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.

Reason Foundation is a tax-exempt research and education organization as defined under IRS code 501(c)(3). Reason Foundation is supported by voluntary contributions from individuals, foundations and corporations. The views expressed in these essays are those of the individual author, not necessarily those of Reason Foundation or its trustees.

Copyright © 2009 Reason Foundation. All rights reserved.
Authors

Editor
• Leonard C. Gilroy

Principal Authors
• Leonard C. Gilroy
• Robert W. Poole, Jr.
• Anthony Randazzo
• Lisa Snell
• Samuel R. Staley
• Adam B. Summers
• Steven Titch
• Ben Tonkin
• Shirley Ybarra
• Carson Young

Contributing Authors
• Clint Bolick is the director of the Goldwater Institute Scharf-Norton Center for Constitutional Government and a research fellow at the Hoover Institution.
• Jonathan Williams is the director of the Tax and Fiscal Policy Task Force for the American Legislative Exchange Council.
Welcome to Reason Foundation’s Annual Privatization Report 2009. Now in its 23rd year of publication, APR is the world’s longest running and most comprehensive report on privatization news, developments and trends.

What a difference a year can make. In 2009, the national economic recession has swung the pendulum strongly toward federal intervention in the economy and there are many indications this interference is making the economy worse, not better. At the very same time, however, interest in privatization is sky-high and far reaching, with many state and local governments facing severe and prolonged fiscal crises. Even privatization-resistant states like California, New York, Massachusetts and New Jersey are now turning to the private sector to help solve major fiscal and capital investment challenges.

APR 2009 details the latest on privatization and government reform initiatives at all levels of government. The “Federal Government” section forecasts a bleak outlook for competitive sourcing under the Obama administration and a hostile Democratic Congress. It also provides an update on NASA’s planned partial privatization of the manned space program, as well as the latest on military housing and lodging privatization initiatives.

In the “State Government” section, we profile the increasingly dire fiscal conditions in the states and offer a comprehensive review of the latest state privatization actions. In addition to numerous discrete privatization initiatives in the states, policymakers’ interest in state privatization and government efficiency boards is demonstrably on the rise and advisory commissions on privately financed infrastructure have been established in California and other states.

Similarly, the “Local Government” section reviews the proliferation of privatization activity in cities and counties nationwide. We profile Chicago’s groundbreaking—but troubled—$1.15 billion parking meter system lease, which has Los Angeles, Pittsburgh and other cities contemplating similar initiatives to generate municipal revenues in the economic downturn. We also review Georgia’s fifth new contract city, Dunwoody, along with a number of privatization initiatives proposed or announced in Los Angeles, Indianapolis and numerous other cities.

This year’s APR also provides a comprehensive overview of domestic and international developments in air and surface transportation, including a wide-ranging overview of the current state of the infrastructure finance market, a review of the latest in highway and airport privatization and a review of the latest in air traffic control reform and aviation security.

APR’s “Education and Child Welfare” section offers a comprehensive update on school choice, with the latest on the weighted student formula, charter schools, school voucher and tax credit programs and non-instructional school services outsourcing. This section also details several child...
welfare privatization proposals announced in various states in 2009.

APR’s “Emerging Issues” section examines four issues attracting significant attention in policy circles. First, we offer a summary of the federal bailouts and stimulus spending to date, which currently totals a staggering $12.9 trillion spent since early 2008. We also review efforts that expand and modernize port infrastructure through public-private partnerships. Another article asks the question, “Are roads still public goods?” Last, we review efforts to improve government efficiency and asset management through the use of real property inventories.

APR 2009 also covers the ever-changing world of telecommunications policy, with updates on IT outsourcing, the broadband stimulus and network neutrality.

This APR also reviews the latest developments in the fields of private corrections and mental health services. We review Arizona’s groundbreaking prison lease proposals, a new Vanderbilt University study finding that private prisons reduce state corrections costs, the looming battle to protect private prison operators’ proprietary rights and numerous other privatization developments in domestic and international corrections. We also profile the emerging issue of state mental health services privatization, with case studies from Florida and Virginia.

The “Water and Wastewater” section surveys the latest on the water and wastewater privatization market and ongoing efforts at the federal level to close the infrastructure funding gap. We also review the proposed water system lease in Milwaukee, now on hold.

Lastly, we offer an update on land use and property rights, with feature stories on the resiliency of Houston’s housing market in the current economic recession and a review of property rights in Arizona after the 2006 passage of Proposition 207, a combined eminent domain/regulatory takings reform measure. We also provide the latest on the property rights front, reviewing recent developments in eminent domain reform.

Your comments on the Annual Privatization Report 2009 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/publications/privatizationwatch), now in its 33rd year of publication. For the most up-to-date information on the rapidly changing privatization world, please visit Reason’s Privatization Center (www.reason.org/areas/topic/privatization) and our weblog, Out of Control (www.reason.org/blog).

Leonard C. Gilroy, Editor
Director of Government Reform, Reason Foundation
leonard.gilroy@reason.org
Annual Privatization Report

Federal Update ........................................................................................................ 1
A. Outlook Bleak for Competitive Sourcing Under Obama Administration,
   Democratic Congress ......................................................................................................... 1
B. Program Assessment Rating Tool (PART) Update ..............................................................3
C. Federal Bill Would Encourage Competition for Commercial Government Services ...... 4
D. NASA’s Partial Privatization of the Space Program ........................................................ 6
E. Military Housing Privatization .........................................................................................7

State Government ....................................................................................................9
A. State Privatization Update ..............................................................................................9
B. State Budget Outlook ................................................................................................... 31
C. State Budget Crises in Perspective: Illness or Fiscal Hangover? ......................................33
D. Rich States, Poor States: The 2009 ALEC-Laffer State Economic Competitiveness Index...38

Local Government .................................................................................................. 41
A. Chicago Nets $1.15 Billion in Parking Meter Privatization, L.A. and Others to Follow ........ 41
B. Dunwoody Becomes Georgia’s Fifth New Contract City ...................................................47
C. L.A. City Controller Recommends Sweeping Privatization Program ..................................49
D. Indianapolis Returning to Privatization Roots ................................................................50
E. Milwaukee County Board Nixes Privatization Push .........................................................50
F. Kansas City, King County Embrace Privatization of Animal Shelters ................................51
G. Other Local Privatization News ..................................................................................... 51

Surface Transportation ..........................................................................................54
A. Infrastructure Finance 2009 .........................................................................................54
B. Long-Term Concessions: the Controversy Continues ......................................................58
C. New PPP Toll Roads ...................................................................................................... 61
D. Leasing Existing Toll Roads .......................................................................................... 66
E. HOT/Managed Lanes Under Way ...................................................................................67
F. Overseas Concession Projects ...................................................................................... 68
G. China Rising: Implications for Private Capital .............................................................. 74

Air Transportation .................................................................................................. 76
A. Airport Privatization ..................................................................................................... 76
B. Airport Security ........................................................................................................... 82
C. Air Traffic Control ...................................................................................................... 85

Education and Child Welfare ..................................................................................87
I. Child Welfare Privatization Proposals for 2009 ...............................................................87
A. School Voucher and Tax Credit Programs Expand in 2009 .............................................. 87
B. 2009 Voucher and Tax Credit Student Outcome Data ....................................................88
C. Democrats Cancel D.C. Opportunity Scholarship Program .............................................90
Federal Update

Contents

A. Outlook Bleak for Competitive Sourcing Under Obama Administration, Democratic Congress
B. Program Assessment Rating Tool (PART) Update
C. Federal Bill Would Encourage Competition for Commercial Government Services
D. NASA’s Partial Privatization of the Space Program
E. Military Housing Privatization Update

A. Outlook Bleak for Competitive Sourcing Under Obama Administration, Democratic Congress

In August 2001, then-President George W. Bush unveiled his President’s Management Agenda (PMA), which was an attempt to improve the way government operates. “What matters most is performance and results,” President Bush said at the time. “In the long term, there are few items more urgent than ensuring that the federal government is well-run and results-oriented.” The PMA focused on enhancing government management and program performance by:

- Strategically managing human capital,
- Encouraging competitive sourcing (competition between public- and private-sector employees to provide certain government services),
- Improving financial reporting and transparency,
- Expanding electronic government to better inform and serve citizens, and
- Integrating funding decisions and program performance.

At first, it sounded as though President Barack Obama’s approach to government management would not be all that different from Bush’s. During the 2008 presidential campaign, then-candidate Obama said in a September 2008 speech, “We will fire government managers who aren’t getting results; we will cut funding for programs that are wasting your money.”

But government management may look very different if Congress has its way. In March, Obama signed the 2009 Omnibus Appropriations Act. One provision of the spending law placed a moratorium on competitions between public- and private-sector employees for performing government services through the end of the fiscal year on September 30. It also required federal agencies to establish guidelines for insourcing work currently being performed by private-sector contractors and prohibits agencies from initiating any studies on shifting work from government employees to private vendors.

Then in April Sen. Barbara Mikulski (D–MD) introduced S. 924, the Correction of Long-Standing Errors in Agencies’ Unsustainable Procurements Act of 2009 or the CLEAN-UP Act. The CLEAN-UP Act would further establish
a greater preference for work performed by
government employees instead of private-sector
contractors by revising Office of Management
and Budget Circular A-76, which prescribes
rules for the public/private job competitions.
This would effectively suspend the competition
process indefinitely.

The bill would also likely expand the
definition or interpretation of “inherently
governmental” functions and/or “functions
closely associated with inherently governmental
functions,” leading to further insourcing.
Mikulski claimed the legislation would “level the
playing field” for government employees. This
seems a strange assertion, however, given that
government workers win the vast majority of
competitions under the existing rules. According
to a May 2008 OMB report, under public/
private competitions, a federal agency was
selected to perform the work 83 percent of the
time over a five-year period (FY 2003-FY 2007).
The competitions that took place during this
period resulted in net annual savings of $25,000
per position (full-time equivalent) competed, for
a total savings of $7.2 billion.

In June 2009, the House Armed Services
Committee approved an amendment to the
Year 2010 (H.R. 2647) that would place a
moratorium on public/private job competitions
for the Department of Defense for the next
three years or until the Obama administration
reviews the entire A-76 competition process.
The amendment, offered by Rep. Jim Langevin
(D–RI), would also suspend any pending
competitions until the Defense Secretary reviews
them and would clarify law allowing federal
employee representatives to protest A-76
competitions.

These efforts are only the latest in a series
of congressional salvos against competition in
recent years. As a June 17, 2009, Government
Executive magazine article relates,

Since 2006, when Democrats
took control of both chambers of
Congress, competitive sourcing has run up against a series of legislative
setbacks. Lawmakers passed measures
to limit which agencies could hold job
competitions, give federal employee
teams rights to protest the outcomes of
contests and exclude health care and
retirement benefits from the process of
comparing the costs of bids.

To be sure, there is definitely a need for
federal contract reform. The Government
Accountability Office reported last year that
the Department of Labor and the U.S. Forest
Service had overestimated the savings and
underestimated the costs of contracting out and a
number of military contracts have suffered from
a lack of competition, poor cost containment
and lax oversight. Overzealous legislators should
be careful not to throw the baby out with the
bathwater, however. The A-76 competition
process has resulted not only in billions of
dollars in savings but also in more effective and
more efficient delivery of government services.

Obama has acknowledged the need to
control government expenditures, as embodied
in the initiative he announced in April to cut
wasteful spending. In a weekly radio address
in which he announced the effort, he declared
that the nation’s future “depends on restoring a
sense of responsibility and accountability to our
federal budget.” Competition between public-
and private-sector employees is an excellent
way to improve accountability and reduce costs
by breaking up the government monopoly on
service provision. Regardless of which party wins
the contract, the mere fact that they are forced to
compete for the right to provide services leads to
improved efficiency and benefits taxpayers.

As of this writing, S. 924 has been referred
to the Senate Committee on Homeland Security
and Governmental Affairs. H.R. 2647 has
been approved, as amended, by the House of
Representatives. The Senate has not yet acted on
it.
B. Program Assessment Rating Tool (PART) Update

In its most recent evaluation of federal government programs, the U.S. Office of Management and Budget (OMB) reveals that programs continue to show improvements in performance, as determined by the federal government’s Program Assessment Rating Tool or PART. The results are only slightly better than last year’s figures, but they have continued to improve in each of the seven years since the start of the PART evaluations. Since the advent of PART in 2002, the government has evaluated the performance of 1,015 programs, constituting 98 percent of all federal programs. During that time, the portion of programs rated “Effective” has more than tripled from 6 percent to 19 percent, “Moderately Effective” programs have risen from 24 percent of the total to 32 percent, programs deemed “Adequate” have nearly doubled from 15 percent to 29 percent, “Ineffective” programs have fallen from 5 percent to 3 percent and programs whose results could not be demonstrated due to a lack of relevant information has declined from a whopping 50 percent to 17 percent. Of all the programs assessed by PART, 80 percent have been scored as “Performing,” while the remaining 20 percent have been categorized as “Not Performing” (see Table 1).

1. A Brief History of PART

PART is an integral piece of former President George W. Bush’s President’s Performance Improvement Initiative (formerly the Budget and Performance Integration Initiative) and grew out of an earlier effort to establish a uniform method of assessing federal program performance and enhance accountability. The Government Performance and Results Act of 1993 sought to attain this by requiring federal agencies to identify both annual and long-term goals and to collect and report performance data. In 2002, PART expanded upon this idea in the form of a questionnaire, to be completed by federal agencies, that would seek to uncover objective information about program design, planning, management and results. In February 2006, the Administration sought to increase transparency and accountability further when it launched the ExpectMore.gov Web site. The portal tracks over 5,000 program performance measures and contains summaries of PART results for all programs that have been evaluated to date, allowing public access to information about which government programs are performing, which ones are not and what steps are being taken to improve performance. President Barack Obama has vowed to significantly alter PART, although it is not yet clear exactly what changes will be made. Most expect that some form of program review will remain, however.

2. How PART Works

Each PART questionnaire consists of 25 basic questions plus questions customized for each of the seven program types: Direct Federal, Competitive Grant, Block/Formula Grant, Research and Development, Capital

Table 1: PART Cumulative Program Ratings by Year Completed, 2002-2008

<table>
<thead>
<tr>
<th>Ratings</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Performing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Effective</td>
<td>6%</td>
<td>11%</td>
<td>15%</td>
<td>15%</td>
<td>17%</td>
<td>18%</td>
<td>19%</td>
</tr>
<tr>
<td>Moderately Effective</td>
<td>24%</td>
<td>26%</td>
<td>26%</td>
<td>29%</td>
<td>30%</td>
<td>31%</td>
<td>32%</td>
</tr>
<tr>
<td>Adequate</td>
<td>15%</td>
<td>20%</td>
<td>26%</td>
<td>28%</td>
<td>28%</td>
<td>29%</td>
<td>29%</td>
</tr>
<tr>
<td>Not Performing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ineffective</td>
<td>5%</td>
<td>5%</td>
<td>4%</td>
<td>4%</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Results Not Demonstrated</td>
<td>50%</td>
<td>38%</td>
<td>29%</td>
<td>24%</td>
<td>22%</td>
<td>19%</td>
<td>17%</td>
</tr>
<tr>
<td>Total Programs</td>
<td>234</td>
<td>407</td>
<td>607</td>
<td>793</td>
<td>977</td>
<td>1,011</td>
<td>1,015</td>
</tr>
</tbody>
</table>

Source: U.S. Office of Management and Budget
Assets and Service Acquisition, Credit and Regulatory. The questionnaire has four parts: Program Purpose and Design, Strategic Planning, Program Management and Program Results and Accountability (see Table 2). Responses are scored by OMB, made public and used to develop recommendations for program improvement and to prioritize funding in the formation of the president’s budget.

<table>
<thead>
<tr>
<th>Table 2: Overview of PART Questionnaire Sections</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Section</strong></td>
</tr>
<tr>
<td>1. Program Purpose and Design</td>
</tr>
<tr>
<td>2. Strategic Planning</td>
</tr>
<tr>
<td>3. Program Management</td>
</tr>
<tr>
<td>4. Program Results and Accountability</td>
</tr>
</tbody>
</table>

The responses to the PART questionnaires are scored from 0 to 100 for each of the four sections and an overall weighted numerical rating is calculated. The score is translated into a qualitative rating according to the following scale:

- Effective ......................... 85–100
- Moderately Effective .............. 70–84
- Adequate ........................... 50–69
- Ineffective .......................... 0–49

In addition, programs may receive a rating of “Results Not Demonstrated,” regardless of their questionnaire score, if they do not have acceptable performance measures, have not collected performance data or otherwise cannot provide enough information to make a reasonable determination whether the program is achieving results.

**Tying Program Scores to Funding Decisions**

As much as it has helped to provide transparency and place greater emphasis on program performance, the weakness of the PART system has always been that the evaluations and information this executive branch tool provides are only as useful as the legislative branch wishes to make it, since Congress is responsible for allocating the money for all the government’s various programs. Thus far, legislators have shown little interest in applying the PART analysis to funding-allocation decisions.

No matter how the Obama administration changes PART or replaces it entirely, it will have to overcome this challenge and obtain congressional buy-in to linking budgetary decisions to program performance if the government is to have results-oriented management and be a good steward of taxpayer dollars.

**C. Federal Bill Would Encourage Competition for Commercial Government Services**

While most action this year by the executive and legislative branches on government management has so far been opposed to competitive sourcing and privatization, a bill sponsored by Sen. John Thune (R–SD) and Rep. John J. Duncan, Jr. (R–TN) would codify a policy of ensuring fair competition between government employees and private-sector vendors for services deemed to be commercial in nature.

The bill, known as the Freedom from Government Competition Act of 2009 (S. 1167 in the Senate and H.R. 2682 in the House of Representatives), would essentially prescribe a “Yellow Pages” test for the federal government: if a government service is provided by private-sector businesses routinely found in the phone book, government should not be in that line
of work. Any such services would be dealt with through competitive sourcing, managed competition between public- and private-sector workers or divestiture of federal involvement (total privatization, whereby the government would stop providing the service and allow the market to satisfy the demand). The legislation carves out exemptions from competition or privatization for cases in which goods or services are required by law to be provided by government, the services performed are inherently governmental, provision of a good or service is necessary for national defense or homeland security purposes or there is no private source capable of providing the good or service. It, further, requires the director of the Office of Management and Budget and the Comptroller General of the United States (head of the Government Accountability Office) to evaluate the commercial and inherently governmental services carried out in each agency and to submit a report to Congress each year describing their findings, justifying activities deemed to be exempted under the Act and providing a schedule for the transfer of commercial services to the private sector.

The bill makes the following findings:

- Private sector business concerns, which are free to respond to the private or public demands of the marketplace, constitute the strength of the United States economic system.
- Competitive private enterprises are the most productive, efficient and effective sources of goods and services.
- Unfair government competition with the private sector of the economy is detrimental to the United States economic system.
- Unfair government competition with the private sector of the economy is at an unacceptably high level, both in scope and in dollar volume.
- Current law and policy have failed to address adequately the problem of unfair government competition with the private sector of the economy.
- It is in the public interest that the federal government establish a consistent policy to rely on the private sector of the economy to provide goods and services necessary for or beneficial to the operation and management of federal agencies and to avoid unfair government competition with the private sector of the economy.

The Freedom from Government Competition Act is based on a principle embodied during the Eisenhower administration as set forth in Bureau of the Budget Bulletin 55-4 in 1955:

*In the process of governing, the Government should not compete with...*
its citizens. The competitive enterprise system, characterized by individual freedom and initiative, is the primary source of national economic strength. In recognition of this principle, it has been and continues to be the general policy of the Government to rely on commercial sources to supply the products and services the Government needs. . . . The Government shall not start or carry on any activity to provide a commercial product or service if the product or service can be procured more economically from a commercial source.

Despite this policy, a significant portion of commercial services are still being provided by federal employees. The Federal Activities Inventory Reform (FAIR) Act of 1998 requires the government to take an annual inventory of which services it provides are “inherently governmental” (and thus should only be provided by the government) and which are commercial in nature. According to the U.S. Office of Personnel Management, there are 1.6 million executive branch, non-postal, full-time, permanent employees in the U.S. government. Of these, 850,000 positions are used to provide commercial services, yet less than 10 percent of these positions have been evaluated to determine whether a competitive process for performing those services is warranted. Proponents of the Freedom from Government Competition Act estimate that reviewing these services and opening them to competition, where appropriate, would lead to cost savings of $20 billion to $28 billion a year.

As of this writing, S. 1167 had been referred to the Senate Committee on Homeland Security and Governmental Affairs and H.R. 2682 had been referred to the House Committee on Oversight and Government Reform, Subcommittee on Government Management, Organization and Procurement.

D. NASA’s Partial Privatization of the Space Program

Once it was thought that one area of government that the private sector could never manage was space exploration and transportation, but that attitude has changed, particularly over the past decade or so. In recent years, the National Aeronautics and Space Administration (NASA) has offered cash prizes to private-sector developers of space and aeronautic equipment innovations and improvements and now it is seeking the help of the private sector to design and build its rockets and spacecraft.

In May 2009, NASA’s acting administrator, Chris Scolese, announced to a congressional subcommittee that the agency is planning to offer $150 million in stimulus-package funds to private companies to design, build and maintain their own rockets and crew capsules. These spacecraft would be used to transport astronauts while NASA finishes its own shuttle replacement fleet. In addition, the White House has ordered a top-to-bottom review of the entire manned space program. The review is to be overseen by former Lockheed Martin chief executive officer Norman Augustine, who is considered sympathetic to private space ventures.

Commercial space programs have flourished in recent years. Engineer Burt Rutan’s Scaled Composites, LLC, won the $10 million Ansari X Prize in October 2004, when the company’s SpaceShipOne craft became the first privately built machine to reach space. The following year, NASA Administrator Michael Griffin announced that the agency was considering buying crew and cargo transportation services to and from the International Space Station from private companies. “We believe that when we engage the engine of competition, these services will be provided in a more cost-effective fashion than when the government has to do it,” Griffin said.

Private space companies like Space Exploration Technologies Corporation or SpaceX and Orbital Sciences Corporation have
made great strides in developing rockets and launching satellites and space probes. SpaceX won a $278 million government contract in 2006 as part of NASA's Commercial Orbital Transportation Services projects. In 2007, Orbital Sciences took over a contract worth $170 million for its Taurus 2 launcher and Cygnus capsule combination after underfunded venture Rocketplane Kistler failed to deliver on its financial objectives.

William Watson, executive director of the Space Frontier Foundation, which promotes commercial space activities, welcomes private-sector involvement in and competition for space transportation services. “Let’s have an American competition in space—to create good jobs, fuel innovation and close the [launch] gap more quickly,” Watson said in a May 2009 FoxNews.com article. “With private funds matching government investment, we can dramatically leverage taxpayer dollars to produce breakthroughs in a new American industry—commercial orbital human spaceflight.”

Aerospace consultant and retired NASA aerospace engineer Don A. Nelson similarly sees privatization as a way to stem rapidly rising costs, address the anticipated launch gap (the government has begun decommissioning the space shuttle fleet and NASA’s problems with developing shuttle replacement vehicles will likely delay future launches to the space station until at least 2016) and allow NASA to refocus on its core mission. As Nelson wrote on the Nasaproblems.com blog earlier this year:

NASA is struggling with developing the Orion [space shuttle replacement] vehicles . . . one for space station crew rotation and another for the lunar mission. It is the Orion space station crew rotation vehicle problems that is causing the launch gap. Privatization of the shuttle fleet solves these problems and allows NASA the time, resources and budget to restructure the Constellation Program (CxP) for their primary goal of returning humans to the moon and beyond. Privatization of the fleet avoids the costly and embarrassing space gap, saves critical space jobs and insures the operation of the space station. Privatization provides avenues to regain a share in the commercial launch market, crew escape pods and the foundation for a 21st century reusable space based transportation system.

The government is increasingly coming to the conclusion that a successful space program will depend on a partnership with private-sector ventures. Utilizing these resources will help contain costs, leverage taxpayer dollars, take advantage of the innovation and expertise of those employed by private firms and free up NASA to focus on its core mission.

E. Military Housing Privatization

The U.S. military’s housing privatization efforts have enjoyed great success over the years and they continue to be expanded. In testimony before the Senate Armed Services Committee’s Subcommittee on Readiness and Management Support in June 2009, Wayne Arny, Deputy Under Secretary of Defense for Installations and Environment, proclaimed that privatization and other initiatives have dramatically improved military housing over the past decade.

“A decade ago, we were maintaining over 300,000 family housing units, two-thirds of which were deemed inadequate by the military departments who owned them,” Arny said. “The private sector responded by delivering modern, affordable housing.”

His written remarks submitted to the committee detailed how privatization has helped improve military housing: “Privatization allows for rapid demolition, replacement or renovation of inadequate units and the sale of units no longer needed. Privatization also enables [the Defense Department] to make use of a variety of private-sector approaches to build and renovate.
military housing faster and at a lower cost to American taxpayers.”

The cost savings realized through the military housing privatization program have been significant. The program has allowed the services to leverage housing dollars by 10 to 1, with $2.5 billion in federal funds generating $25 billion in housing development at privatized installations. In addition, contracts require the private-sector partners to cover maintenance and replacement for 50 years, allowing the government to avoid those expenses altogether.

The success of the military housing privatization program prompted the Army to examine other potential areas for privatization and in June 2009 it announced a new initiative to privatize on-post lodging. Through the Residential Communities Initiative, the Army is moving to privatize on-post lodging for soldiers in a temporary-duty or permanent-change-of-station status who need lodging aboard Army installations. Beginning August 15, 2009, 10 installations will be participating in the Army lodging privatization program: Fort Rucker, Alabama; Fort Leavenworth, Kansas; Fort Riley, Kansas; Fort Polk, Louisiana; Fort Sill, Oklahoma; Fort Hood, Texas; Fort Sam Houston, Texas; Yuma Proving Ground, Arizona; Fort Myer, Virginia; and Fort Shafter/Tripler Army Medical Center, Hawaii.

According to the privatization plan, Actus Lend Lease will take over responsibility for correcting commercial code noncompliance issues and renovating the mechanical, electrical and plumbing systems in the 3,200 rooms at the 10 installations. Lodging operations will be handled by InterContinental Hotels Group (IHG). The Actus/IHG team will convert five hotels comprising 933 rooms to Holiday Inn Express facilities over the next two years at no cost to the Army. Enhanced guest services and facilities at the converted hotels will include complimentary breakfasts, free high-speed Internet access, fitness and business centers, courtesy shuttle vehicles, free guest laundry service, pet-friendly rooms and 24-hour honorsystem convenience stores. Moreover, more than 80 percent of the current 600-plus Army lodging employees who have applied for positions with IHG will receive offers of employment.

The military embraced housing privatization in recognition of the facts that managing real estate and being a landlord were not among its core competencies (in fact, it was doing a rather poor job at this, as the Defense Department readily admits) and that it could offer its members better facilities and services through smart partnerships with private-sector vendors. Just as the Army realized several years ago that providing housing was not a core competency and, thus, should be outsourced to competent private-sector providers, it has now come to the same conclusion regarding hotel operations.

At the end of the day, privatization benefits such as cost savings, life-cycle efficiencies and the like—which are enormous—nevertheless pale in comparison to the improvements in the quality of life for military service members and their families, which was the original point of the housing privatization initiative. As Arny explained to the Senate subcommittee, “Access to quality, affordable housing is a key factor affecting service member recruitment, retention, morale and readiness. Through privatization and increases in housing allowances, [the Defense Department] has made great strides in increasing service members’ housing choices.”
State Government

Contents
A. State Privatization Update
B. State Budget Outlook
C. State Budget Crises in Perspective: Illness or Fiscal Hangover?
D. Rich States, Poor States: The 2009 ALEC-Laffer State Economic Competitiveness Index

A. State Privatization Update
Since the summer of 2008, state fiscal conditions have deteriorated significantly with the onset of the national recession and policymakers in nearly every state have been forced to reckon with mounting budget deficits that necessitate doing more with fewer taxpayer dollars. Deepening fiscal woes are prompting increased interest in privatization among state policymakers. The following sections describe a wide range of current privatization initiatives in the states.

1. Interest in State Privatization and Government Efficiency Boards on the Rise
The magnitude of state fiscal pressures is prompting policymakers in a number of states to look beyond individual privatization initiatives toward more comprehensive and systematic approaches to privatization program development.

A central lesson learned from global experience in privatization is that it works best when governments develop a centralized, independent decision-making body to manage privatization and government efficiency initiatives—a state “center of excellence” in procurement. Experience from Florida, Virginia and Utah—which have each implemented versions of this concept—has demonstrated that having a standardized method for procuring and managing contracts will result in more accountability, transparency and competition. Further, having a dedicated unit manage the process on an enterprise-wide scale ensures that the benefits of lessons learned and best practices are shared among agencies. Altogether, a sound privatization policy framework is essential to maximizing cost savings and value for money in the delivery of state services.

Florida’s Council on Efficient Government, for example, was developed during former Governor Jeb Bush’s tenure and was a key component of a strategy that ultimately helped his administration realize over $550 million in cost savings through privatization and managed competition initiatives. (For more, see “Florida’s Council on Efficient Government Report Finds Privatization on the Rise—But Obstacles Remain” later in this section.) Virginia’s Commonwealth Competition Council has put forth privatization recommendations that are estimated to be saving state taxpayers at least $40 million per year. And as reported in Reason Foundation’s Annual Privatization Report 2008, Utah passed legislation in the spring of 2008 to strengthen that state’s Privatization Policy Board and give it more tools to advance sound
privatization policy.

Over the last year, other states have taken notice and interest in the privatization center-of-excellence concept has risen significantly.

In a proactive effort to address a looming fiscal crisis set to hit in fiscal year 2012 with the expiration of temporary federal stimulus funds, Louisiana Governor Bobby Jindal signed an executive order in April 2009 establishing a new Commission on Streamlining Government (CSG) to find ways to reduce the cost of state government through downsizing, streamlining and privatization. The state legislature subsequently codified the CSG into law in Senate Bill 261, sponsored by state Senators Jack Donahue and Francis Thompson, which was approved unanimously in both legislative houses in June 2009.

By December 2009, the new CSG will prepare a report outlining:

- Recommendations to eliminate, streamline, consolidate, privatize or outsource constitutional and statutory agency activities, functions, programs and services in order to reduce costs, improve efficiency or effectiveness and maintain or improve service levels.

- Recommendations to ensure that agency activities, functions, programs and services are not duplicative and are necessary, meeting or exceeding performance standards and meeting the needs of Louisiana citizens.

- Recommendations for the elimination, consolidation, privatization or outsourcing of an agency to provide a more cost-efficient or more effective manner of providing an activity, function, program or service.

- Recommendations providing for the use of alternate resources to the operation of agencies, activities, functions, programs and services to provide them in a more cost-effective manner without affecting the quality or availability of needed services.

- Recommendations for standards, processes and guidelines for agencies to use in order to review and evaluate government activities, functions, programs and services to eliminate, streamline, consolidate, privatize or outsource them.

The joint House and Senate governmental affairs committees will review the proposals by February 1, 2010 and any restructuring proposals would be presented in the 2010 regular legislative session. According to a June 2009 press release from Jindal’s office highlighting legislative action on his reform priorities, the CSG “is charged with making real reforms to reduce the size of government—anything from eliminating duplicative services to combining entire state agencies is on the table.”

In addition to the CSG, Jindal signed House Bill 794, establishing a nine-member Postsecondary Education Review Commission to review and improve the efficiency of the state’s higher education system. The commission will submit recommendations to the Board of Regents 45 days prior to the 2010 legislative session. The new commission “will ensure our higher education spending is efficient, by recommending ways to streamline functions and better invest in priority areas,” according to Jindal. “We will be working closely with this commission, as well as the Commission on Streamlining Government, in the months ahead as we work to reduce state government spending by eliminating waste and duplication in services.”

In Arizona, the boldest privatization board proposal to surface in any state during the 2009 legislative session came within two votes of passing both chambers. Senate Bill 1466, which would have established perhaps the most comprehensive and strongest privatization and government-efficiency board in the nation, was narrowly defeated in the House of Representatives amid a chaotic and politically charged flurry of legislative activity on the last day of the 2009 fiscal year in an attempt to pass a 2010 budget to avert a partial government
shutdown.

The bill, sponsored by Senate Majority Whip Pamela Gorman, would have created a new Council on Efficient Government (CEG), a state procurement center of excellence modeled largely on Florida’s highly successful Council on Efficient Government and the recently revamped Utah Privatization Policy Board. Under the bill, the CEG would:

- Review whether goods or services provided by state agencies could be privatized to provide the same (or higher) level of service delivery while delivering cost savings or better value for money.
- Develop a standardized, enterprise-wide process for identifying and implementing competitive sourcing.
- Develop rules instituting performance-based contracting as default requirements for state procurements.
- Require state agencies to develop a business case justifying any proposed outsourcing initiative—covering everything from cost-benefit analysis to employee transition plans—prior to deciding whether to outsource.
- Disseminate lessons learned and best practices in competitive sourcing across state government.
- Conduct an annual or biannual inventory of all functions and activities performed by state government, distinguishing between inherently government and commercial activities.
- Require the governor’s office, at least every two fiscal years, to subject three commercial activities undertaken by state agencies to strategic review;
- Create a uniform cost-accounting model to facilitate “apples-to-apples” cost comparisons between public- and private-sector service provision (critical to ensure a level public-private playing field).
- Review and take action on complaints regarding inappropriate government competition with the private sector.

At its core, Arizona’s CEG would facilitate the regular, wholesale review of state government activities with an eye toward right-sizing government through privatization. But at the same time, it recognizes that successful privatization requires a high standard of due diligence in contracting. Hence the CEG would be responsible for establishing a standardized method for procuring and managing contracts in order to maximize accountability, transparency and competition and deliver the best value for taxpayers.

Notably, the Arizona Chamber of Commerce and Industry made SB 1466 one of its legislative priorities in the 2009 session. In a January 2009 editorial, the Chamber explained why:

“With a $1.6 billion deficit for fiscal year 2009 and a $2.2 to $3 billion deficit for fiscal year 2010, the legislature will have to carefully evaluate which government programs should be scaled back, eliminated or privatized. . . Identifying areas where the private sector can perform government functions more efficiently and at a lower cost can be an important part of the budget solution. Additionally, minimizing government competition with businesses will aid in retaining private sector jobs.”

Illinois saw a similar bill introduced in the 2009 legislative session. State Representative Mike Connelly introduced House Bill 4161 (Illinois Efficient Government Act), which would create a Council on Efficient Government in that state largely modeled after the Arizona bill. But the Illinois bill failed to receive a hearing in committee.

For the second year in a row, the Oklahoma House and Senate voted to establish a new, 10-member House-Senate committee and a Legislative Service Bureau office to centralize
the development of state privatization and efficiency initiatives. Senate President Pro Tem Glenn Coffee was the primary sponsor of the Accountability, Innovation and Privatization Act of 2009 (Senate Bill 646), which would establish a new legislative Joint Committee on Accountability, Innovation and Privatization to conduct regular agency performance audits, study the feasibility of privatizing state assets and services, review tax-incentive programs, investigate and eliminate waste and corruption in state government and ensure the efficient and effective use of taxpayer dollars. The new committee would also take over responsibility for designing and implementing a performance-based budgeting program for the state.

SB 646 would also create the Office of Accountability, Innovation and Privatization within the Legislative Service Bureau, which would coordinate the development of the agency performance audits with the state auditor and inspector. Coffee said the program will lead to cost savings and efficiencies in state government and will root out corruption.

At press time, the bill had been assigned to a conference committee to try to resolve differences in the language passed in each legislative chamber. Governor Brad Henry vetoed a similar bill in the 2008 session, but he has not taken a position on SB 646.

Virginia’s House of Delegates overwhelmingly passed an efficiency board bill in February 2009, only to see it stall in the Senate. House Bill 2463, sponsored by Delegate John M. O’Bannon III, would have established a new Government Efficiency Review Commission to review agencies on an eight-year cycle and advise the General Assembly on the elimination of waste, duplication and inefficiency. The proposed commission’s scope included determining whether less restrictive or alternate methods of delivery exist for any given service under review. HB 2463 passed the House of Delegates 95-3, but it failed to pass in the Senate Rules Committee.

2. Infrastructure PPP Advisory Commissions Created in California, New York, Michigan

Just as states are looking beyond individual privatization initiatives toward more comprehensive and systematic approaches to the privatization of general government services and activities, a parallel policy push is developing in the infrastructure field.

The growing demand for infrastructure investment and widespread revenue shortfalls have prompted a number of states to pursue public-private partnerships (PPPs) in recent years to tap private-sector capital and expertise in the delivery of public infrastructure. In most states, PPP initiatives tend to be piecemeal and are easily politicized, given the lack of an overarching institutional framework to incubate projects, facilitate their execution and provide transparency, accountability and critical oversight.

A number of jurisdictions around the world have learned this lesson and created organizations like Partnerships UK (United Kingdom), Partnerships BC (Canada), Partnerships Victoria (Australia), PPP Québec (Canada) and Infrastructure Ontario (Canada) to serve as government’s central procurement body for PPP project development and implementation. These PPP centers of excellence fulfill a number of valuable functions, including project evaluation and selection, process and contract standardization, value-for-money/public sector comparator analyses, contract monitoring and program auditing, and the dissemination of best practices and lessons learned in PPP project development across agencies.

Prior to this year, no U.S. state had created a similar PPP center of excellence, but 2009 saw several bellwether states—California, New York and Michigan—embrace the idea.

In California, where public employee union opposition and the resistance of state lawmakers have stymied the development of infrastructure PPPs in recent decades, the state’s massive budget deficits and growing backlog of infrastructure
investment needs prompted policymakers to pass PPP-enabling statutes in early 2009 authorizing an unlimited number of PPP projects for roads, courthouses and prisons through 2017 and up to 15 transportation design-build projects through 2014.

The legislation also required the state to create a new Public Infrastructure Advisory Commission (PIAC; www.publicinfrastructure.ca.gov) to identify potential PPP projects, research best practices and provide advisory and procurement services to Caltrans and regional transportation authorities, similar to the role played by Partnerships BC and other PPP entities in Canada and Europe. The PIAC will be housed in the state Business, Transportation and Housing Agency.

Under the new law, any proposed PPP contract must be submitted for review by the California Assembly and the PIAC at least 60 days before Caltrans or a regional agency signs the agreement. In addition to reviewing proposed PPP contracts, the PIAC will assist transportation agencies by helping identify suitable PPP opportunities, researching and analyzing international PPP experience, assembling a library of best practices and lessons learned and providing advice and procurement services upon request.

Legislators appropriated no funding to the PIAC, so it will rely on Business, Transportation and Housing Agency staff and support from major California universities. The PIAC began its work in the spring of 2009 by soliciting input from four informal work groups representing state and local government entities, academic and public-policy experts, private partners and community organizations on potential directions and guidance on its early PPP program development.

“We are in high gear on all fronts,” Dale Bonner, secretary of the Business, Transportation and Housing Agency, told Public Works Financing in May 2009, adding that he hopes some PPP projects can be implemented before the end of Governor Arnold Schwarzenegger’s term in January 2011.

Like California, New York State is embracing privatization in response to mounting fiscal pressures that culminated in an unprecedented $17.7 billion budget deficit. In October 2008, Governor David Paterson signed an executive order establishing the New York State Commission on State Asset Maximization (SAM; www.nysamcommission.org) to study the potential for PPPs involving leases of state assets to private investors to provide a long-term revenue stream to the state, modernize its infrastructure and improve asset management.

According to Paterson, the commission “is another important step” in ensuring that New York “continues to make the crucial long-term investments we need to sustain economic growth and secure a valuable quality of life for our citizens. . . . I believe the private sector can be a source of innovation, allowing us to increase the value, efficiency and safety of assets like our aging infrastructure system.”

The SAM commission released its groundbreaking final report in June 2009, framing a new and positive role for privatization PPPs in the delivery, upgrade and modernization of state infrastructure assets in New York. The report recommends over two dozen infrastructure PPP pilot projects across several asset classes, including roads, K-12 schools, higher education and energy (see text box). The recommendations focus on delivering new projects through innovative PPP finance and procurement approaches, as opposed to selling or leasing state assets like the lottery or toll roads and bridges.

The report also calls for the establishment of a State Asset Maximization Board to serve as a PPP center of excellence for the state, acting as a central conduit for approving and developing PPP projects.

According to Paterson, “In the midst of these economic challenges, we must now, more than ever, make long-term investments to spur
New York PPP Opportunities: Roads, Schools, Energy and Beyond

Some of the recommendations in the June 2009 final report of the New York State Commission on State Asset Maximization:

Transportation

- Implement a PPP bridge-improvement program to replace, rehabilitate and maintain New York’s bridges.
- Establish a PPP to develop the Buffalo Harbor Bridge.
- Create a partnership between the New York State Department of Transportation, private railroad companies and investors to advance the development of high-speed rail-passenger service on up to three designated corridors within the state.
- Establish a PPP for the maintenance, repair and operation of the Gowanus Expressway (I-278).
- Encourage the use of PPPs by the Metropolitan Transit Authority for transit-oriented development projects.

Energy

- Support PPPs in the development of electricity transmission and distribution infrastructure.
- Assess the potential for new private investment in extracting natural gas in the Marcellus Shale.
- Assess the potential for locating renewable energy projects, including wind, solar and hydro, on state-owned land and waterways.

Information Technology

- Identify and lease state building rooftops and land holdings through PPPs with wireless carriers to expand their commercial network.
- Establish a PPP for the state's existing data-center assets to help finance new construction and/or to refurbish existing data centers.

Social Infrastructure

- Establish a pilot program that enables school districts in Syracuse and Yonkers to utilize PPPs for major anticipated capital-construction programs.
- Examine and define the conditions under which private financing could be used to support capital-construction programs for healthcare facilities.

Higher Education

- Allow the use of alternate construction-delivery mechanisms (e.g., construction manager-at-risk, design-build) for State University of New York (SUNY) and City University of New York facilities.
- Establish a pilot program for a select number of SUNY schools to lease campus land to private entities.

Underutilized Property

- Formalize a PPP with Empire State Development Corporation and Office of General Services to centralize authority in managing the state’s real estate.
- Employ joint ventures, license agreements, ground leases and other transaction alternatives to unlock revenue from underutilized assets that might be otherwise sold.
- Develop a comprehensive database to inventory and report on the state’s real estate assets by leveraging future brokerage agreements with the private sector for lease administration or other services.
- Establish a joint brownfield cleanup PPP between the city of New York and the state.
economic growth and think creatively about innovative ways to enhance the performance of vital infrastructure assets. . . . This report provides us with a series of ideas for asset maximization projects that could accelerate construction, jumpstart job creation and provide for substantial savings in the years to come.”

The report noted that a number of successful PPPs have been implemented in the state—albeit in piecemeal fashion—including the private financing and development of Terminal 4 at John F. Kennedy International Airport, operations and maintenance at New York City’s Central Park and the construction of new K-12 schools in Rensselaer.

At a press conference announcing the report’s release, Paterson announced that he would implement one of its recommendations by creating the State Asset Maximization Board to approve and provide guidance and oversight for PPP projects. The new board will play a similar role to organizations like Partnerships UK, Partnerships BC and California’s PIAC.

Michigan is also making a clear push toward PPPs. Having undertaken a scoping project to determine that suitable PPP opportunities exist to justify a detailed, enterprise-wide approach, Governor Jennifer Granholm’s administration took the first big step in 2008 by establishing a new Office for Public Private Partnerships within the state Treasury Department. The office is responsible for coordinating, facilitating and providing financial standardization and accountability for state PPP projects across a variety of sectors, including transportation, educational facilities, energy water/wastewater, corrections, public safety and information technology.

The office moved quickly to build expertise, signing a three-year, $3.2 million contract with KPMG for privatization advisory services in January 2009. The firm will provide the state with 12 PPP proposals each year, with a handful likely to be implemented. KPMG’s fees are expected to be paid out of PPP transaction proceeds.

At an April 2009 conference of the National Council for Public-Private Partnerships, office Director Joe Pavona told attendees Michigan is considering a wide range of PPP procurement options, including full concessions (asset leases), shadow tolling, availability payments, design-build, design-build-operate-maintain and design-build-finance.

In her executive budget proposal, Granholm called for the creation of a PPP investment fund within the Treasury Department to invest in financing and developing infrastructure and energy PPPs, capital-asset improvements and other types of projects as determined by the state treasurer and the state budget director. In legislative action, Rep. Lee Gonzales and 10 cosponsors introduced House Bill 4961—broad-based, comprehensive enabling legislation authorizing the state to enter into transportation PPPs—in late May 2009. At press time, the bill had been assigned to the House Transportation Committee and was awaiting a hearing.

While California, New York and Michigan are the first states to embrace the idea of a centralized authority to drive PPP program development, many industry experts believe other states would benefit from a similar shift from a piecemeal approach to PPPs toward the development of more structured and holistic PPP governance structures.

3. Justice Department Opinion Dims Outlook for State Lottery Leases

As recently as the summer of 2008, at least a dozen states were actively considering privatizing their state-run lotteries. But an October 2008 advisory opinion from the U.S. Department of Justice effectively stopped those efforts in their tracks.

In response to a request from Indiana Governor Mitch Daniels for a legal opinion on his proposal to lease the Hoosier Lottery and use the proceeds to fund a new state college tuition program, the department’s Office of
Legal Counsel determined that states would not be in compliance with federal law if they enter into long-term lottery-system leases with private consortia. The ruling found that while states may contract with firms to operate their lotteries, federal law requires that states maintain control over significant business decisions. The opinion also found that private management firms may not receive more than “a de minimus interest in the profits and losses of the business.” According to the opinion, the exemption state lotteries currently have from criminal prosecution under federal lottery laws would no longer apply if those lotteries were managed by private firms rather than the states.

Daniels subsequently abandoned his lottery-lease plan to avoid a legal challenge and began seeking alternate funding options for his tuition proposal.

While countering that states would retain control over any lottery privatization via contractual controls regulating the activities and performance of investor-operators, industry experts also generally agree that the restrictions on states would vanish overnight were Congress to amend the federal statutes in question. According to Tom Osborne, managing director for global financial services firm UBS, “Lotteries have stumbled; what is needed is a federal law.” Absent such a statutory amendment, states and operators would likely be taking a gamble with lottery privatization. The associated political risks and potential limits on the private sector’s role in lottery operations and management would likely dampen bid values significantly, lowering the overall value of a lottery lease. And even if a lottery privatization initiative were to pass, states would face the prospect of having to test the Justice Department opinion in federal court.

Gambling industry consultant Eugene Christiansen told GamblingCompliance.com that the Justice Department “has thrown a monkey wrench into state government fiscal planning. . . . It does so, moreover, when privatizing lotteries is gaining speed in other countries.”

However, one state may have solved the question of how to monetize its lottery without running afoul of federal law. In July 2009, Illinois Governor Pat Quinn signed into law a $29 billion public works bill (House Bill 2424) that includes a partial privatization of the Illinois Lottery as part of the funding source. The bill calls for outsourcing the management of the lottery to a private firm that would be repaid with a five percent share of the lottery profits and the term of the contract would not exceed 10 years. Industry experts believe that since this deal would be structured more as an outsourcing contract—already common in many state lotteries—then a sale should pass federal muster. The bill sets March 1, 2010 as the deadline to ink a deal, so Illinois policymakers will need to move quickly on the procurement.


The Florida Council on Efficient Government’s (CEG) 2008 Annual Report found a tremendous increase in state outsourcing projects since 2001 and identified 551 outsourced projects in Florida state government for fiscal year (FY) 2007–2008, with a lifetime value of over $8 billion.

Those 551 projects represent a 90 percent increase from the 289 projects identified the previous fiscal year (see discussion in Reason Foundation’s Annual Privatization Report 2008, available at reason.org). But the CEG notes that the latest tallies include 332 Department of Elder Affairs (DEA) projects not included in the previous year’s data.

The CEG report also found that:

- Prior to 2001, state agencies identified 16 outsourced projects (see Figure 1). However, from 2001 to 2006, the annual average of outsourced projects increased to 37 projects. Over the last three years, there was an average of over 66 reported outsourcing
Annual Privatization Report 2009

projects per year, with a majority categorized as resolicitations of current activities.

- The average value of outsourced projects was $5 million and the average life for an outsourced project was 2.7 years.

- Five agencies (DEA, Department of Children and Families, Department of Juvenile Justice, Department of Management Services and Department of Corrections) accounted for 90 percent of all outsourced projects.

- An overwhelming majority—87 percent—of outsourced projects included performance metrics in the contract. However, the cost-benefit analysis component of the business case was completed for only 9 percent of the projects reported. As the CEG report notes, these findings “reflect an opportunity for agencies to improve both the quality of pre-solicitation qualifications and post-contract management.”

- Nearly half (46 percent) of the outsourced projects identified by agencies involved services not previously undertaken by state employees.

- Agencies reported 39 outsourced projects with project slippages and/or contract violations.

The CEG also reports that its staff reviewed 21 business cases valued at more than $94 million—with projected cost savings exceeding $29 million—and trained 130 state employees in business-case development and best practices in 2008. According to CEG Chairman Linda South, “By thoroughly evaluating each business case and educating state employees, we ensure both sound business practices and accountability are applied to the investment of state funds.”

As columnist Bill Cotterell wrote in an August 2008 Tallahassee Democrat article, “For return on investment, no agency can beat the Council on Efficient Government. . . . Each of
the council’s four employees saved the taxpayers about $7.25 million last year.”

Despite such successes, several contentious privatization issues arose during the 2009 legislative session. Governor Charlie Crist vetoed a state contracting bill in May that would have significantly increased legislative control over state contracting and privatization. Senate Bill 2694, sponsored by Senate Ways and Means Chairman J.D. Alexander, would have limited the authority of state agencies to enter certain types of contracts unless the legislature granted specific authority to the agency, including:

- Contracts requiring the state to pay liquidated damages or early termination fees based on a breach of the contract if the legislature provides less than full funding of the contract.
- Contracts that require the state to make payments in future years to offset payments not made in the current year.
- Contracts that permit the private contractor to collect and retain fees and other revenues that would otherwise be deposited into the state treasury.
- Leases and lease-purchase agreements for tangible personal property that require the state to pay more than $500,000 over the contract term.

In addition, SB 2694 would have required contracting agencies to notify the governor and legislature before executing contracts exceeding $10 million per calendar or fiscal year, contracts requiring minimal or no payments by the state or contracts requiring initial expenditures by the vendor with no payment by the state within 180 days. The bill would have also required certain provisions to be included in every state contract, including a notice that the contract is contingent upon an annual appropriation by the legislature and a notice that the contract may be terminated if a budget deficit is certified and the funding is eliminated either in a deficit-reduction plan or by an act of the legislature.

Supporters argued that the bill would have reined in costly contracts that would otherwise be difficult to cancel, even during a fiscal crisis like that seen today. But in a letter explaining his veto, Crist countered, “I am concerned that this bill imposes additional contracting requirements on state agencies and those who do business with the state at a time when we should be doing everything we can to streamline bureaucracy and stimulate economic growth.” He added that the bill “hinders the ability of the executive and judicial branches to implement state policy by requiring prior legislative approval of certain contracts for which funds may have already been appropriated,” warning that this would “adversely affect the ability of agencies to negotiate contracts.”

Also, bills that would repeal Florida’s Medicaid privatization pilot program were introduced in both legislative chambers, though both died in each house’s health-regulation committee. Another bill would have created an independent committee to monitor the program and report findings to the governor and the legislature.

The two-year-old pilot privatization program has come under increasing legislative scrutiny amid reports that some patients have had difficulty accessing doctors and medicines. The five-county pilot program operates similar to a health maintenance organization, whereby the state pays contractors a set per-patient amount and the companies select the doctors patients see and what medicines and treatments are prescribed.

