 billion is now being spent annually on the purchase of goods and services from the private sector. And the Office of Management & Budget (OMB) Circular A-76 continues to mandate public-private competition as the official privatization policy of the federal government.

Does Privatization Work?

The bottom line for privatization, or any public policy, is the basic issue: Does it work? To the question "Does privatization work?," the unequivocal answer is YES!

I am amazed, and sometimes appalled, by many of my learned academic colleagues who continue to equivocate when it comes to addressing the question: Does privatization work? The most frequently heard response is that the "data conflict" or that "no clear pattern has emerged." Nothing could be further from the truth. What exactly do the data say?

In a forthcoming book *Contracting for Public Sector Services* being published by the National Institute of Government Purchasing, I make the following statement: "the preponderance of the creditable evidence from domestic as well as international experience suggests that privatization generally results in lower service delivery costs and equal or better service quality." Now, in the spirit of transparency, I am referring specifically to contracting out and outsourcing. How do I come to this conclusion? By reviewing hundreds of research reports and case studies compiled over the last 20 years.

What then accounts for the academic equivocation when the question is posed: Does privatization work? I suggest that the answer lies in the standard of proof utilized. Borrowing terminology from the legal field, if one uses the preponderance of the credible evidence from domestic and international experience as the standard of evidence, then there is no doubt that privatization results in lower service delivery costs and equal or better service quality. However, if one insists on using beyond a reasonable doubt as the standard of proof, then a case can be made that the research is less clear. Why academics continue to cling to the standard of beyond a reasonable doubt says more about social science "niceties" than it does about the realities of the complex world in which public policy plays out.

Privatization & Partnerships

The comedian Mort Sahl was found of saying that "The future lies ahead." While somewhat of a tautology, his comment nevertheless reminds us that the future is always just out of reach and therefore our crystal ball will always be just a little bit cloudy. What then can be said or ventured about the future of privatization? My crystal ball is probably as cloudy as any. However, one bright point of light does shine through clearly: partnerships. My crystal ball says that in the future, privatization will be concerned less with competition and market forces and more concerned with creating partnerships between the public and private sectors. In support of this contention, I refer to the pragmatic words of the Copenhagen Institute, "No single actor, public or private, has the all-encompassing knowledge, overview, information, and resources to solve complex and diversified problems." I can also point to recent domestic and international research that supports this contention. In this future of privatization and partnerships, trust will become the basic building block. Consequently, we will need to understand better the role trust plays in public-private partnerships and how best to develop and maintain it.

Lawrence L. Martin, Ph.D. is a professor and director of the Center for Community Partnerships at the University of Central Florida in Orlando, Florida.

Cutting the Government in Half: Three Reforms

By Grover Norquist, President, Americans for Tax Reform

The goal of the modern conservative movement is to cut the cost of government as a percentage of the economy in half over the next twenty-five years—one generation.

Why then has federal spending as a percentage of national income increased from 19 percent in 2000 to 23 percent in 2006 during a period of Republican control of the House, Senate, and Presidency? And this after federal spending as a percentage of national income had fallen from 23 percent to 19 percent from 1992 to 2000—with Clinton facing a Republican Congress?

Three Reasons

First, the modern conservative movement consists of the "leave us alone coalition" of groups where concerning their primary, vote-moving issue, what they want from the government is to be left alone. This includes gun owners, small businessmen, taxpayers, property owners, and homeschoolers.

Raise taxes as Bush 41 did and taxpayers leave the room. Challenge gun rights and National Rifle Association (NRA) members leave the room. But no constituency walks out of the room when government spending creeps too high. The moving parts of the conservative movement all grumble. They would all like less spending. But there is no organized anti-spending NRA equivalent. Thus overspending is the issue that gets ignored.

Second, this administration has targeted the wrong metric by announcing that its goal is to "cut the deficit in half." The real measure of success is reducing spending as a percentage of the economy. This can be accomplished by slowing the growth of spending and by having pro-growth tax cuts (like cutting capital taxes) create a larger economy. Both are issues conservatives dominate: spending cuts and pro-growth tax cuts. Focusing on the deficit suggests that tax cuts are part of the problem, not part of the solution. And tax hikes are the economic equivalent of spending cuts if you are targeting the deficit.

Lastly, it is politically difficult to "cut" the budget. Even reducing the growth of spending in Washington is considered a "cut."

Within this context, three major areas of government spending for our federal, state, and local governments exist. The first area of reform is retirement security such as Social Security, and federal, state, and local government worker pensions. The second area of reform is health care costs, such as

Medicaid, Medicare, and Veterans Affairs hospitals. And the third reform is education, K-12 and state universities. One never cuts education, pensions, or health care.

The solution to the spending problem is to replace politically suicidal, or at best difficult, efforts to "cut" spending with politically profitable "reforms" of programs that will reduce their long-term costs.

The best example of this is "privatizing" or "personalizing" social security, moving the system from the pay-as-you-go, unfunded, Ponzi scheme to a fully funded, independently held personal savings account system. When fully phased in, every American will be required to save, say, 10 percent of their income and accumulate real resources to buy an annuity at retirement that will keep one out of poverty and allow one to keep all savings beyond that minimum to be spent as one wishes. Social Security can be reformed to cost not its present 20 percent of the federal budget from rather remove it from the budget.

Medicare can be similarly financed through allowing Americans to save their Medicare tax payments. Health savings accounts can give Medicare and Medicaid programs real competitive pressures to reduce costs without voting for any "cuts."

On education the only reform worth enacting is real parental school choice. With private schools costing half of government schools, over time public schools will have to become as cost efficient and effective as private schools.

Pipe dream? No. We are on track to make all three key reforms a reality in the next decade. The case for Social Security reform is politically strengthened as more and more Americans own shares of stock directly through mutual funds, IRAs, and 40lKs. When Reagan was elected only 17 percent of adults owned stock directly. Today it is more than 50 percent of households and two out of three voters in the 2004 election. That number grows as all new companies use defined contribution retirement systems rather than defined benefit plans. And the old-line defined benefit plans are ebbing in the airline, auto, and steel industries. Even government pensions are moving to defined contribution plans in a number of states. Eight of the last 10 changes to state pension plans over the past decade have been towards defined contribution.

Health Savings Accounts (HSAs) have jumped from one million in 2004 to three million in 2005 and Forrester Research predicts 24 percent of all Americans will be covered by a consumer health plan by 2010.

Education choice is within spitting distance in New Hampshire, Florida, Texas, Wisconsin and steps have been made in Pennsylvania, Arizona, and Minnesota. A breakthrough in one or two states is the breach of the dam we need. Scare tactics against school choice (they will sell your kids to the Arabs or harvest their organs) will fall apart with a major state's experience for all to see.

Other reforms with real savings include expanding competitive sourcing, where the private sector competes regularly to provide the services now done by 800,000 government employees whose work can be found in the yellow pages—food services, lawn care, fixing eyeglasses, etc.

Cutting small spending programs like the National Endowment for the Arts is satisfying. But real reduction in the cost and scope of government flows from reforming government spending towards zero rather than nicking it.

Grover Norquist is president of Americans for Tax Reform.

Federal Update

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A. Competitive Sourcing Continues to Expand

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 (see Table 1). 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 studied 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 in FY 2006. 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.

B. Rating Program Performance

Once again the administration subjected numerous federal programs to a performance review called the Program Assessment Rating Tool (PART). Every budget submitted by this administration has used this tool to rate programs and use the ratings to determine budget priorities. Many failing or ineffective programs were outlined for elimination or reduction in previous budgets, however, Congress has not used the rating or the outcomes to determine funding. Legislators have largely ignored previous ratings and fully funded failing or ineffective programs, enacting only seven of the 65 proposed reductions in FY2005 for $366 million in savings. FY2006 saw a much larger acceptance where 89 of the 154 recommendations were either cut or saw reduced funding for $6.5 billion in savings—largely due to PART results.

And PART's results are gaining traction. While not called by name, PART and its findings were outlined in the president's State of the Union address where he said he will recommend reducing or eliminat-

Table 1: Competitive Sourcing Results in FY 2003, 2004, and 2005

Element	FY 2003	FY 2004	FY 2005
Completed Competitions			
Total competitions completed	**662**	**217**	**181**
Streamlined	570	116	124
Standard	92	101	57
Total FTEs competed	**17,595**	**12,573**	**9,979**
Streamlined	5,474	1,201	1,296
Standard	12,121	11,372	8,663
% of competitions where agency determined best result provided in-house (based on FTE studied)	89%	91%	61%
Results from completed assessments			
Gross savings (over 3-5 years)	$1.2 B	$1.5 B	$3.1 B
Net savings (over 3-5 years)	$1.1 B	$1.4 B	$3.1 B
Annualized gross savings	$237 M	$285 M	$375 M
Annualized net savings per FTE	$12,000	$22,000	$23,000

ing more than 140 programs this year. This year Congress is listening too. A large effort headed by the Republican Study Committee, a group of over 100 House Republicans, initiated "Operation Offset" to stem the tide of ever increasing federal budgets. PART assessments were often used as a platform to call for cuts.

To date about 80 percent of all federal programs have been reviewed. The remaining 20 percent will be reviewed in time for the FY2008 budget. Four percent of all programs are deemed "ineffective." Put simply, these programs are not "using tax dollars effectively" and they have been unable to "achieve results." An additional 24 percent of programs are listed as "results not demonstrated," i.e., these programs have not "been able to develop acceptable performance goals or collect data to determine whether it is performing." In other words, more than a quarter of all federal programs cannot show any impact or results for their efforts.

Table 2 outlines the breakdown of PART results:

The administration notes that scores have been improving over time—especially with the number of agencies able to measure effectiveness and demonstrate some sort of results. In fact, half of the 234 programs failed to demonstrate results in the first review in FY2004. That number shrank to 38 percent of the 407 programs in FY2005 and 29 percent of the 607 measured in FY2006.

Table 2: Distribution of Program Ratings FY2007	
Number of Programs Assessed	793
Effective	15%
Moderately Effective	29%
Adequate	28%
Ineffective	4%
Results Not Demonstrated	24%

In an effort to bring more attention to PART the Office of Management and Budget launched a new Web site: www.expectmore.gov.

C. Senate Budget Committee Approves Major Budget Reform Bill

On June 20, 2006, the Senate Budget Committee approved a comprehensive budget reform plan entitled "The Stop Over-Spending Act of 2006" (S.O.S. Act), designed to curb federal spending and restore discipline to the budget process. Sponsored by Senate Budget Committee Chairman Judd Gregg and joined by Senate Majority Leader Bill Frist and several other co-sponsors, the S.O.S. Act includes the following among its provisions:

Caps on Discretionary Spending

The S.O.S. Act would cap discretionary spending at $873 billion in fiscal year 2007, allowing it to rise by 2.6 percent annually in fiscal years 2008 and 2009. It would also limit emergency spending by building in assumptions of emergency spending into the discretionary caps. Exceeding these statutory caps would bring about automatic, across-the-board cuts in discretionary spending.

Presidential Line-item Veto

The S.O.S. Act would create a line-item veto tool that allows a President to target wasteful spending, ask that it be rescinded, and send it up to Congress for expedited consideration.

Creation of Commission on Accountability and Review of Federal Agencies (CARFA)

CARFA would study the accountability and efficiency of government programs

(similar to the BRAC Commission) and recommend the termination of agencies and/or programs. The commission's proposal could be approved with a simple majority vote and Congress would have no opportunity to propose amendments.

Creation of Commission on Entitlement Solvency

The S.O.S. Act would create a commission empowered to provide solutions to the impending entitlement crisis and bring Social Security and Medicare into long-term solvency.

Switch to Biennial Budgeting

The S.O.S. Act would would convert the annual budget, appropriations, and authorizing process to a two-year cycle. The first year of would be reserved for submission of the President's two-year budget, the congressional budget resolution, and appropriation bills. The second year be free for Congress to conduct oversight and consider authorizing legislation.

Deficit Targets

The S.O.S. Act would set a budget deficit target (2.75 percent of GDP in fiscal year 2007, declining to 0.5 percent by 2012) and require budget committees to reduce entitlement spending if the deficit is expected to exceed the target. A failure to make cuts would trigger automatic reductions in entitlement spending (excluding Social Security).

Provisions similar to those in the S.O.S. Act have also been gaining momentum in the House of Representatives. Republican leaders indicated that a Sunset Commission similar to the S.O.S. Act's CARFA would get a vote on the House floor as early as late June. Also, on June 22, 2006, the House voted 247-172 in favor of a line-item veto bill.

D. Defense Business Board—Military Mail

The Department of Defense (DOD) has been employing privatization and other business practices for years. There is even a dedicated commission—the Defense Business Board (DBB)—made up of executives who examine various lines of business and operations that DOD is involved in, looking for opportunities to introduce better results, cost savings, and better mission focus on core functions.

Secretary Rumsfeld has been an avid supporter of the effort and of privatization, especially in areas where the private sector can take over military support functions in order to shift more uniformed personnel into core war-fighting functions. In 2004, he asked the DBB to study the handling of mail services within the Department, asking the board why DOD does not currently outsource its military mail functions and if it could.

A task force was formed to study these questions, finishing its work in December. In its report, *Report to Secretary of Defense, Military Postal Service Task Force Report FY05-5* "Recommendations Regarding the Military Postal System of the Department of Defense" the DBB concluded that military mail services were a prime opportunity for privatization and that they should be. The rationale is simple. Privatization would save money, improve mail service, and free up troops for other core functions—a perfect trifecta.

The report notes that DOD has long struggled to deliver mail in a timely fashion, which has negatively impacted troop morale, especially for those serving overseas. With a focus on achieving results, a strong contract with performance measures can

all but guarantee better performance. One example the report noted was an increased use of technology that would catch packages that are undeliverable before they ever leave the United States.

The DBB noted that defense mail costs are at least $1.8 billion a year, however, the true total cost is unknown because DOD can't actually calculate it. However, relying on research from other postal privatizations the board concluded that privatization could yield cost savings of 30 percent or more.

Finally, and not surprisingly, the board concluded that "delivery of mail is not a core military function." Privatization would indeed free up military personnel to serve in core areas. Currently the work is performed by 352 civilian employees, 4,470 military personnel and 363 contractors.

The DBB recommended a "transformational" solution. One where the DOD takes a "Tabula Rasa" approach to privatizing the collection, processing and distribution of mail. They noted that in order to fully capture private sector best practices, the most efficient business model and the latest technology, DOD should privatize to the maximum extent possible. This was made in light of piecemeal privatization or tweaking the existing system to improve performance. Ultimately the DBB recommended that DOD immediately issue an open-ended RFP in order to leave flexibility for the private sector to be innovative. It further suggested that the RFP include all processes and not a piecemeal solution.

DOD is beginning to move forward on the recommendations—including the drafting of an implementation memo that is waiting for approval. If it moves forward it would be one of the federal government's largest privatization projects in recent years. Secretary Rumsfeld reportedly concurs with the DBB recommendations, which should help move the initiative forward.

E. Capping Federal Spending

by Chris Edwards, Director of Tax Policy Studies, Cato Institute

Federal spending has increased 45 percent in the last five years. The government has run deficits in 33 of the last 37 years. The costs of federal programs for the elderly are set to balloon and impose huge burdens on coming generations of young workers.

Federal policymakers are clearly failing to run a "wise and frugal government" as Pres. Thomas Jefferson advised in his first inaugural address. One problem is that current budget procedures stack the deck in favor of program expansion without regard to the burdens imposed on current or future taxpayers. The costly Medicare prescription drug bill of 2003 and the recent explosion in "pork" spending illustrate how a lack of structural controls leads to an undisciplined scramble to increase spending despite rising levels of red ink.

Part of the solution to the overspending problem is to bind Congress with tighter budget rules, like the rules in place in many states. All the states except Vermont have statutory or constitutional requirements to balance their budgets. In addition, more than 20 states have some form of overall limitation on taxes or spending. Colorado's constitution caps state revenue growth at the sum of population growth plus inflation. Revenues above the cap are refunded to taxpayers. This sort of cap on the overall budget is sorely needed in Washington to ensure that tough spending tradeoffs are not avoided.

1. Past Efforts to Control Spending

Congress has occasionally bound itself to limits on the overall budget in the recognition that the self-interested actions of legislators can otherwise lead to an uncontrolled spending splurge and soaring deficits. One reform effort was the 1985 Gramm-Rudman-Hollings Act. It established a series of declining deficit targets over five years, which if not met resulted in an automatic cut, or sequester, to a broad range of programs. Congress replaced GRH in 1990 with the Budget Enforcement Act. The BEA imposed annual dollar caps on discretionary (annually appropriated) spending and "pay-as-you-go" rules on entitlement programs that required the cost of any program expansion to be offset elsewhere in the budget. Those rules contributed to restraint, but they have since expired.

Bolder efforts to control spending and deficits have been debated in Congress but have narrowly failed to pass. A balanced budget amendment (BBA) to the Constitution was proposed in Congress as far back as 1936.

In 1982 the Senate passed a BBA by a vote of 69-31. In addition to requiring a balanced budget, the amendment would have limited the annual growth in federal revenues to the growth in national income. Unfortunately, the BBA failed to gain the needed two-thirds approval in the House. At the time, a parallel effort resulted in resolutions being passed in 31 states calling for a constitutional convention to approve a BBA, but that effort came up three states short of the required number.

In 1995 Congress again voted on a BBA, and it again failed. The BBA passed the House by a 300-132 margin, but fell one vote short of passage in the Senate.

2. Capping Total Federal Spending

Today, reformers are focusing on statutory rather than constitutional efforts to control the budget. And unlike GRH and the BBA, today's efforts are focused on spending control, not deficit reduction, because of the recognition that deficits are simply a byproduct of the more fundamental overspending problem.

A number of House members, including John Campbell (R-CA) and Todd Akin (R-MO), are introducing bills to place a statutory cap on the annual growth in total federal outlays. There are a number of design features that Congress should consider if it imposes such a cap:

What to Cap

The BEA imposed multi-year caps on discretionary spending, but so-called entitlement spending was not capped. Entitlements, such as Medicare, have been allowed to grow rapidly on automatic pilot, which is pushing the government toward a financial crisis.

Entitlements account for more than half of the budget and should be included under any cap. A cap should be placed on the growth in total federal outlays.

Base of a Cap

A simple way to structure a cap is to limit annual spending growth to the growth in an economic indicator such as gross domestic product or personal income. Another possible cap is the sum of population growth plus inflation. In that case, if population grew at 1 percent and inflation was 3 percent, then federal spending could grow at most by 4 percent. Most people would agree with the principle underlying all of these caps—the government should live within

constraints, as average families do, and it should not consume an increasing share of the nation's income or output.

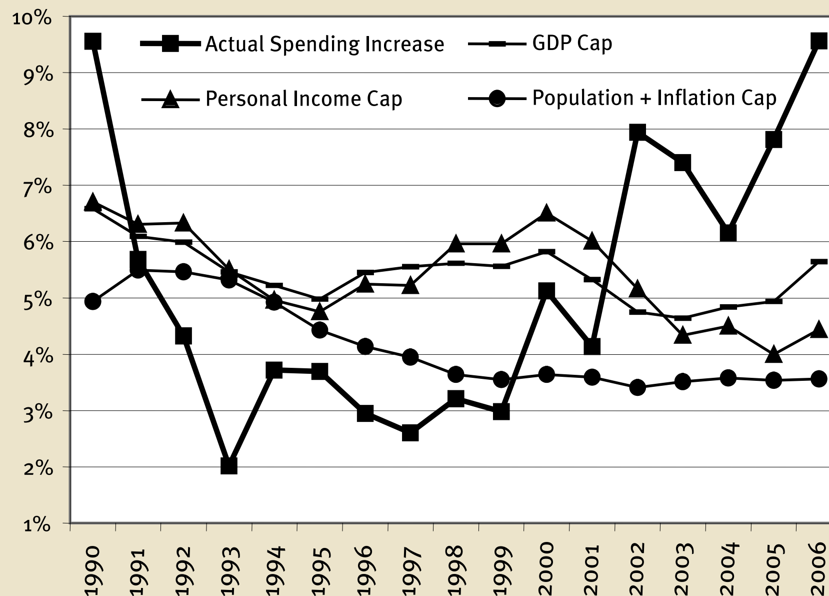
Figure 1 shows actual federal spending growth since 1990 compared to possible caps. The GDP and income caps would be looser than a cap based on population growth plus inflation. Whichever indicator is used should be smoothed by averaging it over about five years.

Figure 2 shows that any of the caps would constrain spending compared to a business-as-usual scenario. But the lower population plus inflation cap would be a much safer approach in case politicians treated a cap as a floor for spending increases and ignored the need to proactively cut wasteful programs. All of the caps would provide protection against a nightmare scenario of continued Bush-sized spending increases, but none would guarantee that Congress acted to make the spending cuts needed to halt the ongoing explosion of federal debt. The House Republican conservative plan in Figure 2 illustrates the spending path needed to bring a halt to the debt explosion.

Cap Procedures

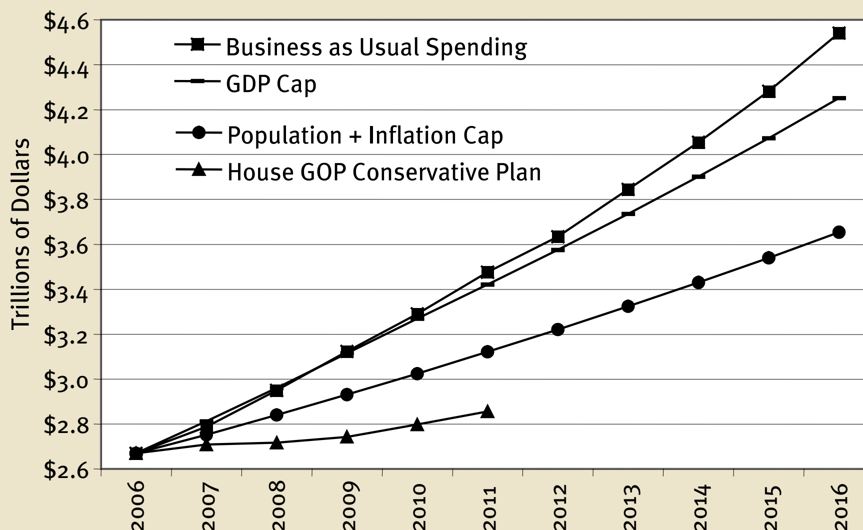
The Office of Management and Budget would provide regular updates regarding whether spending is likely to breach the legal cap, thus allowing Congress time to take corrective actions. If a fiscal year ended and OMB determined that outlays were above the cap, the president would be required to cut spending across-the-board by the percentage needed to meet the cap. GRH and the BEA included sequester mechanisms that covered various portions of the defense, nondefense, and entitlement budgets. A better approach is to cap all spending

Figure 1: Past Federal Spending Increases Compared to Possible Caps



Note: Based on various government data. Spending is fiscal year outlays. 2006 data is estimated. Caps are five-year averages of indicators.

Figure 2: Four Scenarios for Federal Spending



Note: The two cap lines assume that spending would rise each year by the maximum amount allowed.

and subject all departments to a sequester should Congress fail to restrain spending sufficiently.

3. Conclusion

One shortcoming of a statutory spending cap is that Congress could rewrite the law if it didn't want to comply with it. However, with a cap in place reformers would have a high-profile symbol of fiscal restraint to rally around and defend. Over time, public awareness and budgetary tradition would aid in the enforcement of a cap.

Policymakers need more than a cap to avert a coming fiscal crisis—they need to scour the budget for programs and agencies to eliminate. But a cap on spending growth would begin to get the budget under control and provide taxpayer insurance against another federal spending orgy.

This article is adapted from Cato Institute's March 2006 Tax & Budget Bulletin No. 32.

Local and State Update

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A. Local Privatization Update

1. Sandy Springs: A Model "Private" City

At 12:01 am on December 1st, a vision took reality for a large group of citizens in Sandy Springs, Georgia. After fighting Fulton County for over 30 years, their dream became a reality and Sandy Springs was officially an incorporated city—the first new city in Georgia in 50 years.

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 and leader of the 30-year fight 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.

Once they wrestled control away, the new city had a unique opportunity to redefine how their municipal government should look, function, and interact with citizens. 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.

Ultimately 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."

With a focus on efficiency, but more importantly effectiveness of public service, Sandy Springs has embraced the power of competition to determine how services will be provided.

The city does plan to establish its own police force and possibly a fire department (although they currently contract with the county); even with these additional costs Sandy Springs is saving its citizens millions of dollars, upwards of 30 percent in the first year alone.

2. The Sandy Springs Effect

Sandy Springs was the first domino to fall, and is quickly becoming a model city for both cost and quality of services. In a February 13, 2006 editorial in the *Atlanta Journal-Constitution*, Mark Burkhalter, speaker pro tem of the Georgia State House, emphasizes that new cities like Sandy Springs are more responsive to the needs of constituents.

Seeing the wave, Burkhalter sponsored legislation this year that would allow a referendum to incorporate Johns Creek in Fulton County. Additional legislation was passed for the creation of Milton, Chattahoochee Hill County and South Fulton as well. Two additional proposals, for the new cities of Dunwoody and Sea Island, failed to garner legislative support this year.

Residents of Johns Creek and Milton will vote on cityhood in July, and would hold first elections in November. Referendums on the two cities proposed in the south, will be on the ballot in summer 2007.

Mike Bodker, the chairman of the Northeast Fulton County Study Commission heading up the effort for the new city of Johns Creek, suggests that the new city will likely follow Sandy Springs' model and "use privatization and partnering to use tax dollars more effectively." The commission wants to identify and use innovative and competitive solutions, while making its government more responsible, transparent, and accountable to taxpayers.

In addition to these named cities several other communities are reviewing their options. The Carl Vinson Institute of Government at the University of Georgia is currently undertaking feasibility studies for a number of incorporation candidates including Kennesaw, Peachtree City, and Duluth.

All of this activity is very reminiscent of the city of Lakewood, California and what became known as the "Lakewood Plan." Incorporated 51 years ago, the city of Lakewood used an innovative and cost-effective strategy to contract for city services. The City Council set local policy, performed community planning tasks and set the annual budget. However, the services were provided through a contractual arrangement with private companies and neighboring communities. A similar approach is used in Sandy Springs and elsewhere.

As with Sandy Springs in Georgia, Lakewood's incorporation sprung a wave that led to the creation of some three dozen "contract cities" in California.

3. Hamilton County Initiates Managed Competition Agenda

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.

Hamilton County has not formally adopted the guidelines as policy, but rather, will use them administratively in order to amend on the fly and make changes as it learns from experience. The CEC will continue to oversee the development of new guidelines and make any amendments or changes to the policy.

With an initial goal of finding $25 million in immediate savings, the CEC is undertaking several initiatives:

Fire hydrant repair and maintenance—

Lessons in Reform: Hamilton County Competition and Efficiency Committee (CEC)

Specifically, the CEC liked the Florida model because it created the need for a business case—a critical step for the evaluation of alternatives and for consideration of why an organization operates the way it does. The policy includes the following components:

1. Development of a Business Case

The CEC felt that this was a critical step, thus they developed guidelines for the preparation of a business case. The purpose of creating a sound business case is to:

- clearly demonstrate the value to the Board of County Commissioners;
- convey one consistent message to all stakeholders; and
- provide a roadmap for how the project should be developed, procured, implemented and managed.

2. Policy for Cost Comparison Guidance

One of the most overlooked and difficult pieces of managed competition is a cost comparison between public and private alternatives. Knowing this the CEC established a structured approach for making comparisons. The approach is based on:

- public financial management thinking;
- the best identified practices of federal, state, and local governments; and
- a desire to keep the process as simple as possible while ensuring a high degree of validity.

3. In-House Regulations Guiding Bids, Performance, and Costs

In an effort to level the playing field and ensure that public employees were treated fairly, yet held accountable for the performance and results they deliver, the CEC established guidelines for the management of in-house bids. In addition, they considered policies for how employee groups that win a competition will be held to the standards of their bid.

4. Policy Guidelines for Initiative Management

With a recognition that success is often driven by simple management of a sound process, the CEC established guidelines for doing so. Perhaps most critical was their consideration of employee relations and communications with the general public.

5. Hamilton County RFP Development and Procurement Policies

The CEC documented that the existing state of Ohio and Hamilton County purchasing code shall be in effect for the development, acceptance, and evaluation of Requests for Proposal. Law and code will be followed for contract award, negotiation, evaluation and monitoring as well. The CEC did offer some additional guidance for:

- RFP content and development;
- Proposal review; and
- Contract monitoring and administration.

6. Managed Competition Initiative Worksheet

The CEC created a simple "worksheet" that will follow each initiative. The worksheet will help ensure greater transparency and chart progress of an initiative.

7. Managed Competition Flow Chart

Similar to the worksheet, the CEC created a simple decision flow chart or matrix.

Simply by undertaking the review the county realized that they were paying higher per unit prices for new hydrants than neighboring communities. By simply purchasing from their contract the county will save thousands of dollars a year. The CEC is also reviewing the actual operational costs and expects to find savings there as well.

Fleet maintenance—The county spends millions a year performing routine maintenance, including oil changes, on its fleet of vehicles. Experience from other jurisdictions has proven very successful with significant savings opportunities.

Facilities—The CEC is reviewing the county's facilities on a dual track. The first track is somewhat of a space utilization review where it will consider possible consolidation and divestiture of unneeded or underused tracts of land or buildings. This will bring an immediate infusion of cash but also lead to long-term savings as the cost of maintenance is taken off the books. The second track focuses on the actual operations and maintenance functions including janitorial services. These functions will be put through a managed competition initiative.

Information Technology Review—The county's IT infrastructure is fractured and contains many duplications. The review is focused on reducing duplication to generate savings. In addition, the CEC is looking at ways to improve security.

Utilities and Telecommunications Review—The CEC is conducting two separate reviews to find efficiencies in how the county buys and uses utilities and telecommunications.

4. San Diego Managed Competition Ballot Initiative

The city of San Diego has placed a ballot initiative on the November general election that would introduce managed competition. On March 27th the City Council voted 7-1 to allow the measure onto the ballot. The council also agreed to place a ballot measure that would require voter approval for future pension benefit increases.

Faced with a ballooning $1.39 billion pension deficit and a razor-thin city budget that has undergone recent cuts, the mayor included managed competition as a major piece of his fiscal recovery plan. As part of his State of the City address, Mayor Jerry Sanders announced his plans to focus on core services and reengineer city government. "I'm going to reduce waste, duplication and bureaucracy; and I'm going to search for more cost-effective ways to provide quality services." Sanders has suggested that the process will be transparent and contain safeguards to prevent abuse, yet demonstrate results and cost savings. "The goal in this process will be a smaller, more responsive and more cost efficient city government," said Sanders.

This is welcome news to many San Diegoans who have watched their city go through much turmoil in recent years. Just five months into his second term, former Mayor Dick Murphy announced his resignation after a "perfect fiscal storm" erupted in large part to the deepening pension crisis.

Sanders' fiscal plan mirrors many recommendations laid out by a coalition of groups, including *Reason*, led by the Performance Institute [www.sandiegobudget.org], as outlined in the *San Diego Citizens' Budget* [http://www.reason.org/sdcbplan.pdf].

B. State Privatization Update

For three consecutive years the Connecticut legislature has passed government contracting reform, and each time Gov. Jodi Rell has vetoed the bill. This year the vehicle was HB5684, which was written in response to former Governor Rowland's corruption scandal. The legislation would have placed overly burdensome restrictions and regulations on contracting. Despite support for a more transparent process, the proposed legislation had overstepped its bounds and tried to establish outright prohibitions on contracting out and public-private partnerships, forcing Gov. Rell to issue a third consecutive successful veto.

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 and were 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 mission and to deliver services efficiently and effectively, and requires them to leverage the private

sector whenever they can reduce the costs of government.

Georgia had an active year. Recognizing the value of competition the Senate offered SR469, a resolution creating the Senate Environmental Program Privatization Study Committee. The committee will study where it is "advantageous to identify disincentives toward efficiency and cost effectiveness in government enforcement and implementation of environmental laws and regulations and how the introduction of private sector competition or incentives may result in higher quality performance and more effective implementation of such policies and programs." The overriding purpose is to give regulating agencies as much flexibility as possible in running their organizations and effectively enforcing environmental regulations.

In addition, the Georgia legislature considered SB602. The bill was unsuccessful, however it would have called for the privatization or contracting out of at least one mental health facility.

Efforts to place restrictions on privatization in Hawaii went nowhere and were carried over to the next legislative session. Amending Act 90 that passed a couple of years ago, SB942 would have placed restrictions to "enhance government accountability." Prior to Act 90's passage, privatization was effectively outlawed in the Aloha State.

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). 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.

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 perfor-

mance 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.

Under the PROBE review each program will be asked to justify its work and also demostrate that it 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.

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 Indianas Toll Road. Other partnerships are to be examined as part of the governor's transportation plan unfolds.

The only major bill introduced in Louisiana was HB632. The bill would have required that the state department of corrections privatize all adult correctional facilities by 2016. It is currently in committee and waiting to be heard.

Massachusetts heard a bill, H1333, that would have prevented local governments

from privatizing water or sewer services. Fortunately it was killed in committee. Other legislation included S1742, which would have required 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.

Missouri introduced SB958, the "Public Service Accountability Act." It stated that before a state agency could privatize a service, it must prepare a cost-benefit analysis, then prepare a written statement about the findings and its proposed actions. This bill would further have required cost savings of at least 10 percent (so 9.5 percent savings would be turned down?) and limited contract duration to no more than five years. Fortunately no action was taken.

New Jersey's legislature has provided a mixed bag of privatization activities. Several privatization-related bills have been introduced and are awaiting debate. Following the wave of concessions bills and transportation leases, S1777 was introduced, allowing up to 49 percent of the New Jersey turnpike to be "corporatized." The legislation calls for proceeds to be directed to outstanding state pension obligations. Governor Corzine is intrigued by the concept, however, has not actively supported the measure yet.

Unfortunately other legislative initiatives are geared to prevent future privatization efforts. Companion bills were introduced in both the Assembly and the Senate (A2210/S1600) that would establish new guidelines and requirements for privatization. If enacted there would be a chilling effect on privatization opportunities in the state.

The bill requires that savings from privatization be "substantial" yet fails to provide a guideline, opening the door to litigation. However, one must wonder what's wrong with moderate cost savings?

Further, before privatization can take effect, it must be demonstrated that state performance of the function is "contrary to the public interest." It gives public employees right of first refusal for any jobs under contract and the contractor must "provide fringe benefit coverage and a rate of pay and pay progression to its employees performing work under the contract not less than what is provided to state employees."

North Carolina included a study of ABC store privatization in a comprehensive legislative study bill this year. The study will consider full and partial privatization of alcohol beverage control board liquor stores. It will determine feasibility and the effects on price, revenue, safety and enforcement, among other things.

The biggest news in Pennsylvania is HB2572, the "Free Enterprise and Taxpayer Protection Act." It effectively prohibits government competition with the private sector for goods and services. The legislation refers to all government agencies, universities, and schools as well as any public authority. The bill has been assigned to committee but has not been heard.

Texas announced the completion of a deal with IBM to manage email services and systems for at least 13 state agencies. The contract is worth tens of millions of dollars, but is expected to reduce email management costs by 45 percent through the five- to seven-year deal. The contract will transfer about 65,000 inboxes to management by IBM.

Agencies will be able to customize their individual deals. Under the contract agencies will pay between $1.99 and $5.52 a month for management of each inbox

depending on the options the agencies select for their employees. The contract is expandable and soon other publicly funded organizations including city and county organizations as well as school districts will be able to participate in the contract.

Utah considered several privatization-related bills this year with limited success. Perhaps most intriguing was SB 74, sponsored by Senator Howard Stephenson. This bill would have created a privatization task force to identify functions suitable for public-private competition and privatization. The task force would have established restrictions on government competition with private business. Similar committees have been established in many states; however, Utah will have to wait to join the list. The bill failed in the Senate and no action was taken in the House.

Another bill sponsored by Stephenson saw the same fate. SB 175 would have called for the department of corrections to issue an RFP for the new prison that the state needs to relieve prison overcrowding, or allow the private sector to offer proposals at any time. The bill was killed in committee.

The single shining star was the successful passing of SB 80, enabling "concession" model deals for Utah's highways. The passage makes Utah the 23rd state with specific enabling legislation. There is already discussion of using the concession model for the development and building of two new roads in and around Salt Lake.

Vermont is considering S34 that would apply new stricter standards to privatization contracts. In addition, it grants a right of action to the Vermont State Employees' Association to seek redress for any alleged violation of the standards. The bill has passed the Senate. Vermont already requires privatization initiatives to demonstrate savings of at least 10 percent before acceptance.

The Commonwealth of Virginia considered several privatization-related bills this past legislative session as well. In an effort to clarify existing state code, the General Assembly passed SB666 to further enable the state to enter into concession agreements for private toll operations. It was widely believed that the state already had the authority; however, there was little guidance on the matter.

HB667 also passed with calls for more highway maintenance privatization. Virginia already has two very successful contracts for various stretches of highway. Largely because of this success the legislature directed the department of transportation to identify additional opportunities.

For the third consecutive year, Delegate Cline offered HB1122, known as the "Freedom from Government Competition Act." Virginia, which does conduct an activities inventory (defines activities as either commercial or inherently governmental), would have required agencies to produce written justification for keeping a commercial activity in-house, in other words, forcing the state to justify why they haven't privatized a function. Unfortunately, this bill was left in committee…again.

Virginia also debated a bill on putting more prison food service out to bid. It faced the same fate as the Cline bill and was left in committee with no action taken.

C. State Bureaucracy Update

by Chris Edwards, Director of Tax Policy Studies, Cato Institute

The nation's 16 million state and local government workers form a large, growing, and well-compensated class in society.

State and local workers earned $36 per hour in wages and benefits in 2005, on average, compared to $24 per hour for U.S. private-sector workers. Another distinction is that 42 percent of state and local workers are represented by unions, compared to just 9 percent in the private sector.

1. Trends in State and Local Employment

Table 3 shows the number of state and local workers by budget area. The largest area is kindergarten to grade 12 schools. The number of school teachers and administrators increased 22 percent between 1994 and 2004. By contrast, the number of children in the public schools increased just 9 percent during the period.

Another fast-growing area is public safety. Police, fire, corrections, and legal staffs have grown an average 21 percent in

Table 3: State and Local Government Employment

	1994	2004	Change
U.S. Total	**13,912,227**	**15,788,784**	**13%**
Education	**7,098,807**	**8,538,180**	**20%**
K-12 Schools	5,310,339	6,473,425	22%
Higher education	1,586,663	1,848,997	17%
Other	201,805	215,758	7%
Safety	**1,925,986**	**2,323,323**	**21%**
Police	749,308	892,426	19%
Corrections	584,387	701,905	20%
Judicial and legal	321,168	409,944	28%
Fire	271,123	319,048	18%
Welfare	**2,123,500**	**2,038,584**	**-4%**
Hospitals	1,053,356	912,496	-13%
Public welfare	492,387	498,092	1%
Health	360,694	424,158	18%
Housing & development	123,173	114,281	-7%
Social insurance admin.	93,890	89,577	-5%
Services	**1,701,548**	**1,766,101**	**4%**
Highways	544,233	542,642	0%
Parks and recreation	239,605	262,815	10%
Transit	205,994	231,897	13%
Natural resources	187,432	186,006	-1%
Water supply	153,143	162,251	6%
Sewerage	121,594	126,136	4%
Solid waste	110,391	108,882	-1%
Other	139,156	145,472	5%
Other	**1,062,386**	**1,122,596**	**6%**

Source: U.S. Bureau of the Census. Full-time equivalents.

Table 4: State and Local Government Employment in 2004 as a Share of Total Employment in State						
	Total	**Education**	**Safety**	**Welfare**	**Services**	**Other**
All states	**11.3%**	**6.1%**	**1.7%**	**1.5%**	**1.3%**	**0.8%**
Alaska	16.6%	8.3%	1.8%	1.6%	2.7%	2.2%
D.C.	16.2%	4.5%	3.3%	2.3%	4.6%	1.6%
Wyoming	16.1%	8.2%	1.7%	2.9%	2.0%	1.3%
Mississippi	15.0%	8.1%	1.7%	3.0%	1.4%	0.8%
Louisiana	14.6%	7.5%	2.2%	2.4%	1.6%	0.9%
New Mexico	14.5%	8.0%	2.0%	2.0%	1.5%	1.1%
New York	13.4%	6.2%	2.3%	2.3%	1.8%	0.9%
Alabama	13.2%	6.7%	1.5%	2.6%	1.5%	0.8%
West Virginia	13.0%	7.1%	1.4%	1.4%	1.9%	1.2%
Kansas	12.8%	7.6%	1.5%	1.3%	1.4%	1.0%
Kentucky	12.7%	7.6%	1.5%	1.5%	1.3%	0.8%
South Carolina	12.6%	6.7%	1.7%	2.2%	1.3%	0.7%
Arkansas	12.3%	7.2%	1.6%	1.4%	1.4%	0.8%
Oklahoma	12.3%	7.0%	1.6%	1.7%	1.3%	0.8%
Texas	12.3%	7.4%	1.7%	1.4%	1.2%	0.6%
Nebraska	12.0%	6.3%	1.2%	1.6%	2.1%	0.8%
Hawaii	12.0%	6.1%	1.8%	1.4%	1.4%	1.3%
Iowa	11.9%	7.1%	1.1%	1.7%	1.3%	0.8%
Georgia	11.9%	6.8%	1.8%	1.5%	1.2%	0.7%
New Jersey	11.9%	6.5%	2.0%	1.2%	1.3%	0.9%
North Dakota	11.8%	6.6%	1.0%	1.4%	1.7%	1.0%
Montana	11.7%	6.6%	1.3%	1.2%	1.6%	1.0%
Delaware	11.7%	6.1%	1.7%	1.5%	1.3%	1.0%
Idaho	11.7%	6.4%	1.4%	1.7%	1.3%	0.9%
Maine	11.6%	6.9%	1.3%	1.0%	1.3%	1.1%
Tennessee	11.6%	6.0%	1.6%	1.8%	1.5%	0.7%
Virginia	11.4%	6.6%	1.6%	1.1%	1.1%	0.9%
North Carolina	11.3%	5.8%	1.5%	2.1%	1.1%	0.8%
Ohio	11.3%	6.2%	1.7%	1.4%	1.1%	0.7%
Vermont	11.2%	7.2%	1.0%	0.8%	1.2%	1.1%
Utah	11.2%	6.5%	1.3%	1.3%	1.3%	0.8%
Indiana	11.0%	6.5%	1.5%	1.5%	1.0%	0.6%
Missouri	10.9%	5.9%	1.7%	1.5%	1.2%	0.7%
California	10.8%	5.4%	1.6%	1.6%	1.2%	0.9%
Connecticut	10.7%	6.2%	1.6%	1.3%	0.8%	0.8%

Table 4: State and Local Government Employment in 2004 as a Share of Total Employment in State						
	Total	**Education**	**Safety**	**Welfare**	**Services**	**Other**
Washington	10.6%	5.0%	1.4%	1.6%	1.8%	0.9%
Illinois	10.6%	6.0%	1.7%	1.0%	1.3%	0.6%
Michigan	10.6%	6.6%	1.4%	1.0%	0.8%	0.7%
Oregon	10.5%	5.3%	1.5%	1.4%	1.3%	1.0%
South Dakota	10.5%	6.2%	1.0%	1.0%	1.3%	1.0%
Colorado	10.4%	5.8%	1.4%	1.1%	1.3%	0.7%
Florida	10.3%	4.9%	2.0%	1.2%	1.3%	0.8%
Arizona	10.3%	5.6%	1.9%	0.7%	1.2%	0.9%
Maryland	10.2%	5.6%	1.6%	1.1%	1.1%	0.8%
Massachusetts	10.0%	5.7%	1.7%	1.0%	0.9%	0.7%
Wisconsin	9.8%	5.7%	1.4%	1.0%	0.9%	0.8%
Minnesota	9.8%	5.7%	1.0%	1.3%	1.1%	0.8%
New Hampshire	9.8%	5.9%	1.2%	0.9%	0.9%	0.9%
Pennsylvania	9.6%	5.3%	1.4%	1.1%	1.1%	0.7%
Rhode Island	9.5%	5.2%	1.5%	1.0%	0.9%	0.8%
Nevada	8.6%	4.1%	1.6%	1.0%	1.1%	0.8%

Source: Author's calculations based on U.S. Bureau of the Census data. See Table 3 for items included in each budget area.

the past decade. One contributing factor has been the jump in state prison populations in recent years.

State and local health bureaucracies have also grown as Medicaid spending has exploded. In health and other areas, the growth in bureaucracy has been fueled by growing regulatory paperwork that has accompanied expanded federal funding of state and local activities.

Some areas of the state and local bureaucracy, such as hospitals, have not grown. That may be due variously to budget reforms, a shift of work to the private sector, or other changes. In the case of public welfare, the number of state and local administrators has remained steady at about half a million. Meanwhile, the number of welfare recipients has fallen 66 percent since 1994 as a result of federal and state welfare reforms during the 1990s.

2. State Comparisons

The size of state and local bureaucracies varies widely by state. Table 4 shows the number of government workers in each state as a share of employment in the state. Along with the District of Columbia, the largest bureaucracies are in Alaska and Wyoming—states that have an image of rugged individualism. Some of the other states with big bureaucracies also lean conservative in their politics, including Mississippi and Alabama. Nevada has the smallest bureaucracy, with a state and local workforce only about half the relative size of Alaska's.

Numerous factors affect the size of bureaucracies in the states including demographics, crime levels, and the differing

Table 5: State and Local Government Employment in 2004 as a Share of Total Employment in State									
Biggest Bureaucracies									
Education		**Safety**		**Welfare**		**Services**		**Other**	
AK	8.3%	DC	3.3%	MS	3.0%	DC	4.6%	AK	2.2%
WY	8.2%	NY	2.3%	WY	2.9%	AK	2.7%	DC	1.6%
MS	8.1%	LA	2.2%	AL	2.6%	NE	2.1%	HI	1.3%
NM	8.0%	FL	2.0%	LA	2.4%	WY	2.0%	WY	1.3%
KS	7.6%	NJ	2.0%	DC	2.3%	WV	1.9%	WV	1.2%
Smallest Bureaucracies									
Education		**Safety**		**Welfare**		**Services**		**Other**	
RI	5.2%	IA	1.1%	IL	1.0%	MA	0.9%	MO	0.7%
WA	5.0%	SD	1.0%	SD	1.0%	WI	0.9%	GA	0.7%
FL	4.9%	ND	1.0%	NH	0.9%	NH	0.9%	IN	0.6%
DC	4.5%	VT	1.0%	VT	0.8%	MI	0.8%	IL	0.6%
NV	4.1%	MN	1.0%	AZ	0.8%	CT	0.8%	TX	0.6%

Source: Author's calculations based on U.S. Bureau of the Census data.

propensity of states to contract out or privatize services such as prisons and solid waste collection.

Differences between states also reflect bureaucratic efficiencies. For example, while D.C. and Louisiana have deep-seated problems of waste and corruption, New Hampshire is known for its more effective government. Some states, such as Alaska and New Mexico, have high levels of bureaucracy across many budget areas. Other states, such as Pennsylvania and Rhode Island, have consistently lower levels of bureaucracy.

Table 5 shows the states with the biggest and smallest bureaucracies in each budget area. The top states have two or more times the relative number of government workers as the bottom states. It is not clear that the top states get any benefit from bigger government. As one example, my statistical analysis showed that there is no correlation between K-12 employment and SAT scores by state.

One conclusion is that there seems to be substantial room for increased government efficiency in many states. Although this report provides only a brief look at differences in state bureaucracy, the data indicate that some states deliver government services with many fewer workers than do other jurisdictions.

D. State Revenue Boom Paves Way for Tax Cuts

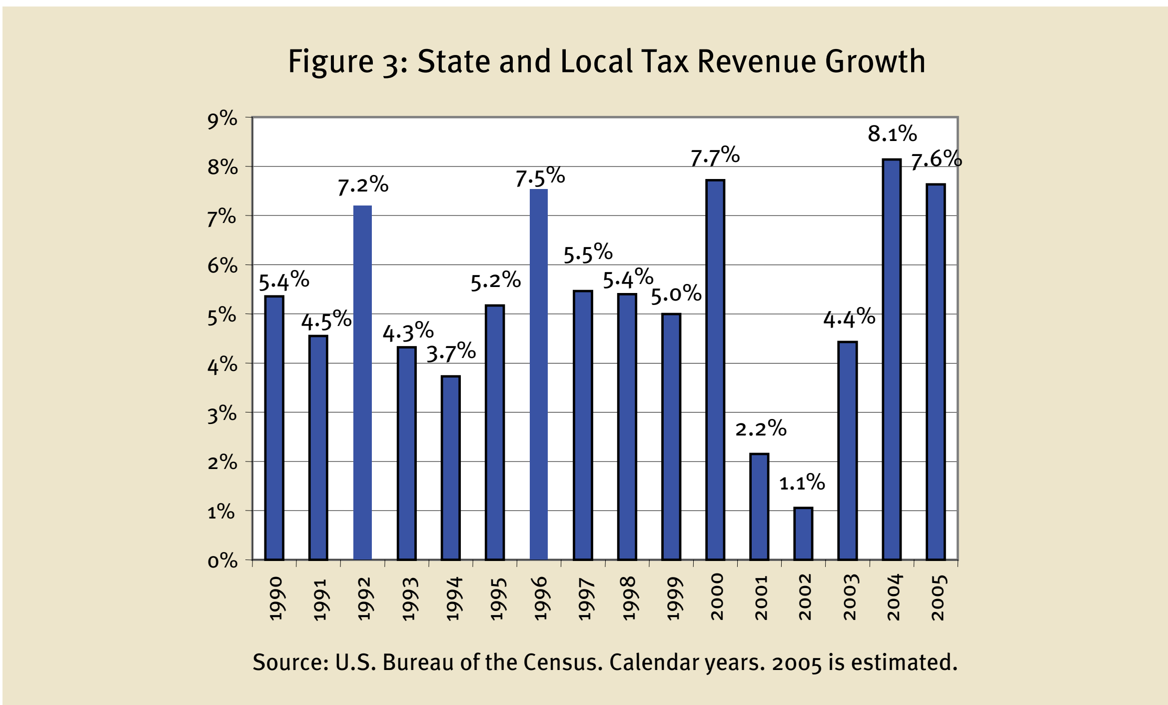
by Chris Edwards, Director of Tax Policy Studies, Cato Institute

The nation's strong economic growth is creating a revenue boom for state and local governments. Figure 3 shows that state and local tax revenues soared 8.1 percent in 2004 and an estimated 7.6 percent in 2005, based on data for the first three quarters of the year.

Both state and local governments are enjoying the surge in revenues. Table 6 shows that state taxes increased 8.7 percent in 2004 and an estimated 8.0 percent in 2005.

Table 6: State and Local Tax Revenue Growth						
	2000	2001	2002	2003	2004	2005
State	8.8%	0.9%	-3.2%	4.2%	8.7%	8.0%
Local	5.9%	4.4%	8.0%	4.8%	7.3%	7.1%
State and local	7.7%	2.2%	1.1%	4.4%	8.1%	7.6%

Source: U.S. Bureau of the Census. Calendar years. 2005 is estimated.



Local taxes increased 7.3 percent in 2004 and an estimated 7.1 percent in 2005.

At the local level, taxes have been rising rapidly for years. As property values have soared, cities and counties have received a windfall because they derive about three-quarters of their tax revenues from property taxes.

At the state level, the economic downturn earlier this decade caused revenue growth to slow and briefly turn negative. But the revenue "crisis" that states complained about was exaggerated, and it is now long gone. By 2005, tax revenues for the 50 states were up 18 percent over the pre-recession peak of 2001. Also note that federal aid to the states has grown at more than 7 percent annually since 2000.

With today's rising revenues, states that had increased taxes to fill budget gaps—such as Virginia—can return the money to taxpayers now that budgets are in surplus. The 50 states enacted net tax increases of $24 billion during the past five years, but now they can reverse course and provide major tax relief in 2006.

Unfortunately, some states are using the revenue boom to expand their budgets beyond sustainable levels, as many states did during the 1990s. In California, Gov. Arnold Schwarzenegger has proposed a general fund budget increase for fiscal 2007 of 8.4 percent, which follows a 9.7 percent in-

crease for 2006. In Maryland, Gov. Robert Ehrlich has proposed a general fund (apart from reserve fund) increase for fiscal 2007 of 11.4 percent, which follows a 7.6 percent increase for 2006.

Which States Are Most in Need of Tax Cuts?

Rather than expand their budgets, states should use current surpluses to reform their tax codes in order to boost long-run economic growth. Most states have the budget room to make substantial tax cuts and tax reforms—three-quarters of the states had tax revenue growth of 6 percent or more in 2005.

Table 7 identifies states that are most in need of tax relief. Those are states that have rapid revenue growth, a high overall tax burden, and high income tax rates. States that measure above average on those criteria are highlighted.

The first column in Table 7 shows increases in state tax revenues between 2002 and 2005. Total tax revenue for the 50 states and the District of Columbia increased 22 percent. The fastest growth was in Alaska, Wyoming, Nevada, Florida, South Carolina, Vermont, and D.C.

