Annual Privatization Report

2008

Edited by Leonard C. Gilroy

Reason Foundation

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Authors

Editor

- Leonard C. Gilroy

Principal Authors

- Leonard C. Gilroy
- Amanda Kathryn Hydro
- Robert W. Poole, Jr.
- Anthony Randazzo
- Skaidra Smith-Heisters
- Lisa Snell
- Varna Sri Raman
- Samuel R. Staley
- Adam B. Summers
- Steven Titch

Contributing Authors

- **William Korchinski** is a chemical engineer who has spent his career working worldwide in the oil refining and chemical industries.
- **Ken Orski** is a transportation policy consultant and publisher of *Innovation Briefs*.
- **David Stokes** is a policy analyst at the Saint Louis-based Show-Me Institute.
- **Jonathan Williams** is the Director of the Tax and Fiscal Policy Task Force for the American Legislative Exchange Council.

Letter from the Editor

By Leonard C. Gilroy

Welcome to Reason Foundation's *Annual Privatization Report 2008*. Now in its 22nd year of publication, *APR* is the world's longest running and most comprehensive report on privatization news, developments and trends.

APR 2008 details the latest on privatization and government reform initiatives at all levels of government. The "Federal Update" section presents an update on the Performance Assessment Rating Tool (PART)—used by the Bush administration to rate programs and determine budget priorities—as well as the latest on the president's competitive sourcing initiative that, despite a slowdown in use, continues to save taxpayers billions of dollars. We also review the recently passed farm bill, which perpetuates a dysfunctional subsidy and earmark program desperately in need of reform.

The "State and Local Update" section offers a comprehensive update on the latest privatiation action across state and local government, including articles on the revamping of Utah's state privatization board, Florida's controversial outsourcing initiatives, Indiana's government reform efforts, and the latest on Chicago's infrastructure privatization innovations, managed competition in San Diego and Georgia's contract cities movement.

This year's *APR* also provides a comprehensive overview of domestic and international developments in air and surface transportation, including a wide-ranging overview on infrastructure finance, a discussion on public-private partnerships in the context of global economic competitiveness and a review of the latest in air traffic control reform and aviation security.

APR's "Emerging Issues" section examines three topics that continue to attract a great deal of attention in policy circles. First, we review the latest federal and state efforts to make government more transparent by allowing taxpayers access to government spending information online. Second, we provide an overview of the latest state lottery privatization proposals. Lastly, we review an emerging area of interest in infrastructure public-private partnerships: our nation's seaports.

APR's "Education" section offers a comprehensive update on school choice, with features on the bipartisan push for more choice, growth in special needs scholarships, charter school achievement and the growth in school empowerment and weighted student formula programs over the last year.

APR 2008 also covers the ever-changing world of telecommunications policy, with updates

on network neutrality, video franchise reform and Internet taxation. In addition, we include an article detailing how cities, once enthusiastic about developing municipal broadband systems, have started to grow wary of funding and owning their own broadband systems after observing the pattern of revenue shortfalls and cost overruns in existing systems.

This *APR* also reviews the latest developments in the private corrections and water industries, including an article on an emerging threat to private water utilities in Scottsdale, Arizona and several other communities nationwide—de-privatization through the use (or threat) of eminent domain.

Lastly, we offer an update on land use and environmental issues, with feature stories on Houston as a model for local land use regulation and the impact of Florida's Growth Management Act on housing affordability in the state. We also provide the latest on the property rights front, reviewing recent developments in eminent domain reform and regulatory takings reform. This section also features articles on the false promise of hydrogen cars and the environmental costs of hemp prohibition.

Your comments on the *Annual Privatization Report 2008* are important to us. Please feel free to contact us with questions, suggestions or for more information. For more privatization news, check out *Privatization Watch* (www.reason.org/pw.shtml), now in its 32nd 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/privatization) and our weblog, Out of Control (www.reason.org/outofcontrol).

Leonard C. Gilroy, Editor

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Federal Update

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A. Program Assessment Rating Tool (PART) Update

In the most recent evaluation of federal government programs, the U.S. Office of Management and Budget (OMB) found that programs continue to show improvements in performance, as determined by the administration's Program Assessment Rating Tool (PART). The results are only slightly better than last year's figures, but they have continued to improve in each of PART's six-year existence. Since the advent of PART in 2002, the administration has evaluated the performance of 1,004 programs, constituting 96% of all federal programs. During that time program ratings have increased across the board: "Effective" programs tripled from 6% to 18%, "Moderately Effective" programs rose from 24% of the total to 31%, "Adequate" programs doubled from 15% to 29% and "Ineffective" programs fell from 5% to 3%. Programs whose results could not be demonstrated due to a lack of relevant information declined from a whopping 50% to 19% (see Table 1).

1. A Brief History of PART

PART is an integral piece of the 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 goal by requiring federal agencies to identify both annual and long-term goals and to collect and report performance data. In 2002, PART expanded

Table 1: PART Program Ratings by Year Completed, 2002-2007

Ratings	2002 (FY 2004)	2003 (FY 2005)	2004 (FY 2006)	2005 (FY 2007)	2006 (FY 2008)	2007 (FY 2009)
Effective	6%	11%	15%	15%	17%	18%
Moderately Effective	24%	26%	26%	29%	30%	31%
Adequate	15%	20%	26%	28%	28%	29%
Ineffective	5%	5%	4%	4%	3%	3%
Results Not Demonstrated	50%	38%	29%	24%	22%	19%
Total Programs	234	407	607	793	977	1,004

Source: U.S. Office of Management and Budget

upon this idea in the form of a questionnaire for federal agencies intended to uncover objective information about program design, planning, management and results. In 2006, the administration sought to increase transparency and accountability further when it launched the ExpectMore.gov website. The portal 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.

2. How It Works

Each PART consists of 25 basic questions plus some additional questions customized for each of the seven different program types: Direct Federal, Competitive Grant, Block/Formula Grant, Research and Development, Capital Assets and Service Acquisition, Credit and Regulatory. The questionnaire is broken into 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 prioritize funding in the formation of the president's budget.

The responses to 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

Program Assessment Rating Tool (PART) Ratings Categories

Programs categorized as PERFORMING have ratings of Effective, Moderately Effective or Adequate.

Effective. Programs rated Effective set ambitious goals, achieve results, improve efficiency and are well-managed.

Moderately Effective. Programs rated Moderately Effective have generally set ambitious goals and are fairly well-managed, but need to improve their efficiency or address other problems in program design or management in order to achieve better results.

Adequate. Programs rated Adequate need to set more ambitious goals, strengthen management practices, improve accountability or achieve better results.

Programs that are NOT PERFORMING have ratings of Ineffective or Results Not Demonstrated.

Ineffective. Programs rated Ineffective are not using tax dollars wisely. They have been unable to achieve results due to a lack of clarity regarding the program's purpose or goals, poor management or some other significant weakness.

Results Not Demonstrated. Programs rated Results Not Demonstrated have been unable to develop acceptable performance goals or collect appropriate data to determine whether or not they are achieving the intended results.

Source: U.S. Office of Management and Budget website, "The Program Assessment Rating Tool (PART)," http://www.whitehouse.gov/omb/expectmore/part.html (accessed July 8, 2008).

Table 2: Overview of PART Questionnaire Sections

Section	Weight (% of Total Score)	Description
1. Program Purpose and Design	20%	To assess whether the purpose is clear and the program design makes sense.
2. Strategic Planning	10%	To assess whether the agency sets valid programmatic annual goals and long-term goals.
3. Program Management	20%	To rate agency management of the program, including financial oversight and program improvement efforts.
4. Program Results and Accountability	50%	To rate program performance on goals reviewed in the strategic planning section and through other evaluations.

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

3. Linking Performance to Funding

Congress has been slow to use PART information to make budget allocation decisions and the administration has had only limited success in convincing the legislature to eliminate or reduce funding for poorly performing programs. According to the FY 2009 budget, in 2007, seven programs were eliminated for a savings of $156 million and six programs were reduced, saving an additional $1.12 billion. In 2006, by comparison, seven programs totaling $230 million were eliminated and four programs were reduced, saving another $300 million. Although these figures may be smaller than the administration would like, the current budget notes, "overall, high performing programs received larger funding increases than those that did not perform well."

4. PART Going Forward

The administration has sought to utilize PART to achieve three main goals: (1) objectively assess program performance, (2) take steps to enhance program performance and transparency and (3) help link program performance to budget allocation decisions. In its short history, it has proven successful at meeting the first two goals, but there is still much room for improvement on the third. In addition to working with Congress to address this shortcoming, the administration has identified a couple of other ways to increase the effectiveness of federal program performance evaluation:

Ensure program goals are adequate and improvement plans are aggressive and result in

PART Sample Questions

- Does the program address a specific and existing problem, interest or need?
- Is the program designed so that it is not redundant or duplicative of any other federal, state, local or private effort?
- Does the program have a limited number of specific long-term performance measures that focus on outcomes and meaningfully reflect the purpose of the program?
- Does the program have ambitious targets and timeframes for its long-term measures?
- Does the program (including program partners) achieve its annual performance goals?
- Are independent evaluations of sufficient scope and quality conducted on a regular basis or as needed to support program improvements and evaluate effectiveness and relevance to the problem, interest or need?
- Are budget requests explicitly tied to accomplishment of the annual and long-term performance goals and are the resource needs presented in a complete and transparent manner in the program's budget?
- Does the program use strong financial management practices?
- Has the program demonstrated adequate progress in achieving its long-term performance goals?
- Does the program demonstrate improved efficiencies or cost effectiveness in achieving program goals each year?

Source: U.S. Office of Management and Budget website, "The Program Assessment Rating Tool (PART)," http://www.whitehouse.gov/omb/expectmore/part.html (accessed July 8, 2008).

improved performance. Program assessment and performance can be improved by reviewing program goals and PARTs that have already been completed. A greater emphasis on following up on recommendations from PART will help to improve future program performance and ensure that recommendations are not ignored or forgotten.

Expand cross-cutting analyses. Assessing the performance or efficiency of a single program is a good first step, but such a myopic focus neglects improvements that may be made by analyzing performance across programs or agencies. The administration seeks to engage in more of this cross-cutting analysis.

The successful implementation of these measures may help to ensure continued improvement in the federal programs subject to the PART.

B. Competitive Sourcing Falls Short of Goals; OMB Blames Congress for Limiting Initiative

A May 2008 U.S. Office of Management and Budget (OMB) report has revealed both continued progress on and continued frustration with, the federal government's competitive sourcing efforts. Public-private competitions during fiscal year 2007 are expected to generate net savings of nearly $400 million over the next five to seven years, but the government is still falling short of its goals.

In FY 2007, the federal government completed 132 competitions comprising 4,164 full-time equivalent (FTE) positions. An additional 112 competitions covering 6,153 FTEs were ongoing at the end of the fiscal year (see Table 3).

While impressive, this represents a decrease from the 37% of FTEs competed in FY 2006 and is far short of the 18,000 positions that agencies had planned to compete. Moreover, the completed competitions represent only about 1.5% of the commercial positions identified as suitable for competition by agency workforce inventories. Nevertheless, the FY 2007 totals bring the total net savings achieved since 2003 to $7.2 billion, versus a cost of implementing the competition programs of approximately $240 million (see Table 4).

This means that taxpayers received a return of approximately $30 for every dollar spent on competitions, regardless of whether the competitions were won by a private contractor or public employees. Over the past five fiscal years, the average net savings per FTE competed is approximately $25,000, a 27% return for each position competed (see Table 5). Federal employees continued to win the vast majority of competitions. Federal employees were selected to perform 73% of the work (as measured by the percentage of total FTEs) competed in FY 2007, which was actually down from the 87% in FY 2006 and the 83% for all competitions over the last five fiscal years.

Table 3: Competitive Sourcing Results, FY 2006 and FY 2007

Factor	FY 2006 Total	FY 2007 Total
Completed Competitions		
Number of agencies completing competitions	20	15
Number of competitions completed	183	132
Number of FTEs competed	6,678	4,164
Total estimated net savings	$1.3 billion*	$397 million
Estimated annualized savings	$220 million	$75 million
Competitions where federal agency selected to perform work (as a percentage of total FTEs competed)	87%	73%
Announced Competitions		
Number of competitions announced	86	112
Number of FTEs announced	9,691	6,153

*Figure rounded to nearest $100 million.

Table 4: Cumulative Results (FY 2003 – FY 2007)	
	Five-Year Total
FTE competed	50,989
Number of competitions conducted	1,375
FTE competed under standard competitions	39,487
Incremental cost	$240 million
Estimated net savings	$7.2 billion*
Estimated annualized savings	$1.1 billion*

* Dollar savings figures are rounded to nearest $100 million.

Table 5: Five-Year Averages	
FTEs per competition	38
Work competed through standard competitions (as a percentage of total FTEs competed)	75%
Incremental cost of a competition per FTE competed	$5,000*
Net annual savings per FTE competed	$25,000
Competitions where federal agency selected to perform work (as a percentage of total FTEs competed)	83%

* Incremental cost figures are rounded to nearest thousand.

Table 6: Popular Activities for Competition, FY 2004 – FY 2007[a]

Activity	FY 2004 FTE	FY 2005 FTE	FY 2006 FTE	FY 2007 FTE	Total, FY 04 – FY 07	
					FTE	%
Maintenance/property management	4,138	1,321	661	861	6,981	26
Information technology	2,207	1,055	1,716	542	5,520	20
Logistics	1,448	2,987	352	253	5,040	19
HR / personnel management & education	1,209	169	391	236	2,005	7
Administrative support	315	763	618	289	1,985	7
Finance & accounting	968	210	341	153	1,672	6
Other[b]	1,609	708	1,130	538	3,984	15

a Data do not reflect NASA science competitions, which were conducted pursuant to a deviation or competitions with no savings data at the time of the compilation of the OMB report.

b Activities in this category include: regulatory and program management support services (3.1%); research, development, test & evaluation (1.7%); depot activities (0.9%); and procurement (2.2%).

The bulk of the work competed consists of maintenance/property management (26%), information technology (20%) and logistics (19%). Other popular activities for competition include human resources/personnel management and education (7%), administrative support (7%) and finance and accounting (6%) (see Table 6).

Prior to 2003, outside of the Department of Defense (DoD), few federal agencies utilized public-private competition to a significant degree. That changed with the OMB's Circular A-76, which called on agencies to consider competition for commercial support services and utilize management tools such as workload measurement, cost analysis, market research and human capital planning to make their programs more efficient.

The OMB report notes that this framework has allowed agencies to:

- Increase their reliance on measurable performance standards, service-level agreements and realistic costing to provide better service, reduce unnecessary spending and achieve greater accountability for results;
- Facilitate greater involvement of interested stakeholders and technical experts in planning and implementing organizational improvements; and
- Strengthen the efficiency of their commercial support activities through the development of standard operating procedures and enterprise-wide solutions, the adoption of new technologies, leveraged purchasing, consolidation of operations and restructured contract support.

In recent years, however, the government's competition endeavors have been plagued by resistance from Congress. Clay Johnson, the OMB's deputy director for management, blames the legislature's increasingly political atmosphere surrounding cost management policies for stunting the competition program's success. The OMB report noted that the decrease in competitions from FY 2006 was largely due to legislative actions that prevent or defund competitions. The Consolidated Appropriations Act, FY 2008, P.L. 110-161, for example, contained a number of provisions limiting the use of competitive sourcing.

Congressional attitudes toward competition do not appear to be warming either. The FY 2009 National Defense Authorization Act (H.R. 5658) contains an amendment that imposes a three-year moratorium on new competitions at the DoD, the government's largest agency. According to Rep. Nancy Boyda (D–KS), who introduced the provision, the measure is intended to address what she sees as an excessive use of contracting within the department. The three-year window is meant to coincide with the Base Realignment and Closure (BRAC) reorganization, where significant functions are being shifted among bases. This moratorium on new competitions would remove an important management tool as the realignment process evolves. From FY 2003 to FY 2007, the DoD has achieved an estimated $2.95 billion in gross savings from public-private competitions, for a return of about $20 for every dollar spent on competition. As of this writing, the Defense authorization bill has passed the House of Representatives and is being considered in the Senate.

C. 2008 Farm Bill Expands Subsidies, Earmarks

One of the major pieces of legislation passed in 2008 was the $290 billion farm bill known as the Food, Conservation and Energy Act of 2008 (Public Law 110-234). The bill became law in June 2008 when Congress overrode President Bush's veto 317-109 in the House and 80-14 in the Senate. The White House opposed the bill because of its hefty price tag and the fact that a significant portion of the benefits were targeted to wealthy farmers. As President Bush argued in his veto statement to Congress, "At a time of high food prices and record farm income, this bill lacks program reform and fiscal discipline."

While roughly two-thirds of the bill's expenditures are devoted to nutrition programs such as food stamps and school lunches, it has gotten even more attention for its subsidies and earmarks, many of which have little to do with the supposed topic of the bill. According to Rep. Sam Graves (R–MO), member of the House Agriculture Committee, "The unfortunate part with the farm bill is, so little of it has anything to do with agriculture… it does get frustrating that the debate centers around things that have nothing to do with farming, nothing to do with agriculture or food policy."

The subsidies, earmarks and expansions of inefficient programs and Great Depression-era policies contained in the 2008 farm bill stand in stark contrast to the farm bill passed just 12 years ago. The Freedom to Farm Act of 1996 was intended to phase out farm subsidies by 2003.

When commodity prices fell in 1998, however, Congress stepped in with bailouts in the form of "emergency" supplemental payments. Congress then reintroduced crop subsidies in 2002.

Sugar subsidies alone are estimated to cost American consumers $1.5 billion a year. That didn't stop Congress from increasing domestic sugar prices, though. The organic agriculture industry is also being propped up by congressional giveaways in the name of the farm bill, as are "local" produce growers.

The corn/ethanol market also appears to be a popular choice for government intervention. Spurred largely by policies like that contained in the energy bill signed into law in December 2007, corn prices have soared in recent years. The new energy law mandates that the amount of renewable fuel (ethanol is the renewable fuel of choice) included in the nation's gasoline supply increase from 4.7 billion gallons in 2007 to 36 billion gallons by 2022. This mandate has caused a huge artificial increase in demand (artificial in the sense that it would not exist under true free-market conditions). Thus, it should not come as a surprise that corn prices have risen from roughly $2 per bushel in early 2006 to approximately $5.50 today.

The size of the legislation's farm subsidies also has implications for international trade. In a letter to a colleague, House Minority Leader Rep. John Boehner (R–OH) argued that the bill "extends flawed policies that keep American farmers dependent on government subsidies and discourage other countries from opening their markets to American farm export." Indeed, America's farm subsidies have been a huge bone of contention with other World Trade Organization (WTO) members and has been one of the key issues that has held up the WTO's Doha round of trade negotiations for years.

Besides the subsidies contained in the legislation, the 2008 farm bill is also distinguished by its numerous earmarks. Among the many examples of pork-barrel spending are the following:

- $175 million to provide water for desert lakes;
- $170 million in relief for the salmon "crisis" on the West Coast (on top of the $60 million

West Coast salmon fisherman received from the federal government two years ago);

- An estimated $126 million in tax breaks over ten years for racehorse owners;
- $125 million over five years for loan and loan guarantee programs to provide high-speed Internet access to people who live in rural areas; and
- $1 million for a national sheep and goat industry improvement center.

An early version of the bill also contained an anti-contracting provision mandating that only government employees be responsible for distributing government aid. While the provision was purportedly intended to protect the privacy of aid recipients by preventing private companies from handling sensitive personal information, numerous public-sector data breaches in recent years have shown that such information is no safer in the hands of the government than a private company. Furthermore, such a provision would harm state efforts to contract with private firms and nonprofit organizations to more efficiently administer their Medicaid and food stamp programs. This provision was stripped out in conference.

D. Senate to Privatize Its Ailing Restaurants

Fed up with persistent financial losses and subpar food offerings at its restaurants, the United States Senate approved a measure (S. 2967) in June 2008 to award management of the facilities to a private-sector contractor. Senate Restaurants, a food service network comprised of the elegant Senate Dining Room, a large cafeteria in the Dirksen Senate Office Building and various coffee shops located throughout the Senate Complex, has long been a source of frustration and the senators have apparently had enough.

Management of Senate Restaurants, whose employees work for the Architect of the Capitol, has been criticized for its failure to introduce new menu items. The poor food quality and service has caused many senators and staffers to flock to the cafeteria in the Longworth House Office Building, which has been privately operated since the 1980s and is currently run by New York-based Restaurant Associates.

The financial differences between the public and private-sector operators are stark as well. According to the Government Accountability Office, Senate Restaurants has turned a profit in just seven of its 44 years of existence. Losses for this year are projected at $2 million and the restaurants will require an additional $250,000 bailout from the Senate's emergency funds just to make payroll. While Senate Restaurants accumulated losses totaling $4.7 million from fiscal year 2003 through FY 2007, Restaurant Associates turned a significant profit and paid the House commissions of $1.2 million. Under a proposed contract, Restaurant Associates would take over the Senate facilities this fall. It is estimated that the company would turn a large profit on the Senate facilities within three years and begin making commission payments of $800,000 a year to the Senate.

Sen. Dianne Feinstein (D–CA), chairman of the Rules and Administrations Committee, which oversees Senate operations, has been the driving force behind the privatization effort. She admitted to being "somewhat dismayed" by criticism from some fellow Democrats opposed to privatization, but was eventually able to sway her colleagues. Said Feinstein, "Candidly, I don't think the taxpayers should be subsidizing something that doesn't need to be. There are parts of government that can be run like a business and should be run like businesses."

State and Local Update

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A. State Privatization Update

1. Utah Strengthens State Privatization Board

Nearly two decades ago, the Utah State Legislature established the Privatization Policy Board (PPB). Its mission is to evaluate and make recommendations to state agencies concerning effective privatization of government services and to address concerns regarding unfair government competition with the private sector.

But with its membership heavily tilted towards public sector representation, the lack of clearly defined duties in its statutory mandate and no dedicated staff, the PPB's efforts thus far have been piecemeal at best. Only two successful privatization initiatives have been completed to date: contracting with Staples for procurement of the state's office supplies and contracting with Xerox to provide state printing services.

In the 2008 legislative session, State Senator Howard Stephenson and State Representative Craig Frank each sponsored bills designed to give the Privatization Policy Board powerful new tools for advancing privatization and in the process elevate Utah to the upper echelon of state privatization leaders. Both bills passed overwhelmingly in both houses and were signed into law by Governor Jon Huntsman, Jr. in May.

Rep. Frank's House Bill 75 expanded the membership of the PPB to include more private sector members and requires:

- The PPB to develop a biannual inventory of "inherently governmental" and "commercial" activities and services performed by state agencies;
- The PPB to develop an accounting method to facilitate accurate cost comparisons between public sector and private sector service providers;
- The PPB to investigate citizen complaints of unfair government competition with a private enterprise; and
- The governor's office to examine at least three potential services or activities for potential privatization every two fiscal years.

Senate Bill 45, sponsored by Sen. Stephenson, goes even further by requiring Utah cities and counties of the first and second class—which includes the majority of Utah's local governments—to submit biannual government activity inventories to the PPB, similar to those that will be prepared at the state level. Also, the bills created a new, full-

time staff position to serve the PPB.

This policy echoes the Federal Activities Inventory Reform (FAIR) Act passed by the U.S. Congress in 1998. It requires annual inventories that identify which activities within the federal government are "inherently governmental" (i.e., a job only government can do) and which are "commercial" (i.e., which can normally be obtained from private enterprise). With this information agencies can identify services that can be competed or privatized. As a result of the FAIR Act, agencies have identified more than 800,000 federal employees engaged in activities—such as data collection, administrative support and payroll services—that could be provided by the private sector.

The Commonwealth of Virginia adopted a similar process at the state level. Under the direction of the Commonwealth Competition Council (CCC), a survey of state agencies was conducted in 1999 to determine what commercial activities were being conducted by state personnel. In the 1999 survey alone, the CCC identified 205 commercial activities that were being performed by nearly 38,000 state employees. According to the CCC's first director, actions taken at the Council's recommendation (based on the inventory results) currently are estimated to be saving Virginia taxpayers at least $40 million per year.

2. Florida's Council on Efficient Government Reviews Controversial Outsourcing Initiatives

In February 2007, Florida Governor Charlie Crist charged the newly created Council on Efficient Government (CEG)—the successor to the Center for Efficient Government, created under executive order by former Governor Jeb Bush—with the task of reviewing three large, controversial state outsourcing projects: MyFloridaMarketPlace, People First and Project Aspire. The CEG released its findings in January 2008.

Starting in early 2000, the state began an effort to upgrade and modernize its core operational software and IT infrastructure, specifically its accounting, cash management, procurement and human resources functions. At that point, these systems ran on five separate tools. By late 2000, several initiatives began to address portions of the upgrade plan, though the CEG notes that they were implemented separately without a cohesive integration plan for how each system would interact with one another. The end result was three separate projects: MyFloridaMarketPlace for procurement functions, People First for human resource functions and Project Aspire for accounting and financials. All three programs required significant modifications with a number of custom enhancements and all have had significant development, implementation and performance-related issues.

a. CEG Findings on MyFloridaMarketPlace

The state signed the $108 million MyFloridaMarketPlace (MFMP) contract with Accenture in October 2002. MFMP created an Internet-based system that allows buyers access to electronic purchase orders, invoicing of goods and services, electronic vendor registration, e-quotes and electronic bidding/sourcing. Vendors can receive information on upcoming bids from all participating agencies and electronically receive purchase orders. MFMP also serves as a performance reporting tool for state buyers on vendor performance in providing products and services. Vendors began registering online in April 2003 and the first state buyers began using the system in July 2003. Today, 29 state agencies, over 13,000 state users and 90,000 vendors use MFMP. The program is self-funded and supported by a 1% transaction fee.

Among the CEG report's findings on MyFloridaMarketPlace implementation:

- The state "was successful in developing and implementing a Web-based e-procurement system. […] The MFMP project team reports that state agencies experienced a reduction in paperwork, faster processing time due to online approvals, expedited transaction times and vendors benefited from having a centralized source of procurement information."
- The state Department of Management Services (DMS) combined the use of

strategic sourcing best practices (a process to leverage demand and select vendors that offer the best value) with MFMP to develop solicitations maximizing value for the state. To date, the DMS reports $71 million in savings through six state term contracts.

- Despite these savings, the CEG was unable to estimate financial savings gained through operational and efficiency savings as a result of implementing MFMP. According to the report, "[it] is assumed that Florida was successful in achieving additional monetary savings through eliminating the need for paper processing of purchase orders and invoices and the reduced requisition to purchase order and invoice to check cycle times." Yet, "[no] process, metric or benchmark were established prior to launching the project to measure and report savings and successes."

- Implementation of this project ran closely to originally projected "go-live" dates.

- The system "improved accountability for the expenditure of state funds and provided better insight into its purchasing patterns."

- An August 2007 customer survey found that overall end user satisfaction with MyFloridaMarketPlace was at 91%, a 5% improvement in customer satisfaction with the purchasing functions and 17% improvement in customer satisfaction in the finance and accounting area as compared to the previous survey from late 2006.

- The original total contract value for five years was $108.2 million. However, Accenture and DMS agreed to extend the MFMP contract for an additional three years, totaling $114 million over the eight-year life of the contract.

- No full-time equivalent positions were displaced as a result of implementing MFMP.

b. CEG Findings on People First

The purpose of People First was to outsource human resource, payroll administration, staffing and benefits functions. Historically, functions were provided by HR staff within each agency and supported by the seven different personnel-related IT systems. People First was developed to outsource many of the functions of full-time state employees and streamline and automate the state's human resource functions by consolidating the seven different IT systems into one.

In 2002, DMS entered into a seven-year contract (2002-2009) with Convergys Customer Management Group, Inc. valued at $278.6 million. The contract term was subsequently amended to extend through 2011, increasing the total contract value to $350 million. Since 2005, the People First project team has deployed 330 system modules and releases. Today over 50 state agencies and entities, including 132,120 active employees, 48,261 benefits-only employees and 47,809 retired employees, use People First in some way.

Among the CEG report's findings on People First implementation:

- People First was "a successful migration from the state's legacy system" and "provided a functional interactive platform with little initial capital outlay." The state saved $12 million from staff reductions, $80 million from the cost avoidance of rebuilding its own system and other efficiencies through the elimination of duplicative services between agencies.

- The initial expectations were to reduce the human resources workforce by over 1,200 full time positions, contributing to a total savings of $173 million over the original seven-year contract term. DMS subsequently revised the projection to reduce the state's HR-related workforce by 971.5 positions. Thus far, 862 positions have been eliminated, resulting in a 70% reduction in the state's HR-related workforce.

- The People First contract was written such that the state turned over its entire HR operations to the vendor; hence, the state will not control or own the software or hardware at the end of the nine-year contract. Additionally, the state would not have contractual rights to the "as built" documentation detailing the system's architecture and software customization.
- DMS recently conducted the first survey of the People First system and found that 59% of the employees surveyed said that People First met or exceeded expectations. Overall, the service center received the best reviews with 70% of the respondents saying they were satisfied or extremely satisfied and 82% saying staff were friendly.
- Project management has been a challenge. A full-time project team was not established for People First until 2005 and it has already had three project managers. Some early implementation problems "may potentially be attributed to the lack of a dedicated team to ensure success." However, the CEG report finds that "[t]he current People First team at the DMS is well organized, employee focused and committed to continual improvement."
- One of the biggest challenges with People First is lack of standardization of business practices across agencies, requiring "excessive" customization to the off-the-shelf software (over 200 customized interfaces). Implementing a standardized, statewide business process "would alleviate some of the trouble of software customization and additional workload issues associated with the divergent business processes."
- Stakeholder buy-in was not fully obtained in the beginning of the process resulting in a certain level of participant dissatisfaction.
- An internal assessment of hardware and software at each agency was not conducted prior to launching People First, resulting in incompatibilities between the various infrastructures. Implementation and performance issues arose as a result of not establishing this initial equipment baseline.
- Most agencies went live with People First in 2004 but were instructed to make staff reductions prior to that. Consequently, due to system-related limitations and the elimination of most HR staff, agencies saw an increase in workload which negatively impacted them. Agency staff members were not properly trained on the new systems or their new roles and responsibilities. Leadership did not communicate changes well within their agencies and untrained staff members were required to work and train in a system that was not fully functional. DMS reports, however, that the People First program is stabilizing.
- Several issues arose during deployment relating to information security and data access. While no personal information was compromised and stronger security protocols were installed, user trust in People First "was negatively impacted." In 2006, DMS established a statewide security guideline manual to ensure the integrity of system data free from unauthorized access.

c. CEG Findings on Project Aspire

Project Aspire was intended to replace Florida's quarter-century-old legacy accounting and cash management systems with a streamlined accounting system capable of serving 36 state agencies with different core missions. After dealing with a lengthy bid protest, the state Department of Financial Services (DFS) chose to award a fixed-price, $68 million contract to Bearing Point (a former KPMG unit) for six years from August 2003 through October 2009. DFS reports that the original budget for Project Aspire was $100 million (excluding debt services). The project was a massive, complex undertaking, requiring an evaluation of existing processes, policies, procedures, shadow systems,

state and federal compliance, workforce transformation, technical requirements, cash management, investment opportunities and an assortment of additional areas.

In May 2007, the state's chief financial officer suspended work on Project Aspire in its testing phase. It was unfinished, over budget and past its originally scheduled completion date. At the time of suspension, the vendor had already left the project, the application was still not fully developed and $89 million out of the $100 million budgeted had already been dispersed to various vendors ($59.4 million of which was paid to Bearing Point). At the time of the project suspension the proposed system has not been implemented at any agency. After the project was halted, staff documented and preserved existing work products that had been developed. The state will retain ownership of the hardware and PeopleSoft software for possible resumption at a later date.

Among the CEG report's findings on Project Aspire implementation:

- A major challenge has been the lack of standardization of business rules among state agencies and the resistance to change to a uniform process. The state did not incorporate third party advice to change existing internal business processes and not over-customize the best of breed software selected—there were 250 customizations on Project Aspire alone. Ongoing design changes created a situation where the agency was unable to place a completion date on the project and continued schedule slippage occurred as a result of project design issues.
- The state accepted a project design that was later found not to meet project expectations. Accepting this work product laid the foundation for future problems, delays and multiple design changes. Further, over the course of the project the state modified or "froze" the project design three times.
- The state faces funding barriers to large project success due to current business processes within state government. Structural changes—including the elimination of specific laws and processes—may be necessary to improve state IT management, procurement and project implementation. However, in implementation, "a resistance existed to making such changes."
- In 2004, various representatives on the project's board of directors disengaged and left the project, negatively impacting the project's success.
- Bearing Point reports that the changes requested by the state were significant in number, which consistently delayed the project. As a result, vendor project teams collaboratively reassessed the project and developed a more conservative strategy for project implementation which increased costs. The revised strategy "cost a significantly larger amount of money and elongated the schedule."

d. Key Lessons Identified

Looking at the experience with all three outsourcing projects, the CEG identified several lessons learned to guide future outsourcing and major internal reorganizations:

- Successful solutions require the designation of an *executive sponsor* with enforcement and conformance authority. A strong sponsor advocates for the project over its life cycle and builds stakeholder buy-in during conceptualization.
- Projects were rushed to the implementation phase before *planning* was completed.
- The state can reduce risk and enhance manageability by discouraging large-scale projects and *encouraging incremental, phased-in approaches*.
- A reliable *multiyear funding model* must be created to enable proper execution of the project life cycle and reduce risks to the state associated with unforeseen changes to the funding model.

- Governments should engage stakeholders early in the planning process and obtain their input prior to project implementation.
- Government must have the ability to restructure business processes to incorporate efficiencies that new technology offers and avoid encumbering the new system with legacy processes. The three projects each ran counter to industry best practices by over-customizing vendor systems, increasing costs and rendering the new systems sub-optimal.
- Continuity of management on projects to maintain vision and mission success is essential. Numerous leadership changes in the projects reviewed led to lost momentum.

In addition to its report on the major outsourcing projects, the Council on Efficient Government issued its 2007 annual report, finding a significant increase in state outsourcing projects since 2001. Prior to 2001, a total of 16 outsourced projects were reported by state agencies, but from 2001 to 2005, the state initiated an average of 25 projects annually (see Table 7). In all, the report identified

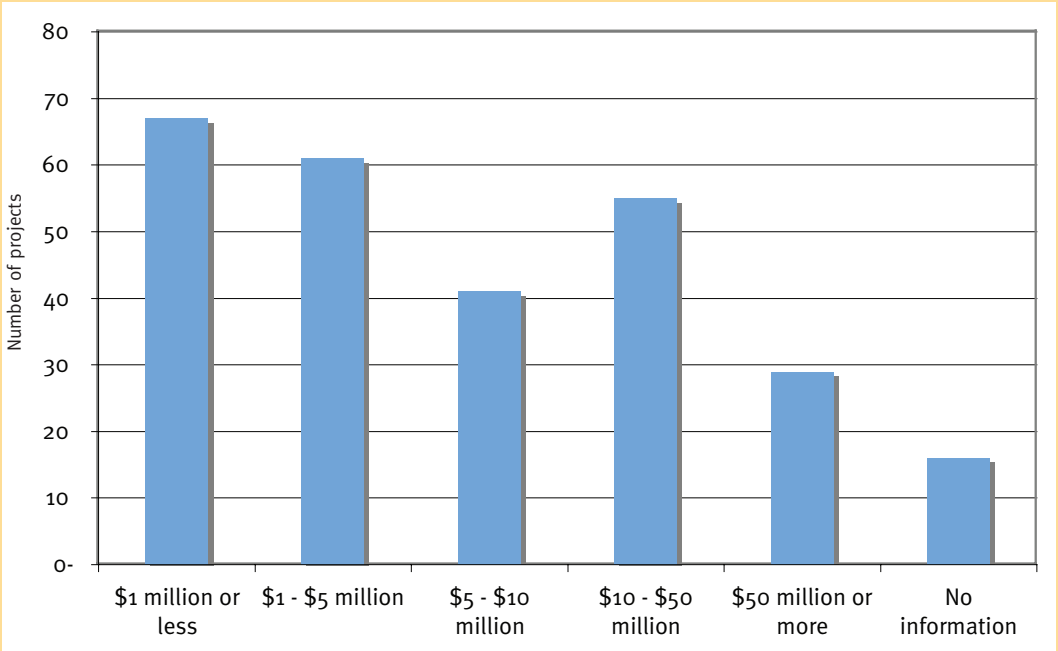
Table 7: Florida State Outsourcing Projects by Year, 1995-2007

Year	Number of Projects Outsourced
1995	2
1996	0
1997	3
1998	6
1999	3
2000	2
2001	16
2002	15
2003	34
2004	32
2005	31
2006	85
2007	46
Total	275

Note: Outsourced projects are arranged by contract start date. Fourteen outsourced projects did not identify a start date.

Source: State of Florida, Council on Efficient Government, 2007 Annual Report.

Figure 1: Florida State Outsourcing Projects by Contract Size, 1995-2007



Source: State of Florida, Council on Efficient Government, 2007 Annual Report.

289 projects currently being outsourced, with a lifetime value of over 5.5 billion dollars.

The CEG report also found that:

- 71% of the outsourced projects have total expenditures less than 10 million dollars; 29% have total expenditures more than 10 million dollars; and 10% have total expenditures more than 50 million dollars (see Figure 1).
- Five agencies (Department of Juvenile Justice, Department of Children and Families, Department of Corrections, Agency for Persons with Disabilities and the Department of Management Services) accounted for 79% of all outsourced projects. Twelve agencies (36%) reported no outsourced projects.
- 40% of the outsourced projects identified by agencies provided services not previously provided by state employees.
- Cost-benefit analyses were not completed for 92% of the projects reported.
- Currently, 21% of agency-outsourced projects either do not have performance metrics or information on performance metrics in the current contract.

3. Privatization Battle Underway in Rhode Island

Privatization in state government has become a volatile political issue in Rhode Island over the last two years. Faced with the challenge of closing a record budget deficit, Governor Donald L. Carcieri stated in May 2007 that he would privatize "every state service that could possibly be performed more efficiently by the private sector." He included sweeping plans in his FY 2008-09 state budget proposal to replace several hundred unionized state employees—including janitors, food service workers and prison counselors—with private sector contractors.

In response to labor union pressure, the General Assembly passed an amendment to the FY 2008 state budget in June 2007 containing sweeping revisions to the state's contracting procedures. What has come to be described in state media as the "anti-privatization law" directs state agencies to conduct detailed cost comparisons before awarding contracts to private sector firms and it also requires that cost savings to the state through privatization be "substantial" (though the term is not defined in statute). Further, before privatization, current employees would first be given a chance to present new cost estimates for their work to reflect any new business practices they could incorporate. Finally, the law gives "affected parties"—program recipients, state employees or labor unions—60 days to appeal state privatization decisions to a Superior Court judge.

Undaunted, in August, the Carcieri administration selected the contractor Hurley of America, Inc. to replace dozens of housekeeping employees at Eleanor Slater Hospital in an effort to save an estimated $13 million over a five-year period. According to the Governor's office, the state Department of Administration reviewed the new law and concluded that it didn't apply to this particular contract since negotiations began before the anti-privatization law passed in June.

In March 2008, Gov. Carcieri formally asked the Rhode Island Supreme Court to rule on the constitutionality of the law and determine whether it violates the separation of powers clause in the state Constitution, exceeds the legislature's constitutional authority and intrudes upon the authority of the executive branch. In a letter to Chief Justice Frank Williams, Gov. Carcieri argued that the new law "makes it virtually impossible to privatize any governmental services or renew contracts of existing services being rendered by private vendors," disrupting dozens of critical state services across agencies and rendering the governor's office unable to reduce state spending to address the current state budget crisis.

He also argued that the law gives standing to an excessively large number of people to challenge privatization decisions, which could clog the state's judicial system with frivolous lawsuits. As Gov. Carcieri wrote to Williams, "capable vendors will

be dissuaded from bidding on new or renewal contracts when faced with the possibility of enduring a process that could be held up for years in internal analysis and litigation."

