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PUBLIC AUTHORITIES AND PRIVATE FIRMS AS PROVIDERS OF PUBLIC GOODS

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EXECUTIVE SUMMARY

Public authorities, which are created by statute but share many of the features of both firms and governments, are responsible for planning and financing much of America's major infrastructure. The structure of these entities insulates them from both the political discipline of traditional governments and the market discipline of private firms. Public authorities enjoy exemptions from many of the statutory restrictions that impose social constraints on firms and governments. They operate free from monitoring that exists either through the electoral checks of politics or the profit-maximizing interests of shareholders. Those to whom public authorities are responsive, such as bondholders, may have interests that vary significantly from the interests of the constituents whom public authorities are created to serve. The result is that public authorities will generally be less efficient than private firms that perform similar tasks.

Private firms providing public works facilities (such as airports, toll roads, water supply, and waste-disposal facilities) tend to be subject to much stronger economic incentives for efficiency than those that affect public authorities. Company managers often have a direct stake in the firm's profitability, and they can be replaced if stockholders become dissatisfied with their performance. Greater information disclosure in the private sector reinforces these incentive effects.

A number of recent examples illustrate public-authority activities that appear inconsistent with social utility, such as spending money on poorly justified expansions and employing advisors not selected on merit. These activities can be traced to these underlying institutional differences.

Two policy implications follow from this analysis. First, public authorities should be made more accountable, perhaps by removing the immunities they currently enjoy. Second, and more fundamentally, the decision to have public authorities provide major infrastructure should be reconsidered, since private firms can often perform these same public functions, while not suffering from the institutional disadvantages of public authorities.

I. INTRODUCTION

A. Why Public Authorities?

As the needs for new and rehabilitated infrastructure increased in the 20th century, governments that traditionally provided these services turned to relatively novel institutions to assist in financing, developing, and operating capital-intensive projects. Roadways, airports, public office buildings, public college dormitories, water and sewage systems, and hospitals have all been financed, developed, and operated via "public authorities," quasi-governmental entities that are statutorily created and that may possess many of the features of general-purpose governments.

While general-purpose governments provide a complex package of goods and services, however, authorities generally provide only a single service. Nevertheless, public authorities may exercise the power of eminent domain,[1] issue debt that is secured by the guarantee or "moral obligation" of the state to cure any shortfall in funds to service debt,[2] issue debt the interest on which is exempt from state and local income taxation, share the sovereign immunity of the state, hold property exempt from local taxation,[3] and earn profits exempt from federal and state corporate income taxes.

At the same time, public authorities generally do not depend on funds received directly from the electorate, and are governed by officials who are not popularly elected. In theory, these features permit more efficient delivery of public goods than general-purpose state or municipal governments. Since public authorities are not limited by existing jurisdictional boundaries, they can address regional or metropolitan problems (such as transportation, water or sewage service) that transcend traditional boundary lines, and can carry out these functions free from political pressures. Since they depend on user fees more frequently than on taxes, they can (again, theoretically) engage in marginal cost pricing of the services they provide and thus link prices to demand and cost in ways that property tax-based financing does not.[4] (Of course, to the extent that authorities receive subsidies from governments, they are less likely to match costs and prices.)

But there is a downside to this picture. Public authorities are not necessarily created with an eye towards efficient delivery of services. Rather, they are typically created to overcome legal obstacles that general-purpose governmental units would face in undertaking the same projects. For instance, authorities with independent revenue-raising power may be able to construct projects without running afoul of debt limitations that apply to the state or its political subdivisions.[5] Since public authorities are not subject to the checks of electoral politics and operate from funds that neither the electorate nor public officials are likely to monitor, their ability to produce goods consistent with the public interest depends on good internal management, the public-spiritedness of their personnel, and monitoring by users of their service.

At the same time, the fact that authorities deliver goods that are financed through user fees or other benefit-based payment mechanisms suggests that their output is frequently measurable in discrete, severable units. Thus, while authorities deal in outputs that have some features of public goods, such as intensive capital costs, or that are susceptible to free-rider problems that may make private provision more difficult, these same outputs have various

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1 See, e.g., Comment, "An Analysis of Authorities: Traditional and Multicounty," *Michigan Law Review*, vol. 71 (1973).

2 See, e.g., Steup vs. Indiana Housing Finance Authority, 402 N.E. 2d 1215 (Ind. 1980); Johnson vs. Pennsylvania Housing Finance Agency, 309 A.2d 528 (Pa. 1973). But see Witzenberger vs. State ex rel. Wyoming Community Development Authority, 575 P.2d 1100 (Wyo. 1978).

3 See, e.g., Milan vs. City of Berlin, 104 N.H. 320, 184 A.2d 454 (1962).

4 See Clayton P. Gillette and Thomas D. Hopkins, "Federal User Fees: A Legal and Economic Analysis," *Boston University Law Review*, vol. 67 (1987).

5 Robert H. Bowmar, "The Anachronism Called Debt Limitations," *Iowa Law Review*, vol. 52 (1967).

features of private goods that are traditionally provided by market participants. The goods and services that authorities provide, such as highways, airports, water or sewage service, and convention centers, do not have the characteristics of nonrivalness and nonexcludability that define the traditional kinds of public goods for which governmental provision is considered most useful, if not essential.[6] Authorities, moreover, typically do not have the power to impose redistributive taxes, and are not generally involved in wealth redistribution. Thus, for the most part, authorities deal with goods and services for which governmental provision is *possible*, but not *necessary*.

Two points should be apparent from this snapshot of public authorities. First, the services they provide—planning, financing, constructing and operating substantial public projects—are not unique to government providers. Instead, the services that fall within the authority bailiwick—capital projects, roads, airports—are also susceptible to private provision (although many of these projects require such a large amount of capital that governments are typically believed to be the best financiers).[7] Second, insofar as public authorities are exempt from both the political checks of general-purpose governments and the market checks of private providers of these goods, there are reasons to suspect that public authorities will be less efficient than private counterparts in delivering the services they are created to provide.

B. The Privatization Alternative

The question of who should provide major infrastructure projects is of great current interest. The federal government has encouraged greater private investment in infrastructure via several measures, including the Intermodal Surface Transportation Efficiency Act of 1991, President Bush's Executive Order 12803 on Infrastructure Privatization, and President Clinton's Executive Order 12893 on Infrastructure. Seven states and Puerto Rico have enacted private toll-road programs since 1988, and a number of major cities have considered selling existing infrastructure assets such as airports, municipal gas and electric utilities, water systems, and wastewater treatment plants. Several large engineering and development companies have set up new divisions or joint ventures to pursue privatized infrastructure ventures, as have several major financial institutions.

Worldwide, the trend toward privatized infrastructure is much further advanced than in the United States. Countries such as Argentina, Australia, Britain, and Mexico are selling or leasing existing airports, highways, ports, and utilities to investor-owned companies and granting long-term franchises to such firms to develop new infrastructure.[8] But the idea of privatized infrastructure has many critics in the United States. It is frequently argued that the relatively unique U.S. institutions of: 1) tax-exempt municipal bonds; and 2) public authorities provide an adequate or superior method of developing and operating public-works infrastructure than reliance on investor-owned corporations.