The second column shows the overall burdens of state and local taxes as a percentage of personal income. For 2004, the U.S. average was 10.5 percent. The other columns show the top state income tax rates. For 2005, the average top individual and corporate rates were 5.5 and 6.9 percent, respectively.

States that combine high income tax rates with high overall tax burdens include California, Louisiana, Maine, Minnesota, Nebraska, New Jersey, New Mexico, New York, Ohio, Rhode Island, Vermont, West Virginia, and Wisconsin. New York, New Jersey, Nebraska, Vermont, and D.C. ranked high on all four tax measures. All those jurisdictions are ripe candidates for tax relief in 2006.

The most important goal of tax reform is to cut top income tax rates. In today's competitive economy, capital, skilled labor, and retirees are increasingly mobile and will gravitate to lower-tax jurisdictions. With the coming retirement of the large baby-boom generation, high-tax states such as New York will shoot themselves in the foot if their tax policies prompt retirees to pull up stakes and head to sunny and low-tax locations such as Florida.

High corporate income taxes are similarly counter-productive. State corporate taxes have a high ratio of compliance costs to revenue collected, and they induce businesses to shift real investments and paper profits to low-tax states and foreign countries.

In sum, rather than expand their budgets and force another budget crunch, states should use today's surpluses to make lasting reforms to their tax systems. After all, competition for jobs and investment will only increase in the years ahead. By restraining spending and pursuing tax reforms, states will be better prepared for the next downturn and better able to sustain long-run growth.

E. Surveying the Battleground on Tax and Expenditure Limits (TELs)

by Barry W. Poulson, Americans for Prosperity, Distinguished Scholar

1. Introduction

When Gov. Ronald Reagan endorsed Prop One, the nation's first tax and expenditure limit, he launched the tax revolt. In 1971 Gov. Ronald Reagan and Milton

Table 7: States Most in Need of Tax Cuts				
	State Tax Revenue Increase, 2002-2005	State and Local Tax Burden, % of Income 2004	Top Individual Tax Rate 2005	Top Corporate Tax Rate 2005
All states	22%	10.5%	5.5%	6.9%
Alabama	25%	8.5%	5.0%	6.5%
Alaska	115%	11.3%	0.0%	9.4%
Arizona	22%	9.8%	5.0%	7.0%
Arkansas	29%	10.4%	7.0%	6.5%
California	16%	10.9%	9.3%	8.8%
Colorado	16%	8.9%	4.6%	4.6%
Connecticut	30%	10.8%	5.0%	7.5%
D.C.	39%	13.6%	9.0%	10.0%
Delaware	33%	10.5%	6.0%	8.7%
Florida	49%	9.8%	0.0%	5.5%
Georgia	20%	9.9%	6.0%	6.0%
Hawaii	33%	12.1%	8.3%	6.4%
Idaho	6%	10.0%	7.8%	7.6%
Illinois	30%	10.2%	3.0%	7.3%
Indiana	26%	10.5%	3.4%	8.5%
Iowa	6%	9.8%	9.0%	12.0%
Kansas	10%	10.3%	6.5%	4.0%
Kentucky	12%	10.0%	6.0%	8.3%
Louisiana	4%	10.6%	6.0%	8.0%
Maine	20%	12.8%	8.5%	8.9%
Maryland	31%	10.5%	4.8%	7.0%
Massachusetts	22%	10.0%	5.3%	9.5%
Michigan	-3%	9.6%	3.9%	0.0%
Minnesota	21%	11.3%	7.9%	9.8%
Mississippi	12%	10.2%	5.0%	5.0%
Missouri	10%	9.2%	6.0%	6.3%
Montana	24%	9.3%	6.9%	6.8%
Nebraska	24%	11.3%	6.8%	7.8%
Nevada	56%	9.4%	0.0%	0.0%
New Hampshire	8%	8.3%	0.0%	8.5%
New Jersey	26%	11.0%	9.0%	9.0%
New Mexico	8%	10.6%	6.0%	7.6%

Table 7: States Most in Need of Tax Cuts				
	State Tax Revenue Increase, 2002-2005	State and Local Tax Burden, % of Income 2004	Top Individual Tax Rate 2005	Top Corporate Tax Rate 2005
New York	33%	13.4%	12.2%	17.6%
North Carolina	23%	10.0%	8.3%	6.9%
North Dakota	31%	10.6%	5.5%	7.0%
Ohio	12%	11.5%	7.5%	8.5%
Oklahoma	22%	9.7%	6.7%	6.0%
Oregon	25%	9.4%	9.0%	6.6%
Pennsylvania	23%	10.4%	3.1%	10.0%
Rhode Island	22%	11.2%	8.8%	9.0%
South Carolina	41%	9.7%	7.0%	5.0%
South Dakota	16%	8.9%	0.0%	0.0%
Tennessee	26%	8.8%	0.0%	6.5%
Texas	18%	9.4%	0.0%	0.0%
Utah	27%	10.4%	7.0%	5.0%
Vermont	39%	11.4%	9.5%	9.8%
Virginia	26%	9.4%	5.8%	6.0%
Washington	18%	10.1%	0.0%	0.0%
West Virginia	18%	10.7%	6.5%	9.0%
Wisconsin	17%	11.4%	6.8%	7.9%
Wyoming	74%	13.7%	0.0%	0.0%

Source: The first two columns are calendar year estimates based on data from the U.S. Bureau of the Census. The second two columns are from the Federation of Tax Administrators. New York income tax rates include New York City taxes. Above-average data items are highlighted.

Friedman traveled the state of California supporting enactment of this initiative. While Prop One failed narrowly at the polls, it set the precedent for tax and spending limits (TELs) at both the state and local level. Since then 28 states have passed some form of TEL, and numerous local communities have also enacted this legislation.

For much of the post-World War II era, government at all levels has increased more rapidly than the private sector. A TEL is a fiscal tool designed to constrain this growth in government. If a stringent limit is imposed, such as being commensurate with inflation and population growth, then government will grow less rapidly than the private sector. If voter approval is required for increased taxes, debt or expenditure of surplus revenue, then government may grow more rapidly than this limit, but government officials must first seek voter approval.

We have learned a lot about TELs over the past three decades, and this information can inform us regarding the future trends in this movement. The best way to understand TELs is with reference to the 'Battle

of the Rent Seekers' (the term "rent seekers" refers to individuals who are able to capture a subsidy, privilege, or other benefit from government). On one side of the budget are the special interests, bureaucrats, and others who benefit when government grows more rapidly than the private sector. On the other side of the budget are private citizens who bear the burden of increased taxes when government grows more rapidly than the private sector. Legislators are in the middle of this rent-seeking battle. If TELs are effective in constraining the growth of government, they can protect citizens from burdensome taxation. Whether or not TELs do in fact protect citizens from unconstrained growth in government depends upon how well they are designed and implemented.

The reality is that most of the TELs enacted at both the state and local level have proven largely ineffective in protecting citizens from burdensome taxation. In a recent study for the Americans for Prosperity Foundation, the author graded the effectiveness of each state TEL. Only 10 of these states received a grade of C or above. Most states either have no TEL or an ineffective TEL. The study highlights the need for states to enact effective TELs that can constrain the growth of government.

Fortunately, 22 states have introduced new TELs, many of which are better designed than existing TELs. Some of these new TELs are based on a model TEL adopted by the American Legislative Exchange Council, which will be referred to as the ALEC model. Exploring the battleground on TELs, including assessing TELs that have been enacted, helps define the prospects for new state and local TELs.

2. Designing an Effective TEL

When Colorado enacted the Taxpayer Bill of Rights Amendment (TABOR), the American Legislative Exchange Council (ALEC) used that Amendment in designing model TEL legislation. However, in response to the criticism leveled against TABOR during the recent recession, ALEC introduced an important refinement in this model legislation.

The new ALEC model links the stringent limits of inflation and population growth to an emergency and rainy day fund. In periods of economic growth, when revenue exceeds the limit, some surplus revenue is allocated to the emergency and rainy day fund. When the cap is reached on those funds, additional surplus revenue is returned to taxpayers. In periods of recession the rainy day fund can be used to offset at least part of the revenue shortfall. The limit is held constant until revenue recovers to the pre-recession level.

The reason that this refinement in the new TEL model is important is that it can end the "ratchet-up effect" of higher levels of taxation and spending over the business cycle. In periods of growth government revenue tends to increase more rapidly than the growth in personal income; this is particularly true in states that rely on income tax. Government spending is increased to match the higher levels of revenue. Then when the economy enters a recession, there is pressure to raise taxes and issue debt to offset revenue shortfalls. There is also pressure to suspend or repeal TELs that constrain government taxation and spending. The result is a ratcheting up of taxation and spending from one business cycle to the next. This "ratchet-up effect" also explains why many TELs are evaded or gutted during periods of recession.

The new ALEC model can both con-

strain the growth of government and stabilize the budget over the business cycle. There is obviously a tradeoff in determining how much surplus revenue should be allocated to the emergency and rainy day fund and how much is returned to taxpayers. But, with a modest limit on the emergency and rainy day fund, this model TEL can achieve both of these objectives. Of course stringent provisions must be included in the emergency and rainy day fund to be sure that they do not become simply a slush fund to finance higher levels of spending.

The ALEC model has been used as the basis for new TEL legislation introduced in 22 states over the past few years, and for TEL legislation at the local level as well. In nine of these states and in a number of local jurisdictions the TEL legislation has been introduced through citizen initiative. In other state and local jurisdictions the TELs have been introduced through the legislative process. Whether the TEL is designed and implemented through citizen initiative or through the legislative process is often crucial in determining how effective the TEL is in constraining the growth of government and stabilizing the budget over the business cycle. While the TEL experience is unique in each state, there are common patterns in the design and implementation of this legislation across the states. The best way to understand the TEL battles is through a survey of case studies.

3. The TEL Battleground

a. Enacting TELs through the Initiative Process

TELs originating through the initiative process are ordinarily designed by taxpayer organizations, and therefore tend to be more stringent than those enacted through the legislative process. This is certainly true of TELs that have already been enacted, such as Colorado's Taxpayer Bill of Rights (TABOR) Amendment, California's (GANN) Amendment, Washington's (I601) Amendment, and Missouri's (Hancock) Amendment.

In each case, however, these stringent limits have been weakened over time. When these states experienced a revenue shortfall, the response was to weaken their stringent limit. The most recent example of this weakening is Referendum C, that has weakened Colorado's TABOR Amendment.

Colorado's Taxpayer Bill of Rights (TABOR) Amendment

The most effective TEL enacted in the states thus far is Colorado's Taxpayer Bill of Rights or TABOR Amendment. TABOR was designed by a taxpayer organization and introduced through the initiative process, first at the local level in Colorado Springs in 1991, and then at the state level in 1992.

Several provisions of the TABOR Amendment have proven to be crucial in constraining the growth of government at both the local and state level. TABOR is a constitutional measure that limits the growth of revenue and spending to the rate of population growth and inflation. That limit is applied to a broad measure of revenue and spending with few exceptions. Surplus revenue above that limit must be returned to taxpayers. Citizens must approve any increase in taxes, debt, or fees. If governments want to spend surplus revenue they must first seek voter approval.

From the outset TABOR has proven effective in constraining the growth of government at both the state and local level. Because TABOR has effectively constrained

the growth of government, Colorado has been able to avoid the fiscal problems encountered in other states, such as California, that lack an effective TEL. As a result, when Colorado experienced a revenue shortfall during the recent recession, the state was able to balance the budget with modest cuts in some state programs. However, Colorado does not have a budget stabilization or rainy day fund, so it was not in a position to offset much of the revenue shortfall.

Colorado has experienced one of the highest rates of economic growth in the country. However, Colorado also experienced a sharp recession accompanied by a revenue shortfall. This past year the Colorado economy recovered and is again growing more rapidly than other states. As the economy recovered, revenues again exceeded the TABOR limit, requiring tax rebates.

Last year the Colorado legislature introduced two ballot measures, Referendums C and D. Referendum C, permitting the state to spend surplus revenue for the next five years, passed. Referendum D, permitting the state to issue new debt, did not pass. Many ballot measures have been presented to Colorado voters since TABOR was enacted. These ballot measures tend to pass at a high rate at the local level, but most ballot measures to raise taxes or spend surplus revenue at the state level have been rejected by Colorado voters.

Critics argue that Colorado has abandoned the TABOR Amendment. That is nonsense; TABOR provides that state and local governments can spend surplus revenue and issue new debt, but first they must secure voter approval. Referendum C did weaken the TABOR limit by modifying the revenue base used to calculate the limit. This pattern of weakening TELs in periods of recession and revenue shortfall is observed in many states with effective TELs.

Ohio's (Blackwell) Initiative

Nine states have introduced new state TELs through the initiative process in recent years. These new state TELs are based on the ALEC model, combining a stringent limit with an emergency and rainy day fund. Thus, they are likely to be more effective than existing TELs in both constraining the growth of government and in stabilizing the budget over the business cycle. They are also less likely to be weakened during periods of recession and revenue shortfall. One of the battleground states for these new state TEL initiatives is Ohio.

While the Ohio TEL was designed by taxpayer organizations, it very quickly became identified with the gubernatorial campaign of Secretary of State Ken Blackwell. Supporters of "the Blackwell Initiative" garnered sufficient signatures to place the TEL on the ballot in 2005. However, Ken Blackwell chose to hold the initiative off the ballot until 2006 in order to coordinate the TEL initiative with his gubernatorial campaign.

It is not hard to understand why the Blackwell Initiative has received broad support in Ohio. Each year the Tax Foundation measures the tax burdens imposed by state and local governments. This year Ohio has the third highest tax burden in the country. At this rate, within a few years, Ohio will have the heaviest tax burden in the country.

Three decades ago Ohio had one of the lowest tax burdens in the country. The increased tax burden reflects higher taxes across the board; income taxes, sales taxes, property taxes, and excise taxes are all above the national average. However, the

Table 8: State Business Tax Climate Index, 2005		
State	**Score**	**Rank**
U.S.	5.000	-
Alabama	5.78	14
Alaska	6.99	3
Arizona	5.14	25
Arkansas	4.64	41
California	4.67	40
Colorado	5.85	12
Connecticut	4.68	39
Delaware	6.29	8
Florida	6.84	4
Georgia	5.35	21
Hawaii	4.87	33
Idaho	5.17	24
Illinois	5.19	23
Indiana	6.01	11
Iowa	4.63	42
Kansas	4.84	34
Kentucky	4.57	44
Louisiana	4.76	36
Maine	4.48	45
Maryland	5.22	22
Massachusetts	5.06	27
Michigan	5.12	26
Minnesota	4.70	38
Mississippi	5.05	29
Missouri	5.42	20
Montana	6.14	9
Nebraska	4.58	43
Nevada	6.84	5
New Hampshire	6.58	6
New Jersey	3.96	49
New Mexico	5.06	28
New York	3.91	50
North Carolina	4.74	37
North Dakota	4.99	31
Ohio	4.11	47
Oklahoma	5.48	17
Oregon	6.08	10
Pennsylvania	5.49	16
Rhode Island	4.11	48
South Carolina	5.03	30
South Dakota	7.38	2
Tennessee	5.60	15
Texas	6.56	7
Utah	5.45	18
Vermont	4.34	46
Virginia	5.45	19
Washington	5.84	13
West Virginia	4.77	35
Wisconsin	4.92	32
Wyoming	7.47	1
D.C.	4.41	-

Note: The index is a measure of how each state's tax laws affect economic performance. The higher the score, the better the business tax climate.

Source: Tax Foundation, Facts & Figures Handbook: How Does Your State Compare?, March 2006, http://www.taxfoundation.org/publications/show/255.html

major culprit is a graduated income tax with one of the highest top income tax rates in the country. Ohio citizens pay a top rate of 7 1/8 percent, and corporations pay 8 1/2 percent. With a graduated income tax, income tax revenues increase more rapidly than income in periods of economic expansion. In this sense the graduated income tax, with high marginal rates, contributes to the ratchet up effect of government from one business cycle to the next.

The outcome of this unconstrained

growth in government is a race to the bottom. Economic growth in Ohio has lagged behind that in other states for decades. Ohio simply can't compete with other states for business investment and jobs with this heavy tax burden. In fact, the Tax Foundation shows that Ohio has one of the worst business tax climates in the country (see Table 8).

The Blackwell Initiative would, for the first time, impose an effective tax and spending limit on state and local government in Ohio. Contrary to what the critics are saying, this proposed tax and spending limit is one of the best designed limits in the country. It would impose a constitutional limit equal to inflation and population growth on increases in government spending. Surplus revenue above that limit would be allocated first to an emergency and budget reserve fund. When the cap on that fund is reached, additional revenue would be returned to taxpayers. In periods of recession the budget reserve fund would be used to offset at least part of the revenue shortfall. This tax and spending limit will both constrain the growth of government and stabilize the budget over the business cycle.

For the last three decades government revenue and spending have been increasing more rapidly than personal income in Ohio. With an effective tax and spending limit in place government revenue and spending will increase less rapidly than personal income. This can set the stage for much-needed tax reform to provide tax relief to Ohio citizens and corporations. If Ohio wants to compete with other states for business investment and jobs it needs to cut income tax rates in half. Broadening the income tax base would close many loopholes in income tax. Incorporating the more generous federal standard deduction and personal exemption would make income tax more equitable as well as more efficient. With this tax reform Ohio could create a business tax climate conducive to rapid economic growth. The first step in getting Ohio back on track is passing the proposed tax and spending limit. Without this legislation, a serious discussion of tax reform and tax relief is unlikely; Ohio will continue to have one of the heaviest tax burdens in the country.

Having a strong gubernatorial candidate endorse the TEL initiative has certainly increased the probability of enacting this legislation in Ohio. Blackwell has been able to generate support from a broad cross-section of citizens who see his endorsement of the TEL initiative as a litmus test for fiscal conservatism. This is particularly important in a state such as Ohio where the current administration has pursued imprudent fiscal policies, blurring the distinction between Republicans and Democrats on this issue.

The Blackwell campaign also illustrates the nature of the battle when a strong gubernatorial candidate endorses an effective TEL initiative. The well-orchestrated attack on TELs at the national level has targeted the Blackwell Initiative. One form of attack is to challenge the initiative on constitutional grounds. The initiative states clearly that approval of increased taxes and expenditure of surplus revenue requires a majority of electors voting in an election. However, the initiative also refers to voting by electors at the local level. Opponents charge that this ambiguity in the language of the initiative is designed to impose a more stringent limit on local governments than on the state. While this legal challenge will not likely pass muster in the courts, it almost assures that the initiative will be challenged in the

Ohio Supreme Court. TEL initiatives usually survive such legal challenges, but the Ohio initiative demonstrates the importance of carefully designing TELs to avoid such legal challenge.

Houston's Prop One Charter Amendment

There is an important link between TEL initiatives to constrain the growth of local government, and TEL initiatives to constrain state governments. Prop 13 was the first TEL to effectively constrain the growth of property tax revenues in California in 1978. The state TEL—the GANN Amendment—was enacted in the following year. Massachusetts passed a local TEL, Prop 2-1/2, drawing upon the local government section of the California model. The first TABOR Amendment was enacted at the local level in Colorado Springs in 1991. Since then Colorado Springs has reduced the mill levy (the effective property tax rate) eight times due to TABOR. In fact, Colorado's TABOR Amendment enacted at the state level was based on the local TABOR passed in Colorado Springs the prior year.

In recent years many states have experienced a property tax revolt, not unlike that experienced in the 1970s. Many local jurisdictions across the country have experienced double-digit growth in property tax revenues. This reflects both increased appraisal values and increased mill levies. City and county governments have responded to the windfall of increased property tax revenues with double-digit growth in spending. Existing constraints on property taxes have often proven ineffective in limiting the increased property tax burden. As a result citizens in some local jurisdictions have introduced local TEL legislation, and some of these initiatives are based on the ALEC model. Ground zero in this property tax revolt is Texas.

For many years Texas citizens have tried unsuccessfully to constrain the growth of government. Texas was one of the first states to enact a state tax and spending limit, in 1978. That tax and spending limit has rarely constrained the growth of state revenue and spending, due to flaws in the design of the limit.

In 1982 Texas enacted a statutory limit on property tax revenue increases. That limit has been ineffective in constraining the growth of property taxes. This increase in property tax burdens is at the center of the debate over tax reform in Texas. Since 1980 local property tax revenues increased six fold, from $3.9 billion to $24.5 billion. According to the Tax Foundation, Texas ranks as the 12th highest in the nation in property taxes relative to personal income. While Texas is generally regarded as a low tax state and has no state income tax, property owners bear a disproportionate share of the tax burden.

It is important to understand why the Texas property tax limits have failed to constrain the increase in property taxes. Texas imposes a very generous property tax assessment cap of 10 percent. Several measures have been introduced in the legislature to lower that assessment cap. Texas also provides for a revenue rollback only after property values are reassessed. Each local jurisdiction then calculates a rollback tax rate. That tax rate must provide the same amount of revenue as in the prior year, plus an 8 percent "buffer". The rollback tax rate must also provide sufficient funds to pay current debt. If property tax revenues come in above the limit, citizens can petition for an election to rollback the increase to 8 percent.

There are several reasons why this roll-

back limit has failed to constrain the growth of property taxes:

1. The limit provides a generous 8 percent "buffer." Legislation has been introduced at both the state and local level to lower that rollback rate.
2. The limit is not triggered automatically. Citizens must first petition to put a referendum on the ballot, and then secure a majority vote to enforce the revenue rollback.
3. Exemptions are provided to some school districts to set rates above the rollback limit. This exempts a substantial share of revenue from the limit in those jurisdictions.
4. The limit lacks transparency and accountability. Legislation has also been introduced to try to increase transparency, and to make it easier for citizens to petition for a rollback election.

Like many states, Texas must now respond to a judicial mandate regarding funding for public schools. The Texas Supreme Court has ruled that school districts lack meaningful discretion in setting property tax rates. In the Court's view this constitutes a statewide property tax, which is prohibited by the Texas Constitution.

The myth of local property tax relief persists despite the evidence from past state efforts to provide this relief. The Texas legislature has been largely unsuccessful in using state funds to provide local property tax relief in the past. The fatal flaw is the fungible nature of state and local funds, and the taxes used to generate those funds.

When local jurisdictions receive state funds to provide property tax relief, they often use those funds to sustain higher levels of spending. In the long run assessment rates and mill levies are often increased, resulting in higher, rather than lower, property tax burdens. All one has to do is look at the annual double-digit increases in property tax revenues in many local jurisdictions over the past decade.

The Texas legislature can provide property tax relief, and also satisfy the judicial mandate regarding school funding. However, Texas must avoid the fatal flaws that have undermined past efforts at property tax relief.

The fatal flaw in past efforts to use state funds to provide property tax relief is the absence of constraints on the ability of local jurisdictions to offset that relief with increased assessments and mill levies. The solution is to impose an effective tax and spending limit on both state and local government.

TELs, based on the ALEC model, have been introduced at both the state and local level in Texas. Houston recently enacted this TEL, Prop Two, in its city charter. The Houston TABOR links a stringent tax and spending limit to an emergency and rainy day fund. This limit will both constrain the growth of spending, and stabilize the budget over the business cycle.

Passage of Prop Two in Houston followed a familiar pattern. When Prop Two was placed on the ballot through an initiative, the Houston City Council responded with its own watered down TEL, Prop One. The latter was clearly designed to preempt the more stringent Prop Two initiative drafted by a local taxpayer group. When both ballot measures passed, the mayor of Houston interpreted the result to mean that the weaker TEL was the binding constraint. The taxpayer group then successfully chal-

lenged that interpretation in the courts, so that the more stringent Prop Two is now in the city charter.

Taxpayer Organizations in Texas have designed a model TEL based upon Houston's Prop Two, and are gathering signatures in half a dozen cities to impose this effective TEL at the local level. The expectation is that successful passage of these local TELs will provide the impetus for passage of an effective state TEL in Texas, as has occurred in other states.

b. Enacting TELs Through the Legislative Process

TELs enacted through the legislative process tend to be less stringent than those enacted through citizen initiative. Legislators are often influenced by interest groups who support higher levels of taxation and spending, but they must also weigh the political costs of imposing a higher tax burden on their constituents.

When legislatures are dominated by special interests they may design and implement ineffective TELs. This enables these elected officials to appear to be fiscally prudent, when in fact they are playing rent-seeking games benefiting the special interests. In some cases these ineffective TELs are designed to preempt more stringent TELs from being enacted through citizen initiative.

In recent years elected officials have introduced TEL legislation based on the ALEC model. However, even in these cases the design and implementation of the TELs tends to be less stringent than those introduced through citizen initiative. The ALEC model is designed to achieve a tradeoff between constraining the growth of government and balancing the budget over the business cycle. Legislators have designed TELs to achieve both of these objectives, but they tend to place greater emphasis on stabilizing the budget than on constraining the growth of government.

Colorado's Arveschaug/Bird Amendment

Colorado's Arveshaug/Bird Amendment is a statutory tax and spending limit passed in 1992, the same year that TABOR was passed. The legislators who designed and implemented Arveschaug/Bird were clearly attempting to preempt the more stringent TABOR Amendment from being enacted. When TABOR passed it required that existing tax and spending limits, including the Arveschaug/Bird limit, cannot be weakened without a vote of the people. This provision, in effect, made Arveschaug /Bird a constitutional limit.

Arveschaug/Bird limits the growth of general fund spending to a 6 percent increase over spending in the previous year. Some general fund spending is exempt from the 6 percent limit. Examples of these exemptions include new programs required by federal law or state or federal court order, and Medicaid over-expenditures. Other exemptions include appropriations for property tax reappraisals, and for fiscal emergencies. Voter-approved tax and fee increases are also exempt.

The TABOR limit and the Arveschaug/Bird limit are interdependent. The TABOR limit applies to the sum of general fund revenues and selected cash fund revenues. However, the state has chosen to refund any surplus revenues only from the general fund. This means that when a TABOR surplus must be refunded, and the cash fund grows more rapidly than the general fund, the state may not be able to increase general fund appropriations at the maximum 6 percent rate.

The 6 percent spending limit has been interpreted by the legislature as a floor rather than the intended ceiling. The reason is that a growth in general fund spending less than the 6 percent would ratchet down the amount of spending permitted in all future years. The legislature makes numerous adjustments to the base of general fund expenditures to assure that the 6 percent limit is reached each year. During the recent revenue shortfall general fund appropriations could not be increased at the maximum 6 percent rate, Several bills have been introduced to lower the Arveschaug/Bird limit below 6 percent.

It is fair to say that Arveschaug/Bird was not meant to constrain the growth of total state revenue and spending. The major impact of the 6 percent cap has been to change the composition of state spending, and stabilize the budget over the business cycle. As general fund spending converged toward the 6 percent limit the result was greater stability in general fund spending. On the other hand, non-general fund spending, especially for capital projects, is not constrained by the 6 percent cap. Over the past decade capital spending has been very volatile, expanding very rapidly during the growth years of the 1990s, and decreasing sharply during the recent recession.

One could argue that the 6 percent cap did prevent the legislature from building general fund spending, i.e. recurring expenditures, into the budget. To that extent the 6 percent cap made it easier to balance the budget when the state experienced a revenue shortfall in the recent recession. However, the binding constraint on the growth of total state revenue and spending has been the TABOR Amendment, not the 6 percent cap. That was clearly the objective of the legislators who designed Arveschaug/Bird.

Florida's Constitutional Revenue Limitation

In 1994 a citizen's group in Florida placed a constitutional amendment on the ballot that would have required voter approval for any new tax or tax rate increase. The Florida Supreme Court ruled that this ballot measure did not meet constitutional requirements for a citizen initiative. Partly in response to this citizen initiative, Florida legislators designed a TEL that did appear on the ballot and was approved by voters.

The Florida TEL limits revenues, not expenditures. Florida's revenue limitation specifies that the revenue cap increases each year by the average annual growth rate in Florida personal income over the previous five years. The revenue cap applies only to "own source" revenues, and not to revenues received from the federal government. The cap exempts revenues necessary to meet the requirements of state bonds, revenues used to provide matching funds for Medicaid, revenues used to pay lottery prizes, receipts of the Hurricane Catastrophe Fund, balances carried forward from prior years, local government taxes, fees, and charges, and revenues required to be imposed by constitutional amendments after 1994. Any revenues collected in excess of the cap are transferred to the Budget Stabilization fund until that fund reaches 10 percent of the previous year's revenues, after which excess revenues are refunded to taxpayers. The legislature can increase revenues beyond the cap by a two-thirds vote of both houses of the legislature in a separate bill that contains no other subject, and that specifies the dollar amount of the increase.

Florida's revenue cap has proven to be ineffective for three main reasons. First, the cap uses as its base the previous year's cap, even if current revenues are well below the

cap. Second, the cap covers only slightly more than three-quarters of net revenues, and the share of revenues covered by the cap has been falling over the years. Third, the cap grows along with state income, which provides for greater growth than TELs in other states such as Colorado.

The Florida revenue cap has proven to be completely ineffective in constraining the growth of government. From the outset the revenue cap has exceeded actual revenues. In fact the revenue cap is so irrelevant the Florida legislature does not even bother to calculate it in setting current budgets. There is only one explanation for Florida legislators designing and implementing an ineffective TEL. They could appear to be fiscally prudent when in fact they are not constrained by the revenue limit. More importantly, they could preempt a more effective limit from being imposed through citizen initiative.

This year a TEL based on the ALEC model has been introduced in the Florida legislature. Florida legislators are responding to taxpayer organizations that want to see an effective TEL in the Florida constitution. They are also responding to a property tax revolt in a number of local jurisdictions where property tax limits could be enacted through the initiative process.

Missouri's House Joint Resolution No. 48

The same patterns observed in Colorado's Arveschaug/Bird limit are evident in more recent TELs introduced through the legislative process. A good example is Missouri's House Joint Resolution No. 48.

The historical experience with TELs in Missouri is very similar to that in Colorado. The Hancock Amendment was one of the early TELs, introduced through initiative in 1980. Hancock is a constitutional limit on the growth of total state revenue. The limit is defined as a ratio of state revenue to state personal income. When revenue exceeds that limit by more than 1 percent, the surplus is rebated to taxpayers. When revenue exceeds the limit by less than 1 percent the surplus is transferred to the general revenue fund. Voter approval is required for new taxes.

For many years the Hancock Amendment proved to be an ineffective constraint on the growth of state revenue. The limit locked in the ratio of government revenues as a share of personal income. Even this weak limit was evaded and avoided by the legislature. The legislature failed to define surplus revenue, and did not enact enabling legislation. Large amounts of revenue were declared exempt from the limit, including tax revenue earmarked for education. The legislature also exempted sales tax revenue and motor fuel tax revenue from the limit. When these legislative actions were challenged in the courts, the courts upheld the actions of the legislature.

In 1996 Missouri citizens enacted an amendment to Hancock through the initiative process. This amendment requires the state to refund excess revenue when growth in state revenue exceeds growth in personal income by 1 percent or more. It also requires voter approval for new taxes. This new amendment has proven to be more effective in constraining the growth of government. In the late 1990s $2.5 billion in surplus revenue was offset by tax cuts and tax rebates.

This year a new amendment to Hancock was introduced through the legislative process. House Joint Resolution No. 48 is a spending limit designed to supplement the existing revenue limit. This proposed amendment would impose a constitutional

limit on total appropriations with the exception of interest and principal on the state debt. The limit is defined as inflation and population growth plus 1 percent. Like the ALEC model, this limit is linked to an emergency and rainy day fund. These funds are capped at 7 percent of state revenue. Surplus revenue above the cap is allocated to these funds, which are then used to restore reductions in appropriations made during periods of recession. Expenditure of funds during an emergency requires the governor to declare an emergency and a supermajority vote of the legislature. Money appropriated from these funds during a recession must be returned within five years.

The major impact of House Joint Resolution No. 48 would be to constrain the amount of state spending and stabilize the budget over the business cycle. The proposed legislation would not impose a more stringent limit on the growth of total revenue and spending. The binding constraint on total state revenue and spending would be the Hancock Amendment as amended in 1996. It is clear in Missouri and many other states that the primary concern of legislators in enacting TELs is stabilizing the budget over the business cycle; constraining the growth of government in the long run appears to be a secondary consideration.

Wisconsin's Taxpayer Protection Amendment (WTPA)

The fiercest battle over TELs is currently being waged in Wisconsin. This battle is significant because it is being waged over a TEL introduced through the legislative process, the Taxpayers Protection Amendment (WTPA). This amendment is based on the ALEC model and would both constrain the growth of government and stabilize the budget over the business cycle. It incorporates the important refinements of Colorado's TABOR Amendment discussed earlier in this report. It would be the most effective TEL introduced in any state since the TABOR amendment. Many have questioned whether such an effective TEL could be introduced through the legislative process, as opposed to the initiative process. At this point the answer is not yet in.

It is not hard to understand why Wisconsin has become a major battleground in the TEL movement. Wisconsin has never had a tax and spending limit at either the state or local level. For most of the post-World War Two period the special interests have been winning the battle, with government revenue and spending increasing more rapidly than personal income. This has left Wisconsin with one of the heaviest tax burdens in the country.

Wisconsin ranks as the sixth highest tax state in the country. Property tax burdens rank as the 11th highest in the country. But the major culprit is the income tax, which ranks among the highest in the country. Individuals pay a personal income tax rate of 6.75 percent, and corporations pay 7.9 percent. It is not surprising that the Tax Foundation ranks Wisconsin as one of the worst business tax climates in the country. Wisconsin has been an underachiever in attracting business investment and jobs, with rates of economic growth far below the national average.

Special interests understand the significance of WPTA for the TEL movement. Passage of WPTA would set a precedent for enacting stringent TELs through the legislative process in other states as well. Special interests have focused both state and national resources to defeat this measure. A

version of WPTA was first introduced in the Wisconsin assembly several years ago. By the time the special interests got done watering down that bill it was opposed by the sponsor and defeated in the Assembly.

This year when WPTA was introduced it received broad support in the Assembly and the Senate. There was strong grassroots support for enacting WPTA to constrain the growth of government at both the state and local level. The Americans for Prosperity Foundation, which led this grass roots effort, even enlisted the support of Milton Friedman to defend WPTA. Polls revealed that 70 percent of Wisconsin citizens supported WPTA. Despite this broad support, opponents were again able to block passage of the legislation.

Wisconsin citizens have had more success in enacting effective TELs at the local level in recent years. Several local jurisdictions have enacted TELs requiring voter approval for new debt issue. As in Texas, this success in enacting effective TELs at the local level may provide the impetus needed to enact WPTA at the state level.

4. Conclusion

In the battle for TELs we should expect a continuation of the patterns observed in the past. TELs emerging from citizen's initiatives and driven by grassroots organizations are likely to be more stringent both in constraining the growth of government and in stabilizing the budget over the business cycle. TELs emerging from the legislative process are likely to focus primarily on budget stabilization, with weaker constraints on the growth of government. However, the recent battles, such as the Blackwell Initiative in Ohio and the WPTA in Wisconsin, demonstrate that elected officials can introduce effective TELs through both the initiative and legislative process. These measures receive widespread grassroots support, especially in states such as Ohio and Wisconsin where citizens bear a very heavy tax burden.

Special interests are often successful in attacking TELs as a threat to what they perceive as their entitlements to tax dollars. As a brief survey reveals, they attempt to preempt effective TELs from being introduced through citizen's initiative or through the legislative process. They introduce weak and ineffective TEL initiatives and they attempt to water down TELs introduced in the legislature. Special interests target elected officials who support effective TEL legislation. Frequently special interests outspend taxpayer organizations who support this legislation by a substantial margin. Perhaps the most frustrating thing for taxpayers is that special interests use tax dollars to defeat effective TEL measures.

The special interests argue that citizens should not be given this voice in fiscal policy, and that we should leave fiscal decisions to elected officials. They maintain that elected officials are better informed and better able to pursue the public interest. But, what citizens observe is that too often elected officials respond to special interests at the expense of the public interest, growing government more rapidly than the private sector. Polls in a number of states reveal that when citizens are asked whether they should be able to vote on tax and debt increases, and whether government should be constrained by TELs, the approval rates are in the 70 percent range. To apply Mark Twain's famous phrase, reports of the demise of the TEL movement are greatly exaggerated; TELs are alive and well in the states.

F. TABOR at the Ballot Box

States are continuing to see a lot of momentum toward enacting tax and expenditure limitations (TELs), despite false claims by critics that Colorado has rejected its landmark Taxpayer Bill of Rights (TABOR), supposedly indicating the failure of the concept. As mentioned in the previous section, claims that Colorado has abandoned TABOR are misleading. Rather, voters decided to suspend TABOR for five years. It is not uncommon for states to weaken TELs in periods of recession and revenue shortfall.

Despite critics' claims, efforts to enact state-level TABORs continue apace. In November 2006, citizens in Maine will vote on a citizen's initiative referendum that would establish the Maine Taxpayer Bill of Rights, a tax and expenditure limitation on state and local governments. The referendum question that will appear on the ballot is: "Do you want to limit increases in state and local government spending to the rate of inflation plus population growth and to require voter approval for all tax and fee increases?"

The initiative would restrict growth in spending by state government to the combination of inflation and population growth. The growth of local school district budgets would be limited to the combination of inflation and the percent change in school enrollment. Municipal and county spending increases would be restricted to the lesser of either the percent change in property values or the combined rate of inflation and population change. Exceeding the growth allowance would require a two-thirds majority vote of the appropriate governing body (e.g. the state legislature, town council, etc.) and a majority vote of the citizens.

A portion of any surplus tax collections above the growth allowance would be diverted to a budget stabilization fund (20 percent), with the remainder (80 percent) returned to the taxpayers as either a tax rebate or a reduction in tax rates.

After achieving the necessary signatures to qualify for the ballot, the referendum was challenged in court. Its status remained in jeopardy until the Maine Supreme Court released a unanimous opinion in May 2006 overturning a Superior Court ruling that the state was wrong to accept petitions submitted after a deadline spelled out in state law. The state Supreme Court decision paved the way for the TABOR referendum to appear on the November 2006 ballot.

A recent analysis by the Maine Heritage Policy Center (MHPC) found that Maine's ranking of state and local taxes as a percent of personal income will fall under TABOR to number 19 by FY 2021, down from number 2 in FY 2006. In addition, Maine's state and local tax collections will grow from approximately $5.6 billion in FY 2006 to $8.7 billion in FY 2021—an average annual increase of nearly $207 million (3.5 percent). According to MHPC President William Becker, "Maine citizens no longer want to be at the bottom the economic barrel in ranking after ranking. Instead, the path to jobs and prosperity can only be found by taming government growth so that it does not exceed our ability to pay. The Taxpayer Bill of Rights provides that direction."

In addition, the effort to enact a TABOR initiative in Oklahoma continues. State Question 726—known as the Stop Over Spending (SOS) initiative—would amend the Oklahoma constitution to limit government spending increases to the combined percentage of inflation plus population growth.

Petitioners collected nearly 300,000 signatures in favor of the SOS measure, roughly 80,000 more signatures than needed to place it on the statewide ballot. The Secretary of State has accepted these petitions, but measure opponents have raised a procedural challenge questioning the validity of roughly 30,000 of the collected signatures. The Oklahoma Supreme Court has agreed to hear the legal challenge.

Measure proponents anticipate that the issue will work through the courts by midsummer, at which point the initiative will go to the governor to place on the ballot. Whether State Question 726 will be placed on the November 2006 ballot is still to be determined.

If enacted, Oklahoma's SOS initiative would dissolve the state's existing rainy day fund and create an emergency fund capped at 5 percent of the total state budget, which this year would total $300 million dollars according to the taxpayer advocacy group FreedomWorks. It would also create a budget stabilization fund capped at 10 percent of state budget ($600 million dollars this year) to be used in case of a budget short fall. If revenues fell below estimates, up to 35 percent of the stabilization fund could be used to fill the budget gaps. Any excess revenue would be returned to state taxpayers in the form of a check or income tax refund. FreedomWorks estimates that each Oklahoma taxpayer would have received $800 this year in tax savings had the measure already been in place.

G. Trends in Government Offshoring

Bill writing wanes but offshoring is still rare

Offshore outsourcing was a hot topic during the 2004 presidential election. State legislators picked up on the public's job security fears and got to work crafting anti-outsourcing legislation. Most of the bills focused on banning or discouraging offshoring in the provision of state contracts and the bill writing actually accelerated after the election. When the dust settled legislators in some 40 states had penned more than 200 anti-offshoring bills. Even so, only about a dozen states actually adopted such measures.

Since the middle of 2005 state officials' interest in offshoring has waned, but some have continued to forge ahead. In Michigan lawmakers have introduced a flurry of anti-outsourcing bills and Colorado's legislature has passed a bill that would give preference to U.S. service providers. The bill removes state procurement rules from existing international free trade agreements, such as the Central American Free Trade Agreement. Gov. Bill Owens has hinted that he might veto it because it could be deemed unconstitutional because international trade agreements have traditionally been the domain of the federal government.

Massachusetts lawmakers are considering Sen. Jack Hart's bill which would prohibit offshoring in state contracts. In 2004, Gov. Mitt Romney vetoed a similar bill, but some think that Romney's presidential aspirations will cause him to reconsider this time. Last year his administration brought a food stamp call center contract back from India. The contract ended up going to a Utah-based provider, but that did not please Hart. The *Boston Herald* reports that Hart might alter his bill to bar out-of-state outsourcing as well. Lawmakers in other states share Hart's sentiments as various other bills have aimed to keep government contracts in state.

Hart's view reflects the longstanding rift between those who regard government—at least in part—as a provider of jobs and those who think government should provide services as efficiently as possible. "Why would we use taxpayer money to fund jobs elsewhere?" he asks. A Romney administration official offered one reason: the state saves $1.6 million each year by outsourcing the work to a Utah provider. Other states have discovered that they can outsource jobs, spend rather lavishly on job retraining for affected workers, and still deliver savings to taxpayers. It is telling that many lawmakers have still decided to stick to their anti-outsourcing ways.

There has always been great disparity between the outrage offshore outsourcing provokes and how often it actually occurs. Private sector offshoring might be growing in prevalence, but it is still much less common than many panicked media reports would have you believe. Offshoring by governments is rarer still.

In recent years, the federal government has increased offshoring somewhat, but as a percentage of total outsourcing it remains small (about 6 percent). It's difficult to find precise figures for federal government offshoring and even more difficult to find figures for state-level offshoring. Still the available evidence suggests that offshoring is very uncommon. For example, an analysis by the California State auditor concluded that it appears that "the state is spending little on services performed offshore." The Center for Efficient Government reports that no Florida state contracts have gone offshore. A March 2006 report from the U.S. Government Accountability Office aimed to help close the information deficit even more. Once again the message was similar: government offshoring is very rare.

The report, *Offshoring in Six Human Services Programs*, (gao.gov/new.items/d06342.pdf), examines four federally funded state-administered programs—Child Support Enforcement, Food Stamp, Temporary Assistance for Needy Families (TANF), and Unemployment Insurance—and two federally administered programs that offer student financial aid—Pell Grant and Federal Family Education Loan (FFEL). The GAO discovered that no work was performed offshore for the federally administered programs. For the state-administered programs, offshoring occurred in one or more programs in 43 states plus the District of Columbia.

Other states have discovered that they can outsource jobs, spend rather lavishly on job retraining for affected workers, and still deliver savings to taxpayers.

Examples of Government Offshoring

- In South Carolina, the contractor hired to update the state's system for managing employer taxes is using software programmers in India to develop the new system.
- In Wisconsin, software programming took place in the United States, but the contractor made use of an offshore help desk for technical assistance.
- In New Mexico, the contractor performed Web development services in India as part of a system that allows the public to file on-line claims.
- In Washington and Montana, contractors offshored periodic maintenance for testing of a system.

Expenditures for the state-administered programs amounted to $1.8 billion and of that roughly $339 million—or 18 percent—was spent on contracts that involved some offshored services. The GAO notes that "the magnitude of actual spending on offshored services we identified is likely considerably lower than $339 million." Why? Even if some part of a contract is performed overseas, chances are most of it is done on American soil. One service provider with many contracts estimates that offshoring amounts to less than 3 percent of the total services provided through these contracts. Another contractor reported that offshored computer software programming accounted for less than 1 percent of the total package of services provided to states. Moreover, the public perception of offshoring—where an agency contracts directly with a foreign company—was also rare. In most cases offshoring occurred when a U.S. company used subcontractors who performed some work overseas.

State officials cited cost savings as a key benefit of offshoring. Fifteen state program directors performed cost comparisons and their analysis revealed wide-ranging but often substantial cost savings.

These comparisons showed that their contracts, with some services performed offshore, would cost from 0.3 to 24 percent less than if all the services in these contracts were to be performed in the United States.

In some cases offshoring helped improve service. For example, contractors might tap a provider in a different time zone to ensure that Americans can reach a customer service representative or technician 24 hours a day, seven days a week. Offshoring also helps contractors during busy periods. A U.S.-based call center may call upon an offshore operation when call volumes become too great to manage alone.

Few state officials identified any problems with offshore service providers, but those who did cited difficulty understanding the English of software programmers or customer service representatives. Customer service and help desk functions were the most common type of services to be offshored and services that were sometimes offshored include claims investigations, supplemental software programming, and data entry.

Surface Transportation

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A. Why Mobility Matters

Tell someone in our nation's cities that congestion is a problem and you probably won't even elicit a blink. Americans know congestion is awful and they're certainly not shy about complaining about it. Any one of us can rattle off the ways congestion frustrates our own lives, but we're less likely to step back, add others' frustrations to our own, and consider the full extent of the problem. Today commuters, customers and businesses shape more and more of their activities around what used to be considered just an everyday irritant. We know congestion is awful, but it may be even worse than we realized.

During the past two decades congestion has shot up over 200 percent nationwide. The average American now spends 47 hours a year stuck in congestion—more than an entire work week—and it's much worse in our big cities. In Los Angeles, the average driver spends 93 hours—more than two work weeks—stranded on the roads. Congestion smothers well-established areas (it's up 183 percent in Washington, D.C.) as well as upstart ones (up 475 percent in Atlanta).

Congestion has gotten much worse in areas where we expect it to be bad, but it's also making life increasing sluggish across the nation, from Portland to Austin to Charlotte. Every major city, as well as many that you might not consider "major," has a growing congestion problem. In 1983, just one urbanized area experienced enough congestion where the average driver in peak hours spent more than 40 hours stuck in traffic. By 2003, 25 urbanized areas reached this threshold.

Naturally businesses want to cater to their customers, but now all sorts of businesses are forced to cater to congestion first. Blue collar plumbers and repairman try to reach as many customers as possible but congestion stands in their way. White collar professionals, from salespeople to realtors,

face similar headaches. Most of us fight congestion on our way to and from work, but these people do battle with it all day long. Congestion makes it harder for would-be buyers and sellers to connect and it also shrinks labor pools.

Shrinking labor pools often hurt high-tech, financial, and other specialized operations most. According to a recent survey, Silicon Valley financial companies fingered congestion as their number-one headache—even ahead of longstanding business headaches like taxes, regulations, and health care costs.

Employers who require workers with specialized skills want to be able to draw from as large a labor pool as possible for, unlike fast food restaurants and certain other businesses, they cannot just hire whoever's nearby. Yet before they hire a promising applicant, employers must be sure that person can actually get to work reliably. Congestion isn't just frustrating because it slows us down. It's frustrating because from day-to-day we don't know how much it will slow us down. This element of unpredictability wears on commuters and employers.

When Dell computers cited congestion as a major factor in its decision to expand in Nashville instead of Austin, Texas learned that transportation troubles can also push businesses to other states. "We lost 10,000 jobs in one day," recalls Texas State Rep. Mike Krusee, who has since helped Texas embark upon our nation's most ambitious congestion-cutting effort.

Dell's decision shocked Texas into making a commitment to improving mobility, but most of the rest of the nation continues to dawdle. Lawmakers often fail to appreciate the mobility-congestion give-and-take. Mobility gives economies vitality that is gradually taken away by congestion. When people, products, and ideas cannot churn freely, an urban area becomes more segregated. It behaves less like a dynamic metropolis that draws on the talents of all its denizens and more like a collection of isolated hamlets.

Reason Foundation has responded by initiating the Mobility Project (see www.reason.org/mobility), a long-term, nationwide effort to help stimulate urban economies by improving mobility and cutting back congestion. The Mobility Project incorporates ideas from a wide range of scholars and presents comprehensive policy recommendations that will help our cities realize their full potential.

Too often lawmakers and voters seem resigned to mounting congestion. Indeed few metropolitan areas are actually intent on cutting it back—making a commitment to slow congestion's growth is usually all they hope to do. Yet congestion isn't like gravity. It's not an unstoppable force. Across the world cities have adopted innovations—some small-scale, some large—that quell congestion. The trick is mustering the political momentum necessary to cobble these innovations together and reinvigorate urban life.

B. Reason's Mobility Project

Reason Foundation is developing practical, cost-effective solutions to traffic congestion with the Galvin Mobility Project, a policy initiative that will significantly increase our urban mobility through innovative engineering, value pricing, public-private partnerships, and innovations in performance and management. Under the leadership of Reason's Director of Transportation Studies Robert Poole, Reason's original research is

Reason's Galvin Mobility Project

Reason's Galvin Mobility Project is made possible by the generous support of Bob Galvin. Bob Galvin is the former CEO and Chairman of Motorola, where he led the company through nearly three decades of successful growth and renewal. He was instrumental in implementing the Six Sigma quality system at Motorola. In 2005, he was awarded the Vannevar Bush Award for "his visionary leadership to enhance U.S. innovation, competitiveness, and excellence at the interface of science and technology with the Nation's industrial enterprise. In the counsels of government, industry, and academe, he unselfishly gave the Nation the benefit of his knowledge, experience and creative wisdom while leading his company in its great contribution to the computing and telecommunications transformation of society."

In May 2006, Reason interviewed Mr. Galvin about urban congestion and the Galvin Mobility Project.

What got you interested in mobility issues?

Galvin: I try to think of big subjects at least once in a while and I was thinking of the jobs situation in America. And even though there's pretty good employment now there are challenges to having enough jobs in America. To me whenever there's a need you have to have a strategy. A strategy is an application of resources and I thought we need some new strategies in the United States in order to have employment opportunities. And two of those things I thought of were there has to be a reliable energy system and the other is we have to eliminate congestion. And I was thinking of it as a convenience and in the middle of my thinking I said wait a minute—congestion is the same thing as an arterial problem in the body. And if it gets clogged, it dies. And all of a sudden I came to a conclusion that if major cities have not awakened to the fact that they have to eliminate congestion, the cities will die.

How will they die?

Galvin: Nobody will be able to get around. It's the same reason the heart dies. The artery gets clogged. The delivery can't be made to the stores, to the factories. People can't get out and around. They can't get to work. They haven't got flexibility.

What do you expect the Galvin Mobility Project to accomplish?

Galvin: I expect it to achieve a recognition of the principle I just described. And then someone asks, "Well, what do you do about it?" Well you have to have arteries. You put in more blood vessels and those blood vessels will come in two forms that are not currently very apparent. One is tunnels and the other is bridges.

Why has our political class been so slow to address mobility and congestion?

Galvin: Most leaders are not good anticipators. I've known lots and lots and lots of leaders and particularly those that are allegedly influential in Washington and they're ossified.

What about the business community?

Galvin: They're oblivious to it.

Do you think that's beginning to change?

Galvin: I think we have a chance to change it, but on its own it's not changing. Over the years I've watched the ordinary thinking of the people who had titles and they were just doing ordinary things. They were never attempting to anticipate the grand situation. What we have to have is a passion. This isn't just another lane on the highway or a little better timing of lights or a picking up of accidents faster. Those are what I call the "art of the possible." And that's what most leaders do; they just deal with the art of the possible.

But that's not real leadership. A leader is someone who takes us elsewhere and I think my thesis will take people elsewhere if they'll follow it.

Few government officials talk about actually cutting congestion. Most just hope to reduce congestion's rate of growth. Why have Americans accepted this surrender?

Galvin: I think they're accepting it unconsciously, reluctantly because they assume nothing can be done about it. If we awaken the world, if we eliminate the problem, imagine what we will do to the dynamics of the economy.

You seem to enjoy taking people farther than they thought they could take themselves.

Galvin: That has been the nature of my life. That's what this is all about. If there is a big problem you have to do something about it. That means, for example, you have to start building tunnels.

France, Australia and other nations have embraced tunneling and other innovative ideas more than we have. How will that affect our competitiveness?

Galvin: I hope it inspires us. The Europeans are way ahead of us. The awakening has to come from our group. We are the alarm clock.

building comprehensive policy recommendations that enhance mobility and help local officials move beyond business-as-usual transportation planning.

In addition to a series of policy studies examining issues ranging from how adding new road capacity impacts the environment to improving the institutions that operate and manage road systems, the Galvin Mobility Project will promote solutions that take the principles of privatization into consideration. The project will explore opportunities to bring the power of the market to bear on mobility through financing and operating innovations such as private investment, public-private partnerships, as well as the demand-management power of variable pricing.

Dell's decision shocked Texas into making a commitment to improving mobility, but, most of the rest of the nation continues to dawdle.

The project will also develop mobility recommendations for individual U.S. cities, illustrating how solutions can be applied to city-specific problems. Throughout, the project team will be working with national and local transportation officials to develop support for implementation of the policy program.