There are early indications, however, that the 2007 anti-privatization law may not survive 2008. According to press reports, the General Assembly appeared poised near the end of the session to approve a bill (not yet been introduced at press time) that would give the governor more flexibility in replacing unionized state workers with private contractors. The new bill—reportedly compromise legislation negotiated late in the session between the governor's office and labor leaders—would effectively roll back the 2007 law. Given this development, a Carcieri spokesman indicated in late June that the governor's office will likely withdraw its request for a state Supreme Court advisory opinion on the anti-privatization law.

4. Indiana Government Reform Update

The Indiana Commission on Local Government Reform—a bipartisan commission established by Governor Mitch Daniels to "recommend ways to restructure local government to increase efficiency and reduce the financial burden on Indiana taxpayers"—released its final report, *Streamlining Local Government: We've got to stop governing like this*, in December 2007. The report includes 27 recommendations for making Indiana's local government more efficient, effective, understandable and accountable. If enacted, the recommendations would reduce the number of local government units by 37% from 3,086 to 1,931 and the number of elected officials would fall from 11,012 to as few as 5,171.

Among the Commission's recommendations:

- A single, elected county executive and a stronger county council should lead county governments. Professionally qualified administrators should report to and be held accountable by this governing body.
- Township government should be completely eliminated and services currently performed by township personnel should be transferred to county governments.
- Local public safety services should be coordinated countywide and regionally where appropriate.
- Only elected officials should have the power to levy taxes.
- To gather sufficient educational resources, the size of some Indiana school districts should be increased.
- All spending, including school spending, should be subject to more rigorous examination by elected officials.

The Indiana Family & Social Services Administration's (FSSA) welfare eligibility modernization initiative is well underway, but has experienced some hiccups along the way (see Reason's *Annual Privatization Report 2007* for more details on this initiative). Indiana began privatizing welfare delivery last fall in a pilot program covering a dozen central and eastern Indiana counties. Each county had previously run its own welfare office, but under the pilot program, operations in the 12-county region were consolidated in the Marion call center run by IBM and Affiliated Computer services. Since the beginning of the pilot program, social service agencies have reported complaints from people who have lost their food stamps or Medicaid coverage or who have had difficulty utilizing either the call center or the new, Web-based application for welfare benefits.

FSSA Secretary Mitch Roob has acknowledged some implementation glitches but defended the privatization. According to Roob, FSSA is addressing problems with the rollout and will not expand the program to other counties until the agency is satisfied with progress in the pilot area. For instance, after resolving some technical issues in a Web program, the number of applications in the pilot area increased 67% from 426 to 712 in just one week. He also noted implementation delays caused by the attention FSSA has given the state's new health plan for low-income adults. Roob also points out that FSSA is currently serving record numbers of people as food stamp recipients

increased nearly 4% between 2007 and 2008.

There were several failed legislative efforts to introduce more bureaucratic oversight of Indiana's privatization efforts. For the second straight year, the General Assembly considered a bill, House Bill 1340, that would have created a Privatization Review Committee to review plans and make recommendations to the governor. The bill would also have required a state agency to develop a privatization plan before privatizing any state program and hold a public hearing on the plan. It would have also required a state agency to perform a cost-benefit analysis before entering into a contract for services, with the Department of Administration compiling semiannual reports on the cost-benefit analysis for each contract. The bill passed out of the House Committee on Interstate and International Cooperation in January 2008, but failed to advance further. A bill with similar provisions, Senate Bill 76, stalled in the Senate Committee on Tax and Fiscal Policy.

5. New York Tightens Privatization Laws

Privatization is likely to face a tough road in New York after Governor David Paterson issued an executive order in June 2008 creating a new set of stringent contracting standards for state agencies and establishing a state task force to review agencies' use of consultants. The order recommends outsourcing only if the contractor will be more cost effective, efficient or necessary to protect public health and safety. According to the state's Division of the Budget, New York State is projected to spend over $800 million on consultant services in 2008-09.

The new task force—consisting of several state agency directors—will review most future contracts with personnel costs of over $1 million per year. After entering into a contract, a state agency will have ten business days to provide the task force a written justification for why it selected private sector consultants instead of state employees. If cost savings are the justification, the agency must prepare an analysis supporting its conclusion.

The new task force will meet quarterly and evaluate contracts submitted for their review. If the task force finds that an agency's use of consultants is unnecessary or in conflict with the provisions of the executive order, it will make recommendations to that entity for reforming its contracting procedures.

Gov. Patterson appears to be following in the footsteps of his predecessor, former Governor Eliot Spitzer, who signed a bill in 2007 prohibiting the Department of Correctional Services from replacing correctional officers with private guards. The bill had previously been vetoed four times by former Gov. George Pataki. In honor of his opposition to privatization in state government, the New York State Public Employees Federation awarded Spitzer an anti-privatization award during its annual convention in September 2007. Spitzer told the assembled audience that, "[w]e don't believe in sub-contracting and contracting out."

6. Other State Privatization News

In August 2007, the Alaska Board of Agriculture and Conservation announced its decision to privatize Matanuska Maid Dairy, a state-run dairy enterprise. The 71-year old dairy was a private cooperative until 1985, when the state bought it out of bankruptcy. Over the past two years, Mat Maid has lost nearly $700,000. According to Board member Kristin Cole, the dairy should have been privatized a long-time ago as it "was never intended that the state be the owner of this asset long-term."

For a second year, the Alabama legislature failed to pass legislation allowing the state to enter into public-private partnerships (PPPs) to deliver privately financed transportation projects. House Bill 70 would have allowed the state's Toll Road, Bridge and Tunnel Authority to enter into PPPs to build new roads and bridges. Despite passage in the House and the support of Governor Bob Riley, the bill was awaiting final consideration on the Senate floor when the regular session ended.

Despite the bill's failure, a multi-state, county-level initiative is advancing to develop a public-private partnership with a non-profit group to

construct, operate and maintain a toll road from Montgomery to the soon-to-open West Bay International Airport near Panama City, Florida. Officials involved believe the partnership would be the first between local entities in two different states, with no state government involvement.

Several bills that would modernize **Arizona's** enabling legislation for transportation public-private partnerships (PPP) were considered in the 2008 session. All were ultimately stalled when a business coalition (with the support of Governor Janet Napolitano) gathered enough signatures to put a transportation funding proposal on the November 2008 ballot. If passed, the measure would increase the state sales tax by one cent to fund approximately $42 billion in new road, transit and environmental projects over the next three decades. The measure also includes general PPP enabling language and would set aside part of the new revenues to establish PPP "seed" funds for road and transit projects.

California clearly has infrastructure on the radar in its 2007-08 legislative session. The Assembly Business and Professions Committee voted down Assembly Bill 2600, which would have modernized the state's decades-old public-private partnership law. Assembly Bill 1261, which would allow a blending of public and private financing to develop infrastructure projects, passed the Assembly Senate Appropriations Committee. A hearing on the bill was canceled in August of 2007 by the Bill author and, since then, no other action has been taken.

Assembly Bill 642 would allow all 58 counties, a dozen selected cities and two special districts to use design-build contracting for wastewater, solid waste and water recycling projects over $2.5 million. The bill passed the Assembly and the Senate Local Government Committee and was awaiting a hearing in the Senate Appropriations Committee at press time. Senate Bill 1699 would have authorized the Sonoma Valley Health Care District to use design-build contracting for the construction of a hospital, health care facility building or other related infrastructure. After passing the Senate and the Assembly Local Government Committee, the bill was placed on the inactive file.

An August 2007 state auditor report blasted

Arizona Governor Janet Napolitano

Colorado's Department of Labor and Employment for its failures to properly oversee a contract for the development of a new computer system to process unemployment benefits and taxes. The Department contracted with a private vendor to create the new system in 2001, but a number of schedule slips and failed tests led to the contract's cancellation in late 2005. The auditor report found that the department relied on the contractor to oversee and manage its project, instead of establishing its own internal oversight mechanisms. The report also found that the Department did not implement rigorous contract monitoring, nor did it did properly research the contractor's qualifications with similar projects before awarding the contract. Department officials expect to open a new bid for the project in 2009, using recommendations from the auditor's report to guide the contracting process.

In October 2007, **Connecticut** Governor Jodi Rell signed Public Act 07-1—An Act Concerning Clean Contracting Standards—into law, tightening the rules governing state contracting. The bill requires that the state develop cost-benefit analyses before contracting out state services to private sector providers. The bill also creates a new contracting standards board that will review state contracts and develop uniform procurement policies. State agencies will be audited by the new board every three years to ensure compliance with procurement policies. Under the new law, the board is also charged with reviewing all new privatization initiatives to ensure that cost-savings do not come at the expense of service quality.

In 2008, the Connecticut House of Representatives considered another bill to tighten the rules on government outsourcing. House Bill 5112, which died at the end of the legislative session, would have required the governor to prepare a report listing all state contracts for services performed outside of Connecticut or the United States. The report would have also included an assessment of the economic costs and benefits of any such outsourced contracts. According to the state's Office of Fiscal Analysis, state agencies would have incurred significant costs under the bill, given the requirement to conduct cost-benefit analyses that many agencies lack the expertise to undertake.

Georgia Governor Sonny Perdue is turning to privatization to transform Georgia's dysfunctional technology services. In December 2007, Perdue announced a major initiative to privatize state technology services, shifting about 500 state employees to private companies and eliminating roughly 200 positions. A February 2008 consultant's report found that the Georgia Technology Authority (GTA)—created in 2000 to provide statewide government technology services—is "a highly inefficient and dysfunctional organization, delivering expensive services." The report concluded that, "the capabilities within the state to fix the problem have deteriorated to such an extent that only an enterprise-wide initiative that draws services and skills from the market has the opportunity to make timely repairs."

IBM and EDS submitted bids to GTA in June 2008 to manage the state's computers and servers. That same month, EDS and AT&T submitted bids to provide telecommunications services. A final contract to manage the state's websites is expected to go out to bid in August 2008. Altogether, the three contracts would total $1.28 billion over five years, affecting operations at 11 state agencies.

Gov. Perdue canceled a similar proposal in February 2003 after taking office. At the time, former GTA director Larry Singer was pursuing a single contract for all of the state's technology services, but Gov. Purdue felt that breaking the contract into several pieces would be a better approach.

A bill that would have allowed **Louisiana** to privatize a facility for forensic mental health patients failed to get approval from the House Committee on Health and Welfare in May 2008. House Bill 737 would have allowed the state Department of Health and Hospitals to contract with private companies to build a 160-bed facility and provide services for prisoners deemed mentally incompetent to stand trial. The bill's sponsor, State Representative Kay Katz, cited the critical shortage of forensic psychiatric beds as the impetus for the legislation. Under the bill, any contract would

have to be approved by the Joint Legislative Committee on the Budget and the health and welfare committees in both legislative houses. The House committee voted 6-3 to defer the bill, killing it for this legislative session.

In January 2008, **Maine** Gov. John Baldacci's administration announced plans to privatize the Elizabeth Levinson Center, a state youth mental health facility. The privatization proposal was included in the Baldacci's supplemental budget bill, which aims to cut overall state spending by $95 million in the current biennium. According to the state's Department of Health and Human Services Commissioner Brenda Harvey, the initiative would save roughly $411,000 annually and would further the state's larger goal of ending the public provision of long-term residential care services. According to Harvey, it currently costs the state an average of $702 per day per resident at the Center, while it costs a similar private facility in Maine, providing a comparable level of care, $546 per resident.

In January 2008, **Maine's** Health and Human Services Department selected Unisys Corp. to manage the MaineCare computer system. Though 100 state workers may be displaced, state officials expect Unisys to hire many of its current employees. The MaineCare billing system, used to process Medicaid claims, has been plagued with problems since its rollout in 2005 and Department officials anticipate that privatization will improve operations while helping the state achieve compliance with federal standards.

In late 2007, **Massachusetts** Governor Deval Patrick announced that the state will review its options for leasing roads and bridges to private companies. Patrick's budget office is seeking to hire a financial company to analyze the impact of privatizing transportation facilities as part of a broader review of the state's massive, $19 billion transportation funding deficit. Patrick is not alone. State Senate President Therese Murray has also asked officials to explore the possibility of transportation privatization. According to Murray, contracting with private business should be pursued before raising state fuel taxes.

A June 2008 report from **Michigan's** state auditor general cast a critical eye on how the state provides meals for prisoners. The auditor's report found that while the state has been relatively effective at managing food service costs, it needs to "consider additional ways to reduce the costs of providing prisoner meals,"—including private-sector contracting. The report pointed to lower costs in Florida (43% lower) and Kansas (11% lower) from utilizing private contractors to provide similar services. The state's Department of Corrections is preparing a request for information from private providers.

Mississippi Governor Haley Barbour signed House Bill 3 into law in June 2008, modifying last year's transportation public-private partnership enabling legislation. The bill increases the maximum length of a toll road concession to 50 years, establishes an enforcement and collection system for unpaid tolls and exempts concessionaires from property taxes. The state is now seeking qualified bidders for its first PPP project, the 12-mile, $345 million Airport Parkway connecting Jackson with its eastern suburbs.

Several anti-privatization bills that failed in **New Jersey's** last legislative session resurfaced in the 2008-09 session. All of the bills are currently in committee. A1650 requires a report detailing all aspects of a proposed privatization and the anticipated net reduction of in-house costs to be posted publicly and reviewed by the State Auditor before any contracts are awarded. A1795 requires the State Auditor to review certain Department of Corrections privatization contracts. S1637 would require state agencies to submit notice of request for proposals or other documents relevant to privatization contracts to certain state employees. A2772 would de-privatize the Motor Vehicle Inspection Program at the end of the current vendor contract.

In June 2008, the *Las Vegas Sun* reported that **Nevada** Governor Jim Gibbons and Mike Willden, director of the state's Health and Human Services Department, had recently met with companies potentially interested in taking over part or all

of the state's mental health system. Gibbons is reportedly pursuing privatization as one strategy to address a 14% budget cut. Any savings realized through privatization would supplement existing mental health services funding.

Momentum is also building in the Silver State for a proposal to develop a 19-mile, privately financed toll lane through Clark County, converting high-occupancy and emergency lanes into managed lanes. The $1.4 billion plan was endorsed in May by the Nevada Transportation Board and is under consideration by a legislative subcommittee on transportation. The subcommittee will continue to study the proposal at an August workshop, after which it will decide whether or not to support the project. Regardless of the subcommittee's decision, Governor Gibbons has indicated that his office is likely to draft new toll legislation for the 2009 session. As it stands today, any toll project developed in Nevada would need a specific exemption from a long-standing state statute prohibiting toll roads or bridges.

Amid a contentious legislative debate over **Pennsylvania** Governor Ed Rendell's proposal to lease the Pennsylvania Turnpike to an international team of investor/operators (see discussion in Surface Transportation section), the state's Senate unanimously passed Senate Bill 1158 to allow the state government or public transportation authorities to enter into public-private partnerships to fund the construction of new roads, bridges and other transportation infrastructure. Sponsored by State Senators Roger Madigan and Jake Corman, the bill does not address a potential concession on the Pennsylvania Turnpike, nor would it allow leases of existing capacity (though highway expansion projects would be eligible for privatization). At press time, the bill was awaiting a hearing in the House Appropriations Committee.

State Senator Robert Wonderling introduced Senate Bill 1273 to privatize Pennsylvania's state liquor monopoly. Pennsylvania is one of 18 "control" states where the state government controls the sale of alcohol products. While control states like Michigan only control alcohol sales at the wholesale level (allowing private operators to run retail stores), the Commonwealth controls the sale of spirits, wine and fortified wine, at both the retail and wholesale levels. Wonderling's bill is expected to be heard in the Senate Law and Justice Committee in the fall of 2008.

In 2007, **Texas** canceled a major, recent privatization initiative—a five-year, $899 million contract between the Texas Health and Human Services Commission (HHSC) and Accenture LLP to modernize of the state's eligibility system for food stamps, Medicaid and other public assistance. From its onset in 2006, the initiative became quickly bogged down by cost overruns, customer service problems and coverage issues; for example, a number of eligible families were denied food stamps, Medicaid and other assistance during a 2006 privatization test in Central Texas. Also, the privatization initiative occurred simultaneously with other major internal system and policy changes within HHSC.

Another important aspect of the failed privatization initiative can be traced to poor employee transition management. At the onset of the Accenture contract, the agency informed thousands of eligibility workers that they would soon lose their positions, leading to the resignation of hundreds of employees. Even though layoff plans were ultimately cancelled, the mass eligibility worker defection left the agency hamstrung in delivering services and it was forced to hire and train hundreds of new eligibility workers. In early 2008, the HHSC's poor performance prompted the U.S. Department of Agriculture—which oversees the food stamp program—to require HHSC to devise a performance improvement plan. The Department had found that less than half of Texas food stamp applications processed in December using the HHSC's troubled new computerized eligibility system were completed within the 30 days required by the federal government.

Despite the cancellation of the Accenture contract, Texas did not totally abandon privatization plans. Officials plan to pursue a hybrid system where state workers would continue to have the

final say on food stamp eligibility, but a private contractor would run call centers and answer applicants' questions about their case status. This plan was threatened in Congress in early 2008 by a provision inserted into the House version of the farm bill that would have prevented states from allowing private contractors to interact with food stamp applicants or to make eligibility determinations, a direct response to the problems with the Texas privatization pilot. However, the provision was not included in the Senate version of the farm bill and House and Senate negotiators opted to keep it out of the final bill.

The revamping of its Privatization Policy Board (see discussion in Section A) was not the only privatization news in **Utah**. A proposal to privatize the state's mental health hospital stalled after the release of a legislative audit with generally favorable findings regarding current costs and patient care at the facility. However, the audit also recommended that the state Department of Human Services study the feasibility of providing a new long-term care facility for the state.

In a 2008 special legislative session on transportation in **Virginia**, Delegate Robert Marshall introduced HB 6036, which would entirely privatize the Commonwealth's state-run alcoholic beverage control (ABC) stores by 2009. The bill would provide for the issuance of a "package store" license authorizing the retail sale of alcoholic beverages for off-premises consumption. The bill would also require the state ABC Board to sell at auction all real estate used as ABC stores and to terminate store leases. The bill provides that any monetary savings realized by the ABC Board from the full retail privatization of government ABC stores be applied to the Transportation Trust Fund. As of press time, the bill had not yet been heard in committee.

During the 2008 regular session, Virginia Governor Tim Kaine signed House Bill 1516, which prohibits a private entity from imposing tolls or user fees (under the state's Public-Private Transportation Act) on any rural portion of Interstate 81 without prior approval from the General Assembly. Gov. Kaine also signed House Bill 955, which expands the Commonwealth's Public-Private Education Facilities and Infrastructure Act to cover any services designed to increase productivity or efficiency through the direct or indirect use of technology. The bill also added technology applications to the types of technology infrastructure projects that may be carried out under the Act.

Also, Delegate Chris Saxman introduced House Bill 1238, which would dissolve the current Commonwealth Competition Council and create a new Commonwealth Realignment Commission. The Commission's responsibilities would include:

- Reviewing the operations of state agencies and state-funded programs with a view toward the reduction of nonessential programs and expenditures;
- Studying and promoting privatization through competitive contracting; and
- Advising the governor and the General Assembly of its findings and recommendations.

The bill was continued to the 2009 regular session.

It may become even harder to privatize state services in **Washington** State after a recent court decision. After the passage of a 2002 personnel reform bill, the state's Department of General Administration developed rules outlining a formal process for state employees to challenge privatization initiatives, either by demonstrating that an initiative will not achieve projected cost savings or by forming a business unit and bidding for the work themselves. Unions complained that the rules were too restrictive, arguing that workers should have the ability to negotiate with management if they will be displaced and reassigned or if they lose work to the private company. In June 2008, Thurston County Superior Court Judge Chris Wickham agreed, ruling that the Department exceeded its authority in restricting the appeal process. The Department has indicated that it may appeal the ruling.

Despite its potential for generating cost savings

and performance improvements, a 2007 legislative audit found that state agencies in Washington have made little use of competitive contracting under the 2002 Personnel Reform Act. Out of 23 agencies and higher education institutions surveyed, only three—two colleges and the Washington State Patrol—have used competitive contracting since it became available in 2005. Agency managers offered two main reasons for the low rate of usage. First, they found the process, with its time-consuming compliance requirements, to be complicated and confusing. Second, state rules make an agency's ability to competitively contract subject to collective bargaining, giving unions the ability to remove the contracting option during labor negotiations and creating disincentives for agency participation.

In **West Virginia**, the privatization of the state-run workers compensation insurance program was completed in July 2008. A 2005 bill signed by Governor Joseph Manchin transformed the state's Workers' Compensation Commission into a private insurance carrier, BrickStreet Insurance. Brickstreet was given a two-year virtual monopoly on workers' compensation insurance in West Virginia, which ended on July 1st when the market was opened to other competitors. West Virginia now joins most other states in allowing private insurers to offer workers compensation insurance. Today, only Puerto Rico, Ohio and three other states continue to operate state insurance monopolies. Brickstreet is currently exploring plans to expand its operation into other states.

In May, Gov. Manchin signed into law the Public-Private Transportation Facilities Act of 2008, granting the West Virginia Department of Transportation the authority to enter into public-private partnerships to build and operate new toll roads. The state is currently considering a potential $300 million partnership for a 13-mile expansion of US 35 in Mason and Putnam Counties.

A November 2007 report by the **Wisconsin** Department of Administration identified at least 74 cases in which state agencies outsourced services despite finding that private contractors would be more expensive. In those cases, the *Milwaukee Journal Sentinel* estimated that contractor costs were expected to exceed the cost of state workers by roughly $12.5 million. State officials have responded that cost savings is not the only important consideration, since agencies often turn to contracting when they need to tap skills and expertise not available in state government, particularly in areas like information technology. A 2006 law requires agencies to perform cost-benefit analyses before contracting out and over 240 such analyses have been undertaken since the law's passage.

The Department of Administration report also confirmed that contracting has been on a significant decline under the administration of Governor Jim Doyle. Over the last fiscal year, the state spent $419.6 million on contracts, down 14% from the $489.8 million spent the previous year. Even more striking, total state contract costs have dropped 44% since Doyle came into office in 2003; that year, the state spent over $745 million on private contractors.

B. Local Privatization Update

1. Chicago Raises the Bar on Asset Privatization

Chicago Mayor Richard Daley continues to raise the bar on municipal privatization. After the blockbuster $1.8 billion lease of the Chicago Skyway in 2005 and the $563 million lease of four underground parking garages downtown—in addition to the dozens of other city services and functions privatized over his 19-year term—Daley is now moving to privatize several additional big-ticket city assets.

While Daley's push to privatize Midway Airport has certainly generated the most attention (see overview in Air Transportation section), Chicago has several other precedent setting privatization initiatives in the works. First, in February 2008 the city and the Chicago Park District jointly solicited qualifications from private bidders interested in a long-term lease of the city's parking meter system—one of the largest in the United States with 35,000

parking meters generating roughly $20 million per year. Chicago's would be the first major public parking meter operation in the nation to be privatized under a long-term concession.

The concession agreement for the parking meter system is anticipated to be 50 years in length and will grant the operator the right to maintain and operate the meters in exchange for an upfront payment to the city. The city will retain parking enforcement authority and the right to set parking fees. Industry observers expect the bid process to be similar to those for the Skyway, the parking garages and Midway Airport.

Chicago officials will need to resolve several legal issues related to the project, including: the city's obligation not to create competing spaces, city maintenance of existing roads and access routes, the city's and Park District's liability for failure to enforce tolls or to increase rates, how to address major project risks (i.e., would revenues be affected if the city pursues congestion pricing in the future?) and how to address changes in parking meter technology.

In early 2008, spiraling costs forced Chicago to cancel an ambitious plan to build a transit station in downtown's "Block 37" and develop express train service from the new station to both O'Hare and Midway airports. The Chicago Transit Authority (CTA) had spent $250 million on the project so far, but rapid construction cost inflation, poor site conditions and larger-than-expected utility relocations left CTA with little to show for their efforts—just an almost-completed shell of a station.

To rescue the project, CTA President Ron Huberman recently announced plans to partner with a private sector team to complete the build-out of the transit station and develop and operate the airport express train service. The city of Chicago is working with the CTA to develop a request for proposals for the project. Meanwhile, the CTA will spend an additional $45.6 million to complete the shell of the station and construct the underground lines to connect with existing rail lines. Work on both is expected to be completed by 2009.

According to Huberman, "[t]he CTA is committed to developing a premier service that will enhance Chicago's standing as a world-class city. Tapping into private sector expertise at this stage allows us to leverage our existing investment in this project, creates an opportunity for outside investment and can bring in partners who have experience building and managing premium services."

Seven firms have expressed interest in pursuing long-term leases of the city's three material recycling and recovery facilities, which are currently operated under a five-year, $78.8 million contract held by Allied Waste Transportation. Mayor Daley has indicated that upfront proceeds from the lease could be used to finance a costly expansion of the city's curbside recycling program. The current contract with Allied Waste Transportation was signed in July 2006 and included a provision that it could be canceled with 60 days notice if the lease plan moves to completion.

2. Georgia Contract Cities Movement Continues to Advance

As discussed in last year's *Annual Privatization Report*, Sandy Springs became Georgia's first new contract city in December 2005, launching a wave of city incorporation in suburban Atlanta involving largely privatized local government. The city of nearly 90,000 was originally created with just four government employees (before starting their own police and fire departments, as required under Georgia's constitution); all other non-public-safety-related functions—such as public works, planning and zoning and parks and recreation—were contracted out to one vendor providing comprehensive services. Sandy Springs maintains ownership of city assets, controls its budget and sets service performance standards, while the contractor is responsible for all operations, services and staffing.

In its third year of cityhood, Sandy Springs' officials reported a budget surplus of over $9 million. Though Mayor Eva Galambos and some on the city council suggested cutting property tax rates to offer some relief to homeowners hit by rising assessment values, a majority of the city council agreed that the surplus be targeted towards a backlog of city

improvements, such as road resurfacing projects, new sidewalks and parks or a permanent police headquarters. In June 2008, the council rejected a proposal to roll back the current millage rate.

Following in the footsteps of Sandy Springs, two new cities—Johns Creek and Milton—were formed in December 1, 2006 using similar contract models (and the same contractor) as Sandy Springs. In December 2007, the small community of Chattahoochee Hill Country became the fourth new contract city in Georgia. All four contract cities were formally unincorporated communities within Fulton County and each required specific state legislation authorizing a public vote on incorporation. With the incorporation of the four new cities, the population of unincorporated Fulton County now stands at just 40,000 people, less than half the population of Sandy Springs itself.

In March 2008, Georgia Governor Sonny Perdue signed Senate Bill 82, allowing residents of the north DeKalb County community of Dunwoody—Sandy Springs' neighbor to the east—to decide if they want to incorporate. By an overwhelming 80 percent margin, Dunwoody residents voted to incorporate in July 2008, making it the first DeKalb County community to implement the Sandy Springs model. The new city of Dunwoody will have approximately 37,000 residents.

One additional community—South Fulton—received legislative approval in 2007 for an incorporation vote, but was defeated at the polls by an overwhelming 85-15% margin. The proposed city would have encompassed all of the remaining unincorporated land in Fulton County and made it one of the few counties in the country entirely composed of municipalities.

Additionally, some state legislators and many residents of the new privately run cities have called for splitting off a new county, Milton, from Fulton County. The original Milton County merged with Fulton County in 1932 and the new county would include the cities of Sandy Springs, Milton, Johns Creek, Alpharetta, Roswell and Mountain Park. "Fulton County is too big to be responsive," Sandy Springs City Councilman Rusty Paul told the *Atlanta Journal-Constitution* in March. "You need a county big enough to get significant projects done, but still small enough to deliver personal services."

However, legal issues loom large for the Milton County proposal. The Georgia state Constitution caps the number of counties at 159, so a constitutional amendment would be required.

3. San Diego Managed Competition Update

A long-overdue reform is coming to the city of San Diego in the form of managed competition. In November 2006, voters passed Proposition C by a 60 to 40% margin, amending the city charter "to allow the city to contract services traditionally performed by civil service employees if determined to be more economical and efficient while maintaining the quality of services and protecting the public interest." The implementing ordinance became law on January 17, 2007.

Prior to Proposition C's passage, the city charter strictly limited the city's ability to contract with private-sector providers for city services. According to the Fiscal Impact analysis of Proposition C included in the voter guide, "This restriction in most cases prevent[ed] the City from entering into contracts with private companies even if doing so is shown through the bidding process to save the City money or create improved services or greater efficiencies."

In addition to allowing for more competition between public and private-sector providers, Proposition C directed the mayor to establish a seven-member Managed Competition Independent Review Board to advise the mayor whether city employees or private-sector contractors will provide certain services more efficiently and effectively. The board's recommendations are subject to approval by the mayor and the City Council.

Despite early enthusiasm for managed competition by Mayor Jerry Sanders's administration, little was done to implement the program over the course of the following year. Implementation has been further delayed by resistance from municipal employees' labor unions, Sanders's re-election bid

About San Diego Managed Competition

- Contracting recommendations will be based upon "best value" to the taxpayers.
- At least two bids from independent contractors must be received.
- Potential contractors must be able to provide the service at a savings of 10% or more as compared to the bid made by employees.
- The recommendation to award a contract to an external vendor or the city employee team will be made by the Managed Competition Independent Review Board (MCIRB).
- The mayor can only accept or reject a contracting recommendation from the MCIRB. He cannot amend it. Likewise, the City Council can only accept or reject the mayor's proposal.
- Should an award go to an independent contractor, employees will not be precluded or hindered from seeking employment with that contractor.
- Appropriate "firewalls" will be established between the employee and management team developing the contract specifications and the employee team preparing the city's employee proposal in order to protect the integrity of the process.
- Employee teams will be provided with support to develop a competitive proposal.
- Statement of Work development will be led by an expert team of outside consultants and supported by the functional expertise of city staff.
- Contracts will be limited to a five-year period and regular audits will ensure the agreed upon level of services is being provided.

Source: City of San Diego, Office of the Mayor, "Mayor Moves 11 City Functions Forward in Managed Competition Process," May 2, 2008, http://www.sandiego.gov/mayor/pdf/080502fs.pdf.

and even a dispute between the mayor's office and the city council over the contract of the consultant the administration wanted to hire to oversee the managed competition program. Although the independent review board has yet to be established, the administration's revised timetable calls for the first contracts to be awarded around the end of 2008.

As evidence of his commitment to the city's managed competition efforts, Mayor Sanders announced in May 2008 that he was moving 11 city functions forward in the competition process. These tasks are currently performed by a total of 292 city employees and comprise $63.2 million of the city's budget. Among the functions being advanced in the competition process are: Approximately one-fifth of solid waste collection services (with additional portions to be bid on in the future), street sweeping, greenery compost facility operations, container delivery services, dead animal pick-up, street maintenance, pavement marking and signs, storm drains maintenance, traffic signals maintenance, street lights maintenance and sidewalk maintenance.

The public debate over managed competition generally revolves around cost savings. Indeed, this was the main focus in San Diego, where the city's spiraling pension crisis and other financial difficulties left it desperate for ways to dig out of its fiscal hole without sacrificing service quality. But it would be a mistake to myopically focus on costs and ignore the many other benefits of managed competition. Data from the Council of State Governments (CSG) indicate that flexibility, access to personnel or skills not available in-house and tapping of private-sector innovation are also important drivers of outsourcing.

The key point is that it does not matter whether contracts are won by private-sector contractors or city employees. The added incentives provided by competition will lead to lower costs and higher-quality services. When government competes, the taxpayer wins every time.

4. Atlanta to Privatize Parking Ticket and Meter Collections

In April 2008, the city of Atlanta accepted bids from companies interested in running the city's parking ticket and meter collection operation, an activity now performed by the City's Public Works Department. The announced privatization initiative comes as Mayor Shirley Franklin's administration struggles with the challenge of closing a projected $140 million budget gap in the FY 2008-09 fiscal year. City officials estimate that Atlanta is currently spending $1.3 million on parking enforcement annually (including the costs for the system's 26 employees), while it collects roughly $3 million from parking fines and meter fares.

According to Department of Public Works spokeswoman Tenee Hawkins, Atlanta expects privatization to bring additional revenues into city coffers and officials are open to exploring ideas from the winning bidder on how to expand the parking program. At press time, no details were available on the contract structure. Any contract would require City Council approval before proceeding to implementation.

5. Philadelphia City Council Votes to Privatize Sludge Plant

On June 20, 2008, the Philadelphia City Council approved the privatization of the city's Biosolids Recycling Center. Officials estimate cost savings to range from $100 million to $200 million over the life of the 23-year contract term. The only bidder, Philadelphia Biosolids Services LLC, is a partnership between the Houston-based Synagro Inc. (a municipal waste specialist), McKissack and McKissack (a Philadelphia-based architectural firm), and Len Parker Associates (a Philadelphia-based, minority-owned contractor). The contractor would take over plant operations and construct a new facility to convert treated waste into pellets that qualify as fertilizer for a broad range of uses. Fertilizer currently produced by the city is highly regulated and can only be sent to farms, abandoned mines and landfills.

C. State Budget Outlook

The health of most state budgets is likely to deteriorate in fiscal year 2008, according to a National Conference of State Legislatures' (NCSL) April 2008 survey of state fiscal officers. Many states are facing the twin challenges of avoiding FY 2008 budget shortfalls and enacting balanced budgets for FY 2009. This stands in stark contrast to the flush budgets seen in recent years.

According to NCSL executive director William T. Pound, "[t]he current health of state budgets is very uneven. […] Whether or not the national economy is in recession is almost beside the point for some states. The fiscal situations have declined so much in some states that they appear to be in a recession."

Lower than anticipated revenue collections appear to be driving current state fiscal conditions and budget shortfalls. In the six months since the previous NCSL survey in November 2007, the number of states reporting budget deficits rose from 7 to 16, with the total shortfall from all 16 states totaling at least $11.7 billion this fiscal year.

FY 2009 is shaping up to be even more challenging. Budget gaps have emerged in 23 states, collectively exceeding $26 billion. Again, slowing or declining revenue from personal income, general sales and corporate income taxes is the principal reason. A majority of states—34 in all—are "concerned" about mounting budget pressures, a deteriorating national economy and the increased problems generated by a possible recession (see Table 8). The number of states reporting an "optimistic" outlook—which has hovered in the double digits in the last several years—totaled just three (Alaska, North Dakota and Wyoming) in the latest survey. Officials in ten states expect their revenues to be "stable," leaving four states (Arizona, Delaware, New York and Washington) with a "pessimistic" outlook for the future.

There may be a silver lining: some states like Louisiana, North Dakota and Wyoming have largely been spared fiscal problems due to energy-related revenues or special economic circumstances. Yet, the report notes, if the national economy continues to deteriorate and falls into recession, the

Table 8. General Fund Revenue Outlook for Fiscal Year 2009				
Optimistic	Stable	Command		Pessimistic
Alaska	Georgia	Alabama	Montana	Arizona
North Dakota	Iowa	Arkansas	Nebraska	Delaware
Wyoming	Louisiana	California	Nevada	New York
	Michigan	Colorado	New Jersey	Washington
	Missouri	Connecticut	New Hampshire	
	Oklahoma	Florida	New Mexico	
	South Dakota	Hawaii	North Carolina	
	Texas	Idaho	Ohio	
	Utah	Illinois	Oregon	
	West Virginia	Indiana	Pennsylvania	
		Kansas	Puerto Rico	
		Kentucky	South Carolina	
		Maine	Rhode Island	
		Maryland	Tennessee	
		Massachusetts	Vermont	
		Minnesota	Virginia	
		Mississippi	Wisconsin	

Source: National Conference of State Legislatures survey of legislative fiscal offices, April 2008.

state fiscal situations will most certainly worsen.

The results of the NCSL survey largely mirror the results of the National Association of State Budget Officers/National Governors Association (NASBO/NGA) Fiscal Survey of the States: June 2008. The NASBO/NGA survey only covers general fund spending, but it found that FY 2008 marked a negative turning point for state fiscal conditions, with a significant increase in fiscal difficulties in stark contrast to recent years. The report suggests that "[t]he decline of the housing sector along with a weak manufacturing sector have combined to cause significant declines in revenue for a number of states."

Among the findings in the NASBO/NGA survey:

- FY 2009 will see only a 1% general fund spending increase in governors' recommended budgets, the third lowest spending increase in the past 31 years and far lower than the historical average of 6.7%.
- The estimated FY 2008 expenditure growth rate totals 5.1%, just over half of the 9.3% increase in FY 2007 and well below the historical average of 6.7%. In addition, 13 states were forced to reduce their FY 2008 enacted budgets, compared to the three states that reducing enacted budgets in FY 2007. By way of comparison, during the last major fiscal downturn in the early 2000's, 37 states were forced to make mid-year budget reductions in FY 2002 and FY 2003 totaling $14 billion and $12 billion, respectively. Notably, these budget reductions occurred after the national economic downturn ended.
- A total of 18 states are assuming negative budget growth for FY 2009 governors' recommended general fund budgets, compared to four states estimating negative budget growth for FY 2008.
- State Medicaid spending is estimated to increase by 4.4% in governors' FY 2009 recommended budgets, over four times the growth rate for the overall general fund.
- The number of states experiencing revenue shortfalls increased in FY 2008. Tax revenues exceed expectations in 15 states, are on target in 14 states and are below expectations in 20 states. Only eight states reported lower-than-expected revenues.
- Recommended net tax and fee changes would generate an additional $726 million in revenue based on governors' FY 2009

recommended budgets. A total of 16 states are recommending net decreases and 11 states are recommending net increases.

- Total balances—ending balances and the amounts in budget stabilization funds—are declining from their FY 2006 peak of 11.5% of expenditures. Balances dropped to 10.5% of expenditures in FY 2007 and an estimated 8.0% in FY 2008 estimates. Under governors' recommended FY 2009 budgets, balances are projected to decrease to 7.5% of expenditures. However, the survey notes that balances remain above the historical average of 5.8% of expenditures.

D. Rich States/Poor States: ALEC-Laffer State Economic Competitiveness Index

By Jonathan P. Williams, American Legislative Exchange Council

The American Legislative Exchange Council (ALEC) released a groundbreaking report in 2007 that can serve state lawmakers and concerned citizens alike, in evaluating their state's fiscal and economic policies, while analyzing the effectiveness of their implementation. *Rich States/Poor States: ALEC-Laffer State Economic Competitiveness Index* helps us all see the negative effects high taxes and other big government policies have on the competitiveness of our states.

The report offers two rankings. The first, the Economic Performance Rank, is a backward-looking measure based on a state's performance among three important variables: Personal Income Per Capita, Absolute Domestic Migration and Non-Farm Payroll Employment—all highly influenced by state policy. This ranking details states' individual performances over the past 10 years.

The second measure, the Economic Outlook Rank, is a forward-looking forecast based on a state's current standing in 16 state policy variables, including Top Marginal Personal and Corporate Income Tax Rates, Property and Sales Tax Burdens and State Minimum Wage. This ranking will help lawmakers gauge their state's economic future based on those 16 factors.

1. State Winners and Losers

The ALEC report details the migration of thousands of Americans from areas with high tax burdens to places where they can experience greater economic freedom. States with a high propensity to tax and spend are finding that their most wealthy and productive citizens are moving across borders into areas that impose less of a financial burden. According to authors Dr. Arthur Laffer and Stephen Moore, "they are voting with their feet for jobs and higher incomes—economic opportunities that are disappearing from some regions of the country, while sprouting in others."

It is telling that a state as beautiful as California has the nation's second-largest domestic population outflow. Despite warm weather, sandy beaches and the Pacific Ocean, Californians are leaving in droves to escape the state's oppressive tax burden. These former citizens are generally the "highest achievers and those with the most wealth, capital and entrepreneurial drive." When the wealthy leave a state with high taxes, this reduces the tax base and leaves the state's economy less productive.