This paper therefore explores the comparative capacities of public authorities and private firms to efficiently provide such infrastructure facilities and services. The objective is not to argue from anecdote, although the paper's claims about public authorities will be illustrated with examples from recent experience. Instead, the paper will identify structural or institutional characteristics about public authorities and private firms that indicate why one would expect each to behave in a manner that does or does not foster efficient practices.

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6 For discussion of public goods, see Richard A. Musgrave and Peggy B. Musgrave, *Public Finance in Theory and Practice* (New York: McGraw-Hill, 1980), pp. 56–58. For a discussion of the limits of the marketplace in providing public goods, see Clayton P. Gillette, "The Private Provision of Public Goods: Principles and Implications," in *A Fourth Way? Privatization, Property, and the Emergence of New Market Economies,* Gregory S. Alexander and Grazyna Skapska, eds., (New York: Routledge, 1994).

7 For historical examples of successful governmental grants to private firms to create public goods, see, Ronald H. Coase, "The Lighthouse in Economics," *Journal of Law and Economics*, vol. 17 (1974); Hendrik Hartog, *Public Property and Private Power: The Corporation of the City of New York in American Law, 1730–1870* (Chapel Hill: University of North Carolina Press, 1983).

8 John O'Leary (ed), *Privatization 1994*, Los Angeles: Reason Foundation, April 1994.

II. ACCOUNTABILITY AND MONITORING OF AUTHORITIES AND FIRMS

A. Overview

Modern public authorities are usually traced to turn-of-the-century arrangements in England and the creation of the Port of London Authority to develop transportation facilities in that city's ports.[9] Although precursors existed, authorities in this country began with the creation of the Port Authority of New York and New Jersey in 1921.[10] Although it is difficult to devise an accurate count of authorities,[11] there is little doubt that they have proliferated in recent decades. Authorities now cover areas as diverse as making loans to college students, providing funds for moderate-income families who seek home mortgages, constructing and maintaining highways and bridges, constructing university dormitories and public buildings, financing power plants, and building hospitals. Since the beneficiaries of these services—college students, mortgagors, travelers, etc.—could otherwise obtain these services from the private sector (and there is historical precedent for their private provision[12]), government provision in a market economy can be justified only if we believe that the level or conditions of government provision will be superior to that of the private sector.

One problem with any inquiry into whether public or private provision is superior is defining how to measure "superiority." For purposes of this paper, I assume that we want the service at issue to be provided as efficiently as possible, taking that term to mean provision at the lowest per-unit cost. Direct measures of superiority, however, are difficult. The tax-free nature of public-authority debt allows them to pass along lower rates to consumers than a private entity would be allowed,[13] even though those lower rates reflect a technicality of tax law rather than a more efficient level of service. Furthermore, because authorities tend to be monopolists, direct cost comparisons with private entities serving the same constituency are difficult at best. Thus, investigation into "superiority" must ultimately consider whether there are reasons inherent in the structure or institutional design of authorities and firms that indicate one is more or less likely than the other to provide a service efficiently.

B. Monitoring Public Authorities

Close monitoring by those who bear the costs of a provider's activities ought to lead to more efficient provision of the service in question. Presumably, these monitors would want costs per unit of service to be as low as possible; hence, they would attempt to detect waste. In short, accountability to constituents should increase the efficiency of any provider of goods and services.

1. Exemption from Political/Governmental Constraints

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9 See Jerry Mitchell, "The Policy Activities of Public Authorities," *Policy Studies Journal,* vol. 18, (1990).

10 See Robert A. Caro, *The Power Broker* (New York: Random House, 1974), pp. 614–15; James W. Doig, "`If I See a Murderous Fellow Sharpening a Knife Cleverly...': The Wilsonian Dichotomy and the Public Authority Tradition," *Public Ad. Rev.* (1983).

11 See Mitchell, "The Policy Activities," at 929. Walsh counted 6000 local and regional authorities and 1000 state and interstate authorities in 1978. See Ann Marie Hauck Walsh, *The Public's Business* (Cambridge: MIT Press, 1978) p. 6. There are currently 39 public authorities created under New York state law. See New York State Division of the Budget, Public Authorities' Administrative and Financial Practices: Report on Implementation of Executive Order No. 173 (December 1993).

12 For studies of the private provision of public goods, frequently with the assistance of government through grants of monopoly or subsidy, see, e.g., Oscar Handlin and Mary Handlin, *Commonwealth: A Study of the Role of Government in the American Economy* (Cambridge: Harvard University Press, 1947); Hartog, *Public Property and Private Power*.

13 See, e.g., 26 U.S.C. §§103, 141.

Initially, one might conclude that authorities are not easily monitored, since authority directors and managers are typically appointed rather than elected by their constituency. Indeed, many critics of authorities cite this point to suggest that authorities will engage in activities that are distant from the interests of their supposed constituents.[14] The archetypal example of this phenomenon was Robert Moses, the head of multiple authorities in New York, who is reported to have consistently ignored the preferences of the electorate, such as by bulldozing neighborhoods before hearings could be held on his development plans.[15]

In addition to not facing electoral checks, authority officials also frequently enjoy statutory exemptions from many of the safeguards that discourage private firms from engaging in conduct inconsistent with social welfare. Some of these exemptions directly affect the financial performance of authorities, and will be discussed in the section of this paper that specifically addresses that issue.[16] But several of these exemptions also affect the issue of accountability wholly apart from financial responsibility.

For instance, authorities may not be subject to zoning laws that are intended to permit planning in their communities. Thus, in recent cases, a hospital authority could ignore sign ordinances that would have been applicable to a private hospital,[17] and an airport authority was exempt from township zoning regulations.[18] Authorities created to construct large power-generating plants have been exempted from requirements, applicable to investor-owned utilities, of demonstrating that such projects are necessary and convenient.[19] While racing events in New Jersey at privately operated tracks are subject to strict regulation, racing events conducted at tracks operated by the state's Sports and Exposition Authority are exempt from such regulation.[20] In a more dramatic instance, the World Trade Center, owned by the Port Authority of New York and New Jersey, was not required to adhere to local fire codes at the time of its bombing.[21]

While some level of accountability theoretically exists because authority personnel may be removable by elected officials, the policies of authorities will rarely be a significant factor in the minds of the electorate when they vote for those officials. A vote for a gubernatorial candidate, for instance, is likely to reflect the voter's view of the economic condition of the state, the candidates' willingness to raise taxes, or the candidates' stand on social issues, rather than on the governor's appointments to the state port authority or highway authority. Thus, there will rarely be situations in which substantial public pressure is brought to bear on elected officials to take action against authority personnel.

2. Incentive Effects

Although authorities seem to operate far from the electorate and other political safeguards, the issue of accountability is more complicated than it initially appears. In theory at least, authorities permit experts in a particular area to address public problems free from the vicissitudes and lack of expertise inherent in electoral

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14 See, e.g., Doig, "'If I See A Murderous Fellow,'" p. 299.