Congestion is not inevitable, and through the Galvin Mobility Project, Reason is working with top transportation experts to end the gridlock caused by business-as-usual transportation planning.

C. Surface Transportation Update

1. Introduction and Overview

Recently tolling has gained in popularity as governments find their roadways in desperate need of repair and expansion and their pockets all but empty. Tolling represents the privatization of highway finance, in which government agencies and private parties alike turn to private capital markets to raise funds up front, repaying the investors over time out of the toll revenues collected. Increasingly, new toll road and toll lane projects are being developed and operated by the private sector, under some form of public-private partnership (PPP) agreement. Both tolling and PPPs may have reached a critical mass of importance for the future of U.S. highways in the 21st century.

In February 2006, transportation expert Kenneth Orski wrote in *Innovation Briefs* that "highway tolling has reached the tipping point." He cited a whole range of recent federal, state, and local government decisions in favor of increased tolling, as well as the general buzz of the January 2006 Washington, D.C. annual meeting of the Transportation Research Board. At that meeting a special TRB committee on the long-term viability of fuel taxes for highway finance released its report, concluding that beyond the next 15 years, fuel taxes look increasingly dubious as the principal highway funding source, and recommending accelerated state and federal efforts to gain experience with tolling and PPPs to lay the groundwork for a longer-term transition to direct, electronic charging for highway use per mile driven.

A recent report for the Federal Highway Administration (FHWA) by PB Consult provides a new perspective on the growing role of tolling. Though toll roads represent only 4,630 miles of the 162,000-mile National Highway System (2.8 percent), they generate $6.5 billion per year (4.5 percent

of total highway expenditures by all levels of government). But that snapshot greatly understates the emerging role of toll roads. The report identifies 147 toll projects that have been moved into the planning, NEPA review, design/finance, construction, or operational stage since 1992, in 22 states and one territory. These projects, if they are all built, total $76.7 billion in cost and represent over 3,400 new centerline miles (13,800 lane-miles) of capacity. The report concludes that at this rate, toll roads are responsible for 30 to 40 percent of new limited-access road mileage (meaning freeways and long-distance highways such as Interstates).

Two key factors help to explain this rapid growth in tolling. One is the mismatch between highway investment needs and available fuel-tax revenues. The latest FHWA biennial conditions and performance report puts the gap between current annual highway investment and the annual sum needed to both maintain asset values and keep pace with travel demand at $51 billion per year. Toll projects are helping to fill that gap. The second key factor is the very rapid market penetration of electronic toll collection. A survey conducted by Tollroadsnews.com, found that over 59 percent of transactions at the 43 largest U.S. toll road operations were being made by transponder as of the first quarter of 2006. All but two large toll agencies (Indiana and Ohio) have implemented electronic tolling. Many of these agencies are implementing high-speed open-road tolling, where toll plazas are removed and tolling takes place by driving under a gantry at normal highway speed; those without transponders have to exit and make use of old-fashioned toll booths off to the side. Nonstop electronic toll collection removes one of the major customer problems with tolling—long waits at congested toll plazas.

Finally, while tolling overall has grown significantly, so has the use of PPP arrangements for toll projects. Table 9 shows the toll roads developed during the 1990s in the first wave of PPP toll roads. Though mostly

Table 9: New PPP Toll Roads in Operation

State	Location	Road	Cost ($B)	PPP Type
AL	Tuscaloosa	Black Warrior Pkwy Br.	$0.025	BOO
AL	Montgomery	Emerald Mt. Expwy Br.	$0.004	BOO
AL	Foley	Foley Beach Express	$0.044	BOO
AL	Montgomery	River Pkwy Bridge	$0.012	BOO
MO	Lake of the Ozarks	Lake of the Ozarks Br	$0.040	BOT
ND	Fargo	Fargo Bridge	$0.002	BOT
CA	Orange County	91 Express Lanes	$0.130	BTO
SC	Greenville	Southern Connector	$0.191	DBFO
TX	Laredo	Camino Colombia	$0.090	BOT
VA	Loudon County	Dulles Greenway	$0.430	BOT
VA	Richmond	Pocahontas Pkwy	$0.325	DBFO
Total			$1.293	

BOO = Build-Own-Operate
BOT = Build-Operate-Transfer
BTO = Build-Transfer-Operate
DBFO = Design-Build-Finance-Operate

Table 10: Privatizations of Existing Toll Facilities				
State	Location	Road	Cost ($B)	Type
MI	Detroit	Detroit-Windsor Tunnel	$0.07	
IL	Chicago	Skyway	$1.83	99-year lease
IN	Indiana	Indiana Toll Road	$3.85	75-year lease
VA	Loudoun County	Dulles Greenway	$0.62	
Total			$6.37	

Table 11: Current PPP proposals, March 2006				
State	Location	Route	Est total cost, $B	Type of Project
CA	San Diego	SR 125	$0.6	new toll road
CO	Denver	C-470	$0.4	add HOT lanes
GA	Atlanta	I-75/575	$1.8	add HOT and toll truck lanes
GA	Atlanta	GA-400	$1.4	add HOT lanes
OR	Portland	3 new routes	$1.0	new toll roads
TX	San Antonio to Dallas	TTC-35	$7.2	new toll road
TX	Dallas	I-635	$3.0	add HOT lanes, rebuild freeway
TX	Dallas	SH 121	$0.3	new toll road
TX	San Antonio	Loop 1604	$0.6	add HOT lanes
TX	Ft. Worth	SH 161	$0.5	new toll road
VA	TN to WV	I-81	$7.0	add toll truck lanes, rebuild highway
VA	Northern VA	I-495	$0.9	add HOT lanes
VA	Northern VA	I-95/395	$1.0	add HOT lanes
			$25.7	

small projects, they total nearly $1.3 billion in new private capital investment. Table 10 shows the results thus far of the privatization of existing toll roads, with four such transactions totaling $6.4 billion. And Table 11 lists PPP projects for new toll roads or toll lanes that are officially under way in six states as of early 2006. These projects total $25.7 billion.

2. SAFETEA-LU Tolling & PPP Provisions

Since the passage of the Intermodal Surface Transportation Efficiency Act (ISTEA) of 1991 (federal legislation authorizing federal highway, highway safety, transit and other surface transportation projects through 1997), each federal surface transportation reauthorization bill has been more favorable to tolling and PPPs. The Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU), enacted late in 2005, was no exception. Compared with the pre-ISTEA situation in which tolls were banned from federal-aid highways, as of 2006 there are six tolling and pricing programs in the federal program, as follows:

- Value Pricing Pilot Program, under

which 15 project-partner state DOTs may carry out a variety of pricing projects, including on Interstates;

- Express Lanes Demonstration Program, under which up to 15 projects may add express toll lanes to congested Interstates;
- Interstate Reconstruction and Rehabilitation Pilot Program, under which up to three states may rebuild an existing Interstate using toll finance;
- Interstate Construction Toll Pilot Program, under which up to three states may use toll finance to build new Interstates;
- HOV to HOT conversion, under which existing HOV lanes may charge tolls to vehicles that do not meet the high-occupancy requirements;
- Title 23 Sec. 129 Tolling Agreements permit states to replace free bridges on the Interstate system with toll bridges.

FHWA has set up a new Tolling and Pricing Team to provide one-stop assistance with any or all of these programs.

In addition to these six programs, there are important financing provisions in SAFETEA-LU. Federal credit support for toll projects has been liberalized under the TIFIA program. And for the first time, PPP toll projects under which the private partner has a long-term ownership interest in the project (e.g., under long-term concessions) can be financed using tax-exempt (rather than taxable) toll revenue bonds. The new law provides for issuance of up to $15 billion of such private activity bonds during the life of the SAFETEA-LU legislation.

3. State Enabling Legislation

States looking into tolling and public-private partnerships sometimes find themselves hamstrung by their own regulations. Many states have no legislation enabling such projects to even be considered and must take that legal step first before planning projects. In 2005 several states worked to change their laws to lay the groundwork for tolling and PPPs.

Texas made some fine-tuning changes in its landmark 2003 tolling and PPP law during 2005. HB 2702, signed by Gov. Rick Perry on June 14, 2005, does a number of things. To defuse a budding controversy over the possible conversion of existing free roads or lanes to tolls, it requires a local referendum to approve any such conversions. It requires that entire concession or other PPP agreements (called Comprehensive Development Agreements in Texas) be made public. Most concession terms will be limited to 50 years. Non-compete clauses cannot limit or prohibit projects of local governments or projects that are in the Unified Transportation Plan. And state and local authorities must approve the methodology used to set toll rates in PPP projects. In addition, the annual amount that the state can invest in toll projects that are not self-supporting from toll revenues was increased from $800 million to $2 billion.

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The first quarter of 2006 saw two new state enabling measures enacted. Indiana passed Gov. Mitch Daniels' bill to authorize the long-term lease of the Indiana Toll Road and the development of I-69 from Indianapolis to Evansville as a toll road, possibly

via a PPP arrangement. With relatively few other PPP toll road prospects, the state did not seek broader tolling/PPP authority. And Utah enacted SB 80, a broad enabling act that permits PPPs for tollways, with projects able to be originated either by the private sector (unsolicited proposals) or the state (via RFPs). The new law includes HOT lanes as one category of toll/PPP project. As in Texas, the state may provide partial funding support for toll projects that do not appear to have sufficient traffic to be 100 percent toll-financed. Concession terms may be up to 99 years.

Efforts to pass enabling legislation are continuing for a second year in California and New York. California Gov. Arnold Schwarzenegger proposed a 10-year Strategic Growth Plan calling for up to $107 billion of investment in transportation infrastructure. The proposed legislation includes the design-build and PPP provisions from 2005's failed AB 850; that measure was approved on a bipartisan basis by the transportation committees in both houses, but never reached the floor in either due to fierce opposition from the Caltrans engineers' union. In New York, Gov. George Pataki likewise revived his tolling/PPP enabling measure from 2005. In support of this effort, the New York State DOT and the University Transportation Research Center held a well-attended day-long workshop on "innovative transportation financing and contracting strategies" in Albany on March 8, 2006. Much of the near-term attention has focused on a possible PPP deal to replace the aging Tappan Zee Bridge across the Hudson River.

4. Sale or Lease of Existing Toll Roads

Strapped governments can also raise cash by selling or leasing their assets, including existing toll roads. Leasing enables the entity to retain ownership of the asset while divesting itself of the day-to-day management and operation of it. Outright sale gets government out of what is often a money-losing project in desperate need of expensive upgrading while reaping a welcome cash bonus for struggling economies at the same time.

Just as the 99-year lease of the Chicago Skyway for $1.8 billion was the talk of 2005, so the 75-year lease of the Indiana Toll Road for $3.85 billion has become the talk of 2006 in transportation circles. Unlike the Chicago transaction, whose proceeds were used to pay off debt and fund other municipal balance-sheet items, in Indiana Gov. Daniels crafted the privatization proposal as the key to fully funding his proposed 10-year highway program. Under the "Major Moves" program, highways throughout the state would be upgraded over the next decade. But the price tag was $2.8 billion more than available funding sources would provide. Thus, the key to fully funding Major Moves became the receipt of up-front lease proceeds from the Toll Road privatization. In the end, the winning bid from Cintra/Macquarie was significantly higher than expectations, enabling the state to propose setting up a long-term fund for further transportation investments.

The successful privatization of the Indiana Toll Road encouraged public officials in other states to consider privatization of their toll roads. The most ambitious effort as of early 2006 was in Houston, where Harris County commissioned three linked feasibility studies on alternatives for the Harris County Toll Road system. Citigroup's team reviewed the best options if the system were kept within the public sector. J.P. Morgan's

team explored a possible sale and estimated that the county could have received as much as $20 billion if it sold the system. A Goldman Sachs team analyzed a long-term concession agreement and concluded that, depending on the length, a lease could bring in $7.5 billion to $13 billion to the county. Ultimately, the Harris County Commissioners Court voted unanimously in mid-June to continue running the county's toll road system.

In Virginia, the existing privately concessioned Dulles Greenway changed hands when Macquarie Infrastructure Group bought an 86.7 percent interest from original owner TRIP II for $620 million. That toll road has 51 years remaining on its concession agreement with the state. Virginia had received five proposals for a long-term lease of the adjoining public-sector Dulles Toll Road in October 2005, ranging up to $5.7 billion. But early in 2006, a new administration decided to do a public-public partnership instead, under which the Metropolitan Washington Airports Authority (which owns the right of way on which the toll road is built) would take over the toll road and use toll revenues to fund $1.7 billion of the cost of extending the local Metrorail heavy rail system to Dulles Airport. Virginia DOT announced in May 2006 that it had reached an agreement to lease the financially troubled start-up toll road, the Pocahontas Parkway in Richmond, to Australia's Transurban. The company will lease the toll road for 99 years, pay off all its debt, and build the long-sought 1.6-mile connector to the Richmond Airport. Instead of paying an up-front fee for the money-losing toll road, Transurban will share 40 percent of gross revenues with the state once the toll road becomes profitable. Meanwhile, a state legislator introduced a bill to study the privatization of the Chesapeake Bay Bridge Tunnel.

In April 2006 Illinois legislators released a request for proposals for a study of the privatization, via long-term lease, of the Illinois State Toll Highway Authority system of toll roads. That large system is under way on a 10-year, $5.3 billion expansion program. In Ohio, gubernatorial candidate (and current Secretary of State) J. Kenneth Blackwell has proposed a long-term lease of the Ohio Turnpike, but unlike the Indiana lease (where the proceeds are all to be invested in transportation infrastructure), Blackwell's plan calls for using the proceeds to create a JOB Fund to put money into a plethora of non-transportation projects. And in New Jersey, although Gov. Jon Corzine initially ruled out leasing the New Jersey Turnpike to bail out the nearly bankrupt Transportation Trust Fund, speculation continues that the former Goldman Sachs banker will consider this option. He was quoted in the *Philadelphia Inquirer* in February 2006 saying "It's not on the table right now. It ought to be proven that these things [Chicago and Indiana] are successful before we actually think seriously about it. There is enough experimentation going on out there. I'd rather wait for the evidence."

Privatization of existing toll roads has also come up in Delaware and Kansas, but at this point no studies are under way in either of those states.

5. PPP Toll Roads & Toll Lanes

Texas continues to lead the nation in PPP toll road projects under development. On January 17, 2006 Texas DOT held a workshop on its PPP toll roads initiative, attended by over 400 people. At the work-

shop, TxDOT made it clear that it prefers long-term concession agreements, though it is open to all types of PPPs. The agency 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.

In other states:

• Oregon selected the winning bidder for three new toll road projects in the suburbs of Portland: a team headed by Macquarie, proposing a long-term concession approach.

• In Colorado, CDOT has proposed a network of six express toll lanes plus the missing link of its beltway, costing nearly $5 billion. The agency has received unsolicited PPP proposals for several of these, but exactly how the projects will be developed and managed remains to be decided.

• In Pennsylvania, the House Select Committee on Toll Roads released the results of a 20-month study in February 2006. It found that the state can afford to build little of the estimated $6 billion in needed highway additions and recommended increased use of tolling and PPPs. Officials have discussed informally a possible lease of the uncompleted Mon-Fayette Expressway, but thus far Pennsylvania lacks enabling legislation for PPP toll roads.

• In Missouri, the St. Louis-based

Regional Business Council released a study in January 2006 calling for a PPP toll bridge as the best alternative for a new I-70 bridge across the Mississippi River.

- The South Carolina legislature authorized tolling to finance construction and operation of a new I-73, to link I-95 with the resort-area Conway Bypass. The state would have to apply for one of the three slots in the new federal Interstate pilot program.

6. Managed Lanes

Separately from the ongoing PPP trends discussed above, a number of large urban areas are studying or implementing "managed lanes" on congested freeways. Generally these are either HOT lanes (in which high-occupancy vehicles travel at no charge and others pay a value-priced toll) or express toll lanes (ETLs) in which all vehicles pay. In either case, the policy is generally to allow bus rapid transit (BRT) vehicles to use the lanes without charge. Managed lanes allow governments to improve traffic flow and raise revenues by restricting access to such lanes to specific types of vehicles, and generally by using some form of pricing as the key traffic management tool. Carpool (high-occupancy vehicle, or HOV) lanes are an early form of (non-priced) managed lanes. The term also includes HOT lanes, express toll lanes, and truck-only toll lanes.

In California, the first HOV to HOT conversion, on I-15 in San Diego, proved to be so popular that the agency in question, SANDAG, is now under way lengthening that project from 8 miles to 20 miles, and widening it from two lanes to four. A new HOT lane project is in the design stage on I-680, a major commuter route from the East Bay into Silicon Valley. And several other HOT lanes are under study in nearby Santa Clara County. The Metropolitan Transportation Commission, which is the Bay Area's regional transportation planning agency, issued an RFP in September 2005 for a regional HOT Network study.

Minnesota marked the first anniversary of its HOV to HOT conversion on I-394 in May 2006. Popular support for the value-priced lanes has been high, though toll revenue has been less than projected. But the variable pricing mechanism is working well and has gained acceptance, validating the similar success with variable pricing in San Diego.

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Colorado's long-awaited conversion of the HOV lanes on Denver's I-25N to HOT lanes took place in June 2006, adding another state to the roster of those converting HOV lanes to priced lanes. Washington State DOT is under way on planning to do likewise for the existing HOV lanes on SR 167 south of Seattle.

In Utah, the state's Transportation Commission voted in April 2006 to convert a 40-mile stretch of HOV lanes on I-15 to HOT lanes. For now, access will be based on drivers buying monthly stickers, initially for $50/month; this is also how the I-15 HOT lane project in San Diego began. Utah DOT plans to convert to electronic toll collection at a later date.

A far bigger project is under construction on the Katy Freeway (I-10) in Houston,

where four variably priced HOT lanes are being added as part of a major reconstruction and widening of that freeway. There is currently a single, reversible HOV lane on that freeway that allows HOV-2 vehicles to purchase access during rush hours, when only HOV-3s are otherwise allowed. The new managed lanes will charge all vehicles except buses and HOV-3s.

Florida is moving forward with several managed lanes projects, all being carried out by public-sector toll authorities. In Miami, the Miami-Dade Expressway Authority, the Florida DOT, and the Florida Turnpike Enterprise have plans, at various stages of development, to add managed lanes to, respectively, the Dolphin Expressway, the Homestead Extension of Florida's Turnpike, and I-95. In Tampa, elevated reversible express toll lanes are under construction on the Crosstown Expressway. The Turnpike Enterprise had plans to add express toll lanes to highly congested I-4 in Orlando, but that project was specifically blocked by

What are Toll Truck Lanes?

The concept of toll truck lanes refers to specialized, heavy-duty, truck-only lanes added to existing major highways. These lanes would be barrier-separated from general traffic to form separate truckways, financed by tolls paid by trucking firms.

The implementation of toll truck lanes would offer a number of benefits:

- It would facilitate the operation of longer combination vehicles (LCVs), an approach used in some western states and in Canada that allows a single driver to carry several times the payload that is permitted in those states in which federal law currently bans LCVs.
- By significantly increasing truck payload capacity, toll truck lanes would reduce the cost of shipping most U.S. freight, making better use of the nation's extensive highway network.
- By separating much heavy truck traffic from automobiles, toll truck lanes would reduce the extent of car-truck collisions, thereby improving highway safety.
- By making possible the transportation of more freight in fewer trucks, toll truck lanes would reduce vehicle miles traveled, fuel consumption, and vehicle emissions.
- The new, heavy-duty lane capacity would also be valuable for emergency use in time of war, natural disaster, or terrorist attacks.
- By making U.S. long-distance truck configurations more compatible with those of Canada and Mexico, toll truck lanes would further the objectives of NAFTA.
- By making use of toll financing, this important addition to the highway system could be accomplished at much less cost to highway trust funds than paying for them out of fuel tax revenues.

For more information on toll truck lanes, see Reason Foundation's 2002 study, *Toll Truckways: A New Path Toward Safer and More Efficient Freight Transportation*, available at www.reason.org/ps294.pdf.

a provision inserted into SAFETEA-LU by Rep. John Mica (R, FL), who opposes the idea.

7. Toll Truck Lanes

One of the most provocative transportation planning studies in recent years was released in spring 2005 by Georgia's State Road & Tollway Authority (SRTA). After modeling the potential of a network of HOT lanes on the Atlanta area's congested freeways, SRTA asked consultant Parsons Brinckerhoff to look separately at the possible benefits of adding truck-only toll (TOT) lanes. Atlanta is the trucking crossroads of the Southeast, but because I-75 and I-85 merge south of downtown into a hugely congested downtown connector, heavy trucks are required to go around downtown on what locals refer to as The Perimeter, I-285. That freeway is also heavily congested, so the combination of a longer route and congested conditions costs 23,000 truckers each day plenty of wasted time. The study's most cost-effective alternative proposed adding voluntary TOT lanes instead of HOT lanes on about half of I-285 and on I-75 and I-85 outside of it. Besides saving truckers more than an hour during rush hours, and attracting 60 percent of such trucks out of the regular lanes, this approach would reduce congestion on the freeways more than the version of HOT lanes modeled in Parsons Brinckerhoff's companion study. SRTA is now doing to follow-up studies of additional TOT lane projects, one in Atlanta and the other in Savannah.

Elsewhere, the very ambitious $7 billion project to add mandatory toll truck lanes to the full length of I-81 in Virginia, as proposed by winning bidder Star Solutions, is still wending its way through the environmental review process. It still faces stiff opposition from the trucking industry, as well as from various local groups and environmentalists who object to widening the highway (which is already a major truck route).

The other serious toll truck lane project is the $14 billion plan by the Southern California Association of Governments (SCAG) to add truck toll lanes capable of handling double- and triple-trailer rigs to I-710, SR 60, and I-15, thereby connecting the ports of Long Beach and Los Angeles to the warehouses and distribution centers in what is known as the Inland Empire in Riverside and San Bernardino Counties. Support for the idea within the business community increased during 2005, and Gov. Schwarzenegger has endorsed the idea as part of his Strategic Growth Plan. SCAG has urged the enactment of enabling legislation for tolls and PPPs to facilitate this project.

8. Overseas Toll Road Developments

The long-term concession model, or lease, that has made such a splash in the United States in 2005-06 has a long history. It originated in Europe during the 1960s, as France, Spain, Italy, and later Portugal all faced the need to develop modern, intercity super-highways but lacked the government funding to do so. France's original concession companies were investor-owned, but all except Cofiroute were taken over by the state following the OPEC oil crises of the 1970s, when reduced toll revenues threatened their financial viability. But between 1999 and 2005, nearly all the European toll road companies were privatized.

The most recent, and largest, of these privatizations took place during the closing months of 2005 in France. The govern-

ment auctioned off its majority ownership interests in ASF, APRR, and SANEF, which account for over 4,360 miles of motorway. Final proceeds are expected to be $17.8 billion. Previous privatizations include Italy selling off its majority interest in Autostrade in 1999 for $6.7 billion, Portugal's sale of BRISA for $2 billion in 1999, and Spain's sale of ENA for $1.8 billion in 2003.

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These countries continue to use the concession model for new toll road projects, such as the Millau Viaduct and A-86 tunnel in France and a new Spanish toll road between Madrid and Toledo. And increasingly, Europe's toll road industry is becoming international. In December 2005, Spain's Cintra won the concession for a $900 million toll road in the Lombardy region of northern Italy, while France's Eiffage has proposed a $540 million northern bypass of Bologna, Italy. And April 2006 saw the announcement that Spain's Abertis would buy Italy's Autostrade for $17 billion, creating the world's largest toll road company.

For the most part, the United Kingdom has not adopted the toll road concession model, with the exception of several toll bridges and the M6Toll, a bypass route to avoid the most congested portion of the M6 motorway through Birmingham. Instead, under the country's Private Finance Initiative (PFI), it has engaged the private sector to add non-tolled highway capacity under design-build-finance-operate (DBFO) schemes. Under such arrangements, the government competitively selects a private consortium under a long-term franchise, promising annual payments tied to performance. (In some other European countries, the main performance measure is annual traffic, which is why those schemes are called "shadow tolls.") In the U.K. version, the performance measures are things like availability of the lanes and pavement condition. The largest such scheme was announced in 2005: to widen about half of the highly congested M25 London ring road, at an estimated cost of $2.6 billion. Five global teams were prequalified in 2005, with the actual bidding process to take place in 2006, selection in 2007, and construction to begin in 2008.

Canada's only major private toll road project is Toronto's Highway 407 Express Toll Route, developed under a design-build contract by the Ontario government and privatized via a 99-year lease in 1999. A two-year controversy over the concession company's right to increase tolls without asking permission (as provided for in the concession agreement) is finally over, after multiple appeals that were all won by the company. A unanimous high court ruling on November 7, 2005 upheld the company's tolling power and ordered the province to re-instate license plate denials to repeat toll non-payers (as also provided for in the concession agreement). The transport minister, while conceding on the toll-raising power, said the province would continue to litigate on the plate-denial issue. But in early April 2006, the two parties announced a settlement, in which the government relinquished its claims in exchange for the company providing some new frequent-user discounts

and agreeing to accelerate its lane-widening program.

Elsewhere, Canadian provinces are largely following the U.K. Design-Build-Finance-Operate (DBFO) model, tapping into private-sector finance, construction, and operation but without tolling (and hence without the net new revenue that tolling brings to highway finance). In Alberta, the government issued an RFQ in March 2006 for a missing link in Calgary's ring road; it would be the province's second DBFO highway project. British Columbia has two such projects under way. One is the C$1.5 billion Sea-to-Sky highway project, to be developed by a Macquarie/Kiewit team that was selected in 2005. The other is the C$600 million Golden Ears Bridge across the Fraser River in Vancouver, to be developed by a team lead by Bilfinger Berger. Although the bridge will charge tolls, they will be collected by TransLink, the local transportation authority, which will bear the traffic and revenue risk. Bilfinger will receive availability payments, as in the U.K. projects.

Asia continues to be an important venue for tolling, especially in the three major countries: Japan, China, and India.

Australia is one of the world leaders in long-term concession toll roads, with a whole network of them in operation in Sydney, the successful CityLink in Melbourne, and a major new toll road, EastLink, under way in Melbourne's eastern suburbs. This A$3 billion toll road will be 24 miles in length, with six lanes, 17 interchanges, and a mile-long tunnel. Once the concession was awarded to a Macquarie-led consortium called ConnectEast, the company offered shares to the public via an initial public offering that raised A$860M. The company itself is putting in A$460 million in equity, with the balance funded by bank debt. As of February 2006, construction was ahead of schedule, with the projected November 2008 opening very likely to be achieved.

Sydney's latest private tollway, the A$2.2 billion Westlink M7, opened eight months early in December 2005. It completes the city's beltway on the west side and is the city's first all-electronic toll road, similar to the Melbourne CityLink. Two other Sydney-area toll concession projects are not doing as well. The Cross-City Tunnel opened in 2005 but has attracted less than half the forecast first-year traffic. Still under construction is the A$1.1 billion Lane Cove tunnel, whose excavation suffered an accident that partially undermined a nearby apartment building. Meanwhile, Brisbane is moving forward with its first toll concession project, a A$1.6 billion North-South Bypass Tunnel beneath the inner city. Two finalist bidders were announced in December 2005.

Asia continues to be an important venue for tolling, especially in the three major countries: Japan, China, and India. The major news from Japan in 2005 was the first step in the long-term privatization of the country's state-owned toll roads. In a plan similar to the privatization of hugely indebted Japan National Railway 15 years ago, the four government toll operators were replaced on October 1, 2005 by six commercial corporations. Japan Highway Public Corporation was broken up into East, Central, and West Highway Companies. The urban toll road companies in Tokyo and Osaka/Kobe were converted into commercial companies, as was the Honshu-Shikoku Bridge Authority. The huge ($395 billion) debt of these toll roads was transferred to

a newly created Japan Expressway Holding and Debt Repayment Organization, which also took title to all the actual toll roads, which it will lease to the six operating companies. They will make lease payments from their toll revenues; those payments are intended to let JEHDRO repay and retire the debt over 45 to 50 years. Although the six new companies are intended to be publicly traded, initially they are fully government-owned. Moreover, the government must approve key management decisions, and it can order them to invest in new, non-viable toll road projects (which is what led to the enormous existing debt burden). How all this will turn out remains to be seen.

For the past 15 years, China has been creating a National Trunk Highway System, which encompassed 21,000 centerline miles as of the end of 2004. China plans to double this number by 2020, to cope with rapid increases in car ownership and truck traffic. A significant fraction of this network is funded, in part, by tolls, and many of the more complex segments are being developed under long-term concession agreements. The concession companies, unlike those in the West, are often joint ventures between the private sector and government agencies.

India is a late-comer to extensive highway development. World Highways reports that only in the last six years has there been a policy shift from rail to roads, with the development of the National Highways Development Project (NHDP), a $13 billion effort to four-lane or six-lane about 13,000 km. of inter-city highways. Phase 1, the Golden Quadrilateral, linked the four major cities of Delhi, Kolkata, Chennai, and Mumbai. Beyond that, the government has identified toll road concession opportunities of as much as $45 billion. A model concession agreement has been developed, with the government willing to invest up to 40 percent of the cost of projects that cannot be fully self-supporting from toll revenues. In February 2006, the National Highways Authority signed two new concession agreements for a project in Tamil Nadu that is part of the North South Corridor, under NHDP phase 2.

Latin America has been using the long-term concession model for more than a decade. Brazil's is the largest program, with over 9,000 km. of toll highway run by the private sector under 36 concession agreements. Early in 2006 the government announced that it would accept bids for 25-year concessions to upgrade and toll another 2,600 km. of federal roads on seven routes, requiring an estimated $9 billion. About half the mileage is in southeastern Brazil, affecting Belo Horizonte, Curitiba, Florianapolis, and Sao Paulo.

Chile has used long-term concessions to upgrade much of the Pan American highway, its major north-south route. And its capital city, Santiago, has also become a showplace for fully automated toll collection. A new 150 km. urban expressway system has been developed over the past several years under four separate concession agreements, but with common electronic tolling standards and full financial interoperability. The last major segment, the 29 km. Vespucio Norte Express, opened in January 2006, three months ahead of schedule. The $620 million tollway is a joint venture of Spain's ACS and Germany's Hochtief.

Mexico continues to use a mix of methods as its government works toward building a nationwide motorway system. In summer 2005 it pledged to spend $11 billion on its road system over a two-year period, including an upgrade of Highway 15 from

Mexico City to the border crossing at Nogales. It continues to award second-generation concession projects for new toll roads, such as the $800 million Libramiento Norte bypass of Mexico City. But it has also begun trying the shadow toll (DBFO) model, beginning with a $51 million project to upgrade a 74 km. route in Guanajuato.

HOT lanes are also starting to catch on overseas. In the United Kingdom, the Transport agency is considering a pilot project to add HOT lanes to the congested M6 motorway between Birmingham and Manchester. That 51-mile section carries 140,000 vehicles per day and is highly congested. And in Israel, the Finance Ministry has become the new champion of a controversial proposal to add HOT lanes on commuter routes into Jerusalem and Tel Aviv (over the initial ideological objections of the Transport Ministry). In March 2006 three bids were received for the 30-year concession for the Tel Aviv HOT lane; the winning bidder will also have the first option to bid on the Jerusalem project.

D. The Many Benefits of Telecommuting

The decision to forego the daily commute and work from home might not seem particularly revolutionary. Yet telecommuting has a positive impact on a surprisingly wide range of issues.

Telecommuting may be the most cost-effective way to reduce rush-hour traffic. It helps improve air quality and highway safety. It conserves energy, expands opportunities for the handicapped, and—when used as a substitute for offshore outsourcing—it can help allay globalization fears. It can even make organizations, public and private, more productive, which is good news for our nation's managers, many of whom have long been suspicious of telecommuting.

Telecommuting may be the most cost-effective way to reduce rush-hour traffic. It helps improve air quality and highway safety.

In some cases managers are right to be wary of telecommuting. Certain jobs are just not appropriate for telecommuting. Like any tool, it is only useful in certain circumstances. Telecommuting will be a sensible choice for certain organizations at certain times. And we must not think of telecommuting as an all-or-nothing proposition. Some may work from home every day, but others may telecommute less often. Workers and managers must learn how to telecommute and part of the process involves discovering the right balance between working remotely and working in the office.

Chances are the more our nation's managers take a second look at telecommuting the more they will come to appreciate its bottom-line benefits.

1. Some Benefits of Telecommuting

More Productive Workers

Managers often regard telecommuters as low-grade scammers, loafing at home when they should be working hard at the office. Yet in many cases telecommuters are actually more productive than their office-bound counterparts.

- According to a March 2006 worldwide survey by Insight Express and SonicWALL, 76 percent of employees report that telecommuting improves their productivity.
- Among AT&T telecommuters, 72 percent report that they get more done at

home than at work.

- J.D. Edwards found that its telecommuters were 20 to 25 percent more productive than office workers.
- A survey of American Express telecommuters found that they produced 43 percent more business than office workers.

Improved Recruitment, Lower Turnover

Offering the option of telecommuting is an inexpensive way for companies to attract and retain good employees. Roughly two thirds of AT&T managers say that telecommuting is an advantage in keeping and attracting good employees. In a survey of 1400 CFOs, a third of respondents said allowing telecommuting and flexible hours was the best way to attract talent (See Table 12). An Ohio manager who makes extensive use of telecommuting notes that junior employees work hard to earn the privilege of working at home. Those who do work at home realize that they enjoy a sought-after perk and work hard to keep it. He credits telecommuting with helping him maintain low employee turnover.

Higher job satisfaction and lower turnover mean that companies do not have to spend as much time and effort in recruitment and training. An extensive *MONEY* magazine survey uncovered more evidence that telecommuting is linked with job satisfaction.

Satisfied workers had more work-from-home options than other respondents, with only 38 percent saying telecommuting was never an option. Unhappy workers were least able to telecommute, with 70 percent reporting it was not an option. The most stressed workers were also least able to telecommute, with only a third saying it was an option for them at work.

Lower Real Estate Costs

With fewer employees in the office, telecommuting allows companies to save on real estate costs, and those savings can be substantial. Nortel estimates that telecommuting saves $20 million per year in real estate costs. With $25 million worth of foregone real estate costs, AT&T saves even more. Unisys may represent the best case scenario—telecommuting allowed the company to cut office space by 90 percent.

Lower Absenteeism (and Presenteeism) Costs

Managers have begun to take note of

Table 12: Attracting Talent	
CFOs were asked: “In your opinion, which one of the following incentives is most effective in attracting top accounting candidates?”	
Offering higher starting salaries than competitors	46%
Allowing telecommuting and/or flexible work schedules	33%
Offering signing bonuses	5%
Offering extra vacation days	3%
Benefits/benefit package/insurance	2%
Other	3%
Don’t know/no answer	8%

Source: Robert Half International Inc. January 30, 2003

costs associated with "presenteeism"—when workers are on the job but, because of illness or other medical problems, are not fully functional. Presenteeism costs U.S. companies over $150 billion per year, a figure that far exceeds absenteeism costs. It's no surprise that employees who don't feel well are not as productive as they could be.

But since illnesses often spread through companies quickly, employees who come to work sick can also drag down the productivity of others. Increasingly, the sick worker who downs gallons of cough syrup and heads to work is no longer regarded as a hero, but a liability. (The British call them "mucus troopers.") More and more managers are recognizing this and urging sick workers to stay home.

Yet there is plenty of gray area between sick and well. Someone in the throes of the flu is clearly sick. But what if that person just has the sniffles? Here telecommuting can help. Although many companies foster a get-to-work-no-matter-what environment, presenteeism research shows that simply being on-site does not make a sick worker fully functional. Those on the verge of sickness would often be better off working from the comfort of their own homes. Telecommuting allows them to be as productive as their condition allows, and staying home will likely quicken their recovery. For example, it would be better for someone feeling under the weather to skip the morning commute and get some extra rest. And, when it comes to getting well, there is no place like home. At home the sick worker can bundle up in with blankets, sip soup, and scuttle about in slippers. In this case, telecommuting also benefits the company at large because it quarantines the sick worker, making it less likely his or her illness will ravage the entire staff.

How many telecommuters are there?

- Roughly 4.5 million Americans telecommute most work days.
- Roughly 23 million Americans telecommute at least once per month.
- Nearly 45 million Americans telecommute at least once per year.
- Worldwide, roughly 83 million people telecommute at least one day per month.

Improved Business Continuity

In the event of an emergency—be it a terrorist attack or the more common act of nature—it pays to have telecommuting capabilities. If employees cannot access the headquarters of a particular business or government agency, that organization can continue operations from remote locations.

Rep. Tom Davis, R-Va, chairman of the House Government Reform Committee, recently highlighted telework's national security benefits. "The decentralization of federal agency functions inherent in a healthy telework strategy can greatly increase the survivability of those agencies in the event of a terrorist attack or other disruptive crisis."

According to Ellen Galinsky of the Family and Work Institute, it was the less centralized companies who recovered from the September 11 attacks fastest. The same theme was uncovered in a recent Telework Coalition survey, as companies with telecommuting programs found it easier to regroup after Hurricane Katrina.

2. Telecommuting Trends

Measuring telecommuting's growth can

The How and Why of Telecommuting

Some findings from a recent survey of 13 organizations (comprising more than 77,000 telecommuters) with well-established telecommuting programs show that:

- Most programs are driven by a desire to reduce real estate costs, but business continuity is becoming increasingly important.
- Recruitment and retention remains a key driver for many organizations, especially since flexibility is in high demand by today's workforce.
- All organizations have "formal" telework programs, but larger organizations stressed the importance of moving the decision to the manager-employee level.
- Internal resistance was fairly common at the outset, but once management saw the benefits first-hand, resistance turned to support.
- Nearly all telework programs are voluntary.
- The training programs vary from none to several weeks of intensive remote training. The trend is toward online training and tools.

Source: The Telework Coalition, "Telework Benchmarking Study: Best Practices for Large-Scale Implementation in Public and Private Sector Organizations," Washington, D.C., 2006.

be somewhat tricky because different organizations define telecommuting differently. But regardless of how it's defined it seems quite clear that telecommuting is on the rise.

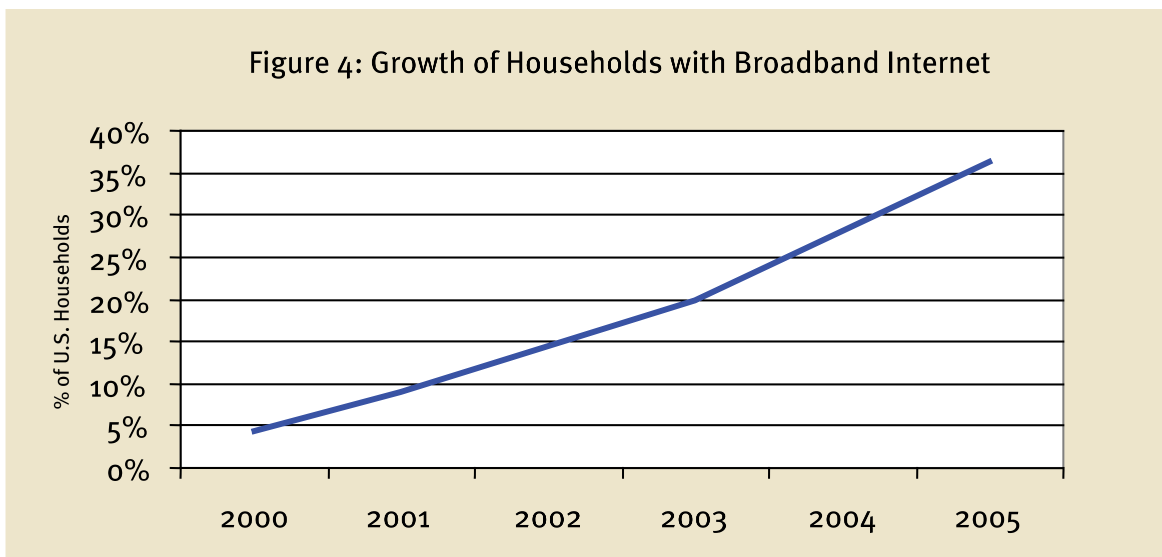
From 1980 to 2000, the number of telecommuters (defined as those working at home at least three days per week) jumped to 4.2 million, a 92 percent increase. During that period telecommuting was the only commute mode besides solo driving to increase market share. U.S. Census figures reveal that everything else—from transit to carpooling to walking—lost market share. In fact, telecommuters outnumber transit commuters in 27 of our nation's top 50 metro areas.

The Census Bureau notes continued growth since 2000 and other organizations have also found continued growth. According to research firm Gartner Inc. more than 23 percent of our nation's workforce worked from home at least one day per month in 2005. That's up from 12 percent in 2004 and Gartner expects the figure to climb to 28 percent by 2008.

Telecommuting has also fared well globally. Gartner reports that 82.5 million of the world's workers worked from home at least one day per month during 2005, more than double the 2000 figure. Gartner expects the world's telecommuters to reach the 100 million mark by 2008.

Technological improvement is crucial to the spread of telecommuting. Take broadband access. It is no surprise that those with high-speed Internet access are more likely to telecommute. High-speed access makes conducting business from home faster (50 times faster than dial up), which also makes it easier and more convenient.

The Internet celebrated its (unofficial) 10th birthday in 2005. In just one decade, it has transformed from a mysterious novelty to a tool that average Americans rely on



every day. Americans are not only getting online in ever-increasing numbers, more and more of us have access to broadband (Figure 4). Five years ago only 4.4 percent of American households had broadband. Today most of those who use the Internet at home have it. More than 36 percent of American households (42.3 million) have broadband. By 2008, analysts expect broadband to spread to over 56 percent of households (69.4 million total households).

Technology can make it easy for workers to stay home, but getting permission to telecommute is a different matter. Analysis from The Family and Work Institute suggests that in recent years managers have not budged much. In 1998, 33 percent of employers surveyed allowed at least some of their employees to telecommute on a regular basis. By 2005, the figure had only reached 35 percent. Surveys of employees also find that telecommuting skepticism is still the norm.

- 80 percent of those responding to a Southern California Association of Governments survey said their employers do not allow telecommuting.
- According to a *MONEY* magazine/Salary.com survey of 26,000 workers, 16 percent of respondents said they could telecommute any time they wanted, 28 percent could do so with their manager's approval and 55 percent were not allowed to.

There is reason to believe that more workers would telecommute if given the opportunity. For example, according to a 2005 San Diego Association of Governments survey, 80 percent of area commuters would telecommute if their employers gave them permission. This probably overstates potential growth—since what people say they will do is often different from what they actually do—but it still shows widespread interest in telecommuting.

Naturally, organizations that query different groups of employers will report different results. And there are some signs that our nation's bosses and managers are rethinking their longstanding suspicion of telecommuting.

- According to a survey of 1,043 large employers by Mercer Human Resources Consulting, the percentage of U.S.

telecommuting-friendly companies jumped from 32 percent in 2001 to 44 percent in 2005.

- Salary.com predicts that more businesses will expand their telecommuting programs and telecommuting took the number two slot on its "Top 10 Salary Trends for 2006" list.
- A 2005 Robert Half International survey notes that 87 percent of executives polled said they plan to increase telecommuting in the coming decade.
- According to *Fortune* magazine's 2006 ranking of the 100 Best Companies to Work for, 79 percent of the 100 companies allowed employees to telecommute at least 20 percent of the time. In 1999, only 18 companies on the list allowed for telecommuting.

JetBlue has embraced telecommuting from its inception. For the past six years, the low-cost carrier has allowed its reservation agents to work from home and the company says the decision has increased productivity and saved money (for example, less office space). Six years ago JetBlue had 40 agents and today it has 1,500, 1,200 of which are telecommuters.

Public-sector managers have been even less likely than their private-sector counterparts to offer the telecommuting option. Some agencies have even been threatened with losing funds if they do not make telecommuting more available to employees. But again, there are signs that managers are warming to at-home work.

Fairfax County, Virginia made good on a goal set in 2003 of having 20 percent of the workforce telecommute an average of one day per week by the end of 2005. And the Defense Logistics Agency shows that even skeptics can be won over. A survey found that three-fourths of the 22,000 employees wanted to be able to telecommute more often, but they often encountered resistance from managers. But eventually DLA managers changed their minds and now they even embrace telecommuting as a way to improve worker satisfaction and productivity and to keep and retain good employees.

The DLA's experience fits within a larger trend among federal agencies. A recent CDW-G survey of federal IT workers found that 41 percent had worked off site in 2005, double the figure of the previous year. And the Office of Personnel Management reports that the number of federal employees who telecommute is on the rise, increasing from 4.2 percent in 2001 to 19 percent in 2004.

There are some promising developments and it does appear that telecommuting is on the rise. Still, given the rapid improvement in telecommuting-enabling technology, overall telecommuting levels remain lower than we might expect. But change takes time and it's likely that more managers and employees will come to appreciate more of the benefits telecommuting offers.

E. Coming to America? A Cautionary View on Importing London-Style Congestion Pricing

Almost as soon as he implemented congestion pricing, London Mayor Ken Livingstone began urging other mayors to follow his lead. The Partnership for New York City, a business association, investigated the idea, but New York Mayor Michael Bloomberg recently ended speculation by insisting he has no plans to bring congestion pricing to the Big Apple. Even so, others, such as San Francisco Mayor Gavin Newsom, have hinted that they might be interested.

1. Congestion Pricing in London

Londoners must pay a toll when they enter the "Congestion Zone"—an eight-square mile portion of central London. Weekdays between 7 am and 6:30 pm motorists must pay the toll—a whopping $14 dollars per day. Don't pay the toll and you face hundreds of dollars in fines. Tolls may be paid online, at certain stores, or by telephone (although several locals reported that paying by phone is rather time consuming). Those who live within the zone enjoy a 90 percent discount.

One Londoner notes that a cab ride that used to take 25 minutes now takes only 10.

London's pricing scheme has reduced traffic congestion by about a third and quickened travel times. One Londoner notes that a cab ride that used to take 25 minutes now takes only 10. American politicians who fret about the political toll of pricing are often heartened to discover that Mayor Ken Livingstone won re-election after implementing the congestion charge. Livingstone recently approved a plan to expand the zone westward, into Kensington, Chelsea, and Westminster. The boundaries will expand on February 19, 2007.

2. Should America Import Congestion Pricing?

But while the concept of pricing is promising, London-style pricing would not be a particularly good fit in America. Flat-rate tolling is a rather blunt traffic management tool, for it ignores the fact that congestion is a peaking problem. In London motorists pay the same amount whether they enter the congestion zone during the morning rush or in the middle of the day. The scheme also ignores differences in how much motorists drive. Motorists pay the same amount whether they drive inside the zone for five minutes or five hours.

And there is the issue of cost. Hundreds of cameras take pictures of cars as they enter the zone, but each day staffers separate the list of those who paid from those who didn't by hand. This makes the system enormously expensive to operate. London is also rare among the world's developed urban areas in that its central business district is actually growing in influence. It's unclear what the effect of congestion pricing would be in American cities, where central business districts are already losing ground to the suburbs.

Still Americans can import certain aspects of London pricing. For example, Mayor Livingstone recognized that pricing can reduce surface street congestion. This allows for more and better bus service. American bus riders would marvel at the frequency of bus service in London. It's common for 90 buses to pass through the Islington area in a single hour. Transit officials in the United States often assume that humans are born with some genetic aversion to bus transit. They don't expect anyone but the transit-dependent to buy bus passes.

Yet Livingstone is proud of the fact that businesspeople in pinstripes hop on his bright red buses. The demographics of bus and rail patrons are essentially the same and 80 percent more trips are taken by bus than by Underground (subway). London shows that travelers care more about whether their trip is convenient, speedy, and reliable, than whether they travel by bus or rail. A recent Reason study outlines how transit agencies can use a different kind of pricing to give transit patrons top-notch bus service.

American policymakers can also learn

something about the importance of trust. Since the inception of pricing, London's leaders have agreed that it's absolutely essential to use toll revenue only for transportation purposes within the city. Anything less would erode the program's legitimacy. Thus far London's political class has made good on its promise.

Compare that to the American experience, where transportation funds have a way of transforming into general-purpose slush funds. In 2002, frustrated Californians passed Prop 42 with 70 percent of the vote. They thought the new law would prevent politicians from dipping into transportation money to fund other programs. And yet Governors Davis and Schwarzenegger invoked a little-known provision that allowed them to suspend the law in times of "emergencies." And so the pilfering continued.

The federal government has even bigger trust issues. Each new transportation reauthorization is filled with more pork than the last. According to Citizens Against Government Waste, the most recent one is packed with nearly 6,500 pork-barrel projects, amounting to $24 billion or nearly 9 percent of the bill. Indeed, however they plan to address mounting congestion, lawmakers in America often find trust deficits nearly as difficult to contend with as financial deficits.

F. Virtual Exclusive Busways: Houston Leads the Way

Bus rapid transit (BRT) can deliver high-quality service if operated on exclusive busways, where there is no congestion. But building such guideways has two major drawbacks. First, they are very expensive, rivaling rail lines in capital costs. Second, they are very wasteful of this expensive capacity, since even high-capacity BRT service (e.g., one every minute—60 vehicles per hour) leaves the vast majority of the capacity (1,500-2,000 vehicles per hour) unused. Hence, very few such busways have been built in the United States.

Carpool lanes are not sustainable as uncongested guideways, but value-priced managed lanes can be kept free-flowing on a long-term, sustainable basis.

A 2005 Reason Foundation study argues for developing the virtual equivalent of exclusive busways, by selling the unused space to drivers willing to pay a market price to bypass congestion. This would generate toll revenue to pay for much of the cost of the guideway, without burdening transit agency budgets. This policy would be far more cost-beneficial than the current policy of relying on carpool lanes as the guideways for long-haul BRT service. Carpool lanes are not sustainable as uncongested guideways, but value-priced managed lanes can be kept free-flowing on a long-term, sustainable basis.

1. The Potential of Rubber-Tire Transit

Canada and South America have longstanding examples of rubber tire transit's ability to offer flexible, cost-effective service that appeals to large numbers of patrons. The surge in interest in U.S. bus rapid transit (BRT) systems is a recognition of the success other nations have enjoyed.

Bus transit can operate with headways as short as five seconds. At 40 to 120 passenger spaces per bus (including standees), theoretical busway capacity is between 28,800 and 86,400 people/lane/hour—exceeding the capacity of light rail and even some heavy rail systems. At its busiest hour the nation's busiest busway, the Lincoln

Tunnel Express Bus Lane (XBL), carries over 30,000 passengers/lane. Ottawa's busway system is used by 40 percent of those within its service area, a much greater proportion than San Francisco's BART heavy rail system or the light rail system of Portland, Oregon.

The Government Accountability Office (GAO) examined six cities that operate both BRT and light rail, and then measured operating costs in three categories: operating cost per vehicle hour, per revenue mile, and per passenger mile. For each category, the large majority of cities experienced lower operating costs with BRT.

Another advantage of buses operating on HOV lanes or exclusive rights of way is greater flexibility than rail transit. As Wilbur Smith Associates points out in its booklet "High Quality Transportation" (on BRT and managed lanes):

The flexibility of BRT allows combinations of different running ways and operating conditions. For instance, a BRT service could begin with a local circulation route in mixed traffic on local streets, proceed on an exclusive guideway, and then circulate once again on a transit priority system in the downtown.

Because bus headways can be much shorter, frequency of service can be much greater with a busway system. It is easier for buses to overtake one another than for rail cars, and because of their smaller unit size, it is easier to fill a bus with passengers going from a common origin to a common destination. Hence, express bus service is easier to organize than express train service. Buses can deviate from routes to avoid accidents or traffic jams. And rail trains are always run by a single monopoly operator, whereas a busway can be open to competing bus and van operators.

2. The Virtual Exclusive Busway

The demonstrated ability of value pricing to manage traffic flow, offering reliable high-speed travel during peak periods, suggests that lanes managed with value pricing could become the second-best alternative to the exclusive busways that transit planners would like to have. If priority is given to bus transit usage, a managed lane can become the virtual equivalent of an exclusive busway, from the transit agency's standpoint. Thus, transportation planners studying the possibility of a whole network of HOT or managed lanes should look upon them not merely as an alternative for drivers and carpoolers. Such a network of managed lanes is also the infrastructure for an area-wide bus rapid transit system—a virtual exclusive busway (VEB).

To elaborate a bit further, although the highway capacity manual may report that a lane can handle 2,300 vehicles per hour, to ensure uncongested flow and prevent traffic-flow breakdown into unstable stop-and-go conditions, a managed lane is generally limited to no more than 2,000 vehicles/hour. Depending on how much demand for BRT service exists, some pre-defined amount of this capacity can be reserved on a long-term basis for bus service for each corridor of the managed lane network. With peak-period bus service at one-minute headways, for example, that would be 60 buses/hour, the equivalent of 90 cars/hour. The balance of the capacity would be available for other vehicles, some operating at no charge (e.g., vanpools, and possibly some other HOVs) and the rest as paying vehicles. As long as overall traffic is kept within these limits, the buses can operate at the speed limit, as unconstrained as if they were on an exclusive busway. Yet because a significant fraction of

the other vehicles will be paying for access, a large fraction of the cost of this busway infrastructure will be paid for willingly, by those purchasing a premium-service auto trip.