2. The State Roadmap to Prosperity

The report describes how low taxes increase the incentive to work and thus increase income, wealth, employment, investment and in-migration. According to the principles of the Laffer Curve, there is a point where any increase in taxes actually reduces tax revenue. Delaware, for example, actually makes an excess profit, relative to its neighbors, on alcohol sales because of its extremely low beer taxes.

An in-depth look at the "Irish Miracle" also helps prove lower taxes help foster economic development. The decision in the 1990s to dismantle Ireland's welfare state—cutting taxes and privatizing a variety of government services—paid huge dividends as businesses and skilled workers flocked to the country. It became one of Europe's strongest economies within a decade and today is known at the "Celtic Tiger."

3. The State Spending Binge

There are two distinct problems with the fiscal cycle of the typical state government. First, when faced with a budget surplus, state politicians cannot spend it quickly enough. Second, when their overspending leads them into a deficit, they attempt to make up the difference by raising taxes substantially. Because of the tendency for state politicians to panic at the prospect of rapidly increasing deficits, they are more susceptible to the knee-jerk reaction of quickly raising taxes to compensate.

Laffer and Moore encourage state legislators to "strive to get more for less, not less for more." In other words, it is much more efficient to lower taxes and let the influx of entrepreneurial activity generate revenue, rather than trying to create artificial government income via high taxes. Avoiding the temptation to overspend during periods of expansion reduces the risk of economic slowdown, as times of affluence are anything but dependable. The report shows that during the 9-11 recession, it was actually the states that cut taxes to stimulate their economies that were hit the least by the national slowdown.

The states are feeling the heat once again, as nearly 30 states now project budget deficits for fiscal year 2009. In the face of these pressures, the principles of *Rich States, Poor States* become even more important as lawmakers look for strategies to solve budget problems—without increasing taxes.

Jonathan Williams is the Director of the Tax and Fiscal Policy Task Force for the American Legislative Exchange Council (ALEC). A complete version of *Rich States, Poor States* is available at www.alec.org.

E. Occupational Licensing Reform in Arizona

Increasingly, if one wants to work or start a business, one must seek permission from the government, pass arbitrary requirements and pay fees to the state. More than 1,000 occupations are currently regulated by the states and many others are regulated at the municipal and federal levels. Occupational licensing affects a larger portion of the workforce than labor unions or the minimum wage, yet it generally does not receive anywhere near the attention received by these other barriers to work.

In Arizona, there is good news and bad news on the occupational licensing front. The good news is that the state is less heavily regulated than most. According to a recent Reason Foundation study, Arizona requires licenses for 72 occupations, below the national average of 92 and similar to neighboring Colorado (69) and Utah (84). California topped the list with a whopping 177 licensed occupations. The bad news is that Arizona is still overregulated, as evidenced by the licenses required for occupations such as acupuncturist, hunting or fishing guide, landscape architect, manufactured housing salesperson, money transmitter, prearranged funeral salesperson and well driller. There is even government registration for geologists.

To address this problem, State Sen. Pamela Gordon sponsored SB 1502, a bill to reform the state's occupational licensing structure by requiring a sunrise process for all potential new licensing laws. The bill restricts new licensing laws by forcing government to consider the costs of new regulation to consumers, businesses and individuals, rather than just the supposed benefits. In addition, the legislation:

- Requires the state to look for evidence of actual harm to the public;
- Prohibits regulation for the purpose of protecting an interest group from economic competition;
- Requires that any regulation deemed necessary be in the least restrictive manner; and
- Requires that the government evaluate alternatives like private (voluntary) certification before imposing new licensing laws.

S.B. 1502 sailed through the legislature and was signed into law by Governor Janet Napolitano on April 29, 2008. The law's provisions represent

a solid first step in preventing future abuses of economic freedom, but additional measures will have to be taken to roll back the occupational regulations that are already on the books. Nevertheless, it may serve as useful model legislation for other states seeking to curb the growth of their occupational regulations.

Although the issue has largely been ignored for many years, there has recently been talk in other states, such as Florida and California, about implementing occupational licensing reforms as well. While there have only been discussions of reform in these states thus far, the fact that the issue is now starting to gain traction may be an early indicator of increasing attention in statehouses in the years to come.

F. Competitive Bidding for Pharmacy Services in St. Louis County, MO

By David Stokes, Show-Me Institute

In 2003, the Saint Louis County, Missouri Department of Health was having serious financial problems. The health department operated three clinics with a shared pharmacy which maintained standard government hours and provided prescription drugs to increasingly large numbers of Saint Louis County residents. In 2002, the county pharmacy filled 295,000 prescriptions at the three clinics, compared to 178,250 in 1997, an increase in demand that quickly stretched thin the department's budget and resources.

If financial stability was to return to the department, the cost increases had to be brought under control. In a bold move, the Saint Louis County Executive's office decided in the spring of 2003 to ask private companies to bid on providing pharmacy services to Saint Louis County citizens using the county's three health clinics. The results of this competitive bidding process and subsequent privatization effort have lowered costs for taxpayers and improved health care services for patients.

In February 2003, in an effort to control spiraling costs, Saint Louis County negotiated a contract with a local pharmacy company, RPh on the Go USA, Inc., to manage the county pharmacy at John C. Murphy Health Center. The contract was done on an emergency basis for a period of two months while Saint Louis County requested bids on providing pharmacy services to the three clinics. It received two proposals back. Walgreens, the nationwide pharmacy giant and LDI, a local pharmacy benefits firm that contracts with a network of independent pharmacies, both bid for the clinic pharmacy work. Saint Louis County selected Walgreens' bid of $5,923,000 per year to provide pharmacy services to residents needing assistance from the Department of Health clinics.

The results have been significant. Before the pharmacy service was contracted out in mid-2003, the pharmacy budget had increased 180% between 1997 and 2002. After the pharmacy service was contracted out, first to Walgreens and later to LDI, the pharmacy budget declined sixteen% from 2002 to 2007. Over the past 12 years, the overall pharmacy budget has increased 136 percent, with the bulk of that increase coming in 1999 and 2000. During that same period of time, the overall health department budget increased 55 percent. Clearly, the rampant spending growth in the pharmacy division before 2003 was having a significant effect on the budget throughout the health department, taking up resources that could have gone to many other worthwhile programs.

How have the private companies fared in meeting the needs of Saint Louis County residents after taking over pharmacy operations? When the initial contract was up for renewal in August 2004, the County Council held hearings to determine the effectiveness of the program before approving its renewal. Along with the fact that the program had saved money for Saint Louis County taxpayers, then-County Health Department Director Dr. Jacquelynn Meeks stated in the hearing, "Overall services have dramatically improved. Walgreens and Interlock are good partners and have provided good service and good value for the County." Dr. Meeks later said that there had been "Very few complaints since Walgreens had been contracted with for pharmaceutical services." Mr. Mike

Agostino of Walgreens also spoke at the hearing, stating that the key to the cost savings was "the focus on providing generic drugs." He added, "The clinics are better served with prescriptions than in the past," and "… the prescriptions are better controlled and there is less waste."

Walgreens did not just provide the same services to Saint Louis County residents for less money. After contracting out the pharmacy, county residents had access to the numerous and convenient Walgreens locations instead of just one county-operated pharmacy. Most of those locations are open 24 hours—the old county pharmacy was not. Walgreens also instituted a 1-800 phone number for the clinics and patients and provided Saint Louis County with the ability to fill prescriptions in 13 languages. Those increased services and options are a major reason why the Saint Louis County Department of Health told the author that they have "no plans to change the program at this time." The Department has recognized and encouraged changes that are working for the people of Saint Louis County.

Walgreens maintained the contract with Saint Louis County until 2006. In early 2006, the contract was rebid and LDI won, with a low bid of $4,250,000. This bid was significantly lower than both Walgreens' 2003 bid of $5,923,000 and Walgreens' revised 2004 bid of $5,423,000. Under LDI, savings have continued and so has good service. LDI uses a modern system of phone, mail and online ordering of prescription drugs for users of the county clinics. It has as a network of pharmacies involved in the county program to serve the needs of county residents who want to fill their prescriptions in person. Walgreens also accepts the LDI prescription card, so now patients of the county health clinics have more options than ever in filling their prescriptions. Saint Louis County renewed the contract with LDI for 2007 and the ordinance authorizes further renewals for two more years, after which another bid process will be required.

In bipartisan fashion, county government brought significant cost savings, more options and better services for patients who use its pharmacy system. These improvements to citizen service and health care are the direct results of competitive bidding and privatization.

David Stokes is a policy analyst at the Saint Louis-based Show-Me Institute. Stokes' August 2007 Show-Me Institute study, Saint Louis County, Drugs and *Competitive Bidding: A Privatization Success Story*, is available online: www.showmeinstitute.org/publication/id.74/pub_detail.asp

Surface Transportation

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A. Overview: Infrastructure Finance

1. Introduction and Overview

During the past 15 years, the world has witnessed a transformation in how major transportation infrastructure is financed, built and operated. Under the general rubric of public-private partnerships (PPPs) or privatization, private capital has made significant investments in both existing and brand-new airports, highways (and bridges and tunnels), air traffic control systems, ports and some urban and inter-city rail systems. Companies specializing in designing, building, operating and managing such infrastructure have expanded into a global transportation infrastructure industry.

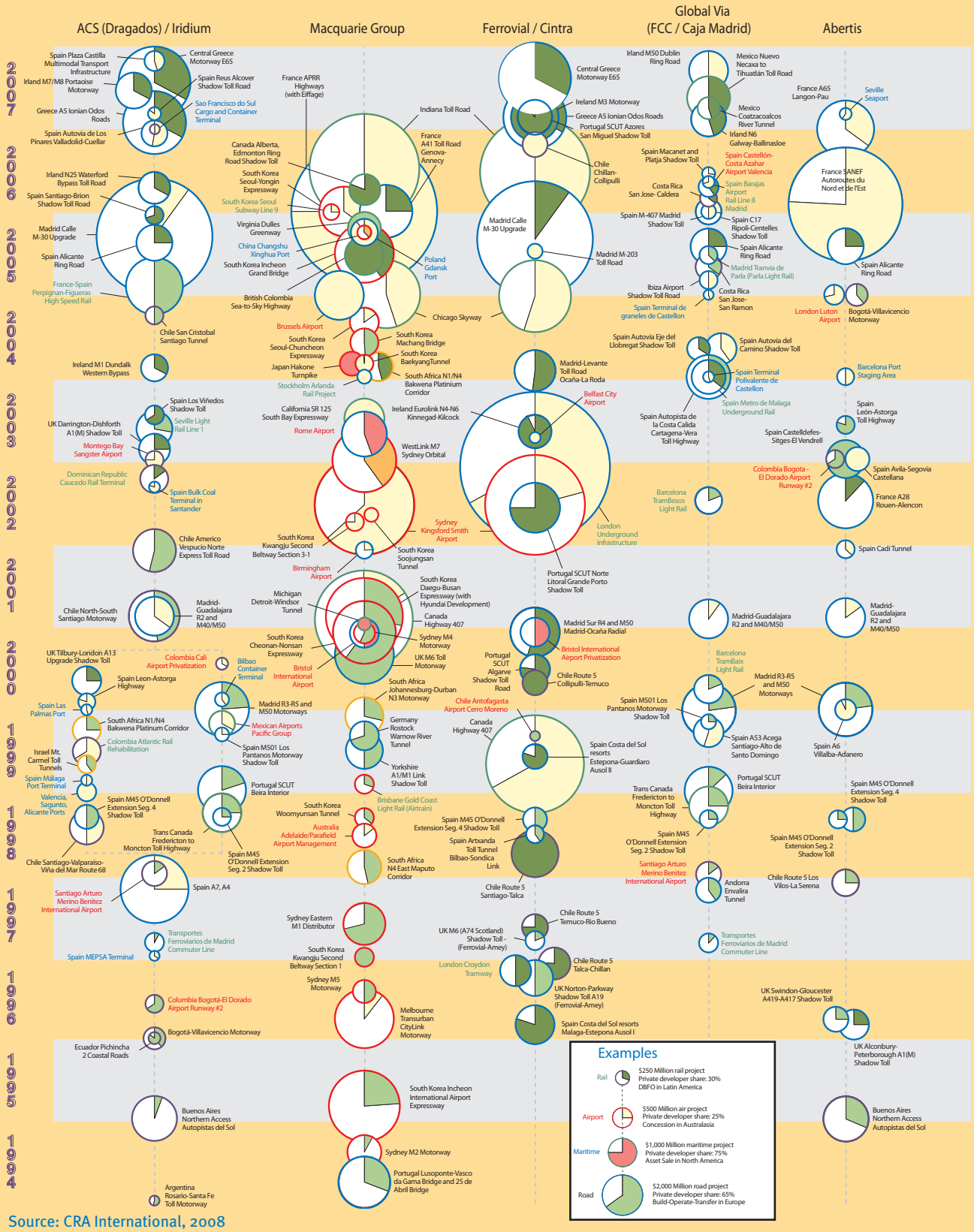
Figure 2 provides a partial overview of significant PPP transactions carried out from 1994 to 2007 worldwide, in transportation infrastructure. This "map" is organized with time on the vertical axis and companies on the horizontal axis (representing 12 of the largest players). CRA International developed the map using the extensive database on PPP infrastructure projects maintained by *Public Works Financing*. The PPP types include outright sale, long-term concession, design-build-finance-operate and joint development (between government and the private sector).

Several trends are made clear by the map. First, transactions have been getting larger over time (as indicated by the area of each circle). Second, most of the activity has been in Europe and Asia/Pacific (e.g., Australia and China, in particular). Third, all 12 major players in the map are non-U.S. firms—from Spain, Australia, Germany, France, the U.K. and China. That is not surprising, in light of government policy in Europe, Australia and the emerging PPP environment of the United States.

2. The Foreign Company Issue

It is important for federal and state policymakers to understand the key role that "foreign" (more accurately, "global") companies are playing in PPP infrastructure. Table 9 lists the world's top 30 transportation PPP companies as of 2007, based on the number of projects they have under construction or in operation and the number of active proposals they have pending. As can be seen, not a single firm in the top 20 is domiciled in the United States. It's only when you reach companies ranked 21 through 30 that three U.S. firms make the list—Bechtel, Fluor and KBR Brown & Root.

Figure 2: Transportation Infrastructure Privatization (1994–2007)



Source: CRA International, 2008

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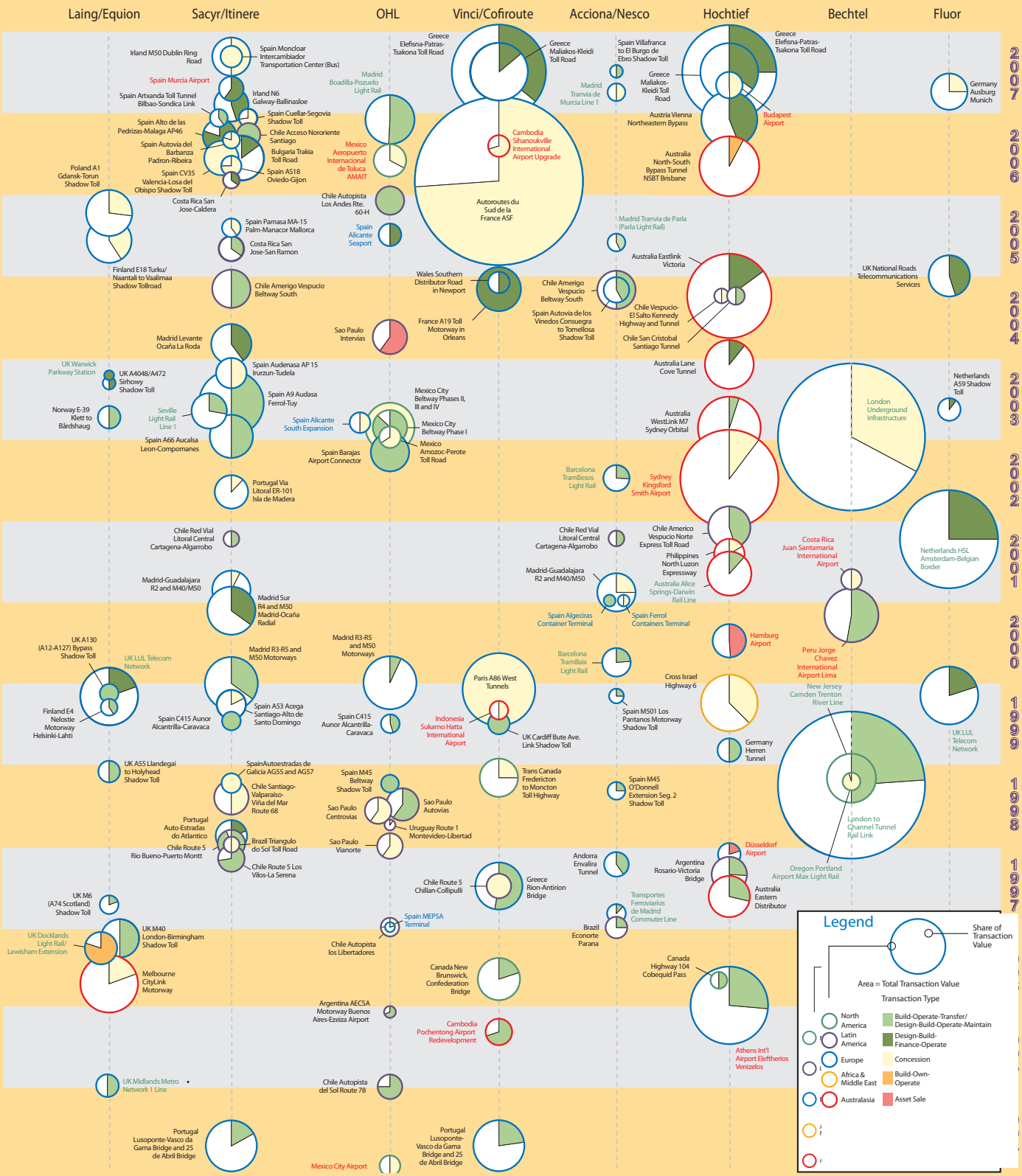

Source: CRA International, 2008

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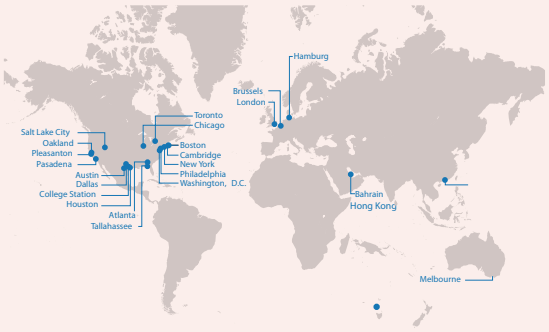

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For more information on the Transportation Infrastructure Privitization Map, please contact:

Steve Grundman, Vice President
Director, Transportation Consulting
(617) 425-3168
sgrundman@crai.com

Jon Bottom, Principal
Transportation Consulting
(617) 425-3392
jbottom@crai.com

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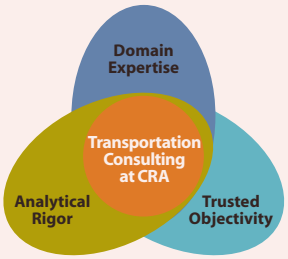

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- Transaction advisory services
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- Cost/benefit analysis
- Economic impact assessment
- Regulatory support and policy analysis

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Much of the expressed concern about foreign companies seems to be based on a misunderstanding of the types of PPP deals that are taking place in the United States. None of the deals that have been completed or proposed involves the outright sale of any airport, road, port or other infrastructure (which might imply the absence of public-sector oversight thereafter). All such deals take the form of long-term leases or other ongoing contractual relationships in which the public sector has a strong oversight/regulatory role to protect the public interest. In a few cases (e.g., the Dulles Greenway), this oversight is carried out by a traditional public utility regulatory agency (the kind that regulates electric utilities, gas utilities, etc.). But in most cases, the oversight is embedded in the long-term contractual agreement, which spells out performance requirements, incentives and penal-

ties and numerous other conditions, including—in the case of toll roads—controls on either toll rates or the rate of return on investment. Given this extensive public-sector oversight, the domicile of the company involved would appear to have little relevance. Far more important is its track record and financial strength.

Two other factors should reduce the "foreign company" issue in coming years: joint ventures with U.S. firms and increasing U.S. investment in PPP project deals. The two largest concession projects for new toll roads financed thus far in the United States—the $1.8 billion Beltway HOT lanes in northern Virginia and $1.3 billion SH 130 (segments 5 and 6) between Austin and San Antonio, Texas—are both joint ventures. The former pairs Fluor (U.S.) and Transurban (Australia), while the latter pairs Cintra (Spain) and Zachry (U.S.). Similar U.S./foreign joint venture teams are showing up in the bidding for other large transportation projects.

Table 9: Top Firms in PPP Transportation Infrastructure, 2007

Company	Country	Projects Under Construction or in Operation	Active Proposals Pending
ACS/Iridium	Spain	59	44
Ferrovial/Cintra	Spain	40	35
Macquarie	Australia	40	17
Sacyr/Vallehermoso	Spain	39	44
Global Via/FCC	Spain	33	11
NWS Holdings	China	25	1
Road King	China	22	0
OHL	Spain	20	45
Hochtief	Germany	18	14
Cheung Kong	China	17	9
Acciona/Necso	Spain	16	36
Vinci/Cofiroute	France	14	21
EGIS Projects	France	14	13
Alstom	France	13	11
John Laing	UK	13	6
Bouygues	France	12	18
Andrade Gutierrez	Brazil	11	12
Bilfinger Berger	Germany	11	10
AMEC	UK	10	2
Balfour Beatty	UK	9	6
Transurban	Australia	8	7
Bechtel	US	8	6
Siemens	Germany	7	7
BRISA	Portugal	7	6
Strabag	Austria	6	11
Skanska	Sweden	6	10
Fluor	US	6	9
KBR Brown & Root	US	6	3
Bombardier	Canada	5	6
Impregilo	Italy	5	5

Source: *Public Works Financing,* October 2007

As for infrastructure investment funds (see below), while no comprehensive data are available on a country-of-origin basis, the strong move of U.S. investment banks, private equity firms and pension funds into "infrastructure" as new asset category suggests that a growing fraction of the funds available for such projects will be domestic in origin—regardless of the nationality of the firms actually building and operating the project. Investors in such funds care about the soundness of their investments—and that means backing the strongest possible project team.

3. Infrastructure Investment Funds

"Infrastructure investing has become an increasing area of focus among institutional investors," reads the opening sentence of "Investing in Infrastructure Funds," a white paper published by Probitas Partners. "The U.S. market in particular is the scene of increased investor interest and great expectations for new investment opportunities," it says and goes on to point out that "For most institutional investors, infrastructure investing remains in a state of flux as it shifts from being a niche sector to become a full-blown, independent asset class."

Probitas provides a useful typology of types of infrastructure projects, reflecting a spectrum of risk/return situations:

- Brownfield projects, existing assets with well-established cash flows, have the lowest return and lowest risk, akin to a long-term bond.

- Rehabilitated Brownfield projects, operating projects in need of immediate capital improvements, are at the midpoint of the risk/return spectrum.
- Greenfield projects, recently financed and built from scratch to be operated over a long period of time, are the highest-risk, but also potentially highest-reward category.

Using this typology, Probitas suggests that Greenfield projects are much like private equity transactions in their start-up phase, but behave more like long-duration fixed-income assets in their operations and maintenance phase. And while Brownfield transactions (such as the long-term leasing of the Chicago Skyway and Indiana Toll Road) have attracted the most attention, Probitas suggests that "Rehabilitated Brownfield and Greenfield projects are likely to exceed Brownfield privatization and concessions in both number and amount of funds employed over time."

Table 10 lists the largest infrastructure funds as of mid-2007. Most of these funds are focused in developed countries, most are sponsored by large financial institutions and many invest across the range of the risk/return spectrum.

Innovation Briefs provided a good overview of infrastructure fund activity as of early 2008. Picking up on a February 2008 statement by Secretary of Transportation Mary Peters that "There's upwards of $400 billion available in the private sector right now for infrastructure investments," the newsletter set out to provide perspective on that number. Reviewing the literature, it provided good evidence that this number is credible. For example, a survey by McKinsey estimates that the world's 20 largest infrastructure funds raised $100 billion in 2006-2007. At the end of 2007, the *Financial Times* estimated the equity capital available for investments in infrastructure at between $50 billion and $150 billion. Innovation Briefs also cites Michael Wilkins, managing director of the European Infrastructure Finance Group of Standard & Poor's, estimating that global capital raised thus far for infrastructure investment is in the $100-150 billion range. A comprehensive listing of infrastructure funds has been developed by Stanford University's Collaboratory for Research on Global Projects. It reports that 72 new infrastructure funds have been launched in 2006-2007, with a combined total of $120 billion.

Thus, the total raised by equity investment funds seems to be in the $100-150 billion range as of mid-2007. That is a global total, not what is available solely to the United States. Although that might sound like it falls far short of Secretary Peters' claim,

Table 10. Largest Infrastructure Funds, as of June 2007

Fund Name	Parent	Amount Raised	Year or Status	Geographic Target
GS Infrastructure Partners I	Goldman Sachs	$6.5 billion	2006	Global
Macquarie European Infrastructure Fund II	Macquarie Bank	E4.6 billion	2006	Europe
Macquarie Infrastructure Partners	Macquarie Bank	$4 billion	2007	North America
Alinda Capital Partners	Alinda Capital Partners	$3 billion	2007	North America
AIG Highstar II	AIG Highstar	$3 billion	In market	Global
Citi Infrasructure Investors	Citigroup Alternative Investments	$3 billion	In market	Developed Markets
Morgan Stanley Infrastructure	Morgan Stanley	$3 billion	In market	Global
RREEF Pan-European Infrastructure Fund	Deutsche-RREEF	E 2 billion	In market	Europe
Abraaj Infrastructure and Growth Capital Fund	Abraaj Capital	$2 billion	In market	Global
Babcock & Brown Infrastructure Fund	Babcock & Brown	$2 billion	In market	North America
Gulf One Infrastructure Fund	Gulf One Bank	$2 billion	In market	Middle East
IDFC Private Equity Fund II	IDFC Private Equity	$2 billion	In market	India
Infracapital Partners	Prudential Plc	L1 billion	In market	Europe

Source: Probitas Partners, "Investing in Infrastructure Funds," September 2007

the point to bear in mind is that this is just equity capital. Infrastructure projects are funded by a mix of debt and equity, with the latter typically accounting for 20-30% of the total. Thus, the global total investment which these funds should make possible ranges from a low of $333 billion to a high of $750 billion. If we arbitrarily estimate that half the global total would be invested in U.S. projects, the high end of that range approaches Peters' number. And these totals are based only on funds in existence as of mid-2007.

4. Pension Funds as Infrastructure Investors

Pension funds are becoming important players in infrastructure finance. Among those investing or planning to invest are corporate pension funds, union pension funds and public employee pension funds. Australian pension funds are credited as the pioneers in this trend, with early investments via Macquarie Bank and others into toll roads and other infrastructure in that country. Two of the largest funds on the Stanford University project's list are Canadian public employee pension fund vehicles. Borealis (which manages infrastructure investment for the Ontario Municipal Employees Retirement System—OMERS) has $10 billion committed and Canada Pension Plan Investment Board $7 billion. In mid-2007, Ontario Teachers Pension Plan teamed with Australia's Victoria Fund Management to purchase 48% of the Birmingham Airport, Britain's fifth largest. And in early 2008, Canada Pension Plan Investment Board made an offer for 40% of Auckland International Airport.

U.S. public employee pension funds are latecomers to this field, but they are now moving in. The giant California Public Employee Retirement System (CalPERS), largest in the nation, allocated an initial $2.5 billion to infrastructure investments late in 2007. Where CalPERS leads, other such pension funds will likely follow.

And such moves will further increase the fraction of private capital that comes from U.S. sources. Reason's *Surface Transportation Innovations* reported in January 2008 that one of the oldest infrastructure funds, Macquarie Infrastructure Group, now has 20% U.S. investors (including Fidelity Investments, Putnam and Blackrock). Its newer fund, Macquarie Infrastructure Partners, has 47% U.S. investors, including the Midwest Operating Engineers Pension Fund and the Mid-Atlantic Carpenters Pension Fund (along with Metropolitan Life Insurance and Northwestern Mutual Life Insurance).

A few public officials have started to ask why U.S. pension funds have not been investing in U.S. infrastructure before now. The answer is simple. Apart from traditional investor-owned utilities (such as electric companies), all major U.S. infrastructure has been owned and operated by government agencies until the new trend of long-term PPPs began recently. Government-owned airports, toll roads and seaports cannot attract equity investments because no one is allowed to own even a portion of them. And with rare exceptions, their all-debt financing is via tax-exempt municipal bonds. Public employee pension funds do not buy tax-exempt bonds, because those pension funds themselves are exempt from taxation and hence do not benefit from the tax-exempt status of the interest payments. By purchasing a tax-exempt bond, such a pension fund would be getting a lower rate of interest than it would from a taxable bond of comparable risk level.

Thus, the important point that is only beginning to dawn on public officials about pension fund investments is this. The only kind of infrastructure investment that makes sense for a pension fund is investment in investor-owned infrastructure. So it is only with the advent of long-term PPP infrastructure projects that the opportunity for pension funds to invest in airports, toll roads, etc. comes into being.

B. National Commission Reports

In the 2005 SAFETEA-LU legislation reauthorizing the federal surface transportation program, Congress created two national commissions to examine the future federal role. The more broadly focused commission addressed policy and revenue issues; a more narrowly focused commission is

dealing with transportation finance issues. The National Surface Transportation Policy & Revenue Commission (www.transportationfortomorrow.org) issued its final report in January 2008. The National Surface Transportation Finance Commission (financecommission.dot.gov), appointed later, issued its interim report in February 2008.

The two reports provide quite a contrast. Both documented the declining performance of our highway system, especially in congested urban areas. And both noted the large and growing gap between what credible reports suggest should be invested in the current highway and transit systems to keep performance from deteriorating even more versus what is being invested now. But after that they diverged sharply. Whereas the Finance Commission's interim report simply laid out a number of possible funding sources and proposed 15 possible criteria against which to measure them, the final report of the majority of the Policy & Revenue Commission would redefine and expand the federal role. In addition to funding highways and transit, the new program would fund eight additional areas, including high-speed rail, freight rail, ports, waterways, energy and environment. The "needs" built into this expanded agenda total $225 billion per year. Based on their stipulation that the federal share of this should be 40%, the majority call for tripling the federal fuel tax. To oversee this enormous program, they call for creation of a central planning body, the National Surface Transportation Commission (NASTRAC).

To be sure, the Policy & Revenue Commission acknowledges that tolling and PPPs can play a larger role in this future transportation program. They even make several specific proposals that would further reduce federal barriers (such as permitting congestion pricing on urban freeway systems in metro areas larger than a million people). But what they give with one hand, they take away with the other. For the first time, there would be federal regulation of PPP agreements entered into between state DOTs and private companies. Toll rate increases would have to be limited to the rate of inflation (regardless of what might be needed for traffic management in congestion pricing projects) and there would be controls on other aspects of concession agreements (such as length of term and non-compete provisions).

Three members of the commission (including the chairman, U.S. Department of Transportation Secretary Mary Peters) disagreed sharply enough with most of the majority's proposals that they wrote a minority report (available at www.dot.gov/affairs/Chairmansstatement.htm). That report rejects the huge increase in fuel taxes (and implicitly the vast expansion of the federal role), while calling for increased use of pricing, toll finance and PPPs. It views as obsolete the current centralized, non-market approach to project selection (by formula, rather than by return on investment) and system management (almost entirely without pricing). How much of this new paradigm the Finance Commission will embrace in its own final report, due by the end of 2008, remains to be seen.

C. New PPP Toll Roads & Toll Lanes

1. New Projects Being Implemented

During 2007 and early 2008, three major long-term concession toll projects reached major milestones. In San Diego, the long-awaited South Bay Expressway opened to traffic in November 2007. The next month saw the financing of the project to add HOT lanes to the Capitol Beltway in northern Virginia. And in March 2008, the first of a number of new PPP toll roads in Texas was financed.

The South Bay Expressway is a 10-mile toll road, SR 125, in the eastern suburbs of San Diego. It was selected as one of several private toll road projects under now-expired California pilot program law from 1989 and faced more than a decade of environmental studies and legal challenges before finally receiving federal and state permission to proceed. At that point, Macquarie purchased the 35-year concession from developer Parsons Brinckerhoff and proceeded to finance and build the toll road, at a cost of some $800 million. It was the first PPP toll road to receive a long-term

loan from the federal TIFIA program, as part of its debt/equity funding structure.

The Beltway HOT lanes resulted from an unsolicited proposal by Fluor Corp., under Virginia's Public-Private Transportation Act. Instead of the unfunded $3 billion plan by Virginia DOT to add two HOV lanes in each direction to the southwest quadrant of the Beltway, Fluor proposed a $1.3 billion plan to add two HOT lanes in each direction instead. The simpler design avoided most of the property takes required by VDOT's plan and was proposed as likely to be self-funding from congestion-priced toll revenues. After several years of design and environmental reviews, along with considerable construction-cost inflation, the final project added more ramps and other connections, boosting its total cost to $1.8 billion. Of that total, VDOT is putting in $400 million and the Fluor/Transurban team has financed its $1.4 billion with a combination of debt and equity. The concession term is 80 years.

The first long-term concession project in Texas (where they are known as Comprehensive Development Agreements or CDAs) was financed at the end of March 2008. It's a $1.3 billion toll road between the outskirts of Austin and the outskirts of San Antonio, a 40-mile southern extension of the new SH 130, which parallels congested I-35. In this case, Texas DOT assessed the project's potential as a traditional public-sector toll road, funded 100% by tax-exempt toll revenue bonds. Based on projected traffic flow, that analysis showed the likely toll revenue able to finance only $600 million, less than half the estimated project cost. Cintra/Zachry proposed doing the project as a CDA and its own analysis concluded that the project could be self-supporting. By the time of financial close, Cintra/Zachry were able to assemble the equity and debt required, provide the state with a modest $25 million upfront fee and provide revenue sharing in the project's out-years during the 50-year concession.

One other large concession project was close to being financed as this was being written: the $914 million Miami Port Tunnel. Unlike the other three, this one is not a toll project. Instead, it is the first major U.S. transportation project to be financed based on what are known as "availability payments." The winning bidder will still design, finance, build, operate and maintain the tunnel, under a 35-year concession. But instead of recouping its investment by collecting toll revenues, the concession agreement provides annual payments over the life of the agreement linked to the company's performance. Fifty percent of the funding is from Florida DOT's budget, with the balance coming from Miami-Dade County and the city of Miami. The twin-tube, three-quarter-mile tunnel will link the Port to the MacArthur Causeway (I-395), thereby keeping trucks off the surface streets of downtown Miami. The winning team of Bouygues and Babcock & Brown was selected in May 2007, but final agreement on the availability payments was not reached until December.

2. Projects in the Bidding Stage

Public Works Financing's 2007 global survey of PPP infrastructure projects identified 71 U.S. PPP highway projects in some stages of being proposed, with an aggregate value of $104 billion. Of those 71, six would use availability payments, with the balance being funded by toll revenues.

Over a dozen of the PPP toll projects were in the RFQ/RFP stage as of early 2008, in five states, with another innovative PPP project in a sixth state. Here is a brief recap.

Florida: The big project in South Florida is FDOT's $1.5 billion plan to expand and modernize east-west expressway I-595, including the addition of reversible express toll lanes. FDOT held a hugely attended bidder's conference in August 2007, followed by an RFQ several months later. Four teams were selected as best-qualified: Babcock & Brown/Bilfinger Berger, ACS-Dragados/Macquarie, OHL/Goldman Sachs/Balfour Beatty and Skanska/John Laing/Fluor. Proposals were due May 27, 2008, with construction beginning in 2009. Because only a portion of the project's cost (the express toll lanes) will generate revenue, the overall project is not self-supporting. FDOT plans

to charge congestion-priced tolls on the express lanes, but the concession company will be paid via availability payments.

The other Florida project is an outer beltway around Jacksonville, of 46 miles in length and including a major bridge over the St. Johns River. Four teams have formed to submit their qualifications for this $2 billion project. As of now, this project will use conventional PPP toll financing.

Georgia: All PPP toll projects are officially under review, due to the retirement of the former Georgia DOT Commissioner and his replacement by Gena Abraham. That leaves three PPP projects which originated as unsolicited proposals —for I-75/I-575 North, Georgia 400 and I-285 West— somewhat on hold. Also on hold is GDOT's planned first solicited PPP toll project, to add managed lanes to I-20 East. An RFQ for that project had been expected in spring 2008, but no date has been announced.

Missouri: Although not a toll project, Missouri DOT is entering into a very innovative long-term contract to repair or rehabilitate 802 deficient bridges in its Safe and Sound Bridge program. The state asked for private-sector proposals in which the winning team would finance the five-year program upfront, with the state repaying them over 25 years (availability payments), using a portion of their federal bridge funds. The cost is estimated at between $400 million and $600 million. The winning team, announced in December 2007, includes Zachry American Infrastructure, Parsons Transportation Group, Fred Weber, Inc., Clarkson Construction, HNTB and Infrastructure Corporation of America.

North Carolina: Several years after creating the North Carolina Toll Authority and giving it permission to do PPP toll road projects, this state seems on the verge of starting the process for its first such project. *Public Works Financing* reports that NCTA expects to issue an RFQ in spring 2008 for developers interested in the proposed Mid-Currituck Bridge. The $400-700 million, seven-mile crossing of Currituck Sound would provide a faster route for tourists going to and from the northern Outer Banks. The project appears unlikely to be self-supporting from toll revenue, so gap-closing funding is being sought from the legislature. NCTA has been studying several other toll projects, including a proposed Triangle Expressway in the Research Triangle area near Raleigh and several others.

Texas: As this is being written, Texas DOT and the North Texas Tollway Authority (NTTA) are still engaged in a long process of trying to agree on the market value of the proposed SH 161 toll road. This is the first test of a provision in a bill enacted in 2007 by the legislature, providing for such a process in cases where either the private sector under a long-term concession (CDA, in Texas) or an existing toll agency could develop a proposed new toll road.

While that exercise proceeds, several other toll projects are at the bidding stage. One leading CDA project is the $1.3 billion project to add managed lanes to the LBJ Freeway (I-635) as part of a massive capacity expansion. Proposals from the short-listed firms are due in June 2008. Due the following month are proposals from the short-listed firms for the $2 billion North Tarrant Express managed lanes north of Ft. Worth. And in March 2008, TxDOT issued an RFP for the DWF Connector managed lanes project. All three of these projects were exempted from a two-year moratorium on CDA projects enacted by the legislature in 2007.

In the greater Houston area, two private teams have submitted unsolicited proposals to develop and operate the 190-mile Grand Parkway, an outer beltway. Zachry American Infrastructure submitted a proposal to Texas DOT, while the team of Williams Brothers Construction and Dannenbaum Engineering submitted their proposal to Harris County.

Virginia: Thus far the leading state in terms of PPP toll projects financed, Virginia has two large projects under development. The first is a companion project to the Beltway HOT lanes, from the same Fluor/Transurban team. It would convert the existing reversible HOV lanes on I-95/395 to HOT lanes and extend them further south, for a total

length of 56 miles. Further studies and negotiations between the developer and VDOT continue, with a final agreement expected sometime in 2008. This project is expected to cost in the vicinity of $1 billion.

The other major Virginia project is a new tunnel and roadway improvement in the Hampton Roads area. VDOT is expected to issue a request for conceptual proposals in the first half of 2008. The basic idea is to toll the two existing tunnels that connect Norfolk and Portsmouth to help finance the new one. The project will also include a freeway extension and a new interchange to link I-264 to the Midtown Tunnel.