15 See, e.g., Walsh, *The Public's Business,* pp. 220–24.

16 See Part IV infra.

17 Macon-Bibb County Hospital Authority vs. Madison, 204 Ga.App. 741, 420 S.E.2d 586 (1992).

18 Swanton Township Board of Trustees vs. Toledo-Lucas County Port Authority, 66 Ohio App.3d 555, 585 N.E.2d 871 (1990). There are, however, cases in which authorities are held to be subject to local ordinances. See, e.g., Shupack vs. Manasquan River Regional Sewerage Authority, 194 N.J.Super. 199, 476 A.2d 816 (1984); Parking Authority of City of Trenton vs. City of Trenton, 40 N.J. 251, 191 A.2d 289 (1963).

19 See Lammers vs. Heartland Consumers Power District, 85 S.D. 205, 180 N.W.2d 398 (1970).

20 See New Jersey Sports & Exposition Authority vs. McCrane, 119 N.J. Super. 457, 292 A.2d 580 (1962).

21 "New York: Of Normalcy and Amout Propre," *The Economist*, March 6, 1993, p. 25.

politics. From this perspective, the fact that authority boards and managers are appointed rather than elected is a positive characteristic. In this way, authorities share many of the justifications for independent administrative agencies.

But will public-authority personnel exercise their discretion in a manner consistent with public interest? There is no reason to believe that the managers and employees of authorities are any more altruistic, or publicly interested, than other members of society. Once we admit that public officials, as all individuals, have incentives other than (or in addition to) serving the public interest, the lack of accountability poses a series of offsetting problems. These other incentives may be as widespread as the desire to maximize leisure time, or subsequent employment opportunities in the private sector, or budgets.[22] Regardless of their source, these incentives may lead authorities to engage in activities that are at odds with the public they serve.

We should be precise about the scope of the claim being made about the interests of managers and employees of authorities. First, I am not suggesting that officials of private firms are more "publicly interested" than public officials. Thus, the comparative claim about the efficiency of private firms and public authorities does not rest on a question of which group is composed of more altruistic individuals. Instead, given that officials of either entity may not be fully devoted to the public interest, the question in each case is whether there are structural constraints that induce officials to act in a manner consistent with the public interest *regardless* of what they would otherwise do.

Second, there is no suggestion that public officials do not confront such constraints. Even if officials of public authorities have incentives other than serving the public interest, it does not necessarily follow that they are immune from legal or other mechanisms that counteract these incentives and induce officials to provide services efficiently. For instance, in many cases, authority boards consist largely of ex-official members who may serve the same public in their authority capacity as they do in their capacity as elected officials. Hence, any incentives that they enjoy as a result of their other public functions will also operate when they act as authority personnel.

Monitoring by these officials, however, does not provide much reason to believe that public authorities will operate as efficiently as private firms. This is because the level of monitoring of the public officials themselves is likely to be inferior to the monitoring to which private entities are subject. Private entities typically have a single objective, maximization of profits (subject to any constraints imposed by government regulation).[23] It is relatively easy to determine whether or not a private firm is "successful," since all that is required is an examination of the firm's profitability. It is true that some problems will exist even under this criterion. For instance, short-term losses may or may not be worth incurring in order to generate long-term profits, where the expectation of long-term rewards are not perfectly incorporated into current share prices. Nevertheless, for the most part, corporations are relatively susceptible to unitary measurements of success.

Public entities, however, do not necessarily serve a single objective. Public officials face multiple, vague, and sometimes competing objectives. Some of these objectives require the most efficient allocation of services; but some objectives are attentive to less tangible standards, such as fair distribution of resources. Thus, measuring performance of public entities can be a relatively complex exercise.[24] The result is that monitoring the "success" of a public entity can be relatively difficult.

Public authorities suffer less from this problem of multiple objectives than do general-purpose governments. Public authorities are created primarily to overcome public-goods problems within a certain geographical area, and do so

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[22] For a description of objectives that public officials might face in addition to serving the public interest, see Ronald A. Cass and Clayton P. Gillette, "The Government Contractor Defense: Contractual Allocation of Public Risk," *Virginia Law Review*, vol. 77, (1991).

[23] In some situations, private firms are required to take into account issues other than profitability. For instance, state antitakeover statutes may require firms to consider the effects of their actions on bondholders. Plant closing statutes may require consideration of the effect a business decision has on the community. See Richard B. Tyler, "Other constituency Statutes," *Missouri Law Review*, vol. 59, 373 (1994).

[24] See Ronald A. Cass, "Privatization: Politics, Law, and Theory," *Marquette Law Review,* vol. 71, (1988).

only with respect to a single good or service. This creates two advantages for purposes of monitoring. First, public authorities do not have to engage in trade-offs among multiple outputs as general-purpose governments must. Municipalities, for instance, must trade off competing services and, when they do so, monitoring the adequacy of provision of any one service becomes problematic (e.g., how much police service would have been available if the school budget were smaller?). Second, authorities tend to engage only in allocative issues, not redistributional ones. Thus, appeals to vague concepts such as fairness are less common than in the case of general-purpose governments.

Nevertheless, there are some limitations to this analysis. Even though authorities tend to charge prices for their services, like private firms, authorities may also be subject to constraints that apply to governmental entities generally and that are not necessarily related to efficient provision of service. For instance, New York has created an Office of Minority and Women's Business Development to develop opportunities for minority- and women-owned businesses to provide goods and services for State agencies and authorities.[25] A provision of state law requires state authorities to consider, when selecting underwriters for negotiated bond sales, the use of minority- and women-owned underwriting firms.[26] These criteria may serve worthwhile social goals, but they are not necessarily related to efficient service provision, and hence further complicate the issue of determining authority "success." In addition, the fact that authorities are monopoly providers means that measures of profitability do not translate easily into measures of efficiency.

3. Market Monitoring

Authorities may also be subject to some market monitoring, just as is the case with private firms. These market constraints may come from either of two sources. The first source is the consumers who pay fees for the services they receive from authorities. Although authorities tend to be monopolies, ratepayers may still have a sense that they are paying "too much" for a particular service. Ratepayers in some situations may have opportunities for "exit," that is, they may be able to shift to alternative sources for the same type of good that is offered by the authority. For instance, after a toll increase by the Jones Beach Parkway Authority from 10 cents to 25 cents, drivers shifted from the toll road to city streets. The result was substantial congestion of those streets and an attempted legislative rollback of the toll. (The rollback was subsequently declared unconstitutional.[27]) Ratepayer monitoring may also take the form of comparing the cost of services in different jurisdictions. Users of urban transit authorities, for instance, may compare the cost of bus or subway service in their locality with that of similar service in other localities.
These monitoring mechanisms, however, are somewhat limited. Comparisons across cities for the same services may be unreliable because of different labor costs or general costs of living. And exit from a service provided by an authority is not universally available. For instance, if the authority is the only feasible source of water or sewage service, ratepayers will have little choice other than to accept the service provided by the authority. In addition, if authorities receive subsidies from tax funds, so that consumers of their services do not pay full cost, those consumers have less reason to discover or complain about inefficiencies in authority operations. Since the loss suffered by any taxpayer as a result of these inefficiencies is likely to be small, taxpayer monitoring of these services is unlikely, even where tax funds are used to subsidize authorities.

