

Reason Foundation



Annual Privatization Report 2007



Edited by Leonard C. Gilroy

Reason Foundation



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Authors

Editor

- Leonard C. Gilroy

Principal Authors

- Ted Balaker
- Shikha Dalmia
- Leonard C. Gilroy
- Amanda Kathryn Hydro
- Adrian T. Moore
- Amy Pelletier
- Robert W. Poole, Jr.
- Geoffrey F. Segal
- Skaidra Smith-Heisters
- Lisa Snell
- Samuel R. Staley
- Adam B. Summers
- Steven Titch

Contributing Authors

- **William D. Eggers** is the global director for Deloitte Research—Public Sector.
- **Jerry Ellig, Ph.D.** is the acting director of the Regulatory Studies Program at the Mercatus Center at George Mason University.
- **David T. Hartgen, Ph.D., P.E.** is a professor of transportation studies at the University of North Carolina at Charlotte.
- **Patrick R. Mullen, Ph.D.** is an assistant professor of public administration and policy, with a joint appointment with the Institute for State Leadership and Policy, at the University of Illinois at Springfield.

Letter from the Editor

By Leonard C. Gilroy



Welcome to Reason Foundation's *Annual Privatization Report 2007*. Now in its 21st year of publication, *APR* is the world's longest running and most comprehensive report on privatization news, developments, and trends.

APR 2007 details the latest on privatization and government reform initiatives at all levels of government. In addition to the latest news on President Bush's continuing efforts to bring more competition to federal programs and save billions of taxpayer dollars, this issue includes an expanded section on the federal Performance Assessment Rating Tool (PART), used by the administration to rate programs and determine budget priorities. Dr. Patrick Mullen, professor at the University of Illinois at Springfield, offers readers a detailed assessment of the PART process, its successes to date, and implementation challenges that still remain.

The "Local and State Update" section offers a wide-ranging review of the latest action across state and local government that includes a state privatization roundup and budget outlook, an article on new accounting rules covering government liabilities, and the latest on Mayor Richard Daley's extensive privatization efforts in

Chicago, managed competition in San Diego, and Georgia's new and innovative contract cities.

As always, this year's *APR* provides a comprehensive overview of domestic and international developments in air and surface transportation, including a summary of Reason's groundbreaking 2006 study, *Building Roads to Reduce Traffic Congestion in America's Cities: How Much and at What Cost?*, which provides a detailed analysis of the looming national congestion crisis and quantifies the investments needed to remedy it.

You'll also find the latest news on highway tolling and public-private partnerships (PPPs) in the "Surface Transportation" section. For instance, we offer readers a detailed overview of long-term toll road concessions, which can mobilize large new sums of capital investment to meet a significant share of the need for new highway capacity. And given the controversy generated by PPPs and concessions over the past year, *APR* features an article by Deloitte Research's public sector global director William Eggers responding to the most commonly-voiced concerns, objections, and misperceptions about PPPs.

Two issues that have attracted a great deal of attention in policy circles this past year are examined in *APR*'s "Emerging Issues" section. First, we review federal and state efforts to make government more transparent by allowing taxpayers access to spending information, typically through "Google government" Web databases. Second, we provide a roundup of several states' proposals to privatize their lottery systems.

APR's "Education" section includes comprehensive updates on school choice and child welfare privatization, as well as two articles on the promise of the weighted-student-funding program for improving low-performing school districts and giving parents more choice.

APR 2007 also dives in to the ever-changing world of telecommunications policy, with updates on video franchise reform, network neutrality, and the municipal provision of broadband services. This update includes an assessment of the rocky start for Provo, Utah's municipal broadband system, as well as a summary of Reason's 2006 study, *A Dynamic Perspective on Government Broadband*, authored by the Mercatus Center's Jerry Ellig.

With private property rights remaining a hot topic in state legislatures and at the ballot box two years after the Supreme Court's controversial *Kelo vs. New London* decision, this *APR* highlights the latest state action on eminent domain reform. We also feature an analysis of Arizona's Proposition 207, a comprehensive package of property rights protections approved by Arizona voters last November that's designed to protect property owners from both eminent domain abuse and regulatory takings via land use regulation.

Your comments on the *Annual Privatization Report 2007* 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 31st 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. Update on the Program Assessment Rating Tool (PART): PART Nears Full Cycle Assessing All Federal Programs

By Patrick R. Mullen, Ph.D.

Under the President's Management Agenda for performance and budget integration, the Office of Management and Budget (OMB) designed the Program Assessment Rating Tool (PART) to breathe new life into performance-based budgeting as envisioned by the Government Performance and Results Act (GPRA). Federal interest in performance information and its relationship to budgeting practices has existed to varying degrees for over 50 years. This interest resulted in the passage of the Government Performance and Results Act (GPRA) and related management reforms of the 1990s. GPRA mandates that federal agencies develop performance information describing the relative effectiveness and efficiency of federal programs as a means of improving

the congressional decision-making process. Among other statutory obligations, GPRA requires federal agencies to publish strategic and annual plans describing specific program activities with the intention of establishing a more tangible link between performance information for these programs and agency budget requests.