3. Innovative Proposals

As the long-term toll concession model becomes more widely known, it is leading to a raft of innovative proposals to reduce highway congestion via the development of large projects that would not have been considered if they had to be funded out of current fuel tax funds. Here is just a sampling of such projects.

Long Island Sound Tunnel: A private developer has proposed a 16-mile toll tunnel beneath Long Island Sound, linking Rt. 135 in Syosset, Long Island with Rye, New York (I-287 and I-95). The idea is to bypass the hugely congested Bronx Whitestone Bridge, permitting much shorter (16 miles vs. 45 miles) and faster trips between Long Island and Westchester County and southern Connecticut. The twin three-lane tunnels are estimated to cost $10 billion.

Seattle Viaduct and Bridge Replacements: Two major components of the Seattle region's freeway system—the Alaskan Way Viaduct along the waterfront and the SR 520 floating bridge across Puget Sound—are obsolete and in urgent need of replacement. The latter is a focal point of the region's successful federal Urban Partnership Agreement, ensuring that it will be funded with tolls. It could be developed as a long-term concession project, since state enabling legislation is on the books. As for the Viaduct, the Cascadia Project of the nonprofit Discovery Institute has proposed replacing it with an "inland bypass deep-bored tunnel" along SR 99. A December 2007 workshop on the concept drew a number of tunneling experts to Seattle, all of whom judged the idea to be feasible.

Maine East-West Toll Road: A $1 billion toll road linking Sherbrook, Quebec to Calais, New Brunswick across the full width of Maine has been proposed by Cianbro Corporation. The 220-mile toll road would be built almost entirely on private land owned by forest-product companies, using largely existing forest road right of way. It would be built to accommodate longer combination vehicles (LCVs) such as twin 53-foot trailers. As currently conceived, partly based on a preliminary feasibility study by Louis Berger Group, it would include intermodal facilities at Costigan, at I-95 and at the Penobscot River.

Honolulu Elevated HOT/BRT-Way: An elevated two- or three-lane reversible managed lane project, open to buses, vans and paying vehicles, has been proposed as an alternative to a $5 billion rail transit line that has been favored by the city government. The $1 billion elevated roadway was compared to the rail line in a detailed simulation project by the University of Hawaii Department of Civil and Environmental Engineering. That study estimated that the HOT/BRT project would reduce congestion on the H-1 freeway by 35%, while offering a fixed guideway for bus rapid transit (BRT) service in addition to toll-paying vehicles.

New York Tappan Zee Bridge Replacement: The New York State DOT is accelerating plans to replace the ailing Tappan Zee Bridge across the Hudson River on I-287. A financing plan is due to be completed by the end of summer 2008. Preliminary cost estimates for the three-mile bridge and related corridor improvements are as high as $8.5 billion, which is beyond the likely financing capability of the New York State Thruway Authority. Hence, there is growing interest in a toll concession approach—assuming the necessary enabling legislation can be enacted.

Detroit-Windsor Bridge: Competing approaches are in play for an additional crossing of the Detroit River between Detroit and Windsor. The two

existing crossings—the Ambassador Bridge and the Detroit-Windsor Tunnel—are both privately owned toll facilities, the former owned outright by the Detroit International Bridge Co. (DIBC) and the latter a toll concession. DIBC is promoting its plan to self-finance a parallel bridge, adding four more lanes to the existing four. But Michigan and Ontario are funding studies of their own new Detroit River International Crossing, a $4 billion project to be built at a new location, since Windsor officials oppose any expansion in the Ambassador Bridge corridor. Whichever alternative prevails, it will almost certainly be toll-financed and very likely privately developed and operated.

California High Desert Corridor: The fast-growing suburbs in the high desert north of Los Angeles have almost no limited-access highways. One of the most promising proposed projects is the 50-mile High Desert Corridor, which would link Palmdale on the west with Victorville on the east, thereby connecting I-15 with SR 14. Los Angeles and San Bernardino County officials have created the High Desert Corridor Joint Powers Authority, which issued an RFP for the project in December 2007. With no identified public funding sources, the project is likely to be toll-financed and quite possibly some form of PPP. Since the route is mostly a freight route, it might even be a candidate for toll truck lanes.

Pennsylvania Toll Concessions: The Pennsylvania Turnpike Commission said (February 2008) that it is planning to request private sector proposals for up to $5 billion worth of PPP toll projects. Two of these would complete the long-stalled Mon Fayette Expressway and Southern Beltway projects in Pittsburgh. The other two would build elevated express toll lanes in Pittsburgh (Parkway East) and Philadelphia (Schuykill Expressway), along the lines of the successful project of this type on the Crosstown Expressway in Tampa, Florida (which began operations in August 2006).

4. HOT/Managed Lanes

In addition to several HOT or Managed Lane projects being done under PPP agreements (discussed previously), there is continued action by state DOTs and other agencies to convert existing HOV lanes to HOT lanes and to add tolled express lanes to existing congested freeways. Some notable projects are the following.

Miami I-95 HOV to HOT Conversion: This $122 million project was one of five winners of the federal Urban Partnership Agreement competition. It is under way, as of early 2008, converting the single HOV lane in each direction on I-95 in Miami-Dade County into two HOT lanes in each direction. This is being done without overall widening of the freeway, thanks to narrowing the width of the general purpose lanes and breakdown lanes. HOV eligibility (for no-charge use of the lanes) is being changed from HOV-2 to HOV-3; in addition, only carpools that are pre-registered with the local ride-sharing agency will be permitted to use the lanes without paying. Variable tolling will be used and enhanced express bus services are to be added. Northbound lanes are expected to open in 2008, southbound in 2009. A planned second phase will extend the HOT lanes into Broward County, as far north as the interchange with I-595.

Houston I-10 Katy Freeway Managed Lanes: Construction is nearing completion on a $2.7 billion expansion/reconstruction of the Katy Freeway, including the replacement of a single, reversible HOV lane with four variably tolled managed lanes. The Harris County Toll Road Authority (HCTRA) is funding the managed lanes portion of the project and will operate and manage the lanes. Houston Metro, the transit agency, is guaranteed up to 25% of the capacity of these lanes, for use by its buses and by carpools. Metro will increase occupancy requirements over time as needed, to ensure that level of service (LOS) C conditions prevail, while HCTRA will do its part by increasing toll rates, as needed, to manage traffic flow. The managed lanes are expected to open by fall 2008.

Maryland I-95 Express Lanes: Work is under way to add express toll lanes (ETLs) to the JFK Expressway (I-95) in the Baltimore area. Construction began on the highly congested Section 100 north of Baltimore in 2006 and will be completed

by 2011. Planning studies are under way on Section 200, which if approved would mean nearly 20 miles of ETLs in this corridor.

HOV Conversion on SR 167, Puget Sound Area: Conversion of the existing (one lane per direction) HOV lanes to HOT lanes was completed in spring 2008 and the HOT lanes were opened to traffic. The nine-mile project uses variable tolling to manage traffic flow. The existing HOV-2 occupancy requirement will remain in place during this four-year pilot project.

I-680 HOT Lanes, Alameda: The first HOV to HOT conversion in northern California is expected to begin, after many years of study, in late 2008. Alameda County will convert the 14-mile southbound HOV lane on I-680 (a commuter route from the East Bay to Silicon Valley) to a HOT lane. The current HOV-2 policy will remain in place

I-15 Managed Lanes Expansion, San Diego: Construction is under way to expand the existing eight-mile, two-lane, reversible HOT lane facility on I-15 into a four-lane, 20-mile managed lanes project. The first phase of the expansion is adding eight miles, with later additions scheduled for 2011 and 2012. The project will include a movable barrier, to provide for three lanes in the peak direction and one in the non-peak direction.

5. Enabling Legislation

Some 21 states saw legislative activity regarding transportation PPPs during 2007 and the early months of 2008, though only a small number passed workable PPP toll road enabling legislation. But the pace of activity suggests that some of the other legislatures that debated such legislation will enact some form of it in 2008. Here is a brief recap of significant developments.

Florida made significant revisions to its pre-existing PPP legislation, for the first time authorizing the long-term lease of certain toll roads and bridges (but not the Florida Turnpike itself). The legislation capped long-term concessions at 50 years, but made provision for exceptions.

Maine's two legislative houses approved LD 1790, which allows private sources of funding to be used in the newly created Highway Investment Trust Fund to enable public-private partnerships. The bill was held over until the legislature reconvenes for possible technical corrections.

Mississippi enacted SB 2375, which allows state and local agencies to enter into long-term contracts with the private sector to develop and operate new toll roads and bridges.

Texas legislators engaged in a major battle over the state's far-reaching PPP tolling enabling legislation from 2003. Populist opposition to the Trans-Texas Corridor program combined with turf concerns by the established toll agencies—North Texas Tollway Authority in Dallas/Ft. Worth and Harris County Toll Road Authority in Houston—led to a number of bills that would curtail toll concessions (called CDAs in Texas) and limit the use of tolling. The bill that eventually passed and was signed into law, SB 792, imposed a two-year moratorium on additional CDA projects, while permitting nearly a dozen such projects that were already in some stage of the proposal process to go forward. It called for creation of a study committee, with appointees from the legislature and the governor, to make recommendations for the future of CDAs prior to the next legislative session at the beginning of 2009. It also set up a process that, in effect, gives local toll agencies first dibs on new toll projects within their metro area.

West Virginia legislators enacted the Public-Private Transportation Act in March 2008, permitting new toll roads to be developed by the private sector. Toll road companies consider the bill to be fatally flawed, since it (1) requires that any negotiated PPP deal must subsequently be approved by the legislature, (2) does not permit any use of state highway funds to supplement toll-revenue funding and (3) sunsets after just five years. At press time, the governor had not signed the bill.

As this report was being was written, active efforts were under way to enact PPP enabling legislation in Alabama, Arizona and Tennessee. Other states where legislative activity seems likely in 2008 include California, Hawaii, Kentucky, Missouri, Nevada, Oklahoma and Pennsylvania.

D. Leasing Existing Toll Roads

Using long-term concessions, with either tolls or availability payments as the financing vehicle, is relatively uncontroversial for new capacity (referred to as "greenfield") projects. It is proving to be significantly more controversial when it comes to leases of existing toll roads (referred to as "brownfield" projects). The path-breaking leases of the Chicago Skyway in 2004 and the Indiana Toll Road in 2005 have become negative examples for some important privatization opponents (discussed in the next section).

Less well-known are two other leases of existing toll roads. Both the Northwest Parkway in Colorado and the Southern Connector in South Carolina are relatively new toll roads whose early years traffic and revenue were drastically below projections, putting their sponsors' ability to meet their debt service obligations in question. In both cases, long-term leases by private investors provide a way to rescue these troubled start-up toll roads, making their bondholders whole thanks to the private sector's ability to refinance on a much longer-term basis.

In 2007 the Northwest Parkway Public Highway Authority went out for bids to lease its troubled nine-mile toll road (which continues the Denver beltway from its northern terminus as E-470 westward to US 36). The winning bidder was a joint venture of Portugal's privatized toll road company BRISA and Brazil's CCR. At financial closing in November 2007, the joint venture paid $543 million for a 99-year lease of the toll road. Of the proceeds, the PHA will use $503 million to defease the bonds used to build the Parkway in 2003, with the balance put into escrow, to be paid to the PHA's member governments after BRISA/CCR build the remaining 2.3 miles of the original Parkway plan. BRISA/CCR will pay another $60 million if timely approvals are obtained for a further 15-mile extension to SH 93. The full concession agreement is posted online (www.northwestparkway.org/concession/FinalCLA.pdf).

In Greenville, SC, the Connector 2000 Association is a nonprofit corporation created to issue the tax-exempt toll revenue bonds for the 16-mile Southern Connector, which opened in 2001. Like the Northwest Parkway, its traffic and revenue have been very far below projections. Given the risk of default, the Association held discussions with an unidentified potential investor about a long-term lease in summer 2006. But since those discussions did not lead to agreement, the Association decided to pursue competitive bids. It held a conference for interested parties in October 2007 and issued the RFQ late that year. But after hiring Goldman Sachs as its financial advisor in February 2008, they decided to issue a revised RFQ later in 2008. A revised timetable for responding to the RFQ and for issuance of an RFP, have not yet been released.

In Florida, based on new legislative authority granted by the 2007 revisions to the state's PPP enabling act, the Florida DOT has announced the possible long-term lease of Alligator Alley, the east-west toll road portion of I-75 between the Ft. Lauderdale metro area on the east coast and the Naples area on the west coast. The 78-mile toll road was widened from two lanes to four and brought up to Interstate standards by 1992. One analysis done for FDOT in 2007 suggested that a 50-year lease might yield $500 million, with a fairly aggressive set of toll rate increases during the first decade. An industry forum on the potential lease was held April 24, 2008 in Orlando.

The largest ongoing lease effort is in Pennsylvania. In 2007, Gov. Ed Rendell introduced legislation to permit the state to lease the Pennsylvania Turnpike, with the entire lease payment received up front, to be used for a kind of endowment fund for highway and transit improvements statewide. With public opinion fairly evenly divided, opponents pushed for and achieved passage of an alternative. Act 44 calls for the state to put tolls on I-80 (which parallels the Turnpike, about 50 miles to the north) and to transfer most of the toll revenues to the Turnpike Commission, which would also raise Turnpike tolls to a significant extent. The combined surplus toll revenues would be used for highway and transit purposes statewide.

But the dollars promised by Act 44 depend largely on the ability to transfer the majority of the I-80 toll revenues to the state for general transportation purposes. That is legally questionable, since the only legal way in which I-80 can be tolled is under a federal pilot program that permits such tolling for the purpose of rebuilding an existing Interstate, not for turning it into a general transportation funding source. If the Federal Highway Administration does not consent to this funding transfer, an April 2008 Reason Foundation study estimated that the net present value (NPV) of the 50-year net toll revenues under Act 44 would be just $7.1 billion, far short of the $26.5 billion claimed for Act 44 including I-80 toll revenues.

In April 2008, Gov. Rendell requested formal bids for a 75-year lease of the Turnpike. On May 19th, Rendell announced the selection of the winning bid—the $12.8 billion bid by Spanish toll operator Abertis and Citi Infrastructure Investors. That topped a $12.1 billion second place bid by Goldman Sachs and Transurban. If approved by the state legislature, the deal would become the largest toll road concession in the U.S., over triple the value of the $3.85 billion lease of the Indiana Toll Road in 2006.

A very different alternative was proposed in New Jersey by Gov. Jon Corzine. Rejecting the idea of leasing the state's three toll roads (New Jersey Turnpike, Garden State Parkway and Atlantic City Expressway) to private-sector toll companies, he instead proposed a plan to "monetize" the toll roads. They would be transferred from the existing New Jersey Turnpike Authority to a newly created nonprofit public benefit corporation (tax-exempt under Internal Revenue Code 63-20). That new entity would issue nearly $38 billion in bond issues based on aggressive toll increases over 14 years (followed by annual inflation-indexing). The proceeds would be used not only to defease or pay off the existing toll revenue bonds but also to bail out the state's underfunded pension funds. In effect, the large toll increases would combine tolling with taxation, since the majority of the revenue would be devoted to bailing the state out of its untenable fiscal situation. As of spring 2008, political opposition to Corzine's plan has been strong and it looks unlikely to be enacted.

E. Federal Concerns Over PPP Toll Roads

The proposed federal regulations on PPP toll roads suggested by the Policy and Revenue Commission (discussed previously) reflect political concerns among some congressional leaders and some interest groups. During 2007, the head of the American Trucking Associations (former Gov. Bill Graves) repeatedly attacked toll road "privatization," apparently thinking of the Indiana Toll Road lease as threatening to create a "fragmented" national system in place of the "seamless" vision of the Eisenhower-era Interstate system. Actual written policy statements from ATA were more nuanced, acknowledging a role for PPPs in developing new highway capacity, which is especially important to the trucking industry. But Graves' comments, picked up and amplified by the more populist association of independent trucking owner/operators, received significant news coverage.

That way of looking at PPP toll roads (brownfields bad, greenfields possibly OK if regulated) underlay a series of hearings organized by Rep. Peter DeFazio (D-OR), chairman of the Highways & Transit Subcommittee of the House Transportation & Infrastructure Committee in the spring of 2007. This critical stance also informed a letter sent by DeFazio and T&I Committee chairman James Oberstar (D-MN) in May 2007 to all 50 state governors and DOT heads. That letter warned the states that the kinds of PPP deals they were doing or considering doing might be against the public interest, that they intended for Congress to oversee such state activities to guard against this danger and that they "will work to undo any state PPP agreements that do not fully protect the public interest and the integrity of the national system."

The Oberstar/DeFazio letter produced a strong response, from individual governors of both par-

ties and from the National Governors Association. With varying degrees of politeness, the general thrust of these responses was that the states know what they are doing, which is moving to meet large-scale funding needs that the federal program is not addressing and that regulation from Washington, DC would not be helpful. The subsequent release by Oberstar and DeFazio of a short white paper on toll PPP issues was somewhat toned down from their letter, but did not back off from suggesting federal regulation.

Thus, between the concerns raised by trucking groups, the hearings and written materials from Oberstar and DeFazio and the endorsement of at least some federal regulatory oversight of state PPP deals by the Policy and Revenue Commission, the stage seems set for a battle over these issues when Congress begins work on reauthorizing the federal surface transportation program in 2009.

F. International Toll Road Developments

The long-term concession model, under which the private sector designs, finances, builds, operates and maintains a roadway, bridge or tunnel for a long (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 superhighway 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; and Spain's ENA 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 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.

Some brief highlights of 2007-08 developments in selected countries are provided below. For the sake of brevity, we have simply attempted to cover some of the most notable developments of the past year.

1. Asia-Pacific Toll Roads

Australia: With a nearly complete network of PPP toll roads in operation in Sydney, most recent activity has focused on Melbourne and Brisbane. In Melbourne, the metro area's second major PPP toll road is under construction, the A$3.8 billion EastLink. Winning bidder ConnectEast (a consortium of Macquarie Bank, Thiess and John Holland) raised equity for the project via an initial public offering on the Australian Stock Exchange in 2004. For this project, the state government of Victoria wanted tolls to be as low as possible, consistent with the project being self-supporting from toll revenues. Hence, it requested no upfront concession fee. The resulting tolls will be the lowest in Australia for a private-sector toll road. It is expected to open in mid-2008.

Brisbane is now the focus of considerable PPP toll road activity. Well along in construction are the A$2 billion North South Tunnel and the A$1.9 billion Gateway Bridge and motorway upgrades. In the bidding process is the A$3 billion Airport Link toll road, with four firms short-listed. That 4.2-mile

toll road will be built mostly in tunnels. And the city is also considering a A$1.5 billion Northern Link, which would form an eastern extension of the North South Tunnel, also built mostly as tunnels. Construction would start in 2010.

China: Few Americans realize that over the past two decades, China has added over 33,000 miles of limited-access highway, all funded via tolls. Most of these toll roads have been built by toll road companies, often state-owned companies but increasingly by private companies under long-term concessions. *Public Works Financing* reported in November 2007, for example, that Macquarie International Infrastructure Fund had agreed to buy 90% of South China Highway Development Ltd, a state-owned company that developed the 19-mile Hua Nan Expressway in Guangzhou under a 27-year concession agreement. Major (billion-dollar scale) bridges and tunnels are part of these developments in China.

A number of articles in U.S. media have depicted China's efforts as part of a master plan by the national government. Tollroadsnews.com has reported that the vast majority of toll roads are actually being sponsored by provincial and local governments. A February 2008 report from the National Audit Office surveyed about two-thirds of the toll roads in China, estimating their total length (including tolled arterials) at 82,700 miles. What the audit report termed "illegal" toll revenues (from unauthorized toll projects or amounts in excess of legal rates) totaled $3.1 billion in the year audited, 2005.

India: As in China, India's booming economy is stimulating a major expansion and upgrade of the country's highway system, much of which is being done via long-term toll concessions. As of 2007, the country had just 3,700 miles of expressways, about 10% of China's total. The National Highways Authority of India expects to authorize 175 concession toll projects, encompassing over 11,000 miles, valued at about $27 billion. That is about half of NHAI's total plan for $53.5 billion in highway investment between 2007 and 2015. One interesting aspect of the concession program, announced by NHAI in early 2008, is that revenue-sharing over the life of the concession term will replace upfront payments for at least a portion of the toll roads.

2. Latin American Toll Roads

Brazil: The continent's largest country is also the leading practitioner of toll concessions, with both federal and state governments authorizing such projects. In October 2007, the federal government auctioned seven 25-year concessions for 1,600 miles of new highways, reportedly worth up to $9 billion. Spanish company OHL won five of the seven, with one going to Spain's Acciona and the other to a local consortium. The state of Sao Paulo plans to follow suit in 2008, offering a 30-year concession to convert and upgrade a 38-mile loop around the western side of the metro area, to become part of an overall 114-mile ring road. Besides paying for the upgrade, the winner must pay a $1.3 billion concession fee. Sao Paulo state will also auction concessions for upgrading two inter-city highways to toll roads.

Chile: In early 2008 Chile was enacting revisions to its generally successful concessions law (which applies to all infrastructure, not just toll roads). The revisions clarify new arbitration rules and add new provisions covering defaults by concession companies. Final legislative approval will clear the way for $2 billion worth of additional toll road projects, including a 30-year concession for the seven-mile remaining portion of the Santiago ring road and a 30-year concession for a 56-mile toll road between Coronel and Tres Pinos. The Santiago metro area has nearly 100 miles of privately developed toll roads, operating with a cashless toll system that is fully interoperable among the four toll companies.

Mexico: The federal government continues the program it began in 2007 of auctioning off various toll roads that it took over from a failed private toll road effort from the early 1990s. The first batch was sold for $4.1 billion in October 2007 to a team of Mexico's ICA and Goldman Sachs. A second batch of three toll roads (totaling 312

miles) was put up for bid in February 2008, with an estimated value of $2.5 billion. Those roads are in the northwestern states, including Baja California. A third batch, constituting another 438 miles, will be offered later in the year in northeastern Mexico. Mexico is also continuing to invite proposals for selected new toll road projects.

3. European Toll Roads

Britain: Although it has used toll concessions for several important bridges, Britain has only one concessioned toll road, the M6Toll near Birmingham. But it has developed a sizeable investor-owned road industry thanks to its policy of offering concessions to upgrade existing motorways using availability payments. In 2007, the Highways Agency proceeded with its largest such project, a 30-year upgrade of the M25 London ring road., valued at $10.5 billion. It calls for widening 63 miles of this highly congested motorway. Three teams were short-listed and submitted bids in November 2007: Amey/Laing/Ferrovial Agroman, Balfour Beatty/Skanska/Atkins/Egis Projects and Vinci/John Laing/Costain/Carrilion. Also in Britain, a new toll tunnel concession project was financed in December 2007. The project, won by Bouygues/HSBC/Bank of Scotland, will develop and operate a second tunnel under the Tyne River, at a cost of $515 million.

France: Two French toll tunnel projects are in the news. The double-deck road tunnel in central Marseilles (converted from a former rail tunnel), will be extended by about one mile under a $290 million, 46-year concession agreement. The original conversion was carried out by a joint venture of Vinci and Eiffage under a 25-year concession, in 1993. The same team will carry out the expansion, under the revised concession agreement. And the $2 billion A86West toll tunnel, being developed by Cofiroute under a 70-year concession, is set to open to traffic in 2009, as construction nears completion. This project closes a three-decade gap in the A86 Paris ring road. Cofiroute overcame decades of opposition from Versailles by proposing to build the missing link as a deep-bore tunnel rather than on the surface.

Ireland: Unlike the U.K., the Irish Republic is going mostly with toll concessions, though since some of the projects will not be self-supporting from toll revenues, some of the projects receive state aid. In summer 2007, the National Roads Authority achieved financial closing for the 30-year, $488 million concession of the M7/M8 Portlaoise toll highway. The winning bidder is a consortium of BAM PPP (Netherlands)/Nacional Toll Roads (Ireland) and Iridium (Spain). Earlier in 2007, financial closing was also achieved for the $400 million N6 Galway to Ballinasloe toll motorway, by a joint venture of FCC/Itinere/Hegarty.

Portugal: Spain's neighbor is in a period of transition. Along with Spain, Portugal began its motorway system using toll concessions, mostly with state-owned toll companies that would eventually be privatized (as was BRISA, in 1999). In the 1990s it shifted primarily to design-build-finance-operate (DBFO) concessions, using shadow tolls. But in 2006, the government concluded that the liabilities created by 30-year shadow toll payment commitments were unaffordable. It began negotiating with concession companies to introduce electronic toll collection as a way of phasing out shadow tolling.

But since then government policy seems to have shifted again. In 2007 the government did go out to bid for several toll concession projects, including the 51-mile Porto orbital toll road and the 3.7-mile Tunel de Marao. The latter will include both tolls and availability payments. But in early 2008, the government offered four DBFO concession projects, to be funded with shadow tolls plus availability payments—but no tolls. In addition, in late 2007 the government announced that it would convert Estradas de Portugal, the state highway regulator, into a government company with a 90-year concession to operate the whole highway network. EDPSA will have the power to toll existing roads and to offer concessions to private companies under toll-sharing deals. It remains to be seen how this new model will fit all the pieces together.

4. Eastern and Central European Toll Roads

Poland: This country has embarked on what World Highways calls the biggest highway project in Europe—the A1 Autostrada, a major north-south route linking the port city of Gdansk with southern Poland and linking into the 364-mile Trans-European Transport route linking Norway and Finland with Poland, Slovakia, Hungary, Serbia, Macedonia and Greece. The $1 billion northernmost first phase is being developed under a 30-year toll concession by Gdansk Transport Company, a joint venture of Skanska/NDI/Laing Roads/Intertoll. As of early 2008, GTC was engaged in litigation with the government over its right to develop the second phase. This second phase will be funded by a mix of real and shadow tolls, due to lower traffic potential. Bidding is under way in early 2008 for another 112-mile section of the A1 and for a 59-mile section of the planned A2. Both of these projects are expected to be financed primarily based on real tolls, with supplemental support (as needed) from shadow tolls. Hence, bidding will be based significantly on how little shadow-toll support each bidder requires.

Russia: Transportation consulting firms have been hard at work in Russia during the past two years, doing feasibility studies on several new toll roads that could be developed as long-term concessions. The three leading projects are a 29-mile missing link in the beltway around St. Petersburg, the 400-mile M10 motorway between St. Petersburg and Moscow and another toll motorway between Moscow and Minsk.

Early in 2007, *Public Works Financing* reported that four international teams had been pre-qualified for the $2-3 billion Western High-Speed Diameter project in St. Petersburg, but by year-end no RFP had been issued. Teams were short-listed for the initial stages of the other two projects during 2007 and by early 2008, the national transportation ministry announced that final proposals will be due by June 2008. The two projects are a 27-mile eastern end of the route to St. Petersburg (estimated at $2.3 billion) and a 19-mile section of the road to Minsk (estimated at $612 million).

G. PPPs Give Leg Up to Global Competitors

Transportation investments rank among the most important a nation can make when it comes to economic competitiveness. While it doesn't get the glam and press of tech giants like Google, Microsoft, Apple, Sony, Infosys or Wipro, all of these companies depend on a well-oiled and smoothly functioning network of rails, roads and runways to keep their businesses growing, their international locations commercially connected, and their economies humming.

In some cases, the importance of transportation infrastructure is obvious. India-based Tata Consulting Service figures that Mumbai's economic growth was slashed from 7 percent to 2.4 percent between 1994 and 2002 because of the terrible shape of its roads and highway network. The Bangalore Chamber of Industry and Commerce even threatened to boycott a major technology conference in the heart of India's Silicon Valley unless local authorities made a commitment to shoring up the city's lagging infrastructure. Fortunately, they stepped up the plate and began upgrading their infrastructure.

Further off the radar screen is how the crumbling infrastructure in Western nations threatens the economic health of their cities. Researchers at the University of Paris, the Imperial College in London and the University of California-Berkeley (among others) are finding that increases in travel speeds of just 5 percent can yield significant productivity gains. Researchers at the University of North Carolina-Charlotte estimate that improving traffic flows to free flow levels could generate tens of billions of dollars in new economic growth in cities such as Dallas and Denver, simply by expanding access to labor and destinations that improve productivity.

The 800-pound gorilla in the room, however, is finance. That's where the private sector is stepping in. In 2000, private infrastructure funds amounted to just under $40 billion per year according to Standard & Poor's. By 2006, the addition of private equity boosted these deals to more than $100 billion. Now,

private equity is capable of leveraging $525 billion in investment capacity worldwide. These funds are simply looking for the right places to invest.

Some countries are in a better position than others to take advantage of private equity through long-term concessions and other forms of public-private partnerships. France, for example, has virtually its entire interstate highway system under the management of privately owned firms, including Cofiroute, Autoroutes du Sud de la France (ASF), Autoroutes Paris-Rhine-Rhone (APRR) and Sanef. Australia has been tapping into private capital using companies such as Macquarie and Transurban to build tunnels and tollroads in its major cities since the 1990s. Overall, Italy and the United Kingdom claimed nearly half of the private investment in public infrastructure in OECD nations between 2003 and 2006 according to Standard & Poor's.

China, however, may be emerging the world's leader in using private capital to build its transportation infrastructure. The nation is embarking on an epic road building program that will match the size of the U.S. Interstate Highway System by 2020 and be completed in less than half the time. The expressway network is intended to link all provincial capitals, 80 percent of the national population and 90 percent of the nation's ports, according to a report prepared by the China Construction Bank Corporation (CCBC). Most of these expressways are financed by tolls and the tollway companies depend on private capital, including substantial investment from Western infrastructure funds, to finance the new roads.

The attraction of infrastructure funds is pretty straightforward. CCBC reports that the return on equity for five expressway authorities ranged from 8.4 percent to 17.1 percent in 2008 alone. A rule of thumb is that infrastructure funds can reliably deliver 10–12 percent annual returns.

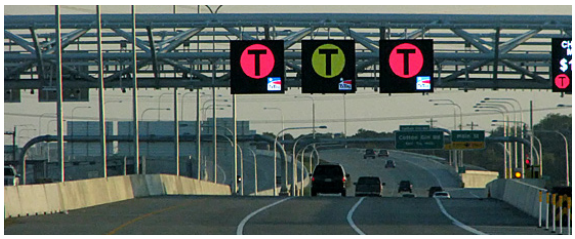
Unfortunately, the U.S. has been slow to tap into this market. Just a handful of projects have closed in the U.S. for a fraction of the amount of capital available on the global market. The Indiana Toll Road remains the largest long-term concession at $3.8 billion and it was for an existing road. The Chicago Skyway attracted a bid of $1.8 billion, another brownfield (existing) facility and the nation's second largest project.

In a good sign, three greenfield (new) toll road deals have been signed recently: California's State Route 125 South Bay Expressway ($800 million), State Highway 130 segments five and six in Texas ($1.3 billion) and the Capital Beltway HOT Lanes (about $1.4 billion in private capital).

Also, a consortium of domestic and foreign companies submitted a bid to lease the Pennsylvania Turnpike for $12.8 billion. While the bid is still making its way through Pennsylvania politics, the strong support of Governor Ed Rendell is a good sign.

While promising, the U.S. market appears to be limited in the short term, largely for political reasons. In the immediate aftermath of the Indiana and Chicago partnership deals, Congressmen James Oberstar (D-MN) and Peter DeFazio (D-OR) sent a letter to governors and state highway officials warning them that the U.S. House Committee on Transportation and Infrastructure would "work to undo any state PPP agreements that do not fully protect the public interest and the integrity of the national system." A strong response from state officials, including public objections from Texas Governor Rick Perry and Indiana Governor Mitch Daniels, quelled some of the protest from Capital Hill and the short-term momentum to rein in PPP projects.

Nevertheless, proponents of public private partnerships were put on notice that the Congress might become active in discouraging the further use of private capital in highway and transportation projects. Combined with further local backlash in Texas and Indiana, global investors may have little choice but to invest their billions in fruitful but less lucrative projects abroad.



Air Transportation

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A. Airport Privatization

1. The Growing Airport Industry

The likely privatization (via a 50-year lease) of Chicago's Midway airport will bring U.S. policy-makers, regulators and airport operators face-to-face with the reality that over the past two decades, much of the world has shifted from government-run to industry-run air-carrier airports. The global airport privatization trend began with the U.K. government's initial public offering of 100% of the shares in what was then called the British Airports Authority in 1987. Since that time, the major airports in Argentina, Australia, Mexico, much of Europe and even South Africa have been privatized, either via share offerings (Europe), sale of major interests to a strategic investor (Mexico, parts of Europe), build-operate-transfer concessions (Latin America) or long-term leases (Australia). The United States is a latecomer to this trend.

Americans coming face-to-face with airport privatization for the first time may be surprised to learn that there is a large, thriving global airport industry with access to global capital markets to finance acquisition and modernization of airports. Table 11 provides a brief overview of some of the major players.

As is the case with investor-owned toll roads, the previous lack of a market in the United States (for anything other than short-term management contracts) means that the existing airport industry is headquartered in Spain, Germany, France and Australia. Thus, in the early days of U.S. airport privatization, the major operating companies in consortia bidding for long-term leases will very likely be non-U.S.-based companies. On the other hand, the financial partners in such consortia are increasingly likely to include U.S.-based infrastructure investment funds.

2. European Airports

Much of the European airport privatization activity in 2007 focused on BAA, which was acquired by Ferrovial in 2006. The new owner began the process of narrowing the company's near-term geographic focus to the U.K. base. In May 2007, it sold its 75% stake in Budapest's Ferihegy Airport to Hochtief AirPort for $2.7 billion. Much of the year was taken up with U.K. government review of the price-cap regime under which the BAA London airports operate, with the company having asked for significant annual air-side fee increases in order to shore up its finances as it opened the long-awaited Terminal 5 at Heathrow in March 2008 and began planning for a third runway there, along with a second runway and new terminal at Stansted. The Civil Aviation Authority came through with a revised price-cap formula for

Table 11. Major Global Airport Companies					
Name	Country	Revenue ($M)	Own or Long Term Concession	Partial Stakes	Management Contracts
Ferrovial/BAA	Spain	$5,200	Heathrow, Gatwick, Stansted, Belfast City, Edinburgh, Glasgow		Naples, Darwin, Melbourne, Perth
AENA (state-owned)	Spain	$3,300	Madrid, Barcelona, 45 others in Spain	Barranquilla, Cali, Cartagena, GAP (Mexico)	
Fraport	Germany	$2,800	Frankfurt. Lima	Antalya, Brisbane, Delhi, Frankfurt-Hahn, Hanover, Xi'an	
Aeroports de Paris (partly state-owned)	France	$2,600	Paris DeGaulle and Orly	Beijing Capital, Phnom Penh	
Macquarie Airports	Australia	$1,100	Bristol, Brussels, Copenhagen, Sydney		
Abertis/ACDL/TBI	Spain	$354	Belfast, Cochabamba, Cardiff, La Paz	Luton, Orlando-Sanford, Santa Cruz, Skavsta	Albany, Burbank, Toronto City Center, White Plains
Hochtief AirPort	Germany	$351	Budapest	Athens, Dusseldorf, Hamburg, Sydney	Tirana

Source: "Global Airport Groupings," Airline Business, December 2007, Reason Foundation files.

the next five years, which though somewhat less than BAA had wanted, still provoked significant protests by the airlines. Based on this new formula, Ferrovial proceeded with plans to refinance its BAA acquisition debt, hoping to complete the process by June 2008.

But in parallel with the CAA's deliberations in 2007, the U.K. Competition Commission began a serious review of BAA's near-monopoly of London-area airports, thanks to its ownership of the three largest airports (Heathrow, Gatwick and Stansted). There is increasing speculation that the Commission will recommend, on competition grounds, that Ferrovial/BAA sell one of these airports; its report is due in August 2008. Major airlines have been supportive of such a divestiture, due to concerns about increased airport charges as well as what they see as BAA's failure to cope adequately with increased U.K. airport security requirements.

In Germany, privatized Fraport received government permission to add a fourth runway and a third passenger terminal at its largest airport, Frankfurt. In exchange, the company accepted new limits on night flights. In March 2008, however, the airport's largest carrier, Lufthansa, filed a legal appeal against those restrictions.

The Czech Republic retained Credit Suisse to advise and assist it in privatizing Prague's Ruzyne International Airport. No official estimates have been released on the airport's potential value, but media reports have put the figure at over $5 billion. The government plans to use the proceeds for other infrastructure investment, primarily highways.

In Italy, Macquarie Airports sold its 45% stake in Rome's Aeroporti di Roma SpA (AdR). The winning bidder was Italian firm Gemina SpA, which paid $1.7 billion. Macquarie acquired the stake in 2003 for $657 million. Gemina previously held 51% of AdR. The airport company's future is somewhat clouded by the bankruptcy and possible privatization or liquidation of its largest carrier, Alitalia. Nevertheless, in December 2007 Standard & Poor's renewed its BBB-/A3 long- and short-term credit ratings on the airport company.

The Walloon regional government in January 2008 announced plans to sell 27% of Belgium's second airport, Charleroi, to a private partner. The Athens International Airport (AIA), developed as a public-private venture by Hochtief and the Greek government in 2001, announced in April 2007 its first profit. In 2005 the government announced postponement of a planned share offering in AIA and no new target date has been set. Finally, in February 2007, the newly elected Dutch government called off a long-planned sale of just under 50% of airport operator Schiphol Group. The

main objector was the Amsterdam city government, which holds 21.8%.

3. Latin American Airports

Argentina was the first country in South America to privatize its airports. In 1998, it leased the country's 32 largest airports to local consortium Aeropuertos Argentina 2000 for 30 years. It has been a contentious privatization, with airlines raising concerns about the transparency of the original process and making ongoing complaints over the high level of airport charges. The International Air Transport Association (IATA) took the government to court over a planned revision of the concession agreement at the beginning of 2007. By year's end, a compromise was reached. It retains the 30-year term, changes the fees paid by AA 2000 from fixed to variable and converts a sum owed to the government by AA 2000 into a 15% government equity stake in the company. The company has also committed to billions of dollars in new airport investments without increasing airport charges.

Brazilian airport operator Infraero may be headed for privatization in 2008, according to both *Aviation Daily* and *Airport Investor Monthly*. The operator of 67 airports, Infraero was considered a privatization candidate as early as 1999, when Argentina and Mexico were first privatizing their airports. But subsequent governments lost interest in the idea. In recent years, the Lula government has carried out some limited privatization experiments at smaller airports and in summer 2007 rumors had it that up to 49% of the shares in Infraero would be offered to investors. President Lula mentioned the idea to reporters in March 2008, saying that the proceeds would go toward construction of new airports.

The long-term concession, under which Bolivia's three major airports (La Paz, Cochabamba and Santa Cruz) have been operated for the past decade, is under threat from the leftist "Bolivarian" government, which announced in mid-2006 that it planned to regain control of the airports. But as of early 2008, concessionaire SABSA (owned by AENA) was still in place, having invested $20 million per year in upgrading the airports and planning to invest $33 million more through 2012.

In 2006 five consortia competed for a 20-year concession to expand and modernize Bogota's Eldorado Airport in Colombia. The winner was Opain, a Colombian/Swiss consortium which offered 46.2% of gross airport revenues to the government as its concession fee. Opain took over the airport in January 2007, only to fall into an ongoing controversy within the government over whether the old terminal should be refurbished or replaced. By March 2008 the dispute was resolved in favor of a completely new terminal, to be opened by 2012. Meanwhile, the government awarded a 25-year concession to manage and upgrade six airports in western Colombia to a consortium of six domestic firms and one Chinese company.

Mexico's airport privatization continues to be a success, with all three privatized operators—GAP, OMA and ASUR—reporting large traffic gains in 2007, thanks to booming competition from a raft of new low-cost carriers. OMA manages 13 airports in central and northern Mexico, ASUR manages nine airports in the southeast and GAP manages 12 Pacific region airports. Mexico City, where a brand new airport is being planned to replace the congested existing one, has the only major airport not yet privatized.