Supporters note that the privatization program saves the state money and offers patients more customized benefits. According to former Governor Bush, who signed the program into law in 2005, “Providers are only paid for the services actually required by the individuals in the plan, not an expansive and expensive menu of services never utilized by healthy patients.”

Critics respond that the program has
gotten bogged down in bureaucracy, with some patients complaining of difficulty getting doctor’s appointments and medicines. Concerns about the quality of care received by patients prompted officials in Broward County, the largest county in the privatization experiment, to pass a resolution stating that they want to leave the program.

On the transportation front, opposition to the proposed lease of the Alligator Alley toll road prompted Senator Dave Aronberg to introduce bills in the 2009 legislative session preventing foreign companies from bidding on long-term leases of state highways (Senate Bill 204) and imposing a two-year moratorium on private-sector leases of state highways (Senate Bill 150). Both bills died in the Senate Transportation Committee.

Aronberg got another chance during negotiations over a Senate transportation bill, proposing an amendment to require legislative approval of any long-term lease of Alligator Alley. He subsequently weakened the amendment in response to objections from several House members who claimed it was too stringent. The House version of the amendment would have required the Florida Department of Transportation to submit all proposed public-private partnership projects to the CEG for review and approval. The bill was not brought up for a final House vote.

Finally, the Florida Department of Corrections canceled its long-running food-services contract with Aramark in January 2009, after a string of fines, violations and critical audit findings had strained the two parties’ relationship in recent years. The agency, which had $9.3 million cut from its food budget for this fiscal year, is seeking bids from other vendors.

5. Privatization on the Policy Radar in Massachusetts

In Massachusetts, budget deficits and revenue shortfalls have rekindled interest in privatization among state policymakers. The state’s “Pacheco Law”—a 1993 procurement statute that many observers say has created numerous procedural obstacles to the privatization of state services—came under scrutiny in May 2009 amid legislative negotiations over the state’s FY 2010 budget, which will require closing a $1.5 billion deficit.

By an 11-28 vote, the Senate rejected a budget amendment that would have repealed the law. Amendment opponents argued that the strict law serves an important oversight function and that its repeal would threaten state jobs. Supporters countered with several arguments in favor of repeal:

- Repealing the law would help the state do more with less through privatization, potentially saving hundreds of millions of dollars that could support vital programs.
- The privatization of state services has effectively stopped as a result of the highly restrictive provisions of the law.
- One provision of the law requires state agencies to compare the cost of using private contractors to a hypothetical cost if state employees were to optimize the efficiency of current service delivery, ignoring the true costs of current service delivery.
- The state auditor already has the authority to unilaterally reject contracts he deems “not in the public interest.”

But the Senate did approve, 24-15, a separate budget amendment that would exempt all contracts under $2 million in value from the provisions of the Pacheco Law, which currently applies to contracts over $200,000. According to amendment supporters, raising the cap would facilitate more privatization and help the state save millions of dollars. The amendment would also establish a special state commission to study the potential for public-private partnerships in state government and provide recommendations for legislation on or before January 1, 2010. At press time, the outcome of the budget negotiations was still unresolved.
In his FY 2010 budget proposal, Governor Deval Patrick included language that would authorize the state’s Registry of Motor Vehicles (RMV) to contract out for registration services. A union representing RMV workers called on state Inspector General Gregory Sullivan to investigate the Patrick administration’s privatization efforts, claiming that the authorizing language is intended to benefit the American Automobile Association, which already operates registry pilot programs in Worcester and Watertown.

On the transportation front, privatization featured prominently in the political discussion over how to fix the state’s broken and debt-ridden transportation system. In December 2008, the Joint Committee on Transportation held a hearing to discuss the potential for leasing roads and bridges to private companies as part of a larger mix of reforms to restructure the state’s transportation bureaucracy, increase revenue, avoid significant toll hikes and address billions of dollars in legacy transportation agency debt.

The Patrick administration followed with a January 2009 announcement that it would privatize 11 service plazas alongside the Massachusetts Turnpike in return for a large up-front payment to the Turnpike Authority as a way to address the agency’s $2 billion debt obligations. Administration officials did not offer an estimate of the plazas’ potential value, but sponsors of similar proposals earlier this decade have claimed the plazas could fetch $300 million.

State Transportation Secretary James Aloisi suggested the state could lease or sell the service plazas to a manager that would then negotiate leases with gas stations, restaurants and convenience stores. Aloisi also noted that money raised through privatization could be used to enhance safety, modernize infrastructure or address other transportation needs, but ultimately decisions over how the funds would be spent would fall to the Turnpike Authority’s board, should it decide to pursue a deal.

6. New Jersey to Privatize Toxic-Waste Cleanup

In May 2009, New Jersey Governor Jon Corzine signed a bill that passed with overwhelming bipartisan support to privatize the cleanup of nearly 20,000 contaminated properties in the state.

The move will overhaul the state Department of Environmental Protection’s (DEP) site-remediation program, which has struggled to address a backlog of nearly 20,000 contaminated sites. Like a similar program in Massachusetts, the new law authorizes polluters to hire licensed private consultants to clean up the contaminated properties and certify their safety.

The Corzine administration originally proposed the program as a way to expedite cleanup of the sites, reduce remediation costs and return properties to the tax rolls. Proponents also note that the new law sets mandatory time frames for cleanups and subjects environmental consultants to high standards and strict oversight.

Corzine also signed a related executive order requiring the DEP to increase its oversight at certain sensitive sites, including schools, day-care facilities and playgrounds. Corzine said the new law and the executive order “will cut though the bureaucracy to streamline the cleanup process and allow more than 19,000 contaminated sites to be evaluated more quickly.”

The Sierra Club questioned the constitutionality of the new law and announced plans to challenge it in court.

7. Successful Rollout for Privatized Workers’ Compensation Insurance in West Virginia

According to most observers, the first full year of implementation of West Virginia’s recently privatized workers’ compensation insurance program has been an overwhelming success.

The full privatization of the program—beginning with the spinoff of the state’s Workers’ Compensation Commission into a
private insurance carrier, BrickStreet Insurance, in 2005—was completed in July 2008 when the market was opened to other competitors. BrickStreet had previously held a two-year virtual monopoly on workers’ compensation insurance in West Virginia; with the opening of competition, it faced over 140 competitors, including more than 25 insurers that had not previously done business in the state.

In August 2008, state Insurance Commissioner Jane Cline detailed a number of benefits of the privatization initiative thus far:

- Privatization helped facilitate a dramatic reduction—from $3.2 billion to $1.9 billion—in the outstanding unfunded liabilities of the old state-run system in just two years, potentially accelerating the payoff of these liabilities by some two decades.

- Workers’ compensation rates declined an average of 30 percent since privatization, saving employers over $150 million annually. According to Cline, “That’s $150 million that companies have to invest in improvements for employees or for infrastructure, for other capital improvements. That’s huge. Especially when you’re talking about a state that wants to be welcoming to employers.”

- There were an estimated 8,532 protested claims in 2008, over 80 percent lower than the average of 46,076 protests filed with the state in 2005 and 2006. The amount of time required for a ruling on protested claims is also down.

In March 2009, Cline announced the mostly positive results of BrickStreet’s first Market Conduct Examination, a standard state review of carriers’ treatment of policyholders and claimants covering claims handling, underwriting practices, complaint handling and other management issues. According to Cline, “BrickStreet passed 59 of the 67 applicable standards. These results are encouraging because BrickStreet has only been a private company for three years.”

BrickStreet was compliant with all of the claims-related standards, but the analysis discovered several errors in the application of underwriting and rating rules that prompted the state to order the company to refund $18 million to over 6,000 policyholders. “The underwriting and rating areas presented BrickStreet with more challenges as the changes in these areas underwent the most revisions during the privatization process,” Cline explained. BrickStreet is also preparing a corrective-action plan to ensure compliance with each of the 26 recommendations made in the examination.

Responding to Cline’s report, BrickStreet President and Chief Executive Officer Gregory Burton said, “We view this report as a positive affirmation of the speed and accuracy with which we grew a healthy private company in a very compressed timeframe. . . . The archaic and antiquated rate making practices that developed in West Virginia during the 92 years preceding privatization had to be quickly disposed of so that our state could offer a workers’ compensation marketplace resembling other states.”

It wasn’t smooth sailing for West Virginia’s workers’ compensation insurance privatization on the political front, however. In February 2009, leaders in the House of Delegates introduced House Bill 2473, which would have required the insurance commissioner to submit any proposed rules or regulations covering the workers’ compensation insurance market to the legislature for review. Such oversight was exempted for workers’ compensation as part of the original privatization process.

Bill opponents, including Governor Joe Manchin, whose lack of support ultimately doomed the legislation, countered that it would bring political risk (through arbitrary, legislative rule changes) that could discourage private companies from providing workers’ compensation coverage in the state. Also, opponents claimed that legislative review was
unnecessary, as the state’s Industrial Council already has oversight over the workers’ compensation insurance market. The bill was assigned to the House Judiciary Committee but failed to receive a hearing.

8. Tennessee Signs Largest-Ever Child-Support Enforcement Privatization Contract

In May 2009, Tennessee’s Department of Human Services awarded a five-year, $49 million contract to Maximus Inc. to provide child-support enforcement services for the 30th Judicial District in Shelby County. It is the largest contract in the nation dealing with the privatization of child-support services, the company said.

To help the district ensure that all children receive support from both parents, Maximus’s Human Services North America division will provide a comprehensive package of services, including locating absent parents, establishing paternity, carrying out support orders and medical support orders, processing interstate cases and providing customer services.

9. Other State Privatization News

In Alabama, the Lieutenant Governor’s Commission on Public-Private Partnerships Projects issued a report in February 2009 with recommendations on the potential use of PPPs to deliver transportation projects in the state. The commission was created in May 2008, in large part to explore innovative finance and project-delivery methods for a long-sought north-south expressway through West Alabama. The commission recommended that it be granted a one-year extension to continue its work to assess the potential impacts of federal stimulus funding, to meet with PPP practitioners and to refine the technical analysis related to corridor selection, tolled versus nontolled segmentation of the project and other engineering considerations. The commission also recommended that in developing its PPP-enabling legislation, Alabama should incorporate best practices from statutes in states like Virginia, Oregon and Mississippi. The state subsequently passed PPP-enabling legislation, discussed in the Surface Transportation section of this Reason Foundation report.

In October 2008, Affiliated Computer Services Inc. (ACS) won a $27 million contract to provide fiscal agent services for the Alaska Department of Health and Social Services’ Medicaid Management Information System (MMIS). ACS secured a $130 million, 10-year contract with the state in 2007 to develop and manage the MMIS. The new 21-month contract allows ACS to administer the system’s claims, recipient help line, pharmacy help desk, pharmacy drug-rebate program, retrospective drug-utilization reviews and preferred drug-list services.

Amid contentious negotiations in California over closing the state’s mammoth budget shortfall, Governor Schwarzenegger has proposed selling assets like San Quentin State Prison, Los Angeles Memorial Coliseum, the Cow Palace, several fairgrounds and other state property to raise money. According to an administration report detailing the proposals, “In this time of fiscal challenge it is imperative the state explore every opportunity to raise revenues to avoid cutting programs. . . . Changing the way the state manages and thinks about real estate has the potential to generate more than a billion dollars for the general fund and help pay off state debt.”

The administration estimates that the sale of the properties could raise $600 million to $1 billion, though it cautioned that any asset sales may not provide revenue immediately but rather over two to five years. Budget negotiations were ongoing at press time, so it is unclear whether state lawmakers will ultimately support any of the governor’s asset-divestiture proposals.

Schwarzenegger also proposed closing nearly all state parks to cut costs. But he suggested that the state could utilize public-private partnerships—ranging from privately managed
concessions at some parks (common at many of the National Park System’s premier parks) to turning parks completely over to private operators—to avoid widespread park closures.

In Colorado, state Senator Lois Tochtrop has asked the legislature’s audit committee to undertake a comprehensive audit of the Regional Transportation District (RTD)—the Denver metropolitan public-transit agency—focusing on outgoing general manager Cal Marsella’s pay and benefits and the agency’s privatization of transit services. Marsella stepped down from his position in July 2009 to take a new position with MV Transportation, a private transit provider operating roughly half of RTD’s bus services for the disabled. According to agency spokesman Scott Reed, the RTD is already subject to a number of regular audits and financial reviews, so a state audit would be “redundant, likely costing taxpayers hundreds of thousands of dollars.”

In Connecticut, several privatization bills surfaced in the 2009 legislative session that failed to reach final passage. Proposed Bill No. 5898 would have amended the general statutes to allow the state to privatize Bradley International Airport and five general aviation airports to save money and increase revenue for the state. Proposed Bill 163 and Proposed Bill 346 would have transferred the administration of all state social-service programs to community-based private providers. Another bill, Substitute Senate Bill No. 1120, would have imposed a two-year moratorium on the rebidding of contracts between state agencies and private providers of health and human services.

The privatization of state psychiatric hospitals (detailed in the Public Health and Safety section of this report) and information-technology services (detailed in the Telecommunications section of this report) were not the only privatization initiatives on the policy radar in Georgia. The legislature considered House Bill 356, which would have allowed local governments to privatize sales-tax collection oversight in order to minimize uncollected taxes. According to Representative Virgil Fludd, the bill’s sponsor, the state would still handle the actual collection of sales taxes, but local governments would be able to oversee collections and contract with private firms to calculate how much is owed to them. The state now provides that service, for which local governments pay an administrative fee. According to Fludd, privatizing that function would also help local governments get more detailed point-of-sale information about where sales-tax revenue is generated.

An Idaho Legislative Services Office audit of a two-year, $659,000 meal-services contract for the Idaho Peace Officer Standards and Training Academy in Meridian identified significant irregularities in the bidding process that may have affected the outcome.

According to the audit, three Idaho State Police employees changed their scoring system during a meeting after having included the original scoring in the solicitation for proposals from potential bidders, raising concerns of potential bias. In addition, the audit also found inconsistencies in the scoring of each bid on such factors as years of experience, employee base and staff identification, each of which served to favor the existing contractor, Shird’s Inc. of Meridian, over competing bidder Aramark.

According to the audit report, “We recalculated the scores and concluded the contract would have been awarded to the competing bidder if these point values had been correctly applied.” Auditors recommended that the Idaho State Police consider whether to rebid the contract.

In response, academy officials defended the procurement process and referred a decision on whether to rebid the contract to the Idaho Division of Purchasing, which issued the original contract. But academy officials have said the current contract won’t be renewed.

Indiana’s Family and Social Services Administration (FSSA) announced in July 2009
that it had ordered an IBM-led consortium to fix problems with the state’s troubled welfare eligibility modernization initiative by October or potentially lose the eight years and $800 million remaining on the $1.2 billion contract.

Indiana began privatizing welfare delivery in 2007, but the initiative was quickly beset with complaints from people who lost their food stamps or Medicaid coverage or who had difficulty utilizing new call centers or the new, Web-based application for welfare benefits.

The IBM-led team currently handles welfare intake in 59 of Indiana’s 92 counties, accounting for nearly one-third of the state’s 1.2 million-person caseload. Murphy told the Indianapolis Star that a recent three-month review of the privatization identified over 200 recommendations to improve training, reduce turnover, add 350 more employees and introduce more technology to speed up approval of welfare applications and reduce error rates.

“We’ll allow them an opportunity to start correcting those items and we expect to see improvement by this fall,” FSSA Secretary Anne Murphy told the Associated Press. “I took it to the governor and I showed him the data and he called the executives at IBM. . . .and told them that they needed to make changes.”

Murphy told the Indianapolis Star that the privatized system is performing no worse than the previous state-run system, but that the recession has swollen the welfare rolls by over 110,000 since 2007. However, Murphy adds that while the state’s old paper-based system was inefficient, the privatization was intended to exceed, not merely equal, the state’s performance.

In December 2008, Louisiana Governor Jindal’s administration released an Efficiency and Effectiveness Audit summarizing state agencies’ efforts to identify wasteful spending, bureaucratic inefficiencies and specific opportunities for cost savings. Among the privatization-related findings and recommendations:

- Outsource centralized Web-based safety training. (Division of Administration)
- Outsource accounting services for the Office Facilities Corporation and Correctional Facilities Corporation. (Division of Administration)
- Outsource the printing and distribution of employee W-2s. (Division of Administration)
- Review and consider options for outsourcing various functions and activities at the Board of Regents, management boards and institutions to the private sector for possible cost savings.
- Explore the privatization of correctional healthcare services. (Department of Corrections leadership is assessing the potential for privatization in the areas of laboratory services, pharmacy services and mental health services.)
- Privatize the collection of fees by probation and parole officers.
- Privatize correctional food services.
- Expand outsourcing of data collection throughout the Department of Education.
- Outsource conference planning to save staff time organizing and completing paperwork for various conferences. (Department of Education)
- The Office of Motor Vehicles’ Customer Services Department has begun to outsource functions related to public tag agents and is considering outsourcing the call center, document management, the International Registration Plan, the interstate compact agreement and apportioned plates/cab cards issuance.
- Aggressively evaluate the feasibility of outsourcing residential licensing functions. (Department of Social Services)
- Locate additional outsourced customer service staff for enforcement services in the district offices, the courts and the district
attorneys’ offices to provide information and resolve problems. (Department of Social Services)

- Outsource information technology audits. (Department of Social Services)
- Seven section and district heads from the Department of Transportation and Development reported possible opportunities for outsourcing functions in their sections.
- Outsource data entry to allow Department of Wildlife and Fisheries biological staff to be more effective by focusing on data analysis, not input.
- The Office of Juvenile Justice is investigating the possibility of outsourcing in some areas, such as pharmacy services.

The privatization of Maine’s Elizabeth Levinson Center, which provides institutional care to individuals with severe mental retardation, was completed in early 2009. The winning bidder, the nonprofit United Cerebral Palsy of Northeastern Maine, took over facility operations March 1, 2009.

Most of the state workers at the center have been rehired by United Cerebral Palsy at the same hourly wage they earned as state employees and according to United Cerebral Palsy executive director Bobbi Jo Yeager, only two-and-a-half positions have been trimmed from the center.

According to the Bangor Daily News, the center, established in 1971, was the last of several former state-run facilities for children with mental retardation to be transitioned to private operations since the 1996 privatization of the Pineland Center in New Gloucester and subsequent privatizations of the Aroostook Residential Center and Freeport Town Square. According to Brenda Harvey, commissioner of the state Department of Health and Human Services (HHS), the private agencies that took over these programs also retained many existing employees.

The state originally had planned to turn over the Levinson Center to a private company by the beginning of last summer, but because of unsatisfactory bids for the contract, the process was delayed.

It is unclear if the state will save the $400,000 it was originally expected to in the first year, but officials note that the main goal behind privatization was to get the state out of the business of providing direct care and more focused on regulatory oversight. Jane Gallivan, director of the HHS Office of Adults with Cognitive and Physical Disabilities, told the Bangor Daily News, “We see the state’s role as quality assurance and quality oversight. . . . The savings was never really projected as being a huge savings.” State officials also note that operation costs would have risen had the state continued to run the facility, as state workers received a 4 percent pay raise in January 2009.

A push to privatize Maryland’s state medical aviation (medevac) services died in the 2009 legislative session. Bills sponsored by Senators John Astle and E.J. Pipkin would have split the current fleet into separate medical and law-enforcement operations and allowed Governor Martin O’Malley to consider bids from private companies to provide medevac services. Any savings would have been applied to emergency medical services ground operations. The sponsors noted that their bills were intended to improve the state-run medevac system, which has come under fire in recent years for a number of maintenance and operational issues. The Senate rejected both bills.

In March 2009, the Michigan Department of Corrections signed a three-year, $326 million contract with Prison Health Services for managing statewide correctional health services. Correctional Medical Services had held the contract since 1998. The new contract addresses dozens of recommendations for improvement offered in a December 2007 National Commission on Correctional Healthcare report and the new vendor will be responsible for maintaining commission standards.

Similar contracts would face more
legislative scrutiny under a FY 2009 corrections appropriations bill (House Bill 4437) that passed the House in April 2009. The bill included two significant provisions related to correctional services privatization in Michigan. The first requires plans for any proposed privatization project to be submitted to the legislature at least 90 days before beginning any effort to privatize. The second requires the preparation of a cost-benefit analysis and legislative approval prior to any privatization. Furthermore, proposed correctional services privatization projects would have to meet a minimum 5 percent cost savings threshold to move forward.

Similar language appeared in two other 2009 bills. House Bill 4892, introduced in May by Representative Sarah Roberts, would require development of a detailed cost-benefit analysis in advance of any proposed state agency privatization initiative. No privatization could proceed without notice of approval from the House and Senate Appropriations Committees indicating a 10 percent cost savings over state provision. House Bill 4584 was introduced in March and would apply similar provisions to school districts, requiring studies before privatizing custodial, food, transportation or other school services. As of press time, neither bill has been heard in committee.

Also in Michigan, the Senate passed an appropriations bill (Senate Bill 247) that included $41,700 for the Historical Society of Michigan to facilitate privatization of the state historical marker program.

During the 2009 legislative session in Minnesota, a looming $5 billion budget deficit prompted Senator Geoff Michel and Representative Laura Brod to introduce Senate File 1291 and House File 1486, companion bills that would require the state commissioner of administration to determine the privatization potential of government programs and activities and review inappropriate government competition with private enterprise. The bills would also require the commissioner to prepare a comprehensive database of all state-owned assets, followed by a legislative report on the potential for privatization. The report would also establish a set of evaluation criteria and apply it to a review of the potential privatization of Minneapolis-St. Paul International Airport and the Minnesota State Lottery.

“With an economy in recession and a growing state budget deficit, it is time for the state to consider bold and dramatic measures,” Brod said in a press release. “Minnesota has fallen behind other states and cities when it comes to these innovative public-private partnerships.” Michel added, “Privatization is bipartisan and happening all over the country and all over the world. This topic should be a big part of the 2009 legislative session.” At press time, neither bill had been heard in committee.

In 2009, Nebraska’s Department of Health and Human Services began implementing the first phases of its privatization of foster care and group-home services. Under the plan, state workers will assess children’s needs and contractors will provide foster or group homes and coordinate services. The plan aims to reduce the number of times children are moved and to eliminate duplication and confusion from having multiple agencies deliver services to one child.

The department is evaluating six private providers of out-of-home care: Nebraska Families Collaborative, KVC of Kansas, Visinet, Cedars, Boys and Girls Home and Family Services of Nebraska and Region 3. The selected contractor will be responsible for acquiring foster homes and facilities and will perform the day-to-day functions of planning, coordinating and delivering services, with financial incentives and disincentives to ensure contractor performance.

In a May 2009 meeting, the State Foster Care Review Board passed a resolution outlining its concerns about the state’s privatization plan, including the quality and availability of foster care services, program accountability and oversight. The resolution accuses the department
of lax oversight of foster care homes and centers, warning that it would likely continue under the privatized system.

Faced with a looming FY 2009 budget shortfall, Nevada Governor Jim Gibbons created the Spending and Government Efficiency (SAGE) Commission in May 2008 to review state government and develop recommendations for streamlining operations, reducing government waste and improving efficiency and customer service.

The SAGE Commission has issued three sets of recommendations to Gibbons since September 2008. Its 23 recommendations thus far, projected to save the state more than $1 billion over five years if implemented, include:

- Establishing a state Evaluation and Sunset Commission to make annual recommendations to the governor and Legislative Commission concerning the potential elimination, modification or reorganization of statutorily created state agencies, boards and commissions.

- Conducting a detailed inventory of all state-owned real estate and buildings, as well as a portfolio-optimization review of all leases. An appointed task force should evaluate the uses for all state-owned property to determine the revenue-producing potential of disposal, lease, trade, sale-leaseback or development opportunities by way of public-private partnerships.

- The Nevada Department of Transportation and the Regional Transportation Commission of Washoe County should develop a distance-based, user-fee pilot program to establish the viability of a pay-as-you-drive user-fee system as a replacement for state fuel taxes.

- All state agencies should review the fees charged for state services every two years to ensure they cover the costs of providing the services.

- Reducing healthcare benefits for state employees and their families to a comparable level of benefits offered in the private sector. Also, ending health-care subsidies for all retired state employees once they become eligible for Medicare at age 65.

In May 2009, the Nevada Assembly voted to override a gubernatorial veto of Assembly Bill 135, giving the state treasurer and the state Board of Finance the authority to review and approve state long-term financial obligations, including certain public-private partnership agreements. The Nevada Senate voted narrowly to sustain Gibbons’s veto.

Also in Nevada, State Budget Director Andrew Clinger announced in October 2008 that the state was studying the potential privatization of the state mail system. “The preliminary numbers that I was given showed potentially it could save us $400,000 a year,” Clinger told the Las Vegas Review-Journal. “It won’t balance the budget but over 10 years, it would save some money.”

In March 2009, the New Hampshire Liquor Commission announced a sweeping modernization proposal aimed at increasing efficiency and streamlining its retail and wholesale operations, licensing and management functions. The proposal was unveiled at a Senate Ways and Means Committee hearing on Senate Bill 181, which would enact the plan into law. The bill would expand the commission’s authority to license the sale of spirits in grocery stores, beginning with a limited number of licenses in a pilot program.

State Liquor Commission Chairman Mark Bodi cautioned that the move is not the first step toward full privatization of New Hampshire’s liquor operation. As Bodi told The Union Leader in December 2008, “I would think that under any circumstances, New Hampshire would preserve fundamentally its control of the state system in some manner. . . . It would be vastly premature to predict and preview the privatization of liquor, of our existing system, at this stage. However, we are looking at a number
of different dynamic ways to improve the nature of our operation and the profitability of our operation.” At press time, SB 181 was awaiting a hearing in the Ways and Means Committee.

Also introduced in the 2009 New Hampshire legislative session was Senate Bill 101, which would have required the Department of Resources and Economic Development to solicit lease proposals for the Cannon Mountain ski area. The bill would also have established a legislative committee to develop the proposal and review responses and would have required the legislature’s Capital Budget Overview Committee’s approval for any lease agreement. The bill failed to pass out of committee.

In addition to the Accountability, Innovation and Privatization Act discussed earlier, the Oklahoma legislature passed several other bills in its 2009 session that may lay the groundwork for increased privatization of state services.

One of the most significant reforms signed into law was the Oklahoma Information Services Act (House Bill 1170), which created a state chief information officer to centralize state technology implementation and reduce redundancy and inconsistencies across state government.

The bill also expands the authority of the State Governmental Internet Technology Applications Review Board to include developing performance metrics for (a) quantifying the value of goods or services provided by state agencies and (b) for considering whether state agency services could be modernized through the use of new technology to provide higher quality goods or services and deliver value for money. According to Senate President Pro Tem Glenn Coffee, “Consolidating all technology and computer responsibilities into one office will bring Oklahoma into the 21st Century and save taxpayers millions of dollars. . . . This will provide for ease in communicating data and information throughout agencies and better serve all Oklahomans.”

Governor Brad Henry also signed House Bill 1963, creating a task force to study the privatization of CompSource Oklahoma, the state workers’ compensation insurance monopoly. The bill states the legislature's intent that CompSource be converted into a private insurance company no later than December 31, 2010 and the new task force will develop a privatization plan to meet that goal. The plan will include an assessment of the potential impact of privatization on current CompSource employees and the most appropriate means of addressing it.

Also, the signing of House Bill 1055 created a new State Employee Health Insurance Review Working Group to study the most efficient and cost-effective way to deliver the highest level of healthcare for state employees at a competitive price. The working group will report on ways to reduce the costs of state employee healthcare coverage, offer state employees choices in healthcare plan designs to allow them to determine what coverage best meets their needs and maximize the state’s leverage in buying medical services and supplies. The working group is authorized to retain the services of private-sector consultants with expertise in state plan design and healthcare purchasing.

In Pennsylvania, Representative Neal Goodman sponsored House Bill 1364 in the 2009 session to prevent any state funds appropriated to the Department of Corrections from being used to privatize or outsource commissary services in state prisons. The bill was assigned to the House Committee on State Government in late April 2009 but had not received a hearing at press time.

The tug-of-war between the Rhode Island General Assembly and Governor Donald Carcieri over the privatization of state services moved a step closer to resolution in 2008. In July, the Rhode Island Supreme Court declined to review the constitutionality of a controversial 2007 state anti-privatization law that Carcieri said “makes it virtually impossible to privatize any governmental services.” Carcieri had originally requested an advisory opinion on the
law from the Court in March 2008 but withdrew his request after forging a compromise with legislative leaders on the issue as part of the FY 2009 budget negotiations.

In the compromise, the legislature amended the law to require the administration to give union leaders six months notice prior to any attempt to replace state workers and to require the administration to provide a detailed cost analysis 60 days before soliciting bids from private contractors. The revised law also limits standing to appeal privatization decisions to the affected employees or their union representatives. The original bill had no time limits and effectively no limits on who could appeal privatization decisions.

In related news, a Rhode Island Superior Court judge in November 2008 ordered Carcieri’s administration to release contracts and other public records related to its privatization initiatives to Council 94 of the American Federation of State, County & Municipal Employees, a union representing state employees. The judge found that under current state law, information about privatization contracts totaling $100,000 or more must be disclosed.

The union had argued that administration officials denied its requests for records related to privatization contracts as required under state law. The Carcieri administration contended it has complied with the law and that the union was adopting an overly broad legal interpretation regarding its implementation.

Amid a protracted battle between South Carolina Governor Mark Sanford and the legislature over the use of federal stimulus dollars, Sanford began a daily feature on his Website called “Waste of the Day” to shine a spotlight on examples of government waste. In one example, Sanford cited state-run golf courses at Hickory Knob State Park and Cheraw State Park, which are losing nearly $500,000 annually. For several years, Sanford has proposed that these courses be privatized because “if there’s anything the private sector has demonstrated an ability to succeed in managing in South Carolina, it’s golf courses.” Instead, legislative budget writers inserted a provision specifically prohibiting the state Department of Parks, Recreation and Tourism from exploring private-sector golf-management options. Privatization proponents counter that the department has already successfully privatized bait-shop operations at several state parks, saving taxpayers thousands of dollars annually.

In May 2009, the Texas Council on Competitive Government issued a request for information to solicit input from private firms regarding current best practices and opportunities for performance-based contracting in vehicle fleet and fuel management services. Of particular interest to the council are discrete and identifiable services that could be established and managed via contract with specified deliverables and service-level agreements. The council identified a number of potential areas of interest, including vehicle fleet maintenance, fleet optimization, fleet needs assessments, car-share programs, fleet tracking and monitoring, roadside assistance, retail fuel acquisition, bulk fuel acquisition, fuel terminal design and maintenance, bulk fuel monitoring and control, idle-reduction technologies and vehicle retrofits.

Also, in June 2009, Governor Rick Perry signed House Bill 1914 (HB 1914) to ensure that prison manufacturing programs will not unfairly compete with private industry. In explaining the need for such protection, the bill’s Senate sponsor, Robert Nichols, cited the closure of a private trailer company in East Texas due to unfair competition from a prison-industry contractor with lower operating costs due to the use of prison-system labor. The bill also abolished the governing board of the current program, the Private Sector Prison Industries Oversight Authority and transferred its functions, property and staff to the Texas Board of Criminal Justice.

A year after signing two pieces of legislation in May 2008 expanding the size and authority of
Utah’s Privatization Policy Board (see discussion in Reason Foundation’s *Annual Privatization Report 2008*), Governor Jon Huntsman, Jr., who will be leaving office to become U.S. ambassador to China, was still considering potential appointments to the revamped board at press time. But the state’s first commercial activities inventory—a key provision of the 2008 board revamp requiring a biannual breakdown of inherently governmental functions and commercial functions performed by state agencies—is underway and is expected to be completed in the summer of 2009.

In January 2009, the Virginia Senate Committee on Rehabilitation and Social Services rejected a bill that would have privatized Virginia’s alcohol retail operations. Senate Bill 1542, introduced by Mark Obenshain, would have privatized the state’s retail stores and auctioned off licenses for the retail sale of alcoholic beverages. According to Obenshain, “Everywhere I go, people ask me about this bill. Democrats and Republicans, young and old, they all want the government out of the business of selling alcohol. . . . Handled correctly, privatizing the ABC Stores will save money and increase consumer choice.” Obenshain plans to revise and reintroduce the bill in the next legislative session.

In response to Washington Governor Chris Gregoire’s proposal to increase state revenue by authorizing 10 new liquor stores and allowing state-owned stores to sell additional products, Senator Tim Sheldon introduced a bill in the 2009 legislative session to privatize a portion of Washington’s state-run liquor stores. Sheldon told the *Seattle Post-Intelligencer* in January 2009, “It’s really way past time to let the private sector in. . . . It just seems like a governmental function we could easily shed in the current economic situation.” Sheldon’s previous attempts to privatize state-run liquor stores met resistance from public employee unions.

According to a January 27, 2009 *Seattle Times* editorial, “The state needs to take the more radical and common-sense step of privatization. It should raise revenue through its power to tax rather than trying to operate as a retailer. . . . With such a high-proof profit margin, it might seem that state government is one savvy retailer, except that everyone knows it is not. It spends too much on labor. Its stores are in the wrong places and do almost nothing to attract business. The state’s profit margin is high only because it reserves the business to itself. . . . In all likelihood, the private sector could do the job much more cheaply.”

In other news from the Evergreen State, the Department of General Administration filed notice of appeal of a May 2008 Thurston County Superior Court ruling invalidating three department rules adopted to implement the competitive contracting provisions of the 2002 Civil Service Reform. The Washington Federation of State Employees sued the agency to have the rules thrown out, complaining that they were too restrictive and that state workers should have the ability to negotiate with management if they will be displaced or reassigned.

In West Virginia, hiring restrictions on state workers announced by Governor Joe Manchin were met by union complaints that the move was part of a stealth plan to privatize jobs in the state Division of Highways (DOH). Union officials complained that already declining DOH employment was a threat to highway maintenance and that Manchin’s April 2009 directive that all agency hiring be approved by his office represented an implicit step toward privatization. According to Manchin spokesman Matt Turner, the governor has no plans to privatize DOH jobs. Turner told the *Charleston Gazette*, “If there are critical vacancies in the Division of Highways, Secretary [Paul] Mattox would bring that to the attention of the governor’s office. There are no plans to privatize. That is not in the works.”

In Wisconsin, legislators introduced bills in the 2009 session that would allow, but not mandate, the state’s Department of
Transportation to privatize driver’s license testing for most non-commercial vehicles. Primary sponsors Senator Joe Leibham and Representative Lee Nerison introduced Senate Bill 58 and Assembly Bill 216 in response to Governor Jim Doyle’s proposal to close 40 Department of Motor Vehicles centers to reduce costs. The sponsors said the proposed closures would have left many citizens without local access to a center.

Bill supporters note that states like Michigan, Montana and Utah have already implemented third-party testing for driver’s licenses. Under the bills, the department would have been prohibited from contracting with commercial driving schools and it would have also been required to conduct annual on-site inspections of third party testers. Doyle previously vetoed a similar bill. SB 58 and AB 216 were assigned to the Transportation Committees in their respective legislative chambers but had not been heard as of press time.

B. State Budget Outlook

The state fiscal crisis that began in FY 2008 deepened significantly in FY 2009 and may continue for several years, according to the National Conference of State Legislatures’ (NCSL) April 2009 budget update. Many states are facing a perfect fiscal storm, with the national recession and the resulting declines in state revenue collections forcing legislators...
nationwide to close massive, multibillion-dollar deficits in current and future budgets.

Figure 2 illustrates historical and projected state budget deficits from FY 2001 through FY 2011. According to the NCSL report, states will face a cumulative $281 billion in budget deficits from FY 2008 through FY 2011:

- FY 2008: By the end of FY 2008, 19 states and Puerto Rico had closed budget deficits totaling $12.8 billion.
- FY 2009: Lawmakers in 31 states and Puerto Rico collectively closed $40.3 billion in deficits in enacting their FY 2009 budgets. But continuing revenue shortfalls into the few months of the new fiscal year prompted lawmakers in 43 states and Puerto Rico to reopen their FY 2009 budgets to close an additional $62.4 billion in deficits.
- FY 2010: State budget deficits are currently expected to peak in FY 2010, with 42 states and Puerto Rico facing $121.2 billion in projected deficits.
- FY 2011: Over 30 states are already projecting deficits for FY 2011. Early estimates peg the total cumulative deficit at $44.5 billion. But with only 16 states reporting preliminary FY 2011 deficit estimates thus far, this figure is expected to rise significantly.

According to report author and NCSL fiscal program director Corina Eckl, “The fiscal situation facing states is like a bad horror movie. The details get more gruesome and the story never seems to end.”

Federal stimulus funds from the American Recovery and Reinvestment Act of 2009 certainly cushioned the blow for states. Calling the infusion of stimulus funds “the only bright spot” for states, the NCSL report notes, “Without that money, state finances would be even more dismal.”

The National Association of State Budget Officers (NASBO) and the National Governors Association (NGA) released a survey of state fiscal conditions in June 2009 offering a similarly bleak fiscal outlook. The report finds that “[t]he 50 states are facing one of the worst fiscal periods in decades,” with deteriorating fiscal conditions in almost every state during FY 2009 and weak fiscal conditions expected to continue into FY 2010 and beyond.

“There are so many issues that go way beyond the current downturn,” NASBO executive director Scott Pattison told The Wall Street Journal. “This is an awful time for states fiscally, but they’re even more worried about 2011, 2012, 2013, 2014.”

Among the findings in the NASBO/NGA survey:

- FY 2009 general fund expenditures are estimated to decline 2.2 percent from FY 2008 and governors’ recommended FY 2010 budgets show a 2.5 percent decrease in general fund expenditures from FY 2009. These are the largest declines in the history of the NASBO/NGA report, as well as the first time state general fund expenditures declined in consecutive years.
- Forty-two states were forced to reduce their enacted FY 2009 budgets by a total of $31.6 billion; by contrast, 13 states reduced their enacted FY 2008 budgets in fiscal 2008 and only three saw reductions during FY 2007. In the last recession, FY 2002 and FY 2003 saw the largest reductions to enacted budgets, with 37 states making mid-year reductions of $14 billion and $12 billion, respectively. These years of peak cuts occurred after the national economic downturn ended in 2001.
- Thirty states are estimating negative growth in FY 2009 budgets and 35 expect negative growth for FY 2010.
- More states are experiencing revenue shortfalls. In FY 2009, tax revenues exceed expectations in only two states, are on target in 10 states and are below expectations in 38 states. By contrast, 25 states reported that
revenue collections exceeded estimates in FY 2008.

- Estimated FY 2009 sales, personal income and corporate income tax collections are 6.1 percent lower than actual FY 2008 collections. States project 1.7 percent growth in tax collections for FY 2010 recommended budgets relative to FY 2009 estimates. But the report notes that many states found their April 2009 tax collections to be well below estimates.

- Recommended net tax and fee changes would generate an additional $23.9 billion in revenue based on governors’ FY 2010 recommended budgets, up from $726 million recommended in FY 2009. A total of 29 states are recommending net increases, while only five states are recommending net decreases.

- Total balances—ending balances and the amounts in budget stabilization funds—are declining from their FY 2006 peak of 11.5 percent of expenditures. Balances dropped to 9.1 percent of expenditures in FY 2008 and are expected to drop precipitously to an estimated 5.5 percent of expenditures for FY 2009. Under governors’ recommended FY 2010 budgets, balances are projected to decrease to 5.3 percent of expenditures.

The national recession continues to dampen state tax revenues, according to a May 2009 report from the Nelson A. Rockefeller Institute of Government at the State University of New York. The report found that first-quarter 2009 revenues were down 12.6 percent (approximately $20 billion) from the first quarter of 2008 in 47 states. The biggest drops were in corporate income taxes (down 16.2 percent) and personal income taxes (down 15.8 percent), while sales tax revenues were down 7.6 percent (see Figure 3).

C. State Budget Crises in Perspective: Illness or Fiscal Hangover?

The economic downturn has no doubt put a great deal of pressure on state budgets. As economic activity declines, states collect less tax revenue. As people lose their jobs or their

![Figure 3: State Tax Revenue Declines Since 2006](http://tinyurl.com/qcd86f)
incomes decline, demand increases for state services like job training, healthcare support, welfare and unemployment compensation. The combination, it is often argued, throws state budgets out of balance and, because states are generally required to enact “balanced-budgets,” often leads to dramatic cuts in state services, tax increases or even both. These actions, it is then argued, further dampen economic demand and worsen the economic situation. Countering this cycle is the chief rationale for states’ recent demands for additional federal assistance.

What’s missing in the discussion of state fiscal crises is critical context. Even if one accepts the shortfall numbers at face value, it is not immediately clear to what extent the budget shortfalls are due to the general economic downturn or to policy decisions made by budget officials. If they have built a budget around revenue growing by 10 percent, for example and revenue grows by only 8 percent, one could argue they are experiencing a shortfall, but not in a way that is meaningful to most people.

Nor do we know whether the current or projected budget is built on years of rapid increases in overall spending. If one’s current budget is built on several years of rapid expansion, a projected cutback may be less severe than it would otherwise seem.

It is worth asking, then, whether we are treating an illness or a hangover. Have the states been efficient stewards of public resources that now, reeling from an economic calamity, need federal support? Or were they, like other sectors, on a spending bender during a robust economy, living as if the boom years would never end? Will another federal infusion now merely put off the steps that states need to take to put their budgets on a more sustainable footing?

1. Analyzing State Revenue

It is argued that the most immediate cause of strife in state budgets is the expected drop in revenue. No doubt, a drop in economic activity will cause state revenues to dip. Whether these actually fall in absolute terms is an open question. Additionally, it is instructive to look at revenue collections prior to the economic downturn. Just as we look at the prior decisions of other companies and sectors appealing for a federal bailout, it is important to look at the history of state budgets. Are the states
experiencing an extraordinary shock outside of their control or did they succumb to their own excess?

This analysis covers the period 2002–2007 using data from the U.S. Census Bureau, the most authoritative source of actual revenue data. The U.S. experienced a modest economic downturn in 2000–2001, due chiefly to the meltdown in the technology sector, with added pressure from the fallout of the September 11, 2001 attacks. The downturn ended by 2002 and we emerged from these shocks and experienced uninterrupted growth until at least 2007.

If economic downturns increase the demands on state services, then the period 2002–2007 should have reduced the demand on these same services. In this period, unemployment dipped to around 4 percent, the lowest in modern times. Gross domestic product posted steady gains. Most economic measures pointed up. Therefore, this article calculates a baseline of revenue and spending from 2002 to 2007 based on inflation and population growth.

In 2002, we had largely recovered from a short-term economic contraction. For the next five years, we enjoyed economic growth, marked by falling unemployment and rising incomes. In this economic climate, states ought to have been able to maintain service levels, adjusting for increases in inflation and population growth. Anything above this baseline is surplus revenue available to the states. Their decisions on this windfall would have real repercussions. It is important to understand how much extra revenue they enjoyed during the boom years.

**Total Revenue**

The top-line number of state resources is total revenue. It encompasses all the money available to a state. This includes all tax revenue, money from the federal government, income from various trust funds, earnings from investments and even state employee contributions to pension systems. It reflects every dollar available to state governments.

In 2002, total revenue for all states was just over $1 trillion (see Figure 4). By 2007, it had risen to almost $2 trillion, increasing 81 percent in just five years. But in that time, inflation and population increased 19 percent. So total revenue increased more than four times faster than inflation and population growth.

However, the 81 percent increase over five years only tells part of the story. Since 2002, total revenue collections have been well above the baseline levels needed to maintain services

![Figure 4: Total State Revenue Collections, 2002–2007](image_url)
each year. This windfall has a cumulative impact. In just five years, the states collected $2.2 trillion more than they would have needed to maintain revenues at 2002 levels. Put differently, if the states had merely maintained their existing programs in between economic downturns, they would have been able to deliver a $2 trillion tax cut at the end of 2007.

2. Analyzing State Spending

There are various ways to look at state spending. Total state expenditures encompass every dollar spent by state government, regardless of its source. Excluding spending on state liquor stores (where this anachronism still exists), utilities and many social insurance programs and including state employee retirement benefits gives us general expenditures. This number also includes money states get from the federal government to support a variety of programs, from highway construction to Medicaid. Excluding money from the federal government gives us direct expenditures, which encompass current operations, interest on debt, assistance and subsidies and capital outlays, among other things.

When evaluating how states manage their fiscal affairs, it can be argued that direct expenditures is the best measure: it is the spending most directly controlled by state elected officials. Notably, it is the category that increased the fastest from 2002 to 2007. Table 3 details the spending growth in each line item, its percentage increase and the amount it exceeded inflation plus population.

While it is interesting to look at direct expenditure, because it is the category most in the control of the legislature, general expenditure gives us a fuller picture of state spending. States receive around 30 percent of their revenue from the federal government. This is because states, to a large extent, have become almost subsidiary branches of the federal government. In recent decades, the federal government has tried to implement certain national programs. It makes money available to the states to implement these programs, provided the states meet certain thresholds or observe certain mandates.

In 2007, general expenditures in the states totaled just over $1.4 trillion, a 28 percent increase over 2002, when general expenditures were just over $1 trillion. If state government had kept spending at 2002 levels, increasing only to account for inflation and population growth, spending would have risen by just around 19 percent over five years. Instead, spending across all states rose by just over 28 percent. Figure 5 shows the difference between 2002 baseline spending and actual spending over the same period.

This spending above baseline adds up. In the five years from 2002 to 2007, states spent just over $300 billion more than necessary to maintain programs at 2002 levels. Keep in mind, this increased spending came at a time of falling unemployment and falling welfare rolls. Unemployment, for example, fell from around 6 percent in 2002 to around 4.6 percent in 2007. Several states went beyond this higher level of spending. Table 4 lists the 10 states with the biggest spending increases from 2002 to 2007. Two of them, Louisiana and Mississippi, experienced devastating storms in 2005, accounting for much of their increased spending. A few more states experienced faster

<p>| Table 3: Aggregate State Spending Growth, 2002–2007 |</p>
<table>
<thead>
<tr>
<th>Category</th>
<th>Actual 2002</th>
<th>Actual 2007</th>
<th>% Increase</th>
<th>% Over Inflation + Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Expenditures</td>
<td>$1.282 trillion</td>
<td>$1.634 trillion</td>
<td>27</td>
<td>45</td>
</tr>
<tr>
<td>General Expenditures</td>
<td>$1.110 trillion</td>
<td>$1.423 trillion</td>
<td>28</td>
<td>47</td>
</tr>
<tr>
<td>Intergovernmental Expenditures (federal)</td>
<td>$364 billion</td>
<td>$457 billion</td>
<td>25</td>
<td>32</td>
</tr>
<tr>
<td>Direct Expenditures</td>
<td>$745 billion</td>
<td>$965 billion</td>
<td>30</td>
<td>58</td>
</tr>
</tbody>
</table>

Reason Foundation  •  reason.org

**3. Conclusion**

State governments are joining a long list of industries clamoring for federal assistance through these turbulent economic times. No doubt, a weak economy will put pressures on state budgets. There will likely be less revenue than states had expected to collect and there may also be greater demand for many state services.

But for the five years immediately preceding the economic downturn, states experienced robust revenue growth and steady increases in overall spending. Their total spending far outpaced inflation. In fact, states collectively spent $300 billion more than was necessary to maintain programs at 2002 levels. As this period coincided with falling unemployment and a generally strong economy, it is not unreasonable to ask how states could have justified such a large increase in spending.

No industry expects its costs to increase every year at more than the rate of inflation. Such a business model is unsustainable in today’s globalized economy. Every industry and every company, is under constant pressure to trim its costs and change how it delivers services. Economic downturns provide an extra incentive to do this and generally help set the stage for a robust recovery. State governments shouldn’t be immune to this. Instead of seeking a temporary bailout from the federal government, states should roll up their sleeves and put their own fiscal houses in order.

This article is an excerpt from a forthcoming Reason Foundation policy study.

---

**Table 4: Spending Growth in Selected States, 2002-2007**

<table>
<thead>
<tr>
<th>State</th>
<th>Actual Spending Growth</th>
<th>State Baseline</th>
<th>% Above</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arizona</td>
<td>58%</td>
<td>28%</td>
<td>107%</td>
</tr>
<tr>
<td>Louisiana</td>
<td>56%</td>
<td>10%</td>
<td>514%</td>
</tr>
<tr>
<td>Wyoming</td>
<td>50%</td>
<td>18%</td>
<td>178%</td>
</tr>
<tr>
<td>New Mexico</td>
<td>47%</td>
<td>20%</td>
<td>135%</td>
</tr>
<tr>
<td>Mississippi</td>
<td>46%</td>
<td>15%</td>
<td>207%</td>
</tr>
<tr>
<td>Delaware</td>
<td>45%</td>
<td>21%</td>
<td>114%</td>
</tr>
<tr>
<td>Florida</td>
<td>41%</td>
<td>23%</td>
<td>78%</td>
</tr>
<tr>
<td>Nevada</td>
<td>41%</td>
<td>30%</td>
<td>36%</td>
</tr>
<tr>
<td>Georgia</td>
<td>38%</td>
<td>25%</td>
<td>52%</td>
</tr>
<tr>
<td>Vermont</td>
<td>38%</td>
<td>14%</td>
<td>171%</td>
</tr>
</tbody>
</table>

D. Rich States, Poor States: The 2009 ALEC-Laffer State Economic Competitiveness Index

By Jonathan P. Williams, American Legislative Exchange Council

The 2009 edition of the Rich States, Poor States report from the American Legislative Exchange Council (ALEC) is a valuable resource for state lawmakers and citizens to evaluate their state's fiscal and economic policies, as well as the results and ramifications of those policies. This year's edition focuses on some of the most critical issues facing lawmakers today, with more than 40 states struggling with budget deficits.

Today, many states find themselves in a world of fiscal pain. Of course, the only reason many of these states face budget shortfalls is because they spent beyond their means. During the good times over the past few fiscal years, states had no trouble finding ways to spend the soaring tax revenues that came their way. Now the so-called structural deficits are back. Predictably, voices from the political left have already begun talking about the “need to raise taxes,” and several states have already voted for significant tax hikes in 2009. Disturbingly for these states, Rich States, Poor States found that high state taxes, particularly income taxes, have a clear and negative effect on income, population and job growth.

Legislators should be forewarned: increasing income taxes is an economic loser. As Rich States, Poor States outlines, states that wish to remain competitive in the 21st century need to avoid tax increases by living within their means. Hard-working families and businesses are required to live within their means each month. Why on earth should we hold state governments to a lower standard?

As in any time of crisis, many elected officials are suffering from a predictable case of “do something” disease. Many state and local elected officials want instant solutions to their budget problems. States are not facing budget deficits because they don’t tax enough. The real problem facing states is the fundamental issue of overspending taxpayer dollars. Overall state spending has grown at an unsustainable rate over the past decade. In fact, state spending is up 124 percent over where it was just 10 years ago and state debt increased by 95 percent during that period. In many cases, states facing the worst budget shortfalls are the same states that engaged in reckless spending. During testimony before the House Ways and Means Committee in Washington, South Carolina Governor Mark Sanford noted:

California increased spending 95 percent over the past 10 years (federal spending went up 71 percent over the same period). To bail out California now seems unfair to fiscally prudent states.

During his testimony, Sanford urged Congress to “accept that there may be better routes to recovery than a blanket bailout, including offering states . . . more in the way of flexibility and freedom from federal mandates instead of a bag of money with strings attached.” Unfortunately, Congress did not take Sanford’s advice. Instead of using economic stimulus dollars to increase education spending (and subsequently having to cut this funding when federal dollars dry up), Sanford wanted to pay down state education debt. But the Obama administration used the strings attached to stimulus dollars to prohibit him from using federal aid in this prudent fashion.