1. How Does the PART Process Work?

The Bush administration has taken several steps to strengthen the performance-resource linkages for which GPRA laid the groundwork. Central to the budget and performance integration initiative, OMB developed the PART as a means to strengthen the process for assessing the effectiveness of programs by making that process more robust, transparent, and systematic. PART is a series of diagnostic questions designed to provide a consistent approach to rating federal programs. Drawing on available performance and evaluation information, the PART questions

rate the strengths and weaknesses of federal programs with a particular focus on individual program results. The PART asks, for example, whether a program's long-term goals are specific, ambitious and focused on outcomes, and whether annual goals demonstrate progress toward achieving long-term goals.

PART is designed to be evidence-based, drawing on a wide array of information, including authorizing legislation, GPRA strategic plans, annual performance plans and reports, and reviewing financial statements, inspectors general reports, and independent program evaluations. The reviews of individual programs are done on a collaborative basis by the OMB budget examiner responsible for the program's budget presentation in the president's budget documents and the program, planning and budget offices in the respective departments and agencies. OMB makes the final PART determinations but the departments can appeal OMB's decisions for a better score for each section where they can demonstrate improvement. The program office can also provide more information the next year to show progress; this is known as "re-PARTing." PART questions are divided into four sections. Each section is given a specific weight in determining the final numerical rating for a program. Table 1 shows an overview of the four PART sections and the weights OMB has assigned.

The answers to the questions in each of the four sections discussed in Table 1 result in a numerical score for each section ranging from 0 to 100. These scores are then weighted to give a summary score, again ranging from 0 to 100, for the program. In the budget documents explaining PART scoring, OMB states "Because reporting

a single weighted numerical rating could suggest false precision, or draw attention away from the very areas most in need of improvement, numerical scores are combined and translated into qualitative ranges." The qualitative ratings and point ranges of the weighted summary ratings are: Effective (85-100), Moderately Effective (70-84), Adequate (50-69), and Ineffective (0-49).

Since the fiscal year 2004-budget cycle, which began with preparation of the 2004 budget request in calendar year 2002, OMB has applied PART to 977 programs (about 96 percent of the federal budget) and given each program one of the four overall ratings discussed above. A fifth category of "Results Not Demonstrated" was given—independent of a program's numerical score—if OMB decided that a program's performance information, performance measures, or both were insufficient or inadequate. As program and budget officers learn how to satisfy PART requirements, they are able to convince OMB budget examiners that there is enough performance information to make a definite determination of where a program falls within the four performance categories. During calendar year 2006, the Administration assessed all remaining executive branch programs, with limited exceptions, and reported the results with the release of the fiscal year 2008 budget request. Table 2 shows the distribution of ratings from calendar years 2002 through 2006 (fiscal years 2004-2008) budget requests.

For each program assessment, PART summary worksheets were published in a separate volume starting with the president's fiscal year 2004 budget request. For the

Table 1: Overview of Sections of PART Questions		
Section (Weight)	Description	Selected Questions
1. Program Purpose and Design (20 %)	To assess whether <ul style="list-style-type: none"> • The purpose is clear, and • The program design makes sense. 	<ul style="list-style-type: none"> • Is the program purpose clear? • Does the program address a specific and existing problem, interest or need? • Is the program designed so it is not redundant or duplicative of any other federal, state, local or private effort? • Is the program design effectively targeted, so that resources will reach intended beneficiaries and/or otherwise address the program’s purpose directly?
2. Strategic Planning (10 %)	To assess whether the agency sets valid programmatic <ul style="list-style-type: none"> • Annual goals, and • Long-term goals. 	<ul style="list-style-type: none"> • Does the program have a limited number of specific long-term performance measures that focus on outcomes and meaningfully reflect the program purpose? • Do all partners (grantees, sub-grantees, contractors, cost-sharing partners, government partners) commit to and work toward annual and/or long-term 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?
3. Program Management (20%)	To rate agency management of the program, including <ul style="list-style-type: none"> • Financial oversight, and • Program improvement efforts. 	<ul style="list-style-type: none"> • Does the agency regularly collect timely and credible performance information, including information from key program partners, and use it to manage the program and improve performance? • Are federal managers and program partners (including grantees, sub-grantees, contractors, cost-sharing partners, government partners) held accountable for cost, schedule and performance results? • Does the program use strong financial management practices?
4. Program Results and Accountability (50%)	To rate program performance on goals reviewed in <ul style="list-style-type: none"> • The strategic planning section, and • Through other evaluations. 	<ul style="list-style-type: none"> • Has the program demonstrated adequate progress in achieving its long-term performance goal(s)? • Does the program (including program partners) achieve its annual performance goals? • Does the program demonstrate improved efficiencies or cost effectiveness in achieving program goals each year? • Do independent evaluations of sufficient scope and quality indicate that the program is effective and achieving results?