The main airport news in Peru in 2007 was the purchase by Fraport of all remaining shares in Lima's Jorge Chavez International Airport, increasing its stake from 42.7% to 100%. The original Lima Airport Partners consortium, which acquired the airport in 2001, included Bechtel with 42.7% and local firm Cosapi with the balance. Bechtel acquired Cosapi's stake in 2002, but with its 2007 decision to exit the airport business, it was happy to sell out to Fraport. LAP has invested over $200 million in the airport thus far. In turn, Fraport says it plans to sell up to 40% of the shares, leaving it with solid majority control.

4. Asia/Pacific Airports

Australia and New Zealand provide a study in contrasts from 2007. Both privatized their

airports in the late 1990s, Australia via 99-year leases (auctioned competitively) and New Zealand by selling large stakes to investors. Both countries put in place "light-handed" regulation, in which the government did not control rates or set performance targets, but basically let the airports' behavior be subject to ordinary competition laws (known as antitrust laws in the United States). The airports in both countries have been modernized and expanded, but airlines have often complained about increases in fees that they considered too high.

In 2007, intense lobbying by Air New Zealand led to some degree of direct government supervision of airport rates and charges. But shortly after the new regime was announced, Air New Zealand filed legal action against proposed runway fee increases planned by Wellington International Airport Ltd. to pay for a $31 million expansion of its international terminal. The government also vetoed a proposed purchase by the Canada Pension Plan Investment Fund of a 40% stake in Auckland International. The government acted under new rules concerning foreign investment in infrastructure under which the investment must be shown to benefit the country according to a list of criteria, as opposed to merely having to show that it would produce no adverse effects.

By contrast, things seemed to go far more smoothly under the light-handed approach in Australia. The two largest airports, Sydney and Melbourne, each reached new deals with their airlines on rates and charges. Melbourne's is linked to the consumer price index for the first of five years, with no increases during the remaining four years. Sydney worked out a long-term agreement, which airport CEO Russell Balding described as "a commercial outcome that involved commercial negotiation," resulting in a "partnership going forward." Details were not disclosed.

Japan announced plans to privatize its major airports in 2004, but aside from corporatizing Tokyo's Narita, no further actions have been taken. But late in 2007, Australia's Macquarie Airports purchased a 19.9% stake in Tokyo's other airport, Haneda. That led to concerns over foreign investment in infrastructure and the introduction, in February 2008, of a bill to bar foreign companies from owning more than one-third of either Haneda or Narita. The bill was drafted by the transportation ministry, which expected it to pass without much fuss. But objections from within the ruling Liberal Democratic Party have, as of this writing, put the bill on hold. Senior lawmakers were quoted in the *Financial Times* and the *Wall Street Journal* to the effect that enactment of such a law would run counter to the government's efforts to encourage foreign investment.

As part of China's major emphasis on expanded transportation infrastructure, its government has been allowing outside investment in airports for a number of years. One of the first investors, Aeroports de Paris, in 2007 announced that it plans to sell its 35% stake in Beijing Capital International Airport Co. Ltd. But while AdP was moving out, other companies were moving in. For example, Fraport purchased a 24.5% stake in Xi'an Airport, one of the few already 100% privately owned airports in China. Fraport will take responsibility for airport operations and commercial development; it is the company's first significant investment in China. State-owned, but commercially run, Changi Airports International of Singapore purchased a 21% stake in Nanjing Airport in December 2007. The only U.S. involvement in Chinese airports is by the Houston Airport System Development Corporation, the commercial subsidiary of the Houston Airport System. It is pursuing airport management contracts in China, as well as in India and Latin America.

India is in the midst of an air-travel revolution, with deregulation having unleashed serious competition from a number of start-up, low-fare carriers. The result is highly stressed airport infrastructure. Until recently, all airports were developed and operated by the government's Airports Authority of India (AAI), a large bureaucracy. Unlike airports in developed countries, where non-aeronautical revenue may comprise half or more of the total, such revenue is virtually non-existent for AAI. To

cope with surging demand, the government several years ago finally allowed the beginnings of airport privatization.

Over left-wing and union opposition, it first permitted build-operate-transfer concessions for the development of replacement airports for fast-growing Bangalore and Hyderabad, based on the success of the privately developed $100 million Cochin International Airport, built in the 1990s and making a 35% profit margin. The larger Bangalore ($300 million) and Hyderabad ($600 million) airports are both opening in the spring of 2008. The only hitch is that now the government is having second thoughts about closing the old airports in each city as originally agreed, which may require increasing the length of the new airports' concession terms to compensate.

The government's second prong was competitive procurements for long-term concession deals to upgrade and modernize the major airports of Delhi and Mumbai. Both are joint ventures between the winning consortium and AAI, on a 74%/26% shareholding basis. But revenues are to be shared 54%/46%. Both expansion projects (of $2.2 billion and $1.3 billion, respectively) are under way, though plagued by strikes and protests.

5. U.S. Airports

Although Congress enacted an Airport Privatization Pilot Program law in 1996, only New York's Stewart Airport was privatized under its terms, at least until 2008. But that appears likely to change, as Chicago moves forward with a 50-year lease of Midway Airport. Under the terms of the pilot program, a city or state wishing to lease its airport and make use of the proceeds for non-airport purposes must obtain the consent of a super-majority of airlines using the airport. Thus, after filing a preliminary application with the Federal Aviation Administration in 2006, Chicago officials spent most of 2007 negotiating with Midway's largest airline, Southwest and then the other airlines, to work out the basic provisions of a lease deal they could approve.

By early 2008 those agreements had been reached. Under the terms of the deal, the airlines would get guaranteed rates and charges for at least the first 25 years of the lease, indexed to the rate of inflation. That replaces the current "residual cost" lease under which the airlines collectively were responsible for the difference between each year's total airport costs and the total of all non-airline revenue—which looked increasingly risky in today's turbulent airline environment. The airlines would also retain some of their traditional veto power over capital projects to be funded by airline charges, but would have no control over projects funded by non-airline revenue.

In response to the city's February 2008 Request for Qualifications, it received serious responses from six consortia; five included prominent global airport companies teamed with mostly domestic financial partners. The sixth was from Carlyle Infrastructure Partners' AirportsAmerica Group, about whose identity Carlyle released no public information. Most likely, the city will next select the three or four teams it judges to be best-qualified and invite them to make formal lease offers. Since the lease agreement has already been drafted, the winning bid will be the one with the highest dollar value. That bid and agreement will then have to be approved by the City Council, the Federal Aviation Administration and the Transportation Security Administration.

If Midway does generate significant value for the city, the lease could be as precedent-setting as the city's January 2005 lease of the Chicago Skyway. That transaction focused global attention on the United States as a new market for privatization of toll roads. But for the same thing to be possible in the airport sector would require Congress to amend the Pilot Program legislation. Although it permits four air carrier airports to be leased, only one can be a large hub, which is how Midway is categorized by the FAA. Nearly all the airports likely to be of interest to airport companies and investors are large hubs of Midway's size or bigger. The FAA's FY 2008 reauthorization proposal, which was largely ignored by Congress last year, had called for liberalizing the Pilot Pro-

gram. It would probably take active lobbying by America's mayors to open up additional large-hub privatization opportunities.

B. U.S. Airport Security

Although the Transportation Security Administration is responsible for all aspects of airport security, it provides only passenger and baggage screening itself, with airport operators and the private sector responsible for providing the other functions under TSA supervision. The two principal private-sector activities are Registered Traveler and Security Screening Partnership. Both programs expanded in 2007.

1. Registered Traveler

The original concept for Registered Traveler (RT) was to enhance security by giving expedited checkpoint screening to passengers who were "precleared" by passing a background check and being issued a biometrically encoded identification card. In this way a member could prove at the checkpoint that he is the same person who had passed the background check. This was intended as part of an overall "risk-based" approach to allocating airport security resources—i.e., relatively more than average resources would be spent on high-risk passengers and relatively less than average on low-risk passengers. But as TSA has implemented RT, members must endure the identical screening at the checkpoint as non-members. The only difference is that they don't have to wait in long lines.

After a several-year pilot program at Orlando by Verified Identity Pass (whose brand is "Clear"), in 2006 the TSA opened the Registered Traveler (RT) program to any company that could meet its standards for security and interoperability and it extended the program to all U.S. airports. Two other companies (Unisys/FLO and Vigilant) entered the field, but by the end of 2007, Clear remained far and away the market leader. As of February 2008, 17 large and medium hub airports had RT in operation, including four New York City-area airports, both Washington, DC airports, all three San Francisco Bay Area airports, Denver and Indianapolis. Atlanta had been expected to select an RT provider early in 2008, but announced it was putting off a decision until at least summer.

Clear investor General Electric developed a shoe scanner intended to be integrated with Clear's RT kiosk (where the biometric check-in takes place), which would permit members to forego having to remove their shoes. But so far the scanner has not been able to pass TSA's certification process. In late 2007, Clear announced a $500,000 Innovation Prize for airport security technology that could speed RT members through security lanes and receive TSA certification.

2. International Registered Traveler

Evidently impressed with the growing appeal of the Registered Traveler program, Congress decided to expand the idea to frequent international travelers arriving at U.S. airports. The FY 2008 omnibus spending bill enacted at the end of 2007 included funding and a mandate for the Customs & Border Protection branch of the Department of Homeland Security to have such a program up and running within two years at the top 20 airports for international arrivals into this country.

The measure was pushed for by the Travel Industry Association and the National Business Travel Association. They pointed to successful programs overseas, in countries such as Australia and the U.K. which provide express-lane entry for frequent travelers who have passed a background check and obtained a biometric identity card. The rationale presented by NBTA and TIA is very much like that used to create the original (domestic) Registered Traveler program overseen by the Transportation Security Administration. Cathy Keefe of TIA said, "Provid[ing] the U.S. government with robust background information on frequent international travelers [would] speed up their entry into the U.S. and allow CPB officers to focus their attention and resources on arriving travelers for which we have less advance information." In other words, it's not just a convenience for frequent flyers, but is also an aid to risk-based security.

That apparently was the genesis of the idea when it was first being considered within DHS. Stewart Vendery was assistant secretary for policy at DHS at the time and is now at NBTA. He told *Aviation Daily* (Jan. 14, 2008), "When I was still at DHS, we were on the cusp of launching a pilot in January 2005 between JFK and Amsterdam. But [Sec. Tom] Ridge left and IRT went into hibernation."

Now international RT is back on the agenda, apparently with its original risk-based focus. That's consistent with other risk-based programs, such as the biometric Nexus access card which pre-clears travelers through U.S.-Canada border crossings. Nexus began at Vancouver International Airport in 2004 and as of early 2008 is up and running at Calgary, Edmonton, Halifax, Montreal, Ottawa, Toronto and Winnipeg airports. And 17 member countries of the Asia-Pacific Economic Cooperation group offer reciprocal privileges for their APEC card, which allows fast-track (and visa-less) airport entry via special APEC lanes at major airports. And as of last year, APEC card-holders with a passport and visa can use the crew lines at U.S. and Canadian international airports to speed their entry into each country.

It appears that CPB practices the risk-based approach to allocating security resources, while the TSA only talks about doing so. As noted previously, domestic Registered Traveler was supposed to focus less screening attention on pre-cleared members, allowing them not merely to have shorter waits in line but also not to have to remove shoes and jackets and unpack their laptops. If DHS permits CBP to implement a risk-based International RT, perhaps it will pressure TSA to return domestic RT to its original risk-based concept.

3. Screening Opt-Out

The little-noticed TSA program under which airports may opt out of TSA-provided passenger and baggage screening—the Security Screening Partnership—expanded modestly in 2007. Early in the year, TSA approved the application of Monroe County, Florida to have FirstLine Security take over screening at Key West airport and provide first-ever screening at Marathon airport. Because air service had expanded at Key West over the past several years, TSA had been forced to supplement its regular screener workforce with 15 people from its mobile National Screening Force, who are supposed to be used only to fill temporary shortfalls. And two airlines wanted to start service at Marathon, which had never had TSA screening. FirstLine's proposal offered 41 screeners to serve both airports at the same cost TSA was incurring to serve only Key West.

And at the beginning of 2008, TSA approved another FirstLine contract, this one to provide first-ever screening at the Gallup and Roswell airports in New Mexico. Those airports became the 10th and 11th to participate in the Security Screening Partnership program. Thus far, no airports that have opted for private screeners have switched to TSA screening, but neither have any airports with TSA screening chosen to switch to private providers.

C. Air Traffic Control

1. Global ATC Commercialization

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%, airport company BAA owning 4%, employees owning 5% 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 findings of academic studies were reflected in a global survey carried out on behalf of Air Traffic Management and published in its Fall 2007 issue. The cover story was "Global Leaders: The High Fliers in Air Traffic Control." The survey queried 400 senior aviation people worldwide, asking them to rate not only ATC/avionics suppliers but also the air navigation service providers themselves. The top five ANSPs, in order, were:

1. NATS (U.K.)
2. Nav Canada
3. FAA's Air Traffic Organization (ATO)
4. Airservices Australia
5. DFS (Germany)

Each winning ANSP was given a long profile article, detailing its major accomplishments. Here are very brief excerpts:

- "NATS, winner of our survey as the most respected air navigation service provider in the world, has come a long way since it was privatized by the UK government six years ago. NATS faces unique challenges—the UK remains the only contestable airport market in Europe, where other providers can bid for NATS' business but NATS can't bid for theirs."
- "The big philosophical debates about the nature of air traffic management in the 1990s all focused on one ANSP—NavCanada. Was the creation of a private [nonprofit] commercial company a good thing for the business? Or would the private sector drive for profits [sic] create safety holes and poor service?"

- "The US' Federal Aviation Administration has come a long, long way in the last few years. The creation of the Air Traffic Organization to look after the restructuring of the air traffic management network in 2003 has been crucial in the way the world's largest air navigation service provider rumbles ever forward. That said, there are difficulties over user fees, staffing and more."
- "Award-winning Airservices Australia is seeking to stamp its impact on the Asian-Pacific region, notably through the deployment of ADS-B northwards up through Indonesia, but also through making its expertise commercially available across Asia."
- "DFS under the leadership of Dieter Kaden has transformed itself from a plodding organ of the state to a dynamic, commercial organization waiting to sell its services in a liberalized European airspace. The final step on its road is a full-scale privatization—already approved by the government—but it needs a change to the German constitution before it can happen."

This ranking is worthy of note for several reasons. First, it will shock many Americans (especially members of Congress) that the FAA was not ranked number one, though there's little doubt that it would have been 20 years ago. Second, four of the top five ANSPs are commercialized entities—i.e., they are self-supporting from fees paid to them by their customers, they exist outside the government's budget process and they are regulated for safety at arm's length by a separate national government safety regulator. Such entities did not exist 20 years ago, but are now setting the pace. Third, the FAA's ATO did make the top five, which is a tribute not only to former Vice President Gore's National Performance Review (which came up with the idea of a performance-based ATO after Congress rejected its full commercialization proposal, USATS) but also to the yeoman work of former COO Russ Chew in turning the ATO from an idea on paper into a functioning reality.

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 enroute and terminal-area ATC services provided. And the FAA's ATO would be allowed to issue revenue bonds for modernization programs, based on the user fee revenue. Because general aviation (GA) 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 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 turboprop 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, 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. However, the White House then issued a possible veto threat, further clouding the outlook for passage of an FAA reauthorization bill in a presidential election year.

Education

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A. School Choice Increases through Bipartisan Efforts in 2008

Across the nation, Democrats are helping make 2008 a banner year for school choice, allowing parents to select the schools that are best suited for their kids.

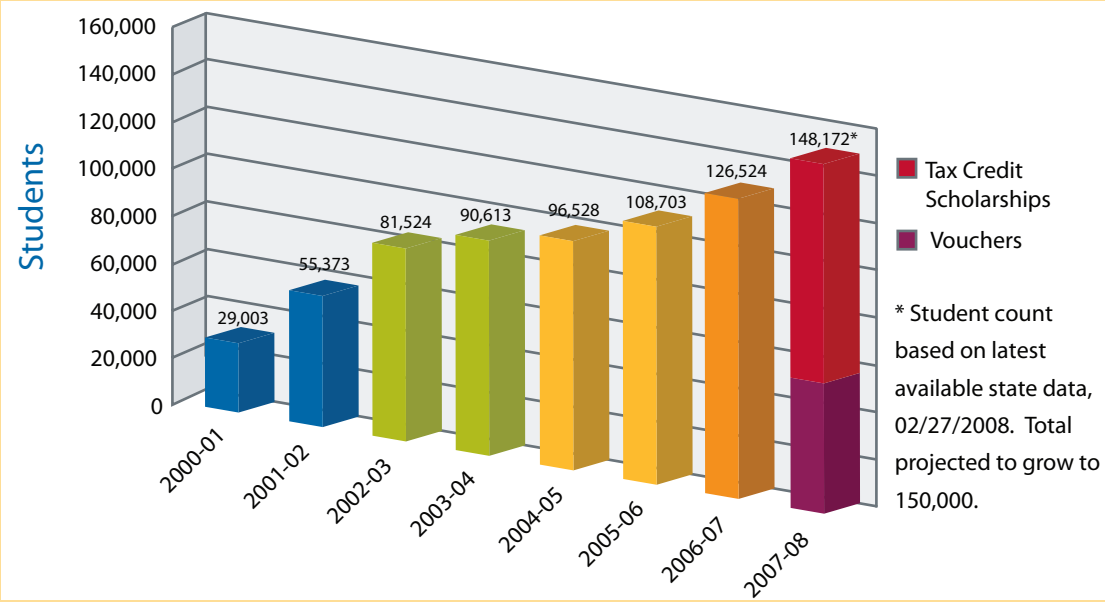
Student enrollment in private school choice programs, which include school voucher programs and scholarship tax credit programs, has increased by 84% over five years, according to the School Choice Yearbook 2007. Figure 3 shows the growth in enrollment targeted school choice programs since 2000. In 2007, legislators in 40 states introduced legislation to advance private school choice programs.

In 2008, the five states with the largest school choice programs are Florida (39,000 students), Pennsylvania (38,000 students), Arizona (28,000 students), Wisconsin (19,000 students) and Ohio (14,000 students). The eight programs that have been enacted within the last three years are off to a strong start, with nearly 19,000 children participating in 2007-08 school year. The evidence shows that school choice is on the rise throughout the country—with every program in existence continuing to demonstrate solid year-to-year student enrollment growth.

School choice is increasingly becoming a bipartisan issue, a large attributor to its growing success. Nationwide, there are now 24 school choice programs in 15 states (see Table 12). In 2008, three new school choice programs have been enacted in Georgia and Louisiana and expanded in Ohio, Florida and Utah. In addition, New Jersey and Maryland are close to passing new school choice legislation.

While Republicans may still be the lead sponsors of most school choice legislation, they are passing new programs with the help of their Democratic colleagues. In a recent Washington Post op-ed, former Washington, D.C. Mayor Marion Barry wrote, "I know it may surprise some that I would support a school voucher program, but I am proud to do so." Three quarters of legislative victories for school choice over the past two years came because of Democratic support.

Figure 3: Enrollment Growth in Targeted School Choice Programs, 2000-2008



Source: Alliance for School Choice, School Choice Yearbook 2007, p8.

In 2006, Wisconsin Gov. Jim Doyle (D) signed a big expansion of the Milwaukee voucher program. Arizona Gov. Janet Napolitano (D) allowed the creation of a tax-credit scholarship program and signed two new voucher programs into law. In Iowa, a new tax-credit scholarship program gained overwhelming Democratic support and Gov. Tom Vilsack (D) signed it into law. Pennsylvania Gov. Ed Rendell (D) signed a $10 million expansion of his state's tax-credit scholarship program that provides disadvantaged children with scholarships to private schools.

In Florida, only one Democrat voted for the corporate tax credit program to provide scholarships to low-income children in 2001. By 2008, however, the legislature passed a $30 million expansion of the "Step up for Students" corporate tax credit program for private school scholarships with the help of a third of the Democratic caucus. The program provides scholarships to 20,000 students with about 64% black and Hispanic students. Apparently, the Democrats took note because 13 of 25 members of the state's black caucus and every member of the Hispanic caucus voted for the expansion. The program will now provide students with 5,000 new scholarships to private schools.

B. New 2008 School Choice Programs

On May 14, 2008, Georgia Gov. Sonny Perdue (R) signed a $50 million Corporate and Individual Scholarship Tax Credit program into law. Under the program, all K-12 students in Georgia public schools are eligible to receive private school scholarships. The new program sets a limit of $50 million. The new law allows corporations to receive a 100% tax credit for donations—up to 75% of their total state tax liability—to organizations that grant scholarships to children who want to attend private schools. Individuals can also donate up to $1,000 per person (or $2,500 per married couple) to these organizations and receive a 100% tax credit for these contributions. Student scholarship organizations must spend at least 90% of donations on scholarships.

Georgia's new school choice law is part of a national trend toward school choice programs without student eligibility restrictions. These pro-

Table 12: State School Choice Programs	
AZ	Corporate Tax Credits for School Tuition Organizations
AZ	Displaced Pupils Choice Grants
AZ	Personal Tax Credits for School Tuition Organizations
AZ	Scholarships for Pupils with Disabilities
DC	Opportunity Scholarship Program
FL	McKay Scholarships Program for Students with Disabilities
FL	Tax Credits for Scholarship Funding Organizations
GA	Georgia Special Needs Scholarships
GA	Tax Credits for Student Scholarship Organizations
IA	Tax Credits for Educational Expenses
IA	Tax Credits for School Tuition Organizations
IL	Tax Credits for Educational Expenses
LA	Personal Tax Deduction
ME	Town Tuitioning Program
MN	Tax Credits and Deductions for Educational Expenses
OH	Autism Scholarship Program
OH	Cleveland Scholarship and Tutoring Program
OH	Educational Choice Scholarship Pilot Program
PA	Educational Improvement Tax Credit Program
RI	Corporate Tax Credits for Scholarship Organizations
UT	Carson Smith Special Needs Scholarship Program
VT	Town Tuitioning Program
WI	Milwaukee Parental Choice Program

Source: The Friedman Foundation for Educational Choice, http://www.friedmanfoundation.org/friedman/schoolchoice/ShowProgram.do

grams join existing programs in Arizona, Vermont, Ohio, Maine, Illinois and Iowa that impose no demographic restrictions for eligibility.

In the South, **Louisiana** passed two new school choice programs in 2008. The first program is a tax deduction for families that pay private school tuition. The deduction, which is worth up to $5,000 per child, was signed into law in April by Gov. Bobby Jindal (R). The second program is a voucher program for New Orleans students that passed with a large bipartisan majority, 60-42 in the Louisiana House and 25-12 in the Senate. The New Orleans voucher program would use $10 million in state taxpayer money to pay private school tuition for as many as 1,500 New Orleans children. Democrats Rep. Austin Badon, from New Orleans and Sen. Ann Duplessis sponsored the legislation.

At press time two more states are close to passing new school choice programs. In **New Jersey**, the Senate Economic Growth Committee voted to pass S-1607, the Urban Enterprise Zone Jobs Scholarship Act. The bill, sponsored by Sen. Raymond Lesniak (D) and supported by Newark Mayor Corey Booker (D), would allow corporations to make tax-deductible contributions to scholarship organizations. The dollars would be used by children in Newark, Camden, Trenton, Elizabeth, Lakewood, Paterson, Orange and Jersey City to attend participating public or private schools of a student's choice.

Similarly, in March 2008, a **Maryland** tax credit scholarship program passed the state Senate. The program, which would provide school choice options to disadvantaged children, was sponsored by Democratic Senator Ed DeGrange and would allow corporations that donate up to $200,000 per year to school tuition organizations to receive a 75% state income tax credit for their contributions.

Perhaps Maryland State Senator Nathaniel McFadden (D) sums up the new Democratic attitude towards school choice best. In support of the Maryland school choice bill, he says that the Maryland legislature "helps all kinds of industries here with tax credits—big business, horse racing, biotech. . . . If you call the bill a sham, then I am shamming for children today."

C. Existing School Choice Programs Expand in 2008

When the **Pennsylvania** legislature finalized the state budget for the 2007-08 fiscal year, lawmakers increased the allocation for the Education Improvement Tax Credit (EITC) to $75 million, an increase of $16 million over last year.

For the 2007-08 fiscal year, organizations making donations to nonprofit scholarship-granting programs can take a total of $44.66 million in credits, as well as $22.33 million in credits for contributions to school improvement organizations. An additional $8 million in credits may be taken for donations to organizations granting preschool

scholarships.

The Pennsylvania EITC was established in 2001 at the urging of then Gov. Tom Ridge (R). The total amount of credits permitted in 2001 was $30 million, with a $20 million limit for donations to scholarship organizations and a $10 million limit for donations to school improvement organizations. Each year, the credit—awarded on a first-come, first-served basis—has been exhausted well before the end of the fiscal year, with more than 2,300 Pennsylvania businesses participating.

The credit for the 2004-05 school year was exhausted in less than two months and in 2005-06 it was exhausted on the first day of the fiscal year. Last year, businesses reached the limit within three months. According to the REACH Alliance, approximately 33,000 students in Pennsylvania received scholarships during the 2006-07 year. The EITC is limited to households where total income is $50,000 plus $10,000 for each child in the household.

In 2007, **Iowa's** nonpublic school choice program received a significant boost when Gov. Chet Culver (D) signed Senate File 601, which expands the School Tuition Organization (STO) 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% 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 tax credit expansion passed one year after the initial program was created, as supporters observed contributions had reached capacity.

In **Milwaukee, Wisconsin** there were 83 private schools participating in the choice program, with a total enrollment of 6,047 students in January 1999. Choice program payments totaled $28.2 million during the 1998-99 school year. By January 2008, there were 120 private schools participating in the choice program, with a total enrollment of 18,882 students. The program for the 2007-08 school year is estimated to cost about $120.3 million. The state's general fund pays for 55% of the program, with the remaining 45% coming from a reduction in state general aid to Milwaukee Public Schools.

In **Ohio**, the Educational Choice Scholarship Program allows up to 14,000 students at low-performing public schools to attend private or parochial schools with tax dollars. For 2008, more than 10,000 applications were submitted—triple the number that arrived during its first year. About 3,500 applications were filed in the first year of the program and 7,900 for the current school year. Interest from private and parochial schools is increasing. In 2008, 49 schools want to participate, compared with 15 the first year and 33 this year.

In **Washington D.C.**, the D.C. Opportunity Scholarship Program served more than 1,900 students during the 2007-08 school year, with an average scholarship amount of $6,986. The program was enacted in 2004 after Congress passed the D.C. School Choice Incentive Act.

President George W. Bush's 2009 budget request for the federal government, released in February, includes a proposal to boost federal funding for the Washington, D.C. school system by $32 million, including a $5 million hike for the D.C. program.

In June 2008 the U.S. Department of Education released the second annual report on the random-assignment evaluation of the D.C. voucher program. The report, *Evaluation of the D.C. Opportunity Scholarship Program: Impacts After Two Years*, from the Institute of Education Sciences, shows that students in several groups are making academic gains as a result of the scholarship program.

The most significant growth took place in the all-important area of reading. More than 88% of students who receive D.C. Opportunity Scholarships posted significant increases in reading achievement. To achieve the same results, other students would have needed about two to four months of additional instruction in reading.

In addition, the report indicated that parental satisfaction for the program continues to be very high, with the majority of parents giving their children's schools the grade of an "A" or a "B." Demand for the scholarships was also extremely high. The study also indicated that students in the program observed better behavior among their

peers in the classroom in scholarship schools than did students in D.C. public schools.

Congress is currently debating the reauthorization of the program. The U.S. House of Representatives passed the annual D.C. appropriations bill with the Opportunity Scholarship Program intact in June 2008. It goes next to the Senate, where positive action is expected. A recent poll by the Greater Washington Urban League demonstrated that 69% of District residents support the plan that funds the scholarship program. Nearly every newspaper in the District has editorialized in support of reauthorization and renewal of the program is backed by Mayor Adrian Fenty (D), former Mayor Anthony Williams and several civic groups.

D. Special Needs Scholarships Continue to Grow

In the first year of the Georgia Special Needs Scholarship Program, more than 5,000 Georgia families applied for special-needs scholarships and the Georgia State Board of Education approved 118 private schools to accept the scholarships. The Georgia program allows parents of disabled children to use the state dollars that would have been spent on their children's education in public schools to send them to the public or private school of their choice. The estimated average voucher will be about $9,000.

The Georgia Special-Needs Scholarship was modeled after the nation's first such program, Florida's John M. McKay Scholarship for Students with Disabilities. More than 18,273 students currently use McKay scholarships, representing a net increase of more than 1,700% since the scholarships became available statewide in 2000. More than 800 private schools accept McKay students in Florida.

Arizona, Ohio and Utah have similar special-needs scholarship programs and according to the Alliance for School Choice, participation rates are at record numbers. For example, participation in Utah's Carson Smith Special Needs Scholarship Program has increased by 402% since Gov. Jon Huntsman (R) signed the program into law in 2005. More than 40 private schools are now participating in the program, according to the Utah Department of Education. Similarly, Ohio's Autism Scholarship Program's student participation has increased by 81% since its inception in 2004.

New research on special needs vouchers demonstrates that school choice for disabled students can actually have positive effects on disabled students who remain in the public school system. In a 2008 study for the Manhattan Institute, *The Effect of Special Education Vouchers on Public School Achievement: Evidence From Florida's McKay Scholarship Program*, education scholars Jay P. Greene and Marcus A. Winters find evidence that Florida's special-education voucher program has improved the education that the public schools provide to the disabled students who remain in the public schools.

They found that those students with relatively mild disabilities—the vast majority of special-education students in the state and across the nation—made larger academic gains when the number of private options nearby increased. Students diagnosed with the mildest form of disability, known as a Specific Learning Disability (SLD), benefited the most from the availability of school choice. About 61% of students in special education have been identified as having an SLD and many of these kids are not much different from non-disabled students. Greene and Winters found that the average student with an SLD who remained in the public school system made an additional 0.05 and 0.07 standard deviation improvement in math and reading, respectively, than they would have made without the McKay program.

E. Charter Schools Enjoy Increasing Market Share

Charter schools continue to be the largest example of education privatization as public schools that operate through a contract with a government authorizer. According to the Center for Education Reform (CER), in the 2007-08 school year, there

were over 4,100 charter schools serving more than 1.2 million children across the country.

Charters schools are growing at a rapid pace. According to 2006-07 data from the National Alliance for Public charter schools, there are now 29 communities nationwide that have 13% or more of students enrolled in charter schools (see Table 13). For the 2007-08 school year, 347 new charter schools opened in 40 states and the District of Columbia—an increase of 8% over the previous year. Today, 40 states and the District of Columbia have charter school laws in place. Of those laws, 21 are considered strong, according to CER's latest rankings; 20 laws are considered weak.

In addition to the growth in market share, the new trend is for entire districts to go charter. In Georgia, the Decatur, Marietta, Gainesville and Warren County school systems became the first four "charter school" districts in the United States. The districts will operate according to their charters in 2008-09, overseen by the state, rather than by the normal laws and regulations governing the relationship between the two.

Georgia is the first state to allow entire school systems to seek public charter status. "Today is a milestone for Georgia," said Lt. Gov. Casey Cagle (R), who pushed legislation through the state legislature last year authorizing the creation of public charter systems subject to state approval. "Charter systems offer the truest form of local control." Public charter status for all four systems goes into effect in August 2008 with the new school year.

Table 13: Top 10 Charter School Markets

Community	Charter Market Share	Charter	Non-charter	All
1. New Orleans, LA	57%	14,822	11,343	26,165
2. Southfield, MI	27%	3,565	9,426	12,991
Dayton, OH	27%	6,036	16,272	22,308
Washington, DC	27%	19,924	55,165	75,088
3. Pontiac, MI	23%	2,687	9,003	11,690
Youngstown, OH	23%	2,615	8,835	11,450
4. Detroit, MI	20%	29,455	117,598	147,053
Kansas City, MO	20%	6,084	24,610	30,694
5. Toledo, OH	18%	6,356	29,368	35,724
6. Chula Vista, CA	17%	4,693	22,198	26,891
Cleveland, OH	17%	11,573	54,814	66,387
Cincinnati, OH	17%	6,846	33,935	40,781
Milwaukee, WI	17%	15,825	78,603	94,428
7. Buffalo, NY	16%	6,538	34,589	41,127
Dearborn, MI	16%	3,487	18,529	22,016
8. Oakland, CA	15%	7,208	39,804	47,012
Brighton, CO	15%	1,751	9,885	11,636
Albany, NY	15%	1,505	8,603	10,108
St. Louis, MO	15%	5,405	31,691	37,096
9. Minneapolis, MN	14%	5,854	36,337	42,191
10. Camden, NJ	13%	2,313	15,244	17,557
St. Paul, MN	13%	6,014	40,034	46,048
Philadelphia, PA	13%	26,834	179,376	206,210
Columbus, OH	13%	8,312	55,699	64,011
Vista, CA	13%	3,487	23,447	26,934
Saginaw, MI	13%	1,456	9,934	11,390
Mohave County, AZ	13%	3,572	24,383	27,955
Napa Valley, CA	13%	2,219	15,199	17,418
Appleton, WI	13%	1,915	13,328	15,243

Source: National Alliance for Public Charter Schools

F. 2008 Charter School Achievement Data

In 2008 charter schools have hit many high-profile academic benchmarks. Twelve public charter schools are among *Newsweek's* 2008 top 100 high schools in America. BASIS charter school in Tucson, Arizona is cited as the nation's top-ranked high school. Twelve charters in the top 100 high schools is a significant achievement because public charter schools currently comprise only 3% of all public schools and are more likely to enroll students from disadvantaged communities.

Charter schools in many communities outperform their traditional public school counterparts. In New Orleans, new achievement test data show charter schools are consistently outperforming their traditional public school neighbors. The Louisiana Educational Assessment Program results from spring 2007 offered the first meaningful comparison of school performance in New Orleans since Hurricane Katrina.

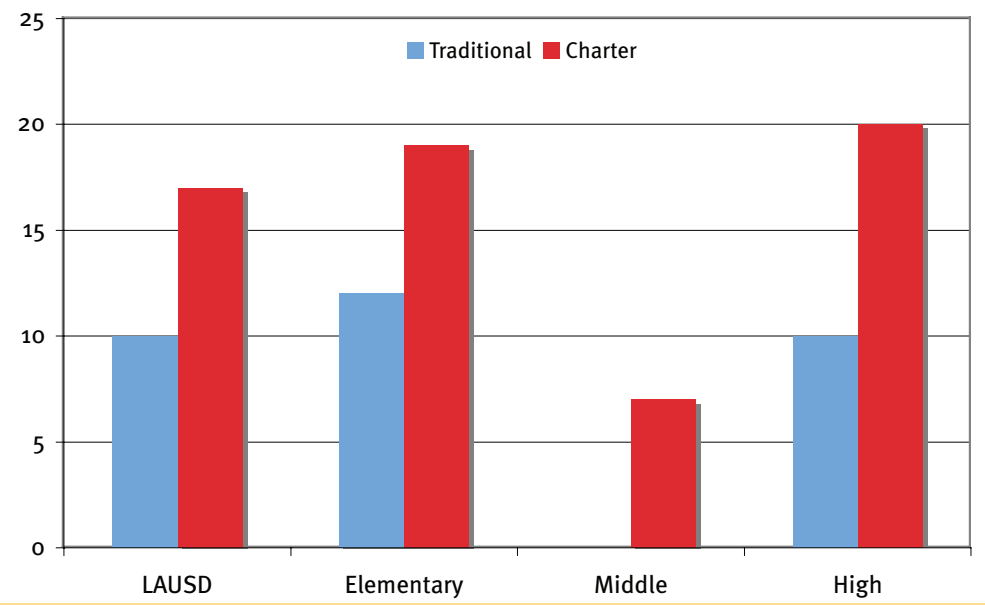
Louisiana charter schools fared well statewide, with 74% of eighth-graders scoring at or above "basic" in English and 76% in math. They topped the state averages of 69% and 64%, respectively. New Orleans charter schools did well, of the 20 top-performing schools in the city, 17 were charter schools, according to an August 1, 2007 *Times-Picayune* article.

1. California Charter School Achievement

Currently there are 687 charter schools in California serving more than 240,000 students. In 2006, the Los Angeles Unified School District (LAUSD) became the first school district in the country to have more than 100 charter schools in operation. Today, there are 125 schools serving more than 41,000 students making LA the largest charter movement in the state. In fact, Los Angeles is the seventh largest charter movement in the nation. Only Arizona, Florida, Michigan, Ohio and Texas have more charter students in their state. Therefore, it is important for the national charter school movement to analyze how charters in LAUSD perform.

Charter schools in Los Angeles are outper-

Figure 4: Median API Change from 2006 Base to 2007 Growth for LAUSD Public Schools



Source: California Charter Schools Association, "Charter School Performance in Los Angeles Unified School District: A District and Neighborhood Matched Comparison Analysis," June 10, 2008.

forming neighboring district schools. On June 10, 2008 the California Charter Schools Association released, "Charter School Performance in Los Angeles Unified School District: A District and Neighborhood Matched Comparison Analysis," an analysis of charter schools in LAUSD comparing charter and traditional public schools performance based on 2006-07 Academic performance index. In California, each school is given an academic performance index, largely based on student test scores on state achievement tests for reading, math, writing and science. The California charter school study found that charters in LAUSD outperform traditional public schools on a variety of student achievement measures.

First, charter schools in LAUSD are more likely than traditional public schools to improve their Academic Performance Index (API) at a faster rate, which means they made more gains on state achievement tests.

Table 14: Median 2007 API Growth by Subgroup and Grade Level for LAUSD Public Schools

Type of School	African American	Latino	Caucasian	SES Disadvantaged	English Learner	Students with Disabilities
LAUSD						
Charter	718	697	858	693	662	596
Traditional	644	705	854	704	672	447
Elementary						
Charter	738	701	913	715	667	*
Traditional	670	722	884	721	691	570
Middle						
Charter	717	723	861	720	656	596
Traditional	632	628	802	627	600	433
High						
Charter	686	688	831	678	660	574
Traditional	598	602	762	615	558	408

Charter schools in LAUSD earned higher median API growth for many subgroup populations
*Insufficient test data
Source: California Department of Education data; California Charter Schools Association Analysis
Note: Subgroups are specified by CDE; Racial subgroups represent the majority populations in LAUSD.

Table 15: Results for Charter Middle Schools in LAUSD

Performance Measure	Charter	Traditional	Performance Measure	Charter	Traditional
2006 Median API Base	729	629	2007 Median API Growth	729	634
African American 2006 Median API Base	693	625	African American 2007 Median API Growth	717	632
Latino 2006 Median API Base	708	620	Latino 2007 Median API Growth	723	628
Caucasian 2006 Median API Base	850	805	Caucasian 2007 Median API Growth	861	802
SES Disadvantaged 2006 Median API Base	714	625	SES Disadvantaged 2007 Median API Growth	720	627
EL 2006 Median API Base	697	595	EL 2007 Median API Growth	656	600
Disabled 2006 Median API Base	608	435	Disabled 2007 Median API Growth	596	433
Percent that Met Both School Wide and Comparable Improvement Targets	22%	14%	2006-2007 Median API Change	7	0
Percent that Met School Wide Targets	56%	33%	Percent that Met Comparable Improvement Targets	22%	14%

Note: Charter middle schools in LAUSD consistently show higher performance.
Source: California Department of Education data; California Charter Schools Association analysis

Second, the academic performance index for African American students is higher in charter schools in LAUSD than in traditional public schools. API results for other traditionally disadvantaged groups are higher at the middle and high school levels, but not at the elementary level.

Finally, charter middle schools in LAUSD, a school age group in which it has been difficult to improve performance, consistently outperform traditional public schools.