State budgets have faced financial duress many times before because of overspending and certainly will again in the future. History suggests federal bailouts are not the answer, as they decrease state sovereignty, encourage future fiscal irresponsibility and reward fiscally imprudent states at the expense of fiscally responsible states.

In the midst of economic turmoil, federal bailouts and budget shortfalls in the states, Rich States, Poor States analyzes why millions of Americans are moving from high-tax states to low-tax states. Arthur Laffer, the father of
supply-side economics and Stephen Moore, senior economics writer at The Wall Street Journal, have teamed up with ALEC once again to provide this in-depth analysis of economic competitiveness in the states. As our elected officials think about beginning the annual task of budget writing, we remind lawmakers that levying tax increases is not a sustainable answer for budget problems.

Especially during an economic downturn, states need to do everything they can to become more competitive, not less. Table 5 compares the economic performance of the top 10 states—according to our 2009 Economic Outlook Rankings—with the bottom 10 states. The results are eye-opening.

This year’s edition of Rich States, Poor States has a special focus on California. The Golden State is not only our nation’s largest state in most every economic metric, it also has a highly volatile political climate. The report includes a case study comparing the vastly different policy approaches used by Texas and California. Furthermore, it compares California’s present with its past. The history of California, centered on the tax revolt crystallized in Proposition 13 in 1978, shows a laboratory experiment in which the state went from fiscal malaise to fiscal health and then back to malaise again. By showing the current class of legislators the ghosts of California’s past, we hope they can begin picturing the ghosts of California’s future.

<table>
<thead>
<tr>
<th>State</th>
<th>Rank</th>
<th>Gross State Product Growth</th>
<th>Personal Income Growth</th>
<th>Personal Income Per Capita Growth</th>
<th>Population Growth</th>
<th>Net-Domestic In-Migration as a % of Population</th>
<th>Non-Farm Payroll Growth</th>
<th>Unemployment Rate, 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Utah</td>
<td>1</td>
<td>86.7%</td>
<td>82.3%</td>
<td>45.6%</td>
<td>26.3%</td>
<td>0.3%</td>
<td>25.9%</td>
<td>2.7%</td>
</tr>
<tr>
<td>Colorado</td>
<td>2</td>
<td>77.8%</td>
<td>84.9%</td>
<td>52.1%</td>
<td>20.0%</td>
<td>4.6%</td>
<td>17.7%</td>
<td>3.8%</td>
</tr>
<tr>
<td>Arizona</td>
<td>3</td>
<td>93.9%</td>
<td>101.4%</td>
<td>47.9%</td>
<td>33.1%</td>
<td>12.2%</td>
<td>34.4%</td>
<td>3.8%</td>
</tr>
<tr>
<td>Virginia</td>
<td>4</td>
<td>80.7%</td>
<td>78.4%</td>
<td>56.4%</td>
<td>12.6%</td>
<td>2.2%</td>
<td>16.4%</td>
<td>3.0%</td>
</tr>
<tr>
<td>South Dakota</td>
<td>5</td>
<td>71.3%</td>
<td>73.8%</td>
<td>63.9%</td>
<td>7.8%</td>
<td>0.2%</td>
<td>15.2%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Wyoming</td>
<td>6</td>
<td>111.4%</td>
<td>114.6%</td>
<td>103.4%</td>
<td>8.5%</td>
<td>2.1%</td>
<td>28.3%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Nevada</td>
<td>7</td>
<td>112.3%</td>
<td>114.6%</td>
<td>48.4%</td>
<td>40.3%</td>
<td>17.2%</td>
<td>45.0%</td>
<td>4.8%</td>
</tr>
<tr>
<td>Georgia</td>
<td>8</td>
<td>67.0%</td>
<td>74.4%</td>
<td>38.5%</td>
<td>23.2%</td>
<td>6.7%</td>
<td>14.7%</td>
<td>4.4%</td>
</tr>
<tr>
<td>Tennessee</td>
<td>9</td>
<td>59.0%</td>
<td>64.8%</td>
<td>46.5%</td>
<td>11.6%</td>
<td>4.4%</td>
<td>8.3%</td>
<td>4.7%</td>
</tr>
<tr>
<td>Texas</td>
<td>10</td>
<td>90.5%</td>
<td>89.8%</td>
<td>55.8%</td>
<td>20.7%</td>
<td>3.4%</td>
<td>20.3%</td>
<td>4.3%</td>
</tr>
<tr>
<td>10 Highest</td>
<td></td>
<td>85.1%</td>
<td>87.9%</td>
<td>55.9%</td>
<td>20.4%</td>
<td>5.3%</td>
<td>22.6%</td>
<td>3.8%</td>
</tr>
<tr>
<td>U.S. Average**</td>
<td></td>
<td>66.8%</td>
<td>69.5%</td>
<td>53.6%</td>
<td>9.9%</td>
<td>0.9%</td>
<td>13.3%</td>
<td>4.3%</td>
</tr>
<tr>
<td>10 Lowest</td>
<td></td>
<td>59.3%</td>
<td>60.7%</td>
<td>52.3%</td>
<td>4.4%</td>
<td>-3.3%</td>
<td>9.3%</td>
<td>4.5%</td>
</tr>
<tr>
<td>Hawaii</td>
<td>41</td>
<td>63.9%</td>
<td>61.7%</td>
<td>54.4%</td>
<td>6.0%</td>
<td>-4.0%</td>
<td>17.3%</td>
<td>2.6%</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>42</td>
<td>54.7%</td>
<td>54.6%</td>
<td>50.9%</td>
<td>1.7%</td>
<td>-0.9%</td>
<td>7.2%</td>
<td>4.4%</td>
</tr>
<tr>
<td>California</td>
<td>43</td>
<td>77.9%</td>
<td>76.6%</td>
<td>56.0%</td>
<td>11.4%</td>
<td>-4.0%</td>
<td>15.5%</td>
<td>5.4%</td>
</tr>
<tr>
<td>Illinois</td>
<td>44</td>
<td>50.9%</td>
<td>55.6%</td>
<td>47.1%</td>
<td>5.1%</td>
<td>-5.4%</td>
<td>3.6%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Ohio</td>
<td>45</td>
<td>40.4%</td>
<td>42.3%</td>
<td>38.4%</td>
<td>1.5%</td>
<td>-3.5%</td>
<td>0.6%</td>
<td>5.6%</td>
</tr>
<tr>
<td>New Jersey</td>
<td>46</td>
<td>54.7%</td>
<td>62.4%</td>
<td>52.5%</td>
<td>4.8%</td>
<td>-5.3%</td>
<td>9.4%</td>
<td>4.2%</td>
</tr>
<tr>
<td>Maine</td>
<td>47</td>
<td>55.8%</td>
<td>60.7%</td>
<td>52.1%</td>
<td>4.6%</td>
<td>3.1%</td>
<td>11.5%</td>
<td>4.7%</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>48</td>
<td>64.5%</td>
<td>61.7%</td>
<td>55.4%</td>
<td>1.9%</td>
<td>-3.7%</td>
<td>9.6%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Vermont</td>
<td>49</td>
<td>61.8%</td>
<td>69.3%</td>
<td>61.2%</td>
<td>3.5%</td>
<td>0.1%</td>
<td>10.2%</td>
<td>3.9%</td>
</tr>
<tr>
<td>New York</td>
<td>50</td>
<td>68.5%</td>
<td>61.7%</td>
<td>55.3%</td>
<td>3.9%</td>
<td>-9.5%</td>
<td>8.3%</td>
<td>4.5%</td>
</tr>
</tbody>
</table>

future—identified by much lower taxes and much higher economic growth.

The final section of the report is a state-by-state detailed description of the key economic variables. The 2009 ALEC-Laffer State Economic Competitiveness Index offers two rankings. The first, the Economic Performance Rank, is a historical measure based on a state’s performance on three important variables—personal income per capita, absolute domestic migration and nonfarm payroll employment—all of which are highly influenced by state policy. This ranking details states’ individual performances over the past 10 years based on this economic data.

The second measure, the Economic Outlook Rank, is a forecast based on a state’s current standing in 15 state policy variables. Each of these factors is influenced directly by state lawmakers through the legislative process. Generally speaking, states that spend less—especially on income-transfer programs—and states that tax less—particularly on productive activities such as working or investing—experience higher growth rates than states that tax and spend more.

Top-performing states in the ALEC-Laffer State Economic Competitiveness Index are highly correlated to economic growth, while many of the losers suffer economic malaise. The top states keep taxes, spending and regulatory burdens low. The biggest losers tend to share similar policies of high tax rates, unsustainable spending and regulation.

While the states are certainly suffering from the current economic downturn, this new publication clearly demonstrates that we cannot tax, borrow or spend our way into prosperity. The report exposes the economic burden that high taxes, irresponsible spending and other big government policies place on our states.

*Rich States, Poor States* is not about Republican versus Democrat or left versus right. It simply highlights how state policy choices can mean the difference between economic vitality and economic malaise.

Local Government

Contents
A. Chicago Nets $1.1 Billion in Parking Meter Privatization, L.A. and Others to Follow
B. Dunwoody Becomes Georgia’s Fifth New Contract City
C. L.A. City Controller Recommends Sweeping Privatization Program
D. Indianapolis Returning to Privatization Roots
E. Milwaukee County Board Nixes Privatization Push
F. Kansas City, King County Embrace Privatization of Animal Shelters
G. Other Local Privatization News

A. Chicago Nets $1.15 Billion in Parking Meter Privatization, L.A. and Others to Follow

In December 2008, Chicago Mayor Richard Daley announced the winning $1.15 billion bid for a 75-year concession (lease) of the city’s downtown parking meters, marking the first privatization of an urban parking meter system in the United States. With over 36,000 meters generating roughly $19 million per year, Chicago’s is among the largest parking meter operations in the country and is already serving as a model for Los Angeles, Indianapolis and other local governments contemplating similar deals. While glitches in the early implementation have prompted significant scrutiny of the transaction from local officials and media, the turbulence of the early rollout now seems to have subsided as operational improvements have taken hold in recent months.

1. Understanding the Parking Meter Concession

In exchange for an up-front $1.15 billion payment, the agreement grants the operator—Chicago Parking Meters, LLC, a consortium led by Morgan Stanley Infrastructure Partners—the right to maintain and operate the meters throughout the life of the contract. The deal also requires the operator to do a wholesale system overhaul, replacing the antiquated coin-based meter system with a high-tech, multi-space/multi-pay meter system that will facilitate payment via cash, credit and debit cards and potentially other pay systems.

“This is the best thing that has happened for us in regards to getting out of this business,” Mayor Daley said in announcing the deal. “This is not the core business of the city of Chicago.” The deal follows right on the heels of the 2005 lease of the Chicago Skyway (netting the city $1.8 billion) and the 2006 lease of four downtown parking garages (netting $563 million).

Under the terms of the parking meter contract, the city retains full responsibility for rate setting, parking regulation enforcement and fine collection. The deal also preserves the city council’s decision-making authority over the number of meters and hours of operation, as
well as the city director of revenue’s authority over the length of time a customer can park.

The operator does have the ability under the contract to supplement the city’s ticketing function if the city’s own performance wanes in the future. But since all parking fines will continue to be collected by and to the benefit of the city alone, the operator does not stand to realize even a penny from enhanced ticketing; hence, hiring additional private ticketers would effectively represent a net cost to the operator, with no additional offsetting revenues.

Parking rates will be allowed to rise each year for the first five years of the contract, after which any subsequent rate increases over the remainder of the contract term will be subject to city council approval. Increases in any given year would be capped to increases in the consumer price index.

Furthermore, the contract requires the operator to replace and upgrade the entire meter system—at its own expense, separate from the $1.1 billion up-front payment—removing significant future operations, maintenance and capital expenditure costs from the city’s books for decades to come.

The city split the proceeds from the parking meter agreement in four ways:

- $400 million was placed into a long-term reserve/revenue replacement fund, bringing the city’s total long-term reserves to $900 million.
- $325 million is being used for mid-term budget relief through 2012, with $150 million drawn down thus far to balance the city’s fiscal year 2009 budget.
- $320 million was placed in a budget stabilization (“rainy day”) fund.
- $100 million was placed in a human infrastructure fund used to supplement the budgets of a variety of low-income support programs for a five-year period.

Michael Smith, a projects lawyer with the firm Baker & McKenzie in Chicago, which represented other bidder groups in the parking meter auction, told Reason Foundation that he sees this transaction as a watershed event for the public-private partnership market in the U.S. that will likely prompt imitators in other local governments. According to Smith, “the city of Chicago was smart to recognize that the parking meter system was an asset worth more than a billion dollars in private hands, but generating little revenue for the city. It just made good business sense to let someone else operate and run the system.”

The bidding process for the parking meter transaction was structured along the same lines as the city’s earlier Skyway and parking garage transactions. The city hired a financial advisor in June 2007 to begin preliminary due diligence and market valuation regarding a potential lease. In February 2008, the city issued a request for qualifications to potential investors and parking operators regarding a parking system lease. Respondents were asked to demonstrate their technical capabilities with regard to operations and maintenance, their ability to implement technological and equipment improvements and their capacity to raise the necessary financing and access operating capital. In March 2008, ten prospective bidders submitted qualification statements, of which six were deemed qualified by the city. The city then began conducting an extensive due diligence process with each of the six bidders as it refined the concession agreement on which the teams would ultimately bid.

In December 2008, the city received two bids from Morgan Stanley ($1.008 billion) and Macquarie ($964 million). Since the two bids were within ten percent of each other, the city initiated a best-and-final bid process. In the second round, Morgan Stanley responded with a $1.157 billion bid, nearly $140 million higher than Macquarie’s $1.019 billion bid. Both bids exceeded the city’s $1 billion minimum acceptable bid threshold. According to city Chief Financial Officer Gene Saffold, “The best-and-final round heightened the competitive tension
among the bidders—and ensured that Chicago received the absolute highest bid.”

2. Chicago’s Early Transition Sees Operational, Political Challenges

The transition to private operation began in February 2009 and was immediately beset with operational challenges, feeding a media and political backlash that focused enormous scrutiny on the early implementation. The combination of the onset of parking rate increases and early transition challenges prompted some pundits and observers—even city aldermen who voted for the concession—to label the months-old initiative a failure and a bad deal for the city. However, by the summer of 2009, the operational issues that plagued the early rollout were largely resolved and the system overhaul was well underway and ahead of schedule.

Operational Issues

The early months of the transition to private meter system operation saw some unexpected operational glitches that attracted significant media attention. In an April 2009 news conference, Chicago Parking Meters CEO Dennis Pedrelli acknowledged that the concessionaire “underestimated the resources required” to reprogram meters to reflect higher rates and address a backlog of broken, jammed and mismarked meters that prompted numerous complaints from citizens over dysfunctional meters and unfair fines. In late May, 250 newly installed meters malfunctioned in a single day. Furthermore, during the spring, local blogs and media outlets hyped a series of incidents of vandalism against meters that further sensationalized the parking meter concession. However, parking experts note that most cities experience a certain amount of parking meter vandalism on an ongoing basis, particularly in response to rate increases. According to the city, Chicago has not seen an atypical level of vandalism in 2009.

In May 2009, Mayor Daley took responsibility for the implementation glitches, noting that the city should have undertaken the transition to privatization more gradually. As Daley told the Chicago Sun-Times, “I’ll take the responsibility. […] There should have been a transition—a much better transition—and there wasn’t. That’s one thing we learned. There should have been a three-month transition.” However, Daley added that the transfer of the Chicago Skyway and the downtown parking garages to concessionaires had proceeded without incident and that if the city did not have the cash infusion from the parking meter concession, “you’re talking about a serious economic crisis for Chicago.”

Despite the early glitches in implementation, the city reports that parking meter operations have been steadily improving and that the concessionaire has responded well following the transitional problems:

- The early transition to concessionaire operation saw a spike in average meter repair times. However, the addition of operational staff has helped to decrease repair times significantly in recent months and the concessionaire has now cut the average repair time to less than half of the level under former city operation. In March 2009, meters reported broken were repaired in about eight business days, far slower than the two-day repair time the city averaged before privatization. However, the concessionaire’s average repair time dropped to roughly 1.5 business days by April and by July, the average repair time had fallen to less than one business day.

- The city has also found that there has been a significant reduction in jammed meters. A May city audit identified only eight meters with jams and as of July 2009, over 96 percent of the meter system is operable on any given day, exceeding the operability percentages in several peer cities.

- The concessionaire has been adding new
multi-space, “pay-and-display” meters to the street at an unprecedented rate. By July 2009, the concessionaire had already replaced 10,236 meters with 1,357 new pay-and-display meters. By contrast, the city installed just 198 pay-and-display meters in a five-year period prior to the lease. The concessionaire has already replaced these older generation pay-and-display meters with 207 newer models.

The concessionaire expects to finish the replacement of all 30,000 meters by the end of 2009—two years ahead of schedule—at an overall expense of between 40 and 50 million dollars. The concessionaire will also make additional capital expenditures over the life of the deal, as pay-and-display meters are typically replaced every seven to 10 years. Some benefits of the new pay-and-display meters identified by the city include:

- More payment options for consumers, since the new meters offer payment by coin, credit card or debit card;
- Each pay-and-display meter replaces roughly seven older meters;
- The new meters use solar power, reducing the need to recycle more than 40,000 9-volt and lithium batteries each year;
- Collection and maintenance crews need to visit meters less often, since the new meters use a wireless network to immediately inform operators when a meter is broken or in need of collection.
- The new technology allows the city to measure system utilization by hour at each block; prior to the concession, the city had to rely on crude approximations of utilization.

Political challenges

With media reports stoking a barrage of citizen complaints regarding the parking meter deal, the city council began to question the transaction and the troubled implementation. Daley administration officials and concessionaire representatives were brought before several contentious council hearings to address questions on various aspects of the deal and its rollout. In June 2009, the council approved an ordinance requiring a 15-day review period before a council vote on future proposals to privatize city assets.

Further, Alderman Leslie Hairston—one of five on the council voting against the deal in December—asked Illinois Attorney General Lisa Madigan to launch a consumer fraud investigation to examine potential “deceptive business practices” concerning broken meters and subsequent parking violation fees; at press time, Madigan’s investigation was still ongoing.

What raised perhaps the most council scrutiny was a June 2009 report issued by the city’s Office of the Inspector General (OIG) arguing that the city did not properly estimate the value of its parking meter system prior to the lease. The report included a valuation analysis claiming that the deal should have been worth at least $2.13 billion. In a press conference responding to the report, Mayor Daley’s chief of staff, Paul Volpe, called the OIG’s estimate of $2.13 billion “ridiculous” and labeled the report “misguided and inaccurate,” as it failed to adequately account for the inherent risks in parking meter operations.

In the aftermath of the OIG report, a June 2009 city council resolution called for city officials to appear before the council’s finance committee to testify on the parking meter concession bidding process, criteria used to determine bidder qualifications and the financial analysis used to determine an acceptable bid amount. In a memorandum prepared as a supplement to his committee testimony, city Chief Financial Officer Gene Saffold noted that:

There is a wide gap between academic theory and the actual marketplace. It is misguided to compare a theoretical value with an actual
market value—one that was reached through taking an asset to market, using a competitive process. Readers of these academic exercises are left with the mistaken impression that the city received less than market value. That is not the case.

Saffold backed up his testimony with a report prepared for the committee by the city’s financial advisor on the parking meter concession, William Blair & Company, critiquing the OIG valuation analysis. Specifically, the Blair report noted two significant inaccuracies in the OIG analysis that rendered its findings incorrect.

First, the OIG report estimated the system’s value on the basis of gross system revenue rather than free net cash flow. The OIG report assumed $500,000 in annual capital expenditures for the parking meter system beginning in year three which, according to the Blair report, dramatically understated the cost of capital expenditures by $4 million annually over the life of the 75-year deal and overstated the amount of free cash flow for each year. In addition, Blair found that the OIG report also failed to account for $5 million each year in system operations costs.

Second, the Blair analysis found that the OIG used an inappropriately low discount rate (7.0 percent) in estimating the meter system’s value, based on a faulty assumption that the parking meters are a “very low risk” enterprise. By contrast, in its own valuation analysis, the city used discount rates in the range of 10 to 14 percent to reflect a medium-to-high degree of risk. Blair notes that there are substantial risks associated with the operation and value of the system that were transferred from the city to the concessionaire in the deal, including system utilization risk, long-term operational risk and other risks associated with the potential for changes in population, economic activity, technology, public transit usage, fuel costs and numerous other factors that affect the long-term economic value of the system. These substantial risks were transferred to the concessionaire and according to Blair, the city would retain these risks if it were still operating the system itself, which the OIG report should have reflected by using a higher discount rate in its valuation analysis.

The Blair report analysis concludes that “by properly projecting [parking meter system] revenues and by applying a discount rate that appropriately reflects the relative risks… the conclusion that the city received full and fair value for the Concession of the [meter system] is clearly supported and affirmed.”

The winning $1.156 billion bid “represented a very aggressive bid, reflecting the robust competitive bidding process, the trophy nature of the asset and the limited number of American public infrastructure investment opportunities,” the Blair report concluded. “The winning bid was at the high-end of the estimated range of [the system’s projected value].”

3. Other Local Governments Look to Parking Asset Privatization

Inspired by Chicago’s parking asset leases, other local governments are currently exploring similar transactions. In late April 2009, the Los Angeles City Council approved a $500,000 contract to study the feasibility of privatizing the city’s 41,000 parking meters and six parking garages. The parking asset lease proposals were a key feature of Mayor Antonio Villaraigosa’s plan to close a $530 million budget shortfall, prevent the layoff of 800 city workers and avoid furloughs in the Los Angeles Police Department, which a competing council budget plan had proposed. Villaraigosa included $80 million of lease proceeds in his 2009-10 budget, though administration officials expect that a well-structured deal could generate a substantially larger value.

Officials in Allegheny County, PA are considering a lease of parking facilities at Pittsburgh International Airport (PIT) to retire $475 million in bonds used to finance a new midfield terminal in the 1990s. Allegheny
County Chief Executive Dan Onorato is proposing a long-term lease of the airport’s parking facilities—13,200 spaces between garages and lots—to a private operator to generate $500 million or more in an up-front payment to defease the bonds. Debt service on those bonds is running $62 million per year, compared with about $22 million in annual parking revenue. Thus, under a lease, the Airport Authority could for many years save a lot more in debt service expense than it would be losing in parking revenue.

An article in the Pittsburgh Post-Gazette quotes Merrill Stabile, president of parking operator Grant Oliver Corp., as saying that investment groups have recently paid 15 to 20 times earnings for parking facilities; he estimated parking at PIT could be worth up to $440 million. Two factors that would influence that value are the length of the lease and what controls on parking rate increases would be included in the deal. At press time, the proposal had not yet come up for discussion in an Allegheny County Airport Authority formal board meeting.

In neighboring Pittsburgh, the city council adopted a new five-year fiscal recovery plan for the city in June 2009—required under state law since Pittsburgh’s designation as a “distressed municipality” in 2003—that includes a plan to privatize city parking garages. The plan was subsequently approved by Mayor Luke Ravenstahl, who initially proposed the initiative in a set of options designed to boost the coffers of the city’s underfunded pension fund. Officials in two other Pennsylvania cities—Philadelphia and Harrisburg—also floated parking asset lease proposals. In Harrisburg, the city council rejected an unsolicited bid for a 75-year lease of its 8,500 public parking spaces, including nine city parking garages, in exchange for a $215 million up-front payment.

At press time, officials in Indianapolis were considering several proposals to enhance the revenues from its roughly 4,000 parking meters, including the possibility of a long-term, Chicago-style lease. The city’s Director of Enterprise Development, Michael Huber, told the Indianapolis Business Journal in July 2009 that the city would use any meter system modernization revenues to fund sewer and road infrastructure projects.

Eight firms responded to a request for parking meter revenue enhancement proposals issued by Mayor Greg Ballard’s administration, including Denison/Walker Parking Consultants, IMG Capital, Affiliated Computer Services Inc., Verrus Mobile Technologies Inc., MobileNow, KPMG, Carl Walker Parking and Energy Systems Group. Proposals ranged from technological and system overhauls to long-term leases to private sector operators.

One proposal estimated the value of a long-term parking meter system lease in Indianapolis at over $100 million. A new city Infrastructure Advisory Commission formed in early 2009 would be responsible for setting spending priorities for any new parking meter revenue. The city also is seeking similar private sector proposals to maximize revenues from more than 10,000 off-street parking spaces in city-owned parking garages and surface lots.

4. Parking Meters in the Context of Chicago’s Asset Leases

Despite the high-profile collapse of a $2.5 billion long-term lease of Midway Airport in early 2009 (detailed in the Air Transportation section of this report), the parking meter concession demonstrates that Chicago continues to break new ground in strategic municipal asset leasing. Over the last four years, the city has tapped over $3.5 billion through long-term partnerships with private infrastructure operators, allowing the city to shore up its budget, upgrade infrastructure, pay down city debt, establish “rainy day” funds, transfer revenue and operational risks to private partners and turn government liabilities into revenue-generating assets.
Chicago’s Policy on Asset Leases

According to its stated policy, the city of Chicago will only pursue long-term infrastructure asset leases when:

- There is substantial financial benefit to Chicago taxpayers and residents;
- Management of the asset is not the city’s core competency; and
- Experienced and professional operators exist who can improve efficiency, quality of service and make enhanced capital investments.

The proceeds from the Skyway, parking garages and parking meter system leases were used to establish long-term reserve funds of more than $1 billion, retire $925 million in debt, reserve over $700 million for mid-term budget relief and invest more than $322 million in neighborhoods, parks and other community programs. The Chicago Tribune recognized the benefits of the Skyway lease in an October 2008 editorial: “The city’s deal to lease the Chicago Skyway to a Spanish-Australian consortium for 99 years has demonstrated the benefits of leasing public assets judiciously. Chicago got a $1.8 billion windfall […] that raised the city’s credit rating and lowered its borrowing costs.”

Indeed, the city’s ability to use lease proceeds to reduce city debt and establish long-term reserves prompted all three major credit rating firms to raise the city’s bond rating, lowering the city’s borrowing costs. In fact, Moody’s Investor Service upgraded Chicago’s bond rating to its highest level in 25 years, citing the “vital infusion” of lease proceeds as a key factor.

Daley’s recent privatization deals have certainly not spared the city fiscal troubles in the current recession, but strategically investing lease proceeds in a combination of short-, mid- and long-term investments has cushioned the fiscal blow and placed the city in a far better position to weather the storm.

B. Dunwoody Becomes Georgia’s Fifth New Contract City

Dunwoody, Georgia’s fifth recently incorporated city, officially opened its doors on December 1, 2008. Five new cities—Sandy Springs, John’s Creek, Milton, Chattahoochee Hills and now Dunwoody—have formed in metropolitan Atlanta since 2005 and, as upstart “contract” cities, relied largely upon a privatized city government model in which private contractors provide almost all non-safety-related services.

The first four new cities signed contracts with the firm CH2M Hill-OMI to provide all of their contracted services. Dunwoody leaders ultimately took a different approach—opting to contract out bundles of services, instead of hiring one operator—and it hired the firm Boyken International to temporarily manage contracting processes. Dunwoody officials have also approved intergovernmental agreements for continued provision of fire and rescue, water and wastewater and emergency 911 services.

Inspired by the successful establishment of neighboring Sandy Springs in 2005—the first and largest of the new Georgia contract cities—over 80 percent of 37,000 residents of the north DeKalb County community voted in July 2008 to incorporate the new city of Dunwoody.

The following month, Georgia Governor Sonny Perdue appointed five interim representatives to guide the establishment of municipal services and facilities, design a tax and fee structure and negotiate intergovernmental agreements in advance of a September municipal election and December 1, 2008 start-up date.

Working groups began outlining the framework of the new city and exploring comprehensive privatization models along the lines of Sandy Springs and the other new Georgia contract cities.

In response to a request for proposals, CH2M Hill submitted the only bid for a comprehensive services contract with Dunwoody. Citizens for Dunwoody, the citizen group that
served as a primary driver of the incorporation effort, began negotiating with CH2M Hill on the structure of a contract. However, a September revenue report found that some anticipated tax revenues were going to materialize more slowly than originally expected and city representatives began renegotiating with CH2M Hill to adjust the service model to match the new revenue projections.

However, as the new city council was nearing a decision on the CH2M Hill contract, a state senator from the area brought forth a last-minute proposal from Boyken proposing a “hybrid” approach to service delivery in which the management firm would coordinate contracting for specific and/or bundled city services among multiple vendors. CH2M Hill subsequently withdrew their bid and the city eventually negotiated a consulting contract with Boyken to guide bidding processes for major city functions.

Dunwoody officially opened its doors on December 1, 2008 with a $14.4 million budget, $4.1 million of which is being paid to contractors providing the bulk of bundled services in three main areas: public works (Lowe Engineers), community development (Clark Patterson Lee) and financial and administrative services (Calvin, Giordano and Associates). City officials signed contracts for several other services in 2009, including ordinance codification, records management, wrecker services and telecommunications and network services. In mid-July, the city is expecting bids for the design of a comprehensive financial management software package for use by the city’s finance department, as well as separate bids for a three-year financial and compliance auditing services contract.

Dunwoody also signed intergovernmental agreements with DeKalb County to continue providing water and wastewater, fire and rescue, sanitation and 911 services. The county also agreed to provide police services through March while the city’s new 48-member police department was being established to meet an April 1, 2009 start date. In fact, roughly 40 percent of the city’s budget—or $5.7 million—is dedicated to police services; increased police protection was one of the main drivers behind the incorporation effort.

1. Chattahoochee Hills Cancels Services Contract

Having only been in operation since December 2007, Chattahoochee Hills faced a revenue shortfall in 2008 and 2009 that ultimately forced it to cancel its contract with CH2M Hill in May 2009. Mayor Bill Hayes told the Atlanta Journal-Constitution that while the town was satisfied with CH2M Hill’s performance, “we just can’t afford them anymore.” He added that, “We couldn’t have started the city without [CH2M Hill].”

The small city (population 2,500) was slated to spend about a third of its annual $1.5 million budget on its contract with CH2M Hill, but declining property tax receipts in 2009 forced significant budget cuts and necessitated cancelling the contract. Chattahoochee Hills currently has only one dedicated CH2M Hill employee—the town clerk—and largely relies on its own staff or CH2M Hill employees shared with the nearby cities of Sandy Springs, Johns Creek and Milton. The company will continue to provide services through December 2009.

2. Other Georgia Contract Cities News

- In its fourth year of cityhood, Sandy Springs officials reported that despite a projected 20 percent decline in revenues, operational expenditures and tax levels will remain stable and many planned capital expenditures will still proceed. Conservative fiscal management has produced a budget surplus exceeding $14 million that will be used to cover revenue shortfalls; city officials note that these surpluses are distinct from the city’s current “rainy day fund”—set at 16 percent of the total budget—which will
not be tapped.

- In fiscal year 2010, Sandy Springs will spend $24.1 million of its $97 million budget—nearly one-fourth—on roads, parks and sidewalk projects. By comparison, the city will pay only slightly more ($26 million) to CH2M Hill for its operations contract. Mayor Eva Galambos told the *Atlanta Journal-Constitution* in May 2009 that the city was in “catch-up” mode on capital projects, since Fulton County had neglected infrastructure prior to incorporation. She added, “What we’re putting into capital annually is about what the [Fulton] County Commission used to steal from us annually.”

- In an effort to speed dispatching and improve emergency response times, Sandy Springs and Johns Creek agreed to jointly develop a $3.5 million 911 center set to open in September 2009. The cities agreed on a joint contract with iXP Corp. to establish and operate the 911 network, which will utilize 54 full-time dispatchers. “The expectation in these two communities is extraordinarily high and we will deliver on them,” Noah Reiter, the assistant city manager in Sandy Springs, told the *Atlanta Journal-Constitution* in July 2009. Johns Creek City Manager John Kachmar added that the initiative should be an improvement over current 911 services provided by Fulton County; “The level of service we’re getting was just not acceptable […] We wanted to do better.”

- In June 2009, Sandy Springs adopted a new innovation and visioning policy, establishing a quarterly process for city workers to provide new ideas on how to best serve taxpayers. “We started with a blank sheet of paper starting this government and I don’t ever want to throw that blank sheet away,” Councilman Rusty Paul told the *Atlanta Journal-Constitution* in June 2009. “We must continually look at how else we can do things.” The city will establish a review process to test ideas and employees who provide the original ideas will receive a merit bonus.

### C. L.A. City Controller Recommends Sweeping Privatization Program

A December 2008 report commissioned by Los Angeles City Controller Laura Chick recommends that the city privatize dozens of major operations as part of its strategy to close a projected $530 million budget shortfall. The report identified Ontario International Airport as the largest potential privatization opportunity, but the report also suggests that the city pursue a wide-ranging privatization program covering such areas as residential solid waste collection, water/wastewater facility operations, fleet maintenance services, city-owned golf courses, animal shelters and parking facilities (discussed earlier in this section).

In the preface to the report, Chick wrote: “[t]he cost of delivering essential services keeps growing at a rate that exceeds the city’s ability to generate revenue and is a major reason we’ve had a structural deficit for years now. When it comes to looking at how the city can fulfill its obligations to the public and pay for it, no subject should be taboo.”

In his April 2009 State of the City speech, Mayor Antonio Villaraigosa noted that he intends to explore “a series of responsible public-private partnerships and advertising opportunities with the potential to generate more than $1 billion over the next several years” to supplement sagging city revenues. And as discussed earlier in this section, the city council approved a $500,000 contract to study the feasibility of privatizing the city’s 41,000 parking meters and six parking garages, a key component of Villaraigosa’s budget plan.

A January 2009 article in the *Los Angeles Business Journal* noted that the last time Los Angeles engaged in a significant discussion on privatization policy was under Mayor Richard
Riordan in the 1990s, when his proposals to privatize Los Angeles International Airport and the city’s parking facilities and golf courses to fill a $200 million budget deficit were stymied by public employee unions and their city council supporters.

Things may be different today, as the city struggles to address an ongoing budget crisis amid a lingering national recession. Milken Institute managing economist Kevin Klowden told the *Journal* that, “If privatization is going to happen, this is the time it will happen.”

**D. Indianapolis Returning to Privatization Roots**

Facing a $23 million budget shortfall, Indianapolis Mayor Greg Ballard is trying to return the city to its privatization roots. Indianapolis is often considered a municipal leader in competition and privatization, having solicited competitive bids on dozens of services starting back in the 1990s under the administration of former mayor Stephen Goldsmith, saving tens of millions of taxpayer dollars.

Noting the cost savings and revenue generated in Chicago from long-term asset leases, Indianapolis is evaluating proposals for a long-term lease of the city’s parking meter system (discussed above), estimated to be worth $100 million. The city is also looking at leasing city-owned parking garages and surface lots.

But Ballard wants to do a lot more. In an April letter, the city executive suggested bidding out grounds maintenance, pool and plumbing maintenance, forestry operations, towing services, water maintenance, payroll management, pool/plumbing maintenance, fleet services, landscaping, payroll, HVAC, electrical services and procurement. Instead of trying to stop the Ballard administration from moving forward, union leaders have stated a willingness to compete to keep their jobs. A city fleet services shop foreman told the *Indianapolis Star* that, “I don’t think we have anything to worry about… we can do the job. We showed them in the past and we'll do it again.” Local union leader Steven Quick appreciates that the unions will be a part of the process, adding, “just going through the process, I think we’ll find savings.”

**E. Milwaukee County Board Nixes Privatization Push**

In September 2008, Milwaukee County Executive Scott Walker released his 2009 budget, which included proposals to privatize several county services, including vehicle maintenance, operation of the county’s economic support call center and non-medical services at the county behavioral health hospital. The proposal also allocated $500,000 for a study assessing the potential privatization of General Mitchell International Airport.

“This budget turns to partnership contracts to maintain core services while keeping jobs within the county, just not necessarily with county government,” Walker said in announcing his executive budget. “This is a budget that does more with less and presents a way to sustain vital services for years to come.”

The privatization discussion quickly became politicized. In November 2008, the County Board cut the privatization measures from its version of the 2009 budget. Walker responded with a series of line-item vetoes that effectively restored nearly all of the privatization measures the County Board had cut. In turn, the County Board responded with a corresponding set of veto overrides that eliminated most of the privatization proposals from the budget. There was one notable exception, however. Walker and the County Board both agreed to proceed on a contract for food services at the behavioral health hospital, replacing 70 food service employees at the complex. This contract began in June 2009.

Walker’s plans to privatize Mitchell International Airport failed to move forward.
after a County Board committee voted unanimously in October 2008 to reject his request for a $500,000 consultant study of a possible deal. Walker had pitched his airport privatization proposal as a way to generate $25 million a year for transit.

Walker indicated that he would likely resubmit separate legislation to recreate some of the privatization initiatives he had originally proposed. He brought the call center privatization proposal back to the County Board in January 2009 and was rejected a second time. The troubled call center has been under fire in recent years for severe staff shortages, prompting citizen complaints and a federal lawsuit.

In addition, Walker’s administration issued a request for proposals in July 2009 for an initiative to potentially outsource janitorial and security services currently provided by the county facilities division. If it decides to move forward, the administration would include the initiative in its 2010 budget proposal.

F. Kansas City, King County Embrace Privatization of Animal Shelters

King County, WA and Kansas City, MO are both privatizing their local animal shelter operations. King County’s animal shelter operations have struggled to address poor conditions and subpar animal care, despite a $1 million increase in funding. Fed up, King County officials announced in October 2008 they were getting the county out of the animal shelter business and will enter a partnership with a community agency.

In response to a high euthanasia rate, a low adoption rate and problems with investigations of dangerous animal incidents, Kansas City also turned to the private sector. A private veterinary group, Veterinary Management Corp., took over the city-owned shelter in March and quickly turned the facility around. The executive offices are now exam rooms, which are more comfortable for the animals. The men’s locker room has been transformed into a place for the smallest puppies and kittens. There is even a cat playground and a horse in the parking lot. The new management has been able to increase capacity within the same space while also increasing the rate of adoption and decreasing the euthanasia rate by about 100 animals a month. City employees who had jobs working in the municipal animal shelter were reassigned to other municipal positions.

In related news, Nevada City, CA may hand management of two animal shelters over to private contractors and Springfield, MA officials are considering privatizing some of the city’s departments—including an animal shelter—to help address budget shortfalls.

G. Other Local Privatization News

- San Francisco’s city council put the brakes on a privatization proposal floated by Mayor Gavin Newsome. Despite Newsome’s plan to contract out some services, no city services were privatized in this year’s budget. Elsewhere in California, San Diego voters ousted pro-privatization city council members, effectively ending Mayor Jerry Sanders’s push for privatization of some city services. And while Novato, CA sanitation officials are pushing for privatization of a municipal waste treatment plant, the proposal is facing significant opposition from some employees.

- Serious budget problems forced the city council in Des Moines, IA to address spending head on. In February 2009, the council approved a budget that reduced costs by cutting jobs and expenses, freezing salaries and privatizing custodial work and turf maintenance. The privatization measure is projected to save the city over $900,000. The city council has also been exploring the possibility of privatizing two publicly owned golf courses. The courses under discussion combined to lose almost $400,000 in the last year.
Several communities in Broward County, Florida began developing private-public partnerships in 2008 and 2009. First, although Hollywood commissioners initially rejected a garbage privatization proposal as a result of pressure from unions that were concerned about losing jobs, the commission reversed its decision after a public outcry when residents discovered that the rejected proposal would have lowered pickup fees and allowed for bulk pickup. In addition to garbage, city officials are also exploring the possibility of contracting out police, fire and engineering services. Second, Pembroke Pines is considering the privatization of its building and zoning department because of a shortage of permit fees in the wake of the housing market downturn. Union officials are lobbying to save these jobs, offering to take pay cuts and reductions in benefits and work hours. Rounding out Broward County’s recent string of privatization initiatives is Sunrise, which is close to a deal that would hand management of a municipal golf course over to a private contractor in early 2010.

Other local governments in Florida have also been active on the privatization front. Because of financial issues, Jacksonville is exploring a public-private partnership for two of the city’s parks. The city is also in the early stages of exploring privatization for some other municipal services. And though the project is moving forward, custodians in Tampa voiced heavy opposition to the city council’s decision to contract out janitorial services, anticipated to result in 27 job cuts. Union opposition and concerns for public safety ended attempts by Charlotte County to privatize some municipal services, including its fire department and emergency medical responders. Sarasota County decided not to pursue privatization of its libraries.

The move toward privatization of some municipal services is gaining popularity in Colorado Springs, CO. A group of residents is arguing that private companies can perform many city services more efficiently than the city itself, improving service quality while reducing cost. Although specifics of a potential privatization plan have not yet been determined, organizers of the pro-privatization group, Taxpayers for Budget Reform, say that they are not advocating for privatization of the police force, fire station or county courts. According to its mission statement, the group promotes “fiscal restraint” and “transparency in government spending” while also educating city and county residents about the budget reform process.

After months of debate, the Tupelo, MS city council decided in February not to privatize the city’s Public Works Department. City public works employees strongly opposed the proposal and put pressure on the city council to nix the deal, even though the plan would have saved the city money while maintaining the same number of jobs. Privatization discussions were marred by accusations that they were held in secret to avoid public backlash.

The town of Duluth, MN, is weighing whether or not to privatize the largest city owned natural gas utility in Minnesota. Mayor Don Ness has requested bids from energy brokers who would assess the value of the natural gas system and help the city decide whether or not to sell the utility. The union that represents most of the utility’s employees has voiced its opposition to the sale, citing concerns about the city’s ability to use the additional funds from the sale wisely.

New Detroit Mayor David Bing has advocated the privatization of toll booths, bridges, trash collection, venues and recreation centers to help address the city’s financial troubles. Elsewhere in Michigan, the Royal Oak city council agreed to privatize municipal building services and is exploring the possibility of privatizing three downtown parking garages, while Macomb County rejected a plan to privatize a nursing home.
Initiatives to privatize garbage services got mixed results in the past year. An arbitrator ruled that Toledo, OH Mayor Carty Finkbeiner could privatize the city’s trash collection services, despite opposition by municipal employees. The move has the potential to save millions of dollars per year. An Albany-based company, ReEnergy Holdings, LLC, has proposed a $338 million deal to buy the Southeastern Public Service Authority (SPSA), which provides trash disposal services for eight Virginia communities. ReEnergy intends to purchase all of SPSA’s assets and invest millions of dollars toward improving a waste-to-energy power plant.

In New York, Washington County is examining a plan to partially privatize waste removal and recycling services and East Hampton officials are considering contracting out management for the town’s dump and recycling facilities in order to reduce spending. However, earlier this year San Bernadino, CA rejected a plan to privatize trash collection. In April 2009, a Falmouth, MA initiative to contract out the town’s waste management services hit a serious roadblock as a result of citizen opposition. And, though some citizens and union leaders oppose the initiatives, Brookline, MA is examining proposals to contract out street sweeping, trash collection and grounds maintenance.

Privatization of recreational services has gotten a largely positive response this past year. In Petaluma, CA, a private company will take over two public swimming pools in an attempt to cut costs. Miami-Dade County, FL is recruiting experts to advise city commissioners on possible public-private partnerships for the county pool as well as transit, water and sewer projects. Barefoot Bay, FL established a commission to explore the use of private vendors for municipal golf and food and beverage operations, both of which are facing financial problems. In a last ditch attempt to save its golf course, the Alameda, CA city council is meeting with the golf commission to negotiate a privatization plan.

Civic and sports facilities are increasingly in the spotlight as potential privatization opportunities. Houston Mayor Bill White has established a committee that is considering privatization of the Greater Houston Convention and Visitors Bureau. Cadillac, MI is accepting offers to manage the Wexford County civic center. And the Virginia Beach city council prepared in February to name two private groups as managers of the city’s Sportsplex, though the plan is taking longer than expected to complete and will generate less revenue than was initially projected.

In New York State, Oneida County officials are looking at proposals to privatize a public health clinic and a public nutrition program. Also, a push to privatize the Cuyahoga County Certified Home Health Agency has been met with public opposition. Nassau County Executive Thomas Suozzi has proposed privatizing three of the town’s sewage treatment plants and the emergency ambulance service. Meanwhile, Lewis County is reportedly considering cutting personnel costs by privatizing three municipal departments.

Privatization is on the agenda in several Massachusetts towns as well. Yarmouth Port has reached an agreement to privatize its town library. Wareham is taking steps toward privatization of some janitorial, IT and transportation services. The town of Milford is considering privatizing its cemetery maintenance. And the Saugus Department of Public Works is cutting back and contracting out more of the town’s large public works projects.

Officials in Fort Worth, TX are reportedly exploring the idea of outsourcing more municipal jobs.

In Eugene or a private firm has taken over operation of non-emergency ambulance service for the city.
A. Infrastructure Finance 2009

1. Introduction

The credit-markets crunch beginning in the second half of 2008 took its toll on infrastructure finance. In the United States, one large toll concession project was financed in the first half of the year (SH 130, segments 5 and 6 in Texas) and several others were expected to close by year-end. However, the only U.S. project that has reached financial close since then (through the first quarter of 2009) is the I-595 project in Florida—and that project’s financing is based on availability payments rather than toll revenues. (Availability payments are annual payments made by the government over the life of the concession term, based in part on the condition and “availability” of the lanes to handle traffic.) Thus, investors in that concession were taking on construction and completion risks but not traffic and revenue risks.

Toll roads in general experienced decreases in traffic in 2008 (and continuing into early 2009) and public-private partnership (PPP) toll roads were no exception. At first, the traffic declines reflected exceptionally high fuel prices (first-half of 2008), but after fuel prices returned to “normal” levels of around $2.00/gallon, the deepening recession took over as the main factor depressing vehicle miles of travel on all roads, including toll roads. These changes increased the risk inherent in toll road financing.

On a global basis, while some toll concession projects are still being financed, the credit crunch has led to much larger proportions of equity being required to make the deals work. For example, the late-2007 financing of the I-495 HOT lanes project in Virginia involved 26 percent equity and the first-half 2008 Texas SH 130 project involved 15 percent. But the bid by Abertis to lease the existing Pennsylvania Turnpike was estimated by September 2008 to be at 50 percent equity and Gloval Via Infrastructure’s $1 billion acquisition of several existing toll roads in Chile in late 2008 required 41 percent equity. By contrast, the early-2009 financial close on Florida’s availability-payment-based I-595 required only 16 percent equity. In Portugal, the $717 million Baixo Alentejo toll road project, funded by a mix of toll revenues and availability payments, was financed in early 2009 with 30 percent equity.
2. Infrastructure Investment Funds

After a record year in 2007 in which they raised $34.3 billion, infrastructure equity funds raised $24.7 billion in 2008, according to Probitas Research. Probitas also reports that there are more than 70 new funds in or coming to market as of early 2009, seeking over $92 billion. Together with the Probitas tally for 2004 through 2008 of $84.5 billion, that would mean a total of $176.5 billion (if all $92 billion is raised in 2009). That figure is close to the $180 billion estimated as available in 2009 by Kearsarge Global Advisers (sourced to Morgan Stanley). While many of the newer funds are focused on emerging markets, more than half aim at developed markets, Europe or North America. The 10 largest funds are listed in Table 6.

Who is putting money into these and other funds? A table in *Infrastructure Investor* lists the largest 50 institutional investors by name, type of institution, amount invested, fund manager, etc. Table 7 provides a summary of the results.

U.S. investors constitute 31.4 percent of the total invested by the top 50 institutions summarized in Table 7. Among them are Metrop-
projects number 77, valued at $84.6 billion. Projects funded as of October 2008 are 33, worth $14.3 billion.

The PWF database also includes figures on the world’s leading PPP transportation companies as of 2008, ranked by projects under construction or in operation as well as active proposals. For these data, shown in Table 8, the project types include airports, ports and rail infrastructure, in addition to highways. The 2008 edition of this database (October 2008) showed a number of changes from 2007, in part due to continued growth and in part due to the sale of interests in various projects from one company to another.

As can be seen from a quick perusal of Table 8, the large majority of project experience is European. Of the top 10 companies, eight are from Europe, one from Australia and one from China. Of the top 20 companies, seven are from Spain, four from France, three from China, two each from Germany and Australia and one each from Portugal and the United Kingdom. U.S. firms only show up in positions 22, 24 and 27—and none of them does concession projects on a stand-alone basis, since all three are basically construction companies, not toll road owner/operators.

4. Noteworthy National Reports

Two important national reports on surface transportation infrastructure were released early in 2009. One gave an overview of the status and prospects for toll roads and public-private partnerships for highway projects. The other was the final report of a national commission on surface transportation infrastructure finance.

The first is actually a set of reports and databases on toll financing developed by Ben Perez and Steve Lockwood of Parsons Brinckerhoff for the Federal Highway Administration. It includes a white paper, four databases, three summaries and various sortings of the data by different categories. The data concern the period from the enactment of ISTEA legislation in 1992 (which began reducing federal restrictions on tolling of federal-aid highways) to 2008. One of its most important findings is that during this period, of the average of 150 centerline miles added per year of expressway-standard highways, between 50 and 75 miles (i.e., one-third to one-half) were financed based on toll revenues. To be sure, toll

<table>
<thead>
<tr>
<th>Rank</th>
<th>Company</th>
<th>HQ Country</th>
<th># in Construction or Operation</th>
<th>#Active Proposals</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>ACS/Iridium</td>
<td>Spain</td>
<td>57</td>
<td>27</td>
</tr>
<tr>
<td>2</td>
<td>Macquarie group</td>
<td>Australia</td>
<td>44</td>
<td>18</td>
</tr>
<tr>
<td>3</td>
<td>Sacyr/Itinere</td>
<td>Spain</td>
<td>40</td>
<td>22</td>
</tr>
<tr>
<td>4</td>
<td>Ferrovial/Cintra</td>
<td>Spain</td>
<td>38</td>
<td>30</td>
</tr>
<tr>
<td>5</td>
<td>Global Via</td>
<td>Spain</td>
<td>33</td>
<td>17</td>
</tr>
<tr>
<td>6</td>
<td>Abertis</td>
<td>Spain</td>
<td>32</td>
<td>7</td>
</tr>
<tr>
<td>7</td>
<td>OHL</td>
<td>Spain</td>
<td>28</td>
<td>33</td>
</tr>
<tr>
<td>8</td>
<td>NWS Holdings</td>
<td>China</td>
<td>24</td>
<td>2</td>
</tr>
<tr>
<td>9</td>
<td>Hochtief</td>
<td>Germany</td>
<td>23</td>
<td>11</td>
</tr>
<tr>
<td>10</td>
<td>Vinci/Cofiroute</td>
<td>France</td>
<td>22</td>
<td>23</td>
</tr>
<tr>
<td>11</td>
<td>Road King</td>
<td>China</td>
<td>22</td>
<td>0</td>
</tr>
<tr>
<td>12</td>
<td>Acciona/Nesco</td>
<td>Spain</td>
<td>19</td>
<td>22</td>
</tr>
<tr>
<td>13</td>
<td>Bouygues</td>
<td>France</td>
<td>17</td>
<td>16</td>
</tr>
<tr>
<td>14</td>
<td>EGIS Projects</td>
<td>France</td>
<td>16</td>
<td>18</td>
</tr>
<tr>
<td>15</td>
<td>Alstom</td>
<td>France</td>
<td>15</td>
<td>11</td>
</tr>
<tr>
<td>16</td>
<td>Cheung Kong Infrastructure</td>
<td>China</td>
<td>15</td>
<td>9</td>
</tr>
<tr>
<td>17</td>
<td>Bilfinger Berger</td>
<td>Germany</td>
<td>13</td>
<td>9</td>
</tr>
<tr>
<td>18</td>
<td>BRISA</td>
<td>Portugal</td>
<td>9</td>
<td>7</td>
</tr>
<tr>
<td>19</td>
<td>John Laing</td>
<td>United Kingdom</td>
<td>9</td>
<td>4</td>
</tr>
<tr>
<td>20</td>
<td>Transurban</td>
<td>Australia</td>
<td>9</td>
<td>4</td>
</tr>
<tr>
<td>21</td>
<td>CCR Group</td>
<td>Brazil</td>
<td>8</td>
<td>9</td>
</tr>
<tr>
<td>22</td>
<td>KBR Brown &amp; Root</td>
<td>USA</td>
<td>8</td>
<td>1</td>
</tr>
<tr>
<td>23</td>
<td>Siemens</td>
<td>Germany</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>24</td>
<td>Fluor</td>
<td>USA</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>25</td>
<td>Strabag</td>
<td>Austria</td>
<td>6</td>
<td>11</td>
</tr>
<tr>
<td>26</td>
<td>Bombardier</td>
<td>Canada</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>27</td>
<td>Bechtel</td>
<td>USA</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>28</td>
<td>Balfour Beatty</td>
<td>United Kingdom</td>
<td>6</td>
<td>2</td>
</tr>
<tr>
<td>29</td>
<td>Alfred McAlpine</td>
<td>United Kingdom</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>30</td>
<td>Skanska</td>
<td>Sweden</td>
<td>5</td>
<td>9</td>
</tr>
</tbody>
</table>

Source: Public Works Finance 2008 Survey of Public-Private Partnerships
revenues are still a modest 5.4 percent of total highway revenues (with the vast majority coming from federal and state fuel taxes). But the trend is clearly upward and it is focused on the high-end portions of the system that are generally the most difficult for the public sector to amass funding for.