3. Houston's Rebuilt Katy Freeway: the World's First VEB

The metro area with the most extensive system of express bus operations on HOV lanes has a project under way that amounts to the country's first Virtual Exclusive Busway. Houston is adding four value-priced managed lanes to the median of the Katy Freeway (I-10), as part of a major modernization of that freeway.

The managed lanes approach emerged as the preferred option in a major investment study in the 1990s. During the environmental review process, the local toll agency, Harris County Toll Road Authority (HCTRA), proposed that the managed lanes be tolled. Toll revenues could pay for their capital cost, and value-priced tolls would manage traffic flow. The environmental impact statement (EIS) was revised to include this option, and after further public involvement activities, this approach was adopted.

Two multi-agency agreements were crucial factors in creating the "public-public partnership" that made this project possible. The Tri-Party Agreement between FHWA, TxDOT, and Harris County deals with roles and responsibilities in design, funding, and construction of the managed lanes project. HCTRA agreed to pay for the construction cost (up to $250 million), design the toll-related elements, and carry out any additional public-involvement activities needed. Toll revenues are specified to be used for debt service, a reasonable return on investment, and operation and maintenance of the managed lanes. TxDOT will secure needed federal funds, obtain right of way for the overall freeway expansion and handle construction. And FHWA authorizes tolling of these lanes on the Interstate system under the federal Value Pricing Pilot Program.

The other agreement is a Memorandum of Understanding (MOU) between TxDOT, METRO, and Harris County. This MOU sets forth the respective roles of these three parties as to how the managed lanes will be operated. In general, HCTRA is responsible for operation and maintenance of the lanes. METRO is responsible for operating bus services on the lanes, with various key protections built in. And TxDOT makes sure the managed lanes are properly integrated with the rest of the freeway and other facilities.

To sum up, the transit agency is guaranteed up to 25 percent of the managed lanes' capacity for transit and HOV uses. And the toll agency guarantees to use its value pricing authority to limit paying traffic to an amount consistent with uncongested traffic flow. The transit agency gives first priority to buses, since their passenger capacity is far greater than those of vanpools or carpools.

4. Implications of Houston's VEB

A number of the features of the MOU that made Houston's first VEB possible are worth discussing in more detail.

Transit Funding

As HOT lanes have begun to catch on among transportation planners, the transit community has begun to appreciate their importance as a way of providing infrastructure for express bus or bus rapid transit service. In particular, transit organizations have begun to advocate for using net toll revenues from managed lanes for both

transit-related facilities as part of the project (e.g., bus stations, park-and-ride lots) and transit operating subsidies anywhere in the region. Such uses are only possible in situations where there are net toll revenues. That is generally the case for projects that convert an existing HOV lane to a HOT lane (as is being done currently in Denver and Minneapolis). But in cases like the Katy project, where significant new lane capacity is being added, the likelihood of any "net" revenues being left over after debt service, return on investment, and operating and maintenance costs are covered is very small. That is why no such commitments are included in the Katy MOU.

But even though METRO is not receiving any net toll revenues, it is still getting a very good deal from this project. On the Katy today it must make do with a single, reversible HOV lane, which it must share with carpools and vanpools. A single-lane facility is far more vulnerable to incident-related congestion (e.g., when a vehicle breaks down) than a multi-lane facility like the managed lanes that will replace it. And a bi-directional facility makes possible reverse-commute bus service, which will be increasingly important as Houston grows and the central business district accounts for a smaller percentage of all jobs. And especially important, thanks to value pricing, the managed lanes will be sustainable long-term as a reliable, high-speed facility.

Busway Capacity

Houston has one of the nation's most extensive systems for express bus service on HOV lanes. So the question arises whether the Katy MOU provides a reasonable level of capacity for METRO, at 25 percent of total vehicles and a guarantee of 65 buses per hour. As of 2003, the Katy HOV lane served 40 buses during its busiest AM peak hour. (The other freeway HOV peak bus levels ranged from 4 to 43.) Thus, the Katy's allocation of 65 buses per hour represents a 62.5 percent increase over its maximum rush-hour bus service today. There is nothing magic about 65 per hour, nor about 25 percent of total capacity. But given the actual level of demand for such bus service today, those numbers appear reasonable.

FTA Approval

HOV lanes in U.S. metro areas have been developed using federal, state, and local funding sources. Federal sources in some cases are exclusively highway (FHWA) funds and in other cases exclusively transit (FTA) funds. The Katy HOV lane received some of each; hence, the FTA had to concur in the decision to change the nature of this facility. In the past, the FTA has had a mixed record on HOV to HOT conversions. It approved San Diego's pioneering project on I-15, but initially raised objections to Denver's plans for a similar conversion on I-25 North. But the FTA seems to have come to terms with HOT lanes, as long as transit service is maintained and suffers no degradation in service quality. Managed lanes using value pricing to maintain traffic flow meet this test.

HOV Occupancy Changes

The vast majority of U.S. HOV lanes are operated as HOV-2 facilities. The most successful become congested over time. But transportation officials are often reluctant to increase the occupancy requirements, for fear of backlash from existing (mostly two-person) carpoolers. Yet Houston had already been willing to bite the bullet on both the

Katy and Northwest Freeways, increasing peak-period occupancy to HOV-3. This very likely made it easier to make the across-the-board change from HOV-2 to HOV-3 for the Katy managed lanes project.

It should also be noted that although federal approval is required for "significant" changes to HOV lanes that have received federal funds, that term appears reserved for major changes in operating hours and converting from HOV to HOT or to general-purpose lanes. Minor changes in operating hours and changing the occupancy requirements do not require federal approval.

Pricing Sustainability

The other key to a VEB's long-term sustainability is pricing flexibility. Paying customers are the key factor in providing the funds for building, operating, and maintaining these managed lanes. But allowing too many to crowd onto the lanes during rush hour would completely defeat their dual purpose of facilitating high-quality transit and providing a reliable, higher-speed trip for those opting to pay for premium lanes. Therefore, the ability to increase value-priced toll rates as high as is needed to maintain LOS C conditions is essential. But since future toll levels might grow to quite high levels, if rush-hour demand in the corridor continues to grow, there is always concern about whether future price increases might be politically constrained. Orange County, California has adopted a managed lanes pricing policy for the 91 Express Lanes that is essentially on automatic pilot; whenever incipient congestion appears during a 12-week period, a toll increase goes into effect for that hour of the day.

The Houston MOU commits the three parties—HCTRA, METRO, and TxDOT—to using pricing in a comparable way to maintain uncongested conditions on the Katy managed lanes. This represents important institutional support for long-term use of value pricing to manage traffic flow. All three agencies have a lot at stake in the performance of the managed lanes. In particular, from METRO's standpoint, they will only function as a Virtual Exclusive Busway if HCTRA increases toll levels when necessary to maintain the free-flow conditions it needs for reliable, high-speed express bus service.

5. Network Benefits

An interconnected network of uncongested lanes offers obvious benefits, opening up a much larger radius of job opportunities. And a region-wide express bus system is far more feasible if it can operate on a region-wide infrastructure that is the functional equivalent of a network of exclusive busways.

Yet such a network would be highly unlikely to come about if it had to be developed with existing federal, state, and local transit system resources. Conceptual designs of HOT Networks for Atlanta, Dallas/Ft. Worth, Houston, Seattle, and Washington, D.C. consist of about 500 lane-miles apiece. At today's urban freeway construction costs, such systems would cost $4-5 billion each. (This would cover the roadway infrastructure but not bus-related elements such as park-and-ride lots or bus stations.) By contrast, a rail transit system encompassing 500 miles (two tracks, 250 miles each) would cost over $30 billion, based on recent experience.

Even though the VEB network would cost considerably less, neither a 250-mile rail system nor a 500-mile VEB network

would be affordable out of transit system funding sources. But the VEB network's capital costs would be largely paid for by drivers paying to bypass congested freeway lanes, so this kind of network would be far more affordable, in practice.

But the VEB network's capital costs would be largely paid for by drivers paying to bypass congested freeway lanes, so this kind of network would be far more affordable, in practice.

6. Needed Federal Policy Changes

Current FTA policy toward HOT lanes and managed lanes is supportive of converting HOV lanes to HOT lanes, so long as transit remains an important use of the facility and transit service quality is not degraded. Since this condition is easy to satisfy by using value pricing, such conversions are increasingly being approved.

HOV lanes qualify as "guideway" for FTA funding, and recent FTA policy on HOV to HOT conversions allows the resulting HOT lanes to qualify, as well. But there is no statutory or policy statement on the status of *new* HOT lanes that get added to a region's system. While a clarifying policy statement from FTA would help, transit agencies should have the certainty of a statutory change to the term "fixed guideway" in Title 49, so as to include value-priced lanes operated in partnership with transit agencies.

A second issue arises in connection with the alternatives analysis that a transit agency must carry out in applying for capital funding under FTA's New Starts program. Given the great benefits of a Virtual Exclusive Busway for transit, a VEB or a VEB Network should be one of the alternatives studied in such analyses.

The third issue concerns New Starts funding itself. A VEB is a very cost-effective fixed guideway for high-volume, high-speed, highly reliable express bus service. As such, it ought to be eligible for New Starts funding. Since as we have seen, toll revenues can support a significant fraction of the capital costs of VEBs and VEB Networks, and local, state, and federal highway funds can be justified for the remainder of the basic highway infrastructure portions of such facilities, FTA New Starts funds should be available for the bus-related infrastructure portions, namely:

- Park and ride lots;
- Direct-access ramps (from stations and other high-traffic entry and exit points);
- On-line and/or off-line stations; and
- Buses.

Eligibility for a project to be considered a VEB for New Starts purposes should be conditioned on a multi-agency agreement such as the MOU in Houston which spells out the amount of capacity dedicated to transit-type uses and the commitment of all parties to use value pricing and occupancy-level adjustments to maintain acceptable level of service conditions on a long-term basis.

7. Conclusion

It's time to rethink America's over-emphasis on carpooling and revisit the advantages of busways. Instead of filling up the empty space on a busway with "fam-pools"—carpools of families that would be riding together regardless—we could fill it up with paying customers. And because those customers would pay value-priced

tolls, their numbers could be limited to amounts consistent with maintaining uncongested conditions even at the busiest rush hours, as proven on the HOT lanes in San Diego and Orange County, California.

Rubber-tire transit (including express bus and vanpools) can be highly cost-effective, especially when operating on exclusive rights of way. Our experience over the past decade with value pricing shows that such pricing can be used to create the virtual equivalent of an exclusive busway, paid for largely by drivers. This is too good an opportunity for transportation planners to pass up.

For more on virtual exclusive busways, see Reason's September 2005 report, *Virtual Exclusive Busways: Improving Urban Transit While Relieving Congestion*, online: http://www.reason.org/ps337.pdf

Air Transportation

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A. U.S. Airport Security

Two major developments in airport security in 2005 turned out the opposite of what people expected. Despite all airports being freed to opt out of security screening provided by the Transportation Security Administration, only one small airport chose to do so. But the long-discussed Registered Traveler program, which nearly everyone had assumed would be a TSA program, will be run on a fee-for-service basis by competing private companies.

The post-9/11 Aviation & Transportation Security Act of 2001 "federalized" passenger and checked-baggage screening at all but a handful of small airports. As a compromise between House and Senate versions, it allowed an initial five airports to go with TSA-certified private security firms instead of TSA screeners, and it further provided that after November 2004, all airports would be given this choice. The initial airports—San Francisco, Kansas City, Rochester, Tupelo, and Jackson Hole—have been satisfied with their contractors, and opted to continue with them after November 2004. Analyses of their experiences found slightly better screening performance than at TSA-screened airports, but also pointed out that TSA ran the program in such a centralized manner that there was little scope for innovation or efficiencies by the contractors.

Thus, during the nearly 18 months after the November 2004 window opened for all airports to opt out, only two small airports applied, Elko, NV and Sioux Falls, SD. After the former withdrew, only the latter went forward with private screeners. Airport directors explained that there seemed to be few benefits from opting out, given that TSA, not the airport, would select and manage the contractor. Moreover, although Congress granted liability protection to producers of aviation security equipment and to screening contractors, no such protection was provided for airports that opted out,

leaving their legal people concerned that the airport might get sued if a security problem occurred.

A January 2006 Reason Foundation report, *Airport Security: Time for a New Model,* called for statutory change to take TSA out of the provision of airport screening services, arguing that it is a conflict of interest for TSA to be both the aviation security regulator and a principal service provider. Devolving this function to each airport, under TSA regulatory supervision, would allow each airport to either hire its own TSA-approved security staff or a TSA-certified screening company. With the funding TSA now uses to operate that airport's screening, the airport could make its own trade-offs between labor and equipment, likely leading to increased airport investment in technology such as fast and efficient in-line baggage screening systems.

The Registered Traveler concept was proposed by a number of people in the early days of TSA as a way for volunteers to seek and obtain a kind of mini-security clearance plus a biometric identity card proving them to be the person who was cleared. That would enable them to bypass the long lines and at least some of the screening procedures applied to people who have not been pre-checked. After some internal debate about the wisdom of the concept, the TSA created and ran a pilot program at a half-dozen airports. While that was going on, entrepreneur Stephen Brill (founder of Court TV and American Lawyer) came up with the idea of operating such a program as a fee-for-service business. After extensive discussions with TSA, he launched the company, Verified Identity Pass, in 2004, and signed up Orlando as its initial airport. It began operations there in July 2005, with TSA doing the background check but the company handling everything else.

Some 70 airports joined a consortium sponsored by the American Association of Airport Executives to promote this kind of model for RT, and to insist on standards for inter-operability among all airports. After some months of smooth operations by Verified at Orlando, the TSA announced that instead of building upon its own pilot programs, it would accept competing private companies as the operators of Registered Traveler services, allowing them to charge annual membership fees. TSA announced a target date of June 20, 2006 for a nationwide roll-out, and two other firms announced they had entered the market: Saflink and Unisys. Verified unveiled partnerships with General Electric and Lockheed Martin to develop additional technology for its program, and to help it interface with airports. By April 2006, Verified had 20,000 paid members at Orlando and had announced tentative deals with Indianapolis, Sacramento, San José, and Toronto airports.

In late April TSA surprised the industry by announcing that it was postponing the national roll-out until 2007, but expected to approve 10 to 20 airports this year, as an expanded pilot program. Still, the idea that this is a value-added service being offered by private firms to frequent travelers has been firmly established.

B. U.S. Airport Privatization

The 1996 federal airport privatization pilot program still had only one airport participant as of early 2006: Stewart Airport in Newburgh, New York. The only remaining applicant for one of the four remaining slots—New Orleans Lakefront Airport—was damaged in Hurricane Katrina and its appli-

cation to the pilot program is currently "in a holding pattern," according to the FAA.

The biggest news in U.S. airport privatization 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). A similar measure was enacted in 2002 to exempt the Chicago Skyway from property taxes. Leasing Midway would be allowed under the 1996 federal pilot program, which still has four slots available. 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 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. And in December 2005, the Illinois Attorney General signed off on the partnership agreement between the transportation agency and the Abraham Lincoln National Airport Commission, formed by a number of local governments. 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.

C. Global Airport Privatization

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. And the global airport industry is undergoing a shake-out, as companies re-arrange their portfolios to better focus their interests.

Several major industry changes have occurred recently. BAA, the first major airport grouping to be privatized (in 1987) is the subject of a takeover battle. This company also operates the Indianapolis International Airport, under a 15-year management contract, and runs the concession operations at Pittsburgh and several other U.S. airports. Spanish toll construction firm and toll road owner/operator Ferrovial made an unsolicited $15.3 billion bid for BAA in April 2006. Ferrovial has been a minor player in airports to date, owning 21 percent of Sydney Airport and 50 percent of the U.K.'s Bristol Airport. BAA rejected the bid, and did likewise with a subsequent $16.5 billion bid from Goldman Sachs.

In another multi-nation takeover, Spanish toll road operator Abertis bought British airport operator TBI for $976 million. TBI owns London's Luton Airport and has long-term lease agreements for the three main Bolivian airports and Florida's Orlando-Sanford Airport, as well as management contracts at Albany and Burbank Airports in the United States.

BAA itself was the winning bidder in

a hard-fought competition for a 75-year concession to run the Budapest Airport. BAA's winning bid was $2.15 billion for the fast-growing 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.

BAA was also one of four firms (along with Babcock & Brown, Goldman Sachs, and Hochtief) that had expressed interest in bidding for the 33 percent stake being offered in Italy's Milan Airport. But in the end, no bids were submitted, as all four evidently decided that the one-third stake was not worth the minimum bid of 600 million Euros.

The German federal government in October 2005 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 placed when New Zealand's Infratil purchased 90 percent of Luebeck Airport from the city government.

Another major player may soon join the set of global companies operating airports. State-owned Aeroports de Paris, operator of de Gaulle and Orly Airports, was corporatized in 2005, and the government plans to sell a minority stake by the middle of 2006. The estimated market value is $5 billion, and the government may sell as much as 49 percent.

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.

Earlier in 2005, Copenhagen airport's winning bid for Bulgaria's two seaport airports was overturned by a Bulgarian court. The $630 million concession had been signed in June, but was overturned in October after protests from losing bidders Fraport and Vinci. Also in central Europe, Slovakia short-listed five bidders for majority stakes in its two largest airports, Bratislava and Kosice. In February 2006 the government selected the Vienna Airport team. But in April 2006, the opposition Social Democrats pledged that they will renationalize the airports if they win the general election in June.

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 competition began in

January 2006 when bid specs became available. The concession excludes the two main runways, since they are already privately managed under a previous concession agreement.

Asia has seen two big developments of late. 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, meanwhile, finally completed the privatization process for the Mumbai and New Delhi airports in early 2006, though not without many ups and downs. After two rounds of bidding leading to five finalists for the 74 percent stake in each airport (for 30 years), 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. Some 22,000 airport workers staged a four-day, nationwide strike to protest the deal, but called it off when the government promised not to punish them for the illegal strike. The government is requiring the winning bidders to retain 60 percent of the existing workers; the rest have been promised transfers to other Airport Authority airports.

D. U.S. Air Traffic Control

The Federal Aviation Administration's largest ever outsourcing survived a challenge in Congress, allowing the consolidation and modernization of its Flight Service Stations to take place, beginning in October 2005. Lockheed Martin had been announced as the winning bidder the previous January, but the agency and its contractor faced two hurdles. First there was a protest from one of the losing bidders, the "most efficient organization" team made up of current FSS employees and Harris Corp. After that protest failed, the FSS union mobilized its friends in Congress to amend the FAA appropriations bill to forbid the agency to spend money implementing the contract. That measure narrowly passed the House, but a companion measure in the Senate failed to make it into the appropriations bill (which in any event, did not get approved until after the contract had already gone into effect). Thus, the FAA (and the taxpayers who provide its budget) are expected to save more than half of the annual cost of the program, with the winning bid of $190 million per year, versus in excess of $500 million that the FSS program had been costing. Lockheed Martin will consolidate from 58 to 20 facilities and will provide them with state-of-the-art equipment to take full advantage of on-line capabilities.

Aside from this outsourcing success, the FAA has been working hard to make the case within the aviation community that its aviation tax system is broken and needs to be replaced. The largest of these taxes is the 7.5 percent tax on airline tickets. Over the past decade increased competition has driven average fare levels downward, reducing the revenue below its historic trend line. At the same time, the amount of flight activity that the FAA's air traffic control system must handle has been growing faster than historical trends, due to the replacement of wide-body flights by narrow-body, the replacement of narrow-bodies by regional jets, and the shift of some first-class and business-class fliers to various types of business jets. The resulting decline in revenue combined with increases in cost is unsustainable. The FAA Administrator and other

senior officials have been suggesting that the replacement system needs to be some form of charge for the ATC services provided, so that revenues will keep pace with workload, but as of spring 2006 the specific funding proposal had not yet been unveiled.

A system of fees and charges could provide the revenue stream to make it possible to issue long-term revenue bonds to pay for much-needed modernization of the ATC system. That, of course, suggests some form of "commercialization" of the system. And that will be bitterly opposed by the FAA unions that have regularly opposed any form of outsourcing. The current aviation taxes sunset as of September 30, 2007, so the battle over these issues will be joined in 2007.

E. Air Traffic Control Commercialization Policy: Has It Been Effective?

Editor's Note: For more than 20 years, think tanks and official study commissions have cited fundamental problems with the U.S. air traffic control (ATC) system, and suggested that it be converted into something like a commercial entity, paid for by fees charged for its services (instead of by user taxes), operating like a high-tech service business, and able to finance large new facilities and technologies by going to the bond markets. Although those efforts thus far have not produced such change in the United States, by 2006 some 40 other countries had "commercialized" their ATC systems along these lines. These air navigation service providers (ANSPs) formed a trade association in the mid-1990s called the Commercial Air Navigation Services Organization (CANSO), which has begun to play a role in global aviation circles. Early in 2006, mbs ottawa inc. published the results of a detailed international study of this ATC commercialization experience. We are pleased to present this summary by Glen McDougall, the lead researcher and author of the study.

Air transport is a major domestic and international industry. It serves an important role in facilitating economic network developments in an increasingly global economy and in allowing personal movements for social and recreational reasons. The air transport industry relies heavily on an integrated system of information, monitoring, and control structures to enable the provision of safe and efficient services. Unlike the physical infrastructure associated with road and rail transport modes, air transport is provided along a series of virtual corridors that require users to be informed of traffic and other local conditions and where management—air traffic control (ATC)—is deployed to prevent conflicts and to ensure safety.

With the advent of small business jets, low-cost carriers, and unmanned aviation vehicles, there is a pressing need for a more responsive and capable air traffic service in the United States. ATC currently represents 5 to l0 percent of airline operating costs, however, when the costs of delays, safety issues, and flight efficiencies are factored in, the financial implications are far more significant than may first appear. There are also questions on how the present system will be able to absorb the future air traffic, which is predicted to double or triple in the next 20 years.

This study suggests there are potential solutions to many of the problems facing the current provider of ATC, the Federal Aviation Administration, to be found in studying how commercialized Air Navigation Service Providers (ANSPs) of 10 countries have performed: Australia, Canada, France,

Germany, Ireland, the Netherlands, New Zealand, South Africa, Switzerland, and the United Kingdom. The governments in these countries addressed similar problems (such as outdated equipment and escalating costs) by incorporating various degrees of commercialization into the delivery of their ANSP services.

As of 2005, over 40 countries had commercialized their ANSP functions to various degrees. The study uses a definition of commercialization that is fairly broad: the introduction of business practices. Under this umbrella countries had a range of organizational options available to them.

For this study, financial autonomy was the prerequisite for being considered "commercialized." The study included: a government department with user fees and access to capital markets, a separate government agency, six variants of government-owned corporations, one private-public partnership where 49 percent is owned by government and the balance by private aviation interests and employees, and one fully private, not-for-profit corporation with a stakeholder-appointed board where the federal government is a member of the corporation. To date there is no example of a for-profit, private company operating a national ATC system.

Table 13: Characteristics of the Air Navigation Service Providers

Country	ANSP Name	Ownership	Economic Regulation[#]	Safety Regulation
Australia[a]	Airservices Australia	Government corporation	Commission oversight	Separate-agency
Canada[b]	NAV CANADA	Not-for-profit private corporation	Self-regulating pursuant to statutory charging principles	Separate-MOT
France[c] (DSNA)	Direction des services de la navigation aérienne	Government department	Approved by Minister	Internal but separate
Germany[d]	Deutsche Flugsicherung GmbH (DFS)	Government corporation	Approved by Minister	Internal but will be separate
Ireland[e]	Irish Aviation Authority (IAA)	Government corporation	Regulatory Commission	Internal but separate
Netherlands[f]	Luchtverkeersleiding Nederland (LVNL)	Government agency	Approved by Minister	Separate-MOT
New Zealand[g]	Airways Corporation of New Zealand	Government corporation	Self-regulating	Separate-agency
South Africa[h]	Air Traffic and Navigation Services Ltd. (ATNS)	Limited liability public company	MOT Regulatory Committee	Separate-agency
Switzerland[i]	Skyguide	Not-for-profit joint-stock corporation	Approved by Minister	Separate-agency
United Kingdom[j]	National Air traffic Services, Ltd. (NATS)	Public/private partnership	Ec Regulator/Price-capping	Separate-agency
United States[k]	FAA Air Traffic Organization (ATO)	Government department	NA – tax based	Internal but separate

Notes
Excluding national, generic anti-trust and similar regulations; all ANSPS derive revenue primarily from user fees except the FAA which is funded primarily by taxation; all ANSPs have access to financial markets except the FAA.
a Established in 1995
b Established in 1996
c Financial Autonomy granted in 1985; Separate organization in department established in 2005
d Established in 1993 and to be a public private partnership in 2007
e Corporatized in 1993
f Corporatized in 1993
g Corporatized in 1987
h Corporatized in 1993
i Incorporated in 2001; predecessor established in 1921
j Financial Autonomy obtained with Public/Private Partnership in 2001
k Separate Air Traffic Organization established in 2004

The characteristics of the ANSPs in the study are shown in Table 13.

Within the countries studied in this project are those that are moving gradually toward more commercialization and those that have taken bold leaps toward total financial and governance autonomy. As a result this study looks at various stages of commercialization from embryonic to fully realized. It looks at the impact of governance structure, regulatory framework and institutional authorities on the performance of the ANSPs, in contrast to the performance of the largest and most complex ATC system in the world, the FAA in the United States, which has remained as a government department.

The study team sought to represent an impartial viewpoint, separate from the contentious issues surrounding "privatization" debates in the United States. In most U.S. debates on ATC reform, "privatization" is used, but the term really should be "commercialization," given that most options still involve government ownership but under a corporate form.

Starting from the belief that good information makes for good policy, the study team pursued inclusive policies while setting the parameters of the study. Funding for the project came from a wide base of participants representing foundations, academic interests, service providers, customers, international organizations, and governments. The team in turn sought input from three universities: The School of Public Policy at George Mason University in Virginia; the Maxwell School of Syracuse University, and the McGill Institute of Air & Space and Law in Montreal. An Advisory Committee was created to review the work and add insight. This prestigious group was made up of aviation and business executives drawn from the United States and abroad. To add depth and insight to the plethora of statistics and legal information gathered by the team, members conducted a full-circle evaluation seeking informed opinions from aviation service providers, regulators, customers, employees, and suppliers from all 11 of the countries studied.

The team looked at the performance of the 10 commercialized ANSPs from l997 to 2004 in comparison to the FAA. A comparison is possible as the Chicago Convention of l944 requires common outputs, making ANSPs an ideal subject for this type of policy study. Each country must provide for:

1. Safe and efficient separation of air traffic;
2. Infrastructure of communication, navigation and surveillance facilities; and
3. Information to pilots.

The study produced three new bodies of work on which to base its expert analysis and conclusions:

1. Legal descriptions by McGill University of the governance structure of each commercialized ANSP, organized by topic (e.g. board structure, how appointed, etc.);
2. Two hundred interviews with ANSP management, unions, customers, regulators, military, technical suppliers, and international agencies in cooperation with George Mason University;
3. Normalized trend analyses of key performance indicators by Syracuse University on safety, modernization, cost, service quality, public interest, and financial stability.

Among the study's most interesting findings:

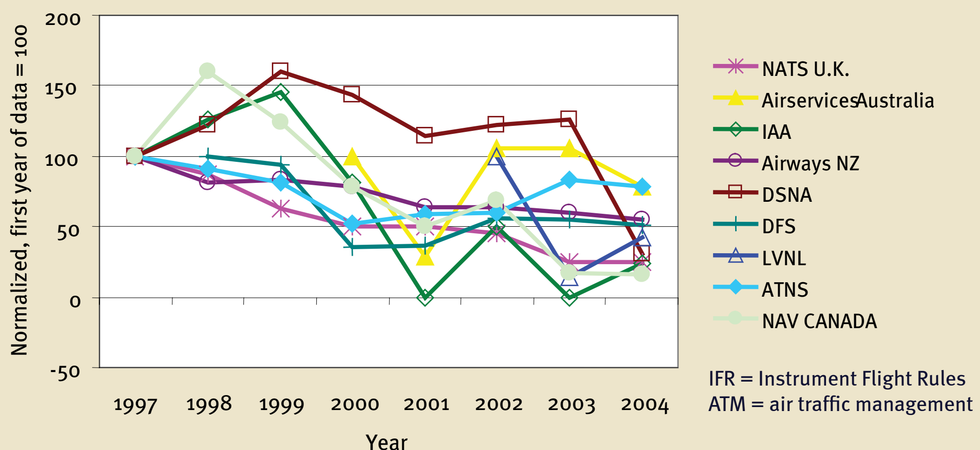
Safety culture was improved dramatically. There was no indication that safety was in any way compromised by commercialization. Transparency and voluntary safety reporting were enhanced. The graph in Figure 5 shows that the general trend in safety incidents is downward. The FAA did not provide a time series of safety incident data. However, an audit report published in 2004 by the Office of Inspector General at the U.S. Department of Transportation found that incident reporting was extremely variable in quality and quantity. Consequently, trend comparisons with the FAA could be inconsistent because of reporting variability.

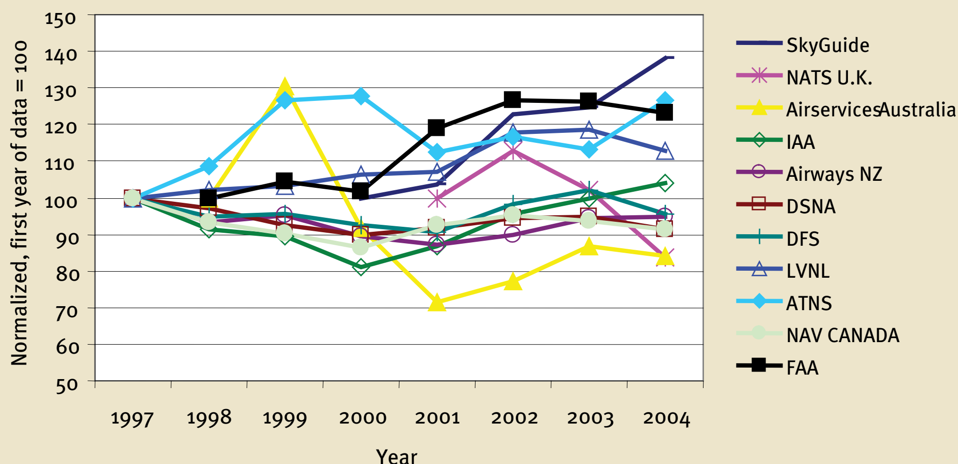
User fees brought users to the table to discuss those services they most desired and to help cut those services which were not crucial to their business success. The emphasis from the ANSP shifted from general policy objectives of government to specific needs of clients. As a result services were streamlined and costs were cut. Even in times of fee increases (i.e. post-9/ll) customers strongly preferred commercialized ANSP services over those formerly provided by government.

Costs were reduced, more strongly in those models insulated by design and/or government restraint from excessive micro-management, whether or not the corporation was fully owned by government. Figure 6 below shows the cost record of the 10 commercial ANSPs compared to the FAA. Note that for South Africa (ATNS) and Switzerland (Skyguide), their growth in costs is explained by rebuilding the ATC system for the rapid growth in air traffic since the end of apartheid in the former case, and building an improved safety function and absorbing military controllers in the latter case. The gap in trends between the best-performing commercial ANSPs and the FAA is about 30 percent.

Service quality improved. Delays showed some improvement as short-staffing was corrected and innovative technologies introduced. There was a major improvement in responsiveness to customer's needs resulting in significant gains in flight efficiency. Customers were strongly supportive of the benefits of commercialization on service quality.

Figure 5: Serious Safety Incidents per IFR Movement ATM-related





Public interest was clarified. Policy objectives of government, such as job creation and regional development, were separated from ANSP-related business goals. Unions advised there was no negative impact on labor: the ability to negotiate wages and benefits was not diminished but employees experienced better technology and working environments. Military-civil cooperation improved. General aviation did not suffer; any charges to general aviation were modest. Small communities still received services.

A regulatory framework must be provided by government with responsibility for safety and consumer protection. Regulators advise that government should strengthen ANSP safety regulatory capacity before commercialization. There were many forms of economic regulation in the various models, tailored to needs of the aviation community and degree of stakeholder influence. Some regulators encourage long-term ANSP-customer price and service agreements.

Financial stability was good despite the combined forces of the air traffic downturn post 9/ll and the SARS outbreak. The most difficult problems were in the United Kingdom where the new public-private partnership suffered from the combination of lower revenues with the traffic downturn, an excessive level of government-imposed debt (necessary to accommodate the chosen equity partner who was only able to invest one-sixteenth of the agreed sale price as cash), and regulated price-caps—this situation has since been resolved.

Stakeholder opinion was unanimously pleased with commercialization efforts. Of the over 200 people interviewed, only one labor representative in Europe wished the system would return to its old ways.

All ANSPs face high labor costs. This is a result of having a highly skilled and limited pool of employees on which to draw. Controllers are well-paid and work low hours. Customers are intolerant of labor disputes.

The profit motive does not factor into any commercialization model studied. There are price caps, legislated rates

of return, excess revenues returned to customers etc. to prevent profit-taking. The primary equity partner for the U.K. public-private partnership is a consortium of airlines stating it is not investing for commercial return.

1. Who Is the Client?

When moving from government provider to commercialized service provider, the fundamental question arises: Who is the client? Whereas the government service provider's client is the government itself and the general public, the commercialized ANSP's client is the aviation industry. Providing financial autonomy to ANSPs tended to reinforce the aviation community as the primary client. Higher performance was noted when the customers had effective influence over the ANSP but not control of it. ANSPs responded to customer needs best when they were insulated from political micro-management and government direction.

Public interest in air navigation services is still there but it is not the same as government's socio-economic or political interests. The public interest is redefined as interest in safety, system efficiency (including delays), access to airspace, consumer protection, good employer, etc. The government has many tools with which to protect this type of public interest, including legislation, regulation, legal recourse, etc. The study showed that it is not essential that the government own and operate ANSPs in order to protect public interest.

2. Stakeholder Involvement

When customers pay user fees they become actively involved in defining which of the ANSP's services they want and how much they are willing to pay for them. Services are maximized and costs are minimized. Transparency is demanded by customers who are few in number and financially articulate. Having close customer involvement in business decisions promotes gains in efficiency and minimizes the "gold-plating" (overbuilding and adding unnecessary features) of investments. However, too much direct control by customers can result in short-sighted management; it is recommended that when a government includes customer presence on the board of directors of an ANSP, it be by "arm's length" representation.

3. Linking Governance Structure to Performance

The study found that ownership was not in itself a critical factor. The most important feature of successful ANSPs was that managers had control of resources, levels of service, and business decisions and that those managers were held accountable for their performance.

Extensive government micro-management, political direction from lobbying, and conflicts between customer service and government priorities were all seen as contributing to low performance. Some ANSPs have mechanisms to insulate them from government (New Zealand), eliminate or reduce government ownership (Canada, U.K.), or have strong boards coupled with government restraint (Australia). The FAA was identified as suffering from extensive government intervention with corresponding poor performance.

The study found that the models with the best performance exhibited three major strengths:

1. Sensitivity to customer needs;
2. Agility in reaching a decision; and

3. Ability to execute the decision.

The report found that some models increase performance more than others. The best commercialization efforts had the following features:

1. Independent governance structure;
2. Effective customer influence; and
3. Robust government oversight.

4. Conclusions

Has air traffic control commercialization been effective? This review of 10 commercial air navigation service providers indicates that the answer is yes. It has enabled continuous improvement in infrastructure modernization, improvements in service quality through improved flight efficiency and delay mitigation and, to varying degrees, cost reduction compared to the departmental benchmark, the FAA. Safety has not been compromised where there has been effective government oversight.

In the end, government, customers, employees and other stakeholders must decide how best to deliver air navigation services in their country. Commercialization is an attractive option because it brings business discipline to the provision of services, results in organizations that are more efficient and responsive to client needs, and reduces dependence on the taxpayer.

by Glen McDougall

Mr. McDougall is a Senior Research Fellow at The School of Public Policy, George Mason University and President of mbs ottawa inc. in Canada. He is a former Director General and Special Advisor to the Government of Canada, having held senior positions in Transport Canada, Treasury Board of Canada, and the Royal Canadian Mounted Police (R.C.M.P.) He was one of the main architects of the first fully privatized ANSP in the world, NAVCANADA. Ten years old this year, NAVCANADA is a success story among commercializations and is often referred to as "The Maple Leaf Solution."

Mr. McDougall's full report is available at info@mbsottawa.com. Details on pricing and ordering can also be viewed at the www.mbsottawa.com Web site. The report is in color and is over 100 pages in length. Each printed report also includes a complimentary CD (comprising an additional 140 pages) on the full legal descriptions of each of the ANSPs studied (including governance structures and regulatory frameworks) provided by the McGill Institute of Air & Space and Law. The report also includes an informative A to Z Guide on what to consider when Air Traffic Control commercialization is being discussed. It would be an equally important read when considering commercialization of other government activities.

Education and Child Welfare

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A. Charter Schools Lead Grassroots Efforts for Choice

Charter schools—publicly funded schools that have more discretion over funds and management than tradition public schools—continue to be the largest example of school privatization. According to the Center for Education Reform, as of October 2005 approximately 3,600 charter schools are operating across the United States serving more than 1 million children. For the 2005-2006 school year, 424 new charter schools opened representing 13 percent growth from the previous year. Charter schools continued to grow in both the private and the nonprofit sectors. They have continued to provide a viable option to parents with children in low-performing schools that are not meeting the requirements of the No Child Left Behind Act. Los Angeles provides a case in point.

In November 2005 hundreds of Los Angeles families, backed by the signatures of 10,000 parents, students and other residents of mostly poor South Los Angeles asked the Los Angeles Unified School District to relinquish control of Jefferson High School and turn it over to Green Dot Public schools, a group of nonprofit charter schools that has successfully raised student achievement in low-income LA communities.

The district rejected that initial request, but in March 2005 the LAUSD school board granted Green Dot charters for six schools in the neighborhoods served by Jefferson. As charter schools, the six campuses will be publicly funded and open to all students, but they'll operate with more autonomy than the city's traditional public schools.

The Los Angeles-based Wasserman Foundation has provided Green Dot with $6 million to help open the new schools in time for the 2006-07 school year. According to the *Los Angeles Times* several hundred families waited together on May 11, 2005 to see if their children would get into one of the new Green Dot Public Schools charter campuses. Green Dot founder Steve Barr told the *Los Angeles Times* that he wants to

highlight the growing influence of charter schools on public education by enrolling hundreds of students who otherwise would have attended Jefferson or nearby Santee High School. Both high schools have issues with severe school violence and poor academic performance.

Green Dot held a lottery to determine which of the more than 1,000 applicants would be part of Green Dot's 640-member ninth-grade class. Currently in Los Angeles approximately 5 percent of the city's 625,000 students attend public charter schools. Some experts predict that ample philanthropic support for charter schools in Los Angeles will cause that figure to rise to 20 percent within a decade.

Charter schools continued to grow in both the private and the nonprofit sector.

In a second grassroots action in Los Angeles, The Alliance for School Choice and the Los Angeles-based Coalition on Urban Renewal and Education, filed complaints against Los Angeles and Compton school districts charging that the two districts failed to provide meaningful notice or transfer options for thousands of students in failing public schools. Federal law requires the school districts to make findings within 60 days, and authorizes the Secretary of Education to cut off federal Title I funds for failure to provide transfer options.

The complaints charge that of at least 250,000 schoolchildren eligible for transfer in Los Angeles, only 527 (.2 percent) received transfers to better-performing schools; while in Compton, zero students have received transfers despite appalling educational conditions. The complaints charge that the districts have failed to adequately make information available to parents or to provide sufficient options. The action demands that the Los Angeles and Compton Unified School Districts immediately provide and publicize public school transfer options for children in failing schools as required by the law. The No Child Left Behind Act (NCLBA) requires that school districts offer to children in schools that have failed to make "adequate yearly progress" for two years under state standards the option to transfer to better-performing public schools within the district. Lack of capacity is not a basis to fail to provide transfer opportunities under the law. Because NCLBA does not provide a private right of action, the parents and their organizational partners must file complaints in the first instance with the school districts, demanding compliance.

"The conditions in Los Angeles and Compton are the tip of a national iceberg," Clint Bolick, president and general counsel for the Phoenix-based Alliance for School Choice, stated. "The problem is that the number of children in failing schools vastly exceeds the number of available slots in better-performing public schools. Public schools alone cannot solve the crisis of inner-city education." A 2004 report by the General Accounting Office found that more than 3 million schoolchildren—overwhelmingly low-income and minority children—were entitled to transfer, but only 1 percent of those eligible actually transferred. Bolick said that similar actions could be filed in almost every large district in the United States. "Millions of children are being left behind in failing schools," Bolick declared. "They deserve immediate access to better educational opportunities, to which federal law clearly entitles them."

The Alliance also called upon U.S.

Secretary of Education Margaret Spellings to cut off applicable federal funds to the districts until they comply with the law or make other suitable educational opportunities available to children in failing schools. Secretary Spellings has authority to take action to cut off certain federal funds to the districts until they comply. The Los Angeles case will help determine whether children in failing public schools can legally utilize private options to offer them more alternatives to their low-performing public schools.

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B. School Choice Update

1. School Choice Continues to Expand in the States

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. "This bill would provide stability for children who often have little in their lives. No group is more deserving, or more needy of school choice," declared Clint Bolick, president and general counsel of the Phoenix-based Alliance for School Choice, a national nonpartisan policy organization that supports expanded educational options for disadvantaged schoolchildren. 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 lasts 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.

But unfortunately, not all legislation passes. In New Hampshire on January 18th by a 14-9 vote, the New Hampshire Senate approved S.B. 131 to create the 21st Century Scholars Fund, which will provide scholarships of up to $3,500 for children in low-income families to attend the public or private school of their choice. All 14 members voting for the measure were Republicans, and eight of the nine negative votes were cast by Democrats. One senator was absent. Unfortunately, in a close vote in May 2006, the House defeated this legislation.

The proposed 21st Century Scholars Fund was a hybrid between state-funded vouchers and scholarships supported through both corporate and individual tax credits. If the measure had become law, the fund would have begun with $1 million in state funding. During the second year, the state would have appropriated another $1 million only after $500,000 is donated by the private sector.

Under the program, the state would have given individuals a credit against what they owed in taxes on interest and dividends, equal to the amount of donations they made to the scholarship fund. Individuals would have had to apply for the credit, and the limit on the total amount of credits to be granted by the state would have been $100,000. Corporations could have received credits against the Business Enterprise Tax

in the amount of donations to the scholarship fund, with the total amount of credits limited to $400,000.

The 21st Century Scholars Fund was modeled after New Hampshire's Healthy Kids program, which provides health insurance to low-income children. The Scholars Fund would have provided scholarships of $3,500 for children in families whose income was at or below 200 percent of the poverty level. The fund also would have provided scholarships of $2,500 for children in families with incomes between 201 and 250 percent of the poverty level.

2. Maine Town Opts for Locally Funded School Vouchers

In March 2006, the people of Swans Island, Maine, a town without a secondary school, voted to pay for their children's education with local tax funds at either public or private secondary schools, including religious schools not funded by the local education authority. The subsidies will be paid directly to parents and involve local funds, not state monies, thereby avoiding church-state issues, according to the proposal's sponsors.

According to *School Reform News*, the 57-44 vote on the tiny island off the Maine coast—where the economy relies on lobstering and most children are ferried to school on the mainland—echoed a much larger national debate over public subsidies to religious schools. Some islanders feel it may also be the solution to a longstanding conundrum over the application of the First Amendment to Maine education law.

In Maine, a local school district that doesn't operate comparable schools—a high school, for example—is allowed to "contract" with an approved public or private school (but not religious schools). Tuition is reimbursed according to a state-set formula. In towns without any schools, parents enroll their children in an approved school, and the school then informs the town clerk, who issues a voucher and reimburses the school for expenses according to the state formula.

3. Significant School Choice Setback in Florida

Florida's Opportunity Scholarship Program gives any student assigned to a public school that has failed two years out of the past four the option of transferring to another public school or using a scholarship to attend a private school. On January 5th the Florida Supreme Court ruled 5-3 that Opportunity Scholarships violate Article IX, Section 1 of the Florida Constitution, which states, "Adequate provision shall be made by law for a uniform, efficient, safe, secure, and high-quality system of free public schools."

The dissenting opinion, written by Justice Kenneth Bell, whom Bush appointed in 2002, found the Article IX mandate does not preclude alternative educational options or indicate public schools are the only method through which the state can provide for the education of its children, which the majority opinion held. The majority pointed to minutes from meetings of the Constitution Revision Committee, which rejected attempts to include language both prohibiting and allowing the state to issue vouchers, before the 1998 election.

By contrast, Bell agreed with a lower court, which had found, "[N]othing in Article IX, Section 1 clearly prohibits the Legislature from allowing the well-delineated use of public funds for private school education, particularly in circumstances where the

Legislature finds such use is necessary."

The legislature granted Governor Bush a temporary fix for the Opportunity Scholarship Program for the current school year. However, the legislature failed to pass a joint resolution, which must be approved by three-fifths of the state legislature, to put a constitutional amendment on the ballot in November 2006 that would protect the scholarship programs.

4. Federal Action on School Choice

In 2006, the Bush administration announced a new $100 million program to aid children in chronically failing public schools by providing scholarships to attend private schools or to receive supplemental services in public schools.

The proposal is part of the Administration's budget, and corrects a flaw in the No Child Left Behind Act (NCLBA) by providing educational options to children who need them. "This proposal marks a giant step forward in making sure that truly no child is left behind," declared Clint Bolick, president and general counsel of the Alliance For School Choice, the nation's leading education and advocacy organization supporting private school options for disadvantaged schoolchildren.

The proposal would create a competitive grant program that would enable children in schools that are "restructuring" under the NCLBA to receive scholarships of up to $4,000 for private school tuition or $3,000 for supplemental services if the children remain in public schools. A "restructuring" school is one that is deemed in need of improvement under applicable state standards for at least six years. NCLBA currently provides for limited supplemental services, and purports to guarantee that children in chronically failing public schools may transfer to better-performing public schools within the district.

Under the proposal, entities eligible to apply for the competitive grants include states, local education agencies and non-profit organizations. The Administration estimates that as many as 2,000 schools will be deemed "restructuring" schools in 2007.

The federal government also offered students who were victims of Hurricane Katrina temporary funding to attend the school of their choice. The Department authorized payments for 157,743 students, more than $120 million, for the first quarter of aid during the 2005-06 school year. This is the largest K-12 school choice program in the country," declared Clint Bolick, president and general counsel of the Phoenix-based Alliance for School Choice. "This program demonstrates the efficacy of school choice in serving students who were in great need of educational options."

The figures indicate that Katrina students were taken in by schools in the District of Columbia and in every state except Hawaii. The states that took in the largest number of students were Louisiana (46,672), Texas (46,324) and Mississippi (17,873), followed by a number of other southern states. Even Alaska took in 27 displaced students.

C. The Case Against Universal Preschool

In summer 2005, a national task force co-chaired by Arizona Gov. Janet Napolitano called for $8 billion annually in federal support for preschool. Similarly, in his 2006 response to President Bush's State of the Union Speech, Virginia Gov. Tim Kaine acknowledged universal preschool as a silver

bullet to help create a better future for the United States. Kaine said, "There's a better way… Many states are working to make high quality Pre-Kindergarten accessible to every family."

States are moving quickly to expand access to state-run preschool. According to Libby Doggett, Pre-K Now's executive director, states cumulatively have committed more than $14 billion to early education. Arizona, New Mexico, Washington, South Carolina, Virginia, and West Virginia are all considering various models of universal preschool, and Illinois Gov. Rod Blagojevich recently announced plans to make Illinois the first state in the nation to offer universal preschool to both three-and four-year-olds. Nationwide, at least 40 states provide state funding for preschool programs, and at least 28 considered legislation to expand state-funded preschool programs in 2005. Three states—Georgia, Oklahoma, and Florida—offer universal preschool.

In California proposition 82, an initiative for Preschool for All failed to win popular support. The Preschool for All Act was representative of national efforts for universal preschool and would have created a de-facto institutionalization of preschool in California by proposing a new government-managed, $2.5 billion a year entitlement program that would have subsidized the preschool choices of middle-class and wealthy families. The proposition was voted down in the June 6th primary election 60.9 percent to 39.1 percent.

1. Government-Run Preschool Programs Fail to Demonstrate Results

There is little empirical evidence to demonstrate any lasting educational or socioeconomic benefit of government-run preschool programs for all children. Evidence from performance on the National Assessment of Education Progress (NAEP), which is considered the nation's report card, argues against the value of investing in universal preschool.

Georgia has had universal preschool open to all children since 1995, and Oklahoma has had a universal program in place since 1998. In a recent analysis of the top 10 best and worst state performers, based on the percentage point change in fourth-grade reading tests between 1992 and 2005 on the NAEP, both Georgia and Oklahoma were in the bottom 10 performers. In fact, Oklahoma was the worst performer of all states in terms of gains in fourth-grade reading between 1992 and 2005, actually losing 4 percentage points.

More specifically, in Oklahoma 33 percent of fourth graders were below basic in reading in 1992. By 2005, 40 percent of Oklahoma fourth graders were scoring below basic. In 1992, 38 percent of Oklahoma fourth graders scored basic in reading, but by 2005 only 35 percent of fourth graders could read at a basic level. Finally, in 1992, 25 percent of Oklahoma fourth graders were proficient in reading, but by 2005, only 21 percent were.

One would expect that a large, statewide investment in universal preschool including high-paid, credentialed teachers and high-quality curriculum would have a positive effect on fourth-grade reading scores. These scores declined, despite the fact that all of the children that took the 2005 NAEP reading test in Georgia and Oklahoma were eligible for universal preschool. In fact, none of the states in the top 10 best performers in terms of gains in fourth-grade reading on the NAEP card between 1992 and 2005 had

implemented universal preschool.

Similarly, a February 3, 2006 study by researchers Russell W. Rumberger and Loan Tran of UC Santa Barbara found no lasting academic impact from state-run preschool programs. They found that while children enrolled in preschool had some moderate advantages in kindergarten performance, the benefit dissipated by third grade. The Goldwater Institute's Darcy Olsen, who has compiled extensive research on early childhood education, provides a useful summary of key findings from preschool studies:

- After 10 years, the Georgia preschool program has served over 300,000 children at a cost of $1.15 billion and children's test scores are unchanged.
- Head Start, the nation's largest preschool program for disadvantaged children, has not measurably improved educational outcomes.
- Historic trends are unpromising. The preschool enrollment rate of four-year-olds has climbed from 16 percent to 66 percent since 1965. Despite the change from home education to formal early education, student achievement has stagnated since 1970.
- America's flexible approach to early education gives children a strong foundation according to widely used proxy measures of preparedness, concrete skills assessments and reports by kindergarten teachers. We find further evidence of the strength of our early education system in international comparisons, which show U.S. fourth graders are "A" students on the international curve, excelling in reading and science and performing above average in math. By twelfth grade, U.S. students are "D" students on the international scale—a decline occurring after fourth grade. Whatever the cause of that decline, it appears to have little or nothing to do with a lack of preparation in the early years.

Finally, the most dubious claim of all is that subsidizing universal preschool will benefit middle-class or wealthy children. A Children's Hospital and Boston College study published in the July 2005 issue of *Pediatrics* found that suburban kids enrolled in a high-quality early education program differed little from their suburbanite peers who were not enrolled. However, at-risk urban children enrolled in high-quality preschool programs did better in school and had better physical and mental health as adults than their peers who did not attend such programs.

2. Responsible Alternatives to Universal Preschool

America's healthy preschool market provides opportunities for parents to choose among a wide variety of educational options, but there are improvements to the current system that will streamline and diversify the market.

One-Stop Shop for Preschool

Rather than creating new tax-funded preschool bureaucracies, states should work toward creating a single, integrated, seamless administrative system that will serve low-income families in each state. The different funding streams that support low-income families have multiple administrative bureaucracies, paperwork requirements, and eligibility requirements. Millions of dollars that could go directly to pay for more low-income preschool slots are wasted maintaining duplicative preschool

programs. States need a one-stop shop with a centralized eligibility list for low-income preschoolers.

Preschool For All Tax Credit

A tax credit approach could help states achieve the policy goal of more quality preschool for children with the most efficiency for taxpayers and the greatest satisfaction for parents. By supporting new preschool slots for low-income and middle-class children, all taxpayers would be able to keep more of their own income to pay for their own preschool choices. A $1,000 tax credit to middle-income families would help them to choose from a wider preschool market, and a corporate tax credit scholarship program could be created to give scholarships that would enable low-income children to attend existing preschools. Pennsylvania's example of the corporate program shows that companies have been responsive to tax incentives. The state expanded the existing K-12 corporate tax credit program in 2003, giving corporations a 100 percent credit for the first $10,000 and up to a 90 percent credit for remaining contributions up to $100,000. To date, $5 million a year is used to target Pennsylvania's low-income children with preschool scholarships. Families of children receiving the scholarships must earn less than $50,000 plus a $10,000 allowance for each dependent. In the first year of the program, 39 preschool scholarship organizations were created.