G. Weighted Student Formula Expands in 2008

In 2007-08, school empowerment and weighted student formula programs continued to grow. Under the weighted student formula model, schools are allocated funding based on the number of students attending, with extra per-student dollars for students who need services such as special education, bilingual or ESL instruction or help catching up to grade level. School principals have control over how their school's resources are allocated for salaries, materials, staff development and many other matters that have traditionally been decided at the district level. Accountability measures are implemented to ensure that performance levels at each school site are met, and with its emphasis on local control of school funding, most teachers' unions have been supportive because the weighted student formula devolves autonomy to the school-site and places responsibility squarely in the hands of each principal.

For **Maryland** in 2008, Baltimore Public Schools CEO Andres Alonso has introduced a decentralized funding structure for city schools. The plan gives principals the authority to make decisions previously handled by the central office. The 2008 budget cuts 310 jobs from the school system's central office, closes a $50 million shortfall, diverts $70 million from the central office to schools and gives principals more power. Principals are absorbing many responsibilities and funding decisions that the central office used to handle, from overseeing janitorial services to determining class size. As Alonso has said repeatedly at principals meetings, "this isn't Christmas."

Currently, principals control only about $90 of the $13,000 that the system spends per pupil. Under the 2008-09 funding formula contained in the budget, principals will have discretion over at least $5,000 per student. On top of that, they will receive $2,200 for each student who is struggling 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. Principals will use the new formula to develop their own school spending plans, based on enrollment projections for the 2008-09 year.

Principals are expected to gather community input as they use their discretionary spending power to craft budgets that meet students' needs. They will control class size, textbook purchasing and whether to keep positions from assistant principals to hall monitors. If they want an art class or an after-school program, they must rearrange their budgets to make it happen.

Parents will also play a role in school-level decisions. For every school, Alonso and his staff are proposing that the PTA or other organized parent group elect four parent and two community representatives. Those six people would have input into a principal's selection and evaluation and they would be responsible for giving Alonso feedback on the principal's annual school budget.

In addition, the school board will vote on an accountability structure defining the goals principals must meet with their newfound power and the sanctions they will face if they fall short. The amount of money a school can gain will be limited to 10% of its budget and the amount it can lose will be limited to 15%. Officials say 125 of the system's 190 schools will gain money over the current year, with an average increase of $493,570 apiece. Twenty-one schools that have received disproportionately high levels of funding in the past will lose money, with an average decrease of $76,822.

In **New Jersey**, after years of court-driven, ad-hoc approaches to school funding, Gov. Jon

Corzine (D) pushed through a weighted student formula school financing reform to create an equitable and predictable mechanism to distribute funding to all children in New Jersey based on individual student characteristics. Gov. Corzine's weighted student funding formula will be equitably applied to all school districts and charter schools beginning in fiscal year 2009. New Jersey charter schools will greatly benefit from the new legislation. Under the old system, charter schools received as little as half as much funding as their public school neighbors. Now they will be funded based on the number and type of students that enroll in the charter school just like every other public school in New Jersey.

In **Massachusetts,** Gov. Deval Patrick (D), is proposing a new form of public schools he calls "readiness schools" that would assume unprecedented control over matters ranging from curriculum and hiring decisions to policies on school uniforms and the length of the school year. Readiness schools, operating under performance contracts, would be launched or managed by teams authorized by and accountable to the local school committee. They would be funded by the school district based on a weighted student formula, with more funds allocated for those students who are more expensive to educate.

Leaders of readiness schools would have increased autonomy in five crucial areas: staffing, budget, curriculum and assessment, governance and policies and school schedule and school calendar. The rules of operation in these areas would be established by the leadership of each readiness school with input from faculty and staff.

Patrick plans to file legislation on the readiness schools in January 2009. If approved by the legislature, the state could have its first such schools by the start of the 2009-2010 school year. Administration officials have an initial goal of 40 readiness schools within four years, but hope to create more after that. There are currently 1,870 public schools statewide.

Like charter schools, which have been operating in Massachusetts since 1993, readiness schools would be allowed to deviate from state curriculum guidelines and experiment with teaching practices. Unlike most charter schools, which are governed by the state, they would report to local school committees. Also unlike charter schools, readiness schools could be created from existing public schools. The readiness schools would be similar to Boston's pilot schools, which were created in 1993 as charter-type schools that are free from school department and collective bargaining rules.

Both pilots and charters have been hailed by advocates for offering more innovative teaching styles and curriculum. The schools typically admit students through a lottery system and many have long waiting lists. Administration officials said readiness schools would be open to all students in a district and would have no admissions criteria.

Under the plan, there are four ways a readiness school could open: a group of educators could form a collaborative and present the local school committee with a plan to operate a school; a district could convert a school with teacher consent; a school committee could contract with outside operators, such as charter school management companies; or the state Board of Education could convert a school deemed chronically underperforming. The schools would be held accountable through performance contracts. If student achievement lagged, the School Committee could vote to take the school back.

H. More School Choice in Florida Improves Public Schools

By Vicki Murray and Matthew Ladner

Competition changes the behavior of low-performing schools. Academic research studies have reported that school choice competition has led to improved performance in public school systems. Florida is the case in point.

In 1999, Florida adopted a dual strategy of accountability from both the top down (state testing) and bottom up (parental choice). This strategy was initiated by former Gov. Jeb Bush (R), who served from 1999 to 2006 and is continuing under

current Gov. Charlie Crist (R), who served as Education Commissioner during much of this period.

Gov. Bush's A+ Opportunity Scholarship Program emphasized standards for the schools, transparency for parents and immediate options for students in chronically failing schools. Failing schools faced real consequences for prolonged failure, including losing students to better quality private schools. Today, more than 900 Florida private schools educate close to 40,000 low-income and disabled scholarship students. Florida also has a vigorous and growing charter school program, with 379 charter schools (and counting) educating more than 106,000 students. What does Florida have to show today for this tough mixture of testing and parental choice? The best source of data to answer this question comes from the federal government. They test representative samples of students in the states on a variety of subjects. The National Assessment of Education Progress (NAEP) provides the nation's most reliable and respected source of K-12 testing data and is the benchmark for all state-level assessment tests.

Children who do not learn to read in the early grades almost never recover academically, falling farther and farther behind with each passing grade. Reaching the middle school years, they literally cannot read their textbooks. Such students become academically frustrated and often disruptive. Hopelessly behind, such children begin dropping out of school in large numbers in the eigth grade. Consequently researchers and this analysis, focus on fourth grade reading scores.

In 1998, a stunning 47% of Florida fourth graders were on this very dropout track, scoring "below basic" on the fourth grade NAEP reading test. In 2007, 70% of Florida's fourth graders scored basic or above on fourth grade reading. The percentage of Florida children failing to master basic literacy dropped by 36%—a remarkable achievement. Meanwhile, the percentage of fourth graders scoring "proficient" increased by 54% and the percent scoring "advanced" (the highest level of achievement) doubled, from 4% to 8%.

In case anyone missed the release of this study, Rob Warren of the University of Minnesota has a new study comparing high school graduation rates in Milwaukee's voucher program and public schools. The bottom line is that students graduate at much higher rates in the voucher program.

Vicki Murray is a senior education fellow at the Pacific Research Institute and Matthew Ladner is vice president of research for the Goldwater Institute.

Emerging Issues

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A. Government Transparency Update

1. Federal Successes

Recent legislation has made it much easier to find out what the federal government is doing with our hard earned money once we turn them over in the form of taxes and fees. In the comfort of your own home you can go online to earmarks.omb.gov and read about every federal earmark from defense spending to "the bridge to nowhere." To further feed the public curiosity, www.usaspending.gov has been established to reveal how government cash is being spent on the seemingly endless, lucrative government contracts and research grants. In fact, the original legislation that mandated the creation of this site was recently strengthened to make the data even more accessible while adding additional checks and balances for accuracy.

If you want to track statistics about the number of government employees, you can tap into their performance scores at www.results.gov and see what each government agency is doing with their funding at www.expectmore.gov. Increasing the transparency, you can track the government as it tries to nail down how much property it owns at www.whitehouse.gov/omb/financial/fia_asset.html.

As the transparency train is clearly picking up speed, many want to make sure it continues successfully roaring down the track. Since July of 2007, Reason Foundation has led a diverse, trans-partisan coalition of over two-dozen organizations across the country that has called on Presidential candidates to sign the Oath of Presidential Transparency. By signing the Oath, candidates are ensuring that, if elected, there will be timely implementation of and administrative commitment to, the letter and spirit of the Federal Funding Accountability and Transparency Act that mandated the creation of www.usaspending.gov. All major candidates were invited to sign the Oath and Sen. Barack Obama (D), Bob Barr (L), Rep. Ron Paul (R), Sen. Sam Brownback (R), former Sen. Mike Gravel, Mr. John Cox and Rep. Dennis Kucinich (D) did so during the course of the primaries. The Oath reads:

I, _____, candidate for President of the United States, pledge to the American Public that, if elected President of the United States, my administration will be fully and robustly committed to open, transparent and accountable government principles. Effective management, accountability, transparency and disclosure of taxpayer expended resources by federal agencies are of the utmost importance to maintain the trust of the American people. The paramount goal is effective and efficient delivery of critical government programs to the American people. Results-oriented management of federal agencies and taxpayer resources must be aggressively pursued and must provide maximum value

for the public good. Within 30 days of accession to the Presidency, I will execute an Executive Order ensuring timely implementation of and administrative commitment to, the letter and spirit of the Federal Funding Accountability and Transparency (FFAT) Act of 2006.

The coalition's letter to the candidates stated that those who take the oath of office assume a solemn duty as stewards of public resources. The public must trust that its government will spend taxpayer dollars in a way that is responsible, efficient and, above all, open to the light of day. Since some unfortunate events in recent years have eroded this public trust, this coalition presented the candidates for the Presidency of the United States with an opportunity to rebuild that trust. For more information on the Oath of Presidential Transparency, please visit www.reason.org/oath.

2. Successes from Last Year's State Legislative Session

While we can all use more sunshine, the aforementioned initiatives have already shed important sunbeams into areas that were dark corners to the general public only a few years ago. Last year's state legislative session saw several efforts to create free, easy to use, searchable websites deemed "Google-government" sites by the general public. This year, efforts have exploded at both the state and local level and they have been met with even more success.

Texas Governor Rick Perry (R) was the real trailblazer of these efforts at the state level last year and his administration has continued to improve on its performance launching a new website: www.window.state.tx.us/comptrol/expendlist/cashdrill.php. Another leader was Florida Governor Charlie Christ (R). Last June, he issued Executive Order 07-107 establishing a Commission on Open Government made up of nine members who were charged with reviewing and evaluating the public's right to the state's data on its meetings and records. In November, he followed up with 07-242 mandating that all government agency websites post an Open Government Bill of Rights. Gov. Crist has also called on his agencies to link to a forthcoming statewide website allowing access to these documents.

In Arizona, the State Treasurer ensures that his website, www.aztreasury.gov/distributions.html, has updated information on distributions daily. Search fields include the recipient name, the geographic location, Arizona county and date. Last year the Illinois legislature failed to pass the Funding Accountability and Transparency Act, but a website to research contracts and contractors has been launched at www.openbook.ioc.state.il.us. All you need to know is the name or even a portion of the name of an entity that does business with the state of Illinois to utilize the site. Kansas state legislators re-doubled their efforts to launch www.kansas.gov/kanview this year and Kentucky Secretary of State Trey Grayson has launched his own site called Check it out Kentucky! at www.sos.ky.gov.

Also in the Midwest, Missouri Governor Matt Blunt (R) required the creation of the **Missouri** Accountability Portal (MAP) with Executive Order 7-24. Visit mapyourtaxes.mo.gov and you can search in both specific and general terms. Nebraska State Treasurer Shane Osborn, looking to show taxpayers where and how their money is spent, has launched nebraskaspending.com and while information is still being filled in, the website is up and running. New York state government activities and information on its contracts can be viewed at www.sunlightny.org thanks to the Attorney General Andrew Cuomo. South Carolina Governor Mark Sanford (R) mandated the creation of a single, searchable website, ssl.sc.gov/spendingtransparency, containing the expenditures of the state with Executive Order 2007-14. He went a step further and required each agency to create its own website for all expenditures over $100. Finally, Oklahomans haven't been left off the train, they can check out www.openbooks.ok.gov.

3. 2008 State Legislative Roundup

Since the start of this legislative session, several states have already been able to enjoy the fruits

of their labor trying to shine light on government spending. And some local leaders didn't wait for direction from state or federal bureaucracies to begin sharing information with their taxpayers.

In **Alabama**, HB215/SB236 called for a "Google-government" website. Rep. Mike Ball (R) was the original House sponsor where the bill fared better with a referral to committee while the Senate version, sponsored by Sen. Arthur Orr (R) has been postponed until further notice. If you live in **Alaska**, Governor Sarah Palin (R) has made each check that the state writes over $1,000 available to the public at fin.admin.state.ak.us/dof/checkbook_online/index.jsp. The state is currently researching whether or not certain types of payments can be posted online and will continue to update their available information as appropriate. Since this website could easily be taken down by the next Governor, SB 201 was drawn up by Sen. Bill Wielechowski (D) to authorize creation of a full "Google-government" website. While the bill made it out of committee, it died there with the closure of the session.

Two pieces of legislation have come out of the **Arizona** legislature successfully, one from each side. HCR 2040 passed through committee calling for a constitutional amendment instructing the State Treasurer, along with each local treasurer, to create a website listing expenditures accompanied by receipts, data on debt services, bond payments, government employees as well as contracts. SB 1235 passed and now requires the Arizona Department of Administration to maintain a public website to allow citizens to review contracts entered into by the state. The original bill passed with an implementation date of 2013, but an amendment pushed the date up to 2009.

AB 1843 introduced by Assemblyman Martin Garrick (R) in **California** originally called for a "Google-government website but after committee, the legislation was amended to language calling on the State Controller to cultivate and develop an approach plan for the creation of such a website. California seems to have stalled in its Senate effort as well with Sen. Tom McClintock's (R) SB 1494, which desired to see each state agency come up with its own website, stuck in an appropriation committee's suspense file.

Delaware's Sen. Charles Copeland (R) and Rep. Gregory Lavelle (R) introduced the Delaware Taxpayer Coalition's 2008 Fiscal Transparency Package and all but one piece has successfully passed out of committee. SB 184/HB 334 requires the creation of the budget website; SB 185/HB 337 requires an additional site to detail the contracts of schools (public and charter); SB 186/HB 338 requires the school districts to post their check registers on its website (this will exclude payroll but does require that pay and benefits for each position be posted at the start of each fiscal year); SB 187/HB 336 calls on the state agencies to do the same with their registers; and SB 188 requires that the data on Delaware Strategic Fund distributions be made available at the state's Economic Development Office's website. This final piece remains with the Senate Finance Committee. Additionally, Sen. George H. Bunting (D) and Rep. Greg Lavelle (R) introduced SB 181 to necessitate posting "the names, positions, employing agencies, salaries, overtime compensation, travel expenses and other reimbursable expenses of all full-time and part-time sate employees, officers and officials."

In May, **Georgia** Governor Sonny Perdue (R) signed into law SB 300 sponsored by Sen. Chip Rogers (R) that called for the creation of a searchable website detailing the state's expenditures. At the local level, Carroll County Chairman Bill Chappelll has put his county's spending online with a detailed listing of checks. You can view it here: carrollcountyga.com. Passed out of the House unanimously, HB 4765 co-sponsored by Reps. Jack Franks (D) and Mike Tyron (R) called for a "Google-government" website; it was referred to the Senate rules committee. In **Iowa**, HF 2439 adds the request for a description of what the purpose of each expenditure is to the creation of such a website. This bill, sponsored by Rep. James Van Fossen (R), is sitting in committee. While the Secretary of State has done his part in **Kentucky** posting his check register online, Rep. Jim DeCesare (R) sought

to have the whole state government's spending posted online with HB 105, but it has been sitting in committee since the start of 2008.

The first to act in 2008, **Louisiana** Governor Bobby Jindal (R) signed Executive Order BJ 2008-2 almost as soon as he stepped foot into office in January. One month later, the state legislature passed SB 37 which requires the creation of a website itemizing expenditures and salaries of statewide officials (excluding the judicial and legislative branches) as well as information on performance standards by January 1, 2009. **Maryland** faces the same deadline since the passage of HB 358 and amended SB 819, the Maryland Funding Accountability and Transparency Act of 2008, which now requires the creation of an easy to use website containing data on state expenditures over $25,000 like grants and contracts. Locally, Howard County has launched www.co.md.us/countycouncil/ccdocs/enrcb9-2008.pdf to present their expenditures over $30,000 to taxpayers.

Michigan's Attorney General, Mike Cox posts his expenditures broken down by quarters at his static site www.michigan.gov/ag/0,1607,7-164-34391-184786--,00.html and has publically challenged the governor to open up the state's check registers as well. Secretary of State, Terri Lynn Land followed suit with www.michigan.gov/documents/sos/FY2007_MDOS_Expenditures_232240_7.pdf. Rep. Jack Hoogendyk (R) introduced HB 5137 calling for the creation of a detailed statewide budget website and it was referred to the appropriations committee. Mississippi was able to achieve statewide success with HB 725, the Taxpayer Transparency Act, which was sponsored by Rep. Toby Barker and signed into law by Governor Haley Barbour this April.

While **Missouri** Governor Blunt has already created MAP, SB 1204, a bill put forth by Sen. Jack Goodman (R), making the maintenance of the site law passed at the end of August 2008. In March, **Nevada** Governor Jim Gibbons (R) issued an Executive Order to create a such a database but no state-based information is available to the taxpayer as of yet.

In **New Jersey**, Sen. Joe Pennacchio (R) and Assembly members Allison Littell McHose (R) and Gary R. Chiusano (R) introduced companions bills S 445 and A 4534 calling for the creation of a "Google-government" website; both remain in committee. HB 420, sponsored by Rep. Tom Brinkman (R), passed the **Ohio** House calling for such a budget website along with a website to view data on property owned by the state as well as earmarks and performance standards. On the local level, the County Commissioner in Hamilton County put up a measure for an easy to use, searchable website of all the county's expenditures. Moving over to **Pennsylvania**, Sen. Pat Browne sponsored SB 1350 that mandates a budget website which would include the grant and contract info similar to many other states along with performance measure results and an analysis of appropriations with detailed descriptions. The bill is currently in committee.

The Appropriations Bill Earmark Disclosure Act of **South Carolina**, H 4356/S 896, demanded more detailed information on the state's earmark request form and insisted on the posting of that request on the General Assembly's website within a matter of three days. The Truth in Spending Act, S 1144, called upon each state agency and local government to maintain an online register of all expenditures over $100. Following these two pieces of legislation, the Senate voted to adopt a provision to the budget that stated that if the local entity failed to post those registers online with detailed explanations resources from the general operation fund would be withheld tying in performance measures. The House amended this provision by making that requirement voluntary.

Both bodies of the **South Dakota** legislature passed HB 1233 brought forth by Rep. Hal Wick (R) to authorize a searchable website updated with data on expenditures, debt payments, compensation for state employees, contracts and commodities. This spring, Governor Mike Rounds (R) vetoed the bill and while the House voted to override his veto, the Senate did not. In **Tennessee**, Rep. Susan Lynn (R) put a spin on what has become the more typical searchable budget website by calling

for a database that not only lists the amount of money and the funding source but exactly what performance is expected in return along with the past performance audits with HB 4034. SB 4095, its companion bill introduced by Sen. Mae Beavers (R), is in committee. Similarly, HB 3094/SB 3489 calls for that more typical budget website and adds the posting of the most recent lost revenue report; in April, it was been placed behind the budget.

As we reported in last year's *APR*, **Texas'** HB 2560, which would have required school districts to post their checkbooks online, failed to pass through the Senate. However a growing number of administrators have publically displayed their approval for the principle by posting their check registers online. In fact, about 150 districts have done so and at the university level, Texas A&M posts its expenditures online here: tamus.edu/financial/transparency.

Sen. Wayne Niederhauser (R) in **Utah** introduced SB 38 calling for a searchable website that would not only apply to all of the state government but also the departments, colleges, universities and local districts (including schools) with $1 million budgets or more. In addition, SB 38 also called for the creation of a Utah Transparency Advisory Board to ensure that private records remained that way. The legislation was amended to exclude the localities and signed into law in March.

Virginia has a website up and running at datapoint.apa.virginia.gov, but Sens. Ken Cuccinelli (R) and Chap Peterson (R) introduced SB 585 to call for even more detailed information for Virginia taxpayers. In the House, the companion bill was sponsored by Dels. Ben Cline (R) and Johnny S. Joannou (D) but don't look for any action on these pieces until next year. However, at the local level efforts are well underway. Fairfax County Board of Supervisors member, Pat Herrity called for a "Google-government" website for his county this past spring. (You can view Reason's interview with Herrity here: reason.org/commentaries/hydro_20080206.shtml.) A little farther north, Alexandria Taxpayers United is calling on their city government to create such a website—you can view their letter here: www.atuonline.org/uploads/06_12_19_grants_and_contracts_website_letter.pdf.

While **Washington** Sen. Ted Stevens (R) sponsored SB 6367 requiring the creation of a searchable comprehensive website complete with performance markers and past audits, it didn't survive committee. Sen. Eric Oemig (D) introduced SB 6818 which wasn't as comprehensive but did call for a searchable budget website and this version was signed into law. Faced with fed-up property owning taxpayers in King County, over 45% of whom did not receive property tax summaries, Councilmember Reagan Dunn introduced the Transparency in Taxation initiative. It passed this spring, requiring the County Treasurer to mail out tax breakdown summaries shining the light for property owners who do not currently receive property tax statements allowing them to see what taxes and fees they are required to pay.

Efforts at the state level to introduce transparency in **Wisconsin** were not successful with AB 862, the Government Checkbook Disclosure Act and AB 739 which would have prohibited state agencies including earmarks in the budget. But, Milwaukee County has launched what it is calling its Government Accountability in Spending Project (GASP) where the public can sift through the county's invoices here: www.milwaukeecounty.headquarters.com.

B. State Lottery Privatization Update

Over the past several years, the idea of privatizing state lotteries has been gaining steam. In 2008, over a dozen states saw proposals to close budget gaps and increase state revenues through long-term lease agreements or concessions, for state lottery systems. While the idea of private investor/operators offering large upfront lumps of cash for lottery concessions has certainly generated tremendous interest among state elected officials, thus far no state has sealed the deal.

Under the various proposals, private companies would compete for the rights to operate a lottery

on behalf of the state through a long-term (30+ year) concession, while the state would continue to own the lottery and retain a strong regulatory role. In some states this means maintaining strict controls over the types of new game products, how games are marketed and minimum prize payout ratios. The lottery concession proposals discussed thus far—and implemented globally in Australia, the United Kingdom and elsewhere—have been conceptually similar to the types of long-term leases seen in other realms of public infrastructure, such as toll roads, seaports and airports.

There's a great deal of flexibility in how a lottery concession could be structured. For instance, investors could give a large upfront payment in exchange for the rights to the lottery's future revenues over the length of the term. The upfront payment would be placed in trust funds or perhaps invested in the state pension fund, the interest from which could be used to finance education, fund transportation projects or cover budget shortfalls.

An alternate structure that may be more politically palatable would be to structure a concession with a modest upfront payment and a guaranteed portion of the lottery's annual revenues. Revenue sharing provisions are also an option if policymakers want to ensure that the state benefits if lottery revenues exceed certain thresholds in boom years.

This is not to say that lottery privatization is easy. There are many legitimate reasons why, while a number of states have begun to explore lottery privatization, no state has yet moved to implementation. Privatization would require due diligence, detailed legal and financial analyses and a carefully negotiated concession agreement that preserves a strong, state oversight role while giving the concessionaire the opportunity and flexibility to maximize the value of the asset.

Even in states where lottery privatization measures have already failed, proponents haven't given up. "In nearly all the states where lottery privatization has been proposed the executive was the proponent," said Arturo Perez, a fiscal analyst for the National Conference of State Legislatures. These governors have not been easily defeated and continue to push for this new revenue source.

Last year's **Indiana** senate bill to privatize the state lottery that failed a floor vote was resurrected by Gov. Mitch Daniels this past session. In April 2008, he again suggested putting the lottery on the auction block and using the money to put low and middle class students through college. Gov. Daniels believes leasing the lottery would raise at least $2 billion and had several offers in that range last year in his first attempt.

Illinois Gov. Rod Blagojevich ignored the successful effort to defeat lottery privatization in 2007

and said in his 2008 State of the State address that a "partial lease of the state lottery" would "help fund up to $10 billion of a $25 to 30 billion state construction program." Supporters have also discussed using the funds a sale would generate to bankroll other parts of its capital spending plan that might fall though with the current budget deficit.

Texas Gov. Rick Perry was defeated in his attempt to turn Texas Lotto into money for cancer research in 2007. However, the state legislature is reportedly planning to take another look at the issue in 2009.

Virginia lawmakers pushing the privatization of their lottery failed in 2008, but aren't deterred. "If we're not going to raise taxes and we're not going to cut expenses, then we have to find a third way," says Del. David E. Poisson, D-Loudoun, a proponent of a privately run lottery. Poisson introduce the lottery bill to the General Assembly earlier this year, though it was killed in committee. He plans to reintroduce the measure in 2009.

Not every attempt is being retried though. **Colorado** came close to lottery privatization in 2007, with a measure to approve selling the state gambling service, nearly making it to a referendum ballot. After the legislature failed to pass a measure, citizen lobbyist Marvin Meyers attempted to fill a petition (see *APR 2007* for more details). The Office of Legislative Legal Services stopped the petition from gaining much ground, however, as the Colorado constitution limits ballot questions in odd years to just matters of taxes or debt. Though legislators said they wanted to revisit the idea in 2008, a bill has yet to come before the House or Senate.

The most common reason states have considered privatizing their lotteries to provide much-needed cash to cover budget shortfalls. **California** is facing a $20 billion budget deficit and has eyed the state lottery as a potential source of funds to help address it. Gov. Arnold Schwarzenegger suggested privatizing the California lotto last year to help fund his healthcare reforms, but was largely ignored. Officials are currently focused on a $15 billion debt securitization of lottery revenues as opposed to a concession, even though a securitization structure would likely generate much less than a lease. Leasing the lottery would most likely require a statewide referendum, but it hasn't been brought before the legislature yet. Currently the lottery provides $1.2 billion for the education system, representing just 1.5% of total K-12 funding.

Florida, already moving to privatize roads and bridges, is considering leasing its state lottery. Investment Bank Lehman Brothers has proposed a $31 billion upfront payment in exchange for the revenues from running the lottery. Puerto Rico Gov. Anibal Acevedo Vilá would like to lease the tropical island's lottery to balance his budget for the next fiscal year. He faces stiff competition, however, from members of the commonwealth's legislature who are opposed to the privatizing.

Some state governors want to use the revenue of leasing the state lottery for education or tax relief purposes. **Vermont** Gov. Jim Douglas would use the potential $50 million in upfront monies to ease the financial strain on homeowners. The additional streams of money from the privately run lotto would also "help clear the backlog of school construction, giving our students twenty-first century learning environments in energy-efficient buildings," according to Douglas' State of the State address this year. Jeff Heyman of JP Morgan told Marketplace public radio that a more aggressive sales model by a private business could net the state a 10% gain in lottery revenues.

Before his resignation, former Gov. Elliot Spitzer proposed offering the **New York** lottery to private investors for a 30-40 year lease. Spitzer's plan would have used $4 billion in lease proceeds to create a perennial endowment to generate $200 million a year for NY state higher education institutions. Spitzer also sought to guarantee the current level of proceeds for K-12 education through the lottery concession proposal.

In other developments in lottery privatization, **New Jersey** Senate President Richard J. Codey has proposed privatizing the state lottery as an alternative to Gov. Jon Corzine's plan raising toll rates on the New Jersey Turnpike. In March, the

Oklahoma Senate passed a bill creating an eight-member panel to determine whether privatization of the state lottery would generate more money for the government than the current operations. However, the bill has stalled in the House.

C. Ports Infrastructure—A New Frontier for Public-Private Ventures?

By Kenneth Orski

Until now, most of the debate about the need to expand public infrastructure has centered on surface transportation, mainly highways and public transit systems. This is partly because growing congestion on the nation's highways has highlighted the need to increase road capacity and partly because a highly publicized event—the collapse of the I-35 bridge in Minneapolis—has focused public attention on the need to reconstruct many of our aging roads and bridges. While these remain important and vital to our nation's growth, a spotlight is being cast on the importance of new investment in ports and intermodal facilities.

A December 3-5, 2007 conference in Coral Gables, Florida was attended by a large number of senior executives from port authorities, shipping concerns and the financial community. Their presence revealed the challenge of expanding port and intermodal infrastructure is resonating strongly with operators, shippers and investors alike. A keynote address by former Transportation Secretary Norman Mineta and the presence of senior officials from U.S. DOT underscored the importance that the public policy community attaches to this issue.

The Coral Gables conference took place against a background of forecasts that predict a veritable "tsunami" of maritime cargo swamping U.S. port facilities in the years ahead. In the past five years, container trade in North America has increased at a compound annual rate of 6.8%. It is predicted to soar by 50% by 2015, from 48 million TEUs ("twenty-foot equivalent unit" container capacity) in 2005 to 72 million in 2015. By 2020, North American ports and their associated intermodal systems will be severely congested, predicts John Vickerman, a widely respected expert in the planning and design of port, intermodal and freight logistics facilities. He estimates demand will exceed current capacity by as much as 200% assuming current productivity and growth levels.

How should U.S. ports respond to this challenge? Some observers suggest that the capacity problem would be solved if port authorities began operating on a 24/7 basis, as many foreign ports are doing. But there are many reasons why that would be impractical in the case of U.S. ports, contend other port officials. Local regulation and work rules limit hours of operation, there is an inadequate labor pool of longshoremen and the need for some slack time to perform routine maintenance will always exist. Only Asian ports exceed the productivity of our own ports, these officials contend and then only because many of them are transshipment ports that do not have to move containers "through the gate" as is the case with destination ports like ours.

In some cases, large private shippers will take care of their growing needs for cargo processing by constructing their own marine terminals. The Maersk Terminal in Portsmouth, VA is the first such terminal in the U.S. to be independently constructed and privately financed by a major shipping line. But in the great majority of cases, major improvements and expansion of physical port capacity and their intermodal connectors currently fall on the shoulders of local taxpayers.

That notion, that local tax-supported bonds should finance port expansion, has started to be challenged, as shown by a debate over who should bear the cost of improvements to the Port of Houston. Harris County Commissioner Steve Radack contends the port authority should finance the $550 million package of port improvements with revenue bonds supported by internally generated fees rather than rely on ad valorem or property tax-supported bonds. Nevertheless, a $250 million tax-supported bond issue was approved by a 65% popular vote.

In some cases, internal bond revenue financing

is feasible. The port of New Orleans derives 90% of its revenue from dockage fees, wharfage fees and other user fees, according to Gary La Grange, President and CEO of the Port of New Orleans. But, as the Coral Gables Conference shows, port authorities are also searching for new sources of capital and for creative new approaches to fund major expansion and improvement of marine terminals and intermodal access facilities.

Container fees have emerged recently as a possible new source of revenue to support investments in port infrastructure. For example, container fees have been used to fund construction of the Alameda Corridor and "availability payments" will be used as the method of financing the Miami Port Tunnel ($1.2 billion) and the Port of Savannah Connector. Both intermodal connectors will be built in their entirety without any initial investment of public funds. Private concessionaires will invest in the projects up front and assume construction and performance risks. The public authority will pay the concessionaires an annual fee based on the condition and performance of the facility and its availability for public use. If maintenance, congestion levels, incident response or other stipulated performance measures are not met, the payments will be reduced.

Container fees are being used in other areas of port development as well. The ports of Long Beach and Los Angeles, which together handle more than 40% of the nation's international trade, have adopted a $35 fee on every loaded container moved in or out of the port complex. The fee will fund, among other things, the replacement and modernization of container trucks that must meet federal 2007 emissions standards. After vetoing a proposed statewide container fee in 2006, Governor Schwarzenegger has reversed his position and is now supporting a $30 statewide container fee on cargo handled at the ports of Long Beach, Los Angeles and Oakland. The estimated $500 million generated annually would be spent largely on infrastructure projects such as new roadways, expanded marine terminals and intermodal connections.

A relatively new trend that may profoundly affect the future of port expansion is the growing willingness of private equity markets to invest in port facilities. For example, last February, the AIG Global Investment Group bought long-term leases to the Port of Newark terminal. The investment division of Deutsche Bank has bought Maher Terminals, the company that runs operations at the Port of Elizabeth in New Jersey and the Port of Prince Rupert in British Columbia. And the Ontario Teachers Pension Fund has taken over the lease from a shipping conglomerate to operate a terminal on Staten Island, N.Y. In each case, the private investors may be expected to inject new capital to improve the facilities and make them more productive.

Even larger initiatives are in the making. The Port of New Orleans is inviting the private sector to participate in a two-billion dollar program of facilities expansion including a new container terminal and a new cruise ship terminal. The Port of Portland or is reviewing the qualifications of 10 potential private bidders for its container terminal, the first long-term concession of an existing U.S. seaport facility. The Port of Corpus Christi is proposing to build new terminal facilities with the help of private capital. And the Commonwealth of Virginia has established a commission to consider privatizing the public Virginia Port Authority.

Just as in the case of toll roads, the global capital markets have come to recognize that ports are a sound investment. Institutional investors with long-term investment horizons, such as pension funds, look upon these assets as a safe investment that offers future returns comparable to those from fixed income and real estate. A growing scarcity of deep water port capacity and environmental obstacles to building new "greenfield" ports have enhanced the value of existing port facilities and raised expectations of a higher return on invested capital. Additionally, experts predict that the widening of the Panama Canal, which will accommodate larger (8000+ TEU) vessels, may lead to a dramatic growth of Gulf Coast and Atlantic ports and enhance their profitability thus making them attractive targets for private investment.

The amount of private capital available for

investment in infrastructure, including ports, is indeed very substantial. A McKinsey survey estimates that the world's 20 largest infrastructure funds have raised $100 billion in 2006 and 2007 alone ("How Investors Can Get More Out of Infrastructure," *The McKinsey Quarterly*, March 2008). *The Financial Times* reported last December that equity capital available for investment in infrastructure ranges from $50 billion to $150 billion. Michael Wilkins, managing director of S&P's European Infrastructure Finance Group, estimates that the amount of equity capital raised globally for infrastructure investments is in the range of $100 billion to $150 billion.

Probably the most detailed and authoritative study of dedicated infrastructure funds has been done by Stanford University's Collaboratory for Research on Global Projects under the direction of Ryan J. Orr. Orr reports in *The Rise of Infra Funds*, published June 2007, that a "tidal wave" of 72 new infrastructure funds have been launched in the last two years. These funds collectively, he estimates, have raised in excess of $120 billion. Assuming a leverage in the range of 65–80%, not uncommon in infrastructure deals these days, the estimated pool of equity capital could support investments in the range of $340 to $600 billion. (The Indiana Toll Road lease for $3.8 billion was financed with only 19% equity capital).

Of the 72 funds in the Stanford University project's database, 31 funds have an estimated value one billion dollars or more each. The two largest funds, Borealis and the Canadian Pension Plan, have $10 billion and $7 billion respectively allocated to infrastructure investing. Other large dedicated infrastructure funds, each in excess of $3 billion, include: Goldman Sachs Infrastructure Partners, Macquarie Infrastructure Partners, Ontario Teachers Pension Plan, Alinda Capital Partners, Citigroup Infrastructure Investors, AIG Highstar Capital, Morgan Stanley Infrastructure, JP Morgan Partners and Babcock & Brown Infrastructure Fund.

Kenneth Orski is a transportation policy consultant and publisher of *Innovation Briefs*. He has also served as Associate Administrator of the Urban Mass Transportation Administration under Presidents Nixon and Ford, a technical adviser to the Federal Transit Administration, a member of President George W. Bush's Transportation Policy Task Force and a member of the Bush-Cheney transportation transition team. He recently served as a member of the Blue Ribbon Panel of Transportation Experts of the congressionally chartered National Surface Transportation Policy and Revenue Commission.

Water & Wastewater

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B. Stockton Calls Off Water Privatization Contract
C. Eminent Domain Threatens Private Water Company Assets

A. *Public Works Financing* Issues 12th Annual Water Privatization Report

Privatization of water and wastewater services continue to face some resistance based on the perception that private profits can be put to better use by public utility managers. Despite this perception, figures from the 12th annual water report from *Public Works Financing* suggest that the drivers of future growth of water and wastewater services provision are likely to be private players.

The large companies included in this survey represent approximately 85% of the total U.S. market for outsourcing water services, which is approximately 5% of the 54,000 publicly owned water and wastewater systems in America. Most of these water outsourcing contracts are held by domestic private firms to provide system operations and maintenance services. The move towards privatization is prompted by a change in the operating procedures of public water utilities from an emphasis on technical know-how to management methods and service delivery.

Contract renewal rates for existing contracts have remained high with a 6% jump from 2006, despite a fall in revenues by 4% to $1.5 billion among the six major players. The total number of wastewater facilities has gone up marginally by 1.3% from 2006. However, industrial outsourcing revenues and facilities have seen substantial increases, including a 7% increase in total revenue from 2006. Communities adopting long-term water contracts have on average enjoyed a $30 million in cost savings for primarily wastewater management. Several new contracts have sprung-up on the West coast and Southeast which could remedy the slow gains.

B. Stockton Calls Off Water Privatization Contract

The city council of Stockton decided to let go of its $600 million water privatization deal in July 2007 as the result of a compromise with three principal citizens groups last July. Stockton's legal battles began when the Concerned Citizens Coalition of Stockton, along with the Sierra Club and the League of Women Voters of San Joaquin County, represented by the law firm Shute, Mihaly & Weinberger appealed to the courts, on the grounds that the city did not abide by environmental requirements before signing the contract.

The city council responded to this appeal with a counter-appeal to the court's ruling that the deal was illegal. This July, the city council dismissed its appeal and formally agreed to pay close to $2 million as settlement fees along with promising to run the city's water and sewerage facilities as well. Concerned Citizens Coalition of Stockton activist

Dale Stocking said, "This is another nail in the concept that the private industry model is better than the public model in delivering essential services."

Private contractor OMI/Thames still holds the responsibility to finish upgrading the city's wastewater treatment plants before it hands over ownership and operation to the city council. The transition plan includes an expansion of staff at an annual cost of about $1.9 million and $665,000 for new equipment making costs $57.8 million annually. This is a $757,045 increase from what the people of Stockton paid OMI/Thames. The Stockton city council's unanimous decision to end the contract with OMI/Thames was also supported by Gary Podesto, Stockton's erstwhile mayor who is popularly thought to be the mind behind the contract; he said "If I were there, I would do the same thing."

OMI/Thames maintains that its intervention in Stockton saved the city millions of dollars in addition to helping it meet environmental quality standards, while the Sierra Club and League of Women Voters of San Joaquin County called the end of the contract a "victory for democracy" indicative of the acrimony that the contract caused when it was signed 13 days before voters (by a margin of 60%) in the city decided that a public vote would be required in advance of any water privatization. The public vote decision was however overruled by the city council and fuelled the citizen-led litigation to return water to municipal ownership. Stockton Mayor, Edward Chavez, drew political lessons from the Stockton fallout when he said, "The real lesson is: If you really want to make people angry, shut them out."

C. Eminent Domain Threatens Private Water Company Assets

In several communities nationwide, the threatened use of eminent domain to expropriate the assets of private water companies—the equivalent of involuntary, forced de-privatization—is beginning to raise concerns in the water industry and presents an increasing threat to private property rights. Several incidents involving the use or the proposed use of eminent domain now dot the water utilities landscape.

These attempts at involuntary de-privatization include the proposed takeover of the Arizona American Water utility by the city council of Scottsdale and the battle for municipal control over water by the residents of Felton, California. These are not however isolated attempts; Tiffin, Ohio and Homer Glen, Illinois also appear to be pursuing a similar path. More recently and the residents of the Rosario, Vusario and the Orcas Highlands on Orcas Island in Washington State are threatening to reverse the substantial benefits that emerge from a long-established private provision of municipal water services through the threat of condemnation.