The survey identified new toll road activity in 33 states and territories during 1992-2008, involving 235 new-capacity projects. The projects break down as shown in Table 9.

<table>
<thead>
<tr>
<th>Stage</th>
<th>Value ($)</th>
<th>Lane-miles</th>
</tr>
</thead>
<tbody>
<tr>
<td>Completed</td>
<td>40.0</td>
<td>3,900</td>
</tr>
<tr>
<td>In construction</td>
<td>17.8</td>
<td>1,734</td>
</tr>
<tr>
<td>In design/finance</td>
<td>19.4</td>
<td>1,887</td>
</tr>
<tr>
<td>In enviro review</td>
<td>23.3</td>
<td>2,266</td>
</tr>
<tr>
<td>In planning</td>
<td>60.5</td>
<td>5,900</td>
</tr>
<tr>
<td>Total</td>
<td>161.0</td>
<td>15,687</td>
</tr>
</tbody>
</table>


The FHWA table that sorts the projects by “Private Sector Development & Financing,” shows 24 projects worth $36.3 billion as having “possible” private involvement and another 24 projects worth $21.4 billion defined as having private involvement. That’s 36 percent of the $161 billion total. That sounds pretty low, but a number of states have only passed enabling legislation in the last year or so. Most projects such states might do as PPP toll roads have not yet been defined as such. Plus, the current recession may shift a number of large projects from the public sector to the PPP side. Hence, the data in this FHWA database probably underestimate the likely magnitude of projected PPP toll road activity.

The other major report is Paying Our Way: A New Framework for Transportation Finance, the February 2009 final report of the National Surface Transportation Infrastructure Financing Commission (http://financecommission.dot.gov). This report is especially noteworthy for documenting the under-investment in surface transportation infrastructure at all levels of government and for recommending that we begin the transition from fuel taxes to a charge per vehicle mile traveled (VMT) as the principal funding source for highways. Because this is likely to be a long and difficult transition, the Commission also recommended near-term measures that would help move the country in that direction, while helping to reduce the funding gap.

It recommends that Congress remove restrictions on tolling urban Interstates to permit metropolitan planning organizations (MPOs) and state DOTs to make greater use of congestion pricing. And it proposes expansions of the two current pilot programs that permit toll financing of (a) new Interstates and (b) reconstruction of existing Interstates. And it also proposes very important expansion and liberalization of both the TIFIA and private activity bond (PAB) programs, which have been important tools to help put together the financing packages for PPP toll roads.

When it comes to possible federal regulation of PPP toll roads, the Commission’s report calls for the federal government to ensure that states adequately protect the public interest. Given that many PPP toll projects will involve the Interstate system (and some other federal-aid highways), some kind of federal oversight role (on interstate commerce grounds) is justified. But since all of these highways are actually owned and operated by the states, it’s appropriate that “primary oversight responsibility should reside with the states.” The federal government should ensure that states make PPP decisions based on a “value for money” analysis (as the Government Accountability Office recommended in 2008) and could provide useful technical assistance on best practices for PPP oversight. The report also calls for reinvesting any proceeds from toll concessions (whether leasing of existing toll roads (“brownfields”) or developing new toll roads (“greenfields”)) into highways and transit, as defined in Titles 23 and 49 of the federal code. Thus, states would continue to be free to lease existing toll roads via long-term concessions, but
the proceeds would have to be reinvested in surface transportation infrastructure (as occurred in Indiana with the Indiana Toll Road, but not with the Chicago Skyway).

## B. Long-Term Concessions: the Controversy Continues

### 1. Federal Officials

The PPP community awaited the appointment of a new Secretary of Transportation with some trepidation, wondering whether the new Obama administration would appoint someone who would continue or oppose the pro-toll/pro-pricing/pro-PPP policies of outgoing Secretary Mary Peters. Incoming Secretary Ray LaHood’s views on many transportation issues were little-known when he took office, but his early expression of interest in VMT charges (though quickly disavowed by the White House press office) sounded promising.

Soon thereafter, Secretary LaHood gave an interview to *The Wall Street Journal* stressing that since the administration was opposed to increasing fuel taxes during a recession, “We need to be open-minded and think outside the box. We need to take everybody’s ideas, whether it’s tolling a new road, tolling a new bridge or public-private partnerships.”

The stimulus bill enacted by Congress in February did contain positive news for PPP toll road financing. One provision exempts private activity bonds (PABs) from the alternative minimum tax, making such bonds fully tax-free. This provision will apply to new PABs issued in 2009 and 2010, as well as new PABs issued to re-fund bonds issued between 2004 and 2009.

A second provision permits the Secretary of Transportation to use up to $200 million of the $1.5 billion allocation for discretionary grants to support the TIFIA credit program. TIFIA has been a key component of several recent large PPP financings, but its funding was getting thin, so this new support for TIFIA will be important in financing deals in 2009 and 2010.

Some evolution of views on tolling and PPPs has come about on the part of two key congressional leaders. Rep. James Oberstar (D, MN) and Rep. Peter DeFazio (D, OR) in 2007 emerged as opponents of PPP toll roads, apparently in reaction to the leasing of the Chicago Skyway and the Indiana Toll Road. But as the highway funding shortfall has grown in seriousness and public awareness, their positions have begun to change.

In the summer of 2008, DeFazio made a trip to Europe, during which he visited several PPP toll projects in France and Spain and talked with transportation officials in both countries. He told an audience at the American Road & Transportation Builders Association’s September 2008 Public-Private Ventures conference that he can now support PPP toll projects to develop new highway capacity, as long as they are regulated to protect the public interest, as other public utilities are. In response to a question, he said that this could be done by states rather than the federal government. And in April 2009, Oberstar expressed support for moving toward a VMT charge or tax, as proposed by the Finance Commission.

In April 2009, several pieces of legislation were introduced that could affect PPP toll roads. A pair of bills supported by the American Trucking Associations are intended to stop the leasing of existing toll roads. S.884 (Sen. Jeff Bingaman, D-NM) would exclude from the count of a state’s highway miles those miles that are “privatized”; such counts are used to apportion federal highway funds. Because this language would apply to new toll roads as well as existing ones, it would undercut the financing of the many greenfield PPP toll roads that require a mix of toll and fuel-tax funding. The other bill, S. 885 (also by Sen. Bingaman) would prohibit the use of accelerated depreciation for toll projects leased to private firms. Besides making the lease of existing toll roads less attractive, it could also apply to the conversion of existing HOV lanes to HOT lanes, at a time when the
use of PPP toll concessions for larger-scale HOT lane and HOT network projects is a potentially important tool for states to use.

On a more positive note, Sens. Kay Bailey Hutchison and John Cornyn (both R-TX) have introduced S.903, which would devolve most of the federal highway program to the states, along with the taxing authority. Unless accompanied by anti-PPP restrictions, such devolution would provide greater flexibility for states to use PPP toll arrangements to upgrade and expand existing Interstates.

2. Texas PPP Toll Road Study Committee Report

After much controversy over whether public sector toll authorities or private firms under PPP concession agreements should build new toll roads in Texas, the legislature in 2007 enacted a two-year moratorium on new PPP toll projects and created the Legislative Study Committee on Private Participation in Toll Roads to study the issue and make recommendations by the end of 2008. Reason Foundation’s Robert Poole was one of three appointments by Gov. Rick Perry to this nine-member committee.

The December 2008 final report is online at www.senate.state.tx.us/75r/senate/commit/c820/SB792Report.pdf. It documents the state’s massive highway funding shortfall and shows that while conventional measures can help, they are unlikely to resolve the shortfall. The report also corrects what had become a very distorted picture of what toll concessions would mean for Texas.

For those afraid that nearly all new highways would be PPP toll roads, it explains that “a relatively small number of projects (located primarily in congested urban areas) are 100 percent toll-viable; toll roads and PPPs will not take over the state.” It also provides data showing that start-up (“greenfield”) toll roads are generally high-risk propositions, rather than being (like the controversial SH 121 in Dallas) large-scale pots of gold that can be used to fund billions of dollars worth of other projects.

The report focuses on how best to protect the public interest in those cases where a toll concession makes sense. Two very important recommendations concern the controversial issues of termination for convenience and up-front payments. On the former, the report suggests that a pre-defined buyout formula (favored by some on the committee) in effect tells the private sector that if the toll road does much better than forecast, the state will take the upside, but if it does much worse, the private sector has to take the losses. If the state’s aim is to avoid windfall profits, the report says that a better approach is revenue-sharing over the life of the agreement (which aligns the interests of both parties for the success of the project). On the question of up-front payments, the report recommends against them. Again, revenue-sharing is a wiser approach and a better fit for the majority of projects which will not pencil out as “pots of gold.”

The toughest issue the committee faced was “local primacy”—the idea that local toll agencies should always be preferred for developing new toll roads, with the private sector option available only if the agency is unable or unwilling to do the project. While that policy might not have huge negative consequences for the two metro areas with large and well-run toll agencies (Dallas and Houston), it could lead to many difficulties for the brand-new Regional Mobility Authorities in the smaller metro areas, attempting their first stand-alone, start-up toll projects, which are inherently high-risk.

Rather than trying to redefine local primacy to fit all circumstances, the report recommended a method to quantify the relative benefits of public-sector and private-sector approaches to doing specific toll projects: the Public Sector Comparator, as routinely used in Australia, Britain and Canada. In many cases, the entity doing these analyses is a specialized one such as Partnerships BC in British Columbia and Partnerships Victoria in Australia. So the report recommended the creation of a similar entity in Texas, staffed with legal and financial professionals hired from the private sector.
3. National Reports on Protecting the Public Interest

Four national organizations have produced long reports on how to protect the public interest in long-term toll concession deals. They are the Keston Infrastructure Institute at the University of Southern California, the National Cooperative Highway Research Program (NCHRP), the Pew Center on the States and the Public Interest Research Group (PIRG).

The broadest and most comprehensive is NCHRP Synthesis 391, "Public Sector Decision Making for Public-Private Partnerships." NCHRP is an ongoing research program of the Transportation Research Board (TRB), in cooperation with state DOTs. Its synthesis reports are generally well-done and this one is no exception. Written by Jeff Buxbaum and Iris Ortiz of Cambridge Systematics (authors of the previous, briefer, report covering the same ground for the Keston Institute), it provides a comprehensive primer on long-term concession PPPs. It describes how governments should make decisions about when and how to use this approach, provides extensive discussion of public-interest issues and how best to deal with them and offers a useful discussion of misperceptions about PPPs, including:

- That rigid non-compete provisions are always involved;
- That PPP deals always mean tolling and the likelihood of windfall profits; and
- That the public sector loses control of the facility.

Unfortunately for such an important report, it is marred by some errors of fact and interpretation, several of which TRB has promised to correct (see discussion in Reason Foundation’s April 2009 Surface Transportation Innovations newsletter, available at reason.org).

The Pew report is “Driven by Dollars: What States Should Know When Considering Public-Private Partnerships to Fund Transportation.” It was stimulated by the 2008 controversy over the proposed lease of the Pennsylvania Turnpike. It’s an even-handed look at what Pennsylvania did right and wrong in pursuing this transaction. Though focusing mostly on the lease of existing toll roads (a small fraction of the likely highway PPP transactions over the next several decade), its guidelines and lessons learned are pretty much on-target. (Alas, this report also contains a few factual errors, such as the claim that most U.S. concession terms are 75 to 99 years, which is falsified by 35-year terms in California and 50-year terms in Texas.)

The PIRG report, “Private Roads, Public Costs: The Facts About Toll Road Privatization and How to Protect the Public,” is a sweeping attack on PPP toll road concessions, similar to the group’s previous report in 2008. It tries to portray this ongoing trend as primarily about the long-term lease of existing toll roads, even though only four such leases have taken place in the United States, while numerous greenfield projects to create new capacity have been financed or are in various stages of procurement. It also implies that most PPP toll road deals are 75 to 99 years and involve large up-front payments, neither of which is the case. And it also states as a good-government principle that “any private deal must demonstrate that it saves money compared to what public authorities could generate by borrowing against the same toll hikes.” This comparative-cost-of-capital argument (also used by PPP critic Dennis Enright) is off-base in several ways. First, it ignores the availability of tax-exempt private activity bonds, which brings the cost of debt capital for PPP deals very close to what prevails on tax-exempt public-sector debt. More important, it ignores the value of the large risk transfers likely to be involved in PPP toll roads (which is a big factor in the Public Sector Comparator model), as well as potential savings in life-cycle cost via the PPP approach.
C. New PPP Toll Roads

1. Enabling Legislation Activity

Alabama: Legislation to permit transportation PPPs was enacted in the first half of 2009. Interest was spurred by three potential projects: elevated express lanes on U.S. 280 in Shelby County, a West Alabama toll road from Mobile to Florence and another toll road from Montgomery to I-10 in Florida and the new airport in Panama City, FL.

Arizona: After several previous years in which efforts to enact a state-of-the-art transportation PPP measure failed to pass, the prospects have brightened in 2009. House Bill 2396 passed both houses of the legislature and was sent to the governor in July 2009. It is based on the model state PPP bill drafted by the Nossaman law firm, with additional provisions dealing with eminent domain and offering a fuel-tax rebate for miles driven on toll roads. Arizona DOT Chief Financial Officer John McGee in April told a Senate committee that the bill could save tens of millions of dollars per year in maintenance costs, via PPP toll roads that cover their maintenance costs out of toll revenues. In addition to HB 2396, the legislature passed Senate Bill 1320, a transportation omnibus bill that includes provisions granting Arizona cities and towns the power to build, operate and finance the construction of toll roads; local governments in Arizona previously did not have express statutory authority to do so.

California: After a number of failed attempts in recent years, Gov. Arnold Schwarzenegger finally succeeded in getting a workable PPP toll roads bill enacted into law. The new SB 4, signed into law on Feb. 20, 2009, permits an unlimited number of projects, allows for solicited as well as unsolicited proposals and applies to all levels of government in the state. Most critically, negotiated concession agreements do not require legislative approval (as in a previous measure that led to no projects); only review by a new Public Infrastructure Advisory Commission (detailed in the State Update section of this report) is required. The state’s Little Hoover Commission is preparing a report on the potential of PPP toll projects in California.

Colorado: Although this state already has PPP-enabling legislation, it has not made use of it thus far. In early 2009, the legislature passed and Gov. Bill Ritter signed SB 108, which replaces the Colorado Tolling Enterprise with the High Performance Transportation Enterprise (HPTE), as well as providing incentives for local agencies to embrace tolling and PPPs. Like its predecessor, HPTE will operate within the Colorado DOT and will be the entity with the power to authorize tolls and enter into PPP agreements. HPTE will have a seven-member board, with four appointed by the governor (to represent the Denver area, Pike’s Peak, north Front Range and I-70 Rocky Mountain Corridor) and three more selected by the first four.

Florida: This state has a workable transportation PPP law under which several greenfield projects are moving forward. It was amended in 2007 to authorize the long-term lease of several state-owned toll roads (excluding the Florida Turnpike). Florida DOT’s first planned lease, of the Alligator Alley (I-75) toll road across the Everglades, sparked two bills by state Sen. Dave Aronberg in opposition. The first, introduced in 2008, would have imposed a two-year moratorium on such leases. The second, filed in April 2009, would have required the legislature to approve any such lease agreement. Current law calls for approval only by FDOT and the 14-member Legislative Budget Commission. Neither was enacted during the legislative session.

Nevada: The Nevada DOT had hoped to launch its first PPP toll project in 2009, but doing so required enabling legislation. Under its Pioneer Program, the DOT had hoped to create a $1 billion PPP project that involved converting HOV lanes on I-15 and US 95 to HOT lanes, two in each direction, on one of the Las Vegas area’s most congested corridors. Opposition to charging tolls on HOV lanes that have been “already paid for” appears to have doomed the bill, AB 524, which the Assembly transportation committee
chair refused to introduce in April 2009.

New York: The stage appears to be set for the introduction of enabling legislation. The nonprofit Citizens Budget Commission released a report in December 2008 on “How Public-Private Partnerships Can Help New York Address Its Infrastructure Needs.” And a second report was delivered to Gov. David Paterson in April 2009 from the New York State Commission on Asset Maximization (discussed in depth in the State Government section of this report), reviewing the issues involved and identifying potential candidate projects. Based on that report, the governor is expected to propose enabling legislation.

Pennsylvania: Despite the 2008 rejection of Gov. Rendell’s proposed lease of the Pennsylvania Turnpike, interest remains high in PPP legislation to enable greenfield toll projects. In 2008 such legislation passed the state Senate by a vote of 49-0, but was not acted upon by the House before the session ended. The Pennsylvania Turnpike Commission late in 2008 requested expressions of interest from the private sector in developing the proposed Southern Beltway and a missing section of the Mon Fayette Expressway near Pittsburgh and received responses from three experienced teams. In the first half of 2009, new PPP-enabling legislation was introduced that, if enacted, would permit both solicited and unsolicited proposals for new toll projects. It passed the Senate in June 2009 and a slightly different bill is to be considered during the summer in the House.

Puerto Rico: The new government of Luis Fortuno “is pushing hard for PPPs as part of its reconstruction plan to jump-start the ailing economy,” according to Caribbean Business (March 19, 2009). It is seeking passage of broad enabling legislation that would apply not only to transportation but to other types of infrastructure (including ports, energy, water and the lottery). The previous administration of Gov. Acevedo Vila laid a lot of the groundwork, in terms of expert consulting advice and studies. In June 2009, the legislature passed and the governor signed a broad PPP-enabling act that would make the state’s economic development bank the lead agency for such projects.

Texas: Despite the pro-PPP findings and recommendations of the Legislative Study Committee on Private Participation in Toll Projects, the state Senate in March 2009 passed several bills that would have curtailed PPP toll projects had they become law. SB 17 by Sen. Robert Nichols would legislate “primacy” for local toll authorities, relegating PPP toll projects to the last available option. And more damaging still, this measure would allow the state to terminate a PPP agreement for convenience, paying a prescribed price (which would leave the private partner to absorb losses and also block the concessionaire from any higher-than-expected profits). The session adjourned without passing any transportation bill, leaving Texas DOT without authorization to continue past 2010 (based on the state’s Sunset Law). Gov. Perry called a special session which reauthorized TxDOT and several other agencies but failed to take any action on PPP toll projects. Hence, no new projects of this kind may be authorized, unless and until the next legislative session (in 2011) enacts new enabling legislation.

2. Notable PPP Projects

Virginia remains a hotbed of PPP toll road activity. The $1.9 billion Fluor/Transurban project that is adding two new HOT lanes in each direction to the Beltway (I-495) will enter its second year of construction in August 2009. The same team is negotiating a concession agreement for a complementary project, under which it would add a third lane to the existing HOV lanes on I-95/395 (the Shirley Highway) and extend those lanes to Fredericksburg and Mas- saponax, a total distance of 93 miles.

A new PPP toll project emerged late in 2008, when the city of Chesapeake, VA accepted an unsolicited proposal from Figg Bridge and Britton Hill Partners to replace the obsolete Jordan Bridge. In exchange for a perpetual franchise, the team will replace the old two-lane drawbridge with a $100 million high-level span and has agreed to add a second span when traffic...
levels warrant it. The team is funding the project entirely with equity, avoiding the troubled debt markets for the time being. Toll collection will be non-cash, with a combination of E-ZPass transponders and video billing.

The other large PPP project now moving forward is a $2 billion effort to relieve congestion in the Hampton Roads/Norfolk area. Elizabeth River Crossings LLC (Skanska, Macquarie and Kiewit), in response to a VDOT request for conceptual proposals, has proposed adding a second tube to the existing Midtown Tunnel, refurbishing the existing Downtown Tunnel and extending the Martin Luther King Freeway. Open-road (cashless) tolling on all three crossings would be the source of revenue. If a panel of experts approves the concept, VDOT will seek detailed proposals in 2009 for a 50-year concession.

Florida has the distinction of having the only U.S. PPP concession project financed during the first half of 2009. The 10.5-mile long I-595 project in Broward County (greater Ft. Lauderdale area) will completely rebuild and modernize this congested freeway, including the addition of three reversible express toll lanes in the median. A team led by ACS and advised by Macquarie submitted the winning proposal in 2008 and the project achieved financial closing in early March 2009. The total $1.656 billion financing comprises $780 million of 10-year bank debt, a $603 million 35-year TIFIA loan and $273 million in equity from ACS. The express toll lanes will charge variable-rate tolls to manage traffic flow, but the revenues will go to FDOT. In turn, FDOT will pay the ACS team via availability payments. This approach has the state taking the traffic and revenue risk, with the private partner taking construction, completion and operating and maintenance risk over the 35-year term of the concession.

Florida’s other availability payment project, the Port of Miami Tunnel, has encountered difficulties. In December 2008, FDOT Secretary Stephanie Kopelousos pulled the plug on the $1.1 billion project, which had been unable to achieve financial closing due to the near-collapse of project team member Babcock & Brown. This was despite project team leader Bouygues Publics Travaux’s plan to replace that firm with Meridiam Infrastructure. Several months of fierce lobbying by local elected officials succeeded by mid-April 2009 in defeating FDOT’s plan to re-compete the project. Instead, FDOT will continue with the Bouygues-led team, provided it can achieve financial closing by Oct. 1, 2009. The 35-year concession will be funded entirely by availability payments, with the state, county and city shares being 59 percent, 36.5 percent and 4.5 percent, respectively.

A third Florida project—the Outer Beltway for Jacksonville—had been on hold for about a year due to uncertainty over the tax treatment of concessions. But in May 2009 the legislature passed a bill exempting concession projects from property taxes. That has cleared the way for restarting the concession procurement, which Florida DOT began in June by withdrawing the prequalifications from March 2005 and starting over. The project is estimated to cost $1.8 billion.

Mississippi is the newest state with a PPP toll road project under way: the $500 million Jackson Airport Parkway. In 2008 Mississippi DOT prequalified three teams and, in August, invited them to submit proposals. The three teams are led by ACS, Cintra and Global Via. The 12-mile tollway will link downtown Jackson with its airport to the southeast and with its northeastern suburbs; it includes a long bridge over the Pearl River. Proposals were due June 15, 2009 and Mississippi DOT hopes to execute a 50-year concession by Sept. 30th.

North Carolina’s Turnpike Authority in April 2009 signed a project development agreement for its first toll concession project: the Mid-McCurrituck Bridge. Under the agreement, the winning team (ACS/Dragados/Iridium/Lochner) will finish the route selection, do environmental and design studies and a traffic and revenue study, make cost estimates and assess the project’s financing—as well as having the right of first refusal to become the toll concession firm if the project proceeds on that basis.

Texas continues to move forward with PPP
toll projects that were exempted from the two-year moratorium imposed by the legislature in 2007. Three major project awards were announced in the opening months of 2009. In January, the $2.1 billion North Tarrant Express project (Phase 1) was awarded to a team of Cintra, Meridiam Infrastructure and the Dallas Police & Fire Pension System. The project will add four managed toll lanes (with HOV discounts) to about 13 miles of congested freeways (SR 121 and I-820) in Ft. Worth. The 52-year concession was awarded conditional on financial closing being achieved by late 2009. The financial plan estimates the financing to be $600 million in bank debt and/or private activity bonds, a $600 million TIFIA loan and $370 million in equity (which puts equity at 23.6%). The balance of the funding, some $600 million, will come from TxDOT. The terms of the competition were that the bidders would propose how much of the overall 36-mile, $5 billion North Tarrant Express each could deliver with $600 million from TxDOT as a down payment. The second-place bidder would have delivered a Phase 1 consisting of 64 lane-miles, versus the winning Cintra team’s 169 lane-miles.

The second project was the $2.7 billion LBJ Freeway (I-635) managed lanes project. Here, again, a Cintra/Meridiam team came in first. TxDOT offered up to $700 million in state funds toward the project, but the winning proposal asked for just $445 million of that amount. Second-place bidder ACS proposed a more costly project totaling $3.9 billion. The project will add managed lanes within the right of way on I-635, partly in tunnels, as well as elevated managed lanes along I-35E. Financial close is expected sometime in 2010. As of early 2009, the financing was projected to be an $800 million TIFIA loan, $800 million in bank debt and/or private activity bonds and $598 million in equity (27 percent equity). Adding the state’s $445 million puts the total close to $2.7 billion.

The third project, announced in March, was the DFW Connector, a $900 million design-build project to double the capacity along 14.4 miles of SH 114/SH 121 near the DFW Airport. The winning bidder was a team of Kiewit and Zachry Construction. Because tolled express lanes are a smaller part of the total project, it could not be financed based on toll revenues. But because design-build is considered one variant of the broader category of Comprehensive Development Agreement (CDA) with the private sector (with toll concession projects being the other major category), this project is the last CDA project to have been exempted from the 2007 moratorium on CDAs.

3. Notable Proposals

A number of large-scale PPP toll projects are in the planning process around the country, some in states that already have enabling legislation and others in states where such legislation is at least being considered.

In Alaska, the Knik Arm Bridge in Anchorage (not the “bridge to nowhere”) is being pursued as a PPP toll concession, by the special-purpose Knik Arm Bridge and Toll Authority. A traffic and revenue study by Wilbur Smith Associates has been completed and two teams to develop and operate the project have been pre-qualified. However, the bridge has become an issue in the 2009 Anchorage mayoral race, with one candidate in favor and the other opposed. Those political factors led to a 3-2 vote by the local metropolitan planning organization, AMATS, to remove the project from the region’s long-range plan, in April 2009. A final vote on the action was to be held in June.

In anticipation of passage in 2009 of state-of-the-art PPP-enabling legislation in Arizona, a number of potential projects are being considered, reports Tollroadsnews.com. One of these is an I-10 bypass, allowing through traffic on I-10 to avoid having to drive through the congested downtown Phoenix portion of I-10. Another would be an I-10 Tucson bypass, with several alternate routes being studied. Several additional toll road possibilities in the Phoenix area include completion of the South Mountain Loop 202, creation of an outer Loop 303 and an I-10...
reliever parallel to the Interstate to the south. Yet another possibility is a toll road between Phoenix and Las Vegas, 300 miles to the north. There is no Interstate highway between these two large metro areas, only US 93 and US 60.

Now that California has workable PPP-enabling legislation, there are a number of urban project possibilities. Several of these are deep-bore tunnels which have been proposed and preliminarily studied to complete missing links in the greater Los Angeles freeway system. The most likely near-term project is a tunnel beneath South Pasadena to close the gap in I-710, connecting this key north-south route to east-west I-210. That project has been held up for about 40 years due to community objections to the negative impacts of a freeway splitting the town in two. Caltrans is now pursuing the tunnel as the only feasible way to complete the project. More costly and higher-risk would be two much longer tunnels. One would link Glendale with Palmdale and its potential commercial airport, by extending the Glendale Freeway (SR 2) northwards mostly as a tunnel under the mountains of Angeles National Forest. The second would be an east-west tunnel linking I-15 in Riverside County with the toll roads of coastal Orange County. This new link would relieve congestion on the only high-volume corridor between the two counties, SR 91.

Other California PPP projects could include networks of HOT lanes in the Los Angeles, San Diego and San Francisco metro areas. A likely near-term project is the planned High Desert Corridor, an east-west route linking Victorville and Palmdale, providing a short route between I-15 and SR 14. An RFP for a large-scale feasibility study is due out by the middle of 2009.

In Michigan, a new crossing of the Detroit River between Detroit and Windsor, Ontario, has long been needed, since the existing Ambassador Bridge and Detroit-Windsor Tunnel are often highly congested, especially with truck traffic. Two projects are vying to provide that capacity. The privately owned Ambassador Bridge has proposed building a second span adjacent to the existing 1929 four-lane suspension span; it would be a $500 million, six-lane, cable-stayed bridge, to replace the old bridge. Simultaneously, a four-government planning process (Michigan, FHWA, Transport Canada and Ontario) early in 2009 received environmental approvals for a new $800 million, six-lane, cable-stayed bridge about two miles south of the Ambassador Bridge and offering more direct connections to Highway 401 in Canada and I-75 in the United States. Total cost of that project, including connecting highways and customs yards, is estimated at $4.2 billion. Both Michigan DOT and Transport Canada favor doing the project as a tolled concession and MDOT is planning to propose PPP-enabling legislation in 2009.

New PPP toll bridges are also in prospect in New York, although that state lacks enabling legislation thus far. Replacing the obsolescent Tappan Zee Bridge is the project that may lead to PPP-enabling legislation. After about six years of study, the state seems to have settled on a $6.4 billion bridge concept, with various mass transit alternatives still to be determined. In August 2008 the NYDOT hired Merrill Lynch to assist with planning the financing alternatives. But PPP toll bridges may come to Staten Island sooner. The Port Authority of New York & New Jersey needs to replace the ancient Bayonne, Goethals and Outerbridge crossings between New Jersey and Staten Island, a potential $2 billion endeavor. The agency is not bound by the procurement laws of either state, so it can use a toll concession approach if it decides that approach makes sense. To help it decide, in April 2009 it selected a team led by Halcrow (and including Jeffrey Parker & Associates and Allen & Overy) under a $460,000 contract.

In Washington State, two tolled megaprojects are in the planning stages, one or both of which could be developed under PPP concessions, which are allowed under the state’s enabling legislation. Replacing the SR 520 floating bridge (which is not tolled) with a modern, electronically tolled bridge has been in prospect ever since WSDOT was selected as one of five Urban Partnership Agreement winners by the U.S. DOT in 2007.
Their proposal called for variable tolling for this project, as both a congestion-relief measure and a funding source. In April 2009, the legislature approved a bill to permit variable tolls to be levied for the project, beginning on the existing bridge. The second mega-project will be a deep-bore tunnel to replace the seismically unsafe Alaskan Way Viaduct. That bill provides for partial toll funding, with large sums to come from the city of Seattle and the state. Of the estimated $4.3 billion cost, an estimated $600 million has not yet been linked with a funding source. The tunnel would be the world’s widest, with a diameter of 54 feet. The plan calls for four lanes plus wide shoulders, with the lanes on two decks.

Finally, several possible toll truckway projects are in various stages of feasibility study. The most studied one would link the Ports of Long Beach and Los Angeles with the Inland Empire warehouses and distribution centers in Riverside County, traversing the I-710 and SR 60 rights of way. Recent studies by the Southern California Association of Governments have estimated the value provided by uncongested truck trips, as well as possible use of double-trailer rigs, to be high enough to permit the project to be self-funding via tolls. Two long-haul truck tollway studies are also under way. One is being carried out under the FHWA’s Corridors of the Future program, focused on I-70 from Kansas City on the west to Columbus on the east, a major truck corridor. The study is reviewing the possible widening of this route by means of truck-only lanes, which could possibly be financed by toll revenues and could possibly be designed and operated to handle longer combination vehicles (LCVs), meaning turnpike doubles and triples. And the Wyoming DOT is doing a tolling study for I-80 across that state, which might be extended to adjacent states. The phase 1 study was released in October 2008, estimating costs and revenues for three alternatives: tolling all existing lanes, adding one lane each way and tolling all lanes and adding two lanes each way as truck-only lanes, with all lanes tolled. A second phase will begin during the first half of 2009.

D. Leasing Existing Toll Roads

1. Pennsylvania Turnpike

Spanish toll road company Abertis—the winning bidder for a 75-year lease of the Pennsylvania Turnpike—withdraws its bid on Sept. 30, 2008, after having extended the time period twice. The legislature had failed to enact the necessary enabling legislation over the summer and with the credit markets deteriorating and some analysts estimating that the $12.8 billion offer was too high, the company decided to throw in the towel. The legislature failed to act despite the FHWA rejecting the state’s application to put tolls on I-80, which parallels the Turnpike further north. The federal agency ruled, as most analysts expected, that using the toll revenues from I-80 for all manner of transit and highway projects statewide was not consistent with the conditions of the federal pilot program that permits up to three Interstates to be rebuilt using toll finance. Tolling I-80, as well as increasing Turnpike tolls, was the legislature’s alternate way of meeting the state’s transportation funding shortfall (called Act 44). Without the revenue stream from I-80 tolls, the legislature must come up with a replacement source of funding by July 1, 2010. In the interim, to meet its near-term obligations under Act 44, the Pennsylvania Turnpike Commission increased toll rates by 25 percent as of Jan. 4, 2009.

2. Alligator Alley

The Florida DOT’s plan to lease the Alligator Alley toll road portion of I-75 (connecting the Ft. Lauderdale area on the east with the Naples area on the west) created considerable controversy during 2008, with one state senator introducing legislation that would put a two-year moratorium on such leases, despite the legislature having given FDOT the authority to pursue such leases in 2007. The deadline for submitting bids has been changed several times, to give the short-listed teams more time to work out their financing proposals. The final deadline was May
18, 2009. On that date, the state received no bids from the prequalified teams, apparently due to a combination of credit market conditions and concern over widespread public and political opposition to the lease.

3. Southern Connector

This 16-mile startup toll road near Greenville, South Carolina, one of a handful developed using a nonprofit entity created under IRS 63-20, has been struggling to meet its debt-service obligations due to traffic and revenue far below original projections. After initially announcing plans in 2007 to lease the Connector under a long-term concession arrangement, the Connector 2000 Association decided to first do an investment-grade traffic and revenue study in 2008. As of April 2009, the Association told Tollroadsnews.com that the study should be out “shortly” and will help them to assess their options.

E. HOT/Managed Lanes Under Way

A number of the PPP toll projects discussed previously involve managed lanes, including I-595 in Florida, I-495 and the subsequent I-95/395 project in Virginia and the LBJ (I-635) and North Tarrant Express projects in Texas. There are a number of other managed lanes projects in various stages of planning and implementation in large metro areas, some of which have PPP potential. Here is a brief recap.

California is the site of considerable managed lanes activity. In August 2008 the Metropolitan Transportation Commission for the entire San Francisco Bay Area approved a $4.8 billion plan to convert existing HOV lanes to HOT lanes and build new lanes to close many gaps, making a relatively seamless network. The bill to permit this plan to move forward, AB 744, was approved 12-1 by the Assembly Transportation Committee in April 2009. The 800-mile network will consist mostly of a single lane in each direction, like the current HOV system. It will involve converting 500 miles of existing HOV lanes and building another 300 miles of new HOT lanes, plus direct connector flyover ramps at six major interchanges. Under most scenarios in the feasibility study, the network would be self-supporting from toll revenues. San Diego is under way on a more modest network, beginning with widening and lengthening the reversible I-15 HOT lanes and going on in future years to add HOT lanes to several other major freeways, including I-5 and I-805. Los Angeles won a federal grant in 2008 to convert HOV lanes on two freeways, I-10 and I-110, to HOT lanes and it has a feasibility study under way on a network of HOT lanes. Riverside County received legislative permission in 2008 to extend the HOT lanes on SR 91 from the Orange County line eastward to I-15.

In Florida, the I-95 Express Lanes project opened its first phase in December 2008, providing two variably priced managed lanes from near downtown Miami northward to the Golden Glades interchange in northern Miami-Dade County. The southbound portion is under construction and slated for a late 2009 opening. A subsequent phase will extend the Express Lanes to Broward Blvd. in Ft. Lauderdale and at that point there will be nonstop express bus service between Miami and Ft. Lauderdale. This project, an Urban Partnership Agreement winner, permits registered carpools of three or more to use the Express Lanes at no charge; all others pay a variable toll via the SunPass transponder that is standard statewide in Florida. Florida DOT has feasibility studies under way on adding managed lanes to I-75 in Broward County and portions of SR 826 (the Palmetto Expressway) in Miami-Dade County. Reversible managed lanes are also being implemented on I-595 in Broward County. FDOT’s winning Urban Partnership proposal suggested that these and possibly other variable pricing projects could become a network of managed lanes.

Georgia won a competitive FHWA grant in 2008 to convert the existing HOV lanes on I-85 to managed lanes, as the potential first step in developing a managed lanes network spanning most of the metro area’s freeway system (replacing the previous plan of building a large network of HOV lanes). The initial project will extend 14
miles on I-85 outside the I-285 Perimeter.

In Texas, both Dallas and Houston have outlined networks of managed lanes based on feasibility studies done several years ago. The Dallas/Ft. Worth metro area has adopted a region-wide managed lanes policy, which will be adhered to by all such projects, whether developed by the local toll agency (NTTA), TxDOT or companies operating under toll concession agreements. The map on the region’s long-range transportation plan, Mobility 2030, shows an extensive set of toll roads and managed lanes on freeways. In March 2009, Houston Metro announced plans to convert 83 miles of HOV lanes on five freeways into HOT lanes, using federal stimulus funds. This will complement the four new managed lanes on the Katy Freeway (I-10), which began charging tolls in early 2009. A HOT network study for the Houston metro area was completed in 2008, funded largely by the FHWA's Value Pricing Program.

The Washington, DC metro area is another one that has done fairly extensive studies of a HOT or managed lanes network, with a comprehensive feasibility study completed in 2008. This region has a number of elements already in place or under way that could be incorporated into such a network, including the under-construction HOT lanes on the I-495 Beltway in Virginia, the existing Dulles Greenway toll road, the planned HOT lanes on I-95/395, the variably priced InterCounty Connector toll road under construction in Maryland and the express toll lanes under construction on I-95 in the Baltimore area. The Metropolitan Washington Council of Governments is developing a staging plan for the HOT/Priority Bus network.

F. Overseas Concession Projects

1. Overview

The long-term concession model, under which the private sector designs, finances, builds, operates and maintains a roadway, bridge or tunnel for an extended (30 to 99-year) period and then hands it back to the government in good condition, has a long history outside the United States. It originated in post-World War II Europe as the principal means for France, Italy, Portugal and Spain to develop modern super-highway networks—the equivalent of the U.S. Interstate highway system. In Europe some of the toll road companies (e.g., Cofiroute in France) were investor-owned from the outset, whereas others were either state-owned or a mixture of state and investor ownership. During the past decade, the governments of France, Italy and Spain sold off their remaining ownership stakes in toll road companies, putting such major firms as Italy’s Autostrade; France’s ASF, APRR and SANEF; Spain’s ENA; and Portugal’s BRISA fully into the marketplace. In those instances where a previously state-owned toll company had held, de-facto, permanent ownership of its toll roads, upon privatization of the company the government defined a concession term of a fixed number of years. Hence, while the companies are traded on stock exchanges, their value is based on the income from the various concession agreements they have, not on actual ownership of the roadways they operate.

During the 1990s in particular and continuing into the new century, the toll concession model spread to Australia and to East and South Asia (especially Hong Kong and then China and India), Latin America and much of Central and Eastern Europe. The emphasis in the Asia-Pacific and Eastern/Central European countries has been on the development of greenfield toll roads, both urban and inter-city. In Latin America, the primary focus has been on upgrading existing two-lane inter-city highways into modern, four-lane divided toll roads.

2. Canada

The largest PPP toll road in Canada is Highway 407 in Toronto, which celebrates its 10th year of privatized operation during 2009. Called 407 ETR (Electronic Toll Route) in recognition
of its complete absence of toll booths, the core segment was built as a public-sector toll road in the 1990s but was leased for 99 years in 1999, for C$3.1 billion (which retired the Ontario government’s C$1.6 billion in toll revenue bonds). Since taking over, the 407 ETR Concession Company (a joint venture of Cintra, Macquarie and SNC-Lavalin) has invested an additional C$1.18 billion on eastward and westward extensions, interchanges and lane additions. The 407 ETR was the world’s first non-cash toll road. It’s been highly successful, attracting some 375,000 drivers each weekday.

Most of Canada’s other PPP highway projects are concessions based on availability payments. That is true of the Sea-to-Sky Highway, South Fraser Perimeter Road and Golden Ears Bridge projects in British Columbia; four such highways in the Calgary and Edmonton metro areas of Alberta; the Disraeli Bridge in Winnipeg; and the Route 1 widening project in New Brunswick. One large project that was intended to be a toll-financed concession—the Port Mann Bridge in Vancouver, BC—fell victim to the credit crunch in February 2009. The toll bridge will now be financed by the BC government and procured as a design-build project. Quebec, too, is making use of availability payment concessions. In 2007 it selected a Macquarie-led team for a 35-year concession to develop and operate the C$400 million A25 highway and toll bridge project in Montreal, financed via a combination of tolls and availability payments. And in September 2008, Quebec awarded the C$1.2 billion A30 project to an ACS/Acciona joint venture, based on availability payments.

Overall, in 2008, some 32 PPP projects (not just in highways) worth C$8.7 billion reached financial close in Canada, according to Public Works Financing.

3. Asia/Pacific

Australia and New Zealand: Australia was a pioneer of toll road concessions in this region, dating back to the Sydney Harbor Tunnel in the 1990s. With the completion of the Lane Cove Tunnel in 2008, Sydney now has an “orbital” (ring road) consisting of six toll-concession highways and tunnels, as well as the separate M4 and Cross City Tunnel concessions. A report produced by Ernst & Young, commissioned by Transurban (which holds the majority of these concessions) estimates that these toll roads boosted the metro area’s economy by A$1.8 billion in 2008 and an estimated A$3.4 billion in 2020.

However, all three tunnel projects have encountered financial difficulties. The original Harbor Tunnel concession agreement included a provision by which the New South Wales government agreed to supplement toll revenues, if needed to meet the company’s debt-service obligations. (That provision was included since the tunnel competes with the Harbor Bridge, whose tolls are based on decades-earlier construction costs.) The Sydney Morning Herald reported in December 2008 that due to reduced traffic, the Harbor Tunnel payments were running about $1 million per week and could total $1.1 billion between then and 2022, the end of the concession period, unless traffic recovered. The Cross City Tunnel is in receivership, due to traffic running far below projections, while the Lane Cove Tunnel’s first-year traffic is about 30 percent below projections.

In Victoria, the 24-mile A$2.5 billion EastLink Motorway in the Melbourne suburbs opened five months ahead of schedule in July 2008, but with fuel prices then at record levels, initial traffic was 28 percent below opening week forecasts. The ConnectEast consortium consists of Macquarie Bank, Thiess and John Holland. The next project in Victoria, the A$750 million Peninsula Link, will be financed via availability payments, the first use of this method in Australia.

Much recent concession activity centers on Queensland, where several major projects are under way in Brisbane. The third of three major projects—the A$4.9 billion Airport Link toll tunnel—began construction in late 2008, despite financial difficulties. Two huge tunnel-
boring machines from Germany will begin work in 2010. The other projects—the A$2 billion North-South Tunnel and the A$1.9 billion Gateway Bridge—are well along in construction.

New Zealand’s first modern toll road opened in January 2009, the NZ$215 million Northern Gateway Toll Road, NZ1. Just 4.7 miles long with two lanes each direction, the toll road extends the non-tolled Orewa-Punhoi expressway to Auckland’s northern suburbs. It uses open-road video tolling, with off-line cash options.

**China:** By the time of the handover of Hong Kong to China in 1997, the former British colony had already pioneered toll concessions for several harbor crossings. China since then has taken up the idea in a major way, with 53,600 km. of tolled expressways in operation by the end of 2007, mostly developed under long-term concessions. The goal is to complete a toll road network of 70,000 km. (43,470 mi.) by 2020. Most of the investment has come from domestic sources, but China has gradually opened up to outside investment in toll projects. In August 2008, as reported by Tollroadsnews.com, China Infrastructure Investment Corp. secured a listing on the NASDAQ exchange. The company’s principal toll road is the 66-mile Pinglin Expressway in Henan. Most other publicly traded Chinese toll road companies are listed on the Hong Kong stock exchange.

Some of the Chinese toll concession projects are impressive engineering feats. One is the world’s longest ocean crossing: the $2 billion, 36 km. long, six-lane Hangzhou Bay Bridge, which opened to limited traffic in July 2008. The bridge reduces the road distance from Ningbo to Shanghai from 400 km. to just 80 km. Large roadway tunnels are also part of the program, including twin 50’ 6” tunnels under the Yangtze River in Shanghai, as part of a $1.6 billion tunnel and bridge project. An estimated 40 to 50 large-scale tunnel-boring machines are estimated to be at work on such projects in China, with diameters ranging from 37 to 50 feet.

**India:** This country’s ambitious highway concession program was announced in early 2008. It was intended to include 175 toll concession projects encompassing 11,000 miles and investment of $27 billion. The government also opted for revenue sharing, rather than up-front concession payments. A number of concessions were awarded during 2008, but by November, the credit market crunch appeared to have slowed things down. The Wall Street Journal (Nov. 12, 2008) quoted the head of the National Highway Builders Federation as estimating that $6 billion worth of highway projects could be delayed as much as two years, due to reduced availability of both public-sector and private funding. And in the first quarter of 2009, the National Highways Authority of India said it had received bids on only 22 of 60 offered toll concession projects. Some link the difficulty to the Authority’s “model concession agreement,” developed prior to the credit crunch. It now plans to redraft the RFPs for the 38 projects that received no bids and offer them again by mid-2009.

**4. Latin America**

**Brazil:** South America’s largest country continues to have the largest toll concession program. The global fiscal crunch has led to the delay or cancellation of $4.5 billion worth of infrastructure projects of all types since September 2008, according to the Journal of Commerce. But concessions are still being awarded. In February Sao Paulo state’s ARTESP signed five 30-year concessions covering the upgrade of 1,700 km. of highways in that state. Winners must pay up-front concession fees as well as making significant investment in upgrading existing mostly two-lane highways to limited-access toll roads. At the national level, federal agency ANTT awarded a 25-year concession for 680 km. of tollways to the RodoBahia consortium, headed by Spain’s Isolux Corsan. In this case, ANTT decided against an up-front concession fee and selected the winner based on which team could make the required $1.3 billion worth of improvements at the lowest toll rate. The work involves mostly upgrading from two lanes to four limited-access lanes.

**Chile:** As the most advanced economy in South America, Chile also has the most sophisticated toll
concessions. While some projects have involved upgrading existing highways to limited-access toll roads (and more of these are in prospect for 2009), recent years have seen the development of a set of all-new urban toll roads in the capital of Santiago. Developed and operated by several different concession companies, they use an interoperable all-electronic toll system. Two additions to this system are now in process. One, awarded to Itinere in August 2008, is a 40-year concession for a 24.5 km. northern access toll road for Santiago, valued at $310 million. The other is a $1 billion project to add the final 13 km. to the Santiago Americo Vespucio ring road. Of the total length, some 7 km. will be built as tunnels. The planned 30-year concession will be offered in 2010.

The Chilean toll road market is now considered “mature,” which has led to some of the toll concessions changing hands during the past year. Global Via purchased two of them for about $1 billion and Abertis also bought two, for $1 billion, from ACS. Cintra has several toll roads on the market, estimated to be worth $2.3 billion.

Other South America: Toll concession projects also exist in Argentina, Colombia and Peru. The Journal of Commerce reports that Colombia’s national road authority in 2009 plans to tender 19 highway projects worth $1.1 billion. Peru expects to be in the market for $1.6 billion in road concessions during 2009-10.

Mexico: America’s southern NAFTA partner was one of the pioneers of toll concession projects in Latin America, but its initial program in the 1990s was poorly structured, resulting in most of the projects being taken over by the government and eventually re-privatized in the last few years, a process which is continuing. The second batch, called FARAC II, was originally to include a combination of existing toll roads and new construction in the northwestern part of the country, 13 total roadways totaling 810 km. and estimated to require a $2.3 billion investment. But after several postponements due to the credit crunch, the bidding that closed on Feb. 27, 2009 led to the government rejecting the only two bids as falling below their minimum investment requirement. A scaled-back and restructured package, now totaling just 345 km., was unveiled in April 2009, with a July 10 bidding deadline. It requires upgrading two existing toll roads and developing three new ones.

Prior to the credit crunch, during the first half of 2008, Mexico awarded two ambitious concessions for new toll roads. One is a $679 million project for an 84-km. toll road between Mexico City and Veracruz, to be financed via a combination of tolls and availability payments. The winning bidder was a consortium of ICA and FCC, both from Spain. The other project is a $1.1 billion, 30-year concession for twin tolled elevated highways from Mexico City to Queretaro, 32 km. in length. The winning bidder was OHL, which will pay an up-front $73 million concession fee and share 0.5 percent of its toll revenues. It will initially build a single 22 km. elevated roadway (above an existing highway), by 2011, which will operate one-way during peak periods. When traffic warrants, OHL will extend the initial section another 10 km. and build a parallel elevated section over the full length of the corridor.

5. Europe

France: One of the most spectacular toll concession projects in Europe will open in June 2009: the first segment of the seven-mile A86 Duplex tunnel. The overall $2 billion tunnel provides the missing link on the A86 ring road around Paris, originally planned as a surface expressway through the historic Versailles area. After decades of opposition to the government’s plan for a surface roadway, French concession company Cofiroute succeeded with its unsolicited proposal to finance, develop and operate the project as a deep-bored tunnel, financed by congestion-priced tolling. The innovative double-deck design is for cars only, with the same overhead clearance as in parking structures. This permits six lanes to be accommodated within the 34-foot diameter tunnel (though initially the tunnel will use one lane on each deck for emergency stopping only). The initial three-mile northern section (to the A13 interchange) is com-
plete and has been undergoing extensive testing since December 2009; it will open to traffic in June. Tunnel boring for the remaining four miles is complete, but outfitting and testing of that second segment (from A13 south to N286) will take another year.

All of France’s tolled motorways are operated by concession companies, some of which are former state-owned firms that were privatized in 2005. One other toll tunnel project made news in 2008. Financial closing was achieved in October for a $244 million project to extend by 1.5 km. the double-deck Prado Carenage tunnel in Marseille. Vinci and Eiffage comprise the tunnel company, whose 25-year concession for the original 2.5 km. tunnel extends to 2025. The concession for the extension runs for 46 years.

U.K. and Ireland: England has few tolled projects, all of them developed as concessions with the private sector. The only actual toll road, the M6Toll near Birmingham, provides an alternative to the frequently congested M6 motorway. Thanks first to record-high fuel prices in 2008 and then to the recession, traffic on both M6 and M6Toll has dropped in the second half of 2008 and early 2009. The other U.K. toll concession projects are all toll bridges.