Source: *Analysis of the Budget of the United States Government, Fiscal Year 2004, Performance and Management Assessments* (Washington, D.C.: February 2003) and the PART Excel spreadsheet questions.

Table 2: PART Program Ratings by Year Completed, 2002-2006

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

Source: Office of Management and Budget, Budget of the United States Government, Fiscal Year 2008, Analytical Perspectives, p. 15.

fiscal year 2005 and 2006 budget requests, similar information was provided on the OMB Web site and in an accompanying CD-ROM. The detailed, supporting worksheets for each program were posted on OMB's Web site. For programs assessed and published with the budget request for the first time, all summary sheets display the program's goals and measures, budget information, significant findings and recommendations (also known as follow-up program actions). Beginning with the FY 2006 budget request, summary sheets for programs that have been reassessed or originally published with the fiscal year 2004 or 2005 budget requests include information on when the program was last assessed and the status of the follow-up actions. Status ranges from "no action taken" to "action taken but not completed" to "completed." For fiscal years 2007 and 2008 reporting of PART results, OMB's PART recommendations are generally aimed at improving program design, management, funding, and/or assessment. They can be general or very specific. Examples of recommendations for each of the four categories are shown in Table 3.

2. Observations About the Impact of PART Reviews

PART is credited for helping to structure OMB's use of performance information for its internal program and budget analysis, making the use of this information more transparent, and stimulating agency interest in budget and performance integration. OMB and agency staff said this helped OMB staff with varying levels of experience focus on similar issues. One of PART's major impacts is its ability to highlight OMB's recommended changes in program management and design. Much of PART's value lies in the related program recommendations, but realizing these benefits requires sustained attention to implementation and oversight to determine if desired results are achieved.

There are inherent challenges in assigning a single rating to programs having multiple purposes and goals. OMB devoted considerable effort to promoting consistent ratings, but challenges remain in addressing inconsistencies among OMB staff, such as interpreting PART guidance and defining acceptable measures. Limited credible evidence on results also constrained OMB's ability to rate program effectiveness, as

Table 3: Examples of PART Recommendations for Categories of Program Management	
Category	Example of Recommendations
Program Design	<p>“Reduce unnecessary subsidies to lenders and other program participants.”</p> <p>“The 2006 Budget proposes to restructure the grant allocation process, providing the Secretary with greater discretion to award funds based on risks, threats, and vulnerabilities.”</p>
Program Management	<p>“Continue to improve the contractor evaluation processes and weapon program performance metrics to focus on schedules and performance against baselines to increase performance and cost-effectiveness.”</p> <p>“Increase the number of accounts supporting this program to quicken the transfer of funds with contractors and increase management flexibility to address changing security conditions and mission priorities. This will significantly improve the obligation and costing process of funds.”</p>
Funding	<p>“Maintaining funding at the 2005 enacted level until the agency can show how it will use additional funds to improve performance.”</p> <p>“Directly related to the PART findings, the Budget includes \$37 million, a \$3 million decrease.”</p>
Program Assessment	<p>“Develop a means of regularly performing independent evaluations to examine program effectiveness.”</p> <p>“Developed baselines for its proposed long-term measures. Without baselines for the measures, it was impossible to verify the performance of the program.”</p>

Source: OMB PART assessments.

evidenced by the 50 percent of programs rated “results not demonstrated” in the fiscal year 2004 budget documents. PART is not yet well integrated with GPRA, which is the current statutory framework for strategic planning and reporting. By using the PART process to review and sometimes replace GPRA, goals and measures, OMB is substituting its judgment for a wide range of stakeholder interests. The PART-GPRA tension is further highlighted by challenges in defining a unit of analysis useful for both program-level budget analysis and agency planning purposes. Although PART can stimulate discussion on program-specific measurement issues, it cannot substitute for GPRA’s focus on thematic goals and department- and government-wide

crosscutting comparisons. OMB is now using PART to a greater extent to evaluate similar programs together to facilitate trade-offs or make relative comparisons.

PART clearly must serve the president’s interests. However, the many actors whose input is critical to decisions will not likely use performance information unless they feel it is credible and reflects a consensus on goals. It is important for OMB to initiate timely discussions with Congress concerning the focus of PART assessments and to clarify the results and limitations of PART and the underlying performance information. A more systematic congressional approach to providing its perspective on performance issues and goals could facilitate OMB’s understanding of congressional priorities

and thus increase PART's usefulness in budget deliberations.