Alternatively, monitoring of authorities may occur at the financing end of service provision (through capital markets) rather than at the delivery end (through consumers). As noted above, authorities typically do not have taxing power. Hence, they can only obtain the capital to undertake projects by maintaining access to bond markets, typically the tax-exempt market. Participants in this market can play a substantial role in monitoring the performance of authorities. Two principal agencies, Moody's and Standard & Poor's, rate the bonds issued by public authorities. These bonds may also be insured or guaranteed by private companies, which will review the financial feasibility of the projects being financed with bond proceeds.

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[25] New York Executive Law §§310-18.

[26] New York State Finance Law §136-b.

[27] See Patterson vs. Carey, 363 N.Y.2d 1146 (N.Y. 1977).

The Securities and Exchange Commission has recently suggested increases in the level of disclosure in municipal bond transactions,[28] a mechanism that would reduce monitoring costs for those who desire to check the financial operation of these entities. At present, issuers of municipal securities, including public authorities, are not required to file registration statements with the SEC prior to issuance. Nor are these issuers required to submit periodic financial reports to the SEC. Hence, those who seek information about public authorities may face higher costs because relevant information cannot be found in a centralized location. In addition, audits of public authorities vary more substantially in frequency and methodology than is the case for private firms. Thus, even when relevant financial information about an authority can be obtained, it may be dated or difficult to interpret.

Each of the factors discussed above constitutes some incentive for an authority to act in an economically efficient manner. Before deciding that these mechanisms are adequate to ensure efficient delivery of services, however, they must be compared to incentives available to private firms that might provide the same services.

C. Monitoring Private Firms

1. Incentive Effects

Managers of private firms face a series of incentives that make their *personal* interests coincide with the interests of the firm, wholly apart from legal incentives. Thus, these incentives work constantly, as opposed to legal incentives, whose effects may be discounted because enforcement is imperfect. Managers of private firms may have ownership rights in the firm, so that they gain personally by increasing the residual profits of the business.[29] Even if they do not gain directly, they are subject to significant monitoring by others who have substantial property rights in the residual profits of the firm. Thus, even if, for example, some managers of a firm wanted to maximize leisure time or fame rather than the firm's profits, the threat of losing jobs as their personal motives were detected would help to counter those incentives.

Since there are no residual profits that flow from the operation of public authorities, these mechanisms do not (and cannot) operate with respect to those entities. Indeed, any personal benefits that managers of authorities obtain are likely to take forms that induce deviations from the public functions of firms. Authority funds may be used to advance personal agendas or power rather than the interests that initially led to creation of the authority. For instance, Annmarie Hauck Walsh considers a series of managers (such as Edward King who survived efforts at ouster from the Massachusetts Port Authority to become governor of the state) who have created relationships with powerful politicians and private supporters and used authority employment for patronage purposes to build bases of power.[30]

Free-rider problems that reduce the level of monitoring may also be more significant with respect to public authorities than private firms. Customers of authorities are unlikely to monitor significantly because monitoring is itself a collective good. That is: 1) monitoring is costly; 2) the amount of loss that any one consumer faces as a result of authority inefficiencies is likely to be small; and 3) monitoring by one customer benefits others. Therefore, no customer has an incentive to invest in detecting or protesting waste within the authority. Hence, the rational consumer of electricity, water, or transportation services supplied by a public authority is unlikely to monitor the provision of the good.

Of course, customers of private firms are similarly unlikely to monitor those firms, should they provide the services currently offered by authorities. In the private firm, however, owners or shareholders who are distinct from

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28 See SEC Release No. 34-33741 (March 16, 1994); SEC Release No. 34-33742 (March 16, 1994).

29 See John D. Donahue, *The Privatization Decision* (New York: Basic Books, 1989), pp. 49–56; Michael H. Schill, “Privatizing Federal Low Income Housing Assistance: The Case of Public Housing,” *Cornell Law Review,* vol. 75, (1990).

30 Walsh, *The People's Business*, pp. 209–32. See also Donald Axelrod, *Shadow Government: The Hidden World of Public Authorities* (1992).

customers, and who may have a substantial proportion of their wealth tied up in the firm, do have significant incentives to monitor in order to protect their investments. In the authority context, “owners” and customers are likely to be the same (constituents within the jurisdiction of the authority). Although not every shareholder has an incentive to monitor (those with a small number of shares will have incentives to free ride on the monitoring efforts of those with large stakes), the objective of *all* shareholders is essentially the same. Thus, as long as there are *some* shareholders (e.g., pension funds) with sufficiently large stakes to monitor management, even managers who do not have ownership rights in the firm will have incentives to act in a manner consistent with the interests of all owners.

2. Market Controls

This conclusion is confirmed by analysis of the markets for *corporate control* and for *managers*. Publicly traded firms operated by managers that fail to maximize their profits are ripe for purchase by others who believe they can do better. The new owners can increase their personal wealth by replacing existing management with personnel more capable of maximizing investors' returns. This possibility serves as a threat that reduces the deviation between owner and management interests. Directors of authorities, on the other hand, are often appointed for terms frequently lasting six or more years.[31] As noted above, the lack of electoral control over appointees reduces the risk of early termination for failure to satisfy their constituents. Since the directors of authorities themselves are substantially free from market constraints, they have less reason to be watchful of subordinate managers.

The fact that private firms issue shares also provides a more comprehensive basis for monitoring. Share prices, at least for publicly traded firms, are reported continuously and generally reflect current information about the firm. While the bonds of public authorities are also traded, secondary markets for such securities are relatively thin and information is relatively occasional. The result is that some forms of monitoring do not apply equally to public and private entities. For instance, shareholders who have not relied on specific misrepresentations of a firm may still recover for violations of federal securities laws, as long as that firm's shares are traded in a “well-developed market.” The less-frequent trading of municipal securities, however, makes similar claims of reliance on market integrity less applicable to the securities of public authorities.[32] As noted previously, securities issued by governments (including public authorities) are not subject to the pre-registration requirement of the federal securities laws and, at least as of this writing, issuers of such securities do not have the same obligations of continuing disclosure that exist in the private securities markets.

3. Investors' Due Diligence

At the financing stage, another difference between private and public comes into play. A privately developed project is typically financed by a mixture of debt and equity (perhaps 80 percent debt and 20 percent equity). Potential buyers of the debt (revenue bonds) carry out their “due diligence” by rigorously examining the economics of the project and all the potential risks (such as construction risk and revenue risk). They know that the project must depend entirely on its own revenues, so the projections of future business activity (traffic or throughput) are critical factors in this assessment.

A comparable public-authority facility is usually financed 100 percent by debt. Its bonds are also revenue bonds, and potential buyers also engage in due diligence. Yet experienced observers note that there is a subtle (perhaps psychological) difference in the assessment of risks when the project is being developed by a public authority. The *implicit* support of a government agency carries a lot of weight; many bond buyers deem it unlikely that the government in question would let the project fail, even if unexpected risks do materialize in the future.

[31] New York State, Division of the Budget, Public Authorities' Administrative and Financial Practices: Report on Implementation of Executive Order No. 173, at 24 (1993).