However, Britain also has a thriving highway concession industry, thanks to the country’s overall Private Finance Initiative for infrastructure PPPs. In the highway sector, these projects are financed based on either shadow tolls or availability payments. A dozen design/build/finance/operate (DBFO) highway concession agreements had been signed as of late 2008, with eight such roadways in operation by that date. An article in Tollways (Autumn 2008) by Nigel Lewis itemized the government’s objectives for such projects as:

- Ensure that the project is designed, maintained and operated to maximize benefits to road users;
- Transfer the appropriate level of risk to the private sector;
- Promote innovation, in both technical/operational areas and in financial/commercial areas;
- Foster the development of a private-sector roads industry; and
- Minimize the financial contributions required from the public sector.

The largest DBFO project is the $8 billion, 30-year concession to widen and operate the principal London beltway, the M25. In 2008 the bidding was won by a consortium led by Balfour Beatty and Skanska. Financial closing had been expected by the end of the year, but was impeded by the credit crunch. Public Works Financing in November 2008 quoted a Balfour Beatty executive’s expectation that the deal would still be financed in the first half of 2009 and potentially with no more than the initial 10 percent equity and 90 percent debt.

Scotland in January 2009 achieved financial closing on its third DBFO highway project, the $478 million M80, heading northwest from Glasgow. The 30-year concession is based on shadow toll payments by the government, as was the case with the first two projects.

Ireland has done both toll concession projects and DBFO concessions based on availability payments. The earliest projects date to 1990, when National Toll Roads plc opened the Westlink Bridge, developed under a 30-year toll concession with the County of Dublin. More recent toll concessions include the N6 (awarded in 2006), the Limerick Tunnel (2006) and the M7/M8 (2007). In March 2009 the National Roads Authority authorized four new DBFO highway projects, to be financed via availability payments.

Italy: As with France, all of Italy’s toll motorways are operated under long-term concessions, with Autostrade as the largest toll company. That company secured a $1.3 billion loan from the European Investment Bank late in 2008 to add a third lane in each direction to 155 km. of the A14 tollway. Earlier in the year, the government approved a new toll increase mechanism, providing for annual increases of up to 70 percent of the inflation rate, supplemented by increases based on the company’s investment into the roadway system over the previous 12 months. Early 2009 interest centers on the Lombardy region, in anticipation of
the 2014 Milan World Trade Fair. A consortium led by Autostrade and Impregilo obtained financing in the first quarter of 2009 for a $2 billion project to build and operate the 33 km. missing link in the eastern part of Milan’s ring road. Though a toll road, it was financed based on availability payments over a 50-year concession term. A second major project will build a 151 km. largely sunken expressway, of which 87 km. will be tolled, between Bergamo and Varese, north of Milan, at a cost of $6.5 billion. A third tollway will be the 62 km., $2.4 billion road from Milan to Bergamo.

Spain & Portugal: Spain’s large and diverse concession toll industry developed out of the government’s reliance on toll concessions to develop its initial motorway system in the 1960s and 1970s. Called “autopistas,” their extent totaled 2,000 km. by 1991, developed and operated by a dozen companies. Government policy under the socialist government of Felipe Gonzales in the 1980s turned against toll roads and policy shifted toward developing non-tolled “autovias.” Several financially struggling autopista companies were nationalized by the government. By the early 1990s, the cost of building and maintaining autovias had become a strain on the national budget and some of the regional governments (such as Catalonia) began authorizing tolled autopistas of their own. Thus, the 1990s saw a revival, under a conservative national government, of toll concessions. But the early 2000s saw yet another change of government and of highway policy, this time retaining concession companies but shifting to shadow tolls. In 2008 regional governments in Catalonia, Galicia, Madrid and Valencia all pursued shadow toll concession projects. Major toll concession companies such as ACS and Ferrovial are actively bidding for these projects.

Portugal likewise has gone through several shifts of policy, beginning with toll concessions mostly carried out by state-owned companies such as BRISA, that were eventually privatized. (BRISA today is responsible for 57 percent of the tolled network in Portugal.) In the 1990s, for new highways, Portugal shifted primarily to concessions financed via shadow tolls, on a DBFO basis. In 2006, the government decided that the future liabilities created by these long-term concessions were unaffordable and began negotiating with the concession companies to transition them to introducing electronic tolling, so as to phase out shadow toll payments. In late 2007 it assigned responsibility for concessions to Estrades de Portugal (EP), a state agency. EP has the power to toll existing roads and to offer concessions to private companies under toll-sharing deals.

In 2008 EP announced it would proceed with nine availability-payment concessions to upgrade 1,500 km. of highways, which will be tolled but are not expected to be self-supporting from toll revenue. The first of these 30-year concessions was awarded in November 2008—a $900 million upgrade of 177 km. of highway from Vila Real to the Spanish border, including a new 14 km. tolled section. Toll revenues will go to EP, while the concession company will get 70 percent of its revenue from availability fees and the rest based on traffic volumes (i.e., shadow tolls). A second project reached financial close early in 2009. The $508 million deal will design, build, finance and operate 344 km. of tollway. Here again, tolls will be paid to EP and the Iridium-led consortium will derive 55 percent of its revenue from availability fees and the balance from shadow tolls paid by EP.

Germany: The land of the non-tolled autobahn has not adopted tolling, except for heavy trucks and an occasional toll bridge or tunnel (such as the Herren Tunnel in Lübeck). Instead, the government has adopted a variant of shadow toll, which it calls A-model highways. The projects offer companies a 30-year concession to upgrade an existing highway, financed by fees linked to traffic volumes. In 2008 regional governments in Catalonia, Galicia, Madrid and Valencia all pursued shadow toll concession projects. Major toll concession companies such as ACS and Ferrovial are actively bidding for these projects.

Portugal likewise has gone through several shifts of policy, beginning with toll concessions mostly carried out by state-owned companies such as BRISA, that were eventually privatized. (BRISA today is responsible for 57 percent of the tolled network in Portugal.) In the 1990s, for new highways, Portugal shifted primarily to concessions financed via shadow tolls, on a DBFO basis. In 2006, the government decided that the future liabilities created by these long-term concessions were unaffordable and began negotiating with the concession companies to transition them to introducing electronic tolling, so as to phase out shadow toll payments. In late 2007 it assigned responsibility for concessions to Estrades de Portugal (EP), a state agency. EP has the power to toll existing roads and to offer concessions to private companies under toll-sharing deals.

In 2008 EP announced it would proceed with nine availability-payment concessions to upgrade 1,500 km. of highways, which will be tolled but are not expected to be self-supporting from toll revenue. The first of these 30-year concessions was awarded in November 2008—a $900 million upgrade of 177 km. of highway from Vila Real to the Spanish border, including a new 14 km. tolled section. Toll revenues will go to EP, while the concession company will get 70 percent of its revenue from availability fees and the rest based on traffic volumes (i.e., shadow tolls). A second project reached financial close early in 2009. The $508 million deal will design, build, finance and operate 344 km. of tollway. Here again, tolls will be paid to EP and the Iridium-led consortium will derive 55 percent of its revenue from availability fees and the balance from shadow tolls paid by EP.

Germany: The land of the non-tolled autobahn has not adopted tolling, except for heavy trucks and an occasional toll bridge or tunnel (such as the Herren Tunnel in Lübeck). Instead, the government has adopted a variant of shadow toll, which it calls A-model highways. The projects offer companies a 30-year concession to upgrade an existing highway, financed by fees linked to traffic volumes. In 2008 regional governments in Catalonia, Galicia, Madrid and Valencia all pursued shadow toll concession projects. Major toll concession companies such as ACS and Ferrovial are actively bidding for these projects. In 2008 EP announced it would proceed with nine availability-payment concessions to upgrade 1,500 km. of highways, which will be tolled but are not expected to be self-supporting from toll revenue. The first of these 30-year concessions was awarded in November 2008—a $900 million upgrade of 177 km. of highway from Vila Real to the Spanish border, including a new 14 km. tolled section. Toll revenues will go to EP, while the concession company will get 70 percent of its revenue from availability fees and the rest based on traffic volumes (i.e., shadow tolls). A second project reached financial close early in 2009. The $508 million deal will design, build, finance and operate 344 km. of tollway. Here again, tolls will be paid to EP and the Iridium-led consortium will derive 55 percent of its revenue from availability fees and the balance from shadow tolls paid by EP.
concession projects with a combined value of $2.4 billion. The first two, for the A8 and A9 highways, are intended to be tendered in 2009 so that construction can begin in 2010. The next four projects would likely involve segments of the A1 and A6 and two segments of the A7, with subsequent projects on the A45 and A60.

G. China Rising: Implications for Private Capital

Private capital will continue to play a central role in China as the emergent economic giant continues its long-term investment in core infrastructure despite what appears to be retrenchment on public-private partnerships (PPPs). Infrastructure demands and the need for efficient facility management will give the nation little choice.

As high-income countries, such as the U.S., Japan and England, continue to regroup from the global recession, China’s economic growth is increasingly driven by domestic demand and investments that focus on the interior and non-export sectors of the economy. Thus, the current retrenchment may end up being more a reflection of a retooling of the PPP regulatory process to address two issues: 1) problems experienced with the implementation of early agreements and 2) a refocusing of investment priorities on projects in less accessible (from a foreign investor perspective) parts of the domestic economy.

Policymakers at the national and sub-national levels recognize that private equity and finance—domestic and foreign—are critical for meeting growing infrastructure needs. Notably, the Chinese government has explicitly recognized the essential role private capital will play in meeting its future infrastructure needs. The National Development and Reform Commission (NDRC), for example, recently called for an increase in private investment to improve competitiveness and spur economic growth. This echoed the message in Enterprise-Led Innovation in China, a World Bank report published in 2009 that urged the Chinese to shift research and development into private companies and out of state-owned enterprises to spur indigenous innovation.

These recent reports are significant because they suggest that the pull back from foreign investment was temporary and that Chinese officials are focused on figuring out how to further privatize major portions of the economy. The NDRC policy statement specifically targeted railways, telecommunications and power generation as potential industries open to foreign investment and capital.

Indeed, China has used private capital and foreign investment to leverage domestic resources to build electrical plants, water treatment facilities, roads and ports. Private capital, particularly foreign finance and equity, was crucial in underwriting these early projects.

Unfortunately, a few poorly designed agreements created problems for local government officials. In some cases, private firms overvalued their projects through optimistic revenue and demand forecasts to maximize the use of debt finance and minimize exposure by private investors. Problems also emerged when private companies would invest in facilities and, once constructed, flip them to new owners. The new owners sometimes managed the facilities at lower levels of service than promised in the initial agreement. Public-private partnerships were supposed to shift risk to the financiers and managers of the facility, but they failed to do so and in some cases even shifted risk back to the public sector. As a result, Chinese policymakers are now working to re-craft legislation in a way that both reduces the potential for private investors to shift undue risk to the public sector and creates stronger incentives for private investors to manage facilities efficiently based on the economic life-cycle of the asset.

The character of China’s growth and the investment opportunities for private capital may be fundamentally different as a new era of private investment unfolds. The global recession has weakened traditional export sectors and the urban economies that supported them. More than 70,000 factories have closed since the recession began, leaving more than 20 million workers unemployed. More than half of China’s toy factories have disappeared, most of
which were in key coastal trading centers such as Guangzhou, Shenzhen and Shanghai. The resulting social unrest has caught the attention of the nation’s top leadership.

Yet these economic losses in the export sector have not yet translated into negative growth for the nation, which is a key indicator of the fundamental long-term strength of China’s economy. Parts of the Chinese economy continue to hum along at robust rates. Despite the global recession, China watchers still expect the nation to achieve 6 percent growth in 2009. While some, including the American Enterprise Institute’s John Makin, are appropriately skeptical about growth continuing at this robust rate, no one is predicting negative growth.

As the global recession wanes, China’s economy will build on the strength of its domestic markets and will likely come back even bigger and stronger. This bodes well for major investments in infrastructure beyond the $500 billion stimulus package approved by the Chinese government in early 2009. As an emergent economic tiger, China recognizes that connecting its cities to the world with roads, rails, airports and traditional ports will be a key to its sustained growth.

Private capital will have a role to play in this investment. In fact, a general rule of thumb for Chinese policymakers is that the source of financing will come in equal parts from the government, domestic non-government financial institutions and foreign capital.

Private investors should look beyond the traditional export economies and toward the domestic market for new opportunities. A better barometer of China’s future economic health is probably in the interior, where construction cranes are still on display and earth-movers are clearing paths for dozens of new roads and highways in urban areas such as Beijing, Chengdu, Xi’an and Chongqing.

Take the example of Chongqing, a city with six million people in its urbanized area and 30 million people in the entire municipality. This burgeoning metropolis will forge an economic influence comparable to the early twentieth century industrial juggernaut of Chicago-Detroit-Cleveland in the U.S. To sustain this growth, the city needs and wants, infrastructure that can support investments fitting a 21st century economy with global connectivity. That means an expanded airport, more roads and highways, new investments in energy production and expanded public utilities.

In transportation, Chongqing policymakers have adopted an impressive mobility goal of achieving a 30-minute maximum travel time within the urbanized area with a population about the size of Houston and a 10-minute maximum travel time within the hilly and topographically challenged downtown Yuzhong District. To achieve this goal, local planners are looking at a wide menu of strategies that still struggle to get on the radar screen of U.S. transportation planners, including congestion pricing and public-private partnerships to build new bridges and tunnels to speed up travel times. Current plans include an underground highway that links major destinations within the central business district. Their commitment to using market-based approaches to expanding and managing road capacity may well put the municipality in a league of its own in the global economy.

Historically, the benefits of private capital to China’s economic future are hard to dismiss. A $12 billion expansion of the Shanghai container port on the Yangshan Islands, connected to the mainland by the 32.5 km (20.2 mile) Donghai Bridge, ensured China could claim the title of the world’s largest container port in 2005. The nation has committed to building a 21st century road network at least as large as the U.S. Interstate Highway System to improve mobility and link its major urban centers. The early toll roads in Shenzhen developed by Hong Kong-based Hopewell Holdings simply could not have been built without private capital providing resources and expertise.

The new era of investment, however, will require that foreign firms have a greater appreciation for the nuances of operating in the Chinese market and a willingness to invest based on a long-term commitment to infrastructure management. Global capital and firms with experience in these areas will find a thriving and interested market for their services in China.
Air Transportation

Contents
A. Airport Privatization
B. U.S. Airport Security
C. Air Traffic Control

A. Airport Privatization

1. Introduction

As airport privatization became a hot issue in the United States in 2008, policymakers and reporters seemed largely unaware that this phenomenon has been a major trend globally since 1987, when Margaret Thatcher privatized (via a 100 percent public stock offering) the former British Airports Authority (now BAA, plc). A detailed report on the subject was published in late 2008 by David J. Bentley Associates in Manchester, U.K. In 160 pages (with subsequent appendices), World Airport Privatization 2008 & Beyond provides a comprehensive overview of the history of airport privatization, the types of transactions involved, a country-by-country review and a profile of about 100 companies that own and operate airports, finance airport privatization or participate in projects to finance, design, build and operate new airports or airport terminals.

The list of companies from this report is too long to reproduce here, but to give some idea of the geographical scope of this industry, Table 10 summarizes the number of firms by country of headquarters, along with an example of a company from each of the 26 countries involved.

<table>
<thead>
<tr>
<th>Country of Headquarters</th>
<th># of Firms</th>
<th>Example of Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>1</td>
<td>AA2000</td>
</tr>
<tr>
<td>Australia</td>
<td>5</td>
<td>Macquarie Airports</td>
</tr>
<tr>
<td>Austria</td>
<td>3</td>
<td>Flughafen Wien AG</td>
</tr>
<tr>
<td>Belgium</td>
<td>1</td>
<td>Brussels International Airport Co.</td>
</tr>
<tr>
<td>Canada</td>
<td>7</td>
<td>Canadian Pension Plan Invest. Board</td>
</tr>
<tr>
<td>China</td>
<td>2</td>
<td>Hong Kong Airport Authority</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>1</td>
<td>Alterra Partners</td>
</tr>
<tr>
<td>Cyprus</td>
<td>1</td>
<td>Hermes Airports</td>
</tr>
<tr>
<td>Czech Rep.</td>
<td>1</td>
<td>Penta Equity Group</td>
</tr>
<tr>
<td>Denmark</td>
<td>1</td>
<td>Copenhagen Airports A/S</td>
</tr>
<tr>
<td>France</td>
<td>2</td>
<td>Aeroports de Paris (AdP)</td>
</tr>
<tr>
<td>Germany</td>
<td>3</td>
<td>Fraport</td>
</tr>
<tr>
<td>India</td>
<td>6</td>
<td>GMR</td>
</tr>
<tr>
<td>Ireland</td>
<td>1</td>
<td>Aer Rianta/DAA</td>
</tr>
<tr>
<td>Italy</td>
<td>4</td>
<td>Aeroporti di Roma (AdR)</td>
</tr>
<tr>
<td>Malaysia</td>
<td>2</td>
<td>Malaysia Airport Holdings Berhad</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2</td>
<td>Schipol Group</td>
</tr>
<tr>
<td>New Zealand</td>
<td>1</td>
<td>Infratil</td>
</tr>
<tr>
<td>Singapore</td>
<td>2</td>
<td>Changi Airports International</td>
</tr>
<tr>
<td>South Africa</td>
<td>1</td>
<td>Airports Company South Africa</td>
</tr>
<tr>
<td>Spain</td>
<td>4</td>
<td>Abertis/TBI</td>
</tr>
<tr>
<td>Switzerland</td>
<td>3</td>
<td>Unique (Flughafen Zurich)</td>
</tr>
<tr>
<td>Turkey</td>
<td>2</td>
<td>TAV Airports</td>
</tr>
<tr>
<td>UAE</td>
<td>2</td>
<td>Dubai Aerospace</td>
</tr>
<tr>
<td>UK</td>
<td>10</td>
<td>BAA plc</td>
</tr>
<tr>
<td>United States</td>
<td>10</td>
<td>Goldman Sachs Infrastructure Fund</td>
</tr>
</tbody>
</table>

Source: Airport Privatization 2008, David J. Bentley Associates
2. U.S. Airport Privatization

Midway Airport and the Airport Privatization Pilot Program

During 2008 and early 2009, the main focus of attention in U.S. airport privatization was the impending 99-year lease of Chicago’s Midway Airport. Spirited competitive bidding—with the basics of the concession agreement presented to all bidders and the only factor in the competition among pre-qualified bidders being the price—led to a winning bid of $2.5 billion from the Midway Investment & Development Company (MIDCo) in September 2008. Originally the deal was supposed to reach financial closing by January, but MIDCo received permission from the city of Chicago to extend this to April 1, 2009, due to difficulties in arranging the financing, given the credit market crunch. When MIDCo failed to close by that date, the city terminated the deal.

Observers pointed to several factors in this outcome. First, John Schmidt of Mayer Brown, the city’s legal advisor on the deal, told Public Works Financing that the value of publicly traded airports had declined by 30 percent or more since the bid was put together. That means MIDCo overpaid by that amount and understandably had difficulty making the numbers pencil out. Secondly, 89 percent of MIDCo consisted of Citi Infrastructure Investors, an infrastructure investment fund that was also a bidder on the forthcoming sale of London Gatwick Airport, arguably an airport with significantly greater growth potential than Midway (if it can win planning permission for its desired second runway). It may have made more sense for Citi to conserve its cash for higher-return deals on which it can bid based on current market values.

Although some expect Chicago to try again once credit market conditions return to more normal conditions, an immediate impact of the collapse of the Midway deal is that it opens up possibilities for other large cities. That’s because the federal Airport Privatization Pilot Program has only one slot for a “large hub” airport, the category to which Midway belongs. And while a number of airports around the country have been suggested by local officials as privatization candidates, nearly all have been “medium hubs,” for which there are three slots in the Pilot Program. The exception is “large hub” Minneapolis/St. Paul International Airport (MSP).

In January 2009, state Sen. Geoff Michel and state Rep. Laura Brod proposed leasing MSP along the lines of what Chicago was doing with Midway, figuring that because of MSP’s much greater traffic, it would yield far more than $2.5 billion. And Gov. Tim Pawlenty was expected to announce a proposal aimed at closing the state’s $5.5 billion revenue shortfall and (according to the think tank Minnesota 2020) “has hinted at large asset privatizations, which may include Minneapolis-St. Paul International Airport.” The potential release of Chicago’s “large airport” slot would remove a serious obstacle to leasing MSP under the Pilot Program.

At least eight medium hub airports have been proposed by public officials as candidates for long-term leases under the Pilot Program: Austin, Bradley (Hartford), Jacksonville (FL), Kansas City, Long Beach, Milwaukee, New Orleans and Ontario (California). Of these, New Orleans appears to have the strongest political support as of this writing. As part of a series of local and state reform efforts, a new Regional Airport Authority was created in 2008 to manage the Louis Armstrong International Airport (which is owned by the city of New Orleans but whose land includes portions of two other jurisdictions). That body is considering two options, either a takeover by the state government or privatization under the Pilot Program. Privatization appears to have the support of Mayor Ray Nagin, several council members and key business leaders. As of June 2009, however, New Orleans had not filed an application with the FAA.

Here is the state of play in the other jurisdictions as of July 2009:

Austin: Discussions began in 2007, with
several elected officials raising the idea and continued into 2008 with an Airport Advisory Committee meeting on airport privatization. No official decision on whether or not to pursue the idea has been forthcoming.

Bradley/Hartford: Several Republican members of the state legislature in February 2009 introduced legislation under which the state would study or proceed to lease this state-owned airport, as a means of coping with the state’s budget deficit.

Jacksonville (FL): Aviation Authority CEO John Clarke proposed a long-term concession for the landside (terminals, etc.) portion of the airport and disclosed discussions with Fraport and Macquarie concerning the idea. However, in early 2009 Clarke announced that he was leaving Jacksonville to become the director of the Indianapolis airport.

Kansas City: Mayor Mark Funkhouser, formerly the city auditor, proposed the idea of leasing the airport in February 2009 and favorable comments were made by the airport director and several council members. But on April 23, 2009, citing too many unanswered questions, the city council voted not to pursue the idea at this time.

Long Beach: In January 2009, the city council held a closed-door session to discuss possible privatization of the airport, following expressions of interest from J.P. Morgan and Merrill Lynch. Since then, however, it has gotten into a public tiff with JetBlue CEO Dave Barger over the lack of progress on promised airport improvements.

Milwaukee: County Executive Scott Walker proposed a long-term lease of the county’s General Mitchell International Airport in 2008, as one component of a set of asset divestitures and cost reductions to resolve shortfalls in the county budget. The idea has not generated a critical mass of support, thus far.

Ontario: Los Angeles City Controller Laura Chick in January 2009 proposed an array of budget measures, including the possible long-term lease of Ontario Airport, which is owned by Los Angeles World Airports, a city agency. Although Mayor Villaraigosa is pursuing the long-term lease of the city’s parking facilities, no action has been taken regarding Ontario airport.

While these discussions were going on, the chairman of the House Aviation Subcommittee, Rep. Jerry Costello (D, IL), revived his anti-privatization language from the 2007 House bill to reauthorize the Federal Aviation Administration. (Because the Senate never brought its version of the bill to the floor, the new Congress is having to start all over on FAA reauthorization.) Sec. 143 of the House bill (HR 915) would exclude airports leased under the Pilot Program from receiving federal Airport Improvement Program grants—even though passengers using such airports would continue to be charged the passenger ticket tax which funds that grant program. In addition, it would increase the airline approval requirement (of the terms of the lease) from the current 65 percent to 75 percent. These measures are clearly intended to make airport privatization more difficult to carry out and less attractive to all parties. By contrast, the FAA’s own reauthorization proposal from 2007 would have expanded the Pilot Program by increasing the number of slots from five to 15 and eliminating the airline approval requirement.

Airport Contract Management

In all the debate over long-term leasing of airports, many people remain unaware that the private sector has been managing various U.S. airports for decades. There are a number of firms that operate and manage general aviation (GA) airports (those without scheduled airline service). Besides those cases, U.K. firm TBI (now owned by Abertis) still operates Burbank and Ayports Management operates Albany, Atlantic City, New Haven, Stewart (NY) and Westchester/White Plains, in addition to a number of GA airports. And for about 10 years, the U.S. division of BAA operated Indianapolis under a management contract. Ayports is the direct descendant of Pan Am World Services which dates back to
the early days of Pan American World Airways. It was subsequently owned by Johnson Controls, then American Port Services and more recently by Macquarie Aviation. It was acquired recently by Virginia-based Aviation Facilities Co. (AFCO).

And speaking of BAA USA, that company recently signed its fourth contract to manage U.S. airport retail operations. In addition to its AirMalls at Pittsburgh, Baltimore/Washington International and Boston Logan, BAA now has a 10-year contract for the same purpose at Cleveland Hopkins International.

Privately Owned Airports

May 2009 saw the opening of an entirely private airport in country music haven Branson, MO. Noting that the nearest airport with scheduled service was 52 miles away (in Springfield) and offered virtually no service by low-cost carriers, a group of entrepreneurs created Branson Airport LLC, acquired a suitable parcel of land in Branson, received airspace approvals from the FAA and set about raising money. With $140 million in hand, they have created a one-runway airport with a contractor-operated control tower and a modest terminal building. In advance of the airport’s May 2009 opening, they began marketing it to low-fare airlines. Because it is not constrained by the usual FAA grant agreements, Branson Airport can offer airlines two-year exclusive rights to link specific cities to Branson. Thus far, it has signed up AirTran for exclusive service to and from Atlanta and Milwaukee and Sun Country for Minneapolis-St. Paul.

Another would-be private airport is still trying to get off the ground—the third Chicago airport at Peotone, 40 miles south of the Loop. For more than a decade, the local business community, outside consultants and the Illinois DOT have been promoting the airport as the answer to the need for additional airport capacity in the greater Chicago area. While the initial concept was more like Branson, it has evolved into a public-private venture, in which the state DOT is acquiring and will own the land and be responsible for the airside (runways, taxiways, control tower) while the private sector would finance, develop and operate the landside (terminal, parking, etc.). Along the way, Rep. Jesse Jackson (D, IL), who represents much of the south side of Chicago, has become a champion of the airport. In March 2009, Gov. Pat Quinn renewed the state’s commitment to getting the project done. In 2008 the state submitted updated plans to the FAA and it continues to acquire land for the airport.

Another privately owned airport may cease to operate as an airport, a casualty of the pullback of DHL Express from the domestic U.S. market. DHL acquired the Wilmington (OH) Air Park when it bought freight carrier Airborne Express, which owned the airport and used it for its central sorting hub. DHL had previously sorted packages at the Cincinnati-Northern Kentucky International Airport (CVG), but consolidated operations at Wilmington after the acquisition. But since DHL as of 2009 has dropped its domestic service and will only serve international markets, its sorting hub needs are drastically reduced. When the state of Kentucky offered it a $1.87 million tax credit to make CVG its hub, that offer decided the issue for DHL. The future of Wilmington as an airport is now in question.

3. Global Airport Privatization

Europe

In the summer of 2008, the U.K. Competition Commission issued its preliminary report on BAA, the privatized operator of the three large airports serving London and all of southeastern England: Heathrow, Gatwick and Stansted. It recommended that BAA be broken up, by selling two of the three London airports and one of its two Scottish airports. Rather than waiting for the final report, Ferrovial (BAA’s majority owner) decided to put Gatwick on the market and this sale has become the main event for European airport privatization in the first half of 2009.
Three bids were submitted by the April 30, 2009 deadline. One came from Lysander Gatwick Investment Group, which is composed of the same three firms that constituted MIDCo (the winning bidder for the failed Midway Airport lease): Citi Infrastructure Partners, John Hancock Life Insurance and Vancouver Airport Services. Another bid came from Global Infrastructure Partners (GE and Credit Suisse), the fund that owns London City Airport. And the third bid was from Manchester Airports Group, Borealis and the Greater Manchester Pension Fund. Passenger numbers at Gatwick in March 2009 were 17.7 percent lower than the previous year (a larger decline than at Heathrow or Stansted) and cargo volume had fallen by about 50 percent in comparison to the previous year for more than six months. The government’s “regulatory asset base value” of Gatwick is $2.33 billion (£1.6 billion) and there was much speculation over whether any of the bids would exceed that amount. On May 13, BAA dropped the Lysander group, saying its price was uncompetitive.

Only minor activity took place in Germany in 2008. Privatized Fraport, majority owner of Frankfurt and various overseas airports, sold its 65 percent interest in money-losing Hahn airport to the original co-shareholder and investor, the German state of Rhineland-Palatinate, for a symbolic price of one euro. The no-frills airport had been losing money and its major airline, low-cost-carrier Ryanair, had threatened to move out if Fraport imposed a planned passenger facility fee. Most other German airports remain owned by their state and municipal governments, although Hochtief and its affiliated investment arm own 30 percent of Düsseldorf Airport and 49 percent of Hamburg Airport.

France’s Aeroports de Paris was partially privatized in 2006 and in 2008 announced its interest in acquiring stakes in some of the French regional airports, such as Bordeaux, Marseilles, Nice, etc. as well as acquiring part-interests in six to 12 airports overseas in the next five years or so. Most French regional airports are currently operated by local chambers of commerce, under license from the national government. Two such airports, Chambery and Grenoble, are operated under quasi-concession arrangements by Vinci and Keolis. Table 11 lists the outcomes of recent tenders or concession management of regional airports.

Most of Italy’s larger airports have been privatized, including Rome, Florence, Naples, Parma, Pisa and Venice. Attempts to privatize Milan’s airports have thus far not succeeded, partly due to uncertainties over the future of money-losing state-owned airline Alitalia. With the very recent privatization of Alitalia and the new Lufthansa Italia now operating at Milan, privatization of Milan’s airports may now return to the policy agenda. Greece apparently still plans to sell at least part of the 55 percent of the Athens airport that it retains (with 40 percent owned by developer/operator Hochtief). It may also privatize some of the larger regional airports.

Spain’s government announced in August 2008 that it will sell a 30 percent stake in the 47 airports operated by state agency AENA (which also operates the air traffic control system). The plan is to first separate the ATC system and then offer investors stakes in individual airports, with AENA retaining majority interest in each. For the two largest airports, Madrid and Barcelona, the governments of Madrid and Catalonia, respectively, will also be allowed to buy shares. This privatization has been delayed by a reshuffle of government ministers and no time frame has yet been published. Portugal also plans to privatize its state airports agency, ANA, but in this case a key aspect is the selection of a private-sector consortium to build a new airport for Lisbon (at Alcochete) and take over at least some of the other airports (such as Faro and Porto). In April 2009 a consortium of Portuguese firms (including toll road operator BRISA and Banco Espiritu Santo) teamed with Changi Airport Consultants from Singapore to bid for this opportunity.
Previously, the only party that had proclaimed its interest was Spain’s Abertis. The tender is expected to begin before the middle of 2009.

The big action in Central and Eastern Europe is expected to be the long-promised privatization of the Prague airport. Although the government approved the plan in June 2008 and a number of firms expressed interest, by year-end the transport minister said he would advise against the sale if bids came in at $2.5 billion or less. As of early 2009, the government was still in the process of selecting an advisor for the privatization, which is nominally scheduled for the second half of 2009 and now looks unlikely before the end of 2009.

**Latin America & Caribbean**

Jamaica several years ago privatized its major tourist airport—Sangster International, in Montego Bay—via a 30-year build, operate, transfer (BOT) concession. Based on the success of that privatization, the government wants to do the same thing for its other major airport, Norman Manley International in Kingston. In October 2008 the government approved hiring an advisory team to manage that privatization process. And in the Dominican Republic, Advent International acquired 100 percent of Aerodom, a leading airport operator in Central America and the holder of a 30-year concession for six airports in the Dominican Republic. Advent is a global firm with a history of investing in Latin America, especially in the airport sector.

Mexico’s airport privatizations in the late 1990s, followed by initial public share offerings (IPOs) in the early years of this century, produced three successful airport operators that now plan to branch out elsewhere in Central America, the Caribbean and South America. But ASUR, GAP and OMA have all experienced traffic declines due to the global recession of 2008/2009, which has put most expansion plans on hold. Once things recover, the Mexican government plans a tender for a new airport serving the Mexican Riviera and is still working on plans for additional airport capacity in the Mexico City region.

After the successful privatization of the Jorge Chavez airport in Lima, Peru via a 30-year concession in 2002 (with Fraport acquiring 100 percent of that concession in 2007), the Peruvian government in 2006 privatized, also via long-term concession, 12 regional airports. It plans to privatize six more in 2009, with final bids due in July and an award planned for August.

It now seems likely that Brazil’s Galeao (Rio de Janeiro) and Viracopos (Sao Paulo) airports will be privatized in 2009. The specifics will be developed with the assistance of both the national development bank (BNDES) and the civil aviation agency (ANAC). The terms and conditions are expected to be released in July 2009. The procedures are part of a plan to prepare Brazil for the 2014 soccer World Cup, which it will host.

**Asia/Pacific**

India’s three brand new (“greenfield”) airports developed under long-term concessions are all operational (at Bengaluru, Cochin and Hyderabad) and the government-approved development of another such airport in January 2009,

**Table 11: French Regional Airport Concessions**

<table>
<thead>
<tr>
<th>Airport</th>
<th>Concession Operator</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vatry (cargo airport)</td>
<td>SNC Lavalin, Aeroport de Montreal, et al.</td>
</tr>
<tr>
<td>Vannes</td>
<td>SEVA, SNC Lavalin</td>
</tr>
<tr>
<td>Angers</td>
<td>SGAAM, Keolis</td>
</tr>
<tr>
<td>Troyes</td>
<td>SGATC, Keolis</td>
</tr>
<tr>
<td>Grenoble</td>
<td>SEAG, Vinci-Keolis</td>
</tr>
<tr>
<td>Chambery</td>
<td>SEAC, Vinci-Keolis</td>
</tr>
<tr>
<td>Clermont Ferrand</td>
<td>SEAAFA, Vinci-Keolis</td>
</tr>
<tr>
<td>Picardie</td>
<td>SEAAP, Keolis-Group K</td>
</tr>
<tr>
<td>Nimes</td>
<td>VTAN, Veolia</td>
</tr>
<tr>
<td>Beauvais</td>
<td>SAGEB, Veolia</td>
</tr>
<tr>
<td>Annecy</td>
<td>CCI</td>
</tr>
<tr>
<td>Deauville</td>
<td>CCI</td>
</tr>
<tr>
<td>Morlaix</td>
<td>CCI</td>
</tr>
<tr>
<td>Tenders awaiting</td>
<td>Lille, Avignon, Brive Souillac, Dinard-St. Malo, Le Havre</td>
</tr>
</tbody>
</table>

Source: David J. Bentley Associates.
at Kannur in Kerala. And work is continuing on the modernization of two major international airports via long-term public-private concessions at Delhi and Mumbai, with a third runway opening at the former in August 2008. Whether the PPP approach will be used for the next two modernizations, at Chennai and Kolkata, remains to be seen, as the Airports Authority of India seems to be resisting further loss of control over the country’s airports.

Air travel has been growing by leaps and bounds in China over the past decade, but only about a dozen of the country’s 150 airports operate in the black. The government has gradually lifted restrictions on foreign investment in airports, with the limit recently increased to 49 percent. Among those taking partial stakes in various airports have been Aeroports de Paris, Changi International, Copenhagen Airports, Fraport and the Airport Authority of Hong Kong. Both AdP and Copenhagen Airports have since withdrawn from their strategic partner minority stakeholdings in Beijing Capital and Hainan Meilan airports, respectively, but Fraport remains committed to China and is seeking new opportunities. The planned initial public offering of Hong Kong International, first planned for 2006, still has no revised date.

Japan has talked about privatizing one or both Tokyo airports, but the political will to move forward has been lacking. In July 2008, the government announced a new study of what regulations should apply to foreign investment in Japanese airports, probably stimulated by Macquarie’s acquisition of a 20 percent stake in Tokyo Haneda Airport. But in May 2009, Macquarie announced that it was selling its shares back to Japan Airport Terminal, the government airport company. The most recent annual report of Tokyo Narita Airport under the heading IPO says “Public listing as soon as possible.” But the government approved a bill in March 2009 to cap equity ownership by an individual shareholder in Narita International Airport Corp. at less than 20 percent.

Singapore’s highly regarded Changi International Airport is being corporatized in 2009. The Civil Aviation Authority of Singapore will be split in two, as of July, with the airport becoming a government corporation and the rest of CAAS becoming NewCAA, responsible for air safety regulation and air traffic control. South Korea’s Incheon airport was announced as a privatization candidate in August 2008. A specific timetable and the method of privatization have yet to be announced, but the Ministry of Land, Transport and Maritime Affairs has confirmed that it will begin selling shares in the airport in 2010. Of the 49 percent that will be sold, a maximum of 15 percent will be allocated “strategically” to a foreign company that specializes in airport management, with the remaining shares sold to private and institutional investors.

Nearly all of Australia’s airports were long-term leased in the late 1990s, culminating with Sydney in 2002. But the state-owned airports in Queensland—Brisbane, Cairns, Mackay and Mount Isa—were not. In 2008 Queensland announced plans to privatize Cairns and Mackay and to offer a 12 percent stake in Brisbane. Mackay was sold in November 2008 to a consortium of private interests. And Australia’s federal government has begun the process of seeking a site for a second airport to serve the Sydney region, since expansion of single-runway Sydney International has been ruled out.

B. Airport Security

In a report prepared for the OECD’s International Transport Forum in December 2008, Reason’s Robert Poole finds considerable parallels in the aviation security policies of Canada, the European Union countries and the United States. In all three cases, policy changes were driven by hijacking incidents, especially after the 9/11 attack on the United States. In all three cases, there is much rhetoric about the importance of risk-based policies (i.e., allocating resources in ways that reflect the risks and benefits), but
instead major policy decisions have been made for political reasons, without benefit of analysis. This is particularly the case for passenger and baggage screening.

1. Passenger and Baggage Screening

Researchers on terrorism at the RAND Corporation and elsewhere point to the asymmetries between terrorists and governments. The former tend to be far more flexible and are able to wreak havoc at relatively low cost, compared with the costs of defending against them. A general policy of “target-hardening,”—providing protective measures at specific sites—unless done in a flexible and ever-changing manner, is a losing proposition, since advanced societies are inherently target-rich environments, whereas terrorists present governments with a miniscule number of targets. Thus, as a general proposition, there is greater leverage in intelligence and interdiction efforts than in target hardening. Nonetheless, since air transportation seems to be an attractive target for various reasons, some kinds of defenses against terrorist attacks on it are probably justified. But security policy should avoid creating the equivalent of Maginot Lines—costly, static defenses that terrorists have incentives to work around. The elaborate and very costly structure of 100 percent screening of passengers and baggage at airports is a potential Maginot Line of this sort.

In the OECD/ITF paper, Poole finds similar airport passenger and baggage screening in all three jurisdictions. But the United States stands out in two ways. First, it is the only one of these jurisdictions to use very costly explosive detection systems on all checked bags, rather than only on suspicious bags. Second, it is the only one whose passenger and baggage screening system is operated almost entirely by government employees. In Canada, screening is the responsibility of a crown corporation called CATSA (Canadian Air Transport Security Authority). Rather than hiring and training a large force of civil servants, CATSA contracts with a dozen private security companies that must meet defined performance standards. This enables the numbers of screeners to be easily adjusted upward or downward, as threat levels dictate. And should terrorists turn their attention to other sectors at some point in the future, it would be relatively easy to scale back the extent of passenger and baggage screening in Canada. In most EU countries, screening is the responsibility of the airport, under national government regulatory oversight. In most cases, the screening operations are outsourced to private security companies, operating under performance contracts. Even more so than in Canada, the level and extent of such screening operations can be tailored to the circumstances of each country and airport. And the system retains the flexibility to increase or decrease the numbers employed for this purpose.

By contrast, the system mandated by Congress in the Aviation and Transportation Security Act of 2001 is highly centralized. In all but a handful of cases, airport screeners are direct employees of the Transportation Security Administration, hired and trained by TSA and paid uniform salaries and benefits nationwide, as civil servants. This 43,000-person workforce would be difficult to downsize, should conditions change. It is also difficult to adjust the numbers of screeners to rapidly changing levels of airline service (and hence passenger throughput).

In a compromise with opponents of centralization, Congress permitted five airports to opt out initially; after 2004, all other airports in theory could also have opted out. However, since TSA is also the aviation security regulator, no airport that already has a large TSA screener workforce has chosen to “kick out” the TSA screeners—though all five original opt-out airports (including San Francisco and Kansas City) have chosen to remain with contract service. The only airports that have taken advantage of the post-2004 opt-out provision have been small airports just beginning to offer scheduled air service at the level that requires airport screening. As of the beginning of 2009, there were
10 airports using contract screening firms, with TSA’s concurrence. The TSA has issued an RFP for contract screening at seven small Montana airports receiving subsidized airline service under the federal Essential Air Service (EAS) program; selection of the winner is expected in summer 2009. Separately, Butte, MT has applied to TSA to join the contract screening program and airport boards in Missoula and Glacier Park/Kalispell, MT have voted to do likewise.

In 2008 TSA received the results of a study it had commissioned on the performance and cost-effectiveness of in-house versus contract security, conducted by Catapult Consultants. Judging from a GAO report summarizing the results (GAO-09-27R), the study found that contract screeners performed somewhat better than TSA screeners and probably did so at no higher cost than TSA screeners. The company recommended that TSA reduce its administrative costs at the airports with contract screeners (which unfairly inflate the cost of contract screening) and that it take the initiative to expand contract screening to several types of airports: those with low-performing TSA screeners, those with large seasonal swings in passenger throughput and those where TSA finds it difficult to hire and retain screeners. It also suggested giving screening contractors additional “degrees of freedom” to foster innovation, superior performance and cost controls. Instead of taking these findings and recommendations seriously, TSA did not release the Catapult study and instead did a quickie study of its own downplaying the performance comparison and portraying the contract firms’ cost in a less-positive light.

2. Registered Traveler

Several months after 9/11, aviation experts Michael Levine and Richard Golaszewski suggested the idea of “trusted traveler.” It began with a thought experiment: why should someone holding a government security clearance have to go through the passenger-screening rigamarole? Wouldn’t it be far more cost-effective to permit frequent flyers (who constitute a large fraction of all those showing up at airports each day) to volunteer for some kind of clearance and if they passed and could prove when they got to the airport that they are the person who was cleared (via a biometric identity card), to let them go through an expedited line, no more burdensome than pre-9/11 screening? Subsequent analysis by operations researchers showed that the concept could cut passenger and baggage screening costs dramatically, while permitting screening resources to be focused on higher-risk passengers.

The TSA said it was willing to test the idea, renamed Registered Traveler (RT) and allowed start-up company Verified Identity Pass to develop the technology and try it out at Orlando Airport. After several years, TSA expanded the pilot program to up to 20 airports and allowed other companies to develop inter-operable systems. As of early 2009, there were three companies in the market, with the large majority of participating airports offering the “Clear” brand pioneered by Verified Identity Pass. RT lanes were available at 22 airports, including all three in New York, both airports in Washington, DC, Indianapolis, San Francisco and many others and as of May 2009, some 260,000 air travelers had joined one of the three RT programs.

However, although RT members could bypass the long lines at screening checkpoints, they still had to go through exactly the same routine once they were at the checkpoint—removing shoes, jackets, laptops, etc. TSA has taken the position that RT is not a security program, but merely an identification program. It can maintain this position because the agency itself has refused to perform background checks on those applying for membership. RT program operators dutifully forwarded the fingerprints from applicants to the clearinghouse operated by the American Association of Airport Executives (AAAE), which also provides this service to airports, to facilitate obtaining FBI criminal history background checks on hundreds of thousands
of airport workers who must have daily access to secure areas at airports. Ever since the RT program began and continuing into 2009 under a new Administration, the TSA has refused to allow the AAAE clearinghouse to submit RT applicants’ fingerprints to the FBI. Instead, TSA itself merely checks the name of each applicant against its terrorist watch list and tells the company yes or no on each one. This is the same watch list against which airlines must match the name of every single passenger before they can be issued a boarding pass. In other words, the only background check which TSA allows for RT applicants prevents the program from being a security program, as originally intended.

In 2008 Verified announced a doubling of its annual fee from $99 to $199 to cope with the high costs of staffing its various facilities with fewer members than projected in its business plan. A number of members failed to renew, apparently on grounds that the higher new rate was excessive, since the RT program did not reduce the hassles at security checkpoints, only the time spent waiting in line. The subsequent reduction in revenue led Verified to the sudden announcement, in June 2009, that it was terminating all operations.

Ironically, a TSA sister agency is now operating a risk-based program something like the original RT concept. It is Customs & Border Protection’s Global Entry program. Would-be members pay a $100 fee and must pass both a background check and an interview. Then, when returning to the United States, they can bypass regular passport control and go to a kiosk where they scan their passport and biometric ID card. During the trial period at the initial three airports, 1,100 people signed up for Global Entry. By the beginning of 2009 it had expanded from Houston, New York (JFK) and Washington Dulles to include travelers re-entering the United States at Atlanta, Chicago O’Hare, Los Angeles and Miami.

C. Air Traffic Control

1. Global ATC Trends

During the past two decades, nearly 50 governments have “commercialized” their air traffic control systems. What that means is they have organizationally separated this set of functions from their transport ministry, removed it from civil service and made it self-supporting from fees charged to aircraft operators for ATC services. These new air navigation service providers (ANSPs) are also, for the first time, being regulated at arm’s length by their government’s aviation safety agency.

Most of these commercialized entities have been set up as government corporations (analogous to the U.S. Tennessee Valley Authority), though a few remain as government departments, despite being paid directly by their users and being able to issue revenue bonds to finance modernization. A handful can be called “privatized,” but the two principal examples are not for-profit companies. Nav Canada is a not-for-profit corporation, governed by a board made up of aviation stakeholders—in effect, it functions as a kind of user co-op. And the U.K.’s National Air Traffic Services (NATS) is a public-private partnership, with British airlines owning 42 percent, airport company BAA owning 4 percent, employees owning 5 percent and the government owning the balance. NATS, also, is operated on a not-for-profit basis.

A growing number of studies have found that the changes encompassed by ATC commercialization have made significant differences in performance, with improved service quality, significantly improved modernization and lower costs. These changes appear to stem from the new customer-provider relationship, in which “user pay means user say,” as they describe it in Canada. At the same time, air safety has remained the same or improved and the public interest has been protected. The most recent study is the book, Managing the Skies: Public Policy, Organization and Financing of Air Traf-
fic Management, by Clinton V. Oster and John S. Strong (Ashgate Publishing, 2007). Oster and Strong explain how air traffic control works and review the global evolution of air navigation service providers. They follow this with detailed reviews of the ANSPs of Australia, New Zealand, Canada, the United Kingdom and Europe, as well as a look at the challenges facing developing countries vis a vis air traffic control. Finally, they discuss the U.S. system, contrasting the tax-funded, politically controlled FAA system with the customer-focused ANSPs in the rest of the developed countries.

2. U.S. ATC Reform

In 2007 the FAA submitted a sweeping proposal to revamp the way U.S. air traffic control is funded, by shifting largely from user taxes (mostly the tax on airline tickets) to user fees based on the en-route and terminal-area ATC services provided. And the FAA's Air Traffic Organization would be allowed to issue revenue bonds for modernization programs, based on the user fee revenue. Because general aviation (private plane) organizations expressed all-out opposition to any switch from their fuel taxes to user fees, the FAA proposal would have let GA continue to pay fuel taxes, but at significantly higher rates, based on a new FAA cost allocation study published in January 2007. The airline industry strongly supported the FAA proposal, the GA organizations strongly opposed it and Congress almost entirely ignored it.

During 2007, the House passed a status-quo FAA reauthorization bill, including modest increases in GA fuel taxes but leaving the basic funding structure unchanged. The Senate Commerce Committee passed a bill that included a $25 per flight user fee, only for jet and turbo-prop planes flying under instrument flight rules (IFR)—the principal users of ATC services. And it included authorization for the ATO to issue up to $5 billion in revenue bonds based on that user-fee revenue, with spending decisions overseen by a board representing aviation stakeholders. This was a small step in the direction of ATC commercialization. But that bill did not make it to the Senate floor during 2007, even though the FAA's authorization expired as of Sept. 30, 2007.

In 2008, the FAA essentially reintroduced its previous proposal. The House took no further action, awaiting passage of a companion bill in the Senate. In April 2008, the Senate reached a compromise under which the user fee, bonding and board were dropped from the bill. This was expected to lead to Senate passage, but other business and the November elections took precedence and the bill never reached the Senate floor.

In 2009, the House Aviation Subcommittee revived and approved essentially its 2007 measure, sending it to the floor. As of press time, the corresponding Senate committee had not taken action, but speculation continues as to whether the $25 per turbine IFR flight user fee will be reintroduced, especially now that revenue for the Aviation Trust Fund is declining, due to reduced airline service, fewer passenger trips and lower air fares—all of which decrease revenue from the ticket tax, the largest source of Trust Fund revenue. Another straw in the wind is that the Obama administration’s 10-year budget proposal includes $7 billion of user fee revenue replacing existing aviation tax revenue starting in 2011, suggesting that the user fee concept has not died.
I. Child Welfare Privatization

Proposals for 2009

In light of the tough economy and tight state budgets across the United States, school choice continues to be an important policy tool to reduce state education budgets and offer parents more high quality options. Numerous fiscal studies have shown consistently that school voucher and school tax credit programs save money both for state budgets and for local public school districts, even after the fixed costs of public schools (costs that do not go away when students leave a school) are taken into account. A 2005 analysis by the Friedman Foundation for Educational Choice, found that America’s school choice programs have saved a net total of $22 million for state budgets and $422 million for local school districts. More specifically, for fiscal year 2009 alone, the state of Wisconsin saved $37 million as a result of the Milwaukee school choice program. Similarly, Florida’s statewide voucher program for low-income students saved taxpayers $38.9 million in the 2007–2008 school year, according to a study released by Florida’s Office of Program Policy Analysis and Government Accountability.

A. School Voucher and Tax Credit Programs Expand in 2009

In the 2008–2009 school year, the Alliance for School Choice reports that more than 171,000 children are benefiting from 18 school voucher and tax credit programs in 10 states. Tax-credit school-choice programs give individuals and corporations credits against their taxes for donations they make to scholarship organizations that pay the tuition for low-income children to attend private schools. Student enrollment in school choice programs grew eight percent over the 2007-2008 school year and has grown 89 percent since the 2003-2004 school year. In 2009, the five states with the largest school choice programs are Pennsylvania (43,764 students), Florida (41,843 students), Arizona (29,539 students), Wisconsin (19,538 students) and Ohio (16,411 students).
In 2009, Arizona, Florida and Iowa lawmakers have passed legislation to increase investments in tax credit programs and expand access and enrollment. In addition, Indiana lawmakers enacted a new tax credit program to offer students scholarships to private schools.

In Arizona, Governor Jan Brewer signed legislation in May 2009 creating a new tax credit scholarship program for children with special needs and children in foster care. This program was enacted in response to a state Supreme Court ruling declaring that a voucher program serving these children was unconstitutional. The new legislation offers priority to the children who received vouchers under the earlier program, ensuring that the educational needs of these children will continue to be served.

This new legislation also expands tax credit scholarship programs in Arizona by allowing a new class of corporation to participate. Insurers can now take a credit against premium tax liability for contributions to school tuition organizations operating under the existing corporate tax credit scholarship program and the new tax credit scholarship program created by this legislation.