The PART process has aided OMB's oversight of agencies, focused agencies' efforts to improve program management, and created or enhanced an evaluation culture within agencies. Although the PART has enhanced the focus on performance, the PART remains a labor-intensive process at OMB and agencies. However, most PART recommendations are focused on improving outcome measures and data collection, and are not designed to result in observable short-term performance improvements. Since these necessary first steps on the path to long-term program improvement do not usually lead to improved short-term results, there is limited evidence to date of the PART's influence on outcome-based program results. Moreover, as of February 2007—the date of the most recent available OMB data—the majority of follow-up program recommendations have not yet been fully implemented. By design OMB has not prioritized them within or among agencies. Because OMB has chosen to assess nearly all federal programs, OMB and agency resources are diffused across multiple areas instead of concentrated on those areas of highest priority both within agencies and across the federal government. This strategy is likely to lengthen the time it will take to observe measurable change compared with a more strategic approach. OMB has used the PART as a framework for several crosscutting reviews, but these have not always included all relevant tools, such as tax expenditures, that contribute to related goals. Greater focus on electing related programs and activities for concurrent review will improve their usefulness.

In the fiscal year 2008 budget request,

OMB discussed its planned next steps to improve the effectiveness of the president's budget and performance integration initiative:

1. Ensure plans are aggressive and result in improved performance through rigorous follow-up on recommendations from the PART to accelerate improvements in the performance of federal programs. This will ensure that the hard work done through the PART produces performance and management improvements through tracking and reporting mechanisms established by OMB.
2. Expand cross-cutting analyses by using the PART to facilitate cross-cutting analysis where there is a higher return than approaching programs individually. The goal of these efforts is to increase efficiency and save dollars by building on the success of previous cross-cutting analyses. OMB states that congressional guidance will be a factor in choosing topics for the next group of cross-cutting analyses.
3. Maximize www.ExpectMore.gov impact by holding the federal government accountable to the public for its performance. OMB states that this “web-based tool provides candid information on how programs are performing and what they are doing to improve.”

3. Conclusions

OMB is to be commended for developing the PART to bring a renewed focus on individual program-level management and performance. PART has had several successes, including

helping structure and discipline OMB’s use of performance information over a broad range of programs, questions, and evidence. PART has also made OMB’s use of performance information more transparent in terms of public reporting of judgments and sources, including explicit recommendations to change management practices and program design in response to PART findings. This has, in turn, stimulated agencies’ interest in performance and budget integration and in improving evidence regarding demonstrating program results. Nevertheless, several challenges have also been evident during five years of PART implementation, such as the consistent application of general principles to diverse cases, which requires interpretation and judgment. Another challenge is for agencies, OMB, and Congress to define agreed-upon program outcomes and reduce complexity to a consensus bottom-line rating. This challenge is exacerbated by the difficulty of obtaining credible information on program effectiveness, which is compounded by limited agency evaluation capacity. If these challenges can be successfully overcome—which will be an incredibly difficult task to say the least—OMB will have gone a long way, through its development of PART, in providing performance-based information on individual programs to the full range of actors who implement budget, policy, and management decisions.

Patrick R. Mullen, Ph.D. is an assistant professor of public administration and policy, with a joint appointment with the Institute for State Leadership and Policy, at the University of Illinois at Springfield.

B. Program Performance Evaluation Continues

This past year brought about another round of performance reviews as the administration implemented its Program Assessment Rating Tool (PART). Every budget submitted by this administration has used this tool to rate programs and use the ratings to determine budget priorities. Many failing or ineffective programs have been outlined for elimination or reduction in previous budgets, however, Congress has yet to use the rating or the outcomes in determining funding. In the FY2008 budget, 91 programs will be terminated for a savings of \$5 billion and 50 programs have seen major reductions providing \$7 billion in savings, for a total of \$12 billion in savings.

In the fifth year of reviewing government programs via PART, the Office of Management and Budget has now assessed about 96 percent (977 programs) of all federal programs. The following chart outlines the breakdown of PART results:

Number of Programs Assessed	977
Effective	17%
Moderately Effective	30%
Adequate	28%
Ineffective	3%
Results Not Demonstrated	22%

The success of federal programs has been growing according to PART’s standards showcasing that now 75 percent of them are operating “effectively.” PART’s primary role is to ensure that these programs do

what Congress mandated them to while being managed effectively, thus providing value for the taxpayers. The programs in the bottom 25 percent are now candidates for termination or reduction in funding to bring about reform. Those that are rated as ineffective “are not using tax dollars effectively” and 22 percent cannot show any impact or results for their efforts or spending because “they have not been able to develop acceptable performance goals or collect data to determine whether it is performing.”

Increasingly, Congress has paid more attention to these ratings as reflected in the number of programs terminated. For example, in FY2005 only seven of the 65 proposed reductions occurred; this year 91 were terminated. Additionally, OMB launched www.expectmore.gov to shed more transparency on PART. On this Web site, citizens are able to view which programs have been evaluated and their ratings are searchable by keyword, topic or agency.