[32] Compare Basic Inc. vs. Levinson, 485 U.S. 224 (1988) with Freeman vs. Laventhol & Horwath, 915 F.2d 193 (6th Cir. 1990).

From the standpoint of potential bond buyers, this implicit state guarantee makes the investment appear less risky if the project is carried out by an authority. But from the standpoint of public policy, the absence of such a "guarantee" with private financing means that those private projects that survive due diligence are likely to be stronger and less likely to fail. Thus, the rigors of private financing appear to act as a stronger "filter" for weeding out less-sound infrastructure projects.

D. The Role of Bondholders

1. Bond Covenants

Bondholders of *both* public authorities and private firms also monitor performance of these entities. Indeed, since access to bond markets is the lifeblood of public authorities, one would imagine that their bondholders would be very effective monitors. Failure to respond to the interests of bondholders would jeopardize the ability of an authority to carry out its projects. For instance, the default by the New York Urban Development Corporation on bond anticipation notes in 1975 generated a credit crisis in New York State generally that led to the appointment of a commission to study reform in all of the state's public authorities.[33] Bond covenants, contractual clauses in an authority's bond resolution, require or prohibit certain actions by the authority, and thus constrain conduct that would be inconsistent with the interest of the bondholders (and typically also the interests of the public). For instance, these covenants may prevent an authority from engaging in risky financial endeavors or spending funds without approval from an outside consultant who certifies that the proposed expenditure is consistent with prudent industry practice. Without these covenants, authorities that had sold bonds at a particular interest rate would have incentives to use the proceeds for projects that were riskier than initially planned.

Further, while shareholders of private firms or customers of either firms or authorities may face substantial difficulties in organizing collective action once they detect inappropriate behavior by managers, the bondholders can more readily overcome that problem. The bond resolution governing each series of bonds will appoint a trustee for the bondholders who is authorized to bring actions in the name of all bondholders should the issuer fail to comply with covenants.
This was precisely the scenario that arose in the case of *United States Trust Co. vs. New Jersey*.[34] In that case, the Port Authority of New York and New Jersey had entered into an agreement with bondholders not to engage in certain mass transit activities. Bondholders were apparently concerned that such activities would require high levels of subsidy that might threaten security for their bonds. When the legislatures of New York and New Jersey abrogated that provision of the bond contracts, the trustee for the bondholders successfully sued to have the states' actions declared invalid under the Contracts Clause of the federal constitution.

Thus, bondholders may play a substantial role in preserving the accountability of both private firms and public authorities. But the interests of bondholders may not coincide with those of an authority's political constituents. While bondholders who have purchased a security at a fixed interest rate want to minimize the risks taken by the issuer, constituents of the issuer may prefer riskier activity that is more consistent with the original purposes for which the authority was created. For instance, bondholders of a toll-road authority might desire increased tolls to ensure adequate security for their bonds, even though one result might be to increase congestion on nearby roads without tolls.[35]

Covenants may also require issuers to act inefficiently by generating gains for bondholders at costs in excess of benefits to consumers. For instance, the debacle of the Washington Public Power Supply System ("WPPSS") was

33 See New York State Moreland Act Commission, Restoring Credit and Confidence: A Reform Program for New York State and Its Public Authorities 9-11 (1976).

34 431 U.S. 1 (1977).

35 See Clayton P. Gillette, "Fiscal Federalism and the Use of Municipal Bond Proceeds," New York University Law Review, vol. 58, (1983).

based on contractual arrangements that required utility ratepayers to bear the costs of projects that were never completed. In that transaction, WPPSS financed the construction of two nuclear power plants by issuing bonds. WPPSS sold the rights to receive power from these plants to municipalities throughout the Pacific Northwest by entering into power sales agreements. Under the terms of these agreements, the purchasing municipalities, or participants, promised to pay their obligations to WPPSS solely out of electric utility revenues that they charge to their residents. They further promised to charge electric utility rates to residents adequate to ensure that their payments to WPPSS would be sufficient to allow WPPSS to pay debt service (principal and interest) on its bonds. Finally, the participants promised to charge those rates regardless of whether the plants were operable or operating, i.e., whether or not the power contracted for was actually generated by WPPSS or received by the participants. It was this last provision that led to characterization of the agreements as having a “take-or-pay” or “hell or high water” nature. This provision was considered necessary to induce bondholders to purchase the bonds at a rate acceptable to WPPSS, notwithstanding that the provision placed on ratepayers (who were not entitled to vote on the acceptability of the contract) the risk that they would pay (over a 40-year period) for multi-billion dollar plants that did not generate a single kilowatt-hour of electricity. It is conceivable that since WPPSS was accountable to bondholders rather than to ratepayers, it was more willing to shift risks of nonpayment to the latter group and away from the former.[36]

2. Tax Subsidies

Authorities face an additional incentive to overexpend (from a social perspective). As indicated above, capital for authority projects is typically raised in the tax-exempt markets; that is, authorities may issue bonds the interest on which is exempt from federal taxation.[37] As a result, potential investors are willing to purchase these bonds at a yield lower than they would demand on a taxable corporate bond of equal quality. This savings may be passed on to the constituents of the authority who pay rates or rents sufficient to allow the authority to pay debt service on its bonds. From the perspective of these constituents, the projects financed through this market generate substantial benefits since their payments are less than would be necessary if the same projects were financed through taxable debt. There is substantial consensus, however, that the losses imposed on the federal treasury as a result of this subsidy—since the treasury is unable to collect taxes on interest earned by bond investors—exceeds the gains to the states and political subdivisions that take advantage of the tax exemption.

This net loss occurs because, given the historical differential in interest rates between taxable and tax-exempt debt of the same quality, the federal government loses more tax revenue as a result of the tax exemption than the issuer gains by being able to attract investors in tax-exempt debt. Assume, for instance, that an investor in the 36-percent marginal tax bracket can invest $1,000 in either taxable or tax-exempt debt of the same quality. Assume further that the taxable bond pays an interest rate of 10 percent and the tax-exempt bond pays an interest rate of 7 percent. At the end of a year, an investment in the taxable bond would return $100 in interest, $36 of which would be taxed, for a net income of $64 to the taxpayer. An investment in the tax-exempt bond would provide both pre-tax and post-tax income of $70, because of the tax exemption. Thus, the taxpayer is better off investing in the tax-exempt bond. The issuer is also better off, since it only had to pay $70 in debt service instead of $100, a savings of $30. But in order to save the issuer this $30, the federal government had to forgo $36 in revenue, an inefficient subsidy.[38] Although there is debate about the amount of the net loss to the treasury,[39] any level of subsidy suggests that local issuers of tax-exempt debt do not internalize all the costs of their projects.

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36 There is, of course, an argument that the officials of the participants had the opportunity not to enter into these power sales agreements and thus accepted them on behalf of their constituents. The veracity and persuasiveness of this argument depends on what one concludes about the roles and relative knowledge about the roles played by a large number of actors involved in the case, including bond counsel; underwriters; and the Bonneville Power Administration, a federal agency.

37 26 U.S.C. §103. See discussion of private activity bonds, infra.

38 For a further analysis, see Robert S. Amdursky and Clayton P. Gillette, *Municipal Debt Finance Law: Theory and Practice* (Boston: Little, Brown & Co. 1992), pp. 428–35.