In Florida, more students will receive annual scholarships to quality schools thanks to legislation signed June 2, 2009 by Governor Charlie Crist that will boost the state’s tax credit scholarship program.

Donations to the newly renamed Florida Tax Credit Scholarship Program may now include contributions from S-Corporations (including insurance companies), which will receive dollar-for-dollar credits against premium taxes.

The tax credit law (HB 453) expands the number of businesses that can participate by giving insurance companies a dollar-for-dollar credit against their premium taxes for donations they make to a program that sends low-income children to private schools. The tax credit program now is supported only through corporate income tax credits and those will continue.

The program also will retain its present cap of $118 million a year. With only corporate tax credits, the program has fallen well short of that cap, donating $73.5 million in the last school year for about 23,000 students attending more than 1,000 private schools.

In May 2009, Iowa expanded its tax credit program to include contributions from corporations in addition to donations from individuals. Allowing corporations to donate to scholarship programs will allow companies to be good corporate citizens while ensuring that additional scholarship money is available to students.

Democratic Governor Chet Culver increased the School Tuition Organization Tax Credit limit from $5 million in 2007 to $7.5 million in 2008. Since 2006, Iowans have been able to receive tax credits worth 65 percent of their contributions to eligible organizations that provide scholarships for students to attend accredited private schools. Families of scholarship recipients must earn less than three times the federal poverty amount guidelines. The corporate tax credit expansion will allow more families to participate in the program.

On June 30th 2009, Indiana lawmakers enacted a $2.5 million corporate and personal education tax credit. The program will provide a 50 percent tax credit for donations to scholarship programs that help lower income students to attend private schools. The bill passed the Senate 34-16 and the House 61-36 with 27 percent of the Democrats voting for the bill.

B. 2009 Voucher and Tax Credit Student Outcome Data

In 2009, several new studies profile specific vouchers and tax credit programs that save taxpayers money and/or improve academic outcomes for participating students and students who remain in the traditional public schools:

- The Comprehensive Longitudinal Evaluation of the Milwaukee Parental Choice Program,
released by the University of Arkansas’s School Choice Demonstration Project on March 24, 2009, shows voucher students in Milwaukee are getting an education at least on par with children in Milwaukee’s public schools for half the cost.

The report found that students in the program generally posted achievement gains comparable to students in the Milwaukee Public Schools (MPS). When compared to children in MPS, students enrolled in the Milwaukee Parental Choice Program experienced statistically significant gains in 7th and 8th grade math.

The report also found that the Milwaukee voucher program continues to save Wisconsin taxpayers tens of millions of dollars a year. For fiscal year 2009 alone, the state saved $37 million as a result of the program. While the report focuses on state sources of funding, when federal sources are included, it costs $13,468 to educate an MPS child, versus a maximum of $6,607 to educate a voucher student.

- A February 2009 study by the Friedman Foundation for Educational Choice reviewed 17 empirical studies that examined the impact of vouchers on academic achievement for students who remain in public schools. All but one found that vouchers improved public schools and none found that vouchers harm public schools.

- Florida’s statewide voucher program for low-income students saved taxpayers $38.9 million in the 2007–2008 school year, according to a study released by Florida’s Office of Program Policy Analysis and Government Accountability.

- A study by the Friedman Foundation for Educational Choice found that the
competition provided by Ohio’s Educational Choice Scholarship program is having positive effects not only on voucher recipients but on the state’s public schools as a whole. According to the study, the increased competition provided by the EdChoice voucher program, available to students in underperforming schools statewide, led to academic improvement in the public schools. More specifically, in the 2006-2007 school year—the program’s first year of operation—public schools showed positive effects in three grades, while no negative effects were found in the other seven grades evaluated.

C. Democrats Cancel D.C. Opportunity Scholarship Program

The 2009 Omnibus Appropriations Act, a $410 billion spending bill signed by President Barack Obama in March 2009, will cancel the D.C. Opportunity Scholarship Program unless it is reauthorized by Congress and authorized by the District of Columbia City council.

The program, created in 2004, currently provides scholarships worth up to $7,500 to more than 1,700 low-income children, serving families with average incomes of $22,300 per year. Since its inception, the program has given scholarships to more than 3,000 students. The program’s per-pupil costs are one-third the cost of educating a child in the traditional D.C. public school system.

Language added to the omnibus bill by Sen. Dick Durbin (D, IL) withholds future funding from the program unless it receives the required approvals. The program received $14 million for the 2008–2009 academic year. The federal Department of Education sat on a positive performance review of the program while Congress was dismantling it. After the program was canceled, the department released the third-year evaluation of it, which was completed in November 2008.

That evaluation shows statistically significant academic gains for the entire voucher-receiving population. Children attending private schools with the aid of the scholarships are reading nearly a half grade ahead of their public school peers who did not receive vouchers. Children in the first cohort of voucher recipients are now 19 months ahead of their public school peers in reading.

President Obama has proposed funding the current 1,700 voucher recipients until they graduate from high school. But the program will not be expanded and the president will not let new students into it. For the program to survive, new legislation will be needed to reauthorize it. That seems politically unlikely to happen, given the voting record of the legislature on the omnibus spending bill that ended the program.

D. Charter Schools Enjoy Increasing Market Share

President Obama championed charter schools in a major education speech in March 2009, praising their innovation and urging states to lift caps on their growth. Charter schools continue to be the largest example of privatization reforms in public education. These schools operate through a contract with a government authorizer. According to the Center for Education Reform, in the 2008–2009 school year, over 4,700 charter schools served more than 1.4 million children across the nation.

The National Alliance for Public Charter Schools reports that in 2007–2008 school year, 12 communities had at least 20 percent of their public school students enrolled in public charter schools, double the number of communities from the 2005–2006 school year (see Table 12). A total of 64 communities now have at least 10 percent of public school students in charter schools.
Several new studies demonstrate that charter schools continue to have a positive impact on student outcomes:

- **A RAND study released in March 2009, Charter Schools in Eight States: Effects on Achievement, Attainment, Integration and Competition,** examines charters in Chicago, Denver, Milwaukee, Philadelphia, San Diego and the states of Florida, Ohio and Texas and bolsters the case for lifting the cap on charters. While the RAND study found no significant difference in student achievement gains in charters versus regular public schools, it found that charter students graduate high school 7 to 15 percent more often and are 8 to 10 percentage points more likely to enroll in college. The study also found that charter schools do not skim the top students away from traditional public schools. In fact, in many locations, students transferring to charter schools have below-average test scores. While public schools have generally made progress with student achievement in the early grades, keeping older students from dropping out has been an intractable problem for public education. Graduation rates in the United States have hovered around 70 percent since the 1970s. For the sake of high school students especially, where these niche schools with more personalized attention and diversified curriculum seem to be making a difference, we need to rapidly expand on the more than 4,700 charter schools serving 1.4 million of the nation’s 56 million public students.

- A 2009 study of charter public schools in the Oakland Unified School District by the California Charter Schools Association shows that charters are outperforming their district public school peers at all grade levels, with high-poverty students, with English Language Learner (ELL) students and with ethnic minority students. The report also found that these gains are most prominent at the middle and high school levels and that the gains are increasing over time. The report, A Longitudinal Analysis of Charter School Performance in Oakland Unified School District, analyzed results from California’s Academic Performance Index (API) growth results and also assessed, in the most detailed analysis to date, charter schools' performance compared to their most “similarly-matched” Oakland district public schools that students would otherwise likely attend. The report found that nearly seven in 10 charter schools (69 percent) on average outperformed their three most “similarly-matched” district schools on 2008 API Growth results. The report also found that charter schools significantly outperformed district public schools in middle (836 to 624) and high schools (688 to 528) and slightly outperformed district schools at the elementary school level (725 to 705). Of the 10 highest-performing public schools in Oakland, all secondary schools were charter schools. Asian, African-American, Latino, English Language Learners and high-

### Table 12: Communities With At Least 20 Percent Market Share, 2007-8 School Year

<table>
<thead>
<tr>
<th>Community</th>
<th>Charter Market Share</th>
<th>Charter</th>
<th>Non-charter</th>
<th>All</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Orleans, LA</td>
<td>55%</td>
<td>17,925</td>
<td>14,962</td>
<td>32,887</td>
</tr>
<tr>
<td>Washington, D.C.</td>
<td>31%</td>
<td>22,175</td>
<td>50,270</td>
<td>72,445</td>
</tr>
<tr>
<td>Southfield, MI</td>
<td>28%</td>
<td>3,638</td>
<td>9,372</td>
<td>13,010</td>
</tr>
<tr>
<td>Dayton, OH</td>
<td>28%</td>
<td>252</td>
<td>16,241</td>
<td>22,493</td>
</tr>
<tr>
<td>Pontiac, MI</td>
<td>25%</td>
<td>2,649</td>
<td>8,162</td>
<td>10,811</td>
</tr>
<tr>
<td>Youngstown, OH</td>
<td>24%</td>
<td>2,663</td>
<td>8,282</td>
<td>10,945</td>
</tr>
<tr>
<td>Phoenix Union High School District, AZ</td>
<td>23%</td>
<td>7,901</td>
<td>26,450</td>
<td>34,351</td>
</tr>
<tr>
<td>Kansas City, MO</td>
<td>23%</td>
<td>7,134</td>
<td>24,449</td>
<td>31,583</td>
</tr>
<tr>
<td>Detroit, MI</td>
<td>22%</td>
<td>30,433</td>
<td>105,554</td>
<td>135,987</td>
</tr>
<tr>
<td>San Antonio TX</td>
<td>22%</td>
<td>13,015</td>
<td>45,888</td>
<td>58,903</td>
</tr>
<tr>
<td>Tempe Union High School District, AZ</td>
<td>21%</td>
<td>3,714</td>
<td>13,702</td>
<td>17,416</td>
</tr>
<tr>
<td>Cleveland, OH</td>
<td>20%</td>
<td>1,274</td>
<td>50,175</td>
<td>62,849</td>
</tr>
</tbody>
</table>

Source: National Alliance for Public Charter Schools, 2009

---

**E. 2009 Charter School Achievement Data**

A 2009 study of charter public schools in the Oakland Unified School District by the California Charter Schools Association shows that charters are outperforming their district public school peers at all grade levels, with high-poverty students, with English Language Learner (ELL) students and with ethnic minority students. The report also found that these gains are most prominent at the middle and high school levels and that the gains are increasing over time. The report, A Longitudinal Analysis of Charter School Performance in Oakland Unified School District, analyzed results from California’s Academic Performance Index (API) growth results and also assessed, in the most detailed analysis to date, charter schools' performance compared to their most “similarly-matched” Oakland district public schools that students would otherwise likely attend. The report found that nearly seven in 10 charter schools (69 percent) on average outperformed their three most “similarly-matched” district schools on 2008 API Growth results. The report also found that charter schools significantly outperformed district public schools in middle (836 to 624) and high schools (688 to 528) and slightly outperformed district schools at the elementary school level (725 to 705). Of the 10 highest-performing public schools in Oakland, all secondary schools were charter schools. Asian, African-American, Latino, English Language Learners and high-
poverty students in Oakland’s public charter schools outperformed their counterparts in Oakland’s traditional public schools. African-American and socioeconomically disadvantaged students had the largest gains over their public school counterparts on the API scoring 77 and 76 points higher.

According to the Los Angeles Times, a 2009 survey by the California Charter Schools Association shows that 12 of the top 15 public schools in performance on California’s Academic Performance Index that enroll a majority of low-income students are charters. The association focused on schools where at least 70 percent of the children qualify for free or reduced-price lunches. Of more than 3,000 public schools statewide that meet the criteria, the highest API score, 967, was earned by American Indian Public Charter, a middle school in Oakland whose students are primarily Asian, black and Latino and have a poverty rate of 98 percent. Ben Chavis, leader of the American Indian Public Charter school, credited the school’s success to a simple focus on the basics. “These poor kids are doing well because we practice math and language arts,” he said. “That’s it. It’s simple.” Of the 12 top-performing charter schools, five are in Oakland, three in Los Angeles County, two in Santa Clara County and one each in San Bernardino and San Diego counties. California has more than 700 charter public schools serving more than 250,000 students statewide.

According to a survey by GreatSchools, charter schools make up 14 percent of the top-performing public schools nationwide, despite accounting for only 5 percent of the public schools in operation. GreatSchools, a San Francisco-based nonprofit organization that helps parents choose the best schools for their children, released the study in January 2009 with BusinessWeek.

Massachusetts charter schools are outperforming traditional public schools in math and English, according to a 2009 study sponsored by the state’s education commissioner and the Boston Foundation, a community organization devoted to bettering the city and region. The study was conducted by researchers from Harvard University and the Massachusetts Institute of Technology.

**F. Philadelphia School Privatization Produces Student Gains**

Philadelphia began its historic privatization experiment in 2002, after the state took over the Philadelphia School District. A 2009 study by Paul E. Peterson and Matthew M. Chingos of the John F. Kennedy School of Government at Harvard University finds that positive student outcomes followed the experiment.

In 2002, the Philadelphia School Reform Commission contracted with the for-profit education-management organization Edison Schools to manage 20 of the district’s underperforming schools and with Victory Schools and Chancellor Beacon Academies to manage five each. The commission also contracted with four nonprofit organizations to manage 16 schools: the University of Pennsylvania (five schools), Temple University (five schools), Foundations (three schools) and Universal (three schools). Since then, the district has terminated several of the contracts and regained control of those schools. Do the terminations reflect the schools’ relative performance? The study by Peterson and Chingos finds that they do not and concludes that (1) for-profits outperform district-managed schools in math but not in reading, (2) nonprofits probably fall short of district schools in both reading and math instruction and (3) for-profits outperform nonprofits in both subjects.

The Peterson-Chingos study, published in the peer-reviewed research section of the Hoover
Annual Privatization Report 2009

Institution’s spring 2009 Education Next, confirms that the effect of for-profit management of schools is positive relative to district schools, with the effect on math achievement statistically significant. Over the last six years, students each year learned an average of 25 percent of a standard deviation more in math—roughly 60 percent of a year’s worth of learning—than they would have had the school been under district management. In reading, the estimated average annual impact of for-profit management is a positive 10 percent of a standard deviation—approximately 36 percent of a year’s worth of reading.

In 2009, Philadelphia schools Superintendent Arlene Ackerman introduced a five-year plan that calls for up to 35 underperforming schools to be shut down and reopened as district-authorized charters or privately managed schools. The first 10, which have not been selected, will convert in 2010.

G. School Districts Embracing Privatization to Cut Costs, Focus on Education

States and municipalities are not alone in facing tremendous fiscal pressures these days. School districts nationwide are being forced to cut costs to respond to the challenges of budget shortfalls and declining tax revenues.

In this context, the Roanoke school board’s recent decision to contract out school transportation services, as well as similar school services privatization initiatives around the country—are notable developments that other school districts are likely to be watching closely, as it offers a timely reminder that privatization can be a powerful tool to help “right-size” school districts and keep them focused on their core mission of educating children.

The school board in Roanoke, Virginia voted in 2009 to contract with a Pennsylvania-based bus company to provide transportation services; the board estimates this will save the school district approximately $250,000 annually. In addition, the company will buy the district’s fleet of roughly 150 buses and will acquire 15 new buses every year to replace the aging stock over time. The district’s current drivers who meet minimum standards will be offered positions with the company.

A Roanoke Times article noted that one school board member said “a private transportation system would make it possible for school officials to focus more on instruction without the distractions of running a bus system.”

In 2009, several school districts are moving to privatize services. In Columbus, Ohio, the district is planning to contract for a portion of its food operations with a private company that is committed to making the food service department more profitable. The schools’ food-service department has been losing money at an annual rate of about $3 million and officials have long discussed privatizing some of the operations. The company, Sodexo, a Maryland-based food-management corporation, plans to raise lunch prices, shrink staffing through attrition and use its national purchasing power to reduce the district’s losses. In Leominster, Massachusetts, the school committee will select a food-management firm to take over the school-lunch program, having voted to privatize the service on May 19, 2009, after the program reported a $400,000 loss. And the Board of Education in Troy, Michigan, voted unanimously in 2009 to privatize transportation services and contracted with First Student, Inc. The decision will save the district an estimated $2.5 million over the next three years.

Privatization of non-instructional support services—such as transportation, food and janitorial and maintenance services—is a common management tool that school boards nationwide use to save money on non-instructional services in order to direct more resources into the classroom.

A 2008 survey of Michigan’s 552 public
school districts by the Mackinac Center for Public Policy found that 42 percent of the districts were contracting out for food, janitorial and/or busing services. The research also identified one Michigan district which estimates a three-year savings of $14.7 million to $21.5 million from privatizing all three services, creating a savings of $557 to $814 per pupil every year. A similar survey in 2007 found that 78 percent of school districts contracting out services reported cost savings from privatization and nearly 90 percent reported that they were satisfied with their privatization experience.

Similarly, a 2008 survey by the Illinois Policy Institute found that 56 percent of school districts in that state contracted for one or more of the aforementioned services, with 43 percent contracting for transportation services (though recent changes in Illinois state law now threaten to reverse the trend toward privatization).

School districts seeking to cut costs and streamline have other options as well. A 2005 study by Reason Foundation and Deloitte Research estimated that U.S. public schools districts could save an estimated $9 billion—the equivalent of funding for 900 new schools or more than 150,000 new teachers—by combining just a quarter of their non-instructional service costs with other school districts. The study also notes that in many places, at least 40 percent of every dollar spent on education never makes it into the classroom and is instead spent on business operations: transportation, food services, information technology, building maintenance, administration and other bureaucratic support functions.

The good news for school districts is that these services are widely provided in the private sector, usually at lower cost, with less risk. For instance, Roanoke's school board stands to realize significant long-term operational savings by ridding itself of service-delivery and maintenance obligations of its buses. The district will no longer be responsible for the costs of owning and maintaining those 150 vehicles, taking a major risk off its hands. In fact, policymakers routinely cite this sort of risk transfer as a key benefit of privatization: contracting out offers a powerful method of shifting important long-term capital and operations/maintenance risks to the private sector. And when the contract is up for renewal in five years, the Roanoke board can rebid it to ensure it gets the most cost-effective service provider.

As with any privatization initiative, the key will be developing a strong, performance-based contract that holds the company accountable for meeting enforceable standards that policymakers set. The school board will need to establish a process for monitoring the contractor’s performance and ensuring it delivers.

With a bleak fiscal forecast on the horizon for state and local governments, school districts in the United States will need to make strategic management decisions along the lines of Roanoke's if they are going to provide quality education for less money. Budgets may rise and fall, but districts’ core missions—preparing students to compete in an increasingly competitive global economy—remain the same. As Roanoke and other districts demonstrate, privatization is one tool school administrators can use to free up dollars from bureaucratic overhead and drive them into the classroom where they belong.

H. Weighted Student Formula Yearbook 2009


In the United States, weighted student formula initiatives exist in at least 14 school districts and Hawaii.

The weighted student formula is a policy tool and financing mechanism that can be
implemented within existing district education budgets to create more efficient, transparent and equitable funding. Weighted student formula is a student-driven rather than program-driven budgeting process. It goes by several names, including results-based budgeting, student-based budgeting, “backpacking” and fair student funding. In every case the meaning is the same: dollars rather than staffing positions follow students into schools. In many cases, these resources are weighted based on the individual needs of the student.

Student-based budgeting employs a weighted formula that helps ensure more money is allocated to students with more expensive educational needs. Today, in most school districts, individual schools are held accountable for results, but principals have negligible autonomy because decisions about budgeting, expenditures, curriculum and hiring are largely made by district, state and other officials outside individual schools. Integral to meaningful accountability, then, is (1) empowering principals to act as leaders of their schools over these matters and (2) empowering parents to pick the public schools they believe best meet their children’s unique needs.

Student-based budgeting proposes a system of school funding based on five key principles:

1. Funding should follow the child, on a per-student basis, to the public school he or she attends.
2. Per-student funding should vary according to the child’s need and other relevant circumstances.
3. Funding should arrive at the school as real dollars—not as teaching positions, ratios or staffing norms—that can be spent flexibly, with accountability systems focused more on results and less on inputs, programs or activities.
4. Principles for allocating money to schools should apply to all levels of funding, including federal, state and local dollars.
5. Funding systems should be as simple as possible and made transparent to administrators, teachers, parents and citizens.

In addition to the weighted student formula, a full school-empowerment program includes public school choice and principal autonomy. Every school in a district becomes a school of choice and the funding system gives individuals, particularly school administrators, the autonomy to make local decisions. This autonomy is granted based on the contractual obligation that principals will meet state and district standards for student performance. Student-based funding is a system-wide reform that allows parents the right of exit to the best performing schools and gives every school an incentive to change practices to attract and retain families from their communities.

Under the weighted student formula model, schools are allocated funds based on the number of students that enroll at each school, with extra money for students who need services such as special education, ELL instruction or help catching up to grade level. Each principal controls how the school’s resources are allocated for salaries, materials, staff development and other areas that have traditionally been decided at the district level. Accountability measures are implemented to ensure that performance levels at each school are met. With its emphasis on local control of school funding, most teachers’ unions have been reasonably supportive of the weighted student formula model because it devolves autonomy to each school and places responsibility in the hands of its principal.

In each district, local context has flavored the weighted student formula in different ways. School districts vary on the names of their programs and extent to which they have empowered schools.

1. In 2008, Baltimore City Public Schools began operating under a decentralization plan called Fair Student Funding. The plan shifted resources and discretion over those resources
from the schools’ central office to its 202 schools and programs. Under the plan, schools get more resources and have more control over them, so that decisions about students can be made by school leaders rather than at the central office. This shift in resources led to a reconfiguration of the central office administration, so that it became leaner and more focused on providing basic administrative support to the schools. In 2008, Baltimore City Public Schools faced a $76.9 million budget shortfall; the Fair Student Funding plan identified $165 million in cuts from the central office to cover the funding shortfall and redistributed approximately $88 million in central office funds to the schools. Schools have dramatic new flexibility over this money. They can redesign their programs according to their needs and identify the staffing positions they require within their budget without staffing positions being dictated by the central office. The money follows the students into schools based on the students’ individual characteristics. Under Fair Student Funding, principals have discretion over at least $5,000 per student as a base funding level, up from about $90 in the 2007–2008 school year. Schools also receive $2,200 for each student who is struggling academically and each student qualifying as gifted, plus $900 for every low-income student in high school. On average, schools will receive more than $9,000 per student, with some of that money designated for specific purposes. Unlike most districts that weight poverty based on the number of children who qualify for the free-lunch program, Baltimore weights academic achievement.

2. In Los Angeles Unified School District, the innovative partnership called the Belmont Zone of Choice was initiated by teachers and community members. The plan calls for a network of pilot schools with autonomy in five significant areas: staffing, budget, curriculum and assessment, governance and scheduling. In 2007, the first two pilot schools opened: Civitas School of Leadership and the Los Angeles High School for the Arts. In 2008, three more pilot schools opened: the School of Visual Arts and Humanities, the Academic Leadership Community and the Los Angeles Teacher Preparation Academy. A total of 10 pilot schools are expected in Los Angeles by 2012. The pilot schools represent a fundamentally different approach to transforming urban public education, providing schools with maximum control over their resources in exchange for increased accountability, all within the economies of scale of an urban school district. Pilot schools are exempt from district policies and mandates. Teachers who work in pilot schools are exempt from teacher union contract work rules, while still receiving union salary, benefits and accrual of seniority within the district. Teachers voluntarily choose to work at pilot schools; when hired, they sign an elect-to-work agreement that stipulates the work conditions in the school for the coming school year. This agreement is revisited and revised annually.

3. The Boston School District has 21 pilot schools as a result of a partnership launched in 1994 by Mayor Thomas M. Menino, the Boston School Committee, Boston District Superintendent and the Boston Teachers Union (BTU). The pilot schools were explicitly created to be models of educational innovation and to serve as research and development sites for effective urban public schools. In 2009–2010, Boston public schools will open seven new pilot schools, including one run by the BTU. Studies from the Center for Collaborative Education have found Boston pilot schools outperforming district averages on every student-engagement and performance indicator. Boston’s pilot elementary, middle and high schools have higher attendance and lower transfer, suspension and dropout rates than the district average. On the Massachusetts Comprehensive Assessment System tests, pilot schools surpass the district averages at every grade level in English and math.

4. In the Chicago public schools, Renaissance 2010 (Ren2010) is an initiative...
to launch 100 new schools in the city’s most underserved communities by 2010. Ren2010 was unveiled in June 2004 by Mayor Richard M. Daley, then-schools Chief Executive Officer Arne Duncan and Chicago business and philanthropic leaders and with a goal of transforming Chicago’s public education system and to provide all families, regardless of their socioeconomic standing, with options for a high-quality public education. Under Ren2010, new public schools have been started by universities, corporations, foundations, philanthropic citizens, private schools and teachers. The approach is the opposite of the traditional one-size-fits-all view of education. Ren2010 schools are independent, giving school leaders the flexibility to respond to students’ education needs. In exchange for this autonomy, they are held to a high degree of accountability. By 2010, Chicago will have 107 Renaissance schools (including new schools and pre-existing charter schools) serving 53,679 students at capacity, equaling 13 percent of the Chicago public school enrollment. The first cohort of Renaissance schools from 2005, including charter and non-charter schools, showed larger annual gains on the state test than the average gains for other district schools. The Renaissance schools gained 6.5 percent in 2006–2007, compared with 2.3 percent gains for the rest of the Chicago public schools.

5. The Cincinnati Public Schools District was a pioneer in the use of student-based budgeting, which took effect there in the 1999–2000 school year. Unlike the previous, centrally controlled allocation system, which resulted in wide swings in funding levels from school to school, dollars now follow the student under student-based budgeting. A key premise of student-based budgeting is that all students with the same level of need receive the same level of funding within school categories, so a school’s budget is tied to its enrollment in each student category. Also, schools determine how their allotted money is spent. In Cincinnati, about 60 percent of the school district’s operational budget is spent at the school level. Through the student-based budgeting portion of the school-level budget, principals control close to 80 percent of school resources. Cincinnati continues to be one of the leaders among Ohio’s urban school districts in performance. The district is tops among these urban systems in the number of state-level report card indicators earned (nine, versus the next highest urban school system, Columbus, with six) and is second only to Akron in its Performance Index Score which is based on the state’s standardized tests for student achievement.

6. In 2006–2007, four schools in Nevada’s Clark County School District (CCSD) implemented student-based budgeting and became Empowerment Schools. Empowerment Schools are given autonomy regarding governance, budgeting, staffing, instruction and instructional minutes with the expectation that they will demonstrate increased student learning annually. According to Jeremy Hauser, an academic manager for Superintendent’s Schools, “The CCSD empowerment model is transformational. It places resources and decision-making in the hands of those who are best equipped to meet the changing educational and social needs of their children—the school community.” In 2009–2010, 17 schools will participate in the Empowerment Schools program.

7. In 2007, then-Superintendent Michael Bennet moved the Denver public schools to a student-based budgeting system. Schools have flexibility in deciding how they want to prioritize their dollars on key staffing decisions about teachers, intervention services, social workers and librarians. In 2008–2009, the school system’s operating budget was $712 million; $338 million of that went to the student-based budgeting system, $325 million was controlled centrally and used for direct support services to students and $49 million was the central office budget. Therefore, principals controlled about 47 percent of the district’s operating budget.
Denver principals also have more discretion over hiring staff than most urban districts in the United States. The teachers do not change jobs based on seniority and Denver has an open-market teacher-hiring process in which principals can interview multiple candidates and decide which teachers will fit best with their schools. The district has also used school closure as an accountability mechanism. In 2007, the school board approved closing eight schools that were under-enrolled and lower-performing. The board projected that moving students from these schools to higher-performing schools would save $3.5 million annually. That money is being used to improve the education of students who will be affected by the school closures, deliver additional resources to underperforming schools and to make money available for new schools and new programs.

8. In 2008, Hartford, Connecticut implemented an all-choice system of schools and student-based budgeting. Students will be equitably funded according to their needs and this money will follow the students to their school of choice. In 2006–07, less than one-half of the school system’s money was spent in schools and classrooms. In the system’s 2009–2010 budget, 70 percent of resources have been allocated to schools and classrooms to support instruction. The district achieved this increase with a 20 percent reduction of central office expenses, including the elimination of 40 district-level positions.

9. In 2004, the Hawaii Legislature passed a weighted student formula program through the Reinventing Education Act. Under the formula, each public school receives a set amount of money for basic needs before student characteristics are considered. In 2009–2010, the base allocation will be $4,885.87 per pupil. After the basic allocation, additional funds are given to educate students with special needs that impact their learning and achievement. Since adopting weighted student formula, Hawaii has seen small, incremental increases in student achievement on state and federal tests and increased the number of students taking advanced placement courses.

10. The Houston Independent School District implemented “weighted student formulas” in the 2000–2001 school year. In 2009, the district remains committed to the decentralization of resources and decision-making authority to the school level, where student academic success is the highest priority. About 60 percent of the district’s operating budget goes to the schools in the form of weighted student allocations. Each school’s allocation is approximately 80 percent of its total resources. The only mandated school position is principal, who has discretion over how to spend the money. Even though Texas raised accountability standards, the number of Houston schools earning an “exemplary” rating from the state increased from 15 to 38 and the number of “recognized” schools rose from 69 to 119—for a record total of 157, an 87 percent
gain since 2007.

11. In 2007, Joel I. Klein, chancellor of New York City’s public schools, announced that the schools would receive their highest-ever funding for the 2007–2008 school year and that the administration’s new Fair Student Funding program would bring greater equity and transparency to New York City’s public school budgets. Beginning with that school year, the principals and their teams at all 1,500 public schools were given broader control over resources, choosing their staffing and creating programming for their students. Under Fair Student Funding, schools have increased dollars because the new formula allocates funds based on student need. Before 2007, principals controlled just 6 percent of their schools’ budgets. In the 2008–2009 school year, each principal controlled about 85 percent of his or her budget. Principals also have greater control over staffing because of a historic agreement the New York City Department of Education negotiated with the United Federation of Teachers. In exchange for an immediate 15 percent increase in teacher salaries, the new contract gives principals the power to make final decisions regarding hiring for all vacancies. There is no more “bumping” by more senior teachers and no more involuntary placements of teachers in any school. This means that, for the first time, principals can choose the teams they think are best for their students.

12. The Oakland Unified School District in 2004 adopted “results-based budgeting,” a process based on a per-student formula that accounts for all expenses associated with school operations. Budgets are allocated to and managed by the schools. Results-based budgeting increases equity, transparency, accountability and site-based decision-making in the budgeting process. In most school districts, schools are charged for average teacher salaries rather than actual teacher salaries. This means a more popular school with more experienced teachers is often subsidized by less popular schools with less senior staff members. In Oakland, schools are charged actual salaries rather than the district average. This increases equity because schools that have more beginning teachers with lower salaries will have more resources based on the same number of students to invest in extra staff, teacher development or additional support mechanisms to help their students achieve. Even though Oakland Unified was forced to make significant budget cuts because of declining enrollment and California’s budget crisis, the majority of reductions were made at the central office and the district worked to protect the unrestricted funding that goes to schools, so that more than 87 percent of the unrestricted budget would go to schools in 2009–2010. The school district has posted the largest four-year Academic Performance Index (API) gain among large urban school districts in California.

13. In 2007, Poudre School District, in Fort Collins, Colorado, adopted student-based budgeting to begin with fiscal year 2007–08. This more equitable, transparent, flexible, student-centered model replaced a traditional model that allocated full-time equivalent staff (FTEs) to schools. In 2007–2008, the new funding formula distributed approximately $83 million of the district’s $170 million general fund budget directly to schools. The remaining $87 million goes to areas excluded from the district’s student-based budgeting, such as special education, alternative programs, textbooks, athletics, utilities, transportation, district service budgets, grants and custodial services. The district gives principals control of approximately 49 percent of its general operating budget. The majority of school districts that have turned to student-based budgeting have done so to increase equity and to help hold schools more accountable for student performance. Poudre demonstrates that student-based budgeting can be a flexible and transparent tool even in school districts with a consistent record of high performance. In Poudre, student-based budgeting is better at allocating resources to individual
14. Saint Paul Public Schools in Minnesota adopted a student-based budgeting system in 2002. The goal was to more equitably allocate resources to schools as a part of a new school funding formula. In fiscal year 2008, the district’s operating budget was $516 million; 45 percent or $234 million, went directly to the schools; 27 percent or $137 million, was resources controlled by the central office that fund school-level programs; and 28 percent or $144 million, paid for central office programs at the district level. Principals also have discretion over hiring through a voluntary transfer process whereby teachers can apply to open positions every year and the principal and the school’s local council conduct interviews and make the final decision about which teachers to hire.

15. In 2002 school year, Arlene Ackerman, a former San Francisco superintendent of schools, introduced the weighted student formula, which allows money to follow students to the schools they choose while guaranteeing that schools with harder-to-educate kids (low-income students, language learners, low achievers) get more funds. Ackerman also introduced site-based budgeting, so that school communities, not a central office, determine how to spend their money. Finally, she worked to create a true open-enrollment student assignment system that gives parents the right to choose their children’s schools. In San Francisco, school principals control approximately 74 percent of their school-level budget through the weighted student formula allocation. For seven consecutive years, the city’s school district outperformed the seven largest California school districts on the California Standards Tests.

I. Child Welfare Privatization Proposals for 2009

In 2009, two states, Nebraska and Washington, moved toward privatizing their child-welfare services.

The Washington State Legislature approved a pilot project in performance-based contracting for foster care that the governor signed into law May 18. Under the plan, the first pilot programs will be launched statewide in July 2012. After two and a half years, the Washington State Institute for Public Policy will evaluate the pilot program for the governor, who will then decide whether to expand or terminate it.

By January 1, 2011, the Department of Social and Health Services (DSHS) must consolidate and convert its existing contracts for child-welfare services to performance-based contracts linking the contractors’ performance to the level and timing of reimbursement for services. DSHS, as well as private contractors and Indian tribes, may provide child-welfare services, including case-management services, under performance-based contracts. Non-profit private contractors must receive primary preference over for-profit contractors.

The legislation calls for the establishment of a Child Welfare Transformation Design Committee, which will select two demonstration sites at which the DSHS must contract out for all child-welfare services and develop a transition plan for implementing the performance-based contracts. The committee will select the location and size of the demonstration sites to ensure a large enough sample size to assess
any meaningful differences in outcomes at the demonstration sites compared with the current service-delivery system.

Effective July 1, 2012, the DSHS must contract for all child-welfare services at the demonstration sites, including the following case-management functions:

- conducting child-caseworker visits;
- arranging for family visits;
- convening of family group conferences;
- development and revision of case plans;
- coordination and monitoring of services needed by the child and family;
- performance of court-related duties, including preparing court reports and attending hearings; and ensuring the child is progressing toward permanency within state and federal mandates, including the federal Indian Child Welfare Act.

The DSHS may not directly provide child-welfare services at the demonstration sites except in an emergency or if the DSHS is unable to contract with a private agency or the contractor or the DSHS terminate the contract prematurely.

The Washington State Institute for Public Policy must report to the governor and the legislature on the DSHS’s conversion of existing contracts for child-welfare services to performance-based contracts. The institute also must review the measurable effects achieved by private contractors at the demonstration sites compared to measurable effects achieved outside them and must report its findings to the governor and the legislature by April 1, 2015.

Based upon the reports from the institute, the governor must, by June 1, 2015, determine whether to expand the demonstration sites or terminate the contracting of all child-welfare services, including case-management services.

Nebraska also began implementing a plan to privatize child-welfare services. The state’s Department of Health and Human Services is proposing to contract with a few large agencies for the more than 4,300 children who are wards of the state and don’t live with their parents or other custodial relative.

State workers would assess the children’s needs and then the contracted agencies or companies would provide foster or group homes and coordinate services.

The changes are designed to cut the number of times children are moved between foster homes and eliminate duplication and confusion that result when several agencies provide different services to a child.

The department plans to reform in-home and out-of-home care for foster children. It is negotiating contracts with six private providers of out-of-home care: Nebraska Families Collaborative, KVC of Kansas, Visinet, Cedars, Boys and Girls Home and Family Services of Nebraska and Region 3.

The state will require providers to acquire foster homes and facilities and coordinate and deliver services. Children’s safety and well-being and preservation of families or timely adoption, will be achieved with financial incentives and disincentives to contractors.
Emerging Issues

Contents
A. Economics, Bailouts and Stimulus: Uncle Sam Replacing the Invisible Hand
B. Expanding and Modernizing Port Infrastructure through Public-Private Partnerships
C. Are Roads Still Public Goods? How Technology is Changing the Character of Transportation Infrastructure
D. The Value of Real Property Inventories

A. Economics, Bailouts and Stimulus: Uncle Sam Replacing the Invisible Hand

On March 16, 2008, the Federal Reserve (Fed) announced a momentous decision to give investment bankers access to the discount window (which offers cheap government loans) for the first time since the Great Depression. The move came in tandem with a bailout for Bear Stearns, a storied institution that is the fifth largest investment firm on Wall Street. Government officials defended the market intervention at the time on the grounds that it was necessary to prevent systemic failure. This was only the start of Uncle Sam stepping in to replace the Invisible Hand in the market.

Six months after the bailout of Bear Stearns, government rescue of firms deemed “too big to fail” became the norm rather than the exception. Starting with A.I.G. and then the Troubled Asset Relief Program (TARP), the Bush administration “abandoned free market principles to save the free market system.” The Obama administration has taken the same position, bringing the full power of the U.S. government to bear on the bear market.

The result has been to leave taxpayers on the hook for trillions in loans and spending commitments. When the Fed opened the discount window to investment banks instead of just traditional banks that are a smaller credit risk, it placed taxpayer money at risk to save securities traders. When Congress passed the Stimulus bill in February it increased the projected national debt by over $1 trillion. (See text box for a complete list of government spending to fight the recession over the last 18 months.)

Not only has the government used spending to fight the recession, but there has been an increase in direct governmental control over private businesses. Facing public outcry, the Treasury Department denied A.I.G. bonuses. Trying to avoid another bailout, former Treasury Secretary Henry Paulson demanded that Bank of America go through with a purchase of Merrill Lynch—even though the move essentially killed the struggling financial giant. And later, Paulson’s predecessor, Tim Geithner, would pressure the Bank of America board to clean house in the wake of its need for additional bailout money, even though those “fired” were the ones that warned against the Merrill merger in the first place.

Outside of the financial sector, President Obama fired Rick Wagoner, CEO of General Motors. The White House tacitly took control
of Chrysler and, after four months of trying to use taxpayer money to bail out the sinking auto manufacturer, decided to take it into bankruptcy. The Treasury Department has also extended its control over executive compensation and bonuses to the auto industry, with Geithner personally weighing whether to honor GM’s contract with Wagoner to pay him a $20 million severance package.

There have also been moves to increase regulatory control for the financial industry. Secretary Geithner has proposed sweeping reforms that would dramatically change the roles of the Fed, Treasury, Securities and Exchange Commission (SEC) and Federal Deposit Insurance Corporation (FDIC) in the market. Some of these provisions include:

- Creating a council to be a super-regulator of systemic risk in the marketplace, largely using the power of the Federal Reserve to dramatically increase rules on firms that are seen as too interconnected in the system to fail;

- Requiring financial institutions to increase their capital reserve ratios—this will reduce systemic risk, but also will also limit the capital that banks have to invest;

- Extending SEC oversight and restrictions to hedge funds—never before required to register or comply with SEC protocols because they offer services specifically to those who want to take big risks;

- Establishing comprehensive oversight of derivatives—under current law, derivatives (essentially financial contracts with value derived from an underlying asset) are not registered with a regulatory agency, but the White House is pushing for them to be traded on an open exchange instead of behind the scenes on paper; and

- New powers for the Fed and FDIC to take over any financial institution—currently, the FDIC only has the power to forcibly seize banks, but President Obama’s proposal would give the government wide-reaching authority. This, combined with other measures, will essentially institutionalize the concept of “too big to fail” and make bailouts the explicit policy of the United States.

All of these measures were being debated in Congress when this went to print.

Finally, Congress has moved toward passing legislation that would allow the Treasury Department to set salaries for private employees. Not content with laws that limit the pay of

---

**Federal Spending to Fight the Recession (Jan. 2008 to Jul. 2009)**

<table>
<thead>
<tr>
<th>Amount</th>
<th>Program</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1.7 trillion</td>
<td>Commercial Paper Funding Facility (CPFF)</td>
</tr>
<tr>
<td>$1.45 trillion</td>
<td>Mortgage-Backed Securities Purchase Program</td>
</tr>
<tr>
<td>$900 billion</td>
<td>Term Asset-Backed Loan Facility program (TALF)</td>
</tr>
<tr>
<td>$900 billion</td>
<td>Term Auction Facility Lending (TAF)</td>
</tr>
<tr>
<td>$727 billion</td>
<td>Global Liquidity Loans</td>
</tr>
<tr>
<td>$540 billion</td>
<td>Money Market Investor Funding Facility (MMIFF)</td>
</tr>
<tr>
<td>$301 billion</td>
<td>Citigroup Bank</td>
</tr>
<tr>
<td>$300 billion</td>
<td>Treasury Securities</td>
</tr>
<tr>
<td>$200 billion</td>
<td>Term Securities Lending Facility (TSLF)</td>
</tr>
<tr>
<td>$152.1 billion</td>
<td>Asset-Backed Commercial Paper</td>
</tr>
<tr>
<td>$150.3 billion</td>
<td>American Insurance Group</td>
</tr>
<tr>
<td>$118 billion</td>
<td>Bank of America</td>
</tr>
<tr>
<td>$29.5 billion</td>
<td>Bear Stearns/JP Morgan Chase</td>
</tr>
<tr>
<td>$9 billion</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>$900 billion</td>
<td>Public-Private Investment Program</td>
</tr>
<tr>
<td>$787.2 billion</td>
<td>American Recovery and Reinvestment Act of 2009</td>
</tr>
<tr>
<td>$700 billion</td>
<td>Troubled Asset Relief Program (TARP)</td>
</tr>
<tr>
<td>$400 billion</td>
<td>Fannie Mae and Freddie Mac</td>
</tr>
<tr>
<td>$300 billion</td>
<td>Housing Rescue and Foreclosure Prevention Act of 2008</td>
</tr>
<tr>
<td>$168 billion</td>
<td>Economic Stimulus Act of 2008</td>
</tr>
<tr>
<td>$24.9 billion</td>
<td>Housing and Economic Recovery Act of 2008</td>
</tr>
<tr>
<td>$9 billion</td>
<td>Unemployment Compensation Extension Act of 2008</td>
</tr>
<tr>
<td>$4 billion</td>
<td>Worker, Retiree and Employer Recovery Act of 2008</td>
</tr>
<tr>
<td></td>
<td>Federal Deposit Insurance Corporation</td>
</tr>
<tr>
<td>$2 trillion</td>
<td>Temporary Liquidity Guarantee Program (TLGP)</td>
</tr>
<tr>
<td>$81 billion</td>
<td>NCUA Capital Stabilization Program</td>
</tr>
<tr>
<td>$25 billion</td>
<td>Making Home Affordable Program</td>
</tr>
<tr>
<td>$10.7 billion</td>
<td>IndyMac Bank</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$12,886,700,000,000</strong></td>
</tr>
</tbody>
</table>
executives of financial firms and the bonuses they can receive, in April the House passed a law that would grant Secretary Geithner oversight over the compensation of any employee—down to janitors and tellers—at any firm that has received federal bailout funds. The bill (HR 1664) was being debated in the Senate when this went to print.

In total, the government has spent nearly $13 trillion trying to end the recession, while dramatically increasing its role in the economy. The free market principle of letting the Invisible Hand guide the market—even through ups and downs—has been largely abandoned in favor of control from Washington. Secretary Geithner and President Obama have both said they don’t want to control the economy in the long-term, but feel they must right now. Unfortunately, the negative consequences of their actions are only prolonging real recovery and may perpetuate conditions that lead government officials to believe that Uncle Sam must maintain control of the economy.

B. Expanding and Modernizing Port Infrastructure through Public-Private Partnerships

Efficient trade depends on the capacity of our nation’s transportation infrastructure, making ongoing infrastructure maintenance and modernization projects crucial to the long-term success of the economy. With the economy in recession and nearly every state facing budget deficits, legislators and local officials are being forced to consider better ways to pay for infrastructure improvements.

Like America’s highways and railroads, ports are an integral part of the nation’s transportation system. Today, many ports must update their facilities to accommodate for changing vessel sizes, fluctuating trends in world trade and escalating global port security standards. According to the American Association of Port Authorities (AAPA) U.S. ports invested more than $31.2 billion to improve their facilities between 1946 and 2006, nearly a quarter of which was invested after 2001. Between 2007 and 2011, 35 of the 85 ports surveyed by the AAPA are committed to investing approximately $9.4 billion in infrastructure improvements.

Unlike highways and airports, shipping ports do not have a dedicated source of federal funds for land-side facilities (There is a Harbor Maintenance Trust fund for dredging projects.) Historically, ports have relied on the revenues generated from their own operations, bonds supported by those revenues and a few government grants to keep their facilities up to date. Some state and local governments appropriate a limited amount of money from their budgets to support port improvements. Generally, however, ports are left to fund themselves.

Public-private partnerships (PPPs) are becoming increasingly popular because port authorities can no longer rely on just their own revenues and the limited amount of funding available from state and local governments to fill in funding gaps and because a growing number of private investors see that ports have a great potential for future returns. These investors are confident that ports will be at the forefront of the economy when global economic conditions begin to improve. As Christopher Lee, managing partner of the private infrastructure investment firm Highstar Capital, puts it, “Ports are going to be one of the first lines of the economy to turn when the environment improves. We want to be ahead of the competition.”

One of the forces driving investor confidence in ports is the opening of the expanded Panama Canal, which is scheduled to be completed by 2014. Once the Panama Canal is expanded, mega-ships, which cannot fit through the Canal in its current condition, will be able to reduce their transit times by cutting through the canal en route from China to East and Gulf Coast ports in the United States. Private investors who put their money down now are likely to receive
generous returns from the lucrative container trade from China, which will be able to arrive on the East Coast faster through the Panama Canal than it could moving inland by truck or rail from West Coast ports in the U.S.

PPPs are a natural extension of the business model for ports because, unlike traditional highway transportation departments, port authorities operate as self-supporting businesses and have always had to compete with other ports to maintain a customer base. Port authorities that capitalize on the port’s natural ability to operate in a business climate by seeking capital from public-private partnerships will be well positioned when the expanded Panama Canal ushers in a new and improved world of shipping.

1. Recent Public-Private Partnerships in the Ports Arena

Oakland, California: Ports America Outer Harbor LLC, owned by Highstar, recently won the right to upgrade and operate five container berths in the Port of Oakland through a 50-year concession and lease agreement.

The company’s operational plan includes an initial payment of $60 million, paid to the Port Authority, as part of a total investment of up to $150 million to upgrade 160 acres and berths within the Port of Oakland. A second, larger phase of the port agreement could involve a $350 million investment that would link the port with more rail lines.

Virginia: The Virginia Department of Transportation (VDOT) received an unsolicited $3.5 billion proposal from an Illinois firm, CenterPoint Properties, to develop a public-private partnership with the Virginia Port Authority.

The company wants to take over the state’s port operations, including the Port of Virginia, which ranks among the 10 busiest ports in the country. The proposed deal is for a 60-year partnership and could be worth $8.9 billion should the Craney Island investment opportunity be exercised. Although the proposal was initially met with skepticism from legislators and members of the media, it is now in the competitive process prescribed by Virginia’s Public Private Transportation Act of 1995. The Virginia transportation department’s time-tested process of reviewing proposals has successfully brought other transportation PPPs to fruition, such as the Beltway (I495) High Occupancy Toll Lane Project, the Pocahontas Parkway and the Dulles Greenway. Competitive proposals for the Port are due in late July, 2009.

The proposal posted on the Virginia Port Authority (VPA) Website suggests that Virginia International Terminals (VIT) would become a subsidiary of CenterPoint with all 450 current VIT employees retaining their positions. The deal would also commit CenterPoint to building the new marine terminal on Craney Island, long considered the only expansion opportunity for VPA with an estimated cost of $2.4 billion. Until now, the cost had always looked prohibitive for this long-desired project.

The Port Authority receives 4.8 percent of Virginia’s Transportation Trust Fund spending, which amounted to $36 million in 2008. With this deal, Virginia can save that $36 million or spend it on other high-priority transportation projects. Additionally, Virginia would get billions of dollars up front from CenterPoint that could be spent on improving other infrastructure and the Craney Island project could finally begin.

Maryland: On April 15, 2009, the Maryland Port Authority (MPA) issued a request for a private investor to lease and operate the Port of Baltimore’s Seagirt Marine Terminal. The MPA would like to partner with a private investor to fund a new 50-foot berth and increase the capacity of Seagirt Marine Terminal’s waterborne containers.

According to the terms of the proposed deal, the MPA would lease the 200-acre Seagirt Marine Terminal exclusively to the private investor. The private investor would be required to invest in a new berth, cranes and other necessary infrastructure, while providing a
revenue stream to MPA.

On June 30, 2009 MPA announced that two consortia—Ceres Terminals, Inc./ Alinda Capital Partners LLC and Ports America Group/Highstar Capital—had qualified to submit offers to enter a possible PPP agreement with the MPA to operate the Seagirt terminal.

Ceres Terminals, along with parent shipping company NYK Shipping Line, operates 32 terminals around the world and it handles more than three million TEU (twenty-foot equivalent unit) containers annually at 23 ports in Canada and the United States. Ceres currently performs some stevedoring services at Seagirt and has had a presence in Baltimore for more than 30 years. Allinda Capital Partners is an infrastructure fund, with $5.8 billion in capital commitments and about $15 billion in purchasing power.

Ports America operates 15 container terminals in North America with a combined throughput of near 13 million TEUs annually. The company has operated Seagirt since the terminal opened in 1990. Ports America is owned by Highstar Capital Fund L.P., a $3.5 billion private equity fund.

The agency will now issue a confidential request for offers document to each group, specifying terms, conditions and other financial responsibilities of a PPP lease at Seagirt. Offers will be due to the MPA on September 4, 2009.

Alabama: The Alabama State Port Authority recently solicited a request for a private partner to invest in the development and operation of the 74-acre Garrows Bend Intermodal Container Traffic Facility (ICTF) in Mobile, Alabama. The ICTF would handle both domestic and international traffic for multiple rail carriers and steamship lines and would finance its own operations. According to the ASPA, the facility would benefit the local economy by creating jobs, improving the ASPA’s competitive position and reducing highway congestion.

According to Jimmy Lyons, director and CEO of the ASPA, “This is the first step in the process by the Port Authority to initiate efforts to identify a private sector partner for development of the intermodal facility and is a continuation of the Choctaw Point project that started in early 2000. From the beginning, we have envisioned this project as a true public private partnership.” Potential private investors must submit a formal expression of interest by May 22, 2009 (more information is available here).

2. Conclusion

Despite the current recession and drop-off in business, private investors are still looking for opportunities to invest in the nation’s ports, suggesting that investors think ports will improve before many other parts of the economy. With state and local fiscal woes expected to continue for several years, cash-strapped governments are increasingly likely to seek opportunities to expand and modernize port infrastructure through public-private partnerships.

C. Are Roads Still Public Goods? How Technology is Changing the Character of Transportation Infrastructure

The 1990s represent a watershed in the history of transportation. In the early 1990s, privately financed toll roads (most notably the M4 and M5) opened in Australia, demonstrating the viability of private sector road development and operation in high-income countries. In 1995, the world’s first fully automated toll road opened in Riverside County, California (the 91 Express Lanes, www.91expresslanes.com). This project was completely financed through private capital (the first such U.S. facility in 50 years) and used variable tolling to regulate traffic levels at free flow speeds. Two years later, the world’s first independent, fully electronic toll road (ETR), Toronto’s 407, opened. Two years after that, San Diego opened the first HOT lane on I-15, fully funding the expansion through tolling. Private
financing of toll roads was no longer considered exotic.