C. Federal Competitive Sourcing Slows, But Continues to Demonstrate Results

The FY2008 budget illustrated a continued implementation, although slow, of public-private competition for federal jobs. In the section devoted to federal management, officials revealed that since the Office and Management and Budget’s (OMB) Circular A-76 overhaul in 2003 they have seen, “process reengineering, workforce realignments, better leveraging of technology and operational consolidations.” Furthermore, the budget’s text also

reiterated that getting rid of the provisions that limit best value contracts “would allow taxpayers to get the best results possible from competitive sourcing.”

In May, OMB reported to Congress on the results of competitions in 2006. The federal government completed 183 competitions, comprised of 6,678 full-time equivalent employees representing about 1.7 percent of the federal workforce. While a wide range of activities were studied, information technology, maintenance and property management were among the most studied areas.

Federal employees won 87 percent of the competitions, generating savings of \$1.3 billion over the next five to ten years. Each position studied saved of \$34,500, or 36 percent gross savings.

Since 2003, 12 percent of the federal workforce has faced a competition, winning 83 percent of them and generating savings of \$6.9 billion. Taxpayers get \$31 for every dollar invested in competition, for a total of \$226 million invested in competitive sourcing. Furthermore, average net savings are 28 percent per position studied.



Table 5: Competitive Sourcing FY2006 Results	
	FY2006 Total
Completed Competitions	
Number of PMA agencies completing competitions	20
Number of competitions completed	183
Number of FTEs completed	6,678
Total estimated net savings	\$1.3 billion*
Estimated annualized savings	\$220 million
Competitions where federal agency selected to perform work (as a percentage of total FTEs completed)**	87%
Announced Competitions	
Number of competitions announced	86
Number of FTEs announced	9,691

* Figure rounded to nearest \$100 million.

** Calculated by FTEs competed.

Table 6: Cumulative Results (2003-2006)	
	Four-Year Total*
FTE competed	46,825
Number of competitions conducted	1,243
FTE competed under standard competitions	36,696**
Incremental cost	\$230 million
Estimated net savings	\$6.9 billion
Estimated annualized savings	\$1.1 billion

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

** Standard competitions require head-to-head competition between the public and private sectors and the development of an MEO staffing plan by the federal incumbent provider.

Table 7: Four Year Averages	
	Four-Year Average
FTE competed	38
Number of competitions conducted	78%*
FTE competed under standard competitions	\$5,000**
Incremental cost	\$25,000
Estimated net savings	83%

* Standard competitions require head-to-head competition between the public and private sectors and the development of an MEO staffing plan by the federal incumbent provider.

** Incremental cost figures are rounded to nearest thousand.

Local and State Update

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A. Local Privatization Update

1. Chicago Remains a Privatization Leader

Chicago's lease of its Skyway for \$1.83 billion in 2005 is widely known. What may not be well known is that Chicago, under Mayor Richard Daley's leadership for the past 18 years, has privatized more than two dozen other functions or assets—and there's more to come.

The city recently leased four adjacent underground parking garages located downtown. The 9,178 spaces made Chicago's system the largest in the United States. Daley and his team realized that parking garage operation were not a core function of government. Having already entered into contractual agreements on other city lots, leasing these lots was a natural extension of the success of the Skyway deal. Morgan Stanley was awarded a 99-year lease over 12 other bidders with a bid price of \$563 million. Additionally, Morgan Stanley agreed to rebuild garage

infrastructure, valued at \$65 million for an initial rebuild and more than \$550 million over the term of the lease.

The city dedicated \$278 million of the proceeds to debt retirement. \$122 million will be used for city park improvements with another \$120 million invested into the Chicago Park District "Reserve" account, generating annual income of \$5 million. Another \$35 million is dedicated for the rebuilding of the Daley Bi-Centennial Plaza. Daley is also considering a lease of Midway airport, several recycling centers and city-owned marinas.

In the same vein, between 1995 and 2005 the city of Chicago successfully privatized 27 other government functions. Because of these efforts, taxpayers have saved hundreds of millions of dollars. In addition to the capital outlay costs needed to equip the city to perform many of these functions, it would cost taxpayers nearly \$45 million annually to bring all of the functions listed in this report back in-

house today. The city estimates that it has achieved cumulative savings of \$175 million in that period.

Furthermore, the city reports achieving an additional \$7.9 million in annual savings from seven privatizations that occurred before 1995, resulting in a total savings of \$102 million.

2. San Diego Passes Managed Competition Initiative

New Mayor Jerry Sanders was swept into office after budgeting scandals left the city in dire straits. Competition was a centerpiece of his campaign, however, upon entering office he learned that the City Charter limited the city's ability to subject services to competition and contract them out. Functions that were provided by public employees were exempted from competition even if contracting out could demonstrate savings, improved services, or greater efficiencies.

A change to the City Charter was needed to enable managed competition. Proposition C emerged and citizens were asked:

Shall the Charter be amended to allow the City to contract services traditionally performed by City civil service employees if determined to be more economical and efficient while maintaining the quality of services and protecting the public interest?