4. Conclusion

There is little empirical evidence from states' experiences with universal preschool to demonstrate any lasting educational or socioeconomic benefit of government-run preschool programs. These programs also make no fiscal sense, and, as with the provision of K-12 education, the costs of publicly run preschools will likely escalate beyond any initiative's projections. Once any program is established and has a large constituency of preschool families, there will be calls for more taxpayer support. Universal preschool initiatives are not self-sustaining and will likely require future support from the general fund to truly provide preschool for all four-year-olds. The current private preschool market offers an array of choices. Government preschool is a formulated, one-size-fits-all approach to education that institutionalizes young children at their most impressionable ages. This is a move backwards that should be avoided.

D. Driving More Money into the Classroom: The Benefits of Shared Services

Education spending constitutes up to half of many state's budgets. Ranging from teachers' salaries to building costs, these budget dollars have in the past mostly escaped the chopping block of the yearly budget-cutting process. In recent years, however, states and school districts are under increasing pressure to reduce education costs, particularly of non-instructional services.

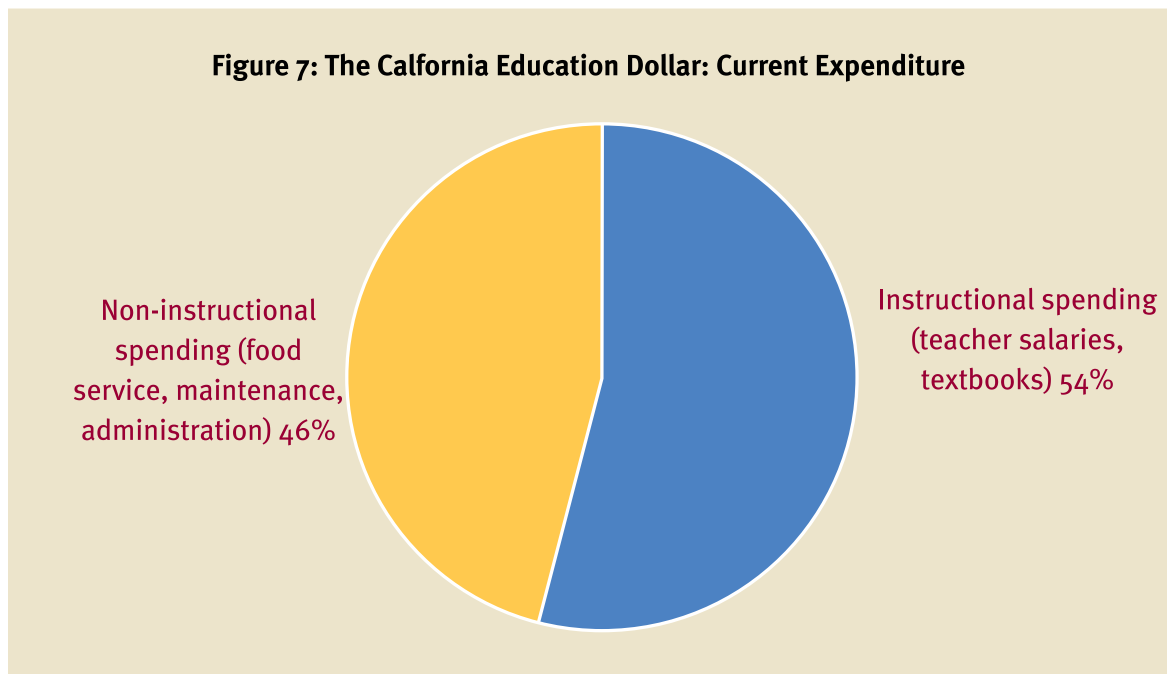
In most states, anywhere from one-third to one-half of every dollar spent on education never makes it into a classroom.

In most states, anywhere from one-third to one-half of every dollar spent on education never makes it into a classroom. The money goes to administration, support services, and operations. Lacking economies

of scale—and often sufficient managerial expertise—many small and medium-sized districts find it extraordinarily expensive to provide the full array of support and administrative services in-house. At the same time, many large districts suffer from duplicative or inefficient administrative systems due to layer upon layer of bureaucracy grown over time. For example, in many states, teachers make up a little more than half of all school district staff. In contrast, teachers account for between 60 and 80 percent of all school staffing in Europe. The resulting high per-student costs in the United States constitute a significant drain on budgets.

The U.S. Department of Education has found that approximately 39 percent of state education budgets are used for non-instructional purposes. More detailed analyses at the state level suggest that the federal statistics may even understate the actual amount going to non-instructional costs. The state of Texas has one of the most detailed systems of school cost accountability. It offers an instructive example for taking a closer look at education spending. Data from the Texas Education Agency (TEA) show that during 2004-2005, Texas school districts devoted only 59 cents of every tax dollar to classroom instruction. The remaining 41 cents went to support functions such as student transportation, food services, facilities maintenance and operations, and general administration. Meanwhile, in California, only 54 percent of per-pupil spending goes to instruction costs (see Figure 7), while in Illinois classroom expenditures represent only 46 percent of the budget. How can states and school districts respond to these fiscal pressures without adversely impacting educational performance? One promising approach is by reducing non-instructional spending costs through shared services. Whether a district has a surplus or deficit, a budgetary feast or famine, arrangements with other school districts, within large school districts, or with outside entities to share services such as transportation, food services, human resources, finances and purchasing can help realize significant cost

Figure 7: The Calfornia Education Dollar: Current Expenditure



Where to Share?

Transportation. Large districts have the flexibility to incorporate sharing in a number of creative ways. The simplest involve internally sharing resources, time, or space, such as when a handful of neighboring schools bands together to host a recruiting fair. Even more interesting, though, are examples of well-planned, formal, shared services agreements. The two school boards in Ontario, Canada have joined together to share bus transportation services and audio-visual resources. By creating a single bus system, the two boards will save $8 million in administrative, capital, and fuel costs over three years. The boards' shared AV library serves classrooms in both districts, saving $300,000 annually.

Purchasing. In New Jersey, the Shared Services Program is a cooperative effort among Middlesex County municipalities that supports the towns by providing a way to reduce daily operating expenses through cooperative purchasing. The program began in 1998 by offering towns aggregate natural gas purchasing, resulting in a 5 percent savings on electricity for public buildings during the first year of the program. Currently the municipalities share services for water/wastewater programs and the purchasing of natural gas, electricity, equipment, services, and supplies.

Administration. Seven districts in Connecticut have a shared services arrangement for administrative services that includes the superintendent, director of instruction, federal programs, special education directors, and a legal agent. Meanwhile, in West Texas, Region 17's service center located in Lubbock, which serves an area encompassing about 19,000 square miles (close to the size of Pennsylvania), provides payroll and accounting services for a number of rural school districts, saving each over 50 percent a year and some up to 88 percent annually. The service center has also established an insurance co-op, which allows about 20 rural districts to purchase optional health services plans, such as dental insurance, at a much lower rate with better coverage than they could on their own.

Human resources presents another good opportunity for shared provision of administrative services. In 2004, the Massachusetts Human Resources Division (HRD) implemented shared services to streamline human services for all state agencies. The HRD allowed government agencies to reduce staffing and save the Commonwealth millions of dollars. In the HRD alone, staffing was reduced by 50 percent while handling more complex responsibilities and offering more innovative services to state agencies. For example, the state agencies devised a new shared recruitment process that reduced the time to fill a position from four months to five weeks.

Technology. Districts have vast opportunities to share technology, ranging from shared systems and applications to shared helpdesk and onsite IT support. Districts across the country have found creative ways to develop payroll and HR systems with municipalities and neighboring schools, to share the cost of software licensing and purchasing applications, and even sharing CIOs with other districts. Sarasota County, NY and the local school district created a shared services partnership for information technology that cut personnel and software costs for the school district.

Facilities and Real Estate. A new frontier for educators is combining forces with the private sector. Examples of successful pairings abound, often where the schedule or needs of a school nicely balanced those of a local business or corporation. The Lincoln Unified School District in Stockton, California negotiated with a private fitness center operator to build a facility on site at a newly planned school. The district will provide the land and the fitness center operator will pay to build the facility. Once operational, private fitness center clients will use the facility in the morning before school and in the evening, while students will use it during the school day.

This article was excerpted from the Reason study, *Driving More Money into the Classroom*, by William D. Eggers, Lisa Snell, Robert Wavra, and Adrian T. Moore. The entire study is available online: reason.org/ps339.pdf

reductions without negatively impacting student outcomes.

E. Child Welfare Update

1. Child Welfare Privatization Continues to Expand

In 2005 Florida became the first state to complete the transfer of all foster care, adoption, and child welfare licensing operations across the state to private agencies—making Florida the first state in the nation to fully privatize its child welfare programs. In April 2005, the Florida Department of Children & Families (DCF) signed the final $75 million contract to turn over all foster care and adoption programs in Miami-Dade and Monroe counties to private administrators. The Miami-Dade and Monroe contract is the 23rd community-based care agreement between the state and a privately run agency. The contract will be in effect for 14 months, according to DCF. Currently, the state is providing services to about 5,000 children in Miami-Dade and Monroe. If the number of children in care rises by more than 3 percent, the state agrees to pay the lead agency, Our Kids, additional money.

The 22 other private child welfare contracts in the state contain no provision allowing the agencies to receive additional funding if their caseloads unexpectedly rise. The Our Kids contract also is the first in the state to explicitly forbid officials affiliated with agency vendors from serving on the Our Kids board of directors, a measure designed to prevent conflicts of interest.

Bids were collected in 22 areas of Florida—some single counties, others multi-county areas—for a "lead agency" that would be responsible for the social work that was once handled by 15 Department of Children and Family (DCF) districts.

Lead agencies that took over responsibilities from DCF over the last four years are responsible for all social services in their area. They typically contract many of those services such as substance abuse, case management and foster care with community providers.

In the five-county Southwest Florida district, for example, case management – the tracking of children in the system – is divided among Lutheran Services Florida, Ruth Cooper Center, and Family Preservation Services. Others providers offer emergency youth shelters, parenting classes, drug treatment and a variety of other services. Florida's Department of Children and Families still does initial child-abuse investigations, adult services, and economic assistance. But once a child or family needs specific services, responsibility falls on the community-based lead agency.

> Florida's Department of Children and Families' officials told *The News Press* (Fort Myers, Florida) that it's a free market and their primary concern is for children and families to have quality agencies to serve them.

One requirement to be a lead agency is to be a nonprofit company. Yet, for-profits have played an important role in supporting the nonprofit lead agencies. For example, Providence Service Corporation, a publicly traded Arizona company, owns or manages three companies that have garnered more than $120 million in state child welfare contracts in at least 11 of Florida's 22 child welfare districts. One of its partners, Camelot Community Care, a nonprofit child social-service provider in Florida and five other

states, has a nearly $100 million contract to provide child welfare in Southwest Florida. Providence executives sit on Camelot's board of directors and decide about child care in Southwest Florida. Its chairman is Providence President Boyd Dover. Providence follows the model similar to for-profit companies managing nonprofit hospitals.

Florida's Department of Children and Families' officials told *The News Press* (Fort Myers, Florida) that it's a free market and their primary concern is for children and families to have quality agencies to serve them. "We're neutral on the issue (of for-profit companies gaining child-welfare business)," said David Fairbanks, a DCF director in Tallahassee. Providence officials, said they compete by dramatically reducing overhead, not by denying services to children. Providence keeps overhead low by renting buildings and keeping a lean crew of executives who manage the work. The company earned $15.7 million in pretax income in 2005 on $145 million in revenue.

Providence's strong fiscal soundness and ability to borrow has helped several nonprofit lead agencies in Florida. Camelot, through Providence, obtained loans for lead agencies in Hillsborough County and Central Florida near Ocala. It also joined together with another nonprofit agency in St. Lucie County on Florida's east coast to provide cash to start up the lead agency there. After the agency was up and going, Providence backed out of control and the board was placed with community leaders.

2. Florida Performance Measures

The implementation of child-welfare privatization in Florida has been a learning process. However, the first positive outcomes for children are beginning to materialize. More Florida children are being adopted, kids are safer, and they're getting more and better services since Florida privatized its child welfare system, according to performance measures tracked by state child welfare officials.

Nearly one in five children served by the Florida Department of Children and Families before privatization was abused or neglected in its care. Today, that figure is one of every 30 and dropping. The number of foster homes in Florida has nearly doubled since 1999, social workers' caseloads are smaller, and the number of children in out-of-home care has also fallen, according to David Fairbanks, a director at the Florida Department of Children and Families in Tallahassee.

Nearly one in five children served by the Florida Department of Children and Families before privatization was abused or neglected in its care. Today, that figure is one of every 30 and dropping.

According to a March 2006 report by Florida Department of Children and Families to *The News Press*, none of the lead agencies that manage abused and neglected children in Florida's 22 areas is meeting all of its benchmarks. In Southwest Florida, for example, Camelot Community Care is meeting five of eight contract performance measures. That's one of the best records in the state." And we're cleaning up a mess. We didn't start out at ground zero," said Harry Propper, CEO of Children's Network. Richard Sapp, who has worked with the child welfare system for years, uses two words to describe the differences since privatization: quick and local.

"I'm really and truly excited about

what is happening," said Sapp, executive director of the Hope House shelter in Fort Myers, which contracts with The Children's Network. "We're seeing things we'd talked about for years that had never happened actually becoming reality." For example, children who need medical care, counseling or therapy now get them—without months of waiting. "It has improved 100 percent, but had the network not been willing to invest more resources, this would never have been possible," Sapp said. Sapp also lauds another innovation: the Protective Investigation Linkage Program. It lets DCF investigators refer families in crisis—but not in such bad shape the court is involved—to services such as food, utility payments, or parenting classes. The idea is to help families avoid becoming involved with the system. "It quickly empowers people to fend for themselves using local resources," he said. "Now, there's enough flexibility to tailor services to local needs—not just state mandates."

Nancy Apperson has been a Lee County foster parent for 18 years, and while she told *The News Press* that the system still has inherent problems such as overloading and staff burnout, for example, she has seen definite improvements. "There used to be just one dentist and a six- to eight-month wait," she said. "Since they went private, they have several dentists who are donating their time. Plus, your phone calls get answered promptly and they have more educational things and parties for the kids."

3. Privatization Improves the Adoption Process

One tangible benefit of the privatization process in Florida has been improvement in the adoption process. For example, the Children's Home Society, which handles 275 to 290 cases at any given time and receives $2 million a year to recruit and train potential adoptive parents has worked to make the process more efficient and parent-friendly.

The agency's overall statistics underscore the improvements. Between July and December 2005, the agency finalized 128 adoptions. Of those, the agency completed 48 percent of adoptions by foster parents; 33 percent of adoptions by recruited families, and 22 percent of adoptions by relatives in less than six months. The agency beat the statewide average in all three areas.

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The Johnson's adoption is one example of the positive changes to the system. Edna and Steve Johnson had been fostering troubled teens for eight years and were in the process of preparing 17-year-old John for life on his own when Edna had second thoughts. The teen had lived with them more than four years and was still in high school.

"I told my husband, 'That isn't a good idea. He's going to suffer out there,'" said Edna Johnson, 62. "He wasn't ready. In my heart I couldn't let him go out there." So the Johnsons, who have six grown children of their own, asked John if he wanted them to adopt him. The process took three months and was complete around Thanksgiving, just a few months before John reached his 18th birthday.

By comparison, prospective parents trying to adopt in the past had to wait months to get into the required 10-week parenting course and months more for their adoption workers to complete criminal background checks, in-depth studies of their home and

other paperwork. Foster parents had to fill out redundant paperwork to adopt.

Besides procedural changes, Levy said changes in law and in philosophy at Children's Home Society have helped to move some children into permanent homes faster. For example, a married person can now adopt as a single individual. That becomes particularly important if, for example, a grandmother is raising her grandchildren but is separated from her spouse. In the past, she couldn't adopt the children unless the spouse agreed or the couple divorced.

Also, foster parents now are given first consideration if a child who has been in their care for six consecutive months becomes available for adoption. Before, a relative could challenge the foster parents' right to adopt.

And now in Palm Beach County, abused, neglected or abandoned children who are not legally available for adoption but are likely to become so soon can be placed with foster parents who are interested in adopting. Currently, about 20 potential adoptive families in Palm Beach County fit that profile.

4. The Ability to Terminate Contracts

A second benefit of the privatization effort in Florida is the termination of contracts with problematic foster care providers. For example, according to a report by the *Sun-Sentinel*, the nonprofit agency that now runs foster care in Broward County, Child-Net, is getting serious about "accountability" when it comes to overseeing contracts. Child-Net officials have terminated a contract with Brown Schools Foundation, a firm with a poor track record that is now running a group home for girls. They are also reconsidering another contract with a firm that operates a similar program for boys with serious behavioral problems. The group has also closed 200 foster homes in the county.

The nonprofit has taken a harder line than the approach of Child-Net's predecessor, the Florida Department of Children and Families. DCF often re-negotiated troubled contracts. But, according to the *Sun-Sentinel* that was the promise of "community-based care," the privatization concept that removed foster-care and other child-welfare services from a ponderous state bureaucracy and placed them in the hands of a more responsive, locally influenced agency.

Texas will follow Florida's lead and move toward privatizing most child welfare services in the state. San Antonio has been selected as the first region to lead the state in privatizing child welfare services. The state of Texas plans to turn over all foster care and adoption management to local nonprofit groups by 2011.

The San Antonio operation, which would be fully functional by the end of 2007, will be the regional center for 27 counties. The San Antonio plan is the first part of a five-year rollout that envisions freeing up Child Protective Services to concentrate on investigating and repairing domestic situations before it becomes necessary to remove children from homes, said Darrell Azar, Department of Family and Protective Services spokesman.

The plan was authorized by the legislature in Senate Bill 6, passed in 2003, which laid out reforms for the state's Child and Adult Protective Services programs. An independent regional administrator will oversee a private network to care for children in state custody, overseeing their placement in foster homes, emergency shelters or treat-

ment centers.

Rep. Carlos Uresti, D-San Antonio, said that more than 70 percent of foster care in Texas has already been successfully privatized. The reform plan will complete that transfer and slowly extend it to case management. "Once the child has been removed from the family, then the private provider will take charge from that point forward," Uresti said.

In 2006, Missouri also moved toward privatized child welfare services. Hundreds of additional foster children in St. Louis and across Missouri will have their cases managed by private agencies.

Missouri state officials have created new financial incentives and sanctions that will help move children to permanent homes more quickly. This approach also rewards agencies that are able to reduce the rates of foster children being abused or returned to state custody. A total of 1,900 new cases will fall under private oversight, up from about 1,300 currently, according to Deborah Scott, spokeswoman for the Missouri Department of Social Services. Of the 1,900 cases, 1,260 are in the St. Louis area, she said.

Sheila Tannehill, of the Missouri Children's Division, said Missouri modeled its private contracts after states like Illinois, where privatization has been credited with helping reduce the number of children in foster care. Tannehill said a key feature of the new private contracts is that they demand results. The St. Louis contracts, for example, require 32 percent of foster children be moved to permanent homes each year. In the past, Tannehill said, private contractors were essentially paid only on the number of children served, not on how well they served them. Now, agencies can have their contracts severed if they fail to meet goals. Those that move children into permanent homes quickly could gain financially.

Under the plan, an agency continues receiving payment for a child for the duration of the one-year contract even if the child has already found a permanent home. That provision seeks to discourage agencies from keeping kids in foster care solely so they can continue receiving a payment.

Before the new contracts were awarded, about 10 percent of the state's 11,000 foster children were under private oversight. Missouri also uses a model of a lead agency partnering with local subcontractors. According to the *St. Louis Post Dispatch,* agencies receiving new contracts in the St. Louis area are:

Missouri Alliance for Children & Families, which will have 525 total cases. Agencies that will provide services under this proposal are Missouri Alliance, Boys and Girls Town of Missouri, Edgewood Children's Center, Missouri Baptist Children & Family Ministries, Presbyterian Children's Services and Evangelical Children's Home.

Catholic Charities, Archdiocese St. Louis, which will have 210 total cases. Agencies to provide services under this proposal are Catholic Charities, Catholic Services for Children and Youth, Lutheran Children and Family Services, Our Little Haven and Bringing Families Together.

Children's Permanency Partnership, which will have 525 total cases. Agencies under this proposal are the Family Resource Council, Epworth Children and Family Services, Youth In Need and Urban Behavioral HealthCare Institute.

Emerging Issues

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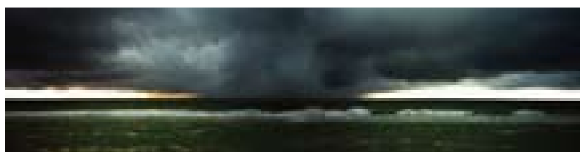

A. Rebuilding After a Disaster: Policy Strategies to Speed Recovery

The extensive devastation wrought by Hurricanes Katrina and Rita in the fall of 2005 will be felt along the Gulf Coast for years to come. In response to the daunting challenge of rebuilding hurricane-damaged areas, Reason developed a set of policy strategies to assist state and local governments in their disaster recovery efforts. While the recommendations in the following sections were developed specifically for the Gulf Coast, they are broad enough to form a useful policy framework that can be applied in other areas in dealing with future hurricanes and other natural disasters.

1. Introduction

Significant investment and time will be needed to rebuild infrastructure and key services in the wake of Hurricanes Katrina and Rita. There is so much devastation and need that a traditional response will not be adequate. Rather, policymakers will need to employ innovative strategies to encourage public-private partnerships and introduce private capital to get the Gulf Coast up and running again quickly.

Perhaps one of the best responses to natural disasters was the response from California Gov. Pete Wilson to the Northridge earthquake in Los Angeles in 1994. One of his administrations finest achievements was the reconstruction of Interstate 10—a project that was estimated to take more than two years was completed in two months and two days after Wilson invoked emergency powers.

Indeed, in a recent *Wall Street Journal* editorial Gov. Pete Wilson offered some sage advice to governors on how to cope with reconstruction needs. In California, Wilson used the broad emergency powers conferred to him to dismiss onerous rules and regulations, in effect bypassing procedural hurdles to get construction up and moving. Second,

the governor used incentives to get contractors to accelerate their performance. Contractors who submitted bids had to agree not only to the cost, but the completion date as well. Furthermore, the contract called for stiff fines for every day the contractor was late, and equally large bonuses for early delivery. As the governor notes, "the winning bidder, C.C. Myers, Inc., put on three shifts that worked 24/7…Myers made more on the bonus than they did on the bid." Wilson adds that the additional investment was well worth it given the restoration of critical infrastructure years before it otherwise would have been completed.

Throughout history the free market has proved itself to be a more vigorous builder of economies and infrastructure than government. Harnessing that vigor can help rebuild the Gulf Coast, and give governments an opportunity to shed unproductive assets while helping to jumpstart the recovery process.

2. Regulating for Recovery

Regulations typically arise to deal with problems where markets have failed, or from political pressure to benefit certain parties by reducing competition, or from attempting to alter people's behavior. Regulation is also popular for imposing an order and certainty onto free markets that many find desirable.

Like all policy instruments, regulations embody tradeoffs. They may effectively resolve a problem, but give rise to new problems or to unintended consequences. To decide if regulation is the right answer, you must look at the tradeoffs between the solution and all of its consequences.

During recovery from Hurricane Katrina, states and local governments should look particularly hard at those tradeoffs. Regulations that may have been viewed as desirable or even a necessary evil during normal times may be an undue or unbearable burden during recovery and rebuilding.

Regulatory changes for officials to consider include:

Develop a Performance-Based Fast Track Contracting System. This will help state and local government get key infrastructure rebuilt much more quickly. When the 1994 Northridge earthquake resulted in the collapse of two bridges on the Santa Monica Freeway, the world's busiest, it was estimated that it would take from nine months to two years to open the damaged sections of the roadway if the bridge repairs were to go through the normal bidding process. The estimated cost to the local economy: $1 million to $3 million a day. To speed up the process the state transportation agency streamlined procurement requirements and offered substantial performance incentives and penalties to the contractor: a $200,000-per-day bonus for completing the project ahead of schedule and a $200,000-per-day penalty for each day the project was behind schedule. The financial incentives resulted in the overpasses being replaced in a little over two months—74 days ahead of the deadline. The $13.8 million the contractor received in performance bonuses was more than offset by the estimated $74 million in savings to the local economy and $12 million in contract administration savings thanks to the shortened schedule.

Suspend Licensing Requirements for Construction Trades. Usually after a disaster there is increased pressure to allow only local licensed construction workers to help the rebuilding. But this only provides great benefits to local licensed construction workers

and great harm to local residents who want to rebuild. Certainly, enforcing rules against fraud and criminal behavior, and helping residents know what to look for in picking someone to work on their house or business becomes much more important when customers are desperate to rebuild. But restricting the supply of workers is even worse and dooms many to wait. For businesses such delays are often fatal. Residents have to be trusted to look out for their own welfare and make what deals are sensible to them, with reasonable help, not a heavy regulatory hand, from government.

Streamline the Building Permit Process. Building review and permitting processes are notoriously slow and cumbersome. Contractors deal with them all the time and learn to live with them, but after a disaster thousands of residents find themselves having to deal with the permitting system and its frustrations.

There is little evidence that building fees and permits have a significant impact on the quality of work and compliance with local codes. Direct inspections for code compliance, with direct punishment for infractions, regulate outcomes rather than inputs and are far more effective. Permit requirements should be limited to ensuring compliance with zoning laws and other such broad community concerns.

To help speed up rebuilding, local officials should modify the permitting system to:

- Eliminate the requirement for building permits for construction activity that creates no significant health or safety risk.
- Simplify issuance of building permits for major construction projects by allowing general contractors to obtain a "master building permit" for structural, electrical, heating and cooling, plumbing, and wrecking work.
- Allow employees and agents to apply for building permits.
- Allow owners of residential and commercial buildings to secure building permits for construction work to be done by their employees or by subcontractors that the owners hire.
- Enhance consumer protection by increasing the city's ability to police illegal contractors and contractors who violate building code provisions.
- Consolidate development review guidelines and develop performance goals and measures with a citywide project-tracking database.
- Create a portal for electronic plan submission and review.

3. Capitalizing Unused Assets to Pay for Recovery

The experience of other governments shows that leveraging the value of the portfolio of state-owned assets can generate significant capital to help with rebuilding efforts. Furthermore, asset sales are also a long-term benefit as well by reducing state expenditures on maintenance while increasing the tax base. Put simply, divesting an unneeded asset is attractive for a variety of reasons.

First, asset divestiture typically results in a lump-sum payment of cash, providing much-needed resources in this time of cutbacks.

Second, divesting state-owned real estate increases the tax base. State-owned lands do not pay property taxes nor do they typically produce sales and income taxes. Moreover,

in constrained real estate markets with limited developable land, state-owned property represents a desperately needed source of capital for private economic activity.

Finally, systematically reviewing the state's assets portfolio and divesting the state of those assets which are not deemed to be most efficiently owned by the state will result in lower maintenance and operations costs, and, hence free money for other priorities. Divesting an unneeded property rids the government of an unproductive asset that saps resources. Selling this deadwood streamlines government service.

State asset sales and realignment can take a variety of forms. In some cases, government entities sell real property outright, in either an "as is" or "entitled" state (having secured necessary zoning approval). In other cases, these transactions are established (particularly for enterprises like a golf course or other fee-generating facility) as a long-term franchise agreement or concession. Still in other cases, such as state-owned buildings, asset realignment includes sale-leasebacks, where the private sector purchases the property for a fixed price and agrees to lease back the facility to the government entity for an agreed upon period of time. Importantly, the state receives a lump sum cash payment in all three scenarios.

A review of assets that could be divested in California netted an interesting find including several billion dollars worth of assets. While other states may not generate the same findings, similar types of properties may offer some potential to Gulf Coast states. Those include:

- Unused or underutilized portions of state correctional facilities, state universities, and state hospitals, particularly in high-growth areas;
- State-owned parking garages;
- State-owned transportation right of way;
- Old or obsolete state-owned buildings in high-value urban commercial real estate markets (shifting located services to leased facilities funded through sale proceeds);
- State-owned maintenance yards and facilities;
- Obsolete or unneeded armories; and
- Developable parcels of state-owned vacant land (does not include conservation lands, trust lands, etc.).

It is important to note that in most cases the properties identified for potential disposal in California provided no direct benefit to the delivery of state programs. For instance, huge buffers exist around state correctional facilities and hospitals. Where once these facilities were located in largely remote areas with low property values, explosive growth has brought both population and commerce into these regions and property values have skyrocketed. What was once a relatively worthless piece of buffer land has become high-value developable land in a housing-starved region. The facilities can continue to operate with smaller buffers.

In other words, the state generated over $23 million more than anticipated through the sale of two parcels of state-owned land.

Other government entities across the United States can confirm the opportunities derived from state asset sales. In June of 2003, the Arizona Land Department generated $51.2 million through the sale of two parcels of land, even though the properties appraised for $27.9 million. In other words, the state generated over $23 million more

than anticipated through the sale of two parcels of state-owned land.

In another illustration, Orange County, California raised more than $300 million through real asset sales and sale leasebacks over the course of 18 months to help recover from collapse into bankruptcy in 1995. In New York, the Empire State Development Corporation also generated hundreds of millions of dollars in revenues through sales and leasebacks of state-owned properties including the New York Coliseum, state mental health campuses, parking lots, armories, and state-owned golf courses. In one of its first sales, New York divested a state-owned golf course for more than $3 million.

In addition, states should be careful not to disregard buildings and facilities that are being used. These assets can also be leveraged through a variety of approaches. For instance, state office buildings, particularly older buildings in higher cost regions, can be sold and replaced with build-to-suit lease facilities in other regions where commercial real estate costs are lower. Additionally, this may enable the program to acquire better, more modern facilities at lower cost.

4. Innovations for Public Buildings and Schools

The Gulf Coast should focus on creating new schools. Chester Finn from the Fordham Foundation has proposed using chartering and contracting to help states quickly build new schools. Governors could put out a bid for proposals to new school leaders. Over the past decade and a half, the charter school movement has been developing expertise in building schools from scratch. Existing school networks—such as KIPP, Aspire Public Schools, Achievement First, Edison, etc. could quickly set up autonomous school networks.

Public-private partnerships offer a proven mechanism to speed up new school projects and manage their costs. During recovery from Katrina, PPPs can help get schools back on line.

According to the Heritage Foundation's Ron Utt, Section 422 of the Economic Growth and Tax Relief Reconciliation Act of 2001, gives local governments across the country "the opportunity to build public school facilities faster, better, and at lower cost by forming public-private partnerships with qualified real estate investors and developers. Under this approach—pioneered in England, Scotland, and Nova Scotia, as well as in the states of Florida and Texas—public school systems can now form partnerships with private-sector investors who fund the construction of public school buildings and lease the facilities to public school systems at annual costs that are below the costs that communities would incur if they built the schools on their own."

To the utmost extent schools should be built with public-private partnerships. Perhaps one of the best and brightest examples of the potential to be harnessed through private enterprise comes from the District of Columbia Public Schools (DCPS). In December 1999, DCPS entered into a unique partnership with LCOR, a firm specializing in developing and managing facilities, to rebuild the James F. Oyster School. The new school will replace the deteriorating 73-year-old school in the Woodley Park neighborhood of Northwest Washington. LCOR will build the new school in exchange for excess land on which a new privately owned 211-unit apartment building, named the Henry Adams House, will be located.

The new school is the first new pub-

lic school built in the District in 20 years. The current school has a leaky roof, does not have a cafeteria or gym, and cannot be wired for computers. The new school will be twice the size of the old one and will have a gym, kitchen, cafeteria, and common space.

A creative financing structure, made possible through the partnership, helped make the new school possible while realizing the value of an undervalued asset, the school's excess land. The new school is being financed by an $11 million, 35-year tax-exempt bond issue underwritten by Paine Webber. The bonds will be retired by means of PILOT (Payment in Lieu of Taxes) payments made by the private owners of the Henry Adams House project. Under the unique PILOT program, the apartment building owners will make these payments in place of real estate taxes.

The unique financing structure has brought these projects to fruition with little or no cost to the taxpayers—truly a win-win situation.

The partnership has brought a much-needed new school, as well as housing, to the D.C. area. Most importantly, the unique financing structure has brought these projects to fruition with little or no cost to the taxpayers—truly a win-win situation.

D.C. school officials started out skeptical but eventually got behind the project when the benefits became obvious. Mary Filardo, former head of the Oyster PTA, said after she helped arrange the deal: "It is important for other communities to do what we have done."

5. School Funding Vouchers or Tax Credits

On September 15, 2005, President Bush proposed $1.9 billion in funding for displaced students. According the White House fact sheet from the President's Katrina Recovery speech, "This funding would be used to reimburse school districts for the unexpected costs associated with educating additional children for the 2005-06 school year, such as teacher salaries, transportation, materials and equipment, special services for children with disabilities, supplemental educational services, and counseling. To ensure that displaced families have maximum flexibility to meet the education needs of their children, the President's proposal would provide compensation to displaced families for enrollment in private, including parochial, schools."

President Bush's proposal would allow the money to follow the child into any school. This model follows the federal funding model for college students. According to Clint Bolick, writing in a September 15th *Washington Times* editorial, the 73,000 college students displaced by the storm can use their federal aid anywhere, at public, private or religious schools. Following President Bush's lead and using the college system as a model, the funding for each displaced K-12 student in the Gulf Coast should follow that child into any public, private or charter school.

Gulf Coast governors possess broad emergency powers. State per-pupil funding was already appropriated for education before the hurricane struck. Governors should use their emergency authority to ensure that the funds will follow the children to whatever schools—public, private or charter—that can quickly enroll children. The per-pupil spending average should follow each child into the school of his or her parents' choice. There are three strategies governors could

employ to offer displaced children more permanent choices and school placements.

First, states could move from an enrollment system based on residential address to a true open-enrollment system with a weighted student formula funding mechanism. States could adopt the decentralized school management system that was pioneered in Edmonton, Canada by superintendent Mike Strembitsky in 1976. Strembitsky developed the weighted student formula (WSF), also known as student-based budgeting, in which each student receives an allocation—weighted according to his or her specific needs—that follows the student all the way to the school. Families are free to choose any public school, and principals have a great deal of discretion over their school budget, which is an aggregation of all the individual student allocations. In the Seattle system, for example, students are assigned "weights" for supplementary funds for categories such as poverty, limited English proficiency, and special education.

A crucial component of decentralized management is to adopt a user-friendly method of school choice, in which parents may choose to send their child to any school within the state without seeking permission from the central office.

A crucial component of decentralized management is to adopt a user-friendly method of school choice, in which parents may choose to send their child to any school within the state without seeking permission from the central office. Decentralized management is a growing trend in the United States. To date the WSF has been implemented in Cincinnati, Houston, St. Paul, San Francisco, Seattle and Oakland. In 2006 it is being implemented statewide in Hawaii and pilot programs are underway in Boston, Chicago, and New York City. A weighted student formula would allow any state school to accept students and to be paid based on the individual characteristics of students.

Secondly, states could create a corporate tax credit scholarship to offer scholarships to displaced students who want to attend or remain in a school of their choice. This program could be modeled after the Florida corporate tax credit program. In Florida the corporations that donate to Scholarship Funding Organizations (SFOs) are entitled to a tax credit on the Florida corporate income tax (Florida has no personal income tax) equal to the amount of their donations, up to $5 million per corporation per year. SFOs use this money to fund scholarships to allow low-income students (those participating in the federal free and reduced lunch program) to attend private schools (religious or non-religious), or to fund transportation to another public school. The private-school scholarship is equal to $3,500 or the total tuition and fees of the private school, whichever is less; the funding for transportation to attend another public school is equal to $500.

The third option is that governors could create a statewide voucher program modeled after the Ohio statewide voucher program. Gov. Robert Taft (R) recently signed into law a new program providing scholarships for students in low-performing schools. Beginning in fiscal year 2007, up to 14,000 students will be awarded scholarships ranging from $4,250 to $5,000 to attend private schools. Gulf Coast governors could create a similar type of voucher program for displaced students, allowing $5,000 to follow each child into the school of his or her

parents' choice.

B. Foreign Management of U.S. Infrastructure

Numerous U.S. ports, airports, roads, and water facilities are already run by foreign businesses

The Dubai Ports controversy in early 2006 launched a firestorm over what kinds of infrastructure critical to national security should be privately operated, particularly by foreign firms. A recent *USA Today/CNN/* Gallup poll showed that around 66 percent of Americans opposed the proposed transfer of six major U.S. port operations to Dubai Ports World, a United Arab Emirates firm, viewing the deal as a national security threat.

It is interesting how foreign involvement in international ocean-borne shipping has generated so much hostility, given that we have long since come to rely on products made by foreign companies that much more directly affect our health and daily lives. Every day, Americans drive foreign cars, drink water distributed by foreign-owned water systems, strap their children into foreign-made car seats, and take medicines made by companies from around the world.

Presumably, most people's fears regarding the port controversy are based on two prevalent myths: (1) there is a greater risk of a security breach when American infrastructure assets are owned by foreigners, and (2) under such a scenario, foreign companies are responsible for the security of critical assets. However, what was often lost in the ports debate was that the Dubai firm was not "buying" the port facilities themselves; they would have simply leased certain terminals at the ports and provided management and logistics services. The ownership of the ports would have remained in domestic hands. In addition, foreign firms are subject to the same legal and regulatory security requirements as any domestic firm or public agency. In the ports deal, the U.S. Coast Guard and the U.S. Bureau of Customs and Border Protection—not Dubai—would have had the primary responsibility for port security.

Setting aside the hyperbole and fears generated during the ports debate, the controversy presents an opportunity to provide a sense of perspective on the foreign management of domestic infrastructure and related national security concerns.

Reality Check: Foreign Firms Already Manage Critical Infrastructure

Many of the critical infrastructure assets that Americans rely on in their everyday lives—including such important assets as airports, highways, and water systems —are managed by private, foreign companies.

Consider the example of Indiana, in America's heartland. Every day, citizens in Indianapolis drink and brush their teeth with tap water provided through the nation's largest public-private water partnership with a domestic subsidiary of a French-owned company, Veolia. Thousands of Hoosiers catch flights at Indianapolis International Airport, an airport entirely managed by a subsidiary of a British company, BAA plc. And families traveling through northern Indiana may choose to drive on the Indiana Toll Road, which may soon be leased to a consortium that includes Spanish and Australian firms.

Indiana is not unique. Here's some perspective on the foreign operation of infrastructure assets and related security issues throughout the United States:

Ports

Foreign companies already own most of the infrastructure used in the domestic shipping industry, including vessels, containers, handling equipment, and port facilities. Approximately 80 percent of U.S. port terminals are leased and operated by foreign companies, largely because federal law requires U.S.-based shipping companies to use American crews, making these firms less competitive.

- For example, 80 percent of the terminals at the nation's busiest cargo port, the Port of Los Angeles, are run by foreign companies (see below).
- Six of seven companies that operate terminals within the Port of New York-New Jersey are foreign-owned.
- At the Port of Houston, the British firm Peninsular & Oriental Steam Navigation Co. (the firm being acquired by Dubai Ports World) handles freight at several public terminals. Inchcape Shipping Services, the world's largest private shipping manager which was recently acquired by a UAE investment company, also has had a long-time presence in Houston.
- At the Port of Boston, P&O Ports, a wholly owned subsidiary of Peninsular and Oriental, and the Massachusetts Port Authority have teamed up to operate the Black Falcon Cruise Terminal.
- P&O Ports is also a 50 percent joint venture partner in Delaware River Stevedores (DRS), which provides stevedoring and terminal services in Philadelphia, PA, Camden, NJ, and Wilmington, DE.
- At the Port of Baltimore, APM Terminals, a division of the Danish A.P. Moller-Maersk Group, operates a private container terminal within Dundalk Marine Terminal. C. Steinweg (USA) Inc., a division of Dutch company C. Steinweg Handelsveem B.V., operates the Baltimore Metal & Commodities Terminal Inc. Terminal. Wallenius Wilhelmsen Logistics, a company born of a merger between a Swedish firm and a Norwegian firm in 1999, operates the Mid-Atlantic Terminal. Finally, Ceres Terminals Incorporated, of Japanese firm NYK, currently provides service at cruise terminals in Bayonne, NJ, Brooklyn, NY, and Baltimore, MD.
- Foreign interests or their subsidiaries operate container cargo terminals at seven of the 10 busiest container cargo ports in the United States.
- Neptune Orient Line, which is 68 percent owned by the Singapore government, bought U.S.-based APL Limited in 1997 and now operates terminals in Los Angeles, Oakland, Seattle, and Alaska.
- Yang Ming Marine Transport Company, which is partially owned by the Taiwanese government, operates terminals in Los Angeles and Tacoma.
- Cosco Container Lines, a division of China Cosco, is owned by the Chinese government and operates a terminal at Long Beach.
- A.P. Moeller-Maersk, a Danish company, is the largest terminal operator in the United States and owner of the world's largest shipping fleet. It operates terminals at the ports of Miami-Dade and Jacksonville, among others, and owns APM Terminals NA, which is building a $500 million private container terminal in Portsmouth, Virginia, scheduled to open next year.
- At Norfolk, Virginia, Ceres Marine

Terminals Inc. is one of the major stevedoring firms and is owned by Japanese shipping firm NYK Line. Norfolk is the U.S. headquarters of French shipping line CMA-CGM Group and Israeli shipper Zim-American Israeli Shipping Co.

- According to Dennis Rochford, president of the Maritime Exchange for the Delaware River and Bay, of the 2,700 ships that pass through the ports of Camden (New Jersey), Philadelphia, and Wilmington along the Delaware River each year, 2,500 are foreign.

It is important to note that the ownership of U.S. ports remains squarely in the hands of local port authorities, and the responsibility for security at these ports lies not with the private companies that operate them, but with American security officials, including the U.S. Coast Guard, the U.S. Bureau of Customs and Border Protection, port police, and local authorities, among others. In fact, every domestic port and terminal operator—foreign or domestic—is required to comply with the 2002 Maritime Transportation and Security Act and submit a security plan to the Coast Guard for approval.

Airports

Of the 517 domestic airports offering commercial passenger flights, 13 have management contracts with private companies, and all of these companies have significant foreign ownership or involvement. For example:

- Indianapolis International Airport is now the largest privately managed airport in the United States and is under a long-term management contract with BAA Indianapolis LLC, a wholly-owned subsidiary of BAA plc (the privatized British Airport Authority). BAA plc also holds medium-term retail management contracts with Pittsburgh International, Boston Logan International, and Baltimore/Washington International airports.
- International Terminal 4 at New York's John F. Kennedy International Airport is operated under a long-term concession deal between the Port Authority of New York and New Jersey and a consortium that includes Amsterdam's Schiphol Airport, which is a corporation run by the Dutch government.
- International Concourse E at Atlanta's Hartsfield International Airport is managed by a domestic subsidiary of TBI plc, a British airport management company. TBI also provides ramp control at four of Hartsfield's six ramps and manages the Airport-wide Flight Information Display System.
- TBI also manages both the international and domestic terminals, develops additional air service, and provides ground handling and cargo services for Central Florida's Orlando Sanford International Airport. TBI additionally provides total airport management services at Burbank's Bob Hope Airport.
- AvPorts, a domestic subsidiary of the Australian-owned Macquarie Infrastructure Company, provides management and operations services at Albany International Airport, Atlantic City International Airport, Tweed-New Haven Regional Airport, and Westchester County Airport.
- Stewart International Airport, located north of New York City, operates under a 99-year lease to the U.S. subsidiary of the U.K.-based National Express Group, PLC.

Like security at seaports, security at

airports is controlled by the federal government. The responsibility for baggage and passenger screening at all of these airport facilities is the responsibility of the Transportation Security Administration—not the companies that hold the management contracts.

Water and Wastewater

Out of approximately 54,000 publicly owned water and wastewater systems, over 2,400 (5 percent) of them contract with private firms to provide system operations and maintenance services. Many of these 2,400 contracts are held by domestic firms with a foreign parent. For example, Veolia Water, the U.S. subsidiary of a French firm, serves more than 600 communities and 14 million people through public-private partnerships with local governments, including the nation's largest water partnership in Indianapolis. Of the four largest water companies that provide operations and maintenance services to publicly owned water and wastewater systems in the United States, only one—OMI—is a domestic company.

In addition, 15 percent of the U.S. population is served by approximately 20,000 private, regulated water and wastewater utilities, including many small systems serving subdivisions or trailer parks. Most of these are owned by domestic subsidiaries of foreign firms.

Regardless of size or scale, the private firms—both foreign and domestic—that provide water and wastewater services to local governments and communities are subject to the same environmental and safety regulations as publicly managed utilities, and all fall under the regulatory supervision of federal, state, and local governments.

Highways

Though increasingly common in Europe and other parts of the world, the phenomenon of privatized highway infrastructure is relatively new in the United States. But it is a rapidly growing trend here, as state and local governments discover they can provide vastly improved services for residents thanks to private capital and private-sector management and operations expertise. While there are few privately operated highways, many of these are managed by foreign-owned companies. For example:

- In 2004, the city of Chicago leased the 7.8 mile Chicago Skyway to the Australian-owned Macquarie Infrastructure Group and Spanish-owned Cintra Concesiones de Infraestructuras de Transporte S.A. for 99 years at a cost of $1.8 billion.
- The same firms were selected as the preferred bidder for the 75-year, $3.85 billion lease of the Indiana Toll Road. This deal is pending approval by the Indiana legislature.
- Cintra is the majority interest in the consortium that won the $7.2 billion bid to design, build, and operate the first Trans-Texas Corridor (TTC-35).
- Macquarie holds long-term concessions to operate the Dulles Greenway toll road in Virginia, the Foley Beach Expressway in Alabama, and the SR-125 toll road under construction in San Diego, among others. Macquarie was also selected by the Oregon Department of Transportation to build up to three toll roads in the Portland area.
- The Australian firm Transurban is part-

nering with U.S.-based Fluor on projects to add high occupancy toll (HOT) lanes to the Capital Beltway (I-495) and along the I-95/I-395 corridor in Virginia.

Protectionist Legislation Introduced

Amid the Dubai Ports hysteria, politicians lined up to take advantage of public fears by introducing a flurry of protectionist bills. The "National Defense Critical Infrastructure Protection Act of 2006" (H.R. 4881), introduced by Rep. Duncan Hunter (R-CA), chairman of the House Armed Services Committee, is one such piece of legislation. The bill would prevent non-U.S. companies from owning, managing, or operating any system or asset that is included in a list of critical infrastructure to be prepared by the Departments of Defense and Homeland Security.

Exceptions may be made if certain officers and directors are American citizens and have been "approved" by the government, a majority of the company's shares are owned by Americans, and other requisite hoops have been jumped through. Moreover, the aforementioned critical infrastructure list would include "any system or asset, whether physical or virtual, that is so vital to the United States that the incapacity or destruction of such system or asset would have a debilitating effect on national security, on national economic security, on national public health or safety, or on any combination of those matters." In other words, the government would have the power to prohibit foreign ownership of pretty much anything it wants.

Free Trade, or Protectionism Debunked

There have been a number of attempted justifications for trade protectionism through the years. Most have focused on the myth that trade impoverishes one party or the other. Of course, free trade enriches both parties to the transaction, or else we would all grow our own food, build our own cars, and make our own computers from scratch. The most recent attack, thrown about in the wake of the Dubai Ports deal, is that it can threaten national security. Desperate cries of "national security" have robbed Americans of many other rights and liberties already.

Is Free Enterprise Next?

The nationalism and protectionism at the heart of the discontent over the Dubai Ports deal is the same kind of thinking that leads people to conclude that the entire agricultural industry must be home-grown and that we must harvest our own food for national security. Despite significant protectionist barriers in the United States and elsewhere, Americans nonetheless are perfectly safe in eating food from all over the world, abundantly available in grocery stores and restaurants across the nation.

The nationalism and protectionism at the heart of the discontent over the Dubai Ports deal is the same kind of thinking that leads people to conclude that the entire agricultural industry must be home-grown and that we must harvest our own food for national security.

Competition, whether local or international, leads to a greater variety and quality of goods and services (thus increasing consumer choice) and lower prices for consumers. This competition should be embraced rather than stifled and micromanaged.

Of course, for politicians and government bureaucrats, it is not about economic

efficiency or consumer welfare; it is about control. Politicians have an interest in perpetuating an "us-versus-them" attitude because it allows them to advance agendas and score political points.

The ubiquitous "them" is ever-changing, shifting with the fears and politics of the day. During the 1980s, it was the Japanese who were "taking over America" as Japanese companies made significant investments in the United States. In the late 1990s, China Ocean Shipping Co. (COSCO) wanted to build a $200 million container terminal at the Port of Long Beach until there was a public outcry and Congress passed a bill scuttling the plans. After a terminal at the port was later vacated by another tenant, however, Cosco was able to take it over and operate at Long Beach. More recently, there was similar hysteria when China National Offshore Oil Corp.'s subsidiary, CNOOC Ltd., made a bid to buy Unocal. Now that Arabs are the political boogeyman of the moment, the Dubai Ports deal has attracted the wrath of the powers that be.

The Dubai Ports Deal and the United Arab Emirates

Protectionist fears of the Dubai Ports World deal are even more ridiculous when one considers the nature of Dubai Ports and the U.A.E. Fears of Arab terrorists infiltrating U.A.E.-owned businesses to launch attacks on America are unfounded and borne out of fear and a lack of knowledge about the U.A.E. According to the Heritage Foundation's 2006 Index of Economic Freedom, the U.A.E. rates "mostly free," placing slightly below Mexico and Peru; slightly above Bolivia, Malaysia, and Thailand; and significantly higher than "mostly unfree" nations such as Russia, India, Turkey, Argentina, or "War on Terror" partner Pakistan.

Add to this the fact that, according to the State Department, "The U.A.E. has been a key partner in the war on terror after September 11, 2001." (Tellingly, the U.S. Navy has no qualms about using the U.A.E. port of Jebel Ali, also operated by Dubai Ports World, for warships such as the USS John F. Kennedy.) The point is that the U.A.E. is a relatively economically liberalized nation—and one of the most liberal, pro-Western states in general in the region—run by wealthy businessmen not intent on destroying relations with a significant trading partner.

Incentives Matter

Even if a foreign company was not from a nation on such good terms with the United States as the United Arab Emirates, this does not mean there should be cause for alarm. Businesses exist to make money in exchange for the goods and services they provide. Allowing terrorists to compromise security and attack your customer base is simply not good business practice. If there is a possibility of such an occurrence, businesses have a strong incentive to do whatever is necessary to prevent it from happening.

This becomes a little more complicated when the business is not entirely private, but owned (in part or total) by a government. In the case of Dubai Ports World, the company still operates in a very competitive market and its efficiency has led to a history of growth and success. The successful completion of the purchase of P&O would have made it the third-largest port operator in the world, with 51 terminals in 30 countries. Thus, there should have been little, if any, cause for concern.

Conclusion

There has been a great deal of paranoia surrounding the Dubai Ports deal. Contrary to public fears, federal and local government agencies would still have been in charge of enforcing security measures; the company would merely operate certain terminals at the ports, not own the ports themselves; and the people operating the ports would be substantially the same. The vast majority of port terminals in America are already operated by foreign businesses.

Private companies, even foreign-owned companies, have successfully owned and operated numerous "critical infrastructure" systems and assets in the United States—from airports to highways to water and wastewater plants—for many years. The country has managed to survive, indeed thrive, under these arrangements because these companies have a strong interest in keeping their customers healthy and happy and maintaining their business.

C. The Government Pension Crisis

Businesses and governments across the nation are finally starting to wake up to the reality of the coming pension crisis. While private-sector pension terminations and freezes, such as those by high-profile companies such as United Airlines, US Airways, IBM, Verizon, and Motorola, are grabbing most of the headlines, the situation is every bit as grave for government pension systems. It is time the government pension crisis gets the attention it deserves.

The steady trend in the private sector over the past 30 years has been a switch away from traditional, or "defined-benefit," pension plans in favor of 401(k)-style "defined-contribution" plans, in which both the employer and employee make annual contributions to a retirement fund that is controlled by the employee. This has allowed businesses to reduce retirement costs, increase the predictability of these costs, and/or attract workers who favor the portability and flexibility of defined-contribution plans. The public sector has, unfortunately, resorted all too often to blaming the stock market and trying to borrow its way out of debt, which will do nothing to solve the underlying funding problems. Increasing life spans, a trend toward earlier retirement, rising health care costs, and the coming retirement of the Baby Boom generation will only exacerbate these problems.

Government pension plans are swimming in red ink. As of April 28, 2006, the National Association of State Retirement Administrators and National Council on Teacher Retirement reported an aggregate unfunded liability of over $323 billion for the 103 pension systems and 127 total plans in its Public Fund Survey. A 2004 analysis by Wilshire Associates pegged the unfunded liability at as high as $366 billion. Moreover, new accounting regulations established by the Government Accounting Standards Board set to take effect in December 2006 will require governments to list as liabilities the full costs of retiree health care benefits, costs one expert has estimated at $1 trillion nationwide. The change will serve as a rude awakening to governments already struggling with high pension costs.

1. Case Studies

Pension funding problems are hitting state and municipal governments across the country:

San Diego

The city of San Diego is the poster child of pension mismanagement. San Diego is

now embroiled in its worst financial crisis ever with a $1.4 billion pension deficit and an estimated additional $1 billion liability for retiree health benefits. Pension costs threaten to consume as much as one-third of the city's day-to-day operating budget for the next fiscal year.

The financial mismanagement led *TIME Magazine* to name Mayor Dick Murphy one of the nation's three worst mayors, and eventually resulted in Murphy's resignation less than five months into his second term.