Now, virtually no toll road in the U.S. is built without electronic tolling capabilities and most are transitioning to either electronic-only tolling or at least dual capabilities. Combined with worldwide progress in developing cutting-edge tolling technology to fund infrastructure and manage traffic (e.g., European GPS-based tolling for commercial trucks, interoperability successes in Chile), a new era for road investments and planning has emerged, challenging conventional ideas about how we provide and manage transportation facilities.

The implications for when, how and by whom public roads are provided are revolutionary. Historically considered a “textbook” case of a public good—a service that only the government could provide because the private sector wouldn’t or couldn’t—privately financed, maintained and operated roads are now considered a viable alternative to pure public provision. More importantly, as technology enables greater market segmentation, reduces collection costs further and allows pricing to prioritize investments more effectively, roads may well transition into a predominantly private good.

Of course, we’re still a long way from a fully privatized, comprehensive road network, but technology has advanced to the point where the concept is no longer largely theoretical. In some cases, private provision of roads is a practical necessity. Over the long run, the transition is probable.

A thumbnail history of a few signature projects helps explain why.

Canada’s Highway 407 ETR opened in 1997 as an east-west limited access highway running 67 miles just north of Toronto. What made this road different from previous roads in North America (and elsewhere in the high income world) was how drivers paid for using the facility: 100 percent electronic toll collection. This allowed two innovations that dramatically changed the road management landscape. First, it allowed users to enter and leave the road without stopping. The toll road was boothless. Second, electronic tolling allowed non-subscribers to use the road without stopping as well, maintaining the same level of service as subscribers (although for a higher fee).

Currently, more than three quarters of the daily travelers use electronic transponders that allow the 407 ETR Concession Company (owned by Spanish company Cintra) to bill users to permanent accounts similar to debit or credit cards. The other users are identified visually and billed; video cameras photograph license plates and cross-match the plate number with motor vehicle records.

More importantly for the future of road management, the facility is self-financing because the toll acts as a true user fee. With electronic tolling, a provider can maintain a high level of service while also allowing the provider to divide up the market based on willingness to pay. In this case, regular users have access to discounted rates through transponders while occasional users pay on a per-use basis through automatic visual billing. Thus, for all intents and purposes, the ETR is a “private” toll road in the sense that it operates like a non-government business and does not depend on subsidies from non-users in the form of taxes (or other fees on non-users) to operate.

The system has been so successful that the roadway has already been widened several times. The highway started as a road with two lanes going in each direction (2 x 2). It was then expanded to 3 x 3 and in some places 4 x 4. Some sections are now even 5 x 5.

Of course, the 407 ETR was not the first privately financed road facility. On the contrary, its contribution was demonstrating how the use of electronic technology can fundamentally alter the way roads are operated. In the long run, this will enable greater private sector participation.

Electronic tolling, however, is only part of the story of the evolution of roads from public...
Another critically important innovation was pioneered by the 91 Express Lanes when the facilities adopted variable pricing to ensure a high level of service 24 hours a day, seven days a week. Most highway tolls are flat rates: one price regardless of the time of day or traffic volume, although the toll level is commonly adjusted for the length of the trip. This rate structure reflects the historical roll tolls have played to finance the initial construction of roads and pay off the resulting debt, but not to pay for road management. This structure served the purposes of the taxpayers who were funding road improvements from general revenues, but not the travelers who actually used the road.

Travelers value the service that the road provides—quick, reliable access to preferred destinations. The concrete and asphalt is a means to an end, not an end in itself. Thus, while a flat-rate toll might generate revenues to pay off the debt incurred to build the facility, toll rates are typically not structured to regulate traffic flow so as to maintain a specific level of service. In other words, they are not used to enhance the value of the product to the road user.

Historically, this made sense for most roads. The technology didn’t exist to allow for toll rates to change within a window sufficient to influence driver behavior. Most toll collections were manual and little thought was given to measuring the actual volume of the traffic on the roadway. New technology, however, has given road managers more flexibility for setting toll rates based on the volume of traffic at specific times of the day, as well as the ability to change the price as traffic patterns change.

The global pioneer in variable rate tolling is the 91 Express Lanes project in Orange County in Southern California. The 10-mile stretch of limited access highway was originally added to a highly congested freeway (SR 91) by a private company, but was sold to the Orange Country Transportation Authority (OCTA) several years later.

Like the private company, the OCTA sets the toll rates based on the traffic volume to ensure free flow traffic 24 hours a day, seven days a week. (In fact, tolls are refunded at the end of the trip if the vehicle doesn’t travel at the speed limit.) As of April 1, 2009, the toll authority set a maximum rate of $9.50 (lower than the $10 peak set in 2008) to achieve this goal. While the high toll rates are sometimes criticized by the public, officials at the authority note that they need to set the price to maintain free flow or “they have nothing to sell.” During times with lower demand, prices are substantially lower; at night, for example, prices can be as low as 12 cents per mile. With toll rates adjusted based on traffic volume, users of the 91 Express Lanes experience a reduction in driving time on that stretch of road from 40 minutes to less than 10 minutes.

Down the road on I-15 in San Diego, high occupancy vehicle (HOV) carpool lanes were converted into high occupancy toll (HOT) lanes where the toll rate changes in real-time based on current traffic volume and conditions. Thus, in addition to using variable rates, tolling on the I-15 HOT Lanes is dynamic, allowing road managers to regulate the volume and level of traffic to maximize the value to its traveling consumers. The program has been so successful that the transportation authority is now expanding the HOT lanes to accommodate additional traffic. Similar technology is being used on I-394 in Minneapolis where rates are adjusted every three minutes to ensure at least 50 mph speeds on its managed lanes.

The combined effects of this technology are revolutionary. Transponders, video license plate recognition and other emerging technologies (e.g., GPS) can collect tolls at free flow speeds, segment the driving market based on willingness to pay and set prices to manage the flow of traffic, enabling more and more facilities to “pay their way” without subsidies from governments.

While the number of new facilities that can be completely funded through user fees remains limited to highly congested urban areas, self-funded roads are often more viable than conventional wisdom allows. For example,
Reason Foundation released a comprehensive road-based congestion mitigation strategy for the Atlanta metropolitan area in 2006 that included tunnels and new highway capacity. Free-flow travel would be guaranteed through a self-funded HOT Lane network that would generate enough additional revenue to make financially feasible a new north-south tunnel. This tunnel would allow regional through traffic to avoid highly congested Downtown Atlanta. Reason Foundation’s research on several projects that could be financed with toll-based user fees is summarized in Table 13.

<table>
<thead>
<tr>
<th>Project</th>
<th>Description</th>
<th>Est. Cost</th>
<th>% Self-Support</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Pasadena Tunnel</td>
<td>4.5 mile, 4 lanes each direction</td>
<td>$1.5 B</td>
<td>100%</td>
</tr>
<tr>
<td>Palmdale-Glendale Tunnel</td>
<td>21 miles (5 miles at grade); double decked</td>
<td>$3.7 B</td>
<td>100%</td>
</tr>
<tr>
<td>Riverside-Orange County Tunnel</td>
<td>14 miles</td>
<td>$7.4 B</td>
<td>59%</td>
</tr>
<tr>
<td>LA HOT Lane network</td>
<td>1,009 lane-miles (385 of them new)</td>
<td>$13.5 B</td>
<td>92%</td>
</tr>
<tr>
<td>San Bernardino-Riverside HOT Lane</td>
<td>410 lane-miles (320 of them new)</td>
<td>$5.8 B</td>
<td>72%</td>
</tr>
<tr>
<td>Atlanta Congestion Mitigation</td>
<td>Four major infrastructure projects including regional HOT Lane network,</td>
<td>$25 B</td>
<td>78%</td>
</tr>
<tr>
<td>strategy</td>
<td>truck toll lanes and new tunnel</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

These facilities, of course, are limited-access highways. It is more difficult to design a system for private provision of local and regional roads. Local roads typically involve multiple points of entrance and egress, since vehicles are provided frequent access to local destinations such as restaurants, offices, residences, shopping centers and entertainment venues. Levying a toll at the point of entry and exit is impractical, although the recent success of implementing a cordon charge around central London suggests that many issues with this approach are now political rather than technical.

Even in the case of local roads, however, technology is once again providing new ways to transition to true user fees that may enable private participation. The most promising U.S. experiment is a mileage fee pilot project undertaken by the Oregon Department of Transportation (ODOT). Using state-of-the-art GPS technology, the ODOT experimented with levying a charge on drivers based on the miles they traveled rather than the gas they consumed. In the pilot project, the state levied a mileage charge that differed based on whether the driver was traveling in state, out of state or at peak periods.

Conceptually, this is a much more efficient funding system since mileage is a much better indicator of impact on the road system than fuel consumed. More importantly, with a mileage charge that varies by time of day, drivers would be given stronger and more direct information about the economic cost of traveling on particular roads at particular times. Since GPS technology provides a means for levying fees based on the specific location and time a car is driving, revenues can be raised directly from the users regardless of the type of road they use and prices can be used to manage traffic flow.

Technology is also providing a more competitive environment on the supply side. This is a critical step if the private sector is to become more involved in providing roads. While road networks still may need to be designed in a holistic context, specific elements and segments of the road network should probably not be managed or operated through a monopoly. By allowing multiple providers to choose different levels of service and quality, regions can more effectively tailor services to specific segments of travelers. For example, operators specializing in meeting the needs of commercial truck traffic may be better owners, operators and managers of commercial roads, with stronger incentives to create (and maintain) facilities such as truck-only toll lanes. Similarly, other operators may specialize in providing road facilities for passenger traffic.
The possibility of differentiating road facilities based on a diversity of providers is not as farfetched as it might seem. Public transport services—whether rail, trolley, ferry or bus—have a long tradition of relying on multiple providers with varying ownership interests and types. In Santiago, Chile, four independent toll road companies manage 97 miles of urban toll roads using electronic, open-road tolling technology to achieve system-wide interoperability. The system is seamless for consumers, who may never even realize that they are driving on roads maintained and operated by different private companies. Since the toll road network is an open road system, the firms have an incentive to create a seamless and user-friendly billing system that minimizes toll avoidance. To accomplish this, providers adapted and applied software already used by utilities to their toll road systems.

Combined with GPS technology, where drivers can be charged based on location, time of day and traffic volume, roads can be managed and operated by small as well as large companies. Indeed, within the road infrastructure investment and management industry, companies frequently combine with other competitors to manage different facilities.

Complete privatization of roads is unlikely within the next decade or two. Nevertheless, with open road tolling, the potential for privatizing the management, if not ownership, of limited-access highways already exists. Moreover, by some estimates, tolling has financed the expansions of as much as half of the limited-access highway capacity added in recent decades.

The expanded use of Public-Private Partnerships (PPPs) to harness the efficiencies of private management as well as tap into private equity markets clearly demonstrates that the private sector recognizes the economic value of road facilities. As national, state and local governments fine-tune and refine their PPP agreements, full privatization by the middle of this century of select limited access highways is conceivable. With additional modifications and innovations in GPS technology, even the privatization of local roads could be feasible by the turn of the century.

This article was adapted from Chapter 13 in Samuel Staley and Adrian Moore, Mobility First: A New Vision for Transportation in a Globally Competitive 21st Century (Rowman & Littlefield, 2008).

D. The Value of Real Property Inventories

Governments struggling in the economic downturn have been looking to divest assets as a way of raising money to cover a reduced tax base. But many are discovering that their lists of property are very outdated. Nearly half of the states and Washington, D.C. do not have the basic property and asset data that a well-run business or responsible family relies on to manage their finances. Several others are still trying to develop them.

Furthermore, most state governments that do have inventories of their property are not proactively managing what they own, which has led to frequent misuse and underutilization of land and assets.
Particularly in times of economic crisis, government must pursue efficient operations and know the full array of financial opportunity associated with its assets.

1. Real Property Inventories

The basic problem is that governments do not keep accurate track of how many acres they own, how much property they lease, how many buildings they maintain and how space is being maximized. In many states, inventories are required by law; however, these laws are often ignored. But even aside from the law, a comprehensive understanding of what government owns is good public stewardship.

The first step is for states and the federal government to map out what land they own or lease, organized either by county or agency (or both). Geographic information systems (GIS) have been used by all levels of government for various purposes—comprehensive planning, tax-mapping and Enhanced-911, to name a few—and are an important tool for developing accurate property maps. These maps can also led to more accurate lists of taxable property, as Wyoming and Ohio recently discovered.

With property maps states can create an inventory of all their real property, both owned and leased. With this centralized inventory, states can then assess what property they are using and what they are not (often called space management). States can ensure efficient land use and sell unnecessary property, bringing in revenues for the government and encouraging local economic growth.

2. Centralized Asset Management

States often have decentralized accounting methods where agencies, counties or municipalities keep track of government-owned land. This means that no one is able to see the big picture and there is no accountability to ensure good records. Data is limited, fragmented, in many cases agency-specific and recorded in multiple formats that lack any cohesiveness. Integrating these databases identifies redundancies that can be eliminated and enhances management capabilities.

Critical to centralization is making agencies produce reports compatible with each other. Often, state agencies will develop their own criteria for measuring property, creating incompatible reports leading to missed opportunities in space management. Government agencies and departments must use similar metrics when taking inventory of their land and assets both to make processing more efficient and also to make management easier.

3. Managing Beyond Mapping

Mapping is not enough. A centralized inventory is not even enough. Only when a real property inventory is used to actively manage government-owned land and assets will the inventory initiative be successful. Too many states stop at just an inventory and do not proactively seek to divest unused or underutilized property. An inventory project must be undertaken with the expressed intention of reviewing and acting to use land and assets more appropriately and efficiently. Land inventories must also be continual and dynamic. An initial inventory and assessment should be done to reduce the bulk of misuse, but the assets of the government must be constantly monitored to ensure efficiency.

Only when government has an accurate map and inventory of its land and assets can it properly manage its resources—constantly and accurately—to maximize efficiency, responsibly steward public resources and take advantage of all economic benefits.

4. Case Studies

Ohio: In 2007, former State Treasurer Richard Cordray, recently elected Ohio Attorney General, realized his state didn’t know how all of its land was being used. “Although perspectives may vary,” he said, “some of that land is certainly unused or underutilized.” He directed...
his office to set about on a two-fold mission: first, to compile a comprehensive inventory of state-owned property and second, to begin looking for ways to put misused property to better use.

Cordray first used GIS to map the state’s land. The initial survey found large amounts of unimproved land along state roads and highways. Properties designated for public office space or storage were discovered to be vacant and unused. Still other state-owned parcels were identified as too small or so peculiarly shaped as to be unusable and had been ignored for years, wasting potential tax revenues and squandering the economic growth that the private sector would have generated.

By July of 2007, Cordray’s inventory had identified many underutilized properties, including a 12.9-acre parcel in west Columbus that was not being used by the state at all. The state treasury department then arranged to sell that land, with legislative approval, to the city of Columbus for a new police heliport. The city benefited and the state brought in nearly $200,000 with the sale.

Even though the real property inventory is not yet complete, the state has already begun looking for opportunities to use its resources effectively. Government doesn’t have to wait for its inventory to be complete to start using its information to collect revenues that address current budget needs.

In the spirit of efficiency, the state has put the entire inventory online for citizens to see. There is a search function available for properties identified. There is also a place for citizens to report public property that the state might not be aware of. Citizens should easily be able to access information on how much property their government owns and what it is using that property for.

On December 30, 2008, Ohio Governor Ted Strickland, signed into law HB 420 which, along with providing state spending transparency and increasing state real property management, codified the Cordray inventory and established a council to oversee its operation and maintenance.

Georgia: January 12, 2005, Georgia Governor Sonny Purdue issued an Executive Order creating a statewide land inventory with the intention of selling unused property. After
a review council researched what would be necessary for the project, the Senate introduced S.B. 158, directing all state agencies “to file inventories of their real property assets with the Georgia State Properties Commission (SPC) and authorized the SPC to compile and index all such inventories into a single complete inventory of all real property.”

From these records, Georgia created the Building, Land & Lease Inventory of Property. The state contracted with the Information Technology Outreach Services of the Carl Vinson Institute of Government at the University of Georgia, which had agreed to use its expertise with Web-based geographic information systems to build the system from the ground up. BLLIP is an online, interactive geographical information system that citizens and state employees can use to search and generate reports using real time information about publicly owned and leased properties and buildings.

Georgia’s example reveals a healthy mix of executive-initiated efficiency that worked with the legislature and representatives from state agencies to develop an inventory that is publicly accessible, designed by top-rated local technology experts and actively seeking divestiture opportunities.

Arkansas: In 2001, the Arkansas state legislature funded GIS technology to be used in creating a statewide inventory of real property, to be managed by the Arkansas State Land Information Board (ASLIB). The established duties of ASLIB include identifying issues, problems and solutions in implementing the Arkansas geospatial data infrastructure; developing procedures for the inventory, storage and distribution of spatial information; and providing GIS educational programs.

Unlike other states, Arkansas organizes publicly owned land by county, instead of by agency. The board is composed of 12 gubernatorial appointees representing state government, city, county and local government, the private sector and institutions of higher education.

Arkansas has established the County Assessor Mapping Program (CAMP), which stems from a 2002 report recommendation. Through CAMP the state maintains a constant relationship with the counties, providing support and collecting real property data. State Geographic Information Coordinator Shelby D. Johnson told Reason Foundation, “We have anecdotal evidence that economic development is the biggest use/return on investment for this data.”

5. Conclusion

Real property inventories and management systems are simply efficient government. It is not a partisan issue, nor one of spending priorities. It is a good governance initiative that can help governments struggling with economic difficulties.

This article was adapted from a forthcoming Reason Foundation study, Knowing What You Own: Efficient Government Through Real Property Inventories, to be released in fall 2009.
Telecommunications

Contents
A. Broadband Stimulus Update
B. IT Outsourcing Update
C. Network Neutrality Update

A. Broadband Stimulus Update

On July 1, 2009, the Obama administration released the rules and deadlines for the $7.2 billion broadband portion contained in the mammoth $787 billion stimulus bill. The National Telecommunications and Information Agency (NTIA), part of the Department of Commerce and the Rural Utilities Services (RUS), an arm of the Department of Agriculture, are responsible for the grants and began accepting applications July 14. The deadline for applications for the first round, which is expected to entail some $4 billion in allocations, is August 14. Finalists will be announced September 15, with awards going out November 7. Two more rounds are expected to follow. The bill requires that the money be allocated by September 2010.

For purposes of the stimulus, NTIA and RUS have defined broadband as 768 kilobits per second (kb/s) downstream, 200 kb/s upstream, relatively low considering most cable modems connect at six megabits per second (Mb/s), almost eight times as fast, with service reaching 10 Mb/s in some areas. Fiber-to-the-home connections transmit between 50 and 100 Mb/s. The government said the low speed was set to encourage wireless development. But even now, wireless broadband is pushing speeds twice that.

NTIA and RUS also imposed a network neutrality requirement. This means recipients will be prohibited from optimizing their networks for specific Web applications, especially video. Major commercial carriers, including AT&T, Verizon and Comcast, say they won’t apply given these rules, which they say will degrade service, an opinion shared by other network engineers—including many unaffiliated with service providers. In what some see as a hedge, NTIA and RUS left open the possibility of revising the rules if they need to attract a field of viable applicants. (For more on network neutrality, see Section C).

The Federal Communications Commission is also expected to weigh in. Although its influence to choose specific recipients may be limited, the FCC may be able to use rulemaking to favor some applicants over others.

The broadband stimulus is aimed at reducing the “digital divide,” the gap between urban and rural broadband infrastructure as well as the adoption gap between middle- and high-income households and lower income households. Today’s telecom policymakers get the subsidy message from both sides. Progressives look at these trends and say free market mechanisms have failed and more government subsidies are required. Rural telephone companies say the only way they can provide affordable broadband is if subsidy mechanisms continue.

But other facts challenge this conventional wisdom. While rural penetration lags, it’s still increasing. From 2001 to early 2008, according to the Pew Internet and American Life Project, rural broadband penetration grew from 5 percent to 38 percent. If we break that down, we see that rural
penetration grew from one in 20 households to almost eight in 20 or 40 percent. This compares to an overall national penetration of 55 percent, according to Pew. Again, there are more users in cities and suburbs, but plenty of real growth in the rural areas, too.

Even so, $7.2 billion does not amount to much compared to the investment commitment the telecom industry has already made, relatively speaking. Combined, telephone, cable and wireless companies invested close to $115 billion in 2007 alone in infrastructure, much of it broadband upgrades and some $350 billion in the four years preceding, according to the Bureau of Economic Analysis.

The allocation process is expected to draw a cross-section of commercial service providers, rural cooperatives, nonprofits, municipal telecom operations and public-private partnerships. Who will walk away with how much cash—and whether the broadband stimulus will succeed—depends on several factors, including how the NTIA, RUS and FCC define “unserved” and “underserved” areas in the context of broadband availability, what regulatory conditions will be placed on stimulus recipients and how much emphasis the agencies will place on stimulus recipients and how much emphasis the agencies will place on supply-side programs—e.g., broadband infrastructure buildouts—versus demand-side programs such as education and training for income, ethnic, racial and age segments of the population that have been adopting broadband at a slower-than-average pace.

1. Determining Priorities

Fiscally conservative analysts say truly unserved areas—communities with no broadband service and no immediate likelihood of private sector investment—should be the stimulus priority. Indeed, the stimulus package sets aside $350 million for identifying and mapping these unserved areas, following examples pioneered by policy reformers in Kentucky, North Carolina and Tennessee.

The second priority should be underserved populations. This is more of a demographic issue than one of infrastructure. The task is not only to raise broadband penetration in rural areas, but also increase adoption among low-income households in areas where there is competitive, affordable service. In Pew’s 2008 Broadband Census survey, 19 percent of respondents using dial-up said nothing would convince them to get broadband. This would suggest the need for funding programs that provide training on the use of computers and Web-based resources, as well as general education and awareness of broadband benefits.

However, free-market oriented policymakers believe it would be economically counterproductive to direct stimulus funds into areas where broadband is plentiful, but not necessarily state-of-the-art. The fear is that it will slow private investment in faster cable modems and fiber-to-the-home programs. Cablevision, a major New York City area cable TV provider, introduced a 101 Mb/s cable modem service in April. Verizon’s FiOS fiber-to-the-home service passes nine million homes. Still, the city of Seattle, where there are several companies providing wired and wireless broadband service at a range of prices, reportedly may seek stimulus funds for its $500 million citywide fiber-to-the-home network, which has been on the planning boards since 2005. On the other hand, the city also said it is in search of a private sector partner.

2. “Sustainable” Projects

Although progressives see the stimulus as an opportunity to fund government broadband initiatives, particularly municipal broadband projects, analysts watching the process thus far see no evidence that NTIA or RUS are inclined toward favoring public, government-financed models over others. Neither the NTIA nor the RUS has engaged in any anti-phone or anti-cable company rhetoric. We may know more once FCC Chairman Julius Genachowski settles into his post, but thus far there has been little in his statements indicating that he will pursue a doctrinaire approach.

On the contrary, those who want to see the stimulus work in favor of greater investment have been pleased by the emphasis NTIA and RUS say they will place on the economic sustainability of the applicants. While in the end the allocation process will be something of a beauty contest among applicants—there will be close calls with some subjectivity involved—both NTIA and RUS
say they want to see business plans that demonstrate realistic sources of revenue growth once the stimulus dollars are spent. “Applicants must state what needs the funds will be used to meet,” said one source close to NTIA. “It can’t be ‘we’ll build it and they will come.’” Plus, all applicants must have a financial commitment for at least 20 percent of the amount of cash they are requesting from another source.

If the federal agencies hold to these requirements, the process should end up favoring incumbent service providers and viable private-public partnerships.

These partnerships can take a variety of forms, including a number of sustainable models that have been attempted in the wake of the purely municipal-run broadband failures. In these cases, a local government seeks out a private industry partner to build and operate a local broadband network. The local government agrees to be the “anchor tenant,” providing the primary source of revenues for the private partner at the outset. Those funds provide the necessary cash flow to permit greater investment in local commercial service. The caveat is that the decision to outsource must be made on the basis of sound economics—i.e., the city’s participation in the broadband partnership must cost less in the long run than other competitive broadband service arrangements (should they exist). To be sure, investment decisions are always subject to risk, but there is far less danger to local treasuries and taxpayers if cities do not favor low bidders by agreeing to cover any losses with subsidies or transfers.

Other models involve nonprofit agencies or operations. The idea is the same as a commercial partnership, only in this case the nonprofit, while it still must demonstrate a viable and sustainable base of income and funding, does not face the return-on-investment priorities that a commercial partner would. Such nonprofits can operate outside of the government sphere or use funding mechanisms that tap both private and public funds. Once again, the key to their success is to avoid using local taxpayers as their final guarantors.

3. Undermining Good Models?

But even if it emphasizes sustainable projects, the federal stimulus can short-circuit more fiscally responsible approaches. For example, a former World Bank and Senate economist and 35-year veteran of the telecom industry is trying to bring fiber-based broadband to a rural section of Vermont using a business model that combines private sector dollars and a nonprofit grassroots effort.

According to The Wall Street Journal, a group of Vermont towns with a combined population of 55,000 partnered with ValleyNet Inc., a local nonprofit group, which in turn hired Tim Nulty, economist and telecom professional, who set up a high-speed network for Burlington, Vt., in 2006, to manage the project.

The plan is to string 1,400 miles of fiber-optic lines across telephone poles to provide a combination of high-speed Web access, phone and cable TV service. The project is to be financed through a capital lease, with the towns raising money from investors to build the network and then leasing it back from them over 23 years.

Nulty told the Journal he would have preferred federal loan guarantees, which would reduce the risk of private investors without necessarily resulting in any cost to taxpayers in the long run. But a proposal by Sen. Patrick Leahy, a Vermont Democrat, that would have directed loan guarantees to projects like Nulty’s, was shot down in the congressional stimulus negotiations. So now Nulty will request a direct cash grant instead.

Nulty and ValleyNet may have been on their way to proving that the slow rollout of rural broadband was not due to market failure; it just needed an adequate business model. Examples like these show the stimulus’s potential to supplant private sector investment dollars that demonstrably exist, serving only to increase debt and reduce wealth.

4. Conditions and Requirements

There also is growing concern that the government could attach regulatory conditions to any stimulus recipients. Here’s where the FCC could make its influence felt most: the stimulus bill, in
very elastic language, calls on the NTIA to follow any rules the FCC sets down for applicants. This would give the executive branch tremendous discretion and could indirectly influence stimulus allocations simply by driving away prospective private sector applicants who would fear that the conditional regulations would put them at a competitive disadvantage. Even without FCC input, NTIA and RUS have already attached network neutrality requirements. Nor has the government been shy about attaching conditions to banks and auto companies that have received bailout dollars. Additional telecom policy stipulations are not beyond the realm of possibility.

These conditions and stipulations could be:

- Content filtering, perhaps against adult sites, gambling sites, social networking sites and peer-to-peer services.
- Agreement to collect sales taxes from out-of-state online merchants, even if federal and state laws in this regard are either under challenge or have been ruled inapplicable.
- Agreement to be deputized into law enforcement activities, including agreement to turn over phone, email and search records on government request.
- Agreement to some kind of “fairness doctrine” for the Internet, such as a requirement to push links to a liberal site on conservative blogs (and vice-versa).
- Agreement to ban the use of targeted Web ads, even though they are invaluable to the growth of small commercial Web sites.

All of these regulations or controls have been proposed at the state and federal level in the past several years and most of them are part of the Democratic agenda (although some, such as content filtering and an electronic records search, have Republican support). The degree to which they will be imposed comes down to how activist the FCC chooses to be.

**B. IT Outsourcing Update**

Faced with multiple and often incompatible computer and information systems, combined with budget pressures and growing demand from citizens for a greater online presence, states and municipalities are turning to outsourcing as a way of unifying and streamlining the information technology and services they use for day-to-day operations.

Virginia is generally credited with launching the large-scale IT outsourcing trend in 2005. There, state officials approved a 10-year, $2-billion agreement with Northrop Grumman to manage the state government’s IT operations. Other states and cities—examples include Georgia, Florida, city of Minneapolis and county of San Diego—have either launched or stepped up programs in the past four years.

While some of these projects have hit bumps, most have begun to meet their goals in terms of reducing costs while improving IT operations for city and state employees and residents and businesses who use them. Even when problems did arise, as they did in San Diego, they provided critical lessons that have been absorbed elsewhere.

Government IT outsourcing generates far less controversy than outsourcing and privatization initiatives in other areas, such as roads, prisons and airports. This is due to several factors. First, IT was never a “traditional” responsibility of government, the way other services supported by heavy infrastructure—transportation, utilities and schools—are perceived. Second, government IT operations are inwardly focused—they support the day-to-day processes of government departments and employees. Hence, politically, there’s no negative perception among voters that a “free” government service is being transferred to a corporation that will run it for profit. Quite the opposite: To the extent that the public sees a benefit from improved IT, it’s in the way they can handle their government business online. If anything, the private sector has raised constituents’ expectations about Web- and Internet-based applications such that frustrations will grow if people can’t find critical information, submit forms or make payments via the Web.

Finally, even state and local governments realize that their IT operations are inefficient
and could benefit from outside management that could streamline systems and run them more cost-effectively. In this they are not so different from many large corporations, which over the years realized that they were spending so much time and money managing IT resources that it was detracting from their core business.

States, counties and cities are realizing that, over the years, their various departments and agencies have been adding computers, networking equipment, applications and databases in isolation of one another. The Department of Motor Vehicles might use one system; the Tax and Revenue Department, another; the agency charged with unemployment and welfare benefits, still another. Not only are costs duplicated, so are data. What’s more, data cannot be shared, errors cannot be corrected, nor can updates be made in any uniform way. With states under new mandates relating to homeland security, immigration, public health, driver’s licenses and taxation, not to mention their own IT budget pressures, the lack of a unified, common IT infrastructure does nothing but exacerbate cross-agency communications problems, data errors, security risks and costs.

Such projects, however, come with multi-million dollar price tags and multi-year commitments and involve multiple subcontractors. States that have been successful have done their due diligence and set measurable goals.

1. **Georgia Streamlines 11 IT Operations**

For example, in November 2008, the state of Georgia awarded IBM an eight-year, $873-million contract to consolidate the following 11 independent IT environments into an integrated operation:

- Administrative Services
- Community Health
- Corrections
- Driver Services
- Georgia Bureau of Investigation
- Georgia Technology Authority
- Human Resources
- Juvenile Justice
- Natural Resources
- Planning and Budget
- Revenue
- Technical and Audit Education

IBM will provide the state with a range of data center services including mainframe and mid-range system management, service desks and disaster recovery. IBM Internet Security Systems will supply security services. In addition, the agreement will enable the state to replace an aging infrastructure and migrate older technologies onto newer IBM technology platforms. Dell, Xerox and AT&T are also supplying equipment and services as part of the deal.

According to the Georgia Technology Authority, IBM began providing IT infrastructure services April 1, 2009. AT&T began providing managed network services May 1, 2009. In the initial two years of the deal, IBM and AT&T must deliver:

- An enterprise-wide service desk with 24/7/365 coverage
- Consolidation of application servers and data storage
- Consistent IT security
- Improved disaster recovery
- Standardized service levels across all agencies
- Comprehensive asset management, and
- Up-to-date technology through regular equipment upgrades.

As part of the agreement, all 291 state employees involved in infrastructure services were offered jobs with IBM. Of the 191 state employees involved in managed network services, 33 received offers. Salaries offered were “comparable” but not necessarily equivalent pay. State employees absorbed by IBM and AT&T, however, retained health benefits (pre-existing conditions were covered) with no waiting time. Their 401(k) eligibility and vesting did not change and their years of service were recognized.

Employee issues are perhaps the one hot button with outsourcing and states have learned to be careful about attempting to derive significant cost savings through staff reductions. Indiana learned this lesson when it awarded its IT outsourcing contract to India’s Tata, one of the world’s biggest IT firms, in 2003. As chronicled by Thomas Friedman in *The World is Flat*, Tata’s
bid came in at $8 million less than its nearest competitor. Much of that savings, however, derived from replacing state employees with Tata employees transplanted from India at much lower pay scales. A backlash ensued, forcing Indiana to re-award the contract to a U.S. company that would draw from Indiana workers.

Since then, like Georgia, states and municipalities have been adopting outsource plans that retain but “re-badge” IT staffers with the outsourcing company.

2. Minneapolis’s Award-Winning Partnership

The city of Minneapolis’s IT outsourcing contract with Unisys has become one of the most admired in the country, earning a “Best Partnership” award from the Everest Group, an IT consultancy, in April. Unisys signed its first five-year deal with Minneapolis in 2003. In 2008, Minneapolis awarded the company a second five-year contract worth $48 million.

Unisys will continue to provide a full range of outsourcing services to manage the city’s complete IT infrastructure, from the data center to desktops and mobile devices. Unisys provides IT management and support services for approximately 4,500 city of Minneapolis employees, fielding an average of 1,600 service desk calls and 160 equipment installs, moves, adds and changes per month. Unisys manages more than 210 server computers and 4,400 e-mailboxes for the city, along with more than 330 network devices, 3,650 desktop devices and 1,100 printers. The Unisys services range from technology planning to end-user support, data center management and network management and address all agencies of the city government, including the mayor’s office, city council, fire and police departments and the public works department.

According to the city, this outsourcing relationship has enabled it to save more than $18 million while expanding the services it provides to residents of Minneapolis.

In addition, the city has embraced wireless networking and mobile computing. With assistance and ongoing infrastructure management from Unisys, the city has installed a safety camera system that it cites as contributing to a 44 percent reduction in robberies, a 17 percent decrease in car thefts and $6 million savings in court costs.

Also, the city and Unisys outfitted a fleet of emergency command vans for wireless field communications. Those vehicles enabled the city to respond within minutes to direct rescue operations in the field during the I-35W bridge collapse in August 2007. Similarly, Unisys has worked with the city to deploy mobile laptops in Minneapolis police vehicles and to provide similar systems to the city’s health and building inspectors.

The Minneapolis partnership provided some pointers for best practices, as identified by Gary M. Stern in an article for SourceMag.com, a site covering the IT outsourcing industry.

Bring union leadership in early.

To overcome union objections, the union was included in the original business planning of the outsourcing agreement. Moreover, the city negotiated a three-year job guarantee for the people that Unisys hired. A total of 26 union IT personnel were offered jobs by Unisys, of which 14 accepted and the remaining 12 found other jobs in the Minneapolis government. Unisys offered the 14 who transferred signing bonuses and improved benefits. Minneapolis saves about $2 million a year, mostly because it has reduced staff and eliminated 40 contract workers at $100 to $200 an hour.

Engage the transferred IT staff through training.

The Minneapolis city staffers who were hired by Unisys were trained at Unisys University, a virtual learning center, where they learn about Unisys’ technologies and processes.

Listen to the users.

Once the staff was trained, Unisys launched a “discovery” process, asking stakeholders, including department heads at police, fire and public works, what IT changes and improvements they wanted to see. Unisys staff also met with existing IT staff, technical teams and field service teams to add to their knowledge base.

Government processes are different than corporate processes.

Unisys staff had to become integrated into
every facet of city government in order to make the IT partnership work. A difference for Unisys consulting for the city of Minneapolis rather than simply another company is that major IT projects need to be authorized by a vote of the entire city council, rather than a CEO sign-off. For example, when Community Planning and Economic Development—which had been a separate arm of the city—was integrated into city government, the city council had to pass an ordinance to permit it. The same applies to new IT work.

3. San Diego Quantifies Deliverables
   In January 2006, the county of San Diego signed a $667-million IT outsourcing contract with Northrop Grumman Information Technology. Northrop Grumman replaced a previous IT contractor, Computer Sciences Corp., with which the county had had a bumpy relationship.

   Transition to the new contractor occurred in five distinct phases: Help Desk, Applications, Desktop, Network and Data Center. Sub-contractors on the project include Hewlett Packard’s EDS, BearingPoint and AT&T.

   Northrop Grumman replaced Computer Sciences Corp. (CSC) as prime contractor on the county’s outsourcing project. That previous deal was marked by a contract dispute over deliverables that, at one point, had led the county to withhold $34 million of a $44 million payment. The dispute ultimately was settled, but the county is incorporating the lessons learned from the CSC experience into the new Northrop Grumman deal.

   Although the episode forced the county to endure some criticism of the outsourcing plan, its problems were not unique; David Perara, an independent IT analyst, told CIO magazine in May 2006 that commercial companies also struggle with large outsourcing deals and the second experience is usually better than the first. A problem with the first San Diego deal—which the county took responsibility for—was a lack of sufficient detail in the contract regarding prices, responsibilities and service levels.

   The new contract includes benchmarking changes that will allow for better price comparisons. For instance, all costs associated with a desktop, such as networking and security, were previously bundled into one price, which made it difficult to compare prices. Those costs are now being split up.

   The county also has created 59 line items to delineate responsibilities for running the help desk. Among those responsibilities, Northrop Grumman must produce and submit help desk solutions and service-level requirements and the county is responsible for reviewing and approving them. A 152-page document defines the operational services and 76 minimum acceptable service levels, each with its own penalty (transaction response time has nine service levels associated with it and desktop repair has 15).

   Consistent with commercial best practices, the contract also breaks pricing for services into components. Desktop maintenance costs, for example, are divided into hardware, software and printer maintenance, among other line items. The first contract included only a lump sum annual service charge.

   The willingness of governments to truly act like enterprises has been a key reason for the growing success of IT outsourcing. Technology authorities supervise state and local projects with IT professionals in charge, which holds contractors to project targets, deliverables and milestones. So far, state and local legislators have avoided attempts at picking one technology strategy over another or hamstringing state IT directors with politically motivated agendas or priorities. If governments continue to embrace this “hands-off” model, allowing state IT authorities to develop and follow industry best practices, states, municipalities and sub-divisions will become part of the digital revolution that much faster.

C. Network Neutrality Update
   Under the guise of encouraging competition, protecting consumers and preserving First Amendment freedoms on the Internet, a coalition of corporations and organizations representing all parts of the political spectrum have been urging the Federal Communications Commission, Congress and even state legislatures to adopt laws that
codify “network neutrality” on the Internet.

Thus far, efforts at regulation have failed to gain headway, but the Obama administration and the new Congress, which has demonstrated a stronger regulatory bent than in the past, show no signs of backing down. The latest legislative strategy may be an attempt to impose network neutrality conditions on any service provider that accepts funds from the $7.2 billion broadband stimulus.

Network neutrality would regulate the transmission of Internet data. It would impose obligations and prohibitions on major service providers that own the networks that connect homes and businesses to the Internet. It would dictate the technology and software that phone companies, cable companies and other Internet service providers (ISPs) could develop, purchase and use in their network. It would limit the quality of choices they could offer their consumers and business customers. It would lead to a host of unintended consequences, the most immediate and likely being a slow, congested Internet with little or none of the utility for the multimedia applications with which it has become associated.

The principles of network neutrality that would be instituted as law are:

- Carriers should be prohibited from blocking access to any legal Web site or application;
- Carriers should be prohibited from preventing any application using the Internet Protocol (IP)—the basic programming language used on the Internet—from running on their networks;
- Carriers must allow any IP-addressable device to attach to the network;
- Carriers must provide users with information about their network service plan information;
- Carriers should treat all data the same and be prohibited from altering, prioritizing or partitioning data with the intent of improving quality for their own services or for select groups of customers or partners.

The first four principles are pointless to legislate because they are necessary conditions for an ISP to do business. An ISP exists to connect individuals and businesses to the Internet at large. A service provider who “violates” these principles would be running counter to its own business model. That’s why, in the nearly 15-year history of American ISP service, there has only been one violation of these guidelines—by tiny Madison River Communications, which attempted to block Vonage’s Voice over Internet Protocol (VoIP service). The FCC forced Madison River to halt the blocking and make a $15,000 payment to the U.S. Treasury as part of an agreement to drop the investigation. Beyond that, it was short-sighted. VoIP services are popular and ISPs, to keep their customers, find they must support them.

By definition, any IP-compatible device can communicate over an IP network. This is simply the way the equipment works. An ISP can’t do anything about it. An ISP may require a password if a user wants to use the portion of the network it owns to connect to other devices, but a password requirement does not interfere with the IP connection itself. Just getting a password prompt is proof that your IP device is operating on the network.

And ISPs are not the only businesses that use passwords to protect their networked assets. Most businesses and consumers, if they are wise, password-protect any laptops, PCs and larger computers that connect to the Internet. That’s precisely because any IP device can communicate with any other.

Information about service is covered in the basic buyer-seller agreement. And if an ISP were to violate it to the point where a consumer or business owner thinks he’s been defrauded, there are existing legal mechanisms to address those cases.

So while any Internet regulation is undesirable, the initial four neutrality provisions don’t really “safeguard” anything. They have the same effect as would a decree that required every motor vehicle built in the United States to drive forward and in reverse. Law or no law, cars are going to be built that way.

The fifth principle, however, would hold serious consequences if given the force of law. The fifth principle of network neutrality would impose limits on how service providers can use their networks to improve the quality, reliability, prioritization and management of data and applications as they move across their facilities. Specifically,
phone and cable companies, along with ISPs such as EarthLink and Covad Communications that predominantly serve businesses, would be prohibited from offering Web site owners (sometimes called Web hosts) any improvement in application speed or performance for an added price. The Web site owners could be of any size, ranging from companies the size of Google to small entrepreneurial Web storefronts.

Network neutrality proponents say regulations are needed because phone and cable companies control most consumer connections to the Internet. As an example, they point to Comcast, the nation’s largest cable company, which in October 2008 confirmed reports that it was intentionally slowing down the rate of voluminous video files that were being transferred via BitTorrent. com, one of many so-called peer-to-peer (P2P) sites that allow users to search for and exchange movies and TV shows between and among their own PCs. Although an October 2007 AP headline reported that Comcast was “blocking” P2P applications, that turned out to be untrue. BitTorrent software is designed to set up as many simultaneous connections as possible between the user’s PC and BitTorrent’s file-sharing site (the more connections, the faster the transmission). To keep BitTorrent users from flooding the network, especially at peak times, Comcast introduced software that limited the number of simultaneous connections the BitTorrent software could set up. BitTorrent users could still reach the site, but the rate of transfer was slowed. Comcast argued this network management decision was made to ensure service quality for the vast majority of Comcast Internet customers whose high-speed connections would be slowed by the amount of bandwidth P2P applications were gobbling up.

The Comcast action, juxtaposed with the reality that P2P protocols such as the BitTorrent protocol are designed to consume as much bandwidth as is available, has sharpened the debate about what the unintended consequences of network neutrality might be. If network neutrality were enacted as bills are currently written, service providers would not be able to take technical countermeasures that would balance bandwidth consumption. Conversely, they would not be allowed to offer rabid P2P users priority connections at a higher price. And whether they charged for it or not, service providers would not be able to prioritize transmission of certain types of data; for example, streaming video or online gaming, even if it would make the application perform better. They would not be allowed to enter agreements with third party providers to give their services special handling. They would not be permitted to improve the quality of their own services, such as Voice over Internet Protocol (VoIP) phone calling, without providing the same level of quality to competitors who use their network.

As such, network neutrality enforcement would add an unprecedented level of government interference in the way Internet applications work and would dramatically influence the extent to which sophisticated transmission mechanisms within the Internet could be used to facilitate future Web applications such as telemedicine and distance learning, as well as entertainment and e-commerce.

Network neutrality proponents state that without neutrality, service providers will be able to create high-speed “toll” lanes on the Internet and relegate those without deep pockets to some sort of “slow” lane. These suppositions are presented with no evidence. Today, the Internet reaches the customer at speeds as high as 15 megabits per second (Mb/s), hardly pokey by any measure and there’s every reason to believe speeds will get faster. The norm was 4 Mb/s in 2005 and 8 Mb/s last year, while prices have remained stable. All this has come about without mandated network neutrality.

As justification for a ban on service providers creating differentiated pricing for faster data speeds or guarantees of higher quality, supporters cite the historical classification of network owners as “common carriers,” a status which they say obligates them to treat all data the same. But the “common carrier” rationale no longer holds. True, only a few years ago, telecom networks were neutral common carriers by default, but then two
things changed. First, the Internet and broadband together enabled an unlimited number of parties to use the network to deliver diverse content, applications and services. Second, network technology evolved to the point where service providers could manage, manipulate and prioritize data in their networks in ways that could add greater value.

Network neutrality mistakenly assumes that service providers deliver commoditized data when, in fact, they deliver packaged information products that have been created and crafted by numerous parties. The amount of bandwidth consumed depends on the amount of processed information contained in the application. Like a big truck holding up traffic with its slow pace, a bandwidth-intensive application can bog down an entire network if not relegated to a “toll lane” where it can be partitioned from general Internet traffic.

Processed information, as opposed to raw data, can take many forms and can be valued using any number of measures. To the user, therefore, the Internet as a delivery mechanism is inherently commercial and non-neutral. As a party to an information-based transaction, the consumer implicitly accepts that the enterprises that have invested in the creation, processing, transmission, presentation and sale of that information are entitled to compensation.

Network neutrality would lock service providers out of the process. It would prohibit the companies that build, own and operate the nation’s broadband networks from taking any strategic role in the management and optimization of information products that use their facilities, to the detriment of everyone who depends on a high-performance Internet. Network neutrality proponents are asking Congress to force the industry to return to a best-effort transmission platform that was the rule only in the Internet’s earliest days.

Such a policy would be nothing short of disastrous for broadband development precisely because it flies in the face of Internet evolution to date. Network neutrality was a necessary condition at the Internet’s birth. Since then, all players have been working toward creating a better, more functional and intuitive online experience—sometimes through cooperation, other times through competition.

What existed in the past was not network neutrality for the Internet, but network neutrality for the phone calls. Calls were point to point, between two parties. The Internet changed that by allowing third parties to add value. That created a new business model. By limiting service providers to a role as providers of “dumb” pipes, lawmakers would fail to recognize the ability of networks to add value to content and applications and participate in the further innovation of broadband applications.

The American system of free enterprise generally respects private property and the freedom to invest and to realize a return on investment through voluntary transactions that yield value to both parties while providing consumers in the market with more diverse products, lower prices and greater value. A policy that allows the law of supply and demand to develop for bandwidth optimization is the best way to preserve the Internet, drive down costs and deliver the promised benefits of a robust Internet to consumers everywhere.

Hospital networks, which use the very same IP protocol as the Internet, can and do prioritize traffic. So do many other business and organizations that operate over the Internet.

The fact is, the Internet is not and never has been, neutral. Nor will a network neutrality policy make it so. In a mistaken belief that they are preserving a democratic Internet, network neutrality proponents are asking Congress to force the industry to return to a best-effort transmission platform that was the rule only in the Internet’s earliest days.

Network neutrality would pre-empt the development of an entire class of optional, but valuable, products, features and services that would make for a better network. For example, any application that has life or death implications and calls for real-time communication—say a remote home-based health monitoring system linked to emergency alarms at a hospital—would benefit from and perhaps require, transmission prioritization.

In fact, the capability to do so already exists.

This article is excerpted from the May 2009 Reason Foundation report, *The Internet is Not Neutral (and No Law Can Make It So).*
A. Arizona Policymakers Considering Groundbreaking Prison Privatization Program

Arizona has long been known as a prison privatization leader, but the state’s ongoing fiscal crisis has prompted policymakers to explore new—and potentially groundbreaking—corrections privatization proposals. Currently, several private prison facilities are located in Arizona, but these facilities primarily house federal or out-of-state prisoners. While the Arizona Department of Corrections (ADOC) does contract with private prison operators to house several thousand prisoners in out-of-state facilities, it does not contract with any in-state private facility to house state prisoners.

This may change amid negotiations between Governor Jan Brewer and the state legislature over how to close a budget deficit in excess of $3 billion. Prison privatization became a central issue in the budget development process, as the legislature passed a budget bill that would require the state to enter into what would represent the first long-term concession (lease) of state prison facilities.

Senate Bill 1028, passed in June, would require the state to issue a request for proposals for a concession agreement allowing private vendors to operate one or more Arizona state prison facilities for a 50-year term in exchange for an up-front payment of no less than $100 million. The bill would also require the ADOC to enter into a lease-purchase finance agreement for its prisons no later than May 2010. Under the law, the agreement would be for a fixed 20-year term and would be required to yield $495 million in net available proceeds for use in fiscal year 2010 and would use ADOC prison facilities as collateral. In addition, SB 1028 would require the state Department of Administration to issue a request for proposals to rebid the ADOC food and commissary service contracts.

SB 1028 was promptly vetoed in July 2009 by Governor Jan Brewer along with a number of other budget bills, a move designed to continue budget negotiations with the legislature. At press time, the legislature was in a special session to complete its budget work and the status of the prison privatization proposals remains uncertain.

According to the Arizona Capitol Times, Gov. Jan Brewer has expressed skepticism about
the concession plan and prefers sale-leaseback agreements for prisons that would keep them under ADOC operation. ADOC director Charles Ryan also expressed concerns over the potential privatization of maximum security facilities and has floated an alternate proposal to tap the private sector to build and operate new prison facilities on vacant land at state prison complexes to add needed capacity and provide space to house the 4,600 Arizona inmates currently held in private prisons in Colorado and Oklahoma.

**B. New Vanderbilt Study Finds Private Prisons Reducing State Corrections Costs**

A study published by Vanderbilt University in December 2008 found that states that contracted with private corrections companies significantly reduced their prison costs compared to states that did not. The study, “Do Government Agencies Respond to Market Pressures? Evidence from Private Prisons,” focused on public and private prison data from 1999 to 2004.

Study author James Blumstein says, “The fundamental conclusion is that, over that six-year period, states that had some of their prisoners in privately owned or operated prisons experienced lower rates of growth in the cost of housing their public prisoners—savings in addition to direct cost savings from using the private sector.” In addition to saving money at privately operated prisons, the study found that public facilities that remain under state operation also had reduced costs.

States could save an average of $13-15 million per year (based on an average of $493 million in state corrections expenditures) through the introduction of private prisons, according to the study.

The authors speculate that cost savings likely occurred due to competition between public and private facilities, leading to more competitive pricing. In addition, public facilities likely benefit from being introduced to operating procedures that enable them to lower costs.

The study references a *Harvard Law Review* report suggesting that private prisons perform as well or better than public counterparts. It concluded that privately operated prisons not only bring about “clearly positive direct cost savings” when compared with publicly operated prisons, but also, on balance, “outscore public prisons on most quality indicators.”

The study notes that cost savings appear to be more significant in states that used in-state private prisons, rather than those that send their prisoners to private facilities in other states. The study suggests that this could be because public prisons can learn from in-state private prison practices.

According to the authors, the study’s findings “should provide policy makers with an additional reason to favor privatization of some portion of a state’s prisons.”