With more than 60 percent of the vote Proposition C passed. The Sanders administration is now developing its competitive sourcing plans.

3. Sandy Springs One Year Later; Others Follow in its Footsteps

The city of Sandy Springs became Georgia's first new city on December 1, 2005. What makes Sandy Springs unique,

however, is the form of operational government. Originally created with just four government employees, the city decided to contract out all other non-public, safety-related functions. The city maintains ownership of assets and ultimate budget control by setting priorities and service levels. Meanwhile the contractor is responsible for staffing and all operations and services.

Sandy Springs recently successfully rolled out its own police and fire departments, as the Georgia state constitution requires that public safety services are provided by government. Counting police and fire employees, the city of 87,000 has only 196 total employees. Nearby Roswell, a city of 85,000 has more than 1,400. Furthermore, Sandy Springs' budget is \$37 million less, and by most accounts provides a higher level of service.

Sandy Springs only spends \$803 per resident and has only 22 employees for every 10,000 residents. It had no tax or fee increases in 2007. Couple that against Atlanta. While a much larger city with perhaps more diverse challenges, the order of magnitude is still significant. Atlanta spends more than \$2,000 per resident and has 183 public employees for every 10,000 residents. Additionally, Atlanta's General Fund budget is expected to increase by 40 percent this year. Mayor Shirley Franklin suggested she'd find the money by looking in "other people's pockets"—code for tax or fee increases.

Following in the footsteps of Sandy Springs, two new cities—Johns Creek and Milton—were formed on December 1, 2006. Both employ similar operating models, with five and three public employees respectively. Both cities have chosen the same contract

operator as Sandy Springs. In doing so, the cities are finding additional efficiencies.

Two other communities—South Fulton and Chattahoochee Hill Country—will vote in June on whether or not to incorporate. Both would likely follow similar operational models. Furthermore, the communities of Peachtree Corner and Dunwoody have legislation pending in the Georgia General Assembly.

By some accounts there are upwards of a dozen upstart communities planned in the metro Atlanta area. Additionally, many of the new privately run cities have called for the creation of a new county, Milton, which had merged with Fulton County in 1931. Given the operational model of several of the cities that would make up Milton County, it is conceivable that a similar operational model will be implemented.

B. State Privatization Update

Alabama's legislature is attempting to authorize the Director of the Department of Transportation to enter into agreements related to the privatization of roads built in the future. The bill, HB121 is still in committee and pending action.

Privatization in Arizona took a step forward when Governor Janet Napolitano approved the privatization of public rest areas, assuming approval from the Federal Highway Administration.

In **Arkansas**, public-private partnerships (PPPs) met a mixed bag. Legislation was passed to strike the opportunity to use PPPs in the state's Information Office as well as in the school districts or public charter schools. However, the legislature passed Act 389 allowing regional mobility authorities to use public-private partnerships.

The **California** Supreme Court unanimously affirmed a ruling by the First District Court of Appeals that the state Department of Transportation could indeed contract out architectural and engineering services. Voters in 2000 passed Proposition 35 explicitly authorizing the state to do so. However, the Professional Engineers in California Government, the union representing state employees, sued to prevent the state from outsourcing work.

Writing for the court, Justice Carlos R. Moreno said that there is “a clear intent by the electorate to supersede prior law, under which the ability of state agencies to contract with private entities for architectural and engineering services was limited.” Governor Arnold Schwarzenegger called the court's decision “a great victory for commuters and taxpayers.”

In **Colorado**, SB 251 would eliminate the requirement that the Regional Transportation District (RTD) contract out at least 50 percent of its bus service, including special services for the disabled. Furthermore, it would cap privatization of bus service at 58 percent.

The bill is promoted by the transit workers union and calls for RTD to maintain employment numbers high enough so that RTD can “step in when private contractors fail.” In order to broaden support, the union agreed to an amendment that would not allow privatization percentages to become an issue in labor negotiations.

RTD officials noted that if they were forced to bring contracted services in, their budget would need to increase by \$35 million a year. Currently RTD pays about \$63 an hour for privatized bus service and \$91 an hour for in-house delivery.

If passed, **Connecticut's** Clean Contracting Standards Act would establish a State Contracting Board and require that appointed members not only have knowledge of privatization, but that they are also part of the selection process. Related bills are currently in committee. Another piece of legislation that would transition all services currently provided by the Department of Mental Retardation into private, non-profit providers is currently being heard in committee.

Privatization efforts continue in **Florida**, most notably with the Florida Government Accountability Act, which allows state agencies to privatize or outsource in order to reduce cost or improve services to citizens. The Lake Okeechobee Watershed Protection Act was passed encouraging and supporting the development of public-private partnerships for water storage to further restore water quality on Lake Okeechobee.