San Diego is currently the subject of numerous investigations. The FBI and the U.S. Attorney's Office (Justice Department) are probing city finances and looking into potential public corruption. The city's failure to properly disclose pension liabilities prompted a Securities and Exchange Commission investigation and led to the suspension of the city's credit rating. These federal probes have been going on for the better part of two years. In addition, City Attorney Michael Aguirre launched his own investigation and concluded that benefit increases in 1996 and 2002 resulted in the illegal underfunding of the pension system and violated the state's conflict-of-interest law. So far, eight former pension officials have been charged with criminal corruption by the U.S. Attorney's Office and District Attorney's Office.

Illinois

In Illinois, taxpayers face a $39 billion pension deficit, earning it the dubious title of worst pension shortfall in the nation by sheer dollars. Illinois seems to be illustrating the maxim that history repeats itself. During the 1980s, not even strong pension investment fund returns could make up for consistent underfunding of the pension system. In 1995, legislators passed a pension reform bill featuring a new payment schedule that would return the pension funds to an estimated 90 percent funding ratio by 2045. Since the state was then, as now, experiencing financial straits, the payment schedule was backloaded so that the plan would go into effect gradually. The 15-year "phase-in" period expires in 2010, when the state's commitment will be $3.8 billion. This is the reason pension costs are expected to explode in the future. By 2045, the required payment will balloon to an astounding $54 billion.

In the meantime, the state is finding it extremely difficult to make even its "phase-in" payments. Gov. Blagojevich and Democratic legislative leaders have agreed to contribute only $1.4 billion of the required $2.5 billion to the pension system in 2007. And what of the difference? In his budget proposal, Blagojevich has dedicated nearly all of the "savings"—nearly $1 billion—to new social programs.

West Virginia

The state of West Virginia faces a $5.5 billion pension deficit and an additional $3.3 billion in unfunded workers' compensation liabilities—a deficit nearly three times the state's annual $3.1 billion general fund budget. In June 2005, West Virginians wisely rejected a risky $5.5 billion pension obligation bond proposal.

Unfortunately, the politicians did not get the message. The West Virginia Teachers Retirement System makes up the vast majority of the pension deficit with an unfunded liability of $5 billion and ranks as the worst-funded public plan in the nation, with only enough assets to cover 22.2 percent of expected liabilities. Mounting liabilities

led to the closing of the teachers' defined-benefit plan (and replacement with a defined-contribution plan for all new hires) in 1991. Incredibly, the state has not learned its lesson. Earlier this year, after enabling legislation was passed by the state legislature and signed by Gov. Joe Manchin, the state's teachers voted to close the defined-contribution plan and return to the same kind of defined-benefit plan that got West Virginia into trouble in the first place!

California

In California, the state's teachers' retirement system (CalSTRS) now faces a shortfall of over $24 billion, and the state's combined contributions to the public employees' and teachers' plans now exceed $3 billion per year. The state was caught off guard by a rapid rise in its contribution levels. State contributions to the California Public Employees' Retirement System (CalPERS), the state's largest pension fund, rose from $160 million in 2000 to $2.6 billion in 2005.

Gov. Schwarzenegger's plan to address such volatile shifts in contribution levels and rein in pension costs by switching all new employees to a defined-contribution plan was scuttled in 2005 when labor unions argued that the language of the proposed ballot initiative could be interpreted to deny death and disability benefits to state public safety workers. Assemblyman Keith Richman (R-Northridge) introduced a constitutional amendment, ACA 23, to shift new state employees to a defined-contribution plan or a hybrid plan starting in July 2007, but the proposal was amended to maintain defined-benefit plans, albeit with lower benefit formulas, and add an optional defined-contribution plan that would match employee contributions up to 4 percent of the employee's salary. As of this writing, the proposal is still pending. Richman does not expect it to make it to the governor's desk, but has not ruled out turning the proposal into a 2006 ballot initiative.

2. The Problem of Political Incentives

In the public sector, politicians and bureaucrats have frequently blamed unfunded actuarial pension liabilities on factors outside their control, such as the stock market downturn that followed the "dot-com" boom of the late 1990s. While sagging returns certainly did not help pension investment portfolios, they account for a fairly small portion of the problem. It is the structural problems and set of incentives inherent to political management that need to be addressed if government pension systems are to be returned to sound financial footing.

One central problem is that public officials have incentives to put off debts like retirement benefits because the bills will not come due until they are long out of office. Fiscal restraint typically does not win elections; new government programs and goodies for the home district do. Business officials have certainly been guilty of putting off their pension debts as well. However, the problem is not as great in the private sector because it is much more difficult for businesses to avoid bankruptcy than for governments, and the vested financial interests of officers and shareholders provide them greater incentives to act to avoid the day of fiscal reckoning.

When capital gains taxes flooded state coffers during the late 1990s, state and local governments thought they had hit the jackpot. Pension fund investment returns were so great that governments didn't need to kick in much, if anything, to cover pension costs. During these flush years, many

governments took "contribution holidays," meaning they did not contribute at all to the pension system.

Some even took advantage of "excess" returns by issuing a "13th check" on top of normal monthly benefit distributions, sometimes in amounts greater than beneficiaries' regular monthly payments (though the systems do not ask beneficiaries to contribute a little extra when pension investment returns are lower than average). Unfortunately, governments assumed that these historic and extraordinary returns would continue indefinitely. When the bubble burst and the stock market inevitably corrected, governments discovered that they had to make up for all the payments they didn't make and all the "excess" disbursements they had made in years prior.

The sharp increase in tax revenues during the late 1990s had other impacts as well. Even after the stock market downturn had begun, governments could not resist the urge to spend the extra money that had accrued. Public employee unions, who often play a major role in politicians' election campaigns, wanted their piece of the pie, too. In California, the state and many municipal governments raised public safety workers' pensions from a "2 percent at 50" plan (whereby an employee with 30 years of experience could retire at age 50 with 60 percent of his final salary) to a "3 percent at 50" plan (allowing the same worker to retire with 90 percent of his final salary)—an increase of 50 percent! Other government employees also saw significant benefit increases. This at a time when workers in the private sector were seeing their benefits being scaled back.

Public pension systems have faced other problems too numerous to discuss in detail in this column. Consider the following partial list.

- Unrealistic actuarial assumptions, such as anticipated investment returns, can lead to a nasty shock when overly optimistic assumptions cause governments to underfund their retirement systems.
- Deferred Retirement Option Programs (DROPs), which allow employees near retirement to collect both a paycheck and their retirement benefits if they agree to work a few years longer, have often proven to be expensive perks.
- Pension obligation bonds, often sold to voters as a simple debt refinancing, are actually risky gambles, because if investment returns do not exceed the debt service on the bonds, often at least 6 percent, the government must make additional payments to make up the difference and ends up even worse off than before.
- Some government pension managers have made investment decisions based on political ideology, rather than trying to maximize returns. This raises fiduciary duty and conflict of interest concerns.

3. The Decline of Defined-Benefit Plans

Over the past quarter-century or so, the private sector has moved steadily away from defined-benefit pension plans. The number of defined-benefit plans has fallen significantly from 103,000 in 1975 to 56,000 in 1998. Over the same period, the number of private-sector defined-contribution plans has exploded, from approximately 208,000 in 1975 to 674,000 in 1998. According to the Pension Benefit Guarantee Corporation (PBGC), the quasi-governmental insurer-of-last-resort for private-sector defined-benefit

pension plans, the number of private-sector defined-benefit plans today has declined even further to roughly 31,000. Virtually no defined-benefit plans have been established in the private sector in the past decade.

Defined-benefit plans are not faring any better in the private sector than they are in the public sector, causing big problems for the PBGC. The PBGC reports that the total unfunded liability of private pension plans is over $450 billion, $108 billion of which is in plans sponsored by below-investment-grade rated companies. While the U.S. government is not required to insure the solvency of the PBGC, which currently has a $23 billion deficit in its single-employer pension insurance program, the expectation is that Congress would not allow tens of millions of voting Americans to be left without their promised retirement benefits. The result would likely be a bailout at least as great as that of the savings-and-loan crisis of the 1980s.

Virtually no defined-benefit plans have been established in the private sector in the past decade.

The PBGC was borne of the Employee Retirement Income Security Act of 1974 (ERISA), the same legislation that established the tax-deductible Individual Retirement Account (IRA). It was established largely in response to high-profile business failures such as the Studebaker Corporation in the early 1960s. Unfortunately, it has done little but taken the isolated tragedies of business failures and socialized them by placing the burden of paying retirement benefits from these failed companies on all taxpayers. As is often the case with government action, the cure is worse than the disease.

One of the major problems with the PBGC is that it has not been able to adequately address the inherent insurance risks. The premiums it charges participating employers is set by law and is significantly below the rates one would expect in a free market. In addition, while underfunded plans are supposed to pay higher premiums as a penalty for underfunding, the PBGC collects only a small percentage of these variable rate premiums due to loopholes and congressional bailouts offered to various industries, such as the steel and airline industries. The Bush administration and Congress have made (private-sector) pension reform addressing these and other issues a priority this year, but, as of this writing, the House and Senate are struggling to resolve differences in competing bills.

Even if premium levels are tweaked a bit, though, the fact that they are dictated by political, not economic, forces dooms the PBGC to ultimate failure. Privatizing the PBGC would allow private companies with strong financial incentives to establish pension insurance premiums that would more accurately reflect the level of risk, as evidenced by the health of the pension plan to be insured. The private sector successfully provides all sorts of insurance: auto, health, life, renters/homeowners, etc. Why not private pension insurance as well? By contrast, the government has demonstrated that insurance is one of its many weak spots, as evidenced by the PBGC, the savings-and-loan crisis, and the flood insurance debacle (Hurricane Katrina and others).

4. Defined-Contribution Plans in the Public Sector

In response to many of the aforementioned government pension funding prob-

lems, some governments are following the example of the private sector and switching to defined-contribution retirement plans. Now numerous states—including Colorado, Florida, Louisiana, Maine, Michigan, Montana, Ohio, Oregon, South Carolina, Vermont, Virginia, and Washington—offer defined-contribution plans to at least some of their state employees.

Some states, like Florida, offer defined-contribution plans only as an option in addition to traditional, defined-benefit plans, not as a replacement. Government employees in Oregon participate in both a defined-benefit plan and a defined-contribution plan. Michigan switched over to a defined-contribution plan back in 1997. And just last year, Alaska passed a measure to close its defined-benefit plan to new employees and switch to a defined-contribution plan, although the Alaska House voted in April 2006 to delay the implementation of the new retirement plan for one year. (As of this writing, the state Senate has yet to act on the postponement legislation.)

Privatizing the PBGC would allow private companies with strong financial incentives to establish pension insurance premiums that would more accurately reflect the level of risk, as evidenced by the health of the pension plan to be insured.

5. The Advantages of Defined-Contribution Plans

Defined-contribution plans offer a number of advantages over defined-benefit plans. The chief benefit to the employer is that their predictable costs allow for greater stability and accountability. Costs are known in advance (since they are simply a set percentage of payroll) and don't change much from year to year. This is a sharp contrast to the volatility in contribution levels experienced under defined-benefit plans.

For governments, this is particularly helpful in the budgeting process, as legislators—and the taxpayers on the hook for any funding shortfalls—do not have to worry about being surprised by greater-than-expected contribution requirements when the stock market sours and the pension fund's investment returns plummet. This added predictability of government finances eliminates the risk of unfunded liabilities and thus ensures full funding of the system. Note that governments can still offer attractive compensation packages by increasing salaries or the level of the government's contribution, but they must ensure that these compensation increases are paid for.

Defined-contribution plans offer a number of benefits to workers as well. They are portable, that is, they can be "rolled over" from one employer to the next when an employee changes jobs. This is particularly attractive to younger workers, especially given that, according to the Bureau of Labor Statistics, the median job tenure in 2000 was 4.7 years, and only 2.6 years for employees aged 24 to 34.

Finally, defined-contribution plans offer individuals the freedom to invest their money as they see fit. Moreover, risk levels and investment strategies change with age. Defined-contribution plans thus offer the freedom and flexibility that one-size-fits-all government-managed pension plans cannot.

6. Another Solution: Voter Approval Requirements

There is another crucial reform governments can implement to stem the tide

of ever-rising pension costs that deserves mention. In addition to switching from defined-benefit plans to more predictable and fiscally responsible defined-contribution plans, governments can restrain pension costs by enacting constitutional or charter amendments requiring voter approval of all increases in government employee benefits. This allows the taxpayers, who are ultimately responsible for paying state employees' salaries and benefits, to act as a final check against unreasonable benefit increases.

This strategy has helped "liberal" San Francisco keep retirement costs in check while "conservative" areas like the city of San Diego and Orange County, California, have been brought to the brink of financial ruin by their pension systems.

7. Conclusions

While the conversion of government defined-benefit plans to defined-contribution plans and the implementation of voter approval requirements may help to reduce retirement costs, they certainly are not cure-alls. At best, these solutions will only stop the bleeding. Persistent pension underfunding, sometimes over the course of decades, has led to debts that will have to be paid one way or another. Governments may minimize the resulting cuts to important government services by adopting strategies such as privatizing or outsourcing certain government functions, selling unused or underutilized assets, consolidating similar government agencies and functions, implementing performance reviews to identify waste and poor-performing programs, and eliminating lower-priority programs. These cuts may be painful in the short run, but they are necessary if governments are to return to solid fiscal position and ensure that public employees' retirement costs are covered without soaking taxpayers in the process.

D. The Truth About Occupational Licensing and Free-Market Alternatives

If you want to work, more and more often you have to seek permission from the government, pass arbitrary requirements, and pay fees to the state. Once upon a time, "all" you needed to do to go into business and make a living for yourself was obtain the know-how, equipment, and/or business acumen necessary to keep your business afloat. Today, professions from doctor and lawyer to lightning rod installer, auctioneer, and chimney sweep require a license or other form of government consent.

Did you know that you need the government's permission to work as a rainmaker in Arizona, a fortune teller in Maryland, or a florist in Louisiana?

Occupational licensing laws are often sold as a way to protect consumers by establishing minimum standards of competence and safety, but this is dubious at best and oftentimes outright deceptive. All that is truly needed to protect consumers are normal business incentives to attract customers and make a profit, coupled with a legal system that defends property rights and ensures that justice is served in the event consumers are harmed. Far from being a beneficent attempt to protect consumers, licensing regulations are typically lobbied for by business interests in order to suppress competition and enhance their own bottom lines.

Higher prices and reduced consumer choice notwithstanding, the real tragedy of occupational licensing is that it prevents many people from working their chosen

professions. Burdensome regulatory barriers are especially harmful to the poor, who have the greatest need to improve their economic standing and should be encouraged to pursue entrepreneurial ventures, not stifled.

While the use of occupational licensing across the country is universal, not all regulation is created equal. Some states make prospective employees and entrepreneurs jump through more regulatory hoops than others, and some licensing laws seem just plain silly. For instance, California requires licenses for roughly twice as many occupations as Ohio, Louisiana, and Virginia. And did you know that you need the government's permission to work as a rainmaker in Arizona, a fortune teller in Maryland, or a florist in Louisiana?

1. Background

Occupational licensing in the United States is pervasive. More than 1,000 occupations are currently regulated by the states, not to mention municipal requirements. Kids even need the government's permission to run makeshift lemonade stands during their summer vacations. Occupational regulation can take the form of a license, certification, or registration requirement (not to mention numerous other types of regulations, such as business permits, that mandate how and where business is to be conducted). Prospective employees and entrepreneurs may be forced to pay fees (application fees, license fees, examination fees, renewal fees) to the government, take educational or training courses or obtain a full degree in a particular field from certain accredited schools, undergo an apprenticeship or gain experience as a "lower-level" employee in the field, and/or pass an examination. There may also be minimum age, residency, and citizenship requirements. These requirements are arbitrary and may vary widely from one jurisdiction to another—even for the same occupation.

As with other governmental regulation, the trend in occupational licensing is continued growth. Governmental and bureaucratic inertia leads to more laws and regulations, but rarely are these laws and regulations ever re-evaluated to see if they are having the effects they were intended to, are overly burdensome, or still necessary (if they ever were). Though technology and practices are continually changing, licensing requirements are seldom given a second look. Thus, the number of licensed occupations continually increases.

The percentage of the workforce that must obtain a license to work has grown from just over 4 percent in 1900 to more than 18 percent today. Hence, occupational licensing laws directly affect a larger segment of the population than other significant barriers to work, including labor unions (less than 15 percent) and minimum wage laws (less than 10 percent). Despite its impact, occupational licensing receives only a small fraction of the attention enjoyed by labor unions and the minimum wage.

2. Occupational Licensing Survey of the States

In an effort to get a rough measure of occupational licensing regulation among the states, Reason Foundation conducted a survey using data from the Department of Labor and the 50 states. Of particular help was the CareerOneStop.org Web site, a cooperative effort between the DOL and the states that includes a job bank, information on wage and occupational trends, a searchable database of government agencies providing employment-related services, and a database of occupational licensing require-

ments by job or state.

According to the survey, the most regulated state in the nation is California, which requires licenses for 177 job categories, nearly double the average (92), followed by Connecticut, Maine, New Hampshire, and Arkansas (see Table 14). Seventeen states license more than 100 job categories. Only Missouri (41) licenses fewer than 50. Figure 8 below illustrates the number of licensed occupations by state. Note that with the striking exception of California, Western states tend to be less regulated than Midwestern and Eastern states.

Occupational licensing laws are also very arbitrary, as evidenced by the disparity in which occupations are licensed and how burdensome the licensing regulations are from one state to the next. For example, there were several cases in which neighboring states had significant differences in the number of licensed job categories: California (177) and Arizona (72), Arkansas (128) and both Missouri (41) and Mississippi (68), New Jersey (114) and Pennsylvania (62), North Carolina (107) and South Carolina (60), Tennessee (110) and Alabama (70), and Florida (104) and Alabama (70). This begs the question: If some places work just fine with minimal or no regulations, why must others be plagued with restrictive laws? Are things so drastically different just across

Table 14: Most and Least Licensed States

Rank	State	Licensed Occupations
1	California	177
2	Connecticut	155
3	Maine	134
4	New Hampshire	130
5	Arkansas	128
6	Michigan	116
6	Rhode Island	116
8	New Jersey	114
9	Wisconsin	111
10	Tennessee	110
Rank	**State**	**Licensed Occupations**
41	Colorado	69
41	North Dakota	69
43	Mississippi	68
44	Hawaii	64
45	Pennsylvania	62
46	Idaho	61
47	South Carolina	60
48	Kansas	56
49	Washington	53
50	Missouri	41

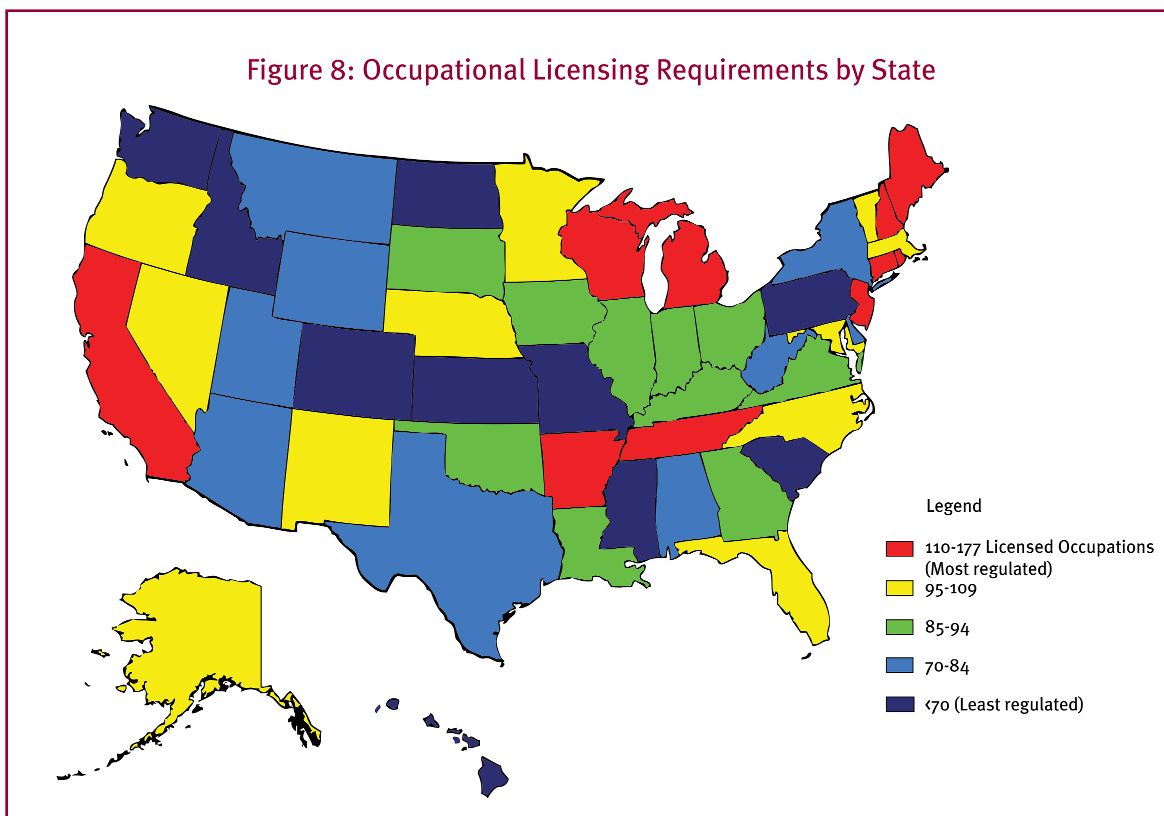

Figure 8: Occupational Licensing Requirements by State

state lines that this disparity could be justified? Not likely.

Some licensing laws are seemingly senseless and others are just plain bizarre. For an illustration of these kinds of licensing requirements, consider the following: auctioneer (several), beekeeper (Maine), chimney sweep (Vermont), elevator operator (Massachusetts), florist (Louisiana), fortune teller (Maryland), interior designer (several), lightning rod installer (Vermont), mussel dealer (Illinois), rainmaker (Arizona), reptile catcher (Michigan), sheep dealer (Iowa), turtle farmer (Louisiana), and whitewater rafting guide (Maryland).

3. The Economics of Occupational Licensing: Serving Public Interests or Special Interests?

While occupational licensing laws are billed as a means of protecting the public from negligent, unqualified, or otherwise substandard practitioners, in reality, they are simply a means of utilizing government regulation to serve narrow economic interests. Such special-interest legislation is designed not to protect consumers, but rather to protect existing business interests from competition. This suppression of competition damages the business climate, reduces consumer choice, and allows licensees to charge higher prices than they would be able to in a truly free market. These artificially high prices harm consumers.

Numerous studies have revealed little, if any, improvement in service quality from compulsory licensing.

Numerous studies have revealed little, if any, improvement in service quality from compulsory licensing. Oftentimes, licensing laws actually reduce service quality and public safety. There are a number of reasons

why product or service quality and health and safety may actually be diminished by occupational licensing:

1. Less Pressure to Compete

   Since it is more difficult to work if one has to obtain a license, fewer people will enter a given licensed profession than would exist in a license-free case. Less competition for licensees means less pressure to offer higher quality or lower prices to attract business. Thus, licensed businesses will be more inclined to pocket more of their profits and invest less in developing higher-quality goods and services.

2. Improper Training Requirements

   Established standards may sound all well and good, but what if you establish the wrong standards? Conditions and required knowledge may vary from place to place, but with a single rigid set of standards, licensed workers may be forced to spend time and money learning useless, or even incorrect, things. Moreover, high-quality workers must perform routine tasks that could be done by less-qualified workers, leaving them with less time to devote to honing high-quality, specialized skills. Licensing, therefore, discourage specialization and makes licensees less effective and less able to serve their customers.

3. Licensing's "Club Mentality"

   While licensing boards ardently prosecute unlicensed workers (regardless of whether or not there is reason to believe a health or safety issue is involved), they are typically much more hesitant to discipline "one of their own." Making public the indiscretions of a licensed worker brings unwanted negative publicity and, like a union whistleblower, is often seen as a form of treason by the whistleblower's licensed colleagues. Thus, not only are unscrupulous or incompetent licensees not punished, they are allowed to continue their work and the public is left in the dark about the hazards of doing business with them.

4. False Sense of Security

   Because of the reluctance of licensing boards to discipline negligent licensees for their transgressions and the risk that licensing exams test the wrong skills or prove only that one is trained to pass the test, the government's seal of approval gives consumers a false sense of security about the competence of licensees. This false sense of security causes people to be less critical, and possibly less demanding, of those with whom they do business than they otherwise would be.

5. Do-It-Yourself Jobs and Reduction in Repeat Medical Visits

   Consumers unwilling or unable to pay the artificially high prices caused by licensing may resort to dangerous do-it-yourself jobs or skip needed medical visits. It should come as little surprise, then, that electrocution rates are higher in areas with strict electrical licensing requirements, as more consumers risk performing their own electrical work. Similarly, states with stricter dental licensing laws also have the highest incidence of poor dental hygiene, and states with tougher optometry licensing laws report higher rates of blindness.

6. Black Market Creation

   Some workers and consumers may simply choose to ignore government licensing standards and operate outside

the law. These transactions are typically not enforceable and consumers are more likely to become the victims of charlatans and scam artists.

4. Licensing Violates the Freedom to Work

As much as occupational licensing makes consumers worse off, perhaps the greatest tragedy of licensing regulations is that they stifle the freedom to work in one's chosen occupation. Fees, needless education or irrelevant experience requirements, and other regulatory hurdles serve as a barrier that prevents many people from making an honest living.

Such cost barriers disproportionately affect the poorest members of society, who are in the greatest need of occupational freedom to improve their living standards. Occupations with relatively low start-up costs such as taxi driving, hairbraiding, child care, and numerous home-based businesses that the poor might otherwise take advantage of are unattainable because the costs of obtaining a license are too high—and usually unnecessary. The poor are thus doubly hurt by licensing laws because their smaller disposable incomes are less able to absorb the resulting price increases, and they have fewer job opportunities because jobs they could have performed in the absence of licensing are made prohibitively costly by unnecessary regulations.

As if restricting entry to numerous jobs and denying an individual the right to freely earn a living were not enough, the government adds insult to injury by claiming that it is doing so in the best interests of the public. By imposing rigid, one-size-fits-all licensing laws, the government claims to "protect" members of the public not only from incompetent workers, but also from themselves. Not only is this false, it is condescending and paternalistic. Apparently, by this "logic," we consumers are too stupid and incompetent to make our own decisions about whom we do business with.

5. The Alternative: Self-Regulation and Market Forces

The belief that consumers are left unprotected if the government does not step in to regulate it is a common misconception. In fact, the private sector does at least as good a job as the government in protecting consumers. Those that lack faith in the free market neglect two crucial elements that serve to protect consumers and encourage the delivery of high-quality products: business reputation and the legal system.

The significance of a business's or worker's reputation cannot be understated. What would happen for example, if certain state governments stopped licensing exterminators, chiropractors, and barbers? Would people be living in bug-infested dwellings and running around with bad backs and bad haircuts? Of course not. When looking for a place to get your hair cut, you probably just ask your friends for a good referral. If you happen to get a bad haircut anyway, you simply go somewhere else next time. Herein lies the beauty of the free market: businesses have an incentive to provide the goods and services customers want at the best possible price and quality. Bad service is just as much a killer for business as high prices.

Word of mouth is not the only means of assessing a business's reputation, however. Private certification organizations also provide consumers with information about the product and service quality they can expect from certain sellers. There are a couple of different ways to provide such an

evaluation. One model is to simply use the reputation of a certifying organization, such as Consumer Reports, Good Housekeeping, or CNET, to determine whether or not a product is "good." Competition among various rating agencies will lead them to try to outdo each other by providing the most accurate information and establishing higher standards for certification.

A second certification model allows for different levels of quality. A certification organization may issue practitioners a test or subject them to inspection and grade them according to their performance. A business certified as high-performing could then advertise itself to consumers as "Grade A." Unlike the single standard—predetermined by the government—of occupational licensing, these multiple standards provide a greater array of information to consumers and allow them to make better decisions based on their individual quality, price, and risk preferences.

Unfortunately, there will always be cases of worker negligence. When consumers are harmed by poor workmanship, faulty products, or dishonest businessmen, the courts serve as a final resort to ensure that the consumer is compensated for the harm done. If all else fails, the legal system provides an additional incentive for businesses to provide high-quality goods and services. If you are injured by a defective product, you can sue the manufacturer for negligence and perhaps fraud. If the stigma of being tried and convicted for selling faulty products is not enough to deter shady business practices, the economic effects of a guilty verdict certainly are.

6. Recommendations and Conclusions

As the state-by-state occupational licensing survey illustrates, the right to work is heavily regulated across the nation. Some states have more work to do than others to restore economic liberty to those wishing to engage in the occupation of their choice and improve their standard of living.

In light of the destructive effects of occupational licensing laws on consumers, aspiring workers and business owners, and individual liberty in general, occupational licensing laws should be abolished. Private-sector alternatives such as voluntary certification encourage entrepreneurship and allow consumers to obtain valuable information about product and service quality while leaving them free to choose to do business with practitioners that best meet their needs. The powerful free-market incentive to maintain a solid business reputation and the existence of the legal system to address negligence or wrongdoing are all that is needed to "protect the consumer."

Although abolition of occupational licensing regulations and other laws that restrict economic liberty, such as minimum wage and zoning laws, should be the ultimate goal, we must recognize that this is probably not feasible in the near term. In recognition of this, here are a couple of "second-best" options that may have a better chance of making a more immediate impact:

1. Conduct Periodic Occupational Licensing Reviews

   Occupational licensing boards and laws should be continually evaluated for their relevance and perceived need. These reviews should, first and foremost, evaluate whether licensing laws pass the "laugh test" (fortune tellers and rainmakers?). They should also ensure that regulations are narrowly tailored, and that they are providing at least some measure of public benefit, not merely a

gravy train for special interests and bureaucrats. Reviews should, furthermore, analyze licensing board performance by evaluating enforcement actions against licensees.

In addition to abolishing occupational regulations in obvious cases of political favor, licensing laws should be subject to removal if: (a) few other jurisdictions (say, fewer than 40 percent) have seen the need to license the occupation, (b) too few practitioners are licensed to financially justify the existence of the licensing board, or (c) there is a history of little or no enforcement activity, suggesting that either the licensing board is not doing its job or there is no cause for action.

2. Enact "Sunset" Provisions in Occupational Licensing Laws

Sunset provisions cause the law in question to expire after a certain period of time unless they are specifically renewed by legislators. Enacting such provisions in occupational licensing laws would improve accountability by forcing occupational licensing boards to periodically justify their existence. Rather than allowing more and more confusing licensing codes to pile up and be forgotten, as they have a tendency to do, legislators would have to take a more active interest in the scope and effectiveness of licensing laws.

While the above oversight measures are not perfect solutions, their implementation would help to increase the accountability of occupational licensing boards and restore some semblance of common sense to licensing laws. They would also restore a measure of economic freedom, resulting in more jobs, more competition, and more consumer choice.

Environmental Services and Issues

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A. Water Privatization Update

B. Supreme Court Issues Murky Decision in Wetlands Case

A. Water Privatization Update

1. *Public Works Financing* Issues 10th Annual Water Privatization Report

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 (see Table 15). *PWF* also reports that municipalities have taken water utilities back in only 2 percent of contracts that came up for renewal in 2005.

2. World Water Forum and Privatization

This year the global water community met in Mexico City for the 4th World Water Forum sponsored by the World Bank to address global water and sanitation issues facing the world. Currently 1.1 billion people live without access to safe water, while 600 million lack basic sanitation. Nearly two million deaths worldwide, every year, are attributable to unsafe water and poor sanitation. The World Water Forum is an

Table 15: 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*

opportunity for the larger global community to discuss efforts to increase access to safe water.

This effort began several years ago with the United Nation's Millennium Development Goals, which among other things, proposes to reduce by half the proportion of people without sustainable access to safe drinking water by 2015. The World Bank has been supportive of these goals and has initiated more than 2,500 public-private partnerships or privatization initiatives throughout the world to accomplish these goals.

Despite resounding success—only 7 percent of initiatives between 1990 and 2004 were deemed failures by the World Bank—the forum was met with a small but vocal group of protestors. These groups took to the streets based on an ideology that the private sector should have no role in addressing these challenges. However, as Fredrik Segerfeldt points out, currently 97 percent of water distribution in developing countries is in the hands of government, and look at what their management has been able to accomplish: not much.

Private investment in developing countries is back on the rise, by more than a third over the previous year. It is clear that the private sector not only should continue but will continue to play a role in the delivery of water and sanitation systems around the world.

3. New Study from the Globalization Institute

The Globalization Institute, a London think tank, issued a new report on global water privatization, "Water for Life," that takes attacks on privatization head on. Mischa Balen, a Labour Party activist and the study's author, points out that private sector management and investment in water systems have actually been very successful, increasing access to water, cutting disease by introducing sewerage systems, and reducing prices for ordinary people. And that too often opponents of privatization focus on ideology and not facts.

The study notes that in the "vast majority of cases, where the private sector has been called upon, it has delivered the goods—even in cases decried by critics as 'failures.'" Balen argues that the most effective and efficient way to increase water access to countries in the developing world is utilize the resources the private sector has—its innovation, capital, expertise, and efficiency.

For example, Balen describes how vital contracts are because they improve the overall transparency and accountability of an initiative and the operators. Targets and goals are documented and payment should be based on achieving those outcomes.

Mischa Balen, a Labour Party activist and the study's author, points out that private sector management and investment in water systems have actually been very successful, increasing access to water, cutting disease by introducing sewerage systems, and reducing prices for ordinary people.

Incentives also play an important role—one that opponents do not understand. Yes, private companies have a profit motive. It's that motive that leads them "to act in the interests of the consumers." The repercussions of bad customer service are all too real for the private sector, which can easily be replaced. Governments face no such threat and have no incentive to deliver. Incentives can also be written into contracts for achieving greater water quality or improving

access in rural areas with bonuses or other financial rewards. In fact, many global contracts are already written that way and there has been tremendous success. For example, access in Tunja, Columbia has improved by more than 10 percent. Gabon has seen a 15 percent increase. Chile is perhaps the greatest example, where 99 percent of urban citizens and 94 percent of rural citizens now have access to clean, safe water. Balen also notes that incentives can work the other way too. Financial penalties can be worked into contracts to penalize poor performance.

These ideas also dovetail into a discussion of "efficiency vs. wastage." One of the biggest problems facing most water delivery systems is water loss or wastage. Simply, this is water "lost" somewhere in the system once it leaves a treatment plant. Private companies have all the incentive in the world to prevent wastage and water loss as it negatively impacts their bottom line.

At the end of the day, Balen argues that the private sector is an essential player in the delivery of water services globally. The report deals a crushing blow to activists who have chosen ideology over reality.

4. Brookings-AEI: "Water Provided by Privately Owned Systems is Not Less Healthy or More Expensive"

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.

The reviewed consisted of every community water system in the United States from 1997-2003 but is limited to privately owned systems. It does not conduct a comparison of other private sector participation, including contracts for management and operation and other public-private partnerships.

5. Survey of Public-Private Partnerships Dem-

onstrates Success Here in United States

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.

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.

This data mirrors survey results from *Public Works Financing*, which show municipalities as very satisfied with both partnerships and their private partners. More than 92 percent of contracts that were up for renewal in 2004 were again outsourced, either to the incumbent or to another private provider. Less than 6 percent of systems up for renewal reverted back to the municipality, and less than 2 percent were not renewed for other reasons.

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

Table 16: Current Regulatory Compliance as Compared to Before Partnership	
Better	74%
Equal	22%
Worse	4%

Source: Water Partnership Council

Table 17: Current Frequency of Complaints Compared to Before Partnership	
Better	7%
Equal	56%
Worse	37%

Source: Water Partnership Council

Table 18: How Rate Change Compares to Pre-partnership Projections	
Better	6%
Equal	76%
Worse	18%

Source: Water Partnership Council

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.

Table 19: Current Employee Financial Compensation as Compared to Before Partnership	
Better	53%
Equal	34%
Worse	13%

Source: Water Partnership Council

Table 20: Current Employee Benefits as Compared to Before Partnerships	
Better	20%
Equal	40%
Worse	40%

Source: Water Partnership Council

6. Water Activist "Runs Tap" Against Privatization

In what can only be called bizarre, performance artist and anti-privatization activist Mark McGowan, is leaving six taps running for a year in protest against water privatization in the United Kingdom.

This will be done in secret London addresses so as to prevent disruption of his plan. It's estimated that the stunt will lead to more than 100 million liters going down the drain.

McGowan acknowledges that London is facing drought conditions, yet claims that he's not "wasting water for nothing," suggesting that the private water companies waste billions of gallons of water a year through under-investment.

B. Supreme Court Issues Murky Decision in Wetlands Case

Property Owners Need Protection from Wetland Bureaucrats

Those hoping that the U.S. Supreme Court would limit the scope of federal wetland jurisdiction were deeply disappointed in its June 2006 ruling in *Rapanos vs. the United States*. Widely regarded as one of the most important property rights cases in recent years. it challenged an expansive interpretation of the 1970 Clean Water Act through which the federal government sought to extend its reach to literally every little backyard pond or puddle.

While the court ruled 5-4 that federal authorities had overstepped their bounds in this case, it failed to provide a clear test to distinguish the waters that fell under federal jurisdiction from those that fell under state jurisdiction. In short, the court failed to

capitalize on a golden opportunity to clearly define the scope of—and provide a check on—the federal government's authority to regulate private property.

The *Rapanos* case involved a Michigan developer whom the federal government has been hounding for close to two decades now. Rapanos' crime? He shifted sand from one part of his property to another without a federal wetland permit, allegedly a felony under the Clean Water Act.

Rapanos was convicted in 1997 on criminal charges and paid hundreds of thousands in fines, served 200 hours of community service and three years of probation. The only reason Rapanos escaped a prison sentence is that the judge who oversaw his trial was so disgusted with the inflammatory legal tactics employed by the government prosecutors that he rejected their sentence request. For instance, the prosecutors likened Rapanos to a devil and compared his "treeless property" to the "Warsaw ghetto without Jews."

The Supreme Court previously refused to review Rapanos' criminal conviction. But after John Roberts was appointed to the court last year, it agreed to take up the civil case that the Environmental Protection Agency launched—and won in lower courts —against him. Rapanos, defended by the California-based Pacific Legal Foundation, argued that if he needs a federal wetland permit (that, on average, costs $300,000) then potentially every property owner with the smallest pond or puddle would need one as well. Rapanos' property is bone-dry, thanks to its sandy soil and the drainage ditches that the county government built around it at the turn of the century—except for two wet spots which he was not planning to touch. Furthermore, he maintained, even if the wet spots could be deemed wetlands, the federal government has no jurisdiction over them because the Constitution's Commerce Clause limits the Clean Water Act's jurisdiction to navigable waters—and the nearest such waters are 20 miles away from his property. If the Act indeed allows the federal government this kind of reach, then it itself is unconstitutional, he insisted.

The EPA, however, argued that it has the right to regulate any property with a "hydrological connection" to navigable waters. But given that evaporation and rain make all waters, in the end, part of one big hydrological cycle, the government's position literally aims to assert its authority over all U.S. waters.

This is a position that runs counter to the Supreme Court's ruling in the 2001 SWANCC (Solid Waste Agency of Northern Cook County) vs. the U.S. Army Corps of Engineers. In that case, the court threw out the government's "migratory bird rule" that sought to protect isolated wetlands under the Clean Water Act on grounds that ducks and geese crossed state lines and used them as resting places. Yet the government is now in effect asserting the "migratory molecule" version of the "migratory bird" rule.

The government did not arrive at such an expansive understanding of the Clean Water Act all at once. This interpretation has evolved incrementally over a period of 25 years. According to an amicus brief filed by the National Association of Home Builders in the *Rapanos* case, the Army Corps of Engineers until the mid-'70s believed that its regulatory authority extended only to navigable waters. In 1975, the Corps asserted jurisdiction over navigable waters and their non-navigable tributaries up to their headwaters. Then it became navigable waters and waters adjacent to them.

But all along the Corps disavowed any intention of ever regulating any "manmade non-tidal drainage and excavation ditches on dry land." Yet that is precisely the scope of regulation the government sought to validate in *Rapanos*.

Four justices—Scalia, Thomas, Alito, and Roberts—clearly felt that the government has overstepped its reach in wetlands regulation. According to Scalia's plurality opinion, wetlands regulation should only extend to bodies of water with a surface connection to a permanent navigable waterway:

The extensive federal jurisdiction urged by the Government would authorize the Corps to function as a de facto regulator of immense stretches of intrastate land–an authority the agency has shown its willingness to exercise with the scope of discretion that would befit a local zoning board. We ordinarily expect a "clear and manifest" statement from Congress to authorize an unprecedented intrusion into traditional state authority. The phrase "the waters of the United States" hardly qualifies.

[…] In sum, on its only plausible interpretation, the phrase "the waters of the United States" includes only those relatively permanent, standing or continuously flowing bodies of water "forming geographic features" that are described in ordinary parlance as "streams[,] … oceans, rivers, [and] lakes." The phrase does not include channels through which water flows intermittently or ephemerally, or channels that periodically provide drainage for rainfall.

[…]Therefore, only those wetlands with a continuous surface connection to bodies that are "waters of the United States" in their own right, so that there is no clear demarcation between "waters" and wetlands, are "adjacent to" such waters and covered by the Act.

Justices Stevens, Souter, Ginsburg, and Breyer dissented, upholding the government's expansive view of regulation—that it could literally regulate any land that held water at some point and could potentially flow into a ditch, creek, stream, or river.

Justice Kennedy became the tie-breaker in a 4-4 split. Kennedy—whose opinion will guide the lower courts in future wetlands cases—issued a separate opinion that was technically a concurrence with the plurality, though it rejected the interpretation of the scope of appropriate wetlands regulation offered by Justice Scalia.

According to Kennedy, wetlands fall under federal control only when there exists a "significant nexus" between wetlands and navigable waters. But he did not say precisely what this "nexus" would consist of. Such a vague criterion for intervention will effectively invite federal regulators to fill in the ambiguity as they see fit on a case-by-case basis. This is especially the case given that federal courts often defer to the Corps' scientific expertise in such matters. It is unclear at this point how much effect, if any, the *Rapanos* ruling will have in reining in the government's broad exercise of wetland regulation.

As for Rapanos himself, the status of his legal battle remains uncertain, as the Supreme Court's ruling sent his case back to lower courts for further examination.

Existing federal wetland regulations that don't employ an expansive interpretation of the Clean Water Act already cover 111.5 million acres of land—an area that is bigger than the size of California. According to the United States Department of Agriculture, if the government were to compensate landowners—which it doesn't—for the develop-

ment potential they have lost on just this land, it would have to cough up $162.6 billion. This is equal to the combined 2005 profits of the top 15 Fortune 500 companies.

Making this amount of land off-limits to development, among other things, raises real estate values, forcing home buyers to pay higher prices. Businesses, however, are affected too as higher home prices mean that they have to pay higher wages.

But the real question is: do wetland regulations deliver environmental gains commensurate to the damage to the economy? Environmentalists argue that wetlands offer a natural filtering mechanism to purify polluted run-offs and keep our lakes and rivers clean. “But restricting development,” notes Harvard University economist Edward Glaeser, “is the most expensive filtering system devised by man.”

There are far cheaper ways to cleanse run-offs and maintain water quality. One possibility would be to grow fields with especially absorbent vegetation. In its *Rapanos* decision, the Supreme Court missed an opportunity to prod the federal government to look for more cost-effective ways to protect the environment that don’t trample on the rights of property owners.

Telecommunications

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A. Why Governments Should Stay Out of the Telecom Business

An increasing number of local governments are proposing either to build and operate broadband networks for residential and business use, or to develop broadband infrastructure for wholesale lease to commercial service providers, or otherwise take action to accelerate the availability of broadband Internet access throughout downtown areas. Wireless technologies have lowered costs, making such schemes seem feasible.

A 2004 survey found that 621 public power systems supply broadband services. About 23 municipalities offer fiber optic service to the public. News reports claim that "hundreds of cities" are considering some type of municipal Wi-Fi. And San Francisco Mayor Gavin Newsome even declared free or low-cost wireless Internet access a "fundamental right." High-profile proposals in Philadelphia, San Francisco, Houston and other cities have drawn a lot of attention.

Yet, it is unclear what problem these local governments are trying solve. Over a third of all American households already have broadband Internet service—over half of the households that use the Internet. Considering that mass use of the Internet is only about a decade old, this displays amazing market penetration. And prices have been falling steadily.

Many argue that government deployment of broadband will spur economic development, attracting high-tech jobs and business investment. But government-subsidized broadband services actually discourage private investment, leaving less opportunity and incentive for private firms to enter the market. Townships, cities, counties and even states getting into the telecom business to directly compete against the private sector undermine technological progress and violate fundamental principles of American free enterprise. Most existing government broadband systems compete with private firms, or enjoy local monopolies, to the

detriment of broadband consumers. Just as bad, a great many government broadband systems lose money and drain local budgets while falling behind new technologies, and thus their service quality declines.

Many of the proposed city-wide wireless systems are less problematic. Cities like Anaheim, Houston, and even San Francisco are now looking at proposals whereby a winning bidder will get access to city light poles and properties to install wireless antennas and other equipment in exchange for broad availability or low cost services. Other companies can install competing systems if they so desire.

But organized activist groups are diligently working to make sure that broadband services are provided by government agencies or regulated monopolies with taxpayer subsidies. They abhor market competition in broadband services and are aghast at proposals from Google and others to provide free wireless broadband services and make their revenue off of ads.

A large group of policy analysts have signed the *Municipal Broadband Compact* to establish principles for efforts to create city-wide broadband access. The principles seek to maximize competitive private provision of broadband services and avoid monopolies and subsidies. Reason has published a list of over *50 Questions Public Officials Should Ask about Government Broadband Services* that will help officials evaluate the technical, economic, political, and legal aspects of municipal broadband proposals.

The Compact recommends keeping these issues in mind when optimizing broadband deployment:

1. Access to broadband can often be expanded by eliminating unnecessary regulations that delay, raise the cost, or even effectively ban the construction of new network facilities.
2. Municipalities and other local units of government should be prohibited from investing in, managing or operating broadband infrastructure and services.
3. Congress should restrict the authority of states to regulate and tax broadband infrastructure and services in the interest of preserving interstate commerce.
4. Telecom taxes and cable franchise fees should be eliminated to encourage investment in broadband services.

The Municipal Broadband Compact, the Questions Public Officials Should Ask about Government Broadband Services, and Reason's other research and commentary on these issues are available online at http://www.reason.org/wifibroadband/.

B. The Rise and Fall and Rise of Municipal Broadband

Cities choose public-private partnerships as better model

As scores of U.S. cities and towns are exploring "municipal broadband," whereby cities provide broadband Internet service, some city officials around the United States are rejecting the assumption that local governments and municipal utilities need to finance, build, own and operate retail telecommunications networks.

In many ways, the "municipal telecom" movement represents the antithesis of the privatization trend. Even as cities and towns begin to divest ownership of sanitation services, water and sewer, public transit and toll roads, the notion that the local government needs to take a direct role in the provision of cable television, telephone high-speed

Internet services has been compelling to city councils throughout the country, at least until recently.

A turning point came in August 2005, when the city of Philadelphia, which in late 2004 had proposed a plan to build and operate a wholesale broadband backbone network to support a citywide network of wireless hotspots, instead, turned the project over to EarthLink Inc. after a round of competitive bidding. Under the terms of the agreement, EarthLink, not the city of Philadelphia, will own and manage the network, set prices, provide services to the city, and work in partnership with a city-affiliated non-profit organization—Wireless Philadelphia—to meet the city's social goals for inexpensive citywide broadband access. As of late April, the contract was awaiting final approval from the city council, which is expected before the end of the spring session.

More municipal wireless projects have been proposed since Philadelphia launched its initiative. Major cities that have awarded contracts include San Francisco, Anaheim and Portland, Oregon. Other projects are up for bid in Chicago, Minneapolis and Phoenix. Yet none of them calls for funding by the city or through municipal bonds.

The last several months have seen a burst of activity from cities looking to get on the wireless bandwagon. As of mid-April 2006, 58 regional or citywide municipal WiFi systems were in operation, according to Esme Vos, a municipal wireless consultant and editor of the Muniwireless.com Web site. This list did not include Anaheim, the only major city to launch municipal wireless service. The California city went on-line the third week of April.

In addition, Vos reports that 32 cities have deployed hot spots on a limited basis. These include Los Angeles, Daytona Beach, Fl., and Baton Rouge, La. Another 35 cities use WiFi for municipal and public safety only. Finally, 69 more cities are in deployment or have issued requests for proposals (RFPs). A total of 194 cities have reached the RFP phase or gone beyond it, compared to 41 in January.

At the time it proposed the project in the fall of 2004, Philadelphia was the largest city to take up municipal broadband. The plan brought national attention to the municipal broadband trend, which until then had largely been confined to small and mid-sized communities. Philadelphia amplified the debate about state involvement in broadband that had already been brewing in telecom policy circles: Whether municipal systems could ever be self-sufficient, whether these systems represented sound use of taxpayer funds or city borrowing power, and whether it was appropriate at all that the local government compete with commercial providers it has the power to regulate and tax. The debate reached its peak when the Pennsylvania legislature, responding to both the Philadelphia wireless project and the troubled municipal wireline broadband project in the small community of Kutztown, passed a law prohibiting local government sub-divisions from funding or owning competitive telecom networks.

1. The Early Years

The municipal broadband movement had its roots in municipal cable TV deployments more than 15 years ago. In 1989, Glasgow, Kentucky launched what is believed to be the first municipal cable TV operation after growing frustrations with service from Charter Communications, the local cable franchisee. Over the next few

years, municipal cable operations sprang up in other small towns, such as Paragould, Ar., Negaunee, Mi., and Cedar Falls, Iowa.

At the time, the Internet was a low-speed public data network used primarily for commercial email and file transfer. The explosion of consumer Internet applications, which would fuel demand for service integration and broadband speeds, did not begin until 1996, when the World Wide Web emerged.

The Web gave city officials a new civic imperative—broadband. A city with wide availability of broadband, they reasoned, would be more competitive in attracting tech-savvy professionals, business and investment (a cause-effect relationship research has never shown). Municipal cable gave way to municipal broadband. Cities like Tacoma, Wa., Ashland, Or., Lebanon, Ohio and tiny Kutztown in Pennsylvania began multi-million dollar projects to deliver retail cable, telephone and high-speed Internet services to residents, often in direct competition with local incumbents.

These communities believed that broadband, like conventional dial-tone telephone or electricity, fit the monopoly utility model. Infrastructure requirements were so expensive that the free market would never be able to provide ubiquitous service. Municipal broadband proponents ratcheted up the "market-failure" argument as cable and telephone companies were slow to invest in fiber-to-the-home technology, a robust, but high-cost broadband access platform. If sparsely populated areas or low-income households could not generate the revenues to achieve payback on broadband investment, governments, they reasoned, could bridge the gap.

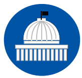
Much like they did in the 1930s and 1940s, they felt that cities could issue long-term bonds to fund broadband networks, and repay those bonds with future revenues. Critics warned, however, that unlike classic utility models, broadband service was not perceived as the necessity that electricity and water were. Broadband economics, critics warned, also depended on a value proposition: the broadband connection to the home brought no immediate tangible benefit in and of itself; consumers needed to appreciate the value of the diverse applications broadband could support. Municipalities, critics warned, would be faced with the same marketing problem that was in part stalling commercial build-out: Consumers needed more reasons to buy service.

In addition, critics said cities spending millions of dollars on fiber optic systems were too quick to dismiss the potential of other broadband technologies, including new generations of digital subscriber line (DSL), which boosted the capacity of pre-existing copper lines, and of wireless service. Cities installing broadband citywide risked finding their system obsolete in the fast-changing arena of Internet technology.

2. Municipal Broadband Falls Short

Most of the early municipal cable and Internet projects limped along. None truly obtained self-sufficiency. As early as 1998, studies such as *Costs, Benefits and Long-Term Sustainability of Municipal Cable Television Overbuilds* by University of Denver professors Ronald J. Rizzuto and Michael O. Wirth, were examining municipal cable balance sheets and pointing to their consistent dependency on cross-subsidies, interest-free loans and special taxes.