39 See Dennis Zimmerman, *The Private Use of Tax-Exempt Bonds* (Washington, D.C.: Urban Institute Press, 1991), pp.

The combination of subsidy and lack of oversight of authority operations suggests that authorities may be willing to undertake projects that would not be funded if those same projects had to pass the level of scrutiny applied in other capital markets. For instance, the Port Authority of New York and New Jersey created a grand plan for the modernization of Kennedy Airport in New York, dubbed "JFK 2000." The plan included a $12-million "people-mover," a $7-million baggage tunnel, a $37-million terminal, and a $39-million parking garage.[40] The Port Authority had to abandon much of the plan because the airlines that used the facility found the plan impractical and refused the pay fees that were to service the project. The fact that private firms (airlines) were unwilling to foot the bill for the project may indicate a greater attention to its efficiency than the Authority was willing to pay. In the interim, the Port Authority spent $130 million on the plan, including $7 million on the useless tunnel.[41]

III. EXPENDITURE REQUIREMENTS AND AUTHORITY PERFORMANCE

As noted above, governmental entities often have multiple and potentially conflicting objectives that make it hard to monitor their performance. One way in which to overcome this difficulty is by placing constraints on the capacity of the entity to spend money. These constraints may force governmental entities to publicize their expenditures or to make expenditures under conditions that reduce the likelihood that money will be used for arbitrary purposes.

These requirements can be seen as legal mechanisms that reduce the search costs for potential monitors who seek information about the entity's expenditures. For instance, newspapers, political opponents, or interested citizens may easily discover information about local government expenditures as a result of these requirements. The requirements, therefore, are the functional equivalent of the obligations of private firms to produce financial statements or file registration and disclosure statements with the Securities and Exchange Commission. In the case of municipalities, these expenditure limitations take such forms as itemization and notice requirements[42] or absolute restrictions on budget increases.[43]

In addition, state and local governments frequently face requirements that limit their discretion in awarding construction contracts. The function of these requirements, which typically take the form of mandating bidding procedures for public contracts,[44] is to ensure that localities pay the lowest reasonable price for contracts and to avoid the use of contracts as political favors.

Public authorities, however, are frequently exempt from these expenditure controls. Authorities have a checkered history with respect to bidding requirements. The Port Authority of New York and New Jersey, for instance, recently awarded a contract for a $250-million power plant with no competitive bidding and no public hearings, notwithstanding questions about the need for the power plant and its environmental effects.[45] State statutes may

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40 See Michael Moss, "More JFK Waste Revealed," *Newsday*, March 4, 1994.

41 Joseph W. Queen, "Fire Lapses in Airport Facelift," *Newsday*, November 8, 1993, and personal communication with Paul Karas, former director of Port Authority's JFK 2000 project.

42 See, e.g., State ex rel. Korzen vs. Brewster, 304 N.E.2d 46 (Ill. App. Ct. 1973).

43 See, e.g., Ariz. Rev. Stat. Ann. §42-303 (C), (D). One commentator has reported that a combination of exceptions to expenditure limitations has essentially swallowed the rule. See M. David Gelfand, "Seeking Local Government Financial Integrity Through Debt Ceilings, Tax Limitations, and Expenditure Limits: The New York City Fiscal Crisis, The Taxpayer's Revolt, and Beyond," *Minnesota Law Review*, vol. 63, (1979).

44 See, e.g., Advance Tank and Construction Co. vs. Arab Water Works, 910 F.2d 761 (11th Cir. 1990); Associated General Contractors of California vs. City of San Francisco, 813 F.2d 922 (9th Cir. 1987).

45 See Michael Moss and Joseph W. Queen, "JFK: Runway to Waste: Kingdom & the Power: How the Port Authority

explicitly exempt authorities from bidding requirements that would otherwise apply.[46] Not all authorities are exempt from these procedures.[47]

As infrastructure privatization has begun to emerge, some commentators have argued that a private firm with a franchise to finance, develop, and operate a new wastewater plant or airport terminal should be required to follow the traditional public-sector procurement and bidding procedures, so as to protect the public from the award of subcontracts to friends of the developer and other inefficient practices. This argument misunderstands the institutional differences involved in the two cases. A government department or public authority is spending taxpayers' money and may well need to be constrained by regulations that mandate bidding procurement processes aimed at using competition to get the best value for their money. But in a privatized infrastructure venture, the private developer has at least some of its own funds at risk (assuming the project, as is the usual practice, is financed by a mixture of equity and debt). Hence, the developer/operator has strong financial incentives to obtain the most cost-effective supplier relationships. Not to do so reduces its own projected return on investment. Thus, while the public entity should be constrained by proscriptive procurement regulations, such regulations are irrelevant in a privatized context.

There do exist some compensating restrictions on public authorities. They may, for instance, be subject to scrutiny from the state auditor or attorney general.[48] Moreover, the level of official scrutiny of authorities has increased in recent years. For instance, in 1961 the New York Court of Appeals held that the Triborough Bridge and Tunnel Authority (which had issued substantial tax-exempt debt, had the power of eminent domain, engaged in activities traditionally performed by government, and was entitled to use New York City employees to perform its functions) was not subject to provisions of law that provided access to public records of government.[49] That result would likely not survive the current state Freedom of Information Law, which declares that the public "should have access to the records of government."[50]

General constitutional requirements also limit the expenditure policies of authorities. Specifically, authorities are subject to the "public purpose" requirement that all state constitutions impose on states and their political subdivisions.[51] This requirement limits expenditures to those that satisfy a relatively broad test that prevents the use of public funds for functions that return benefits primarily to a relatively small segment of the population.[52] Nonetheless, courts have approved public-authority financing of a wide range of projects that arguably return disproportionate benefits to discrete individuals rather than the public at large. These include sports stadiums,[53]

Decided to Build a $250-Million Power Plant at Kennedy Airport without Having to Tell Anyone About It," *Newsday*, July 19, 1992.

46 See, e.g., Ala. Code § 4-3-60 (1975); Yacenda Food Management Corp. vs. New Jersey Highway Authority, 203 N.J.Super. 264, 496 A.2d 733 (1985).

47 See, e.g., Norfolk Electric Inc. vs. Fall River Housing Authority, 417 Mass. 207, 629 N.E.2d 967 (1994); Yellow Cab of Cleveland vs. Greater Cleveland Regional Transit Authority, 72 Ohio App.3d 558, 595 N.E.2d 508 (1991).

48 See, e.g., New York State Finance Law §8; Pa. Stat. Ann. title 53, §306.

49 See New York Post v. Moses, 176 N.E.2d 709 (1961).

50 New York Public Officers Law §84.

51 See Amdursky and Gillette, *Municipal Debt Finance Law*, pp. 84-87.

52 Concrete definition of a "public purpose" is difficult. See, for instance, State ex rel. Douglas v. Nebraska Mortgage Finance Fund, 283 N.W.2d 12, 21 (1979) (public purpose is one that promotes "public health, safety, morals, security, prosperity, contentment and the general welfare of all the inhabitants").