Two additional efforts were tabled in Florida. The first would have created the Tampa Bay Area Regional Transportation Authority and encouraged the option of PPPs in regional multimodal transportation improvements. The second called for an evaluation of all major privatization efforts in the last five years and a comparison on cost to see if money really was saved as related to state information technology.

There are some efforts to privatize underway in **Georgia**. HB461 calls for the privatization of the state's mental health centers and HB291 would allow the Georgia Arts Alliance to employ PPPs to support the arts. This bill was brought forth because of the successful PPPs that the Georgia Research Alliance has gained in higher education.

Hawaii repealed the sunset of the law

authorizing state and county departments and agencies to provide government services through contracts with private entities. In addition, HB1824, currently in committee, would authorize purchasing agencies to establish public-private partnerships for the construction of state facilities.

Efforts in **Illinois** would allow public-private partnerships to be used in transportation and agriculture. S1333 would create PPPs with the Passenger Service Rail Act and S378 would create the Transportation Act. The Transportation Act would authorize the Department of Transportation and the Illinois State Toll Highway Authority to enter into public-private agreements for the development, operation, and financing of transportation facilities.

After two years of study **Indiana** signed a contract with an IBM-led consortium to reform and modernize the state's welfare system. The 10-year \$1.16 billion contract anticipates saving a half billion dollars over the next 10 years on administration. Savings will increase as fraud and errors are brought down, and could balloon savings to north of a billion dollars.

Before modernization, the application process in Indiana was very paper-intensive. Bankers' boxes full of files and paper literally crowded each of the state's 107 county offices. Each benefit program had its own records and requirements, creating large case files and an extremely laborious process.

Client interaction only took place in face-to-face meetings and often required multiple trips. Upon entry into the system clients were assigned a caseworker, and regardless of availability, that's the only person they could interact with. It didn't

help that the caseworker was the only one who knew where a client's file was.

Under the new operations, a premium will be placed on client services. By moving into an electronic-based system, new internet and phone services will become available. For the first time in Indiana, clients will be able to access caseworkers 24 hours a day, 7 days a week. Governor Daniels said "no longer will they have to contact the system only at places and times convenient to the bureaucracy, then wait a month or longer for an answer or decision."

The new system will also improve Indiana's high error and fraud rate. In addition, Indiana has the worst welfare-to-work record in the country. Currently errors cost Indiana taxpayers \$100 million a year, not counting fraud. Simply eliminating that is a major benefit. However, providing a path to self-sufficiency is perhaps even more valuable.

The IBM-led team will be responsible for adding new ways for clients to interact with benefits administrators and caseworkers. Additionally it will be responsible for data collection and electronic storage. Perhaps one of the most important aspects will be the development of new technological improvements around the state's current core computer system.

IBM offered employment to all existing state employees too. And not just employment, but better pay, benefits, pensions and career prospects than the state plan. Furthermore, employees will be able to spend more time helping people and not just pushing paper. The modernization will be phased in over several stages, as the next stage cannot begin until the previous stage is completely and successfully transitioned.

Privatization efforts that require

legislative authority in Indiana face a difficult uphill battle for the time being. In fact, a proposal to allow the private development of two new toll facilities was scrapped after achieving Senate approval. The House, now under Democratic leadership, didn't give the bill a hearing, effectively killing it. Furthermore, it wouldn't entertain a hearing privatizing the lottery. House Speaker Pat Bauer considers privatization a non-partisan issue, i.e., it's the "politics of greed...and you can be a Democrat and do that, too."

There were several legislative efforts to thwart privatization efforts by creating more bureaucracy in Indiana. H1062 would have created a Privatization Review Committee that would review plans and make recommendations to the governor. Furthermore the bill would ensure that no contracts were signed that would extend into the administration of the next governor. H1313 would establish a general accountability office to review all privatization contracts entered into after December 2004.

Maryland legislators are calling for the Maryland Transportation Authority to implement PPPs with HB662, which is in committee. However, they were able to pass legislation requiring that notice and information be given to the General Assembly and the Department of Legislative Services before issuing a public notice of procurement for PPPs. Additional efforts to allow private companies to administer the programs of the Maryland Small Business Development Financing Authority and Child Placement Services were withdrawn.

In efforts similar to Indiana's legislation, **Minnesota** is calling for a required state employee cost comparison before entering

into any transportation privatization contracts, a 10 percent savings requirement and an annual report. S1278 addresses competitive sourcing and acquisition. Bills in both chambers call for pay equity compliance meaning that “a state agency may not accept a bid or proposal for a contract in excess of \$500,000 from a business with more than 40 full-time employees in the state unless the Commissioner of Employee Relations has approved the business’ plan to establish equitable compensation relationships for its employees and has issued the business a certificate of compliance.” Legislation remains in committee.

Missouri’s Public Service Accountability Act, if it passes, would require most public bodies to conduct a cost benefit analysis of any privatization program. In **Montana**, a joint bill called for a privatization study for state agencies, however, it did not gain support.