Proponents of municipal broadband dismissed these reports as flawed, erroneous or pure misinformation, as they would



Municipal Developments	Year	Technology and Market Developments
Glasgow, Ken., after frustrations with incumbent cable TV provider Charter Communications, becomes one of the first municipalities to launch a competitive cable TV system.	1989	
Marietta, Ga., begins construction of municipal fiber backbone.	1996	Asymmetric Digital Subscriber Lines (ADSL) standardized, delivering data transfer rate of 8 Megabits/second over 1.5 mile loops.
Tacoma (Wash.) Click! Network goes online, offering cable TV, Internet, and phone service. Ashland (Ore.) Fiber Network goes online.	1997	Data Over Cable Service Interface Specification (DOCSIS) 1.0 standardizes cable modems.
	1998	
	1999	Institute of Electrical and Electronics Engineers (IEEE) specification 802.11b standardizes 2.4 GHz wireless networks (known as "WiFi"). DOCSIS 1.1 is issued, fine tuning 1.0
	2000	
Tacoma Power halts construction on Click! Network as spike in wholesale electric prices depletes Tacoma Power's reserve fund, which has also been funding Click!. Construction later resumed.	2001	Vonage founded and quickly becomes the leading national provider of Voice over Internet Protocol (VoIP) telephone service (January).
Bristol Virginia Utilities fiber optic network goes online. Using private funding, NYCwireless, a New York non-profit, places free wireless hot spot in Manhattan's Bryant Park. Google takes branded sponsorship in 2005.	2002	Boingo Wireless launches nationwide network of 400 WiFi hotspots (January). DOCSIS 2.0 is issued, supporting 30 Mb/s symmetrical, VoIP, and enhanced quality of service (January). T-Mobile and Starbucks announce WiFi hotspot deployment in 1,200 locations.
Referendum to establish a municipal fiber system in Batavia, Geneva and St. Charles, Ill. (Tri- Cities) defeated. (April). Kutztown, Pa., municipal fiber system goes online (August).	2003	Intel unveils Centrino chip enhancing mobile communications technology for laptop PCs (March). ADSL 2+ standardizes delivering 20 to 25 Mb/s over 1 mile loops. IEEE 802.11g specification is introduced, allowing higher data transfer rates than 802.11b. Skype founded, offering VoIP service based on a proprietary protocol.

Municipal Developments

Technology and Market Developments

2004

Municipal Developments

- Chaska, Minn., municipal wireless system goes online.
- UTOPIA, Utah's 14-city wholesale fiber optic network, goes online. After promising local governments an "open access" network, UTOPIA awards AT&T exclusive retail rights for one year. After protests from Utah ISPs, UTOPIA changes terms of the A&T deal and signs second retail deal with MSTAR, a Provo ISP.
- Provo, Utah, iProvo fiber backbone goes online (July).
- Marietta, Ga., sells uncompleted fiber system for $11 million after investing $35 million (July).
- Second Tri-Cities, Ill. muni broadband referendum defeated (Nov).
- Philadelphia outlines municipal wireless plan (November).
- Pennsylvania enacts law severely limiting municipal entry into competitive telecommunications (November). Similar legislation is considered, sometimes adopted, in other states throughout 2005.

Technology and Market Developments

- Consumer wireless spending overtakes wireline spending.
- Broadband use overtakes dial-up for consumer Internet access (August).
- Early demonstrations of Worldwide Interoperability for Microwave Access (WiMax), offering high-throughput broadband over long distances.

2005

Municipal Developments

- Philadelphia issues RFP for municipal wireless, setting out a "cooperative wholesale" plan whereby the city will own the network and regulate wholesale rates. (April).
- After running out of money, Grant County (Wash.) Public Utility District elects to halt municipal fiber construction and "stand pat" with incomplete system (April).
- Ashland, Ore., facing $15.5 million debt load, halts construction and sets plans to sell Fiber Network (May).
- Fiber To The Home Council lists 16 municipal FTTH systems in operation (May).
- JupiterResearch predicts half of municipal wireless systems will fail; recommends cities pursue public-private partnerships (June).
- Referendum approving municipal fiber system in Lafayette, La., passes (July).
- San Francisco outlines TechConnect municipal wireless project (September).
- Google suggests free wireless service in San Francisco to be supported by advertising (September).
- Wireless Philadelphia selects EarthLink, but abandons "cooperative wholesale" plan. EarthLink is given ownership of the network and allowed to set wholesale rates (October).
- San Francisco Mayor Gavin Newsom declares broadband Internet access to be a basic human right (October).
- Chaska, Minn., discloses it spent $300,000 above its original $600,000 budget to optimizeg its municipal network (November).

Technology and Market Developments

- AT&T WiFi network reaches 10,000 hot spots internationally
- Number of broadband lines in the U.S. reaches 38 million, according to FCC. (June).
- Verizon begins FiOS fiber-to-the-home trials in Keller, TX (June).
- AT&T begins Internet Protocol Television (IPTV) rollout (September).
- Cingular completes upgrade to Universal Mobile Telecommunications System (UMTS), a third generation mobile phone technology in 18 major U.S. markets (December).
- Number of U.S. broadband users reaches 47 million, according to Computer Industry *Almanac*. (December).

2006

Municipal Developments

- San Francisco TechConnect issues RFP (February).
- Provo's Energy Department requests $1 million transfer from electricity reserve fund to cover revenue shortfalls for the iProvo fiber system. (February).

Technology and Market Developments

- Verizon Wireless introduces VCAST service, providing audio and video downloads for cell phones (January).
- Verizon begins national FiOS rollout (January).
- Number of WiFi hotspots worldwide hits 100,000, with 37,000 in the U.S., according to Jiwire. (January).
- Boingo Wireless network reaches 26,000 hot spots internationally (February).
- T-Mobile network reaches 6,000 locations in U.S. (February).
- Nokia and T-Mobile introduce dual WiFi/cellular phones and service. (February).

continue to do with follow-up reports from the Beacon Hill Institute, the Progress & Freedom Foundation and The Heartland Institute, which reached the same conclusions.

Yet the pattern of poor performance became harder to refute as municipal broadband operations across the country continued to fall behind. In the meantime, broadband proponents had trouble pointing to any outright success in which a municipal broadband operation achieved positive cash flow, low prices, and a sizable enough market share to not need subsidies.

- Marietta Ga., after investing $35 million in a system, sold its system for $11 million.
- Grant County, Wa., Public Utility District, halted construction in April 2005, electing to "stand pat" with only a portion of the residential areas covered.
- Also last spring, Ashland, Or., after lengthy debate, opted to put its uncompleted system up for sale rather than continue funding it.
- Balance sheets for systems in Lebanon, Ohio; Bristol, Va., and Cedar Falls, Iowa, continue show rising debt and deficits, along with revenue shortfalls propped up by subsidies and transfers.
- Proposals on the table since 2004 and earlier—in Truckee-Donner, Ca.; Crawfordsville, In., and Palo Alto, Ca., have not attracted the low-interest financing the business plans require.

The last three major fiber-optic projects to have been proposed were in Batavia-St. Charles-Geneva, Il. (the so-called "Tri-Cities"), Provo, Utah; and Lafayette, La. In the Tri-Cities a $62-mllion plan for a municipal retail fiber-to-the-home plan was voted down twice, first in April 2003 then in November 2004.

In 2004 Provo, Utah launched iProvo, a $39.5 million fiber optic backbone—relying on one local retailer to handle retail broadband sales. The system failed to cover its costs for 2005 and the retailer went out of business. In March 2006, iProvo requested a transfer of $980 million from Provo's city electric utility to pay for shortfalls in 2006. The operation has advised the city it may need $2 million more in transfers in the next two years.

In Lafayette, La., a $125-million fiber-optic initiative passed in a July 2005 referendum. Construction has not started, in part because Lafayette's financing plan has been tied up in courts. BellSouth and Cox Communications, the two area incumbents, have claimed the plan violates Louisiana law because it calls for electric revenues to be used to pay off loans if the telecom side cannot meet its debt obligation.

3. The Rapid Rise of Municipal Wireless

Lafayette may have proved a pyrrhic victory for municipal fiber optic, as no other project like it has been announced since. Cities instead have turned their attention to broadband wireless, particularly WiFi, a standardized format for transmitting high-speed data via radio over distances of about 100 feet. Originally embraced by businesses to extend the reach of local area networks around corporate campuses, the easy installation and inexpensive equipment WiFi uses made it popular among consumers for home networks and as an amenity in coffee shops, hotel lobbies and airports.

Of the current operational systems, most have launched in the last few months. Even so, the road has been bumpy. One of the earliest systems, Chaska, Mn., which

launched in 2005, is often cited as a successful example of government-run municipal wireless. It markets service for $15.95 a month. Although cheaper than other wireless services, its speed is substantially less than competitors. In addition, the city ran into radio optimization problems and spent $300,000 on top of the initial $600,000 investment to improve signal coverage.

St. Cloud, Fl., which launched free city-wide service in early 2006, is experiencing similar problems, according to press reports. As system use grows, customers who had been getting acceptable connections began having trouble accessing the network. The city has advised some residents to purchase a $170 wireless bridge in order to improve their connections.

4. Backlash Against Partnerships

Government-run wireless operations tend to be limited to small towns and, either way, are fast becoming the exception. Rather, the trend is toward public-private partnerships in municipal wireless. Aside from Philadelphia, the other closely watched wireless effort the past year has been in San Francisco.

In April, San Francisco TechConnect awarded its municipal network bid to a partnership of EarthLink and Google. When the TechConnect proposal was floated the previous fall, Google proposed a free wireless business model using location-based advertising.

Two Bay Area activist groups, Media Alliance and the Community Technology Foundation of California, which originally supported municipal wireless, have come out against plans to turn operations over to Google, which they claim is no better a choice than the incumbent "monopoly" telephone and cable companies. They continue to demand city ownership of the network.

The Google plan, they say, forces low-income users to trade privacy for free service. To deliver location-based, personalized advertising, the system would have to track the user as he or she moves around the city, as well as the user's spending and purchasing habits. In addition, they complained (with some validity) that the winning proposal fell far short of requirements contained in TechConnect's original plan. With national attention on the San Francisco wireless project, many felt that the city expedited the bid to engineer a quick win for San Francisco Mayor Gavin Newsom, who is said to have presidential aspirations. Newsom himself has invested political capital in the success of TechConnect. At the time the proposal was announced, Newsom declared free broadband was a "civil right."

Opposition to public-private partnerships is not limited to San Francisco. In Minneapolis, the Institute for Self-Reliance has attacked the city's plan to award a contract to a private partner. As its counterparts argue in San Francisco, the Institute for Self-Reliance has argued that citizens will be better served if the city government owned the network and supplied the service.

5. The Outlook

Despite objections from some circles, it is doubtful that any future large-scale municipal broadband projects will be funded from government coffers. Since Wireless Philadelphia began moving forward, almost every announcement of a wireless project is qualified with the phrase "no taxpayer dollars will be used."

In the end, these decisions are made from an extremely practical standpoint—

most cities simply don't have the funds to devote to a telecom network. Yet, it is no less a victory for the free-market approach. Even without using tax dollars, when cities effectively insert a monopoly, especially in a fast-changing, high-tech field, consumers lose the free market advantages of cutting edge technology and competition-driven lower prices.

In the end, the arguments put forth by those urging caution were validated. The emergence of companies such as EarthLink, MetroFi and Google showed that the phone and cable companies have no monopoly on broadband innovation. Changes in franchise regulations are speeding competition in broadband and cable markets, and prices are dropping as a result. Applications that have emerged since 2000—legal music downloads, multiplayer gaming and most recently, movie downloads, are providing the badly needed value proposition broadband has lacked. Broadband use in the United States is reaching 60 percent.

Better still, the relationships between municipalities and broadband service providers are growing less antagonistic. In past years, municipalities turned to consultants who specialized in the legal and financial mechanisms of public utility operation, and who tended to advocate a more confrontational stance toward local incumbents.

For assistance with wireless, cities are instead relying on experts who have experience with wireless network design and operation. While not always philosophically aligned with free-marketers on the government's role in broadband, these consultants are attempting to create better lines of communication and cooperation between municipalities and the wireless industry. Most of their efforts are spent on educating city governments about the true costs, capabilities and limits of wireless technology. Matters are coming full circle. For example, AT&T (formerly SBC), which had aggressively fought municipal-owned broadband, is one of 20 bidders for a wireless project in Grand Rapids, Michigan.

Public-private partnerships, however, face challenges and, as with any government project, the risk for abuse remains. Most agreements give the private partner a substantial break on the cost of right-of-way and the use of city-owned property. These concessions are granted in return for the obligation to meet citywide coverage requirements and price points. The city needs to have the appropriate accountability safeguards in place to assure its partner follows through on its commitments.

City officials also must avoid getting too wrapped up politically in the success of the project, a problem that may already exist in San Francisco. Should city-sponsored systems encounter robust competition, or miss their revenue targets, local officials, afraid of being identified with a failure, may be tempted to "bend the rules" and inflate city budgets, "loan out" city employees or use other means at their disposal to inappropriately sustain the partnership. This, however, is a danger with any contractor relationship.

In their public-private form, municipal wireless systems show every sign of growing in the near-term. How successful they will be in the long term remains to be seen. The best that can be said is that the public, in most cases, is not bearing the risk.

C. Network Neutrality Update

While it has fueled heated argument in telecom policy circles, "network neutrality" remains a misunderstood principle. The

network neutrality principle contains three basic elements:

- No service provider should be permitted to block access to any Web site or Web-based application.
- No service provider should prevent any device capable of using the Internet Protocol (IP) from accessing the network.
- Service providers must treat all data that moves across their networks the same way.

At first glance, it sounds reasonable and fair, given that much of the Internet culture is tied to equality and ease of access. The Internet's foundations lie in the spirit of open community. No site on the Internet was closed off. Likewise, anyone with a PC and a phone connection could share his or her own data with the on-line world. As the Internet matures and its commercial aspects become even more predominant, many believe that to preserve this spirit of community and openness, government must enforce network neutrality.

The push for network neutrality has come from the liberal side of the spectrum, driven mostly by fears that commercial enterprises, especially the large telephone and cable companies that control most of the broadband "on ramps" to the Internet and World Wide Web, will begin to exercise greater control over the consumer's Internet experience. This could take the form of favoring applications from content and applications providers who agree to form business ties with carriers to outright blocking of Web sites and applications, such as Voice over Internet Protocol (VoIP) calling, offered by competitors.

Until this year, the net neutrality debate was fomenting among technology elites, but confined to the legislative background. With the past few months, however, the issue has caught the spotlight. In Congress, there are two House bills, a Senate bill and a Senate proposal to legislate network neutrality.

In response to assertions by AT&T, Verizon and Comcast that carriers had the right to seek compensation from providers of bandwidth-intensive content and applications for management strain they place on the Internet, in April, MoveOn.org, the Web-based liberal activist group, took a position in favor of network neutrality, pushing it further into the policy limelight. In May, Rep. Edward Markey (D., Mass.), ranking member of the House Telecommunications Subcommittee, introduced legislation that would codify network neutrality into law. The measure has the backing of House Minority Leader Nancy Pelosi D., Ca.). Authors of these measures ultimately hope to add a network neutrality amendment to the two draft telecom reform bills currently moving through the House and Senate.

Phone companies, cable companies and ISPs appear ready to endorse the first two elements of network neutrality—access to Web sites and IP interconnection—arguing that these aspects of the Internet were never in danger to begin with. No U.S. service provider has ever made it a policy to block applications or Web sites. There has been only one instance of application-blocking, when Madison River Communications, a small North Carolina Internet service provider, blocked Vonage's VoIP application. Using existing enforcement mechanisms, the FCC ordered Madison River to stop the blocking and fined the ISP $15,000. Likewise, no U.S. service provider has ever attempted to block connection of an IP device to the network. And since IP is a standardized format, it

would be difficult to do so.

The third element, non-discrimination in treatment of Internet traffic, has caused the most controversy, however. Simply stated, a network neutrality policy decrees that carriers cannot selectively improve or guarantee the quality of third-party applications and services that cross their networks—let alone charge for it. Conversely, any quality enhancement offered to one, must be offered to all. It doesn't matter if you are Sony Pictures streaming "The Da Vinci Code" in high-definition and 5.1 Dolby stereo, or the soccer mom down the street emailing a photo of the kids to grandma: your data gets treated the same as everyone else's. Network neutrality proponents also argue that improving service for one is equivalent to diminishing service for another. There is no room for "good, better, best" distinctions.

Opponents of enforced neutrality argue this policy would set a significant precedent in the economic regulation of the Internet—equivalent to the introduction of price controls. Since network neutrality would prohibit telephone and cable companies from allocating the costs of managing large amounts Internet traffic to the parties directly responsible for that high-traffic volume, it would interfere with the law of supply and demand. Companies that supply Web-based services like movie downloads and multiplayer games that consume large amounts of bandwidth and require real-time, error-free delivery will be economically divorced from bandwidth they consume or the management resources they use.

This stands to have consequences for all users of the Internet, opponents argue, be they simply consumers who like to surf, small businesses with low-volume Web sites, or major corporations who seek to use the Web to create new revenue streams, because it would prohibit the creation of special lanes to handle traffic that requires extra care and management.

Right now, there is no shortage of bandwidth, thus it remains fairly inexpensive. Some engineers argue that advances in IP technology will always ensure adequate bandwidth. In that case, the network neutrality issue is moot. Others say that it is inevitable that applications will consume the bandwidth available, and that sooner or later, carriers will be required to engineer their networks to manage and optimize high bandwidth services. Since a network neutrality law would prevent a carrier from turning to the very parties whose services require optimization and quality safeguards, it would leave carriers with two lesser options: Spread those management costs among all users, raising the cost of broadband service for everyone no matter what their usage habits, or continue to attempt to manage traffic within the current "best effort" framework of IP.

Although the network neutrality issue is often portrayed as a grassroots effort against a handful of phone companies, there are large and diverse interests on both sides.

Major players in broadband applications, content and e-commerce who support network neutrality include Google, eBay and Amazon.com. The Financial Services Roundtable, a group representing the nation's largest banks and financial institutions, has also backed legislation. Microsoft and Yahoo are leaning toward support as well, although they have yet to openly advocate it.

Meanwhile, in addition to the phone and cable companies, numerous manufacturers of Internet infrastructure equipment,

There are No "Dirt Roads" on the Internet

Network Neutrality advocates are trying to scare us into believing that if carriers create a two-tiered management structure for handling Internet traffic, everyday users will be shunted off the information highway onto the backroads.

"The top tier would be a "Pay-to-Play" high-speed toll-road restricted to only the largest companies that can afford to pay high fees for preferential access to the Net," eBay CEO Meg Whitman wrote in a letter to members of the on-line auction giant urging their support for network neutrality. "The bottom tier–the slow lane–would be what is left for everyone else. If the fast lane is the information "super-highway," the slow lane will operate more like a dirt road."

But Whitman mischaracterizes the issue as a matter of the Internet speed when in reality, it is about the way sophisticated Web-based applications are handled.

Network neutrality demands we treat all information the same. But today there are Web applications and content that need to be treated differently in order to work properly for the user. Obvious examples include DVD-quality video, which not only takes up a lot of bandwidth, but calls for low latency (the delay between transmission and reception of data bits) and real-time error correction. Another is VoIP, which also has little tolerance for high latency. A policy of network neutral non-discrimination would diminish the quality of these services out of the box.

Consumers are paying for a high-bandwidth connection to their home. They are not paying for the prioritization, quality and management of third-party applications that are delivered over this connection. Furthermore, the service providers, who own this connection, do not believe consumers should have to pay for this additional optimization and management. They want to selectively target the large Web content and applications providers, such as eBay, who are responsible for the increased bandwidth management costs–and who profit from the services that need them.

Quality of service is not a zero-sum proposition. Improving quality for one does not diminish quality for another. Most data that moves across the Internet will continue to work as well, if not better, in an environment where carriers are allowed to manage and prioritize bandwidth. Overnight package delivery recognizes the mission-critical needs of some shipments. Yet overnight delivery does not diminish standard three-day service. The same shipper, in fact, may use both services, depending on specific requirements. If we were to apply the principle of "neutrality" in package delivery, it wouldn't change three-day service; all it would do is prohibit anything faster.

ranging from broadband powerhouse Cisco Systems to Ellacoya Networks, a privately held vendor of network management technology, have urged caution on the policy, as have a number of investment research and analysis firms who fear it will slow broadband investment.

It is difficult to say which way this will go. Network neutrality proponents are attempting to make the issue about free speech on the Internet and preserving its open nature. Their arguments are flawed but com-

pelling. The major media companies, which also plan to use the Internet for delivery of high-bandwidth services, also have an interest in promoting network neutrality.

On the other side, it is clear that some legislators do grasp the inherent problems of a network neutrality rule. During his opening statements in a Senate hearing on network neutrality May 25, 2006, Sen. John McCain (R, AZ) stated that network neutrality legislation would not cover the prioritization of 911 calls made over the Internet using Voice over Internet Protocol (VoIP). Although he did not say so in so many words, his comments called attention to the fact that one of the government's few regulatory requirements regarding Internet services—VoIP 911—runs directly counter to network neutrality's principle of non-discrimination.

Still, despite the new interest in the issue by organizations like MoveOn.org, it has not hit voter radar the way other telecom reform issues such as video franchising, "a la carte" cable pricing, or content regulation have. Right now, the burden of forcing change is on the activists, as network neutrality is not codified anywhere. As the Republican majority in Congress has not proved responsive, much depends on how much momentum lawmakers such as Markey and Pelosi can generate. If telecom reform is passed this session, a network neutrality provision will likely be left out or diluted. If reform is shelved until next year—and Democrats gain a majority in Congress, the issue stands to become more visible and volatile.

D. Video Franchise Reform Update

Although just one facet of the policy debate on telecommunications deregulation, reform of video franchise fees has bubbled up as an action item in statehouses and in the U.S. Congress.

Video franchises are the revenue-sharing agreements that cable TV companies sign with local governments in return for the right to offer video services to customers. As the country's largest telephone companies begin to deploy broadband networks that can support cable TV and cable TV-like services, they have been pressing for changes in the process that would let them apply for a statewide franchise in one fell swoop, eliminating the need to go from town to town to negotiate individual agreements, as cable companies were forced to do in the past. Franchise reform, they say, would allow them to deliver competitive video services to consumers faster and cheaper.

So far Texas and Indiana have passed measures that allow statewide franchising. Virginia passed a bill that attempts a degree of reform, but still keeps much of the franchising authority with cities and towns. There are bills pending in Kansas, Louisiana, Missouri, New Jersey and South Carolina. The Florida state legislature also introduced a franchise reform bill, but lawmakers adjourned before the bill reached the floor.

National franchising is a provision in an unnumbered draft telecommunications reform bill sponsored in the House of Representatives by Reps. Joe Barton (D., Tex.) and Bobby Rush (D., Ill.). In the Senate, a draft bill sponsored by Sens. Ted Stevens (R., Alaska) and Daniel Inouye (D., Hawaii) calls on the Federal Communications Commission to standardize the franchise process, but preserves a degree of authority to municipalities. As the law is currently drafted, municipalities would have thirty days to approve a franchise application from a new

entrant. If the municipality fails to act, the FCC acts as franchising authority by default.

Consumers have proved generally supportive of franchise reform, which promises to deliver a new competitive alternative for local cable companies, dominating local markets, even where direct broadcast satellite (DBS) services are an option. After the bill failed during the Texas legislature's regular session in the spring of 2005, constituent pressure put it back on the docket in the special session that summer, when it passed.

For the telephone companies themselves, statewide franchises offer expedited market entry, faster revenues and a more predictable procurement and deployment schedule.

Aside from the cable companies, which have lobbied heavily against franchise reform, resistance to reform has been strongest from local franchise agencies, which fear loss of a key revenue stream as well as political leverage. Estimates from the Mackinac Center for Public Policy put total franchise payments in the United States at $3 billion a year.

In some communities, revenues from franchise fees pay for use of city right-of-way and compensates the city for costs it incurs when service providers need to dig up streets to bury cable. But more often than not, the right-of-way fees are levied on top of franchise fees, and franchise fees go directly into the city's general revenue pool.

Typically, local franchise agreements call for cable companies to pay 3 to 6 percent of video-related revenues to the franchising authority. Since companies have the right to pass these fees onto customers, they effectively amount to a special tax on consumers of video service. At the local level, the "video-related" revenues subject to fees are negotiable. In addition to percentages of straight-up billings for cable TV service, towns often demand a portion of revenues from advertising sold by local cable companies and a cut of sales commissions received from home shopping networks.

Franchise agreements also call for companies to set aside channels for public access, education and government (PEG). Most local franchise agreements carry build-out requirements that ensure the cable company serves the entire community. Finally, local franchising agencies often use the process to negotiate specific side deals, such as free service for schools and government buildings. These provisions can extend areas unrelated to cable or telecom services. A study by the Pacific Research Institute found that, in addition to other requirements, Verizon was asked to turn over a parking lot for use as free parking for a library. Another city requested free cable television for every "house of worship" and a 10 percent discount for select customers. Yet another asked a franchisee to fund a new recreation center and pool.

While state measures tend to keep revenue-sharing and aspects of local control in place, they do codify them. Texas and Indiana allow municipalities to collect 5 percent of service revenues, but limit the definition to cable billings only and exclude advertising and commissions from shopping channels, not to mention other concessions. The federal measures are similar. PEG channel requirements are also retained.

Build-out requirements remain a point of controversy, however. While telephone companies state they are committed to providing video service to all areas, they have generally opposed legislated timetables. Opponents of franchise reform have seized on this resistance, accusing the phone companies of

targeting only high-income neighborhoods and "red-lining" less affluent areas.

Although telephone companies have shown an inclination to begin deployment in higher-end communities, there is no evidence that they plan to limit upgrades to those areas only. Indeed, their early pricing strategy attempts to undercut cable packages and offer less expensive options in an effort to capture consumer segments where cable penetration is poor. Verizon, for example, offered a 35-channel plan for $12.95 a month, in its north Texas markets, undercutting all competing low-rate packages. In Ft. Wayne, Indiana, the company began its roll out of video services in the lower-income neighborhoods first.

Meanwhile, Edward Whitacre, chairman and CEO of AT&T, told the Detroit Economic Club in early May that the company intends to make its Project Lightspeed Internet Protocol (IP) video services available to more than 5.5 million low-income households as part of its initial build in 41 target markets.

While the inclination is to take such statements at face value, evidence of these commitments appears in the balance sheets of manufacturers from which telephone companies buy network equipment. Vendors that have in the past sold to cable companies are telling shareowners that telephone company sales will be a key contributor to future growth. In its 2005 Annual Report on 10-K (a corporate report submitted annually to the Securities and Exchange Commission), Motorola Inc. noted that its Connected Home Solutions Segment, a leading U.S. supplier of set-top boxes and cable modems, "is capitalizing upon the introduction of video services by telecommunications operators to their subscribers ("Telco TV" or "IP TV") with products that support delivery of video content using both copper-outside-plant and fiber-to-the-premises networks."

Motorola reports that in 2005, 5 percent of the Connected Home Solutions Segment's $2.8 billion in revenue, or about $140 million, came from telephone carriers. To enhance its competitiveness in this area, in February the company completed the acquisition of Kreatel Communications, which it described as a "leading" developer of IP-based set top boxes.

Motorola's chief competitor in set-top boxes, Scientific-Atlanta, was acquired by Cisco Systems, the leading manufacturer of IP routers for $7 billion. Cisco has said it aims to wed its Internet and IP know-how with Scientific-Atlanta set-top box technology to develop video networking solutions for the major phone companies.

Given the size of the investments on the part of vendors—and the payoff they are already beginning to see—it is hard to conclude that they expect their phone company video services to be a niche market offered to a tiny percentage of wealthy U.S. households. Policymakers should be wary as well.

But it could be consumer pocketbook issues that trump all others. When competition appears, prices go down. For example, when Verizon unveiled its FiOS fiber-optic video service in Keller, Plano and Lewisville, three communities near Dallas at $43.95 a month for 180 video and music channels, the local cable provider, Charter Communications, immediately dropped its prices, offering a bundle of 240 channels and fast Internet service for $50 a month. It had been charging $68.99 for the TV package alone.

The consumer experience in Texas followed the trend in other markets where cable competition has been introduced. Wher-

ever there is video competition, consumers see a break. In Florida, for the first time in a decade, Comcast is not raising rates in Manatee and Sarasota counties, according to a report last week in the *Miami Herald*. The reason: Verizon—working within the current franchise process—already has introduced cable services in Manatee and is close to a franchise agreement in Sarasota.

In a new report, Yale M. Braunstein, a professor at the School of Information at the University of California at Berkeley, cites FCC measurements of competitive and non-competitive cable markets that found subscription rates for basic and expanded basic services were on average 16 percent lower in the competitive group. Using the data as a baseline, Braunstein predicts cable competition franchise reform will save California consumers between $690 million to $1 billion.

In another recent study, Thomas W. Hazlett, professor of Law and Economics at George Mason University, explains "Were head-to-head wireline video rivalry now offered to just under five percent of U.S. households, to extend nationwide, annual benefits to consumers are estimated to approximate $9 billion, with overall economic welfare increasing about $3 billion per year."

The likely outcome is that the push for franchise reform will continue. Even if efforts fail in Congress, reform will continue in the states. That's not to say debate won't be contentious. Officials in Roselle, Illinois ordered AT&T to halt a network upgrade for 180 days so the town could make a decision on the video franchise implications. The Roselle delay is part of a coordinated effort by at least 11 other local communities in suburban DuPage County to stop telephone companies from upgrading their networks—even if it means delaying citizens a competitive choice for cable TV—until exact franchise rules can be determined.

Bottom line, telephone companies seem willing to accept retention of a revenue-sharing arrangement, PEG obligations and loosely constructed build-out requirements. Cable companies seem to want the ability to upgrade to a state franchise when a competitor enters, or at the very least, be subject to the same rules. Their early opposition to any franchise reform has given way to efforts to assure they get a fair deal.

Few companies or lawmakers have called for the outright elimination of franchise fees, even though competition subverts the very definition of "franchise," which implies a degree of geographic exclusivity. Yet changes in technology, particularly the way the Internet can be used to deliver video, may challenge the entire franchise structure. In recent weeks, some local officials have begun to acknowledge this.

In Oklahoma, Attorney General Drew Edmondson issued an official opinion stating that a telephone company with existing statewide authority to place its phone lines in the public rights-of-way does not need to obtain separate municipal franchises if it plans to provide additional services—including video—over its phone lines.

"A 'telephone line' does not cease to be a telephone line because it is used for transmitting video service in addition to voice service," Edmondson wrote in his opinion. "Although we can find no Oklahoma cases on this point, cases in other jurisdictions that grant telephone companies statewide access to rights-of-way have decided this issue."

In another development, the Connecticut Department of Utility Control tentatively

ruled that telephone companies that use IP video platforms are not subject to franchise fees.

Internet-protocol television is "merely another form of data stream," the DPUC ruled, according to Multichannel News.

Already users can download video programming from Web sites. iTunes and Vongo are only two examples. In mid-May, Fox announced plans to make episodes of its hit series "24" available on Myspace.com. The revenue from these downloads is not subject to franchise fees. It begs the question as to how local agencies might react if cable and phone companies were to set up their own Web-based content aggregation units and shift collection of video revenues to those operations.

Curt Pringle, mayor of Anaheim, is the only elected official in a major metropolitan area to suggest local municipalities wean themselves from franchise fees because they hinder broadband deployment.

"The current franchise system inhibits additional companies who might be subject to it from entering the marketplace and investing in infrastructure when they are challenged by the expense and difficulty of attaining enough market share to recoup costs," Pringle told the Federal Communications Commission in April. "Franchise fees and many elements within franchise agreements, therefore, are merely an artificial intrusion by government into the consumer marketplace. Attempts to apply franchise fees and agreements to some providers, while exempting others, effectively eschew the market.

"Therefore, eliminating these fees and impediments…will allow equitable competition amongst the variety of video service providers. In this way, and without local government interference, the various systems compete in price, quality and quantity and consumers decide which service provider they prefer."

Growth and Land Use

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A. Eminent Domain Update

Politically, the high water mark of the American socialist movement was 1912 when Eugene Debs captured 6 percent of the presidential ballot and more than 1,200 socialists were elected to public office throughout the nation. The movement went into decline after that, focusing more on the hearts and minds of America's intellectuals and labor leaders. In law, some of those ideas hung around and apparently found a home within the minds of America's leading legal scholars, and the implications for markets and private sector development are severe.

This may seem like a bold, perhaps even ideological, conclusion. But this progressive-era thinking is evident in how the U.S. Supreme Court justified the condemnation and seizure of private property for economic development purposes in *Kelo vs. City of New London*. The Court, in a 5-4 decision, upheld New London's efforts to clear the Fort Trumbull neighborhood of New London for redevelopment even though the only legal justification was economic development and increasing the tax base and the primary beneficiaries would be private developers. Virtually any project that could show a net improvement in the tax base over current uses could be considered a justification for condemning private property under the "public use" provisions of the Fifth Amendment.

1. *Kelo* Undermines Property Rights

The legal and ultimately economic principle at stake was whether individuals

had a fundamental right to private property that could prevent the democratic majority from taking their homes or businesses. Our Founding Fathers believed private property rights were fundamental for securing liberty: embracing James Otis's phrase "A man's house is his castle" wasn't a flippant deference to ego. The castle was a protective fortress from covetous and arbitrary actions by government and your neighbors. "One of the essential branches of English liberties is the freedom of one's house," Otis said. James Madison, for example, wrote in his *Essay on Property* that "Government is instituted to protect property of every sort; as well that which lies in the various rights of individuals, as that which the term particularly expresses. This being the end of government, that alone is a just government which impartially secures to every man whatever he owns."

In *Kelo*, however, the Supreme Court said the government could seize the property of private homes and businesses and hand them over to private developers, even if the only motive was to raise new tax revenue from economic development. One of the concurring justices, Anthony Kennedy, was even more direct. He believed the property could be taken because the city had a well-considered development plan to justify the redevelopment.

In *Kelo*, however, the Supreme Court said the government could seize the property of private homes and businesses and hand them over to private developers, even if the only motive was to raise new tax revenue from economic development.

Thus, in effect, the U.S. Supreme Court said your home is no longer your castle. If the majority of your local city council, county commission, or state legislature doesn't approve of who is living in your home, how your home was made, or what your home is used for, and the city has a better idea for how it could be used, the government can take it and give it to someone else. Majority rules.

In economic development parlance, the majority decision demonstrates that a community benefit is created from the seizure of private property, justifying its condemnation and transfer to another property owner. Property ownership becomes subject to a cost-benefit rule and is no longer a matter of civil liberties. The key question before the courts is whether the government followed the proper procedures—had the right number of hearings, made an official declaration of public purpose, followed the correct state statute, or properly conformed to the intent of state law.

2. How *Kelo* Alters Redevelopment Policy

Of course, *Kelo* was focused narrowly on property rights. Other basic rights such as free speech, religious practice, trial by jury, protection from unreasonable searches and seizures still exist and are constitutionally protected. For now. But, the idea that one's home is her castle went out the window. For all intents and purposes, property ownership has lost its status as a "right" and its place as a substantive check on government power, although the government still has to compensate property owners for their property once it's seized. Of course, that's little consolation to families and small businesses thrown out because your local government and well-heeled property developers have better ideas about how it should be used (and who should live or

work there).

The urban landscape has been fundamentally altered. Why should a company privately negotiate with property owners when it can go to the government and have officials take it for them? The government can do it cheaper, and it often sells the property at a subsidized price. (Otherwise the private company would buy it itself to control the conditions of sale).

Conservatives supporting the *Kelo* decision believe that it strengthens the private sector's role in economic development and redevelopment. Jeff Finkle, the president of the International Economic Development Council, a trade association representing economic development professionals and agencies, notes that without eminent domain for economic development purposes and the ability to transfer property to another private party, cities might become land developers themselves. "Communities will just use alternative means for achieving economic development ends," Finkle said in an interview for *Reason* magazine in 2003.

The private sector has not technically been excluded from developing property. The politics and dynamics of redevelopment, however, make this result inevitable, even if unintended. And the effects are real. Take the opening line from an article by Joshua Ackers in the *Albuquerque Journal*: "There is a lot of money to be made in Rio Rancho's Unit 10, and Rio Rancho's City Council soon might put itself in the position of deciding who is going to make it." The city is going to condemn two square miles of the city and offer it to private developers for redevelopment.

These kinds of actions now have carte blanche in America's cities thanks to *Kelo v. New London*, and the pragmatic progressive perspectives of five Supreme Court justices. The idea that they were encouraging the overthrow of capitalism was probably not obvious when the Supreme Court justices sided with the city of New London. But that's the effect.

3. Political Backlash

The *Kelo* decision generated a tremendous amount of media coverage and provoked a sense of outrage across wide swaths of the American populace. For example, a Quinnipiac University poll taken in Connecticut found that 89 percent of respondents opposed the taking of private property for private uses, even if it promotes the "public good." Similarly, a *Wall Street Journal/NBC News* poll taken just weeks after the Kelo decision found that survey respondents cited "private-property rights" as the current legal issue they care most about.

Fortunately, the U.S. Supreme Court left an opening for the states. While federal law and the courts would not protect private property owners from eminent domain, states could. Since the *Kelo* decision, 47 states have begun reviewing their eminent domain laws. Nineteen states have either signed or passed laws further restricting the use of eminent domain according to the Castle Coalition, a grassroots organization in Washington, D.C. tracking state eminent domain legislation.

Some states have adopted strong laws. Florida, for example, prohibits land seized by eminent domain to be transferred to another private landowner for 10 years. Indiana excluded economic development as the sole reason for using eminent domain and is considering tightening up its criteria for determining blight. Alabama was one of the first states to restrict eminent domain

significantly by adopting a blanket prohibition on using eminent domain for economic development purposes.

State courts have also begun to rein in eminent domain. The Michigan Supreme Court ruled in *Hathcock v. County of Wayne* (2004) that economic development was not a legitimate public purpose. The decision was significant because it reversed the Michigan Supreme Court case *Poletown v. City of Detroit* that began the wave of condemnations for economic development purposes 20 years earlier. More recently, the Oklahoma Supreme Court rejected the reasoning of *Kelo*. In *Board of County Commissioners of Muskogee County v. Lowery*, the Court ruled that economic development was not a legitimate public use under the Oklahoma Constitution.

The federal government has also responded to the *Kelo* decision. On June 23, 2006—the first anniversary of the Kelo decision—President Bush issued an executive order preventing federal agencies and departments from exercising the power of eminent domain for primarily economic development purposes or to benefit private parties, limiting the allowable use of eminent domain to the taking of private property for public projects such as government buidings, hospitals, or roads. Further, the U.S. House of Representatives passed the Private Property Rights Protection Act of 2005 (H.R. 4128) in late 2005, which would prevent state and local governments from exercising the power of eminent domain for economic development purposes if they receive federal funding, as well as prohibit the federal government from condemning property for economic development. Also, the House approved H.R. 3058, an amendment to a Treasury, Transportation, and Housing and Urban Development Appropriations bill that would deny federal funds to any state or local project involving the use of eminent domain on economic development grounds. Several Senate bills covering eminent domain reform have also been introduced, though no bills have passed to date.

4. Conclusion

Though the *Kelo* decision cast a dark cloud over the landscape by exposing how frail the protection of private property rights has become, the silver lining is that popular support for private property rights protection has surged since the *Kelo* ruling, with efforts at all levels of government to restrict the power of eminent domain to a more limited set of uses. Prior to *Kelo*, there was little recognition among average citizens of the power of government to take land from one owner and give it to another. Perhaps the biggest irony of *Kelo* is that, despite the Court's ruling, it has led to a greater awareness of eminent domain abuse and a strengthening of private property protections across the country.

B. Protecting Landowners From Regulatory Takings

Oregon's Measure 37 a Model of Reform for Other States

In response to decades of increasingly burdensome state and local land use regulation, a majority of Oregon voters took a decisive stand in favor of property rights in November 2004. They passed Measure 37, a ballot initiative designed to provide relief to landowners whose properties have been devalued by three decades of regulation and to protect Oregon's property owners from economic hardship that may result from future regulations.

Measure 37 requires that local governments either: (1) compensate landowners when land use restrictions reduce the value of their property (so-called "regulatory takings"), or (2) waive the restrictions and reinstate the rights that property owners had at the time they bought their land. Proponents argue that Measure 37 restores to landowners property rights that have been taken away from them by land use regulations. In this view, the regulation of private property for the public benefit should be paid by all taxpayers instead of by individual landowners. Measure 37 also provides a check on government power by ensuring that state and local governments adequately weigh the costs and benefits of public action.

Measure 37 specifically exempts several types of land use regulations from compensation claims, including historically recognized public nuisances, public health and safety regulations (such as building codes, health and sanitation regulations, and pollution controls), regulations enacted to comply with federal law, and regulations restricting or prohibiting pornography sales or nude dancing.

Measure 37 also provides a check on government power by ensuring that state and local governments adequately weigh the costs and benefits of public action.

Measure 37 gives local governments 180 days from the date the owner submits a written request for compensation to process the claim and make a decision on a remedy if it finds that compensation is due. If the government has not resolved a Measure 37 claim after 180 days, then the owner may file a lawsuit in the circuit court in the county in which the property is located. Property owners found to have successful Measure 37 claims are entitled to reimbursement for attorney fees, expenses, and other costs associated with filing their claims.

Finally, Measure 37 offers much discretion to state and local governments in creating their processes for handling compensation claims, while simultaneously protecting property owners from any onerous administrative burdens (such as exorbitant claim processing fees or excessive documentation requirements) that governments may choose to impose upon Measure 37 claimants.

1. Debunking Prevalent Measure 37 Myths

Myth: *Measure 37 Decimates Land Use Regulation*: Perhaps the most commonly voiced arguments against Measure 37 among opponents are that its real aim is to subvert Oregon's land use laws and that it will result in endless sprawl and land use conflicts. However, Measure 37 does not apply to all land use regulations, and it does not prohibit state and/or local governments from adopting laws that regulate public health and safety.

Myth: *Measure 37 is Costly and Complex*: Opponents have complained that Measure 37 will be costly and complex to administer and that compensation claims could total untold billions of dollars, for which Measure 37 provides no funding mechanism. In practice, however, state and local governments have favored waiving regulations rather than compensating successful claimants, limiting the cost burden they bear under Measure 37.

Myth: *The Measure 37 Claims Process is Arbitrary*: Opponents complain that the Measure 37 claims process is arbitrary since it provides no standards for how government decides who gets paid and who

doesn't. However, Measure 37 can be seen as an effort to correct for the unfairness that results from traditional zoning, where some property owners are limited and others are not. Measure 37 proponents also counter that the measure gives every property owner exactly the same right: the right that they had to develop their property at the time they bought it.

Myth: Measure 37 Will Harm Agriculture: Though most of Oregon's County Farm Bureaus supported Measure 37, some opposed it on the basis that it would hurt farmers by leading to increased taxes and rolling back safeguards that protect Oregon farmland from over-development. Concerns about Measure 37's potential impact on farmland conversion exemplify the perceived conventional wisdom about farmland, open space, and the pace of urbanization in the United States that is at odds with actual land use and agricultural productivity trends. Only around 6 percent of the nation is urbanized, and most states have more than three-quarters of their land devoted to rural, agricultural, and open space uses. There is little evidence to suggest that the nation or individual states face a farmland shortage or crisis.

2. Exporting Measure 37 to Other States

Measure 37, and the lessons learned from both the campaign behind it and its implementation since its adoption by voters, offers a template for property rights advocates to follow in their efforts to enact meaningful regulatory takings reform in other states. Some of the issues other states will need to consider are listed below:

Choice of Vehicle

Drafters will need to decide if they want to amend the state constitution or, alternatively, state statutes. Depending on state law, constitutional amendments or statutory changes may be achieved either through citizen initiative or state legislative action.

Combining eminent domain and regulatory takings reform: In the wake of the U.S. Supreme Court's *Kelo vs. New London* decision, dozens of states have taken steps toward restricting the use of eminent domain to a narrower set of justifiable circumstances. At the same time, legislators and activists in several states have indicated interest in "Kelo-Plus" measures that combine, in one comprehensive set of statutory changes, increased protections against physical takings via eminent domain with increased protections against regulatory takings along the lines of Measure 37. The advantages of pursuing a "Kelo-Plus" measure are several. First, it offers a single vehicle to address both physical and regulatory takings at the same time, effectively "killing two birds with one stone." It also capitalizes on the tremendous public and political momentum generated in the aftermath of the *Kelo* ruling to enhance the protection of private property rights.

Retroactive or Prospective

Measure 37 was designed to cover both new regulations adopted by state and local governments as well as those that are already on the books, given Oregon's unique situation of having in place a far-reaching, decades-old land use regulation system. However, most states have been far less aggressive in extending their regulatory reach through land use controls, so it may make more sense for proponents to design regulatory takings measures on a prospective basis, unless there is a particularly egregious

regulatory situation in their state that they seek to address. The concept underlying a prospective-based measure is clear and easy to understand: if government wants to adopt a regulation that reduces the value of privately owned land, then it will need to compensate landowners for that impact.

Choice of Remedy

From a financial perspective, allowing both compensation and waivers as remedies gives the most flexibility to government in how it addresses valid regulatory takings claims. Under Measure 37, cash-strapped cities and counties have chosen to issue waivers to settle most of the claims processed to date, ensuring that property owners are granted the rights they received when they originally bought their property, while simultaneously giving government an option to avoid monetary liability. However, measure proponents in some states may find deregulation to be the preferred option as a means to effectuate a regulatory pullback, rather than offering a compensation remedy that would keep the existing regulatory regime in place.

Identifying Victims of Regulatory Takings:

In terms of messaging and making an impression on voters, one of the central lessons learned from the Measure 37 campaign was that it is essential to find a human face—or series of faces—to associate with a regulatory takings measure. Instead of explaining the concept of regulatory takings to voters in the abstract, being able to highlight a visible "victim" whose property rights have been taken from him via regulation offers two strategic benefits: (1) it can help measure proponents craft a powerful message that resonates with voters, as it conveys to them that their own property rights are not immune from regulatory takings; and (2) it conveys a legitimate message about the importance of protecting the minority against the abuse of the majority—a well-established concept in the national consciousness.

3. States Take Action on Regulatory Takings

Property rights activists and legislators in several states are already taking steps to enact regulatory takings reform, capitalizing on the momentum generated by the successful passage of Measure 37 in Oregon in 2004 and the state Supreme Court ruling upholding Measure 37's constitutionality in February 2006. Several of these states are also combining regulatory takings reform with curbs on the use of eminent domain in what have come to be known as "Kelo-Plus" measures. For example:

Arizona

The citizen-led Homeowners Protection Effort (HOPE) is gathering petitions to place a property rights protection initiative on the November 2006 ballot. The initiative would stop local governments from using eminent domain to take private property for private development in order to generate more tax revenue. It would also give property owners an opportunity to seek compensation when government adopts land use regulations that decrease their property's fair market value.

California

Property rights activists in California gathered roughly one million signatures to place the "Protect Our Homes Act" on the November 2006 ballot. If passed, this initiative would amend the state Constitution to tighten the rules on the use of eminent domain and ensure just compensation

to landowners whose properties have been devalued through government regulatory actions.

Georgia

Senate Resolution 1040 (S.R. 1040) passed the Senate Judiciary Committee on March 3, 2006. S.R. 1040 would create a constitutional amendment authorizing the General Assembly to pass a bill in 2007 requiring local governments to pay compensation to property owners for the imposition of "unreasonably burdensome governmental actions," including land use and zoning regulations.

Idaho

Citizens in Idaho gathered over 49,000 signatures to place the Idaho Private Property Rights Protection Initiative on the November 2006 ballot. Similar to Measure 37, the Initiative would provide just compensation when a government entity reduces one's home or property values through zoning and other land use regulations. It would also limit governments' ability to take one's property and give it to another private party or person.

Missouri

The supporters of two competing citizen initiatives aimed at curbing eminent domain abuse face a May 9, 2006 deadline for collecting the signatures necessary to get these initiatives placed on the November ballot. One of these initiatives, a constitutional amendment proposed by the group Missourians in Charge, would restrict the use of eminent domain while also providing compensation to landowners whose property values decline because of government regulations enacted after October 7, 2006.

Montana

Citizens are currently collecting signatures to place Initiative 154 (I-154) on the November ballot. I-154 would require state and local governments to compensate property owners for diminished value resulting from a regulation enacted after the acquisition of their property, unless the government repeals the regulation or waives its application to the affected property. I-154 would also prohibit the government condemnation of private property if it intends to transfer an interest in the condemned property to a different private party.

South Carolina

On March 15, 2006, the state House approved two bills that limit governments' ability to take property. By an overwhelming vote, the House approved H.B. 4503, which tightens state statutes governing the exercise of the eminent domain power and includes a provision that requires local governments to compensate landowners if new regulations decrease private property values. The regulatory takings provision was stripped from a companion bill, H.B. 4502, that would place a constitutional amendment on the ballot in November.

Washington

In February 2006, the Washington Farm Bureau filed final language with the Secretary of State's Office for Initiative 933 (the "Property Fairness Act") that would require state and local government to compensate landowners when regulations "damage the use or value" of private property. While it bears some similarity with Measure 37, Initiative 933 would go further by requiring agencies and local governments to detail any "actual harm or public nuisance" that

proposed regulations are designed to stop or prevent, the extent to which they affect private property owners, and whether the goals of the proposed regulations could be achieved by less restrictive means, such as voluntary programs with willing property owners.

Under the initiative, property owners would be entitled to waivers or compensation for restrictions imposed any time after January 1, 2006. In July, Initiative 933 supporters submitted 315,000 signatures supporting the measure to the Secretary of State's office, which if verified will qualify the measure for the November 2006 ballot.

Wisconsin

In March 2006, the Wisconsin Assembly passed AB 675 by a vote of 56-40, creating a process for a property owner to seek compensation from a municipality when the value of his property is reduced due to the imposition of land use regulations. The bill, introduced by Rep. Sheryl Albers (R-Reedsburg), is modeled after Oregon's Measure 37. It has been sent to the Senate and referred to the Senate Committee on Housing and Financial Institutions.

> Property rights will be increasingly critical to successful planning efforts in the United States.

4. Conclusion

Measure 37 represents the boldest response yet to the use of regulation to provide public benefits at private expense, and its passage in a state with a long tradition of (and public support for) growth management suggests that urban planning may not be sustainable unless it incorporates property rights into the regulatory framework. For those in the urban planning profession, the main lesson to be learned from Oregon's experience with Measure 37 is that property rights will be increasingly critical to successful planning efforts in the United States.

Inspired by Oregon's experience with Measure 37, citizens, activists, and elected officials across the nation are accelerating their efforts to develop statewide regulatory takings measures aimed at protecting private property rights from the expanding reach of government and preventing landowners from being forced to bear the hidden costs associated with government regulation. As the advancing efforts to replicate Measure 37 in other states suggest, the message that the regulation of private property for the public benefit should be paid by all taxpayers—not just individual landowners—is clearly resonating with the public.

Portions of this article first appeared on *Planetizen* at www.planetizen.com. For more information on Measure 37 and design considerations for measure proponents in other states, see Reason Foundation's April 2006 study, *Statewide Regulatory Takings Reform: Exporting Oregon's Measure 37 to Other States*: reason.org/ps343.pdf

C. Do School Impact Fees Make Sense?

School districts across nation and local governments are scrambling for new ways to generate revenue for local public services. In recent years, school impact fees have become prominent in local headlines.

The legal and political foundation for impact fees for core public infrastructure and services is reasonably well established. Thousands of municipalities across the nation have levied fees for water, sewer, fire, police, roads, parks and other services.

In some cases, when they are properly calculated and levied, impact fees can be an effective way for local governments to finance enhancements to their local network of core infrastructure. Tap-in fees for water systems, for example, serve the same purpose as a connection fee for cable or telephone services. Ongoing maintenance costs, service upgrades, debt service, and operating costs are paid for through the monthly fee.

Unfortunately, impact fees are the wrong tool for the wrong job when it comes to funding public education. At best, they are just stop-gap funding that doesn't address long-term capital needs. More often, they are smoke screens for groups that are less interested in addressing the real capital needs of schools than in making growth less likely by raising the costs of new housing.

1. Are Impact Fees Fair?

Impact fees are a blunt and confusing tool for meeting school facilities shortfalls. Houses don't send children to school, families do. As a result, no school official can predict how many children, if any, will be sent to a local school district from any one subdivision. New homes can be bought by many people who do not add to the school population: homeschoolers, empty nesters, families who move within the school district, families who send their children to private schools, and childless households. Even counting bedrooms isn't a reliable way to measure the demand for school buildings. Families will often put multiple children in bunk beds, or convert extra bedrooms to a home office.

Impact fees also raise questions of fairness and equity: is it fair to ask residents who don't use these school facilities to pay for them? While childless homeowners certainly benefit from public schools, they already pay property taxes that contribute to public education, regardless of whether they have children who attend school or not. With an impact fee, they pay again.

On an even more basic level: Why should new families have to pay extra for new facilities while established residents benefit from facilities paid for by the entire community, new and old?

2. Practical Limits to School Impact Fees

Even if these questions are resolved satisfactorily, practical limits prevent impact fees from being applied equitably and rationally. Effective and properly applied impact fees have the several key characteristics, including

- Transparency, by tying funds raised in the targeted areas directly to the beneficiaries of the service provided. Water users, for example, will be paying for the cost of the water system.
- Independent accounts, so that revenues are deposited in dedicated funds to facilitate auditing and accounting transparency.
- Professional standards and scientific methods for calculating and measuring the size of the impact fee. The fees are tied directly to the start-up capital costs of the project using estimates that bear a reasonably and professionally accurate relationship to the service provided.
- Identifiable service areas. An impact fee to pay for new roads, for example, is levied within a transportation improvement district that is directly related to the homes or businesses that will use the service.
- Appeal procedures, so that fees can be

challenged and evaluated using an independent body such as the courts or an appeal board.