53 See, e.g., Lifteau v. Metro. Sports Facilities Commn, 270 N.W.2d 749 (Minn. 1978); Ginsberg v. City and County of Denver, 436 P.2d 685 (Colo. 1968).

industrial plants,[54] or single-family mortgage programs.[55] This is not to say that these activities should not pass muster under the "public purpose" doctrine; it is only to say that the courts allow such latitude for that doctrine that it cannot be a rigorous constraint on authority expenditures.

In addition, federal tax law implicitly places controls on authorities. The Tax Reform Act of 1986 placed a cap on the dollar volume of private activity bonds[56] that can be issued within each state. This volume cap limits the amount of bonds that can qualify for tax-exemption under federal tax law each year for each state to a maximum of $50 per resident or $150 million, whichever is larger. The volume cap applies to many, but not all, of the functions engaged in by authorities. For instance, it applies to qualified redevelopment bonds,[57] qualified student loan bonds,[58] and most exempt facility bonds.[59] It does not, however, apply to bonds issued to finance governmentally owned airports,[60] docks and wharves,[61] or governmentally owned solid waste disposal facilities.[62] One function of the volume cap is to require states to set priorities on borrowing. Although states are given latitude to allocate the volume cap any way they like,[63] states that have a greater demand for capital than can fit within the volume cap must limit their private activity bonds. Where demand for these bonds exceeds the volume cap, there will be substantial pressures for states to reduce the amount of bonds issued, and this should translate into pressures for efficiencies in the operations of authorities that receive specific allocations of the state's volume cap. There would be little effect, however, where states can fund all the desired activities without exhausting their allocation of volume cap. There is some evidence that unused volume cap does exist.[64] Hence, the potential efficiencies to be generated by this device may not be very strong.

The above arguments suggest that authorities are not free from either explicit or implicit restrictions on budgets and expenditures. At the same time, these restrictions do not appear to be as systematic or rigorous as reporting requirements, generally accepted accounting principles, and economic incentives for efficiency that apply to publicly held firms. Even though authorities are increasingly being subjected to disclosure requirements that apply to all issuers of tax-exempt bonds, as in the adoption and proposed expansion of SEC Rule 15c2-12 which relates to municipal disclosure,[65] the audience for these requirements tends to be creditors rather than constituents. As

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54 See, e.g., Basehore v. Hampden Industrial Development Authority, 247 A.2d 212 (1968).

55 Massachusetts Municipal Home Mortgage Finance Agency v. New England Merchants Natl Bank, 382 N.E.2d 1084 (Mass. 1978).

56 Private activity bonds, not to be confused with non-public purpose bonds, fall within a category of debt issued by state and local governments on which principal and interest is not necessarily exempt from federal taxation. Bonds fall within the category if they are issued for purposes that fail tests known as the "private business use test" and the "private security or payment test." See 26 U.S.C. §141. For elaboration of these tests, see Amdursky and Gillette, *Municipal Debt Finance Law*, pp. 463-71.

57 26 U.S.C. §144(c).

58 26 U.S.C. §144(c).

59 26 U.S.C. §142.

60 26 U.S.C. §146(g)(3).

61 26 U.S.C. §146(g)(3).

62 26 U.S.C. §144(h).

63 See Zimmerman, *The Private Use of Tax-Exempt Bonds*, p. 287.

64 See Zimmerman, *The Private Use of Tax-Exempt Bonds*, pp. 306–16.

65 See 17 C.F.R. §240.15c2-12.

indicated above, the possibility that the interests of bondholders will diverge from those of the authority's political constituents suggests that they are imperfect substitutes for each other. That being the case, there is reason to doubt that authorities will face the same level of market discipline that is applied to private firms engaged in the same activities as public authorities.

IV. PERSONNEL ISSUES

As indicated above, elections serve as only weak mechanisms for monitoring the activities of public officials. Voting is "binary," in that voters can only cast ballots "for" or "against" a candidate rather than for separate parts of the candidate's performance or proposals.[66] Nevertheless, elections provide some signal of satisfaction with the performance of public officials. The market for managers in private firms provides a more continuous and rigorous check on the performance of managers than is the case with authorities. Indeed, personnel practices within authorities may be subject to neither market constraints nor political checks. Lower-level managers within authorities are less susceptible to market checks because authorities constitute localized monopolies, so that their performance is not readily susceptible to comparison with peers. Some comparison is available to performance of managers in other jurisdictions, e.g., the salary scale and rates of return in one airport authority could be compared to those of other airport authorities. These comparisons are somewhat skewed, however, because authorities do not compete with one another, and their geographical disparity may introduce other variables that render direct comparison unreliable. At the same time, authority personnel may not be subject to the political checks that normally affect government workers. For instance, personnel of the New Jersey Sports and Exposition Authority are statutorily exempt from requirements of the state's civil service law;[67] this kind of exemption is not untypical for public authorities.

The possibility that personnel issues will become unrelated to merit tends to increase, moreover, as we move from internal personnel to authority contracts with nonemployees. Many of the instances in which authorities retain consultants are also tied to the need to have access to capital markets. Typically, this will require authorities occasionally to employ experts such as bond counsel, underwriters, and financial advisers. While some statutes regulate the selection of these experts,[68] consulting contracts may be exempt from competitive bidding or other requirements that seek to ensure both disclosure of relationships between the government and the expert and confirmation of the outsider's expertise.

Recent disclosures concerning the political contributions of consultants retained by the New Jersey Turnpike Authority[69] and the Massachusetts Water Resources Authority,[70] demonstrate that consultancies have been awarded to firms that are closely tied politically to the authority or to general government. These relationships indicate that even where expertise exists, those who are selected to fill the roles may become entangled in conflicts of interest.[71]

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[66] See Robert Tollison, "Rent Seeking: A Survey," *Kyklos*, vol. 35, (1982).

[67] See N.J.S.A. §5:10-5(t).

[68] See, e.g., New York Public Authorities Law §2879 (adopting guidelines for personal service contracts similar to laws governing state practices with respect to the use, award, monitoring, and reporting of personal service contracts).

[69] See "Wall Street May Push Own Ban On Campaign Contributions," *The Bond Buyer*, July 13, 1993.

[70] See, e.g., "MWRA Dismisses Syndicate, Adviser; Unveils New Rules Covering Disclosure," *The Bond Buyer,* July 22, 1993.

[71] See, e.g., City of Miami vs. Benson, 63 So.2d 916 (Fla. 1953) (same firm serves as financial adviser to city and purchaser of bonds); "April Trial Date Set For Pontiac Schools' Suit vs. Bond Firm Of Miller Canfield," *The Bond Buyer*, March 22, 1994 (law firm alleged to have served as bond counsel while also representing senior manager for bond offering, without issuer's consent).