In Scottsdale, the city council voted in July 2008 to undertake a study on the potential condemnation of the Miller Road Treatment Facility—currently owned by Arizona American Water—after two recent contamination incidents. In January 2008, consumers were instructed to switch to bottled water for three days after Arizona American discovered that the levels of the suspected carcinogen trichloroethylene (TCE) briefly exceeded federal drinking water standards due to an equipment malfunction. A similar incident occurred in October 2007. In April 2008, Arizona American paid $69,000 in fines for the two TCE contamination episodes.

The facility is a Superfund site and while owned by Arizona American, three companies—Motorola, Siemens and GlaxoSmithKline—are responsible for environmental remediation under the terms of a 2003 federal consent decree. The three companies are the original source of the decades-old groundwater contamination on the site and jointly built the water plant as part of the federally mandated Superfund cleanup. The plant was subsequently sold to Arizona American.

After the January incident, the Maricopa County Department of Health Services found that there was never a health danger to any customer and Arizona American subsequently disconnected the well that created the problem from the rest of the water system. The company is also implementing a number of improvements in response to the incident, including new safety measures, on-site

staff around the clock and new control panels, alarms and daily sampling. The Justice Department and U.S. Environmental Protection Agency required Motorola Inc., Siemens Corp. and GlaxoSmithKline to pay a $500,000 civil penalty for the system failures that led to the TCE release.

TCE contamination at this Scottsdale facility has been a recurring problem over the years, even when the facility was under municipal control, according to state Department of Environmental Quality records. One investigation reveals that the facility has had excessive TCE levels in drinking water supply 16 times between August 1994 and January 1995. Despite paying fines, Scottsdale admitted no liabilities and also failed to notify public authorities to avert a potential contamination of public waters.

Despite the contamination problems Arizona American's performance has been far better than the municipal record, calling into question the use of eminent domain to take over the water system. As Arizona American Water President Paul Townsley wrote in a July letter to the company's Scottsdale customers, "government's power of eminent domain was never intended to be used to take over a private business providing a good product and good service to its customers."

Scottsdale is not the only city in Arizona pursuing similar action. In March, the town of Cave Creek, Arizona will take over the operation of its water utility from Arizona American Water. After losing a 2005 bid to purchase the water system to a private company, the town opted to pursue condemnation to buy the system, citing a need for public control and service quality issues as its main justifications. In March 2007, Cave Creek finally purchased the water utility through condemnation, though the city opted to contract with Arizona American for another year during the transition to public ownership. The acquisition was facilitated by a low-interest loan from the state Water Infrastructure Financing Authority.

The community of Felton, California also recently used the threat of condemnation to take back control of its water system from California-American Water (Cal-Am), a subsidiary of the German multinational corporation RWE. Cal-Am and the San Lorenzo Valley Water District (SLVWD) settled less than a week before the planned start of an eminent domain trial.

In February this year, city officials of the Rosario, Vusario and Orcas Highlands on Orcas Island in Washington State decided to sell their private water utility to the publicly owned and operated Eastsound Sewer and Water District as a result of public pressure. For several years now, the residents of Orcas Highlands have been provided water through Rosario Utilities, a small private company. In September last year when a large investor-owned company Washington Water Services purchased Rosario Utilities the threat of eminent domain emerged. The residents of Orcas Highlands set about gathering support for a vote on annexing their private water utility to the publicly owned and operated Eastsound Sewer and Water District. In February the residents of the areas approved the annexation. The residents now intend to work with the publicly owned and operated Eastsound Sewer and Water district to purchase or more likely transfer to public ownership via eminent domain the originally owned private water utility from Washington Water Services.

Earlier this year Fort Wayne, Indiana, began the process of re-establishing publicly owned water utilities by shifting close to 9,000 customers of Aqua Indiana (a subsidiary of Aqua America) to public water. In 2002, Fort Wayne began using eminent domain to purchase the utility from Aqua Indiana.

In the light of the U.S. Supreme Court's 2005 ruling in *Kelo v. City of New London*—and the overwhelming attention in the public policy sphere to protecting private property rights that followed—the attempt to use eminent domain to expropriate the assets of private water companies presents a worrying trend, especially given the record of successful water management by private entities, the counter track record of municipal failures in water management, the tremendous costs and risks local governments take on in the face in rising long-term operations and maintenance, the need to upgrade and expand aging water systems and compliance with increasingly stringent environmental regulations.

Telecommunications

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A. Cities Seek Alternatives To Municipal Ownership

After observing the pattern of revenue shortfalls and cost overruns, most cities have grown wary of funding and owning broadband fiber optic systems aimed at delivering telephone, cable TV and high-speed Internet service to all businesses residences in the community.

A total of $840 million has been lost on some 52 municipal wireline broadband ventures surveyed in a 2007 study by the Pacific Research Institute. The majority of these were attempts to build fiber-to-the-home (FTTH) networks, which aim to surpass the speed and performance of current commercial broadband services. Most of broadband networks in place today use fiber optics to reach small curbside cabinets that serve 8 to 16 homes. These in turn deliver signals the last few hundred feet via copper or coaxial cable. FTTH, as the term implies, runs a fiber optic line to every home. Although the platform delivers a much higher bit rate, up to 100 megabits per second (Mb/s) compared to current hybrid copper and coax and systems, which can range from 1.5 Mb/s to 15 Mb/s, they are more expensive to deploy. Hence, without a demonstrable consumer willingness to purchase services above basic cable and Internet, (e.g., high-definition TV service, premium cable channels, premium Internet speeds), FTTH operations, whether commercial or municipal, can find themselves cash-strapped fast.

Such was the case with iProvo, the municipal fiber optic system in Provo, Utah. After admitting it had severely underestimated the average revenue per user the system would generate, the city in May agreed to sell iProvo to Broadweave Networks, a South Jordan, Utah startup, for $40.6 million. The $39.5 million system aimed to deliver 100 Mb/s FTTH to all homes and businesses in Provo. Although buildout was completed in 2005, the operation was racking up larger and larger deficits each year while failing to meet customer and revenue goals. For fiscal year 2007, ending last June 30, iProvo lost $2 million and required a special allocation of $1.2 million from the Provo city council to keep the operation afloat. In December 2007, iProvo reported it was on pace to lose another $2 million this current fiscal year.

The past 18 months have also seen large cities gain a more realistic understanding about the costs and limitations of citywide wireless Internet systems, particularly after EarthLink, which in 2005 launched a new business strategy built around participation in public-private municipal wireless partnerships with major U.S. cities.

These ventures themselves were a response to

the cost overruns of municipal fiber. Deployment costs were lower and cities were loath to spend any taxpayer money on them. They turned to public-private partnerships with companies like EarthLink, giving the company business responsibility in return for a share of the revenues. In general, the terms of these agreements would give the private partner exclusive access to city-owned right-of-way, such as light poles, city buildings and other city structures, in return for the obligation to deploy wireless access points, essentially WiFi hotspots, that guaranteed indoor coverage at minimum to the first floors of every home and business in the city. In some cities, provider partners agreed to offer discounted prices to low-income neighborhoods. Chicago, Houston, Phoenix, Portland or and San Jose, CA. were among a number of large cities that proposed wireless projects. In all cases, they would have competed with private sector wireless networks, albeit not ubiquitous.

Even with favored right-of-way arrangements, EarthLink found it too expensive and difficult to meet the citywide coverage requirements. In engineering its initial system in Philadelphia, EarthLink found it would need twice as many access points as originally forecast. Mandatory discounts wreaked havoc with its revenue models. In 2006, EarthLink abandoned the municipal wireless market before beginning construction in most cities where it had reached agreements.

EarthLink's competitors did not fare any better. MetroFi and Azulstar, which were active in a number of West Coast markets, both ran into financial trouble and most of their municipal agreements remain in limbo. Fortunately, most of their partnership agreements were terminated before construction began, so cities—and taxpaying residents—did not find themselves liable for any major infrastructure costs.

This has not been the case, however, with a number of municipal broadband systems that moved forward with construction and now find themselves in financial trouble as losses mount, and, in some cases, initial loan payments come due.

1. UTOPIA Goes South

Policy research has documented the pattern of municipal broadband losses in Dalton, GA ($172 million); Tacoma, WA ($110 million); Grant County, Washington ($76.4 million), to name the three most costly ventures. In Utah, a reckoning is approaching for one of the country's most visible and highly touted municipal projects, the Utah Telecommunication Open Infrastructure Agency (UTOPIA), a consortium of 14 Beehive State cities that operates a fiber optic network off which they wholesale bandwidth capacity to retail Internet service providers (ISPs). ISPs then offer residents phone, cable TV and Internet services via FTTH.

UTOPIA was created in 2004, funded by a 20-year, $180-million loan backed by sales tax revenues pledges from 11 of UTOPIA's 14 members (see Table 16). The operation has completed construction in just six of UTOPIA's pledged cities, although it has begun a controversial program of building out selectively in the three "non-pledging" cities that have not put tax revenue at risk.

All together, the system has only 7,274 customers, representing 17% of the 42,780 street addresses its fiber network passes, according to PacketFront president Matt Wenger, manager of UTOPIA's network operations. Even then, plans had called for UTOPIA to pass 69,000 addresses by this date. It also has had ongoing problems with its retail partners, who have done a poor job at marketing and customer service, Wenger said. Along with construction delays and lower than expected revenues, UTOPIA failed to get an anticipated $67 million loan from the U.S. Department of Agriculture's Rural Utilities Service (RUS). According to Wenger, the loan had been approved, but the actual funding was not. Unfortunately, UTOPIA spent the money before being told it would not receive the funds.

UTOPIA's latest financial statements showed a total of $21 million in losses in 2006 and 2007. The agency projects another $17.3 million in losses for 2008. At a September 2007 hearing of the Interim Subcommittee on Government Competition and Privatization, consisting of members from the Utah

Table 16: Municipal Participants in UTOPIA		
City	**Population in 2004**	**No. of Households**
UTOPIA's 11 Pledging Member Cities		
Phase 1		
Lindon	8,363	1,977
Midvale	27,029	10,729
Murray	34,024	13,303
Orem	84,324	24,156
Payson	12,716	3,869
West Valley City	108,896	33,463
Phase 2		
Brigham City	17,411	5,840
Centerville	14,585	4,238
Layton	58,474	19,144
Perry City	2,383	786
Tremonton	5,592	1,808
The Nonpledging Member Cities		
Cedar City	20,527	7,134
Cedar Hills	3,094	1,701
Riverton	25,011	6,594
The Dropouts*		
Roy	35,503	N/A
Salt Lake City	185,421	N/A
South Jordan	39,198	N/A
Taylorsville	55,632	N/A

*Cities that originally planned to join UTOPIA but opted out when they refused to pledge sales taxes to back the loans.

Source: Utah Telecommunication Open Infrastructure Agency

Senate and House of Representatives, David Shaw, UTOPIA's general council said he could not predict when the consortium would reach break-even.

As of late April, UTOPIA faced a $14 million shortfall with a debt payment coming due May 1 for which it did not have funds.

To regain sound financial footing, UTOPIA has proposed refinancing its 20-year loan with a new 33-year bond. While averting the necessity of forcing pledged members to tap their pledged sales tax revenues, the new deal would raise the overall cost of the loan (principal and interest) to $504 million from $351 million, according to calculations by the Utah Taxpayers Association, which has been advocating UTOPIA's sale or dissolution.

2. Rural Broadband?

Just as troubling as the massive debt refinancing are the steps UTOPIA is proposing to become more fiscally sound. The company has suggested shifting its marketing toward more wealthy and populated markets where they would compete with commercial carriers, but with any losses or shortfalls backed by tax reserves.

Its management company, PacketFront, has said it plans to require contracted commitments from at least 40% of the residents of a community to purchase UTOPIA services before it will begin FTTH construction in that area. Second, it will require homeowners or landlords to finance the cost of the installation of the fiber optic drop from the area node to the home (most likely trenching and burial), an estimated $1,800 to $2,200 cost that would be paid in installments as part of the monthly bill.

UTOPIA, created to provide low-cost, ubiquitous FTTH service to rural, unserved areas, is now selectively deploying to areas and households with the means to afford a long-term commitment and where broadband service already is available.

This was not the founding mission. UTOPIA, like many municipal broadband projects, was sparked by fears that rural, less densely populated portions of Utah would be left out of the "broadband revolution." Commercial service providers, such as Qwest and Comcast, some local officials believed, would only be interested serving high-income urban and suburban areas which promised profitable return on investment. UTOPIA was originally pitched as a statewide fiber optic network that would reach Utah's unserved rural communities.

Utah's 85,000-square-mile expanse is largely rural, but UTOPIA doesn't extend to those parts. Instead, the network runs the approximate 150 miles through the Wasatch Valley, from the state's northern border south through Salt Lake City, south to Spanish Fork and Payson. This is where most Utah residents live and where much of the state's future growth is expected to take place. Utah's population growth ranks as the fifth in the

U.S., according to the U.S. Census Bureau. A review of service provider marketing information shows that competitive broadband service is available throughout the Wasatch Valley.

At the September privatization hearing, several Utah legislators, including subcommittee co-chair state Sen. Howard Stephenson, expressed concern about UTOPIA's growing tendency to provide services in areas already served by the private sector. He particularly criticized UTOPIA's strategy of bidding against the private sector for exclusive access to new upscale real estate developments in non-pledged cities.

As the price for not pledging sales taxes, UTOPIA's Shaw explained, the consortium will not extend its fiber backbone to points all over town. Although Shaw parsed this condition as if the non-pledging town were waiving its right to universal UTOPIA service, Stephenson openly mused whether a city's non-pledging status actually benefits UTOPIA by relieving the agency from the expense of providing complete local coverage.

Also unknown is to what extent UTOPIA might be underbidding commercial competition while using its tax guarantees as a crutch. At the same hearing, a commercial UTOPIA customer spoke of taking competitive bids from Qwest and a number of other private sector service providers to build a high-speed fiber optic connection to his new facility. He chose UTOPIA, he said, because it was significantly lower than the other bids. Considering the cost of cable, electronics, labor and construction is fairly consistent no matter what private company is doing the construction, discounts like these raise questions as to whether UTOPIA is using its access to tax dollars to compete unfairly with the private sector.

For those who follow municipal broadband, UTOPIA's shift away from a goal of ubiquity to selective deployment based on average revenue per user is not surprising. The realities of the broadband market have led other municipal operations to adopt the commercial tactics they once promised to abjure. In Bristol, VA, Bristol Virginia Utilities won local support for its $27.5 million municipal FTTH system based on promises it would offer cable modem speeds at $20-a-month. After two years of red ink, BVU announced it would only provide fiber connections to customers who committed to purchasing a minimum of $50 in monthly services.

Ashland, OR., approved a municipal FTTH project that also was supposed to be citywide. After completing construction to the wealthiest neighborhoods in the city, the municipal operation ran out of money. It halted construction and now markets the taxpayer funded network only to high-income households. Even then, the Ashland Fiber Network can do little but limp along.

As these municipal fiber systems falter, the private sector is ramping up. Fiber now passes 12 million U.S. homes, about 10% of all the homes in North America, according to an April FTTH Council report prepared by RVA Market Research. Of those 12 million passed, 2.9 million are connected—a 25% take rate. Of that 2.9 million, 770,500 (26%) were added in the last six months. And, more significantly, of that 2.9 million, 2.1 million (72%) are Bell company accounts (mostly Verizon). Non-Bell incumbents account for about 14%. Municipalities, who have been doing this for 10 years, account for 4% and that share is dropping.

The age of fiber is finally beginning. And while Verizon has taken the lead with it FiOS service, it will be interesting to see if AT&T and Qwest, which are using hybrid fiber-copper platforms, adjust. Nonetheless, after some initial reluctance, Wall Street is rewarding companies for making these investments. Plus, as rising fuel prices create greater interest in telecommuting, household demand for the bandwidth fiber offers will only increase.

3. In Search of Alternatives

The documented problems municipal broadband systems have had over the years have resulted in many cities giving more thought to alternatives. In some small and mid-sized cities, leaders have shown that the commercial market can provide broadband ubiquity if the area does its best to

create a climate that welcomes investment and attempts to work with local employers, business users, service providers and non-profits.

Graham Richard, the former mayor of Ft. Wayne, IN, said communities facing economic transition should do as much as they can to work with the private sector. In a keynote address at the Southeast Information and Communications Technology Symposium, a technology and policy conference held in April in Raleigh, NC, Richard said Ft. Wayne was one of the first cities in the country to benefit from state franchise reform. A 2006 Indiana law allowed new competitors to enter without spending months negotiating a franchise agreement with a local authority. Using franchise reform as an incentive, Richard enticed Verizon Communications to invest $100 million and launch FiOS, its FTTH service, in Ft. Wayne.

The mayor also looked beyond the phone and cable companies and courted large companies and enterprises in the area that would immediately benefit from the enormous bandwidth Verizon's fiber network would offer. Richard formed a task force drawn from the city council, local businesses and the local chamber of commerce, which in turn worked closely with Raytheon, a major Ft. Wayne employer and area health care providers, which, because they were looking for better data networking solutions, agreed to contribute $1 million to the project.

In bringing various stakeholders together in advance, Richard's approach in Ft. Wayne is similar to the path taken by Corpus Christi, TX, which established partner agencies, identified large applications and set measurable goals before building a network. The only difference was that Corpus Christi funded construction of a wireless broadband network at the outset, although it later sold the operation to EarthLink. With EarthLink departing the business, it is likely the network will be sold again or reacquired by the city.

But Corpus Christi's municipal wireless project was unique. It sought first to construct the network to streamline its own costs as a telecommunications user. Competitive retail Internet services, although discussed in the nascent stages, was not the primary objective. In its approach to municipal wireless infrastructure, Corpus Christi turned the whole process on its head. Corpus Christi's citywide WiFi network was initially conceived as a way for the city electric and gas utility to automate meter reading. True, it financed and built the citywide WiFi system, but then essentially privatized it by selling it to EarthLink in a deal in which it recouped its entire investment. Corpus Christi then turned its effort to programs that would encourage city departments at first, then average consumers, to use the municipal network. Unlike most other cities that simply threw money into broadband networks, assuming the entire population would rush to sign up, Corpus Christi made a concerted effort to identify viable applications in advance of the decision to build the network.

4. New Models?

Most officials who work in local government or with publicly owned utilities appreciate the inherent problems launching service in competition with the private sector. However, those in truly rural communities where there is no broadband at all still fear the market model will not work and have opposed legislative efforts that would prohibit or otherwise raise obstacles to municipal broadband networks. It is in these areas, cities and towns of less than 10,000 population, that there may be room for creative public-private partnerships that can provide needed market stimulus to push broadband, perhaps even FTTH platforms, to markets previously thought unprofitable.

The small size of these markets mitigates some financial risk. Wholesaling broadband may yet have some potential, if municipalities are willing to adjust their revenue models. UTOPIA went wrong in tying its revenue stream to retail consumer services. It took responsibility for funding the network, but put the onus of selling services on the shoulders of its retailers. Similarly in municipal wireless projects, although many cities did not pay for their networks, the cities' financial return hinged on how well the private partner performed.

In order for municipal ownership to work properly, cities need to see an immediate, regular and guaranteed return on their investment. The soundest model is similar to the approach some states are taking with toll roads. In essence, the state uses its funds to build the highway, but then leases the highway to a private operator, usually for a substantial upfront fee. The private operator is now completely responsible for maintaining the highway, using toll funds as user fees. State taxpayers benefit because they pay less road taxes. Toll road users "pay for use," but probably at a lower net cost gained from having a business, not the government managing the road.

Likewise, it is easy to imagine a scenario in which a small town builds a fiber network, then leases it, again for a substantial upfront fee, to a network management company, which then takes on the responsibility of signing up retailers and ensuring delivery of services. The municipality benefits from recouping its initial investment, through the initial payment and then through regular lease payments which service the remaining debt. Taxpayers end up far less liable, yet the community will end up being served by one, two or more providers who buy capacity on the backbone.

PacketFront comes very close to this model in the European markets it serves. The company operates municipal networks in Vienna, Amsterdam and Västeräs, Sweden, a town about 100 miles west of its home base of Stockholm. In the U.S., in addition to UTOPIA, it manages a municipal network in Danville, VA.

While not going as far as the scenario above suggests, Tim Scott, PacketFront's director of sales-North America, speaking at the Southeast ICT symposium, said the company will handle as many as six critical business steps on behalf of cities:

- Broadband planning, asset assessment, design and engineering;
- Organizational and governance, including legal navigation;
- Financing;
- Market strategy;
- RFPs, project management, implementation; and
- Operations.

At this point, PacketFront looks for the city to provide the fiber or wireless infrastructure. It does not appear to lease the fiber, but it also is not clear what kind of compensation terms it accepts or the extent of services it offers UTOPIA. Scott, for example, ducked an audience question as to whether routine UTOPIA maintenance is handled by employees of PacketFront or the member cities.

The company, nonetheless, is experimenting with models in the U.S. market. To be fair, UTOPIA has some value. It would be a logical development if PacketFront took an ownership stake in its operations.

5. Universal Service Issues

But even radical municipal programs must exist within a larger universal service policy framework.

From a macro level, it's been difficult to measure the scope of the problem. The FCC's current metrics woefully misdefine broadband speed as 200 kb/s and break down service availability by zip codes. The metrics are being revised by a new survey that will drill down almost county by county. At the same time, states are mounting similar investigations, if only to know where to direct development funds. Still, one rural town, due to the successful acquisition of an RUS loan or investment by farsighted management of the incumbent phone company, may enjoy broadband services of better quality than some dense urban areas, while another rural town 20 miles away is stuck with dial-up.

Several state initiatives are already underway to pinpoint unserved areas. Agencies such as the e-NC Authority and ConnectKentucky, literally with personnel on the ground, have more up-to-date information on areas where broadband deployment is either marginal or non-existent. State agencies are also aware of immediate priorities, such as when a large manufacturer is assessing an area of the state for a new factory. Thus, they are in a position to

marshal and direct resources to address projects that will yield an immediate payoff for residents, employers and industry partners.

Both states see industry as a partner—not a competitor. Both organizations receive funds from state and federal sources, but they also were wise enough to understand that there was more to broadband infrastructure than fiber. They reached out to companies, enterprises and associations across the industry supply chain.

The e-NC Authority has received funding from most of the broadband service providers serving the state: BellSouth (since acquired by AT&T), Alltel, Sprint, Verizon, the state's cable providers, the state's rural electric cooperatives and the state's rural telephone cooperatives. It has also received support from Cisco Systems, Hewlett-Packard, IBM and Microsoft, DukeNet, Sprint, Capital Broadcasting and Curtis Media Group. Likewise, ConnectKentucky, which was launched in 2004, has drawn participation from Apple, AT&T, Computer Associates, Humana, Intel and Nortel. All of these companies want broadband. Their businesses depend on broadband expansion for growth.

While the goal remains to bring inexpensive broadband connectivity to as many people as possible, a more enlightened approach shifts away from large infrastructure projects to making the benefits of broadband relevant to all classes of potential users. No matter where they stand on policy, broadband advocates find it troubling that adoption rates are low in low-income communities even when service is available for free. "Demand-side" programs that raise education, awareness and access to technology, often run by private non-profit groups, stand to be more targeted and cost-effective at building digital inclusiveness..

The digital divide is not a failure of the market. Individual broadband needs vary enough that universal service cannot be guaranteed by pervasive infrastructure. The market already has demonstrated that private capital exists for infrastructure development. Enlightened policy seeks to create a climate that welcomes that investment. So far we've seen that this is best accomplished by avoiding attempts at government-funded centralized infrastructure planning, engaging all segments of the broadband industry and energizing leadership at the state and local level.

B. Video Franchise Reform Keeps Moving

Cable TV franchise reform has continued to move steadily through the states over the past 18 months.

Since spring 2007, seven more states had passed reform laws that allow cable TV competitors to enter local markets more quickly. They joined 11 states that had enacted legislation in 2005 and 2006. Significant wins occurred in **Tennessee**, which approved legislation after voting it down in 2006. The **Louisiana** legislature this spring revived and approved a franchise reform bill that had first passed in 2006, but was vetoed by then-incumbent Gov. Kathleen Blanco (D). Blanco's successor, Gov. Bobby Jindal (R), as of early June, was expected to sign the legislation into law.

In general, all the bills permit companies seeking to offer competitive phone, cable TV and high-speed Internet services to apply directly to the state for a franchise—that is, authorization to build infrastructure and provide services in a given community within that state. The statewide franchise rules replace a process by which service providers must negotiate individually with the government of each city and town. This has often led to delays and added costs as different towns would make different demands.

Statewide franchising essentially standardizes the terms of all local franchising agreements: specifying the maximum franchise fee that could be collected (usually 4 to 5%), defining "gross revenues," and setting terms for the provision and support of public, educational and government (PEG) channels.

Generally, states that move forward with franchise reform see an upswing in infrastructure investment from incumbent telephone companies, who look to cable TV and cable TV services to pro-

vide the revenues to cover their investment in fiber and DSL rollout (see Reason Policy Study, *Better Prices and Better Services for More People: Assessing the Outcomes of Video Franchise Reform*). Verizon expects to spend $23 billion rolling out fiber optic-based broadband to 18 million homes in its territory between 2007 and 2010. Verizon has operations in eight states that have enacted franchise reform, providing the company with a more predictable build-out timetable and ensuing revenue projections.

Both the competition and buildout stories have proved strong enough that franchise reform opponents avoid addressing them. Instead, many have blamed the decline of public, educational and government (PEG) channels in some areas as an undesirable result of franchise reform. PEG channels, which are usually sustained through franchise fees, provide a local outlet for area individuals and groups, often in the political or social minority, critics say. They also allow telecast of community business—such as city council and school board meetings.

While PEG channels appear to be in decline, the ease at which video can be posted online through such websites as YouTube may be a heavily contributing factor. PEG channels require studio space, expensive cameras and editing equipment, and—when it comes to creating a polished production—professional experience. On the other hand, relatively inexpensive digital video cameras and PC video editing software allow anyone with the motivation to become a "citizen journalist" and reach beyond the community to the wider world. For example, when Gordon Bloyer, a longtime public-access television host from Portage, Ind., found his PEG channel off-the-air, he immediately took his local activism to YouTube, where, according to a profile in the February 2008 issue of *Governing* magazine, he reaches a far wider audience.

In addition, while franchise reform opponents like to characterize PEG programming as popular democracy in action, the reality is that much of it is closer to the "Wayne's World" parody made famous on Saturday Night Live. In Wisconsin, state Senator Jeffrey Plale (D-South Milwaukee), a co-sponsor of that state's new cable franchise law, recalled a public access show that featured a man offering grilling tips. "Should the ratepayers really pay for that?" he asked *Governing*. The same article cited a Los Angeles public access show where the host regularly engaged in juvenile stunts, such as simultaneously running on a treadmill while painting, eating a pie and attempting to take calls from viewers.

States that have currently passed statewide franchise reform are: California, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Louisiana, Kansas, Michigan, Missouri, Nevada, New Jersey, North Carolina, Ohio, South Carolina, Tennessee and Texas.

Arizona and Virginia have passed qualified franchise reform measures. Colorado, Idaho and Utah have voted down franchise reform.

States where franchise reform legislation is pending include New York, Washington and Wisconsin.

C. Growing Doubts About Network Neutrality

Despite a renewed push by some members of Congress and the Federal Communications Commission to forge network neutrality regulation for the Internet, a growing cross-section of the U.S. telecommunications and information technology industry is urging greater caution about rules that stand to introduce an unprecedented level of regulation to both the marketing of Internet services and applications and the underlying network technology that supports them.

A network neutrality law would stipulate that service providers must treat all applications that transverse their facilities—from low-volume, fault-tolerant services like email, to bandwidth-rich, error-sensitive applications like video, gaming and peer-to-peer (P2P) services—the exact same way.

The latest bill, introduced in May and co-sponsored by Reps. John Conyers (D-MI) and Zoe Lofgren (D-CA), would subject broadband

providers to antitrust violations if they block or slow Internet traffic.

This joins two other pending bills. In January 2007, Sens. Olympia Snowe (R-ME) and Byron Dorgan (D-ND) reintroduced sweeping network neutrality legislation that had died in the previous Congress. Later that year, Rep. Ed Markey (D-MA) introduced a version in the House.

If enacted, these laws would prohibit service providers such as AT&T, Comcast and Verizon, as well as hundreds of smaller ISPs and Internet hosting providers from using any network management technology to improve or manage the quality of sophisticated multimedia services that consume large amounts of bandwidth. Nor would they allow service providers to take steps to safeguard more pedestrian Web traffic from congestion created by these high-bandwidth applications. They would also prohibit service providers from charging consumers and businesses a higher price for, say, guaranteed speeds or tiered quality levels. In short, in the neutral network vision, all Internet traffic must contend for the same limited bandwidth with no application getting special treatment. And any quality enhancement offered to one must be offered to all—at no additional charge.

Proponents say network neutrality was a founding principle of the Internet and, only by mandating it as law will the Internet remain free and open to all users. Without neutrality, they say, service providers, through their control of the transmission facilities, will be able to pick winners and losers. This is done by offering quality controls to one while withholding them from another, blocking and "censoring" websites and applications they do not like. As a recent example, network neutrality advocates pointed to a decision by Comcast to slow down P2P file transfers using the BitTorrent protocol.

Yet it was this very example that prompted greater examination of the issue. P2P files tend to be television shows and feature-length movies, files that can be hundreds, even thousands, of megabytes in size. While Comcast was deliberately throttling down the speed at which these files were crossing the network, it was not blocking them. Comcast, in a more apt analogy, was placing a traffic light at the entrance ramp to a busy expressway, a common way to manage traffic congestion during rush hour.

Indeed, some telecom network analysts, even while not predisposed to supporting cable company positions, said Comcast, as a network owner, has a right to do so, particularly when a small group of users threaten the service quality for many more. As if punctuating this point, the BitTorrent protocol is specifically designed to consume as much available bandwidth as it can and not yield any back should network congestion rise.

The good news is that Comcast and BitTorrent were able work out their differences without government interference, demonstrating that market mechanisms can resolve conflicts between high bandwidth users and the quality issues they raise for the larger user community. Under the terms of the accord, Comcast will pursue more "agnostic" network management technology that does not target the BitTorrent protocol directly, but, at peak times, prevents a user of any application from hogging too much bandwidth. For its part, BitTorrent acknowledged Comcast's right to manage its network in order to assure a quality online experience for as many users as possible.

The disregard current network neutrality legislation has for the network management and quality assurance is its most troublesome aspect. U.S. Internet traffic was about 1.5 petabytes (10^{15} bytes) per month in 1996. By 2002, monthly traffic has reached 100 petabytes. By 2006, traffic was 700 petabytes per month, amounting to 8.4 exabytes per year. In a report issued by the Discovery Institute in January, authors Bret Swanson and George Gilder wrote that U.S. Internet traffic in 2015 will be 50 times larger than 2006. Rather than exabytes (1018 bytes), the industry will be measuring traffic in terms of zettabytes (10^{21} bytes) or one million million million bytes.

The FCC, which has held hearings on net neutrality in Cambridge, MA and Palo Alto, CA has so far resisted calls for regulation beyond its cur-

rent network neutrality guidelines, which prohibit application blocking, but do not prevent network management. Chairman Kevin Martin and the two other Republican commissioners favor an unregulated Internet. The two Democratic commissioners support stronger neutrality regulation.

The industry, however, is no longer as polarized on the subject as politicians. Google, Apple, Microsoft and Disney, which two years ago were unequivocally behind network neutrality, have tempered their support, concerned that without network management mechanisms, Internet applications they seek to develop—from searching, entertainment, advertising and co-called "smart home" appliances—will never work right under enforced network neutrality. Even as Google hosted a rally for Democratic presidential candidate Barack Obama, who used the occasion to endorse network neutrality, Google executives such as Andrew McLaughlin, the company's head of global public policy, were saying "None of us want any kind of heavy-handed regulation."

Elsewhere, John Chambers, chairman of Cisco Systems, the leading supplier of Internet routers and switches said, "Broadband Internet access service providers should remain free to engage in pro-competitive network management techniques to alleviate congestion, ameliorate capacity constraints and enable new services."

Most recently, Mark Cuban, maverick tech entrepreneur and co-founder of HDNet, a high-definition programming service, blogged, "I have no sympathy for bandwidth hogs."

D. Outlook for Internet Sales Taxes Still Murky

The hunger state and local governments have for Internet sales tax revenues have only intensified. Fortunately, for most consumers, current law forces most state legislatures to keep their hands off online purchases most Americans make.

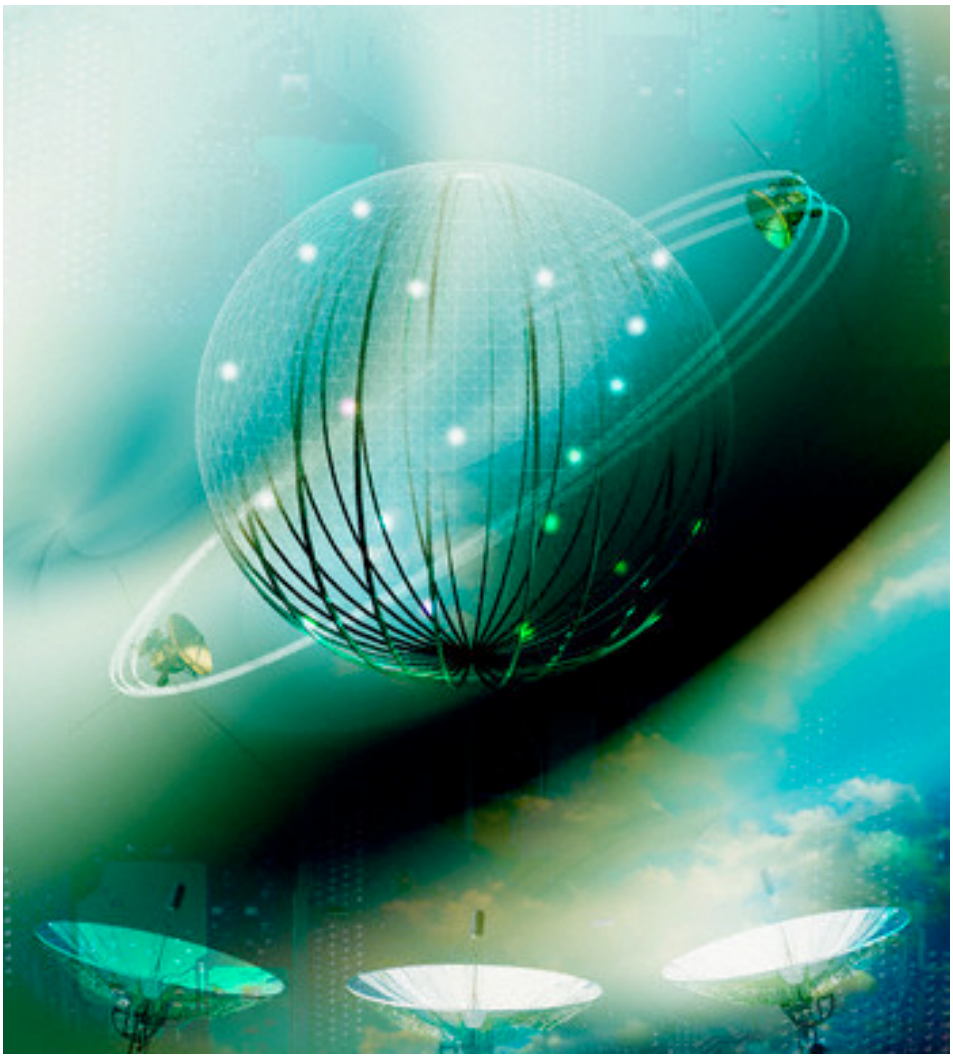
The primary initiative to tax online retail sales, which are projected to reach $204 billion this year according to market research firm Forrester Research, is the Streamlined Sales Tax Project (SSTP). In a much more aggressive move, the New York State legislature this spring enacted a controversial law to force out-of-state online retailers to collect sales taxes by dramatically redefining the meaning of the term "nexus," coined by the U.S. Supreme Court in a key 1992 decision on sales tax collection.

The issue of Internet taxes itself is confusing. Since a majority of Americans do not pay sales taxes on many online purchases, there is an assumption that Internet purchases are tax-free. The confusion is exacerbated by the regular debate on the U.S. Congress on the Internet tax moratorium.

The congressional moratorium, extended last year to 2014, applied to taxation of Internet services. It means neither the federal government, nor state or local governments, can slap a sales or excise tax on cable modem, DSL or dial-up Internet access services. The only exceptions are eight states that taxed Internet access before Congress approved the first moratorium in 1998 and were "grandfathered."

The collection of sales taxes on products purchased over the Internet—be they books, clothing, consumer electronics, household appliances or automobiles—largely has been governed by the 1992 U.S. Supreme Court decision in *Quill Corp. v. North Dakota*, which essentially exempts merchants from collecting sales taxes from out-of-state purchasers. That's why online purchases from Web-based retailers such as Amazon.com and Overstock.com do not tack on sales taxes for a majority of Americans, while online purchases from Best Buy.com, Target.com and BarnesandNoble.com—which have corresponding brick-and-mortar stores in most states—do.

The Supreme Court test was that the merchant, to be sales tax-liable, must have a corporate base of operations—a "nexus"—that is, a store, warehouse or office—within the state. For example, because Amazon.com is headquartered in Seattle, residents of Washington State must pay sales tax on their Amazon purchases. But the necessity of keeping up with the complexity of the rules in



what amounts to some 6,000 U.S. state and local tax jurisdictions, said the court, places too heavy a burden on interstate commerce.

The most organized effort to tax online sales, the SSTP, draws its argument from the Court's language in *Quill* that cites the complex process of compliance, not the sales taxes themselves, as the burden on interstate commerce. Hence, the "streamlined" approach, which aims to make compliance as simple as possible with an eye toward surviving any future constitutional test.

SSTP, launched in 2000, has certified software for commercial websites that automatically calculates, bills and records state and local sales taxes on purchases wherever they originate. Theoretically, the automation eliminates the accounting complexity. Plus, if the merchant uses either the certified software or its site is hosted by an SSTP-certified service provider, it is not liable for payment or compliance errors. Currently 44 states participate in the SSTP project, but only 18 have begun enforcing sales tax collection.

Meanwhile, New York State opened a new front in April, passing a statute to its tax code defining any New York-based website that accepts sales commissions from out-of-state online vendors based on "clickthroughs" as a "nexus" for that vendor.

The use of commissions for Web clickthroughs that result in sales has become a common model for online advertising. For example, Amazon.com, through its Amazon Associates affiliate marketing program, provides hundreds of thousands of websites with a link to its site in exchange for commissions of up to 10%. Amazon believes it has 10,000 affiliates with New York addresses. The average sales tax in New York is 8%. However, up until now, no lawmaking body has attempted to define an in-state, but independent third party as a nexus for an out-of-state business. Critics of the new statute consider it an overreach.

Amazon.com and Overstock.com, while registering in New York to be in compliance, have responded with lawsuits, claiming that the statute runs counter to *Quill*. Both companies also say they can't determine whether affiliates are actual legal residents of New York, whether their websites are hosted within the state at all, nor can they control the affiliate websites, nor determine whether a specific ad is a direct or indirect solicitation for business.

Land Use and Environment

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A. Houston Land Use May Serve as Model for Future Land Regulation

In America, Houston may be the very definition of an urban outlier. Unlike older industrial cities—such as Boston, New York or Chicago—Houston grew up in a post-industrial age, using services, commerce, technology and energy as the pillars of its economy. As a logistical and energy industry hub, it depends on its connectedness to the outside world for its economic vitality. Houston's population ranks among the nation's most diverse and its economy among the most dynamic. Nowhere is this embrace of change and dynamism more evident than what can be seen on the ground in the city's real estate market.