- Rebate provisions, so that residents and businesses within the impact fee district will not be overcharged for the services provided. This also minimizes the likelihood the fee can used as a way to raise revenues for other services, or to subsidize future or existing users.

Most school districts don't systematically collect data on what neighborhoods or subdivisions their students come from. They can't tie specific facilities to the families who will benefit the most.

Take the city of Pickerington. The city is in a fast-growth county outside of Columbus in central Ohio. The local school district determined it needed a new elementary and middle school to meet growing demand. The city wanted to help fund the new facilities, so it tried to levy a fee on new homes.

Yet, data gathered from the school district showed that most of the students in the new buildings would likely come from at least six separate cities, villages, and townships. Neither the school district nor the city had determined how many students in the facilities paid for by new Pickerington residents would actually come from the new subdivisions. This raises the possibility that the new residents would be subsidizing district-wide facilities.

In short, school impact fees lack many key components of an effective, efficient, and viable financing tool.

3. Courts Muddy the School Finance Waters

Beyond these practical considerations, however, school impact fees face an even bigger problem. Recent school funding litigation has significantly undermined both the theoretical and practical relevance of using impact fees to fund school facilities. In order to boost school spending across the board, public school advocates have challenged state funding formulas in the courts.

Forty-five states have been involved in some form of school finance litigation, notes Michael Griffith in a policy brief for the Education Commission of the States. Thirty two of these cases have centered on whether states fund public education at an "adequate" level. While only fourteen states have lost on adequacy grounds so far, Griffith notes that the pace of courts ruling against state government is picking up. Half of the successful cases were resolved within the last three years.

At the core of these lawsuits is whether state governments have a constitutional duty to fund public education in a fair and equitable manner. Most of these lawsuits are aimed directly at minimizing the role of property tax, centralizing school finance at the state level, and equalizing funding across the state.

Shifting the burden of financing new facilities to new residents, even though they will have broad-based community benefits, may compromise this statewide duty. Moreover, impact fees, by definition, will be levying in growing areas of a state. High-growth areas also tend to be high-income areas. So, impact fees may contribute to a more inequitable distribution of funds for school facilities within a state.

4. Conclusion

Properly designed and implemented impact fees have the potential to streamline public service delivery by aligning benefits with revenues and costs. School impact fees simply don't measure up to the task of

meeting local school facility needs without creating inequitable and unfair financial burdens for community newcomers—a select, targeted minority. They don't meet the basic criteria necessary for ensuring impact fees are transparent and accountable. Their role in school funding is also significantly muddied given recent trends toward centralization of school finances.

This article is based in part on testimony delivered by Reason Foundation's Samuel R. Staley, Ph.D. to the Local and Municipal Government and Urban Revitalization Committee of the Ohio House of Representatives on behalf of The Buckeye Institute for Public Policy Solutions in Columbus, Ohio.

D. Denver Launches Permit Reform Effort

Bureaucracy is driving up the costs of development in Denver, according to the city's multi-agency Development Council. The Council, established by Mayor John Hickenlooper to revamp the city's slow and burdensome development review and permitting process, released a report in July 2005 that found that delays in the process increase the cost of development in Denver by approximately 3 to 5 percent. The Council likens these delays to a tax that drives developers to Aurora, Lakewood, Douglas County, and other jurisdictions that compete with Denver for development investment.

With over $1.4 billion worth of permits issued in 2004, the Council estimates that Denver's "bureaucracy tax" totaled roughly $40 to $60 million of added costs for developers in that year alone. And this is no small concern. Regulatory delays and uncertainty increase the costs of development in communities nationwide, which in turn places upward pressure on housing prices, reduces housing production, and limits the market's ability to provide affordable housing.

To address this issue, the Council's report outlines a series of reforms intended to streamline the development review process and create a more certain regulatory climate for developers to operate within. For example, the Council found that there are currently no city-wide performance goals or standards for how long development review should take. Not only would such standards be created in the reform effort, but the Council also recommended creating a city-wide project tracking system and project management database that would allow city staff, elected officials, developers, and other stakeholders to see exactly where a project stands under the new development review scheme.

The experience of Clark County, Washington may be useful as Denver embarks on its permitting reform, particularly with regard to measuring performance and ensuring that reforms are actually working. In 2000, Clark County's Community Development Department undertook a similar reform effort as part of a wide-ranging performance audit. By comparing actual outcomes to performance measures and goals over the next several years, Clark County was able to identify significant variances from its performance goals and analyze why they were occurring. For example, despite reforms the county was still missing its time goals for approving certain single-family building permits by over 200 percent. This led to subsequent reviews to determine further areas for improvement.

Performance reviews also helped track improvements. Between 2000 and 2002, the county reduced the average time to deem development applications "fully complete"

(containing all required information for review) from 60 days to 50 days. Though still a long way from meeting their goal of 30 days, the share of applications deemed complete within 30 days increased from 22 percent to 33 percent during that time.

> Regulatory delays and uncertainty increase the costs of development in communities nationwide, which in turn places upward pressure on housing prices, reduces housing production, and limits the market's ability to provide affordable housing.

Denver's Development Council has begun to seek public input on its draft report, and a 12-member advisory board will be appointed to guide further reforms. But the city has already started taking steps to streamline its permitting and approval processes.

An appeals board comprised of city department heads has been established to resolve disputes holding up projects in the development pipeline. And the city's Community Planning and Development Department has teamed with the city attorney's office and the Public Works and Parks and Recreation departments to start streamlining the permit approval process to reduce delays.

Still, city leaders are not underestimating the difficulty of the task ahead, particularly affecting change in city employees steeped in an entrenched bureaucratic culture. According to Public Works Director Bill Vidal, "Transforming them is at the root of the process...[t]hey have to stop being merely regulators and work more on being facilitators. It's not easy, but it's working. Many of these people felt they were the unsung heroes of the city, saving the city from possible harm. But we have to show them that doing the process well doesn't necessarily translate into doing a good job."

The Council's draft report is available online: http://www.denvergov.org/admin/news/newsforms/Development%20Review%20Draft%20Report.pdf

E. Privatizing the Inner City?

Urban Homestead Zones Can Help Revitalize City Centers

The decline of the nation's central cities is well documented as are the struggles to revitalize them. Success has been sporadic, at best, and highly targeted. What revitalization that is occurring tends to be focused and localized—block by block or neighborhood by neighborhood. Redevelopment is most often seen in "hip", artsy, or historic neighborhoods and downtowns, not the more expansive parts of the cities with working class, industrial, or commercial legacies.

This pattern of redevelopment is in contrast to the kind of growth occurring in suburban areas. Most suburban cities tend to be smaller, more fragmented, and mirror neighborhood development. They also tend to be private. University of Maryland Professor Robert H. Nelson observes that less than 1 percent of all Americans lived in private community associations in 1965 (the beginning of the modern suburban housing boom). By 2005, 18 percent do, accounting for 55 million people. More importantly, half of all new U.S. housing has been built within private community associations, condominiums, or cooperatives.

Perhaps the lesson for central cities is that they need to emulate the neighborhood style governance of suburbs as a way to

promote reinvestment and redevelopment. This may mean breaking up parts of the central city rather than annexing suburbs into one big regional government. In Ohio, one state legislator is suggesting cities do this by taking a few bold steps on two important issues: education and public safety.

1. The Missing Middle Class

For urban neighborhoods and their central cities, economic stabilization and redevelopment will depend crucially on attracting and retaining a middle class. Older central cities suffer from a number of daunting challenges, not the least of which is a crumbling infrastructure, high tax rates, and obsolete housing stock, but their inability to maintain a broad middle class undercuts efforts to promote sustainable development. The middle class brings wealth, consumer demand, and a family-oriented sensibility to neighborhoods and city governance, and these elements are sorely missing in many central cities. Broad-based economic development cannot be achieved when cities lack the economic and tax base capable of sustaining the middle managers, entrepreneurs, and professional families that have now become the economic anchor of the broader economy.

Two concerns stand out above all others as impediments to reinvestment in central cities by middle class families: personal safety and quality education. Ohio State Representative Larry Wolpert is tackling personal safety and quality education in older cities head on in part by challenging the conventional notion of who makes the core decisions about governing the neighborhood.

2. Urban Homestead Zones

Rep. Wolpert, chair of the Ohio House Local Government Committee, introduced the concept of Urban Homestead Zones as a product of an 18-month investigation into land use and growth management practices in Ohio. A critical part of stemming the flow of families out to the suburbs and urban hinterland, he concluded, was creating more vibrant and livable central cities. That couldn't be achieved if families were too scared to walk around the neighborhood and couldn't send their kids to good schools.

The homestead zones would address these deficiencies at the neighborhood level by shifting budgetary authority and decisionmaking from the city council to the neighborhood level. The zones would be voluntarily established by local residents, cover at least 10 but not more than 150 acres, and be "blighted" in order to take advantage of the legislation. Unlike most blight designations used for eminent domain purposes, these criteria for blight are narrower, more specific, and easier to measure. An area within the inner city would be considered blighted if, over the last 50 years,

- The area had experienced a 50 percent decline in population;
- Violent crime had increased at least 30 percent; and
- Poverty had increased 50 percent.

Once established, the homestead zones would be given the authority (and funding) to implement two programs that would encourage neighborhood stability and revitalization:

- Establish a private security force, financed by a special assessment on properties within the zone; and
- Establish a legal right to an educational voucher for households that invested in residential renovation (a minimum of

$120,000 under current legislation) that could be used to offset tuition at private schools.

The cities covered by the program are Ohio's "Big 8" and includes Akron, Canton, Cincinnati, Cleveland, Columbus, Dayton, Toledo, and Youngstown.

3. Fresh Thinking About Revitalization

Rep. Wolpert's vision is fresh thinking about urban revitalization and has the potential to give new, important tools to citizens and public officials in our traditional central cities. The concept of an Urban Homestead Zone also reflects a shift in thinking about public policy's role in revitalizing inner-city neighborhoods. Rather than use a more traditional approach emphasizing large-scale projects like sports stadiums, citywide administered community programs, more visible marketing, or simply transferring more resources to existing city governments, the Urban Homestead Zone focuses directly on the needs, aspirations and expectations of citizens and residents (both existing and future).

At its core, it moves decisionmaking down to the street level. It encourages personal and physical investments on the parcel level, providing a foundation for long-term, sustainable redevelopment. Central cities already have distinctive neighborhood qualities, and the homestead zones provide a way for these neighborhoods to further tailor public services to their specific needs.

The homestead zone concept recognizes the incremental and organic nature of urban revitalization, a process that often occurs through the ongoing, small scale and interconnected decisions of individuals and households. Few inner city neighborhoods, despite the press garnered by a few exceptions, are revitalized by large-scale redevelopment of entire blocks (commercial or residential). Urban Homestead Zones recognizes this process of revitalizing a neighborhood parcel by parcel, rather than block by block, and provides a mechanism for reinforcing this dynamic.

4. Concerns About Current Legislation

Despite Rep. Wolpert's forward-thinking vision, the current legislation in Ohio suffers from some significant drawbacks. Legislators and citizens thinking about emulating or adopting the program should pay careful attention to the following factors.

Don't set the local investment threshold too high. Incomes vary by region and city, but pay careful attention to the middle class income range. Homes targeted toward the middle class in inner cities often sell for well below similar homes in suburban areas and investment thresholds needed to trigger the program's benefits can be set so high the middle class can't meet them.

The Ohio legislation, for example, would mean a family moving into a city (or buying another home in the city) would have to shoulder the burden of the mortgage on the building plus invest $120,000. For a new family, this could mean financing $200,000 or more (since homes in older central city neighborhoods often sell for $80,000 or more). A $200,000 investment could be a similar size house, a bigger yard, and access to better public schools in the suburbs of almost all Ohio's major cities. Investments on the scale of the current bill, then, really end up targeting high-income households.

The benefits of the zone designation could be expanded dramatically by lowering the threshold. Bringing the reinvestment financial threshold to $50,000 or $75,000

(exclusive of the initial mortgage) would allow for significant remodeling and investment well within a middle-income family's budget while bringing many homes in these neighborhoods to contemporary standards.

Avoid setting the thresholds that qualify an area for zone designation too high. While the Ohio legislation defines blight using specific, measurable criteria, the current criteria are sufficiently narrow that few neighborhoods would likely qualify. Moreover, the criteria are keyed into historical trends. The concern should be less on how long it took for a neighborhood to decline and more on revitalizing already depressed inner city areas.

Benchmarks such as a percentage of crime, home values, or poverty above or below the city average would be more accurate and consistent with achieving the goals of revitalization. Regional benchmarks can also be used because central cities compete with suburbs for homes and families. The appropriate competitive comparison is probably not other neighborhoods within the city, but nearby suburban cities and locations.

A shorter time period for monitoring trends, perhaps 20 years, would be more reasonable. Most Ohio cities, for example, began losing population in significant numbers around 1970.

School voucher programs should be managed and coordinated locally if they are funded locally. The current Ohio legislation allows the state legislature to establish the total number of school vouchers available. But at least part of the funding for the Urban Homestead Zone program will come from a Tax Increment Financing program designed to fund the vouchers (an Education TIF). The legislature should not be able to limit the number of vouchers provide in a zone if the TIF fully funds them. Indeed, the fact the legislature might limit the number of vouchers will likely dilute the incentives to form a zone (and reinvest in the neighborhood) because politics may limit the number of vouchers available in the future. For the program to be effective, the program must have as much certainty as possible linking benefits to neighborhood revitalization.

Avoid further regulation of private schools in inner cities under the guise of "accountability." If the concern is that private schools do not perform as well as public schools, that issue should be addressed in education reform legislation, not economic revitalization legislation. Little or no evidence exists showing that private schools perform more poorly than competing public schools. Yet, state testing mandates add a significant resource and cost burden onto private schools that participate in the voucher program, reducing their incentives to accept children from these zones and diluting the expected benefit from investing in the zone by individual households.

5. Conclusion

Cities concerned about revitalizing their inner city neighborhoods and encouraging broad-based reinvestment beyond boutique neighborhoods and downtowns should consider programs that move decision-making down to the neighborhood level. In part, this process emulates some of the most attractive features of new suburban development—governance on a neighborhood scale and efficient provision of core public services. On a more pragmatic level, programs such as Rep. Wolpert's Urban Homestead Zones provide a way for cities to directly address poorly provided services that are critical to retaining and attracting middle class families back into the city.

Public Health and Safety

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A. Privatizing Public Hospitals: A Win-Win for Taxpayers and the Poor

Hospital expenditures accounted for almost a third of the $1.6 trillion the United States spent on health care last year. According to the U.S. Department of Health and Human Services, over the 10-year period from 1990 to 2000 the average cost of an inpatient stay at a public hospital increased nearly 50 percent, compared to only 20 percent at private, for-profit hospitals. By 2001 the $7,400 cost of a stay at a public hospital was 24 percent greater than at a private for-profit ($5,972).

Why are costs rising so rapidly? In the case of public hospitals, a conflicting mix of social, political, and business objectives results in weak incentives to control costs. Cost burdens come from inefficient accounting, restrictive government personnel and procurement regulations, a tangled web of bureaucracy, and a general lack of accountability.

Most public hospitals lack the strategic advantages enjoyed by private hospitals including: a marketing orientation, volume purchasing systems, state-of-the-art information systems, standardization of supplies, outcome management systems, computerized case management systems with cost-per-procedure variables among physicians performing the same procedures, physician practice management, and technologically advanced patient care. These innovations

boost productivity and cut costs. Private, for-profit hospitals blazing technological trails exert a "peer effect" when their public and not-for-profit counterparts mimic their behavior. Studies have shown that for-profit hospitals offer lower levels of hospital expenditures, higher quality care, and virtually the same patient health care outcomes relative to their public and nonprofit counterparts.

Many attractive alternatives exist that benefit both taxpayers and the poor. Municipalities throughout the country and around the world have demonstrated they can serve indigents more efficiently and effectively by selling public hospital assets and turning to the private sector.

1. Red Tape Can Kill…Information Technology is the Antidote

Bureaucracy, red tape and outdated medical reporting and accounting systems not only inflate costs but can also jeopardize lives. By one estimate, shoddy quality control costs Americans $500 billion per year in avoidable medical costs, or roughly 30 percent of all health care spending. Of course lives lost are more important than money lost. Medical errors claim anywhere from 44,000 to 98,000 American lives every year, roughly 15 to 30 times the death toll suffered from the terrorist attacks on September 11, 2001.

Most experts agree that increasing nurse-to-patient ratios is at best a short-term response to the deadly epidemic of medical errors. The long-term prescription is for hospitals to invest in digitized patient files, computerized prescriptions, telemedicine, and other IT investments. The returns on these investments can lower costs and make hospitals safer. Today, only 17 percent of the nation's hospitals use computerized order-entry systems; a mere 13 percent have adopted electronic patient records.

In general, private hospitals face stronger incentives to adopt IT than do public hospitals. Blazing the trail is one of the nation's most innovative private nonprofit health care providers, Kaiser Permanente. Since its 3.2 million members in Northern California pre-pay, Kaiser has an incentive to keep costs down and keep its customers healthy. Each patient/member has an electronic medical record that includes lab and test results, radiology images, hospitalization records, diagnoses, prescriptions, allergies and other data, all accessible from the desks of 5,000 Kaiser doctors or any of 12,000 of the company's examining rooms. Doctors can quickly access medical histories and test results, while computerized expert systems alert them to potentially harmful interactions in the event of multiple prescriptions.

Another example of major IT investments is St. Vincent's Hospital in Birmingham, Alabama, a showcase for the nation's largest private nonprofit health care system, Ascension Health. Doctors can instantly download lab results, X-rays, and CAT scans from the hospital's wireless (Wi-Fi) network. Robot arms perform precise surgery, machines measure medicines, surgical tools have bar codes so they can be tracked and don't end up in patients, and nurses can scan bar codes on patients to check that medicines are given as doctors prescribe.

Expert computer systems automatically check for problems such as drug interactions and allergies and can even guide doctors in choosing treatments. Investments in new diagnostic devices save lives. The private hospital chain HCA (Hospital Corporation

of America) is implementing a computerized order-entry system for medicines at many of its 190 hospitals. An order instantly goes to nurses and to the pharmacy. Once approved by a pharmacist, a drawer at the patient ward clicks open and the nurse can pull out the appropriate pills. The drawer automatically tracks inventory and nurses use scanners to read the bar code on the pill bottle to confirm it's the right drug and dosage, and on the patient to ensure it's the right patient. Digitizing has cut HCA's drug-dispensing time in half and weeded out some 20,000 potential errors.

Recently, IBM joined forces with the renowned Mayo Clinic, a private nonprofit. Their objective is to analyze electronic medical records to rapidly assess patients' responses to new treatments for cancer and other diseases. When combined with information emerging from the human genome project, this collaboration should accelerate doctors' ability to identify causes and prevention of diseases.

According to the Institute of Medicine the routine use of electronic records should help reduce tens of thousands of deaths and injuries caused by medical mistakes every year. A paperless system also cuts administrative costs by eliminating the need to produce, maintain and store enormous amounts of paper files.

Telemedicine is also poised to save lives and cut costs. This involves the use of sophisticated remote electronic and video-monitoring systems that let one doctor (or nurse) treat several patients simultaneously, and to remotely consult and provide expert care.

As an experiment, a pair of doctors at the Johns Hopkins University School of Medicine set up videoconferencing equipment at an Intensive Care Unit (ICU) at Hopkins' sister hospital across town. They sent the video feeds, along with real-time patient vital sign data, to computers in the doctors' homes. For four months, the doctors took turns watching patients from home on 24-hour shifts. The results were astonishing: Deaths declined by 50 percent. According to one doctor: "Catching a lot of little things added up."

The doctors eventually launched a company with an eICU that functions like a Bloomberg terminal for patient data. It displays readings on blood-oxygen levels and other data, and with the click of a mouse can switch from one patient to another. Proprietary software continuously monitors vital signs and pops up "smart alerts" when patients deviate beyond established ranges.

Instead of simply adding nurses to improve the quality of care, a Norfolk-based private health care system, Sentara Healthcare, invested in eICUs to monitor 55 beds in three hospitals. In 2002, Sentara reported the system saved 90 lives a year, while also saving millions of dollars by avoiding pricey complications. Although launched with the best of intentions, nurse ratio mandates such as California's could have the perverse effect of delaying implementation of potentially life-saving IT investments.

Some 2,000 hospitals have joined an initiative known as the '100,000 Live' campaign to cut down medical errors. Led by Harvard's Dr. Berwick, chief of the nonprofit Institute of Healthcare Improvement in Cambridge, Massachusetts., his employees scour the world for simple, proven remedies for medicine's reliability woes, anything from better infection control to eliminating drug mix-ups, and standardizing basic procedures. Key initiatives include: measuring

performance and issuing report cards releasing performance results to the public, instituting teamwork training and empowering nurses to challenge doctors, and pushing for the digitization of medical records so crucial test results and other vital records can be tracked and communicated. Innovative hospitals are showing they can drastically cut medication errors and all but eliminate some deadly hospital infections.

Strategic IT investments lower costs and make hospitals safer. The challenge facing many public hospitals today is how to fund investments like the digitization of patient information, and the computerization of prescriptions, billing, and other administrative tasks. Public hospitals face three main obstacles:

- First, IT requires **large, up-front investments** in training people and in specialized equipment. Since public hospitals cannot access equity markets, this limits their funding choices. Their options include navigating the bureaucratic decision-making process to generate internal funding, raising money from the community (through nonprofit foundations for example), or requesting additional tax dollars from the federal government or from state and local governments (issuing bonds or passing tax increases).
- Another reason public hospitals are slow to adopt IT is a **fear of job losses**. Some controlling stakeholders (unions, etc.) automatically object to labor-saving investments.
- Finally, public hospitals face **perverse incentives**. Excessively dependent on public insurance, large, powerful monopsonistic buyers like Medicare (for seniors) and Medicaid (for the poor), stand to reap most of the savings generated by IT. Also, since public hospitals are largely paid based on volume, IT that eliminates duplication and unnecessary tests, shortens hospital stays, and gets patients out of intensive care units faster can cut a public hospital's revenues faster than it cuts costs. This gives public hospitals even more reason to resist adopting new technology. It also helps explain why the cost per stay has grown so persistently in public hospitals.

In sharp contrast, a private medical care system, like Trinity Health in Novi, Michigan, has a better chance to earn a return on its IT investments. With 44,000 full-time employees, Trinity Health has implemented an automation project worth more than $200 million that includes 23 hospitals and hundreds of outpatient facilities. Its investment in an expert system that alerts doctors to harmful drug side effects caused doctors to revise their orders some 25,000 times over three years. This saved scores of patients from potential complications. Another critical IT investment, creating electronic records, means patients now get faster treatment.

2. What are the Options?

Local governments are increasingly quitting the hospital business. In 1980, there were some 1,800 public hospitals. By 2003, after a wave of closures, consolidations and privatizations, the number had dropped almost 40 percent to 1,121.

Health care is more than just hospital care. When a public hospital becomes too expensive to own and operate, multiple options exist for states, cities and counties to cut costs and continue to serve their communities' health care needs. These include: selective outsourcing, public-private part-

nerships (via joint operating agreements, joint ventures, and lease agreements), or the outright sale of the hospital.

Outsourcing

Think of a hospital as a collection of small to medium businesses operating under one organizational roof. This can include anything from laundry and maintenance services to laboratory and clinical services. Selective outsourcing first entails the conceptual transformation of a hospital into a holding company that owns and operates a host of profit centers (kitchen, laundry, maintenance, information systems, medical legal services, laboratory test facilities, clinical services, etc). It is useful to distinguish between "core" and "non-core" functions and activities. Core functions define the hospital's competitive advantage. Non-core functions are standard services widely available in the marketplace and are prime candidates for outsourcing. Once identified, non-core profit centers can calculate their costs, and reconfigure themselves to compete against outside contractors that offer similar services. Outsourcing opportunities can include anything from non-clinical support services (cleaning, catering, building maintenance), to clinical support services (laboratory services) or specialized clinical services (such as radiology or lithotripsy) and routine procedures (such as cataract removal).

Public-Private Partnerships

In a joint public-private operating agreement, the government can turn over management of the public hospital to the private sector and still retain some control by appointing part of the board overseeing the agreement. Under a joint public-private venture, governments can sell a portion of public hospital assets for cash, retaining power to appoint board members of the new entity. For example, in 1997 California's Sequoia Healthcare District netted $30 million in cash from its joint venture with the private nonprofit Catholic Healthcare West (CHW). The newly created Sequoia Health Services is governed by a 10-member board (equally split between the hospital district and CHW). CHW was granted a 30-year contract to operate the hospital. Another public-private partnership option is to lease the hospital, clinics, and equipment to a management firm. For example in New Mexico, a private company, Province Healthcare, has agreed to lease the county's Memorial Medical Center for 40 years agreeing to a pre-paid rent of $150 million. Several safeguards—covering such areas as the type and levels of services offered, access for indigent and uninsured patients, and patient, physician, and employee satisfaction levels—were explicitly built into the contract.

Sale

A sale produces a cash payment that can be used to retire debts and establish a trust fund for community health care. For example, after retiring public bond debt from the sale of Conroe Regional Medical Center in Texas, the county used the residual "profit" from its privatization to launch a nonprofit foundation to meet ongoing community health needs. The community also collected new property taxes and other payments from the now-private for-profit hospital. Indigents fared best of all. Here privatization raised cash, reduced debt, and created a better system for serving the poor and uninsured. Closing a public hospital does not mean the government can walk

away from its responsibility for indigent care. After shedding their public hospital(s), many governments switch from the role of producers to that of providers or purchasers, contracting with local hospitals and clinics to purchase only the bed days they need for indigent care. For example, Orange County, California, no longer owns and operates any hospitals. Instead, the Health Care Agency administers indigent care through multiple (HMO) contracts with local hospitals and clinics.

3. Where's the Safety Net?

Many local governments have shifted from running hospitals to becoming selective purchasers of health care. Instead of owning and operating a public hospital and producing health care for indigents, governments are increasingly contracting with private providers to treat indigents. Consider the case of Milwaukee's public hospital—first known as County General and later as Doyne Hospital.

By the 1980s Doyne's managers were making regular visits to the county board of supervisors to report budget shortfalls. Annual bailouts ran as high as $15 million per year. Moreover, deferred maintenance and an inability to raise sufficient funds to invest in new facilities, equipment, and technology began to impact performance. By 1995 the drain on public resources combined with a threat to the county's bond rating forced county supervisors to shut down the public hospital.

The county instantly transformed itself from a producer of health care through its public hospital, to a purchaser of health care through private for-profit and nonprofit hospitals and clinics. Taking the $37 million a year in local, state and federal money that it had used to pay for indigent care at Doyne, the county placed the money in a program they call the General Assistance Medical Program (GAMP). Much like Medicaid, GAMP pays private hospitals and clinics a fee for seeing its patients.

Milwaukee residents who might otherwise have gone to Doyne can now visit any of dozens of hospitals and clinics. All 10 private hospitals and 15 neighborhood clinics signed contracts with the county to treat the medically indigent. Milwaukee's experience suggests a community can live without a public hospital and still provide a safety net.

An assessment made five years after the hospital closed indicated the county's indigent population had roughly the same access to medical care as before. However, patients today have more choices in terms of how to access that care. In fact, fewer use emergency rooms, and more visit clinics where early diagnosis and treatment prevents more costly interventions later. Prescriptions are filled at local pharmacies instead of the public hospital, and many now get their health care right in their own neighborhoods at local clinics or private hospitals. Meanwhile, all of this is costing taxpayers less money than before.

While from the county's perspective, running GAMP is not cheap, it's a bargain compared with the constant drain of running a public hospital. It also offers a more predictable budget for health care than did the public hospital.

Interestingly, in shutting down the public hospital, the county also did away with many of the competing stakeholders (special interest groups) that indirectly supported health care for the poor. In the past, squeezing money out of indigent care meant cutting the public hospital and a likely battle

with 2,000 unionized employees. Now the county buys its indigent care like a commodity, and it represents little more than a line item in the budget. A risk is that since the health care budget has lost some of its stakeholders, and now competes directly with other line items like roads, parks and police, politicians may be more tempted to cut the health care budget to fund other priorities.

The new safety net also has some other gaps. Federal law requires emergency rooms to take all comers, regardless of ability to pay. Some state and federal laws also require hospitals to provide charity care. In Milwaukee, private hospitals and clinics have had to step in to cover more uncompensated care. In some cases matching funds are available to pay a share of the care provided to Medicaid patients and the uninsured.

However, many specialists have grown frustrated with the paperwork involved with GAMP and have dropped out of the program. Yet, even if private hospitals and clinics lose money on GAMP, they do not lose as much as they would without it, so they rank among its biggest supporters. Finally, GAMP only covers 20,000 of Milwaukee's estimated 120,000 uninsured. The lesson is that responsibility for indigent care does not disappear with the public hospital. A safety net for indigent care still needs to be in place.

4. Reengineering the Safety Net

The aim of most public health care programs in the United States is to improve access to medical care mostly by filling the gaps in the private health insurance market. These public programs typically include direct subsidies to health care providers (public or private hospitals) to provide health care, or the provision of some insurance to the uninsured.

Public hospitals exist to provide medical services directly to the uninsured, but there are several alternatives. One option is to subsidize private providers by providing direct subsidies for uncompensated care or reimbursement through public health insurance (like GAMP or Medicaid). Fees are paid to private hospitals or HMOs for each indigent served. Another option is to purchase private insurance for indigents (like Blue Cross/Shield).

Finally, state and local governments could be pioneers in the new frontier of health insurance and offer indigents medical savings account vouchers (MSAVs) combined with catastrophic health care coverage.

Public health care dollars could be placed in accounts individually owned and controlled by indigents and the uninsured. Patients would pay with MSAVs for most medical services from those accounts. Private hospitals and clinics would compete on the basis of value for money. The government would make regular deposits to the MSAVs of patients with chronic conditions, leaving them free to choose among competing "focused factories" (specialized hospitals and clinics) for ongoing treatment.

A major problem is that providing free hospital care or free insurance results in a substitution away from private health care. People are less likely to purchase private insurance and more likely to choose jobs with higher salaries and no health benefits. In 1999 the Andril Fireplace Motel in Pacific Grove, California offered its service workers a health care plan that included a small co-payment. The workers refused the employer-provided health insurance, instead choosing to accept more money, because they said

they could get free health care at the emergency room at Monterey County's public hospital, Natividad.

Roughly a third of the uninsured live in households with incomes greater than $50,000 per year, apparently choosing not to purchase health insurance even though they can afford it. Of those who become uninsured at any point in time, Census Bureau Data show that roughly 75 percent obtain insurance within one year, while only 2.5 percent remain uninsured more than three years.

An unintended consequence of governments trying to help the uninsured is they inadvertently create more of them. According to one critic, "California's public hospitals…confront a severe crisis…a steadily growing demand by uninsured and vulnerable patients…matched against a shrinking pool of funds available to pay for care." Today, California's public hospitals are all paying close attention to a federal decision to freeze Medicaid (Medi-Cal) payments and shift over half a million enrolled patients into HMOs (similar to what Orange County has done). Directing Medicaid money to HMOs instead of safety net hospitals and shifting more of the burden from the state to counties is expected to present even more challenges for the state's public hospitals.

5. Conclusion

Benevolent citizens have learned the hard way that running a public hospital is a tough business. Municipalities throughout the country and around the world have demonstrated they can serve indigents more efficiently and effectively by selling public hospital assets and turning to the private sector. In the United States, communities often receive a cash payment to retire debt and establish trust funds for community health care. Since 1994, over 100 charities have emerged from hospital sales that control a combined total of nearly five billion dollars. Even strong advocates of nationalization now acknowledge that the growing scrutiny of public hospitals has "raised the level of the discussion…[and increased] focus on the need for care by uninsured citizens…on the services required, and on how to finance and deliver those services."

As Nobel Prize winner Milton Friedman stated with regard to the high cost of health care, "a cure requires reversing course, reprivatizing medical care by eliminating most third-party payment, and restoring the role of insurance to providing protection against major medical catastrophe." He sees medical savings accounts as one way to resolve the growing financial and administrative burden of Medicare and Medicaid: "a medical savings account enables individuals to deposit tax-free funds in an account usable only for medical expenses, provided they have a high-deductible insurance policy that limits their expenses." In effect, "it would be a way to voucherize Medicare and Medicaid. It would enable participants to spend their own money on themselves for routine medical care," rather than having to rely on public hospitals or on HMOs, while still insuring indigents against medical catastrophes.

Besides crowding out private insurance, when well-meaning state and local governments run public hospitals and pass well-intentioned regulations and mandates, evidence suggests they inadvertently raise health care costs and lower performance. It is time to reengineer our safety nets. Carefully crafted deregulation and privatization, combined with subsidized medical savings

account vouchers (MSAVs) and high-deductible insurance for indigents, can bring us the best of all worlds: lower taxes and better services.

This article is an excerpt from Reason Foundation's 2005 policy brief by Dr. Francois Melese, *Privatizing Public Hospitals: A Win-Win for Taxpayers and the Poor*, available online at: http://www.reason.org/pb41_privatizing_hospitals.pdf

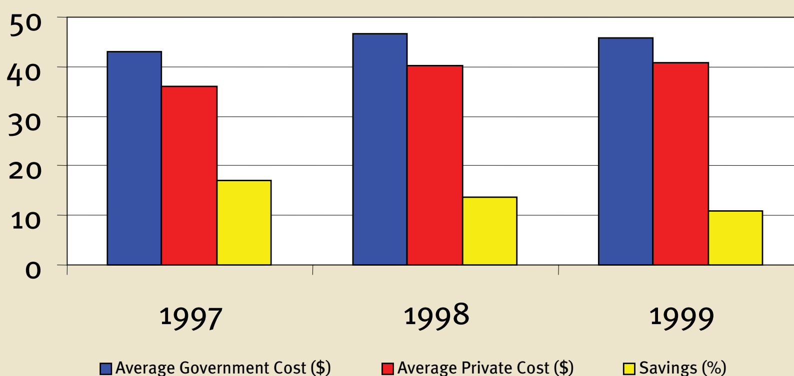
B. New Prison Cost Comparison Study in Arizona Flawed

The Arizona Department of Corrections (ADC) released its latest cost comparison study between the ADC-operated facilities and private facilities operated for the state (available online at www.azcorrections.gov/reports/completemaximusreportdocuments.pdf). State law requires that occasional reviews be conducted and the first two studies found that the private facilities operated with significantly fewer tax dollars than their public counterparts, achieving cost savings of 17, 13.6 and 10.8 percent in 1997, 1998, and 1999 respectively. Despite history in Arizona and a clear track record of success throughout the country, the latest ADC review suggests that private prison costs were 8.5 and 13.5 percent higher than state costs.

It's easy to see why the quick turnaround—the methodology used for the comparison changed. In doing so it lowered the costs of ADC facilities and hiked the costs of private facilities. After several years of study and a widely accepted methodology that consistently produced results that demonstrated the success of private prisons, the ADC chose to change the rules. Put simply, the new cost analysis ultimately removes or deducts costs traditionally attributed to the ADC from their bottom line, while adding additional costs to the private facilities.

First, the formula used to generate the average daily cost is inconsistent and the authors fail to give a justification. The state's own *Per Capita Cost Documentation* reports that private prisons managed 1,678 inmates in 2003 and 1,685 in 2004—this includes temporary and emergency beds that the private facilities operated inside existing facilities. However, the analysis uses only 1,250 as the bed count for private facilities. This inflates the true per bed/inmate cost by

Figure 9: ADC Average Costs and Savings: The First 2 Studies



several dollars a day.

Second, the analysis leaves out any construction and start-up costs. Private facilities factor these costs into their contract price upfront and recover those costs over the life of the contract. However, the state separates capital and operational expenditures and does not account for these costs in their per bed/per day cost. These costs, conservatively add between $3 and $5 per bed. This cost should be added to the in-house cost of the state estimates.

Third, while the analysis attempts to capture only those costs borne by both facilities it fails to subtract out special treatment costs that each private facility provides under contract, not provided by the state. While there is no way to account for these costs given the available data, it certainly does skew the results. Private facilities' prices would drop by at least a $1 if these services were removed from the evaluation.

To be fair, not all of the changes are necessarily wrong or unfair. For example, costs for contract administration and oversight are added to the average daily cost of private facilities—adding roughly $2 to the bottom line cost. This is a common and widely accepted practice. Indeed, it was undertaken in the previous two reviews as well.

However, this raises a question. One argument often made against private facilities is that they're not accountable and that oversight is lacking. However, the private prisons are charged an additional oversight fee, which begs the question: who is more accountable—public or private facilities? In this review, no additional oversight costs are charged to ADC facilities. It seems as if public and private facilities are held to different standards—and the private facilities achieve a higher level of oversight given the extra cost to administrate and monitor those facilities. Given that actual contract administration represents a tiny fraction of the cost added to private facilities, it can be inferred that ADC facilities do not have the same level of oversight or else they would have been applied the same costs. The extra cost should be considered an extra benefit.

The comparison also assumes away some costs for the ADC facilities. It pretends that money was not spent by the state. For example, it removes $1.09 from the daily cost of ADC beds for the work incentive plan because this cost is "entirely borne by the state." Given that this is a state program this is not a surprise. However, costs cannot be ignored or assumed away just because of management. If the ADC were operating the private facilities this program would remain in place—and those costs would continue to be borne by the state. Thus, they should be included in any consideration and review of the true costs of operating a facility.

The study authors suggest that these changes should be made because "historical" data can only tell you so much. And that ADC may develop a better design and generate savings in future projects. While this may be true, historical data is also important. It provides a baseline and an expectation. For example, since the first introduction of private prisons in Arizona the real (average) cost per inmate per day has declined from $47.27 a day in 1995 to $44.77 in 2004. During the same time, public facilities have seen a double-digit percentage increase ($43.79 to $53.63).

If the data were assessed before adjustments (additions and subtractions) the private facilities would continue to fare

very well. Consider this, the average cost of ADC facilities in 2003 and 2004, $46.90 and $47.30, are both HIGHER than the average private cost ($43 and $46.57). That's even after adding additional oversight to the bottom line.

Another key consideration is that private facilities can only control their costs. They have no impact over state administrative or oversight costs. The data suggests that they have superior ability to control their costs and prevent escalation. The average daily rates over the course of the three studies is evidence enough—where they've had direct control over their costs, they've gone down. ADC's went up in every category.

Beyond this, the new study format also fails to consider the relative quality between public and private prisons, a true disservice. While costs are important, quality and performance are just as, if not more, important factors that should be included in any consideration.

C. Federal Privatization Study Demonstrates Privatization Success

This month, the Justice Department's National Institute of Justice released a study, *Contracting for Imprisonment in the Federal Prison System: Cost and Performance of the Privately Operated Taft Correctional Institution* (available online at www.ncjrs.gov/pdffiles1/nij/grants/211990.pdf)

The researchers set out to determine whether the low-security private prison facility located in Taft, California performs as well as publicly operated facilities do within the federal prison system. They compared the cost of contracting the operation of Taft Correctional Institution (TCI) to what the federal government would have spent if it had run the facility. This is a hypothetical comparison. It's worth noting that the model used to determine what the cost of public operation would be represents a 'best-case' or 'low-cost' scenario compared to actual data for other facilities.

The researchers also compared the cost of operating TCI to that of other existing low-security federal prisons. TCI was evaluated on the basis of the quality of its performance during its first six and one-half years of operation as compared to publicly operated federal prisons over the same period.

The findings:

The private facility SAVED taxpayer money.

The contract at TCI cost the government $142.1 million, while the estimated cost of government operation was between $151.6 and $158.6 million. Thus, the private facility saved between 6 and 10 percent or $9.6 and $16.5 million. During all five years of the analysis, the net cost of contracting was less than the lowest estimate of direct public operation.

In the hypothetical model for public operation of the Taft facility, the researchers assumed that staffing levels would be the same as the privately operated facility and that pay is at the 'mid-grade' level. In actuality, the private provider employed more employees, but offered a less expensive package of employee benefits. In addition, labor costs (wage and salary) for the private facility were higher than many other public facilities it was compared against. Had the private facility been located in another part of the country with lower prevailing wages, the difference between public and private labor costs would have been much greater. For example, if the facility had been located in Yazoo City, Mississippi (the site of one of

Table 21: Per-Diem Rates and Cost Savings: TCI vs. Federal Prisons					
	1998	**1999**	**2000**	**2001**	**2002**
Taft (Private)	52.43	33.82	33.25	36.88	38.37
FCI Elkton	46.59	39.72	39.77	44.75	46.38
FCI Forrest City	44.2	39.46	39.84	41.65	43.61
FCI Yazoo City	44.15	41.46	40.05	43.65	42.15
FCI Ashland	69.96	62.75	63.47	64.12	63.38
FCI Bastrop	56.75	53.75	52.67	57.15	52.97
FCI Big Spring	58.8	54.71	51.03	67.99	70.88
FCI Butner	51.78	45.76	47.04	50.93	54.27
FCI Latuna	58.47	56.47	57.36	71.39	60.02
FCI Loretto	62.59	61.42	63.22	49.32	50.86
FCI Milan	73.93	66.77	62.97	62.56	63.23
FCI Petersburg	65.79	61.79	61.79	56.97	60.59
FCI Safford	58.65	56.51	58.57	58.51	58.69
FCI Seagoville	61.48	59.41	61.03	77.4	75.83
FCI Texarkana	49.29	47.52	49.68	53.34	55.55
Low Savings	-15.79%	16.68%	19.82%	12.93%	9.85%
High Savings	41.01%	97.43%	90.89%	109.87%	97.63%
Average Savings	9.32%	57.87%	60.79%	54.89%	48.63%

Note: Highest costs per year are shaded red. Lowest costs per year are shaded green.

the similar federal facilities), the contractor's labor costs would have been 24 percent lower, and savings would have increased as well.

A simple review of per diem rates provides even stronger evidence of cost savings from the private facility. Indeed, TCI housed prisoners at a significantly lower daily per-prisoner cost than the Bureau of Prisons experienced at 14 low-security, federally operated prisons.

The private facility had the lowest per diem rate in every year except its start up year (1998), when costs were higher, as expected. After 1998, TCI had nearly a double-digit advantage in every year over the next lowest per diem in the federal system. The cost savings is even more dramatic when compared against the average and the high cost per diem facility.

The private facility did NOT jeopardize quality.

While cost is important, the quality or performance of a prison facility is critical. The review concluded the following about the private facility: "very efficient performance, fully responsive to contract requirements, more than adequate results, reportable deficiencies but with little identifiable effect on overall performance." It was determined that the contractor delivered what it promised in the contract, and what the contracting agency expected. Indeed, the federal Bureau of Prisons exercised its option to renew the contract after the three-

year base period, and has done so in every subsequent year since.

In addition, the rates of assault are lower at TCI than at the average low-security publicly operated facility. There have not been any homicides at the private facility. While there was one escape, it was followed by immediate remediation and policy changes.

The type and amount of health care was found to be the same, although the private facility used a different staffing model that relied on more doctors and registered nurses. Thus, inmates were more likely to see a doctor at the private facility than in public facilities.

However, not all findings favored TCI. It was found to have higher rates of drug use and a greater number of inmate grievances.

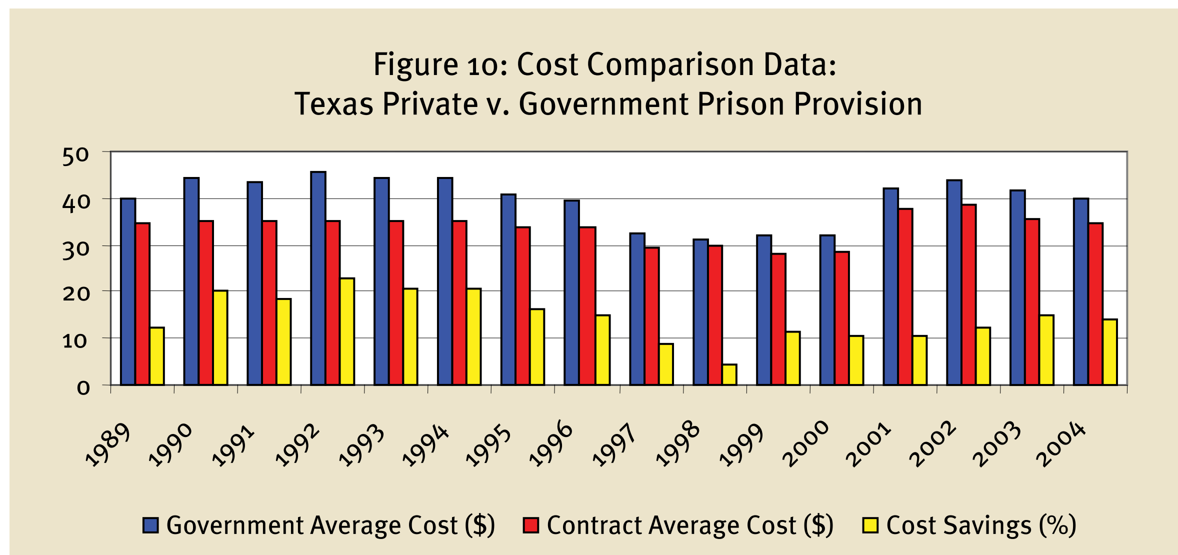
The private facility performed ABOVE minimum compliance and contractual requirements.

On the most comprehensive and in-depth measure of performance—the extent to which the private operator met its performance obligations established in the contract—the firm performed at levels above and beyond mere compliance with these contractual requirements.

With results like these, it is understandable why the federal Bureau of Prisons continues to seek public-private partnerships to manage a growing federal prisoner population. This is even more evidence that private prisons not only work, but that they work well—saving taxpayers money, protecting the public, and securing the rights of inmates.

D. Texas Axes Criminal Justice Policy Council, Comparison Continues

The state of Texas eliminated the Texas Criminal Justice Policy Council and the biannual cost comparison study of public and private prison costs. However, the state's Legislative Budget Bureau has taken over the comparison enabling the longest running public vs. private operational cost comparison to continue. This review provides the best historical and trend data of the costs between public and private facilities as well as the impact private facilities and competition can have on a prison system. The average daily cost of operation in a government-run facility was $41.64 and $40.06 in 2003 and 2004 respectively. Costs in private facilities



under contract in Texas were only $35.47 and $34.43 representing savings of 14.8 and 14.1 percent. Savings are even more dramatic when the operational costs of jails are compared.

It is noteworthy that competition has forced a gradual decline in per-inmate incarceration costs in both public and private facilities. Texas spent about the same per inmate, on average, in both public and private facilities in 1989 as it does today some sixteen years later despite inflation and escalating costs. Furthermore, after a change in reporting in 2001, both types of facilities are seeing their costs trend down. Competition between public and private facilities is having a noticeable effect on the cost of incarceration in Texas.

E. Book Review: Merchandising Prisoners—Who Really Pays for Prison Privatization?

By Paul Doucette, Executive Director, Association of Private Correctional & Treatment Organizations (APCTO)

In his new book, *Merchandising Prisoners—Who Really Pays for Prison Privatization?*, Rutgers University professor and Associate Director of the National Center for Public Productivity Byron Eugene Price sets out to understand the motives behind decisions by public policy officials to privatize correctional facilities.

The work is well researched and presents the arguments both for and against privatization. On page 40, the author calls for more analysis:

A note of caution: the excellent data provided by opponents of privatization, such as the large unions that generate reports slamming privatization, can be called into question. These unions are compromised of government employees, and they clearly have a vested interest in seeing privatization fail. The same can be said of the for-profit prison firms; they generate lots of reports that contend that they are superior at saving taxpayers money. Only objective analysis will settle this questions that plagues policy makers and taxpayers.

Unfortunately, Mr. Price fails to provide that much-needed "objective analysis." In an effort to claim the cover of academic integrity, on page after page the author treats the reader to a back and forth recitation of a wide variety of assertions, both pro and con, regarding private prisons. The references range from Thoreau's *Social Contract* and Adam Smith's, *The Wealth of Nations* to the *Civil War* and *Jim Crow* laws.

Nevertheless, the undercurrent of bias is clearly evident in the discourse concluding on the back flap of the book jacket. The publisher says, "Ultimately, he (Price) concludes that the desire to save costs is not the primary reason for state prison privatization. Rather, the more plausible explanations revolve around political and ideological factors such as the party of the governor, and the overall political and ideological culture of the state. This work sets the record straight about the decision to privatize state prisons, revealing the political bias that often drives these policy choices."

It is not my purpose here to document all of the flaws in logic, conclusion and assumption extant with in the book. Rather, I turn only to the last chapter to deal with the "problems which exist for Prison Privatization."

Health Care

The article correctly points out that prison officials are obligated under the

Eighth Amendment to the Constitution to provide prisoners with adequate medical and mental health care. What follows is a lengthy discussion of the failure of prison health care in New York. It is not a pleasant picture. Unfortunately, the author missed the fact that New York doesn't have any privately operated prisons.

The health care discussion continues with a tragic story about an eighty-pound inmate dying of starvation. The author fails to note that the location in question is the Corcoran facility, which is operated by the State of California and staffed by members of the most anti-private and politically active corrections union in the country, the California Correctional Peace Officers Association (CCPOA).

Human Rights

Even more damning is the author's allegation that "For-profit prisons have done a poor job of protecting an inmate's civil and human rights." Broad generalizations concerning abuse, violence, inhumane physical conditions and filth are not documented, although the author does cite the cancellation of a contract with Esmor Corporation for problems at the Elizabeth, New Jersey immigration detention center. Interestingly, this is one of the few items in the book not footnoted.

Mr. Price himself admits the successes achieved by private prisons. On page 30 of the book, Mr. Price details the results of a study of private prisons in the United States by the Criminal Justice Institute. According to Mr. Price, the study says, "… private prisons outperform their public counterparts on many important measures hands down; for instance, private prisons had fewer escapes (70 per 100,000 prisoners) than public prisons (87); fewer incidents of major misconduct (3 incidents versus 7.5 incidents per 10 prisoners); fewer incidents of general misconduct (3 incidents versus 15 incidents per 10 prisoners); and, most significantly, fewer prisoner deaths due to homicide, suicide, and accidental causes (7 deaths versus 25 deaths per 100,000 prisoners). According to the report, there were also fewer prisoner assaults committed against staff in private prisons."

State Finances

The book argues that states facing budget challenges are beginning to consider eliminating mandatory sentences and "three strikes, you're out" legislation as a way to reduce the prison population and that this could hurt private prisons. He indicates that the southern part of the country is the least likely to release "their twenty-first century slaves—prisoners—anytime soon". Since Mr. Price holds the industry responsible for these laws in the first place, his criticism is understandable. Again, he fails to point out that individual companies and APCTO do not lobby for stricter or longer sentences. Public employee unions—especially the CCPOA—have historically lobbied for those measures.

Safety

Completely ignoring the statistics he quoted from the Criminal Justice Institute study of private prisons showing them far superior in important performance measures, the author argues that the industry pays lower wages than government, has a higher turnover rate than government and does less training than government. There are a variety of reasons for the statistics he cites, but in the end, by his own admission,

they don't seem to have an impact on facility, offender and employee safety. In fact, after talking at length about Adam Smith's emphasis on incentives, he fails to note that if private providers didn't provide competitive wages and benefits, they would have few, if any employees at all.

As I indicated at the outset, the author and I agree that an objective analysis of public-private correctional partnerships would be advantageous. I would like to suggest three. While none of the studies could be considered the definitive work on the subject and both supporters and detractors of public-private correctional partnerships take issue with elements of each, the results do provide several instructive conclusions.

Contracting for Private Prisons in the Federal Prison System: Cost and Performance of Privately Operated Taft Correctional Institute, by Abt Associates of Cambridge, Massachusetts. It found:

- operating costs 6-10 percent less than the cost of government operation at comparable facilities; and
- a highly accountable operator providing quality service.

Prison Privatization in Pennsylvania: the Case of Delaware County, by the Allegheny Institute of Pittsburgh, Pennsylvania. The Allegheny Institute found:

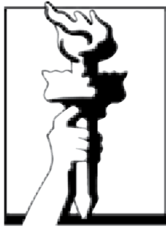
- that the county has saved more than $37 million on construction and operations over the seven years of private operation;
- assaults by inmates decreased dramatically;
- that the state of Pennsylvania rated the quality of the prison as excellent; and
- inmates at the facility said that food quality improved significantly.

Inter-relationship between Public and Private Prisons—Does the existence of prisons under private management affect the expenditures of state governments on prisons under public management? Two professors from Vanderbilt University found:

- operating costs at private prisons are "on average 5% to 20% lower than public prisons"; and
- in states where at least 20 percent of the prison beds were provided by private operators, the corrections budgets for operation of the non-private beds increased at a rate 13 percent slower than in states which had no private beds.

These three studies are part of the larger body of evidence demonstrating that private corrections delivers cost savings and high-quality services. Reason examined data from 18 quality comparison studies conducted since 1989 and found that private prisons outperformed, or were equal to, their government counterparts in 16 of 18 studies. In studies comparing costs, private prisons demonstrated significant savings in 22 of 28 studies (reason.org/ps290.pdf).

Lower construction costs, lower operating costs, high-quality operations featuring treatment, education and rehabilitation and increased accountability are real benefits to be derived from public-private correctional partnerships and APCTO continues to urge that such partnerships be considered as government looks for solutions to the problem of providing safe and secure care and custody to criminal offenders.



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