**C. U.S. Corrections Population Growth Slows**

The number of adults in the corrections system in America continued to rise in 2008. One in 31 adults in America are under some type of correctional supervision, according to a March 2009 study by the Pew Center on the States. Counting offenders in prisons, on probation and out on Table 14: U.S. Prison Population, 2000-2008

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>Federal</th>
<th>State</th>
<th>Local Jail</th>
<th>Male</th>
<th>Female</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>2,012,410</td>
<td>145,416</td>
<td>1,245,845</td>
<td>621,149</td>
<td>1,848,189</td>
<td>164,221</td>
</tr>
<tr>
<td>2001</td>
<td>2,035,272</td>
<td>156,993</td>
<td>1,247,039</td>
<td>631,240</td>
<td>1,860,232</td>
<td>175,040</td>
</tr>
<tr>
<td>2002</td>
<td>2,105,619</td>
<td>163,528</td>
<td>1,276,616</td>
<td>665,475</td>
<td>1,921,476</td>
<td>184,143</td>
</tr>
<tr>
<td>2003</td>
<td>2,159,902</td>
<td>173,059</td>
<td>1,295,542</td>
<td>691,301</td>
<td>1,969,187</td>
<td>190,715</td>
</tr>
<tr>
<td>2004</td>
<td>2,211,090</td>
<td>180,328</td>
<td>1,316,772</td>
<td>713,990</td>
<td>2,013,449</td>
<td>197,641</td>
</tr>
<tr>
<td>2005</td>
<td>2,275,458</td>
<td>187,618</td>
<td>1,340,311</td>
<td>747,529</td>
<td>2,073,261</td>
<td>202,197</td>
</tr>
<tr>
<td>2006</td>
<td>2,335,764</td>
<td>193,046</td>
<td>1,376,899</td>
<td>765,819</td>
<td>2,124,305</td>
<td>211,459</td>
</tr>
<tr>
<td>2007</td>
<td>2,378,416</td>
<td>199,618</td>
<td>1,398,624</td>
<td>780,174</td>
<td>2,163,489</td>
<td>214,927</td>
</tr>
<tr>
<td>2008*</td>
<td>2,396,140</td>
<td>201,142</td>
<td>1,409,442</td>
<td>785,556</td>
<td>2,180,688</td>
<td>215,452</td>
</tr>
</tbody>
</table>

*Statistics as of June 2008

Source: Bureau of Justice Statistics
parole, 7.3 million adults were in the corrections system in 2008. Although most of those, about five million, were on probation or parole, the prison population also grew from 2007 to 2008.

In March 2009, the Bureau of Justice Statistics released data for the preceding year, showing an increase of 17,724 inmates (see Table 14). However, this was a significant decline from the previous year’s increase of 42,652. The number of inmates in private prisons also grew, albeit at a slower rate than in 2007 (see Table 15).

Table 15: U.S. Private Prison Population, 2006-2008

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>Federal</th>
<th>State</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>113,697</td>
<td>27,726</td>
<td>85,971</td>
</tr>
<tr>
<td>2007</td>
<td>125,997</td>
<td>31,310</td>
<td>94,687</td>
</tr>
<tr>
<td>2008*</td>
<td>126,249</td>
<td>32,712</td>
<td>93,537</td>
</tr>
</tbody>
</table>

Source: Bureau of Justice Statistics

D. Private Prisons Battle to Retain Proprietary Rights

The ability of private corrections to protect propriety information has come under attack recently at the state and federal level. In July 2008, a Nashville, TN judge ruled that Corrections Corporation of America (CCA) must comply with the state’s open records laws. Under the ruling, the court found that the private prison company was “the equivalent of a government agency.” CCA has appealed the decision, but the ruling leaves open the question: should all private firms that contract with government be considered public entities?

On May 15, Representative Sheila Jackson-Lee (R-TX) introduced H.R. 2450—the Private Prison Information Act—a reprise of a similar bill that failed last year. This bill would subject all prisons holding federal inmates to Freedom of Information Act (FOIA) requests and make them report all the same information as publicly operated federal facilities. There is currently no law that requires private prisons to be subject to FOIA, that forces them to release inspection results or incident reports or that mandates that they comply with state open records laws.

In Oklahoma, state legislators have been trying to get information from private prisons in a different way. As they consider what price they will negotiate with companies that run six pris-
ons in their state, lawmakers want to know how private firms like CCA, The GEO Group (GEO) and Cornell develop their bid proposals. The private firms consider this information proprietary and believe that making it public would hurt their competitive advantage.

E. State Private Corrections Update

Arkansas has considered multiple proposals in their legislature this year that would open the state to privatizing some of their jails. These efforts have been largely unproductive, as Governor Mike Beebe and leaders in the legislature are opposed to using private companies to run state correctional facilities, even though Arkansas state prisons are exceeding capacity by 8 percent, forcing the state to rely on over 1,200 county beds. However, in Texarkana, a city that sits on the Texas-Arkansas border, Miller County sheriff Ron Stovall has said he would like to hire a private security company to take over the deteriorating Miller County Correctional Facility. Necessary repairs are estimated at $1 million. Community Education Centers (CEC), which runs a similar facility in neighboring Bowie County, Texas, has offered to run the Miller County facility. Depending on the success of this public-private partnership, Arkansas may reconsider privatizing state facilities.

California is considering expanding its use of private prisons to manage massive overcrowding. Governor Arnold Schwarzenegger said in a June 2009 policy speech, “other states have privately run correctional facilities that operate at half of the cost. Why can’t we?” The system is currently about 59,000 inmates over the 100,000 inmate capacity it was designed to hold—and that is after transferring about 11,000 inmates to out-of-state prisons (see Reason Foundation’s Annual Privatization Report 2008 for more details). A federal court ruled in February 2009 that California would have to release a third of its prison population. The state has appealed and litigation could continue for years. However, in the meantime the state may pursue contracting with private firms to ease the burden of overcrowding and add in-state capacity. In addition, Michigan Governor Jennifer Granholm has offered two empty public prisons in her state to California if the states can reach an agreement on the right price.

In May, San Diego County planning commission officials approved a proposal from CCA to build a massive, 2,172-bed secure detention facility for immigrant detainees. CCA already operates the 700-bed San Diego Correctional Facility nearby the proposed location of its new prison. This facility houses immigrants awaiting deportation or appealing an immigration case. The new mega facility will employ over 300 people.

A Colorado prison is experimenting with an innovative rehabilitation program at the medium security, 750-bed Cheyenne Mountain Re-Entry Center (CMRC). The facility, run by CEC, focuses intensely on drug and alcohol treatment programs, education, job search and computer skills and a “lifestyle change” class. These programs have established a unique prison culture. At CMRC, inmates call each other “mister” and confront each other about unacceptable behavior. The prison is full of signs declaring the special facility’s primary axioms: “If you don’t like yourself change,” “Be right-sized,” “Make better decisions,” “Examine your motives,” and “Anger is one letter away from danger.” Results have thus far been mixed, with some inmates speaking highly of the program and others noting a struggle to decrease violence.

The operations of a prison in Delaware were successfully transferred from The GEO Group (GEO) to CEC in January. Eight months after taking over the George Hill Correctional Facility, GEO found itself in an unusually high amount of litigation. With costs running high, GEO decided to exercise its right to leave the deal and after another managed competition, CEC, which focuses more heavily on rehabilitation programs, won the contract to manage the facility.

Florida’s prison population is nearing 100,000 and legislators are looking at all options to handle the growing number of inmates. In June 2009, Governor Charlie Crist signed into law Senate Bill 1722, which authorizes the state cor-
rections department to begin shipping prisoners out of state, including some to private prisons. The state also increased its prison capacity with a 384-bed expansion of the privately run Graceville Correctional Facility, set to open in July.

Not all has gone well though. A bid to privatize Suwannee Correctional Institution fell through in May. Even though the privatization was written into the state budget and would have saved the state an estimated $3.4 million in operating and payroll costs, the fear that a private firm wouldn’t be able to handle inmates with behavior problems thwarted the privatization process.

On the federal front in Florida, U.S. Immigration and Customs Enforcement awarded GEO a renewed contract in April to operate the Broward Transition Center, which the private prison company has done since 1998. The new contract totals $21 million per year and requires GEO to expand the number of beds from 600 to 700.

Georgia will be getting 160 new jobs in Hall County after U.S. Immigration and Customs Enforcement (ICE) gave CCA a contract in March to manage the North Georgia Detention Center in Gainesville. Idaho announced this May that it would not pursue privatization of the Idaho Correctional Institution in Orofino. As reported in last year’s Annual Privatization Report, the state has a history of private corrections challenges from the legislature. However, CCA did win a contract to continue running the Idaho Correctional Center in Kuna. Maine Gov. John Baldacci’s budget for 2010-11 includes a plan to send 118 inmates to a CCA prison in Minnesota. The proposed two-year deal would save the state $2 million as it tries to close an $838 million budget deficit.

A new prison in Mississippi will create over 400 jobs, opening in fall 2009 and boasting 2,567 beds. The $128 million facility to house federal prisoners (mostly illegal immigrants) is the fourth CCA prison in the state. A developer in Missouri has proposed building a minimum-security jail near Kansas City, the area’s first private detention center. The $7 million facility would create 65 jobs and would hold about 350 inmates, with the potential to double capacity through expansion. The current community jail is over-crowded, according to Jackson County Communications Chief Calvin Williford.

The Nevada legislature passed a bill in June that sets basic standards for all private prisons in the state. These standards include staff level and training requirements. The legislation also requires that private facilities reimburse the state for costs of apprehending escaped prisoners. The first new facility to be built under this new law is being developed by CCA as a 3,000-inmate facility for Storey County that would employ roughly 600 people.

New Jersey is also experimenting with its corrections system. Residential Assessment Centers in Newark and Trenton, run by CEC, are designed to house parole violators that haven’t committed a new crime, but have missed a meeting or failed a drug test. New Jersey has a recidivism rate of 65 percent for the 14,000 inmates it releases each year. This new program will house select non-crime-related parole violators for up to 30 days and then release them back on parole. State officials estimate the program will help avoid $14 million in costs to incarcerate inmates. The program has already diverted nearly 1,000 parolees and saved over $2 million.

In Oklahoma, Comanche County commissioners approved a 1,536-bed medium security facility proposal from GEO. The new prison will create 300 correctional officer jobs, plus additional staff and could be open by January 2010. CCA completed the expansion of its Cimarron Correctional Facility two months earlier than announced, increasing capacity to 1,692-beds. However, the state has withheld $200,000 of payments, claiming that CCA failed to meet contract terms, which required keeping staff positions at Cimarron filled, including certain medical personnel. In 2008, Oklahoma has withheld over $589,000 from different private prison companies for failures to meet contractual obligations regarding staff positions. The Oklahoma legislature commissioned an audit of contract violations in 2008 that uncovered the shortages.

In the wake of legislative investigations into
CCA, the state has decided not to renew its contract with the private operator. However, the state is not abandoning privatization. The Board of Corrections will be seeking contract proposals to house 1,920 medium-security inmates and 360 maximum-security inmates. The state is also seeking new terms on contracts, including an opt-out clause for the state to terminate the contract at will and an increase in the provision of mental and physical health services.

In Tennessee, a new effort is being made to privatize Shelby County Jail after two previously failed attempts in 2005 and 2006. Shelby County Sheriff Mark Luttrell wants to lease some beds from a CCA-owned detention facility, the Shelby Training Center.

Texas, which has used private firms to run prisons for years, successfully transferred three prisons from one private firm to another in January. Management & Training Corporation (MTC) won a $62.6 million, six-year contract to operate three northeast Texas prisons. The Billy Moore Correctional Center and Diboll Correctional Center were handed off to MTC, which beat out CCA in a bid for the contract. MTC also took over Sanders Estes Correctional Center from GEO. The process shows how continued competition for contracts helps provide governments with the best quality and price. The Billy Moore facility was originally privatized by MTC, who later was outbid by CCA, only to get it back this year. Meanwhile, in April, GEO won a ten-year contract worth over $100 million to continue operating the 685-bed Central Texas Detention facility in Bexar County.

**F. International Private Corrections**

New Zealand Prime Minister John Key introduced a bill to the nation’s legislature that would allow managed competitions to award contracts to private prison companies. The bill states: “Opening up prison management to contractors provides an opportunity for innovation and change in the way in which prisons in New Zealand are operated.” As of this writing the bill was being debated in the Law and Order Committee. A key priority for legislators is that contracts are clearly worded and tightly managed. Although there are no private prisons in New Zealand today, the Auckland Central Remand Prison was privately run from 2000 to 2005.

In nearby Australia, a recently released New South Wales (NSW) parliamentary report found that “the private management of prisons will likely produce greater cost savings and efficiencies than if they were to remain in the public system.” The report details the results of the committee's inquiry into the privatization of prisons and prison-related services in NSW, covering such topics as cost savings, public safety and escape rates, rehabilitation programs, staffing levels and the impact of privatization on publicly managed prisons.

Elsewhere in Australia, Sydney's Parklea jail will continue its move toward privatization, with five companies bidding to manage the facility. However, the Cessnock jail privatization plans have been shelved. And in England, a penal reform charity has teamed up with a private security company to bid on a management contract for three 600-bed prisons.

**G. Mental Health Services Privatization Update**

The past year has seen a slew of new privatization initiatives that are changing the landscape for how states are delivering mental health services. Florida has long been the leader in psychiatric care privatization. Since the mid-1990s the state contracted with the private sector to operate several of its psychiatric facilities, ranging from large state hospitals to forensic psychiatric treatment centers to its civil commitment center for sexually violent predators. But in 2008, Georgia shifted the paradigm one step further in starting to develop a program to close all of its existing state-run facilities and contract with a private firm to build and operate a new system of hospitals for the mentally ill.

Like many states, Georgia faces rapidly escalating costs to maintain its aging mental health facilities, along with budget cuts to help close the
state’s two-billion-plus-dollar budget shortfall. At the same time, the state has also become the focus of a U.S. Justice Department investigation into civil rights violations after the Atlanta Journal-Constitution exposed appalling conditions in Georgia’s state-run mental hospitals in February 2008. Since 2002, the paper found that over 130 patients have died from neglect, abuse or poor medical care in the state-run facilities and there have been nearly 200 cases of patient abuse.

To clean up its act and avoid a federal civil rights lawsuit, Georgia’s Department of Human Resources has recently taken the first steps in an initiative to privatize the operations and management of all of its state psychiatric hospitals. The initiative would involve a massive consolidation, closing all seven of its existing state hospitals and replacing them with three new, privately financed, privately operated facilities—all by 2012. The central goal of the privatization initiative is to completely reshape the way the state provides services, dramatically improving service quality and patient outcomes, treating more patients in the community and lowering spending from current levels.

In October 2008, the District of Columbia’s Department of Mental Health similarly announced that it would be closing all of its mental health centers and replacing them with privately run facilities, expanding the number of patients treated while generating tens of millions in cost savings.

In May 2009, Santa Barbara County, California announced a proposal to transfer operations of its mental health system to Prison Health Services (PHS). Sheriff Bill Brown said, “Over the years, with the closure of mental health facilities across the state, county Jail has become the de facto mental health facility. The jail is not the best place for people with mental health problems.” Under the proposed plan, PHS will operate the psychiatric care facilities for two years, starting in July 2009, before coming up for renewal. Sheriff Brown estimates the contract will save the county more than $500,000.

In July 2009, the Texas Department of State Health Services initiated a discussion with Montgomery County, Texas and a private company on the construction and operation of a new 100-bed forensic hospital to address the state’s need for additional capacity. The state and Montgomery County are working out an intergovernmental agency agreement whereby the county would pay for the construction of the hospital and subcontract the operation of the hospital to a private company.

These reform efforts—along with initiatives in Missouri, Montana and Alabama—come on the heels of several successful innovative projects demonstrating why policymakers around the country are increasingly turning to privatization to dramatically improve the quality of mental health services while reducing costs.

1. Case Study: South Florida State Hospital

For over a decade, Florida has successfully privatized a number of state psychiatric hospitals and correctional mental health services, dramatically improving patient care and outcomes while innovating to drive costs down. The first was South Florida State Hospital (SFSH), privatized in November 1998. The aging Pembroke Pines facility had never been accredited in its 40-year history and was facing a major class action lawsuit concerning patient abuse and abysmal conditions when it was privatized.

Within 10 months of receiving the contract, the private operator was able to get the existing facility accredited by the Joint Commission (a national, nonprofit healthcare accreditation organization), while at the same time financing and building a new, modern facility to replace it. No state capital dollars were involved and the lawsuit was subsequently dismissed. In addition, the annual debt service on the new hospital, plus the cost to operate it, has been less than what the state had spent to simply operate the old facility. Further, the state will own the new facility when the debt is retired.

The results speak for themselves. After privatization, the hospital reached some significant operational milestones, reducing the average patient stay from eight years to less than one year while maintaining a low recidivism rate and virtually eliminating the use of seclusion.
and restraints to manage patient behavior. SFSH has also significantly increased the number of patients admitted and discharged to such a degree that Florida was able to close a separate state hospital and its catchment area was assumed by South Florida State Hospital, with the savings invested into community services.

South Florida State Hospital now serves over 50 percent of Florida’s population with just 25 percent of the state’s civil beds. Noting these improvements, the Florida Statewide Advocacy Council—a state watchdog group—unanimously passed a resolution in 2003 supporting further privatization of Florida’s psychiatric facilities.

SFSH also recently rolled out the first electronic health records system in a Florida state psychiatric hospital. The system increases the accuracy of treatment at the hospital and has created a benchmark for every other hospital in the state to aspire to. Significantly, the contractor paid to develop this cutting-edge system itself—recognizing the operational improvements it would facilitate—even though such improvements immediately become property of the state.

Cost savings in Florida have also been impressive. The state’s Department of Children and Families reported to a legislative committee in 2007 that the average cost per bed in the privately operated facilities was as much as 15 percent lower than at the state-run hospitals.

In Florida’s contracts, the state retains the ability to terminate the contract without cause with a mere 30 days notice, a provision clearly aimed at ensuring contractor accountability. Further, Florida has also negotiated fixed-cost contracts that effectively hold facility budgets flat over multiple budget cycles, a far cry from the budget variability typically seen under state operation.

2. Case Study: Williamsburg’s Eastern State Hospital

The Virginia Department of Mental Health, Mental Retardation and Substance Abuse Services currently operates sixteen mental health and other residential treatment facilities, including Williamsburg’s Eastern State Hospital (ESH)—the nation’s first public psychiatric hospital dating back to 1773. By the late 1990s, conditions at ESH had deteriorated to the point that it became the subject of a U.S. Justice Department lawsuit to rectify substandard care and living conditions.

In addition, the combined challenges of a decreasing patient population, obsolete facilities on a sprawling 500-acre campus, noncompliance with industry accreditation standards and the potential loss of Medicare/Medicaid reimbursement dollars prompted policymakers to look to private sector solutions.

To turn things around, the Department embarked on a large-scale ESH modernization project facilitated by an innovative public-private partnership. This multi-phase project involves partnering with a private contractor to consolidate 26 buildings into six, deliver new state-of-the-art geriatric and adult mental health facilities, and develop a strategic plan for the 400 surplus acres generated as a result of the initiative. The first phase of the project—the new Hancock Geriatric Treatment Center—opened in April 2008 and recently won an innovation award from the National Council of Public-Private Partnerships. The next phase of the ESH modernization—a new adult mental health treatment center—is set to open in 2010.

One of the more notable aspects of the ESH modernization is that the initiative did not come from within, but was received as an unsolicited, private sector proposal for turnkey development submitted under the state’s Public-Private Education Facilities and Infrastructure Act (PPEA). The contractor is not only delivering the new facilities on an accelerated schedule, but the efficiencies incorporated into the design will deliver large future cost savings through dramatically reduced life-cycle maintenance costs. And because of the more efficient use of space on the campus and the patient-centric design of the new facilities, the partnership will deliver where it really counts—improving patient care, outcomes and safety.

Despite the current recession, the municipal water privatization market seems to be in a holding pattern, according to the 13th annual water contracting report from Public Works Financing (PWF). A spurt of new business the previous year drove industry-wide revenues up 4 percent in 2008. At the same time, deepening municipal fiscal woes did not prompt large numbers of municipal utility managers to seek operating efficiencies through privatization.

A total of 1,336 municipal, state or federal government agencies contracted out at least one part of their water or wastewater utility in 2008, representing a 9 percent decrease from 2007 (though almost identical to 2005). Also, a total of 25 new operations and maintenance (O&M) contracts worth over $943 million in lifetime value were signed in 2008, while six privately operated plants reverted to municipal control. The survey is based on a review of the six largest water utility operators.

Government clients appear to remain largely satisfied with their current outsourcing contracts, as the water industry’s contract renewal rate has averaged nearly 95 percent since 2005 (see Table 16).

According to the companies surveyed in the PWF report, a key challenge currently facing the water industry is opposition to privatization on the part of both consulting engineers who advise municipal water managers and environmental activists. Furthermore, the federal stimulus appears to be prompting municipalities to delay decisions on capital projects and hold out for stimulus funding. Larry Chertoff of Alinda Capital told PWF that “Everybody thinks they’re going to win the lottery, but they’re not.” Chertoff believes this bodes well for proponents of alternate project delivery methods, because municipalities will be increasingly eager to build critical projects in coming years, a natural fit for private developers.

B. EPA Estimates $335 Billion in U.S. Water System Investment Needs

The nation’s drinking water systems will require $335 billion in capital investment by 2027, according to a new U.S. Environmental Protection Agency (EPA) report.

The EPA’s 2007 Drinking Water Infrastructure Needs Survey and Assessment identifies a 20-year capital investment need of
$335 billion for public water systems eligible to receive funding from state Drinking Water State Revolving Fund (DWSRF) programs (approximately 52,000 community water systems and 21,400 not-for-profit, non-community water systems). The estimate includes costs for repairs and replacement of transmission pipes, storage and treatment equipment and other projects required to ensure compliance with the Safe Drinking Water Act (SDWA).

As Figure 9 shows, transmission and distribution account for the largest portion of spending needs ($200 billion or 60 percent), with additional needs for treatment, storage and new water supply projects.

According to the EPA, “The large magnitude of the national need reflects the challenges confronting water systems as they deal with an infrastructure network that has aged considerably since these systems were constructed, in many cases, 50 to 100 years ago.”

The EPA uses the assessment results, published every four years, to allocate DWSRF funds to states and tribes as required by SDWA. Overall needs are likely much higher than the EPA estimate, which excludes capital projects related to dams, raw water reservoirs, future growth and fire protection from the analysis.

C. White House, Congress Seek to Increase Water/Wastewater Funding

Federal policymakers are taking steps to increase funding water and wastewater infrastructure. The American Recovery and Reinvestment Act (ARRA), the federal stimulus bill signed into law in February, included a $6 billion appropriation for water infrastructure. ARRA provides $4 billion for the Clean Water State Revolving Fund and $2 billion for the Drinking Water State Revolving Fund.

ARRA also modifies state revolving fund procedures for the use of these funds. For example, the funds will remain available until September 30, 2011 and the current 20 percent state matching requirement will be waived. States must give funding priority to projects ready to begin construction within 12 months and they must disperse at least 50 percent of the funds in the form of principal forgiveness, negative interest loans, grants or any combination thereof.

The stimulus bill was not the only piece of federal legislation related to water infrastructure development. In March 2009, the House of
Representatives passed the Water Quality Investment Act of 2009 (H.R. 1262), authorizing $19.4 billion for a variety of water quality measures. The bill combines five separate bills passed by the House in 2008. The bill includes: grants to state pollution prevention and control programs, watershed pilot projects, grants to states for water pollution control revolving funds, alternative water source pilot projects, sewer overflow control grants and remediation of sediment contamination in parts of the Great Lakes region. At press time, the Senate was working on their version of the legislation.

Next, in early 2009, Representative Bill Pascrell, Jr. (D-N.J.) introduced the Sustainable Water Infrastructure Investment Act (H.R. 537), which would encourage a greater private sector role in water infrastructure development by expanding access to private activity bonds (PABs), a tax-exempt financing mechanism made available to private companies developing public infrastructure projects.

H.R. 537 would remove current volume caps that limit the amount of PABs that can be issued in a given state for water and wastewater projects, expanding the availability of low-cost financing for private infrastructure developers. According to the National Association of Water Companies, removing the state volume cap on PABs would help to control water rates (due to lower cost project financing), free municipal partners from limitations on tax-exempt financing, spread virtually all financial risk to the private sector, free up traditional tax exempt municipal bonds for other uses and provide municipalities with the security to facilitate and fund critical multi-year water projects.

[Note: ARRA authorized $15 billion in additional private activity bonds for “exempt facilities,” including water and wastewater infrastructure. The expanded PAB allocation is available for two years and the portion of the $15 billion each state receives will be based on unemployment levels. ARRA also exempted all PABs from the Alternative Minimum Tax (AMT) for 2009 and 2010, a move designed to spur investor demand for these bonds.]

In July 2009, Representative Earl Blumenauer (D-Ore) introduced H.R.3202 (Water Protection and Reinvestment Act) to establish a $10 billion annual water trust fund to repair and upgrade America’s water and wastewater systems. H.R. 3202 would be financed by fees on bottled beverages, products disposed of in wastewater, corporate profits and the pharmaceutical industry.

The indirect nature of the proposed fees raised eyebrows in the water industry. “The trust fund mechanism created by this bill would serve to further mask the value of water through taxes on unrelated activities and discourage responsible water use and conservation through heavy, broad utility subsidizations,” said the National Association of Water Companies Executive Director Michael Deane in testimony before the U.S. House of Representatives Committee on Transportation and Infrastructure.

Deane continued, “Aggregate water use can only be reduced by changing the way people think about flushing their toilets, watering their lawns and washing their dishes and how industries think about water as an input cost. Similarly, public support for spending on environmental infrastructure can only be increased by changing the way people and businesses think about those very same activities. Neither goal can be achieved by creating opaque ways to fund water initiatives that allow users to continue thinking of water as a disposable resource.”

Last, a bill (S.1005) to reauthorize the State Revolving Funds and improve water and wastewater infrastructure was marked up in the Senate Environment and Public Works Committee in May 2009. The Clean Water State Revolving Fund (CW-SRF) and Drinking Water State Revolving Fund (DW-SRF) were last reauthorized 22 years ago and 13 years ago, respectively. S.1005 would appropriate $35 billion for water projects expected to take
more than five years, including infrastructure, recycling and conservation measures. Of that, $20 billion is allotted for the CW-SRF and the DW-SRF could receive up to $14.7 billion in funding.


According to the report, the rating of Excellent “reflects the supportive regulatory environments, monopolistic market positions, a mostly residential customer base and relatively low operating risk compared with other utilities.”

The report continues: “Many rated water companies also have modest nonregulated segments, which primarily provide operational and consulting services to water and wastewater facilities. Despite tight margins and low cash flow generation, these nonregulated operations pose limited incremental risks to the company’s consolidated credit profile. In addition to the complementary nature of the utilities’ nonregulated segments to their regulated operations, the risks are mitigated because the water companies pass operating and capital costs through to the facility owners, who are usually highly rated.”

E. Milwaukee Puts Water Privatization Study on Hold

In May 2009, Milwaukee city officials announced that they had put on hold a study on a potentially groundbreaking long-term lease of the city’s Water Works.

Mayor Tom Barrett and the city’s common council had previously authorized City Comptroller Wally Morics to solicit proposals for a consulting team to conduct a study on the potential lease. The solicitation netted 16 proposals from teams of financial, legal and engineering advisors.

Morics proposed a 75- to 99-year lease of the city’s water system in return for an up-front payment in excess of $500 million. Morics proposed investing and annuitizing the up-front payment to generate over $30 million a year to supplement tax revenues, avoid layoffs and shore up the city budget.

Morics predicts significant interest on the part of potential bidders, as the utility has been well-maintained and nets $20 million a year. However, political pressure to keep rates low prompted the utility to draw $10 million from reserves to cover 2008 expenses.

Morics sees a water system lease as a way to extract value currently trapped in the asset. Under current law, all system profits must remain with the system and cannot be used to supplement general fund dollars. Privatization offers the city a way to use the up-front proceeds to augment general fund dollars.

Environmental activists and public employee unions lined up in opposition to the proposed lease, forming the Keep Public Our Water coalition to lobby aldermen and oppose any privatization attempt. Responding to opponents’ fears over losing control of the system and the potential environmental implications of such an agreement, Morics noted that “[w]hatever safeguards that need to be there in terms of quality, performance, maintenance of the plant, those will be built into the lease arrangement to assure that at the end, you turn on your tap, you’re still going to get clean, safe drinking water and you’re not going to be draining Lake Michigan away to nothing.”

Wayne State University law professor Noah Hall, an architect of a recent eight-state compact
to prevent water diversion from the Great Lakes basin, told the Milwaukee Journal-Sentinel in May 2009 that “[i]t is not an environmental issue one way or the other, but really an issue of ensuring good management and accountability, which can be accomplished through either public or private operational management.” He added that, “[t]he lakes don’t care whether it’s public or private employees who are treating the wastewater and running the water systems. [...] From the lakes’ perspective, what matters are the results.”

An April 2009 article in Public Works Financing suggests that Milwaukee’s long history with wastewater privatization could be beneficial in navigating the union and political hurdles associated with a groundbreaking water system monetization. The Metropolitan Milwaukee Sewerage District first privatized the operation of its wastewater system in 1998 and last year it signed a new 10-year, $400 million wastewater operations contract with Veolia Water North America.

F. U.S. Conference of Mayors Recognizes Phoenix Water Partnership

In January 2009, the U.S. Conference of Mayors announced that the Lake Pleasant Water Treatment Plant—built and operated by American Water on behalf of the city of Phoenix—earned the 2009 Excellence in Public/Private Partnership Outstanding Achievement Award.

The plant, built to address the water needs of one of the fastest growing U.S. metro areas, opened in 2007 and was built by the design-build-operate (DBO) team of American Water, Black & Veatch and McCarthy Building Companies. The facility is the largest DBO project in the nation.

The Lake Pleasant plant incorporates the latest in modern water treatment technology and automation and the design uses indigenous materials and replanted native flora to blend the facility with surrounding environment.

“American Water is truly honored to receive such a prestigious award from the U.S. Conference of Mayors,” said Donald Correll, president and chief executive officer of American Water. “The city of Phoenix decided in the early 90s that it wanted to proactively address the future water supply needs for its citizens. Working with our partners, in 2007, we opened a state-of-the-art plant that serves approximately 216,000 customers and has a capacity to treat 80 million gallons of water per day.”

Phoenix Mayor Phil Gordon added, “Thanks to the efforts of the partners and our city of Phoenix staff, the plant also was designed to easily expand to treat 320 million gallons per day, continuing to ensure a viable water plant for Phoenix for years to come.”

American Water was awarded the $336 million DBO contract in August 2003 to serve as the prime contractor and to manage and operate the facilities for the first 15 years (with a subsequent five-year renewal option). Construction of the Lake Pleasant facility began in the summer of 2004 and opened in 2007.
A. Private Land Development in Houston Defies Recession

The effects of the economic recession have been surprisingly uneven among and within nations. On a global level, some nations, most notably China and India, are expected to post economic gains in 2009 and beyond. More surprising may be the resilience of certain regions and urbanized areas within nations. Houston, Texas is a case in point for the United States, particularly since it provides lessons for other cities on how a relatively unregulated land market allows the private housing market to respond to local economic circumstances.

The story of the global recession is now familiar. Prolonged economic expansion combined with easy credit fueled a housing bubble in the U.S. and elsewhere. Lenders provided increasingly exotic mortgages and relaxed lending rules to meet apparent rising demand for homeownership in the face of an unsustainable escalation in housing prices. When housing prices finally outstripped household incomes, the market collapsed.

The collapse of the housing industry alone, however, was not enough to reverse economic growth. The riskier lending agreements were folded into mortgage-backed securities and financial markets didn’t (or couldn’t) adequately evaluate the risk of those investments. Thus, when the housing market folded, the financial market seized up as banks and investment houses scrambled to re-evaluate their books and determine the value of their assets. As foreclosures mounted, investment banks folded, dramatically increasing uncertainty in financial markets, sending marginal banks into bankruptcy and squeezing out lending for all but the most credit-worthy borrowers.

The collapse of consumer demand, combined with an effective lock-down on commercial and consumer lending in the fall of 2008, sent an already sluggish world economy into a full-blown recession. As consumer demand in high-income nations fell, imports of goods and services plunged in those countries, dealing a severe blow to export-dependent economies in the developing world. (Notably, as discussed in the Surface Transportation section of this report, China’s economy is humming along at about 8 percent growth on the strength of its domestic economy while the regions relying on exports, such as Shanghai and Guangzhou, have contracted severely).

In the U.S., housing markets in several metropolitan areas went into a tailspin. Sixty-two of the 100 largest metro areas experienced housing market declines between the first quarter of
2008 and the first quarter of 2009, according to an analysis by the Brookings Institution. Metro areas experiencing double-digit declines in housing prices included Fort Myers (FL), Fresno (CA), Las Vegas (NV), Miami (FL), Riverside-San Bernardino (CA) and Stockton (CA). Overall, housing prices fell by 6.9 percent among the nation’s largest metro areas.

This is why Houston’s 4.7 percent increase in housing prices stands out. Rather than falling off a cliff, Houston’s housing market remained relatively stable even as its regional economy stagnated in the face of the recession. Houston’s average monthly residential building permits climbed higher and peaked later than every other Texas metropolitan area, including Dallas-Fort Worth, San Antonio and Austin. Indeed, even after the housing market began to soften (in 2006), 100,000 single-family permits were issued over a two-year period in Houston.

In part, a robust regional economy helped shore up local housing prices. Houston is the fourth largest city in the U.S., with a population of about 2.2 million and the sixth largest metropolitan area, with a population of 5.7 million (and an urbanized area population of about 4.3 million). Houston’s economy would rank 20th worldwide in terms of the total value of goods and services produced and it boasts the nation’s highest concentration of Fortune 500 headquarters outside Chicago and New York.

As the recession unfolded in late 2008 and early 2009, output as measured by the Gross Metropolitan Product declined by only 0.7 percent from its peak as metropolitan area output declined by 3.3 percent nationally, according to the Brookings Institution. Wages increased 1.3 percent during the first quarter of 2009, higher than the average of 0.4 percent for the 100 largest metropolitan areas. An unemployment rate of 6.5 percent in Houston at the end of the first quarter of 2009 is well under the average for the largest metropolitan areas (8.8 percent) and the nation as a whole (9.0 percent). The unemployment rate inched up to 6.9 percent in May 2009, according to the U.S. Bureau of Labor Statistics, but that figure is still well below the national average (although higher than in San Antonio and Austin).

Yet Houston’s economic resilience is itself a bit of a puzzle. During periods of strong worldwide economic growth, the region would naturally benefit from its position as a global hub for the energy industry and international trade. ConocoPhillips, Marathon Oil, Halliburton and Sysco call Houston home. The city’s port is the nation’s second busiest (behind the Port of Los Angeles and Long Beach), although it’s the largest in terms of foreign tonnage. While these are advantages in boom times, one would expect that the city’s economy would be more vulnerable to swings in exports and imports and slumps in the energy industry. High energy prices in the summer of 2008 boosted profits for major energy companies, but prices dropped as the recession hit full swing. International trade swooned in the fourth quarter of 2008 and first two quarters of 2009.

But Houston has avoided major economic pitfalls. Its housing market has remained remarkably strong, accounting for 36 percent of single-family housing permits issued in Texas. In fact, Houston’s multifamily permits have out-produced its main in-state rival Dallas in seven of the last eight years and the combined Dallas-Fort Worth metropolitan area in four of the last eight years.

So, what explains Houston’s robust housing market?

A significant part of the answer may be in the way the city approaches land development. Meeting consumer demand and adjusting to changing economic circumstances is easier and faster in Houston than in any other major urban area in the United States. This efficiency is an artifact of history as well as a result of Houston’s stubborn resistance to planning fads and conventions. Citywide zoning referenda were turned down at the ballot box in 1948, 1962 and 1993. Houston remains the largest city in the coun-
try without land-use zoning, a planning practice that makes land use a political decision rather than an economic one. Zoning implements comprehensive urban planning by dictating specific land uses for specific parcels of land and it is usually approved through a legislative process at the local level.

Cities typically have a zoning code that specifies which land uses are permitted in which types of zones. A zoning map is then overlaid on the city to geographically peg zones to specific parcels of land. Some zoning codes are simple, identifying a dozen or so residential, commercial, industrial, open space or agricultural zones. Others are far more complex, specifying land uses for as many as 100 or more zones. For land to change use, for example, from residential to commercial (or changing even from one single-family housing type to another), the zoning map must be amended through an open, participatory legislative process. Rezoning for small projects can take months, while approvals for complex projects may take years.

Houston, in contrast, allows for a mostly free market in land development. Since most land parcels were platted before contemporary urban development, land use is regulated through deeds or covenants that run with the land, not with the owner of the land. In many cases, particularly in older parts of the city, deeds are very broad and sometimes do not specify any restriction on use or include only very specific restrictions (e.g., exclusions for meat packing plants, farms, grocery stores, boarding houses, etc.).

Traditional zoning designates specific land uses for specific parcels. So, in a single family residential zoning district, only single-family homes are allowed. The zoning code often specifies lot sizes, square footage, set backs, height restrictions, garage design and even landscaping requirements.

While land use is largely regulated through private deeds and covenants, land development is subject to other public restrictions and approvals. The city regulates land development through its subdivision regulations in Chapter 42 of the city code. Thus, property owners can purchase single-family homes and redevelop the property for mixed use or higher density use without interference from the city as long as they meet the requirements for physical infrastructure, public safety and other codes. (And the private deed does not restrict the particular type of land use.)

The construction of new buildings or expansions of existing buildings require plat approval, but the key criteria involve whether the developer has made sufficient accommodations for code specified performance measures such as street widths and access, stormwater runoff, sewer access, rights of way, open space (in multifamily units) and other concerns related to public infrastructure.

Plats that do not require the dedication of public streets or increased demand on infrastructure often can be sent through a streamlined review process that includes administrative approval.

Moreover, the planning commission’s primary criteria for approval are whether the proposed plat is in compliance with the performance standards established in the city code. In principle, even a complex, mixed-use plat application requiring planning commission action could be approved in four weeks as long as it met the performance requirements specified in the Houston subdivision code. Even if the planning commission defers a decision, the city code requires action within 30 days of the deferral.

Given the streamlined nature of development approvals, Houston is accommodating urban infill at very high rates (for the U.S.). Between 2000 and 2007, the city of Houston attracted 53 percent of the region’s population growth, according to demographer Wendell Cox. Population density increased by 14.3 percent (a significantly greater share than either Dallas-Fort Worth or San Antonio, but slightly less than Austin). Most of this growth is likely going inside the I-610 loop, a circumferential limited-
access highway three to five miles (five to eight kilometers) outside of the downtown Houston.

Unfortunately, this streamlined approach to regulating development, which accommodates market-driven tastes and preferences, is under assault. Increasingly, local officials and citizens are agitating for a more open and participatory planning process that could potentially compromise the ability of private developers to make the kinds of adjustments necessary to keep Houston’s housing market dynamic and flexible.

Oddly, the clamor to supplant the market-based approach to land development in Houston is promoted under the banner of Smart Growth, a political movement established to combat suburban sprawl and promote higher densities and mixed land use. Houston’s system of private covenants and deeds has created a flexible and efficient regulatory framework that already meets these goals without specific political involvement.

By imposing a legislative approval process combined with traditional zoning, local Smart Growth activists may be throwing the baby out with the bathwater. An open, participatory procedure lengthens the time it takes to approve new projects. Pegging land uses to politically determined designations on a map triggers legislative review. Thus, the private sector will be faced with a more burdensome process for developing land to meet the increasing urban needs of the city of Houston and the region.

Fortunately, an attempt to create a centralized, statewide approach to urban planning was defeated when Gov. Rick Perry vetoed Senate Bill 2169. In his veto message, Gov. Perry said: “Decisions about the growth of communities should be made by local governments closest to the people living and working in these areas. Local governments can already adopt ‘smart growth’ policies based on the desires for the community without a state-led effort that endorses such planning. This legislation would promote a one-size-fits-all approach to land use and planning that would not work across a state as large and diverse as Texas.”

Indeed, the adoption of a politically oriented legislative approach to planning may well undo a process in Houston that has worked efficiently to meet local needs and has provided an important hedge against the global recession.

**B. Property Rights Update**

Texas Governor Rick Perry has signed a bill that asks voters to amend the state constitution by limiting the government’s ability to take private property using eminent domain authority. If voters approve the ballot measure, HJR 14, in this November’s elections, the constitutional amendment would prohibit government officials from taking property and giving it to a private developer to increase tax revenue. Critics like the Texas Farm Bureau say the bill would not go far enough in protecting property rights. They believe that additional protections, such as compensation for property owners for lost access to their land, fair market value reimbursement and the right to repurchase land not actually used for the condemning purpose must be present in reform efforts.

Meanwhile, the Texas Supreme Court has refused to hear a case involving the use of eminent domain to take 17 properties for the new Dallas Cowboys stadium in Arlington. If passed, HJR 14 might offer some protections to the affected landowners.

Federal officials are optimistic that they will be able to acquire land in southwestern Pennsylvania for the 9/11 Flight 93 Memorial without invoking eminent domain. Interior Secretary Ken Salazar says agreements have been made with most of the landowners and that the rest are continuing negotiations, which are expected to end quickly. The government’s original deadline for negotiations passed, but they have not attempted eminent domain proceedings.

The U.S. Supreme Court has agreed to hear arguments regarding the constitutionality of Florida’s Beach and Shore Preservation Act. The Court will determine whether a project that
would widen a seven-mile stretch of beach by
210 feet would violate the property rights of
beachfront landowners. Florida has proposed a
state-owned public beach, 60 to 120 feet wide,
between private beachfront land and the Gulf
of Mexico. At issue is the state government’s
authority to restore eroded coastline when it
modifies private property boundaries. The Flor-
da Supreme Court determined last year that the
restoration does not unconstitutionally deprive
owners of littoral rights without just compensa-
tion.

A case facing Wisconsin’s Common Coun-
cil about a property dispute between a private
landowner and the city of Milwaukee turns on
the city’s designation of the property as blight.
Although the empty grass plot poses no health
hazard, it impedes business growth and should
be seized, according to Assistant City Attorney
Greg Hagopian. Following Kelo v. City of New
London, courts have yet to make the narrower
determination of blight in terms of economic
health versus public safety.

A New York property owner whose four
buildings were seized a decade ago received an
apology and $475,000 from the village of Port
Chester. William Brody’s property was seized
in 1999 after the city posted notice in a local
newspaper, which was the minimum require-
ment under the law. Brody’s subsequent law-
suit prompted a new law in 2004 that requires
municipalities to inform property owners by cer-
tified mail or personal delivery that they intend
to take the land.

Another lawsuit involving the 1999 develop-
ment project in Port Chester was dismissed by
a federal appeals court. The owner of a seized
parcel of land in Didden v. Village of Port Ches-
ter alleged that a city official in 2003 demanded
an $800,000 bribe for the owner to keep his
property. Joined by Supreme Court nominee
Sonia Sotomayor, the 2nd Circuit upheld a lower
court’s ruling for the defendant, holding that the
suit was filed after the statute of limitations had
passed. The court held that the time limit began
when the owner knew that his property might
be seized, rather than at the time of the alleged
extortion. Legal scholars like University of Chi-
ca’s Richard Epstein have heavily criticized the
Circuit Court’s decision, which is sure to gain
some attention during Sotomayor’s nomination
hearings.

A New Jersey bill that would limit the use
of property seizures to further private develop-
ment may become law by the end of the year.
The bill would require that developers pay ten-
ant for vacating a property and would give
up to $21,000 in rental assistance to displaced
residents. It would also narrow when and how
developers must notify tenants that their prop-
erty is being seized. Notices to affected tenants
would state whether or not eminent domain
is being invoked and also clearly inform those
affected that they have 60 days to challenge the
municipality’s decision in court. Municipal offi-
cials would be required to produce the evidence
they relied on to support a blight determination
if the seizure was challenged in court. The bill
comes in light of recent abuse of eminent domain
by private developers following 2005’s Kelo v.
City of New London decision.

Missouri’s courts are involved in a battle over
potential ballot measures that would restrict the
use of eminent domain to take private property
for redevelopment. Previous measures in 2006
and 2008 did not survive legal disputes. Supporters of the ballot initiative are starting earlier this time, trying to claim a spot in the 2010 election. Cole County Circuit Judge Richard Callahan heard arguments in May on a lawsuit by the Missouri Municipal League. The suit claims the state ballot summaries and financial estimates prepared for the eminent domain initiatives are unfair and insufficient.

Multnomah County officials have petitioned the Oregon Supreme Court to review the long-running Dorothy English case, seeking to avoid a $1.15 million judgment it was ordered to pay last month. The case is at the heart of Oregon’s Measure 37 campaign, a law passed in 2004 that allows property owners whose property value is reduced by environmental or other land use regulations to claim compensation from state or local government.

City officials in Montgomery, Alabama are under fire for using eminent domain to systematically seize hundreds of parcels of property. Despite a tightening of the state’s blight laws after the Kelo decision, critics say that officials are finding creative ways around any restriction through local and state blight, tax, zoning and public nuisance ordinances.

Maine State Representative Jayne Crosby Giles has introduced a bill to protect Maine businesses from unfair treatment under eminent domain proceedings. Her proposal would base compensation on a “going concern” value when the state needs to acquire business properties for roads, bridges and other public projects. This valuation method will take into account the full value of the seized business, rather than just the real property. LD 1207 would appoint an ombudsman to each property owner whose business property is seized via eminent domain.

In Connecticut, Governor M. Jodi Rell has proposed the elimination of the Office of the Ombudsman for Property Rights. The Office, established in 2006, assists both government and property owners in working through eminent domain takings. The state is expected to save $200,000 per year, but may face even higher long-term litigation costs.

Massachusetts State Representative Richard Ross has introduced a bill that would prohibit the government from taking property by eminent domain in order to give it to another private developer. The bill would require that the state demonstrate that property is being seized for public use.

State legislators in Maryland passed a bill allowing the government to seize Pimlico Race Course, home of the Preakness Stakes. They can also seize Laurel Park racetrack and the Woodlawn Vase, which is awarded to the Preakness Winner. The move comes after Magna Entertainment Corporation, which owns Preakness, went bankrupt this year.

A state Senate committee in Virginia voted down Delegate Rob Bell’s proposed constitutional amendment to ban the exercise of eminent domain solely for the purposes of economic development. The Senate Privileges and Elections Committee defeated Bell’s bill, HJ 725, in a 10-5 vote. The measure had already cleared the House of Delegates in a 68-31 vote. Proponents of the measure said a constitutional amendment would enact permanent protections for owners of private property.

A bill that would have prohibited gas pipeline companies working in Arkansas’ Fayetteville Shale Play from using eminent domain to acquire a right-of-way for feeder pipelines was defeated in a House committee.

The Mississippi House and Senate overwhelmingly passed separate versions of a bill restricting government takeovers of private property. House Bill 803 limits the state government’s eminent domain power, saying it can’t be used to buy private property to enhance tax revenues by turning property over to commercial developers. However, Governor Haley Barbour vetoed the bill in March 2009 on the basis that “it would do more damage to job creation and economic development than any government action since Mississippi rightfully began trying to balance
agriculture with industry in 1935.”

A bill limiting eminent domain seizures in Colorado was indefinitely postponed by the state legislature. Senate Bill 63 would prohibit railroad companies from condemning land through eminent domain. It went on to propose that because of lingering concerns left by federal law, in the event eminent domain was used, railroads must reimburse the property owner for all attorney’s fees and other costs related to the condemnation.

Hawaii residents showed support for exercising eminent domain against Molokai Ranch, the island’s largest landowner for more than a century. Community leaders and over 300 activists gathered to debate the seizure of the ranch, which accounts for 40 percent of Molokai Island.

C. Property Rights in Arizona: The Sky Hasn’t Fallen

By Clint Bolick, Goldwater Institute

Back in 2006 when I was debating in favor of Proposition 207 (Prop 207), the Arizona Property Rights Protection Act, the reaction from city attorneys and those who feed at their trough was one of absolute hysteria: if the initiative passed, they fretted, civilization as we know it would end. Or at least municipal zoning and planning, which, after all, is the basis of modern civilization.

Nearly three years later, after Prop 207 was passed by a 2-1 margin among Arizona voters, none of the doomsday predictions has come to pass. Arizona cities still zone and plan. Very few lawsuits have been filed. But something else has transpired: Arizona cities are (generally) behaving themselves and no longer are riding roughshod over property rights.

Prop 207 contained two components: a prohibition against the taking through eminent domain of private property for the use of another private owner (which already was part of the Arizona Constitution but had been ignored until a recent court decision); and a requirement that cities pay compensation when their regulations restrict the use and diminish the value of a person’s property, except in specified circumstances (such as public health and safety, transportation or traffic control, pollution, etc.).

Generally, cities are complying by restricting their land-use regulations to the exceptions listed in the law. They are not taking actions like limiting building heights so as not to obstruct a neighbor’s view or down-zoning to reduce permissible uses.

Initially, several cities tried to create a loophole wide enough to drive a Mack truck through. The bill allows a city to ask a property owner to waive Prop 207 rights in connection with a building permit or variance application. It makes sense that if a property owner asks the city for permission to do something, he can’t turn around and sue the city for diminution in value for granting the request. But some cities forced applicants for development permits to waive Prop 207 rights for all future city regulations, in essence repealing Prop 207 for the affected property owners. Because the waivers run with the property, a developer could bind thousands of future homeowners by signing a single Prop 207 waiver.

The Goldwater Institute sent letters to cities that were using the illegal letters, threatening to sue. One by one, they abandoned the illegal waivers. Now cities spend more time figuring out how to comply with the law than how to evade it.

At least three Prop 207 claims have been filed:

- The city of Flagstaff enacted a historical preservation ordinance that diminished property values. Pacific Legal Foundation is seeking compensation for the property owners.
- The city of Tucson passed an ordinance that placed severe restrictions on the ability to demolish property. The Goldwater Institute represents Michael Goodman, an in-fill
developer who buys dilapidated buildings and replaces them with upscale housing for university students. The city repealed the ordinance, but the Institute is seeking compensation for the diminished value during the time when the ordinance was effective.

Maricopa County imposed a complete moratorium on building permits on thousands of properties surrounding Luke Air Force Base, which limited even the replacement of damaged property. The Goldwater Institute filed claims on behalf of hundreds of property owners and the county repealed the moratorium.

Why did Arizona succeed in enacting the nation’s most sweeping protections of private property rights when voters in other states have failed to do so? And why is the law effective, when a similar law in Oregon faced enormous backlash? Three circumstances in Arizona provide lessons for property rights reforms in other states:

- The campaign for Prop 207 emanated from the city of Mesa’s eminent domain case against Randy Bailey, in which the city tried to take Bailey’s brake shop and give it to a hardware store that wanted to expand. The Bailey case was highly publicized and won widespread sympathy for property rights reform. It transformed an abstract issue into one with which most Arizonans could personally identify.

- Unlike the Oregon law, Prop 207 is not retroactive. Compensation claims for city actions that were valid under previous law will almost certainly undermine public support.

- Having an effective watchdog group like the Goldwater Institute or Pacific Legal Foundation is essential for keeping local governments honest. Some cities will enact regulations even in the face of compensation claims. But that is the point: under Prop 207, it is the public generally and not individual property owners, that will bear the financial burden of land-use restrictions.

Property rights reforms can flourish, especially when local governments overstep the bounds of constitutional limits and fair play. Sadly, local governments can be counted on to do just that. The challenge for freedom advocates is to take advantage of local government tyranny to persuade legislators and voters that more stringent limits on government power are necessary.

Clint Bolick is director of the Goldwater Institute Scharf-Norton Center for Constitutional Government and a research fellow at the Hoover Institution.
Reason’s archive of privatization and government reform research and commentary is available at www.reason.org/areas/topics/privatization/

For the best bimonthly analysis of developments in outsourcing and privatization, subscribe to *Privatization Watch*: www.reason.org/publications/privatizationwatch/

And for regular privatization commentary, please visit Reason’s weblog, Out of Control: www.reason.org/blog