As cities across the nation reel from the steepest housing market decline since the 1930s, Houston's real estate market is surprisingly strong. While new housing sales have fallen dramatically, they haven't fallen as far or as steeply as in other cities across Texas or the nation. More and more observers are attributing this resilience to the market-driven nature of the city's land development process, including a real-estate market unencumbered by zoning.

More than 2 million people live within the city's borders while another four million round out the metropolitan area. Houston may well emerge as the archetype city of the 21st century. Urbanist Joel Kotkin used the term "Opportunity Urbanism" to describe the city in a study for the Greater Houston Partnership, pointing out that Houston's entrepreneurial drive, affordability, tolerance for diversity and willingness to adapt to changing economic circumstance may well propel it to become the next U.S. megacity.

Underappreciated in the city's success may be its uniquely flexible and adaptable approach to land-use regulation. Unlike every other major city in the U.S., Houston has shunned zoning regulation, preferring to leave choices about land uses up to the real estate market.

The benefits of this market-based approach are most apparent immediately adjacent to and inside the "Loop" (the I-610 beltway, a ring road about 10 miles from the city center). Redevelopment occurs at a rapid pace inside the Loop, creating a mix of land uses rare in most U.S. cities, where aggressive zoning segregates and highly regulates land uses. High-rise apartment buildings and commercial towers emerge on redeveloped property quickly and notices of higher density and mixed-use redevelopment dot parcels of land throughout the

inner-loop area.

Despite the lack of municipal zoning, land development is not completely unregulated in Houston. The city has adopted several statutes to set standards for infrastructure, parking, building setbacks and building location. More importantly, in many parts of the city, private deed restrictions that limit future land uses run with the land, not the property owner. Nevertheless, substantial amounts of land are unrestricted by private deed and property owners aggressively promote the flexibility and economic opportunity resulting by the lack of regulation.

Such dynamism in the housing market has created uneasiness among some neighborhood groups and political tensions have risen. Recently, a grassroots flare-up over the proposed redevelopment of an older apartment complex into a 23-story residential tower triggered neighborhood protests that threatened to undermine the market-driven nature of development. In addition, a city council member is currently running for mayor using a "Smart Growth" banner that would inevitably lead to a more regulated development environment. As a result, local housing and real-estate developers have organized to raise public awareness of the dangers of adopting conventional planning rules, founding Houstonians for Responsible Growth in 2008.

If these changes result in less flexibility in the real-estate market, Houston residents may suffer in the long run. The market-driven nature of the city's land market means that the housing sector is likely to rebound faster than in other cities facing traditional regulation through zoning. "The resulting correction," economists at the Houston Branch of the Federal Reserve Bank of Dallas write in a 2008 report, "takes place in the context of prices that are squarely in line with local construction costs and without the painful supply induced downturn underway in many other markets."

The Dallas FED report points out that the relationship between zoning and high housing costs "is a robust one." They point out that even some academic research suggests that Houston homes in more regulated neighbourhoods tend to be less affordable than those in other zoned cities or even in deed-restricted neighbourhoods within the city. "In summary," the authors write, "Houston's low-and-slow home prices have made real estate a relatively accessible and safe investment for the area's residents even as other cities' markets have become expensive and volatile. The early phases of the current housing downturn—the boom and bust in prices—were barely felt in Houston." Houston began to feel the pinch in its housing market when credit dried up as the subprime mortgage crisis narrowed mortgage availability throughout the economy.

Houston's permissive approach to land development, combined with benefits of a strong global commodity market, has helped the city avoid the peaks and valleys of the housing market evident in other U.S. cities, where regulation delays supply side adjustments to rising demand and magnifies the effects once the bubble bursts.

B. "Smart Growth" Planning Reducing Housing Affordability in Florida

Florida is recognized as a national leader in the "Smart Growth" movement. The state has given housing goals a special prominence in regional and urban planning, explicitly requiring its cities to plan for a diverse range of housing needs and types.

However, a growing body of research strongly suggests that some of the goals of Smart Growth's advocates may be inconsistent with the realities of housing development.

In fact, despite statewide planning goals and programs designed to promote affordable housing, housing costs have been increasing in Florida faster than the national average. According to the National Association of Realtors, home prices in Florida exceeded the national average for the first time in 2005. Housing price increases have also outpaced income growth. Indeed, since 1994, housing price inflation has outstripped income growth by a factor of two to one.

Not surprisingly, housing affordability has suffered. Housing affordability in Florida tracked

the national average for much of the 1990s but declined significantly after 2000.

Florida's housing opportunity index—a measure of how many households can afford the "median" home based on income and housing price—has eroded sharply, particularly since 2005, falling well below the national level by 2007. While affordability nationwide was just over 10% lower in 2007 than it was in 1991, affordability in Florida has plummeted by more than 50% over the same time period and has eroded by nearly 60% since its peak of 80.7 in 1994.

Despite these trends, few analysts have examined Florida's statewide growth management law and its impact on housing markets and prices. This is surprising because a large body of research has shown that local and statewide development regulations significantly impact housing production and costs.

Among the handful of studies that have examined Florida's housing market, one conducted by Reason Foundation in 2001 found that Florida's Growth Management Act (GMA) may have contributed as much as 20% to rising housing costs between 1994 and 2000.

In partnership with the James Madison Institute, Reason analysts recently updated and extended the 2001 study by analyzing housing price data from 1990 to 2006. A statistical analysis of housing trends in 56 of Florida's 67 counties found that as much as 16% of housing-price inflation during that time period can be attributed to planning under the state's GMA, a result consistent with previous analysis and research.

The updated evidence in the report confirms that growth-management regulations increased median single-family home sale prices on a statewide level. This relationship becomes evident through summary data as well as more sophisticated statistical analysis that controls for factors such as changing household incomes, single-family home quality and public policy.

This should be of particular concern to Florida policymakers given recent significant downturns in housing affordability. The report found a disconnection between the goals of statewide growth-management laws that seek to ensure affordable housing for their residents and the effects of these growth-management policies when implemented.

The results of the research suggest that some of the goals of Smart Growth advocates may be inconsistent with the realities of housing development. To the extent that more compact, higher-density urban development is encouraged through growth-management laws designed in ways similar to Florida's, higher housing prices could result. First, higher density urban areas are associated with higher housing prices as more people compete for an increasingly scarce resource: land. Second, by forcing development into existing urban areas, housing development will tend to take place in fast-growing areas, propelling consumers to bid up the price of land.

The decreased housing affordability resulting from GMA implementation suggests that measures to check housing affordability were either inadequately designed or have not been implemented consistently by Florida's cities and counties. A 1999 report by Florida's Affordable Housing Study Commission (AHSC) supports this contention, finding that the GMA requires local plans to provide detailed information regarding the location, cost and funding sources for a variety of community infrastructure needs (e.g., road, water and sewer systems) but sets the bar lower for affordable housing. Local governments are required to quantify the affordable housing deficit in the housing elements of their plans but not how they will address such a deficit.

These problems may be compounded by the very structure of Florida's GMA. While explicitly including goals to promote housing diversity and affordability, it imposes planning mandates that are likely to increase housing costs. Thus, there is a breach between planning goals and planning implementation. This is particularly notable in policies aimed at reducing sprawl. By encouraging higher-density development, urban planning is likely laying a foundation for increased housing prices unmatched by increases in incomes and other factors, resulting in deteriorating housing affordability.

This fundamental contradiction in the planning process is unlikely to be resolved by refining regulations and imposing more development controls. Though housing element requirements call for local governments to provide adequate sites for affordable housing, the lack of guidance regarding how this is to be accomplished already leads to a "piecemeal approach to planning for affordable housing," according to the AHSC, despite requirements that mandate consistency. The AHSC has found that some communities fulfill their housing requirement by delineating high-density residential areas on their future land-use maps, even though this approach does not guarantee the future availability of designated lands for such uses and could lead to an over-concentration of affordable housing in one geographic area. Other communities have addressed the housing requirements by either indicating that land for affordable housing is already built-out or that such needs have already been met by adjacent communities.

Florida's experience under the GMA demonstrates that strong growth-management laws that tie local planning to statewide goals run the risk of further politicizing the development process, increasing transaction costs and creating an imbalance between housing supply and demand. This disequilibrium may exist in the aggregate as well as for specific types of housing, putting upward pressure on housing prices and, ultimately, reducing housing affordability.

Policymakers should recognize the difficulty of achieving affordable housing goals through GMA-style smart growth planning, given its impact on housing and real-estate markets. The American housing market is dynamic and current comprehensive planning tools may not be able to capture this dynamism. This is particularly true in the context of America's legal system, which continues to protect property rights and respects

the importance of meeting consumer demands for most goods and services, including housing.

The article above is an excerpt from "Statewide Growth Management and Housing Affordability in Florida," published by The James Madison Institute. The full text of the paper can be found online at www.jamesmadison.org/pdf/materials/610.pdf.

C. Property Rights Update

1. State Eminent Domain Reform Update

As reported in previous editions of *APR*, the 2005 U.S. Supreme Court's *Kelo vs. New London* decision upholding the exercise of eminent domain for private development spawned a national public backlash and prompted the vast majority of states to enact reforms curbing eminent domain abuse. As the Institute for Justice (IJ) reports in a January 2008 study, *Doomsday? No Way: Economic Trends and Post-Kelo Eminent Domain Reform*, 42 states had passed some type of eminent domain reform by the end of 2007.

Contrary to the gloomy predictions espoused by municipal leaders, urban planners and redevelopment advocates, the IJ report found that there appear to be no negative economic consequences from eminent domain reform, even in states like Florida and South Dakota that passed what are generally regarded as the strongest reforms. Trends in construction jobs, building permits and property tax revenues were essentially the same after reform as before. These variables would have been directly affected if the dire predictions from eminent domain reform opponents—who frequently claim that eminent domain is necessary to boost private development, jobs and taxes—were indeed true.

IJ followed up *Doomsday* with two June 2008 studies arguing that government redevelopment efforts can stifle economic development projects and actually hinder urban revitalization. In *Baltimore's Flawed Renaissance*, authors find that Baltimore's redevelopment strategy has been deeply flawed and negatively impacted by the city's aggressive use of eminent domain over the past half century. While the city's Inner Harbor has evolved into a premier attraction, the bulk of the city remains a relic of post-WWII urban decay and bears the scars of failed government-backed redevelopment in decades past. According to the report, the city's post-WWII revitalization efforts prompted an exodus of businesses to outlying areas where they would not be threatened with eminent domain and taxed exorbitantly. The authors conclude that, "[the] city's lack of progress on so many fronts is a direct by-product of its failure to understand and treat the real source of its problems: hostility to private property rights and a resulting flight of capital that largely drained the city of its economic lifeblood."

In *Simplify, Don't Subsidize: The Right Way to Support Private Development*, independent developer Doug Kaplan details the bureaucratic and regulatory hurdles small developers face as a matter of routine. Using Santa Cruz County, California as a case study, Kaplan argues that the amount of paperwork and fees that go along with each of the intricate regulatory steps actually stifles urban economic development. Kaplan concludes that "more often than not, local governments don't 'catalyze' private development; they drive it away by making it too expensive."

After the brisk pace of state-level eminent domain reform between 2005 and 2007, activity slowed considerably this year, with few legislatures addressing the issue in the 2008 legislative session. The most notable is **Delaware**, where Governor Ruth Ann Minner vetoed Senate Bill 245, the state's second round of eminent domain reform. In 2005, Delaware became the first state to reform its condemnation laws after *Kelo*, though IJ found that it "provided only modest reform, allowing eminent domain abuse to continue." SB 245 would have restricted eminent domain to its traditional uses—roads, schools, government facilities and the like—while still allowing local governments to exercise eminent domain to address public health and safety concerns. In June 2008, the state legislature failed to override Minner's veto on the last

day of the session.

In Colorado, the Senate Government Committee killed HB 1278, which would have curbed the Denver Regional Transportation District's (RTD) power of eminent domain. As originally drafted in the House, the bill would have limited RTD to acquiring private property through condemnation only for "public transit purposes." By the time it reached the Senate, the bill had been watered down, only requiring RTD to sell land it acquires back to the original owner if not used for the original purpose for which it was acquired.

The Louisiana legislature passed SB 295, referring a measure to the November 2008 ballot that would modify some of the eminent domain provisions in the constitutional amendment passed by voters two years ago.

In March 2008, Missouri's state Supreme Court overturned a lower court ruling that would have blocked local governments from using eminent domain for private development. The case involved a dentist in Arnold, Missouri whose property was deemed blighted to make way for a redevelopment project.

Property rights activists in New York suffered a setback in 2008 when the U.S. Supreme Court refused to hear a lawsuit aimed at halting the controversial Atlantic Yards redevelopment project in Brooklyn. The Court rejected an appeal by 11 property owners and tenants facing condemnation to advance a $4 billion redevelopment project that includes a new stadium for the New Jersey Nets basketball team and over a dozen high-rise office and apartment buildings. The plaintiffs argued that the condemnation is unconstitutional because it involves the use of eminent domain for the benefit of a private developer, not for a legitimate public use. According to the project's developer, property rights activists have now lost 20 court decisions relating to the Atlantic Yards project. The plaintiffs' attorney plans to continue to pursue the case in state court.

In February 2008, the New Jersey Supreme Court Appellate Division ruled that property owners are entitled to 45 days notice before property can be taken through condemnation. The ruling stems from a case involving three Harrison, New Jersey business owners whose properties were designated as blighted in 1997, but were not given specific notice that their properties would be taken. In 2003, Harrison officials finally notified the property owners, but refused to allow for any appeal since the 45-day notification period had ended.

In July 2008, Rhode Island Governor Donald Carcieri signed SB 2728 restricting the use of eminent domain powers. The bill restricts the use of eminent domain for economic development purposes and outlines four permissible uses of eminent domain: projects under public ownership and use; transportation projects; projects involving public utilities, telecommunications and common carriers; and actions taken to address public health, safety or welfare issues. In addition, property owners subject to condemnation will be compensated at a minimum of 150% of the fair market value of the real property and will also receive compensation for expenses related to relocation and business re-establishment. However, property rights activists warn that further reform may be needed, since the bill does not address the statutory definition of "blight" and offers only a vague definition of what constitutes an economic development project.

Utah Governor Jon Huntsman signed HB 323, excludes certain parks, trails and other recreational facilities from the scope of what is classified as a public use for eminent domain actions. The bill amends last year's legislation regarding the use of eminent domain to acquire property for the purpose of building new public trails. According to the bill's sponsor, Rep. Aaron Tilton, a judge informed him that the provisions of last year's bill could be skirted by simply designating the use of targeted property as a park when the actual use was for a recreational trail.

2. California Voters Approve Weak Eminent Domain Reform Measure

As reported in *APR 2007*, California voters faced two competing ballot measures on eminent domain reform in 2008. In June, voters approved

the weaker of the two bills, Proposition 99, which was placed on the ballot by the California League of Cities and environmental activists. Critics argued that Prop 99 would only make marginal tweaks to the state's eminent domain law, prohibiting government from condemning owner-occupied single-family homes or condominiums for private redevelopment projects. Voters approved Prop 99 by a 65–35% margin.

Voters rejected a more comprehensive property rights protection measure, Proposition 98, placed on the ballot with the support of the Howard Jarvis Taxpayers Association and the California Farm Bureau. In addition to preventing the condemnation of homes for private redevelopment projects, Prop 98 would have also applied to businesses, farms and churches and would have prevented the exercise of eminent domain for the purpose of natural resource protection. The most controversial provision would have phased out rent control in California, generating significant opposition from local governments. Prop 98 was defeated at the polls by a 55–45% margin.

3. Regulatory Takings Update

Local governments routinely pass restrictions on the ability of property owners to use their land in ways that were legal at the time they bought their property—resulting in enormous losses to private property values—without compensating owners. This typically occurs through such means as zoning regulations, historic district preservation ordinances and other types of land use regulation that control the use of private property. These actions are referred to as "inverse condemnation," or more simply as "regulatory takings."

After several decades of enduring egregious regulatory abuse under Oregon's centralized, statewide planning and zoning system, voters passed Measure 37 in 2004, requiring government to either pay landowners for these "regulatory takings," or waive the regulations. Over three years of implementation, Oregon landowners filed more than 6,600 Measure 37 claims with the state; most sought to build residential subdivisions on farm and forest land located outside of designated urban growth boundaries. Almost immediately after passage, Measure 37 became the subject of a sustained media attack from a variety of interest groups attempting to thwart its implementation, dissuading other states from adopting similar measures.

As reported in last year's *APR*, the Oregon legislature also disapproved of Measure 37 and passed bills to gut it significantly. One bill referred a measure to the November 2007 ballot—Measure 49—that would drastically water down Measure 37.

Measure 49 offers aggrieved Oregon landowners three options:

- build one to three homes on their property under an "express" option, with no documentation required on property value "lost" due to regulation;
- build up to 10 homes by providing documentation on how much regulation has diminished their property's value;
- or complete an approved Measure 37 project by proving they had vested rights by investing significantly in the approved development project.

In January 2008, the state began sending notices to the roughly 6,600 Measure 37 claimants, giving them 90 days to choose which of the three options they would pursue. By mid-June, a total of 4,022 claimants had responded, with 91% opting for the express option. The remainder of Measure 37 claimants did not respond at all, presumably forfeiting their chance to develop their property. According to Oregonians in Action (the original sponsor of Measure 37) president David Hunnicutt, "[t]here are quite a few people who just said, 'Forget it, every time we get something back it's taken away from us.'"

The state's Department of Land Conservation and Development prepared a report for the legislature in June 2008, finding that Measure 49 will drastically reduce the number of houses built in the countryside, relative to Measure 37. Instead of

the potentially 100,000+ houses that could have been built under Measure 37, the state will only see approximately 13,000 under Measure 49.

However, Measure 49 faces a legal challenge from activists arguing that development rights originally granted under Measure 37 amount to a contract and cannot be nullified by Measure 49. A federal judge will hear the complaint in August 2008.

In 2006, property rights advocates in Washington were unsuccessful in convincing voters to pass a Measure 37-style ballot measure: Initiative 933. The measure was in large part a reaction to the Critical Areas Ordinance passed by King County officials in 2004, which places severe restrictions on rural landowners. The ordinance included clearing and grading restrictions that essentially forced many rural landowners to leave a majority—up to 65%—of their properties untouched. County officials argued that the regulations were necessary for flood control and to protect groundwater quality.

In July 2008, a state Appeals Court overturned those provisions the King County Critical Areas Ordinance. The Court found that that the ordinance is an illegal, indirect tax on development. Attorney Brian Hodges, who brought the suit on behalf of local property rights activists, told a local radio station that the ordinance "basically drew a line around rural King county and said 'we're just going to blanket take-away 50 to 65% of your property.'" At press time, County officials were considering whether to appeal the decision.

In Alaska, a local ballot measure modelled after Measure 37 was defeated at the polls in October 2007. Voters in the Matanuska-Susitna Borough of Alaska—covering a territory the size of West Virginia—rejected Proposition 1 (the Private Property Protection Act) by a 71–29% margin. The measure was sponsored by representatives of the Mat-Su Taxpayers Association but was opposed by citizens groups, the local builders association and the local board of realtors, who feared that the measure could expose the Borough to costly lawsuits and compensation claims. One of the measure's sponsors, Penny Nixon, responded to the vote by saying, "I'll be the first to declare [Proposition 1's result] a stunning victory for socialism."

D. Are Hydrogen Cars Good for America?

By William J. Korchinski

Hydrogen cars have captured the imagination of politicians and the public alike. Governor Arnold Schwarzenegger, Senator John Kerry and Energy Secretary Samuel Bodman have all hailed hydrogen as an important component of the nationwide effort to develop cleaner, greener and more sustainable sources of energy. In addition to hydrogen's perceived efficiency and environmental friendliness, policymakers also have welcomed hydrogen as a source of energy that could wean the country off its dependence on oil and foreign sources of energy.

Hydrogen cars have been the most obvious symbol of efforts to move the country into a hydrogen-powered future. Policymakers envision a world in which the only emission from a car's tailpipe is water, the byproduct of hydrogen fuel cells.

According to a 2007 Reason Foundation report, however, hydrogen's promise as a truly clean and efficient alternative to oil is still only a promise. At present, hydrogen is not an efficient or environmentally friendly alternative to the gasoline that powers nearly all automobiles. Hydrogen fuel cells in the cars themselves produce virtually no pollution, aside from water. However, depending on the technology used, the manufacture of hydrogen fuel cells produces as much or more net pollution than the manufacture and use of gasoline.

Moreover, hydrogen would not significantly reduce the country's dependence on foreign sources of energy. The hydrogen manufacturing process requires substantial quantities of natural gas. Since production at known natural gas reserves in the United States and Canada has levelled off, the United States would need to look elsewhere for sources of natural gas to create the hydrogen for its

hydrogen-powered future. Russia and countries in the Middle East are, as with oil, the largest producers of natural gas.

Policymakers' desire to reduce pollution is admirable, but hydrogen may not yet be the answer. Instead, other technologies—including clean coal processes and nuclear power—show promise.

William Korchinski is a chemical engineer who has spent his career working worldwide in the oil refining and chemical industries. Currently he runs his own business, Advanced Industrial Modeling, Inc., in Santa Barbara, California. The above is the executive summary from Reason's November 2007 study, *Are Hydrogen Cars Good for America?*, available online at www.reason.org/ps363.pdf.

E. The Environmental Costs of Hemp Prohibition

Regulation of Cannabis sativa L. is complicated by the fact that there are two common varieties of the plant with very different properties: the agricultural variety, known by the common name hemp and the pharmacological variety, marijuana. Prior to prohibition in the United States, industrial hemp was the subject of considerable excitement and speculation. The same is true today, as lawmakers and stakeholders in many states are considering the potential for reintroducing industrial hemp into the domestic economy.

The environmental performance of industrial hemp products is of particular interest because, to a large degree, environmental inefficiencies impose costs on society as a whole, not just on the producers and consumers of a specific good. Many commodities which came to replace traditional uses of industrial hemp in the United States in the last century and a half have created significant environmental externalities.

Assessments of industrial hemp as compared to hydrocarbon or other traditional industrial feedstocks show that, generally, hemp requires substantially lower energy demands for manufacturing, is often suited to less-toxic means of processing, provides competitive product performance (especially in terms of durability, light weight and strength), greater recyclability and/or biodegradability and a number of value-added applications for byproducts and waste materials at either end of the product life cycle. Unlike petrochemical feedstocks, industrial hemp production offsets carbon dioxide emissions, helping to close the carbon cycle.

The positive aspects of industrial hemp as a crop should, however, be considered in the context of countervailing attributes. Performance areas where industrial hemp may have higher average environmental costs than comparable raw materials result from the use of water and fertilizer during the growth stage, greater frequency of soil disturbance (erosion) during cultivation compared to forests and some field crops and relatively high water use during the manufacturing stage of hemp products.

Overall, social pressure and government mandates for lower dioxin production, lower greenhouse gas emissions, greater bio-based product procurement and a number of other environmental regulations, seem to directly contradict the wisdom of prohibiting an evidently useful and unique crop like hemp.

The above is the executive summary from Reason's March 2008 study, *Illegally Green: Environmental Costs of Hemp Prohibition*, available online at www.reason.org/ps367.pdf.

Public Safety

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A. Pew Center Study Finds Rising National Prison Population

A new report from The Pew Center on the States says that one in every 100 American adults is behind bars today. Between 1987 and 2007 the national prison population has nearly tripled from 585,084 to 1,596,127. Pew also estimates another 723,131 inmates in local jails, putting the total U.S. prison population over 2.3 million—more than any other nation on Earth. Florida had the highest rate of prison growth in 2007, up 4.5%, while California decreased its inmate population nearly that much.

The percentage of state budget spending on prisons has also grown dramatically in the past few years according to the Pew study. Oregon comes in at the top of the list, committing 10.9% of its budget to corrections. Florida and Vermont share second at 9.3%, with Colorado (8.8%) and California (8.6%) rounding out the top five. Virginia has made great strides according to the Pew Study, having reduced its corrections spending 8.1% in the past 20 years to 6.7%, one percentage point below the national average.

The increasing general prison population has spurred growth in the private corrections sector. Total capacity in private facilities has nearly reached 200,000 beds across 312 institutions in 35 states and the District of Columbia. According to the Association of Private Correctional and Treatment Organizations, as of June 2008 at least 24 states (including DC) have capacity for 1,000 or more prisoners across their various facilities. Texas is the largest state contracting out to private firms for corrections services with 79 different facilities with a total capacity of 57,011.

B. Savings and Losses for Federal Detention Facilities

With a federal prison population now over 30,000, officials are increasingly turning to privately run facilities. Tougher immigration laws have caused U.S. Immigration and Customs Enforcement (ICE) to turn to detention contracts to meet logistical and financial limits. According to Detention Watch Network, the ICE saves over an average of $31 per person, per day, through private firms compared to agency-run detention centers. These financial benefits are spurring ICE to contract out more of its facilities. Detention Watch also cites a report showing that, at the end of 2007, 38% of ICE detainees were held in private facilities or in prisons managed by a private firm.

Table 17: Private Prison Capacity by Facility Type [as of June 2008]				
Facility Type	Male	Female	Either	Total
Prison	116,050	4,627	0	120,677
Detention Center	48,557	300	78	48,935
Com./Rel. Center	11,775	1,505	1,371	14,651
Jail	3,941	0	0	3,941
Treatment/Educ.	2,999	906	1,687	5,592
Mental Health	1,746	17	652	2,415
Non-Residential	0	0	1,825	1,825
Total - All Types	185,068	7,355	5,613	198,036

Source: Association of Private Correctional & Treatment Organizations | www.apcto.org

Table 18: Private Prison Capacity by Security Type [as of June 2008]				
Security Type	Male	Female	Either	Total
Maximum	25,340	1,298	129	26,767
Medium	109,020	3,003	54	112,077
Minimum	35,587	789	563	36,939
Close	2,559	0	0	2,559
Res. - Secure	10,733	1,784	388	12,905
Res. - Open	1,439	442	1,391	3,272
Non-Residential	50	39	3,428	3,517
Total - All Types	184,728	7,355	5,953	198,036

Source: Association of Private Correctional & Treatment Organizations | www.apcto.org

Not all is positive for federal officials though. Recently, ICE contractors have been accused of inmate misconduct. The ACLU sued U.S. Customs and the private firm Corrections Corporation of America (CCA) twice in 2007. Allegations range from poor medical care to overly cramped housing to unsanitary living conditions. The outcome of cases in these matters are pending before several courts, but the ICE has already acted to increase its oversight vigilance with a "detention-inspection task force" for responding to complaints by detainees.

Not to be slowed by the accusations, CCA recently announced a contract to build and operate a new federal prison in Pahrump, Nevada. The new facility will house over 1,000 inmates from the U.S. Marshals Service, Federal Bureau of Prisons and ICE. The prison will be CCA's 42nd company-owned facility nationwide.

In Congress, the Private Prison Information Act of 2007 was referred to committees in both the House and Senate. Two subcommittee hearings have been held on the matter, the most recent in June 2008. At that hearing, Reason's Director of Government Affairs Mike Flynn testified that the Act could allow the general population to obtain proprietary or confidential information from the private prison companies. The bill, sponsored by Sen. Joe Lieberman and Rep. Tim Holden among others, would put private prisons under the requirements of the Freedom of Information Act. FOIA currently only applies to public agencies, but PPIA would greatly expand information available about private companies to the general population.

C. State Private Corrections Update

Arizona now has nearly 25% of its inmates in private prisons, according to the *Arizona Daily Star*. This fact has been cause for both praise and concern amongst state leaders. Legislation that would have tightened the rules for Arizona's

private corrections industry failed to pass out of committee in March. Senate Bill 1142, drafted by Governor Janet Napolitano's Office and introduced by Republican Sen. Robert Blendu, would have restricted the types of out-of-state felons that can be held in private prisons and mandated a new set of reporting requirements for private prison operators.

The measure was not the first attempt to increase private prison regulation. Then-Sen. Pete Rios introduced a bill in 1998 with similar provisions that failed. But the past 10 years have changed his position on the matter, after seeing the positive effect CCA prisons have had in providing jobs and other economic benefits to Arizona communities.

SB 1142 was also not the last attempt in Gov. Napolitano's fight against private prisons. The Arizona Senate rejected another bill in June, this time sponsored by Sen. Debbie McCune Davis, which would limit the type of prisoners private prisons could accept into their custody. Support to defeat the bill came from both Republicans and Democrats.

While debate continues in the state legislature, a project that sent Arizona felons to Indiana state prisons by private contract ended in 2008. An agreement was reached in March 2007 between the two states to ease overcrowding in Arizona by utilizing unused beds in New Castle, Indiana. But a riot in late April 2007, along with a lockdown in January, has caused officials to dissolve the agreement, citing a failure to properly contain the prisoners.

This comes as a setback to the private prison industry, which has promoted such agreements to help fill its beds throughout the nation with prisoners from other states. More prisoners means more jobs as facilities run at higher capacity. But the April riot by out-of-state prisoners brought many questions and a second clash between inmates and prison guards triggering a January lockdown was the final straw. The private operator of the New Castle facility, The GEO Group, Inc. (GEO) has since enhanced security and maintains the effectiveness and efficiency of their prisons, but Indiana now says they need the room for their own prisoners.

On the local level, Mohave County officials rejected a proposal from CCA in May to build a new medium security prison near Dolan Springs, Arizona. Although the developers promised the prison would only be for low-level crime, opponents claimed other prisons had made similar promises and failed to up hold them.

CCA was successful in developing a prison in Eloy, Arizona, though and opened the new facility in late 2007. The Saguaro Correctional Center can house up to 2,000 inmates but was built exclusively for prisoners from Hawaii. Over 2,900 miles from the islands, CCA contracted with the Aloha State to house some of its prisoners on the mainland and CCA has announced plans for a second facility in Eloy to house 3,000 more inmates.

Before that plan goes through, however, CCA may have to wait for results from a proposed audit of their facility by the **Hawaii** state legislature. Senate Bill 2342 commissioned a "full audit" of the facility on grounds that such a survey has not been done for any of the state's mainland facilities since they began sending prisoners there in 1995. Concern was raised about the CCA-run prison after a *Time* magazine article alleged the Eloy facility was concealing violent incidents from the public record. Director of Hawaii's Department of Public Safety (DPS) Clayton Frank opposes the bill, especially with its high, $150,000-plus price tag. He says the DPS already conducts ongoing, quarterly surveys that thoroughly audit the CCA prison to assure compliance is being met.

In April, **Colorado** Gov. Bill Ritter signed into law a bill that provides financial incentives for private prisons to develop innovative security programs and provide education. The legislation allows the state more flexibility in setting rates for prisoners in private facilities; previously there was no flexibility in negotiating adjustments to existing contracts.

Given the state's rising prison population, Colorado is increasingly turning to private prisons to

provide beds for its inmates. Roughly 22% of the state's prisoners are held in private facilities and that number could rise to 40% in the next few years, according to state Department of Corrections Executive Director Ari Zavaras.

In **Texas**, a think tank has proposed decreasing the number of repeat offenders by offering incentives to private prisons. Marc Levin, director of the Center for Effective Justice at the Texas Public Policy Foundation, said in a June 2008 article that the state should change its current contracts with private prisons, which house nearly 15,000 inmates. The current contracts outline all procedural matters for private facilities, making them carbon copies of state-run institutions. Instead, contracts could give private companies freedom to innovate in their corrections operations, offering bonuses based on reduced recidivism and increased inmate education growth. This incentive idea would be the first of its kind in the United States.

California prisons will be allowed to continue their reform process according to the state Third District Court of Appeals in June ruling. With over 165,000 inmates overcrowding the state prison system, Governor Arnold Schwarzenegger ordered the state to start using private contractors to ship its prisoners to other states. So far, 3,900 inmates have been sent to prisons in Mississippi, Tennessee, Arizona and Oklahoma, reducing what is considered "an imminent and substantial threat to the public safety."

The issue before California's courts was whether the transfers violate state provisions limiting the use of private contractors for state jobs. The California Correctional Peace Officers' Association sued in 2006 to stop the transfers and won in a Sacramento County Superior Court. The officer's union has announced it will appeal the Third District Court's reversal of that decision to the state Supreme Court.

Gov. Schwarzenegger's office says that before they started moving prisoners over 15,000 inmates across 29 of the state's 33 prisons were being housed in makeshift conditions that posed substantial safety risks. The appellate court justices agreed, finding that the prison overcrowding forced early releases, prisoner back-ups, greater potential for the transmission of infectious diseases and polluted groundwater with spills from overtaxed local sewage systems. More humane conditions for prisoners by utilizing transfers are at the core of the state's prison reform project.

For those remaining in state, inmates are more and more likely to find themselves in a privately run facility. As the state continues to utilize private prisons for its low-security inmates, Gov. Schwarzenegger has requested a $67 million increase in spending from the legislature for its contract with GEO. The increase would help cover increasing food costs, health care and utilities, along with added funding for more inmate rehabilitation.

Some state lawmakers say the pay increase is too much, especially in light of the state's projected $8 billion budget deficit through 2009. However, the new total would still be substantially lower than the $118 per inmate per day rate the state pays to house prisoners in its own facilities. GEO's rate is $60 per inmate per day.

Idaho Governor C.L. "Butch" Otter has not been as successful as his California counterpart. Otter tried for six months to convince the legislature that privatizing Idaho's new prison is the best management decision, but state lawmakers balked nervously. The prison is necessary due to the 50% increase in inmates since the year 2000. Abandoning his efforts to have a totally privatized prison—owned and operated by a private corporation—Otter now says he'll accept a partially private contract.

Idaho already has one prison privately run by GEO and the new prison would have a similar contract.Gov. Otter's new position is very attractive to legislators, who would prefer its prisoners remain close to home. It is also more fiscally attractive than the status quo of sending prisoners out-of-state.

Florida may be building its sixth and largest private prison. GEO has a new facility for Jackson County on the drawing board, a $70 million, 1,500-bed prison called Graceville Correctional Facility. GEO has also said they are considering

building a seventh prison, this one in Marion County. Florida's five privately run state prisons currently house 7,000 prisoners.

Pennsylvania's flirtation with privatizing forensic units in its state-run mental hospitals came to an end earlier this year. The state announced in August 2007 that it would accept bids from private firms to take over two forensic units at the end of 2008 after merging its Mayview and Torrance State Hospital branches. However, the Pennsylvania State Corrections Officers Association—representing over 200 employees in the forensic facilities—put up a big fight, arguing that privatization was a "reckless gamble with public safety" and would open the door to prison privatization. In the end, the Department of Public Welfare reached an agreement with the union whereby they would not pursue private contracts in exchange for cost cutting measures on the side of the union.

In Tennessee, CCA announced in February that it is going to build a $143 million, 2,000-bed facility outside Nashville. The Trousdale Correctional Center, when completed sometime in early 2010, will be CCA's eighth prison in the state, but will also house some federal and out-of-state prisoners. CCA also announced plans to expand its Adams County facility in Mississippi by an additional 564 beds and will have finished by the spring of 2009. CCA currently has four prisons in Mississippi and is completing a fifth facility in Tallahatchie County.

Oklahoma, already with six private prisons, is potentially planning a seventh in Warner. The proposed prison design came from a local Muskogee County architect in coordination with Detention Solutions Inc. out of Tulsa. Elsewhere in the state, CCA said it would complete the expansion of its 1,800 bed Cimarron Correctional Facility in Cushing by January 2009.

Rhode Island officials are facing a frustrating problem as they try to make budget cuts across the board. A plan to privatize prison counselor positions, saving the state over $450,000, has been stalled because state laws grant job and salary security to those who've worked for the state for over 20 years. Lawmakers seeking to rectify the problem also have to adjust a law that limits the privatization of state services.

D. International Private Corrections Update

Citing the success of Brazil's Humaita Prison, a South Korean firm has begun construction on the nation's first private prison. The prison, located in Yeoju, Gyeonggi Province, is scheduled to open in 2010 with a capacity to hold 500 inmates. The government granted permission for the prison to open in 2002, but it has taken several years to get the approval of the Yeoju community. The prison will provide a wide-range of programs to rehabilitate inmates and help their transition back into communities.

Peru has announced plans to build several new prisons as it seeks to solve its inmate overpopulation crisis. Two will be built and managed by private firms in the nation's first foray into privatizing corrections facilities. South Africa has also developed its first public-private partnership prison program and has accepted several bids to build five new facilities in the county.

E. CSI for Real: How to Improve Forensic Science

American television viewers of popular programs such as CSI would be led to think that the forensic science lab is a bastion of white-coated scientists whose empirical and unbiased results are virtually always reliable and beyond significant dispute. A forensic scientist testifying that an accused in a criminal trial is the source of the evidence analyzed and interpreted at the scientist's lab can leave a jury strongly convinced that the scientist's conclusions are unimpeachable confirmation of the defendant's guilt. The actual quality of such testimony, unfortunately, is often quite different; in the wake of DNA exonerations, the reliability of forensic testing and testimony have come under extensive critical examination and have been found

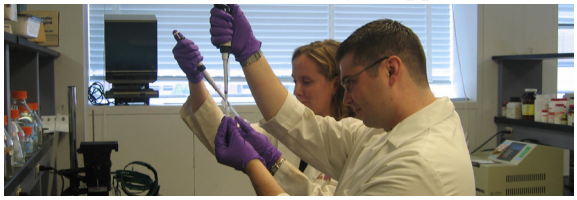
to be limited, in large part due the forensic lab's monopoly status.

Forensic error occurs at significant rates—both unconsciously and consciously (fraud)—because the current institutional structure of forensic science discourages the discovery of truth. In pure science, results are scrutinized by other scientists and subjected to criticism, review—and reproduction. The rule-governed, competitive process of pure science does not obtain, however, in most forensic labs where results are subject to little or no public or peer review.

Several factors contribute to the unreliability of forensic science labs, including: evidence monopoly, budgetary dependence bias, insufficient quality control, information leakage or information "pollution", no division of labor between the forensic analysis and interpretation, lack of forensic counsel for the defendant and lack of competition among forensic counselors for customers.

To rectify these systemic problems and bring forensic science within a praxis that more closely resembles pure science, Reason Foundation's Roger Koppl and Adrian Moore have produced a report, *CSI for Real: How to Improve Forensics Science*, that proposes the following reforms:

- **Competitive self-regulation**. Instituting competitive self-regulation for forensic science would produce conditions similar to those that obtain in pure science: research results that are subject to the discipline of review and reproduction. Subjecting forensic scientists to the same discipline would bring forensic science results more closely within the reliability level of scientists in other fields.
- **Rivalrous redundancy.** The principle of redundancy should be as extensively applied to police forensics as other fields. Patients get a second doctor's opinion when sick. Failsafe measures are built into power plants. But forensic science has only adopted limited forms of redundancy to-date, such as the verifications that may go on within a crime lab. Randomly chosen evidence could be sent to multiple, competing labs within a given jurisdiction to create greater accuracy.
- **Establishing an Evidence Control Officer (ECO).** The ECO would be the sole point of contact with the lab receiving the evidence. He would further employ random-number generators to determine which lab will be sent a given piece of evidence and when to provide the same evidence to more than one lab.
- **Information hiding.** Withholding data that might induce bias, such as whether blood being tested came from the victim or the suspect, would reduce the chance of bias and lower the probability that results will be skewed away from the truth.
- **Statistical review.** If a given lab produces an unusually large number of inconclusive findings, its procedures and practices should be examined.
- **Division of labor with vouchers.** Vouchers for retaining forensic counsel are a matter of justice analogous to the Sixth Amendment right to legal counsel. Just as indigent defendants are provided legal counsel at government expense, so too should they be provided forensic counsel. This would also have the effect of increasing competition for forensic services, thus establishing incentives for avoiding shoddy or fraudulent work.
- **Privatization of forensic labs.** This would eliminate the current incentives for labs to ally with police theory. Each jurisdiction would employ several competing forensic labs. Evidence would be divided and sent to one, two or three separate labs. Chance would determine which labs and how many would receive evidence to analyze. This structure would discourage sloppy work.



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