The recent SEC investigation of the award of a contract for underwriters of New York City bonds was initiated because of this concern.[72]

In addition, firms in politically sensitive positions may fail to point out legal or financial difficulties in order to avoid disrupting the transaction or losing business that depends on successful completion of the transaction. The Securities and Exchange Commission Staff Report concerning the fiscal crisis in New York City, for instance, expressed concern that law firms serving as bond counsel and underwriters may have been engaged in just such inattention to matters of detail when involved in bond transactions.[73] Further, because the fees of these experts are typically capitalized into bond issues rather than paid as operating costs of the authority, these costs may be more difficult to discern or to monitor. The Securities and Exchange Commission has occasionally used the failure of bond issuers to disclose relationships with experts as a basis for an antifraud suit,[74] and the Municipal Securities Rulemaking Board has adopted (and the SEC has approved) a rule precluding political contributions by dealers to officials involved in issuing municipal bonds[75] (a rule that is being challenged on First Amendment grounds).[76] In addition, the nonbinding Guidelines for governmental issuers of the Government Finance Officers Association require disclosure of relationships of contingency fees to named experts.[77] Markets for bond counsel, underwriters, and financial advisers also provide some checks to ensure minimal competence in these areas, notwithstanding occasional actions that suggest a lack of expertise.[78]

None of the above is to suggest that private firms, which also need to raise capital to engage in the projects currently financed through authorities, would be immune from conflicts of interest or other inappropriate conduct. But consider again the difference in incentives, noted previously, between a private firm with its own funds at risk in a project versus a public authority making use of other people's money. The managers of the private firm have far stronger personal incentives to select competent, cost-effective advisers, since failure to do so is likely to harm the firm's profitability.

In considering whether public or private entities are superior providers of public works, it is worthwhile to take into account their relative capacity to avoid legal mechanisms that are intended to detect and deter such behavior. Here again, the discipline of the market may provide an advantage over the threat of legal liability, regardless of the identity of the target of that threat.

V. POLICY IMPLICATIONS

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72 See "SEC Investigation Of Holtzman, Fleet Endures Into 1994; Future Uncertain," *The Bond Buyer,* March 14, 1994 (investigation of relationship between former New York City Comptroller and Fleet Securities, which was selected for city bond underwriting syndicate after her political campaign received $450,000 loan from the firm's banking affiliate).

73 See Securities and Exchange Commission Staff Report on Transactions in Securities of the City of New York, Chapter Six (1977).

74 See, e.g., SEC vs. Washington County Utility District, 676 F.2d 218 (6th Cir. 1982) (failure to disclose financial relationships between issuer's manager and underwriter).

75 See Securities and Exchange Commission, Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others 13–15, SEC Release No. 34-33741 (March 16, 1994).

76 See "No Constitutional Right to Bribe," *The Bond Buyer,* March 28, 1994.

77 Government Finance Officers Association, Disclosure Guidelines for State and Local Government Securities §XII.D (1991).

78 See, e.g., In re. Jo M. Ferguson, 5 SEC Docket 37 (August 21, 1974); Abell vs. Potomac Insurance Co., 858 F.2d 1104 (5th Cir. 1988).

Table 1 summarizes the major points made thus far about the relative performance constraints applicable to public authorities and investor-owned firms. It is clear, as conventional wisdom would have it, that authorities can finance and operate public projects with greater flexibility than general-purpose governments. But authorities enjoy a level of autonomy from political and market constraints that raises serious questions about the efficiency of their operations.

By contrast, we have shown that private firms, which can also produce the public works for which authorities are usually created, are subject to a greater degree of scrutiny and accountability for performance than public authorities. Private infrastructure providers are subject to all the same public-interest constraints (planning, zoning, environmental review, etc.) required of any private developer—but from which authorities may often be exempt. And private firms are subject to powerful economic incentives and constraints that penalize their managers for inefficient behavior—constraints and incentives which are either nonexistent or much weaker for public authorities.

A moderate, and frequently heard recommendation is to bring public authorities more into line with other governmental entities by making authorities subject to requirements that apply to ordinary government departments. While elimination of special immunities would have beneficial effects, it would hardly constitute a panacea. General-purpose governments also enjoy numerous immunities from regulations that affect the private sector, such as zoning requirements. Thus, applying to public authorities the same level of regulation as applies to other governments does not mean that authorities would be subject to all the requirements imposed on private firms. Yet the reasons for allowing general-purpose governments these exemptions do not apply with equal force to public authorities. Unlike those governments, authorities are not subject to the political checks that serve as substitutes for market checks. Thus, simply including public authorities within the broad range of governmental immunities cannot be expected to improve their performance dramatically.

Table 1

COMPARISON OF PERFORMANCE CONSTRAINTS

Factor	Public Authority	Private Firm
Accessible to Voters	No	No
Subject to Public-interest Regulations	Sometimes	Yes
Clear Performance Measures	Sometimes	Yes
Customer Monitoring	Low	Low
Rating-agency Monitoring	Medium-high	High
SEC Disclosure Requirements	No	Yes
Managers' Financial Incentives	Low	High
Owners' Financial Incentives	No	Yes
Implicit State Guarantee	Yes	No
Bondholder Monitoring	Yes	Yes
Shareholders' Monitoring	No	Yes
Incentive to Overexpand	Medium	Low

Procurement Regulations	Sometimes	N/a
Managerial Performance Controls	Low-medium	High
Corruption Incentives	Sometimes	Low

One might conclude, therefore, that public authorities should be denied the exemptions that apply to general-purpose governments and treated like private firms. Merely applying the regulations that apply to private firms to authorities, however, misses the point. Once we recognize that authorities (a) perform many functions that are readily susceptible to private provision, and (b) suffer from structural or institutional designs that render them less likely than firms to provide those services efficiently, it makes sense to allow those firms to engage in the provision of public works, rather than to tinker at the margins with the design of public authorities.

Thus, the strongest recommendation that follows from this analysis is that general-purpose governments should consider privatization of many of the functions currently provided by authorities, such as airports, toll roads and bridges, water supply, wastewater treatment, and solid waste disposal. This can be done via the sale or long-term lease of existing facilities (especially those in need of upgrading, expansion, and modernization) and via long-term franchising of new facilities, which can be designed, financed, built, and operated by private consortia. In the case of well-managed authorities, the entire entity can be reorganized as a corporation and then sold (as the British did with their major airport authority and water authorities). In other cases, individual facilities might be offered for sale or lease (as, for example, in the case of a port authority owning an airport, bridges, and harbor facilities).

The federal tax code's long-standing subsidy for tax-exempt bonds for public works facilities remains a problem, for it burdens a privatized facility with higher debt-service costs that can pose a financial and political barrier to privatization. Addressing this issue is beyond the scope of this paper, but to the extent that the federal government wishes to promote the use of private capital for the nation's infrastructure, consistent with recent executive orders by Presidents Bush and Clinton, the creation of a level playing field in infrastructure finance should become a priority issue.

VI. CONCLUSION

It is tempting to divide activities into those that must be supplied by the public sector and those that must be supplied by the private sector. The very existence of public authorities, whose activities bear some of the characteristics of each sector, belies that notion. That leaves open the issue of which sector *should* become involved in any given activity. The argument herein does not suggest that there is a single answer to that issue. Rather, the argument indicates that whichever institution is selected to provide a public good may have reasons to diverge from its appointed task. Therefore, the choice of an institution should rest, at least in part, on its relative susceptibility to the kinds of controls and constraints that reduce that risk. Both economic theory and current practice indicates that private firms have distinct institutional advantages in this respect.

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