Nevada legislators made a broad-based attempt to privatize government services, although some of these efforts fell flat because they did not take action before a legislative deadline. Those efforts were privatization of motor vehicle registration, privatization of the regulation of foster care, and the privatization of ombudsmen used for dispute resolution in common-interest communities. There is still legislation pending in committee: the privatization of early intervention service providers for infants and toddlers, the privatization of jails, and the privatization of public works as they relate to management and inspection of construction projects. Perhaps most notably, AB74 would encourage all agencies that receive money from the State General Fund to look at privatization of services as a

viable option.

Although **New Jersey** has not passed any legislation, multiple bills are currently in committee. All bills were introduced last session, and none of them is friendly toward privatization. Companion bills require that “no decision regarding the privatization of any service provided by the State should be made without a careful evaluation of the long term impact of the privatization on the State, its citizens and its employees.” The bill basically requires a report detailing all aspects of the privatization and the anticipated net reduction of in-house costs to be posted publicly and reviewed by the State Auditor before any outside bids can be solicited. A2168 would require the State Auditor to review potential Department of Corrections Privatization contracts in a similar manner. Then S1557 would require state agencies to submit notices of request for proposals and other documents pertinent to privatization contracts to the state employees who may have in fact lost their job to privatization. Another attempt to de-privatize the Motor Vehicle Inspection Program when the vendor contract concludes was made with S1556.

Additionally, Governor Jon Corzine partnered with UBS Investment Bank to conduct an evaluation of state assets, identifying which were most appropriate for privatization and the potential value. The review looked at assets owned by the state and its independent authorities. All assets were considered, including but not limited to toll roads, transit facilities, rights-of-way, buildings, air rights, naming rights, airports, bridges, water facilities, ports, parks, lottery and the student loan portfolio.

New Jersey currently has the third highest level of debt per capita in the nation,

as well as the highest level of property taxes. The state carries at least \$29.7 billion in debt with payments eating 8 percent of state spending. This also does not account for unfunded pension liabilities. Given this, the state is looking to generate new value to have a significant reduction in existing debt, allow new capital investment, and deliver new efficiencies and quality to existing services.

Tier 1 assets have a sound commercial viability and a meaningful value to the state. These assets are early candidates for privatization:

- Atlantic City Expressway
- Development rights at New Jersey Transit stations
- Garden State Parkway
- New Jersey Lottery
- New Jersey Turnpike

UBS also identified several Tier 2 assets. Essentially, these are assets that would likely be successful, but there just isn't enough information at this time.

- Atlantic City International Airport
- Fiber Optic Network
- High Occupancy Toll lanes
- Naming Rights
- Newly-Tolled Facilities
- PNC Bank Arts Center

Of the assets, the Lottery and Atlantic City Expressway scored the highest in terms of viability. Closely behind those two were the NJ Turnpike, Garden State Parkway, HOT Lanes, newly tolled facilities, development rights at train stations, naming rights and the PNC Bank Arts Center.

New York's current situation is not that different from its neighbors in New Jersey: all legislation is pending in committee.

A1647 would provide for awarding of public works contracts as well as creation of a Privatization Advisory Board. Companion bills A5644 and S153 also call for the creation of a Privatization Advisory Board but add statutory requirements for the awarding of public works contracts by the Triborough Bridge and Tunnel Authority as well as the Metropolitan Transportation Authority and its subsidiaries.

While A5851 aims to promote fairness in competitive bidding by providing for enforcement of prevailing wage provisions applicable to public work construction projects, companion bills would similarly enforce competitive bidding. Additional legislation aims to enact the Public Private Partnership Disclosure Act requiring state agencies entering into PPPs to promulgate rules and regulations regarding review and disclosure relating to such relationships as well as public notice and a report to the legislature. Similarly, A1021 calls on all public authorities owning, leasing, and controlling critical infrastructure to study the potential consequences of privatization before engaging in it.

Ohio State Treasurer Richard Cordray proposed creating a central inventory of state properties with a goal of weeding out unused or under-utilized land. An initial review of just 20 counties representing 36 percent of Ohio's population found 7,364 state-owned properties—nearly 6 percent of those properties remain unimproved or unused. Those 446 properties appear to be suitable for divestiture and private development.

Cordray wants government to reduce the amount of vacant land it owns and restore those properties to the tax rolls. Indeed, Cordray suggested that the state should

“feel an obligation to ensure that state-owned properties are being utilized to their maximum potential.”

The proposal includes a “defining principle” for the state’s property policy:

If the State owns land that is non-productive, and if there is no immediate plan to make that property productive, then the private sector and community groups should be given the opportunity to propose one or more plans to improve and utilize that property, and the presumption should favor any such proposal that results in the disposition or use of the land to create value, jobs, tax revenue, and community improvement.

Utah made an attempt to privatize its correctional facilities but the bill failed. And Vermont’s HB272, which would completely prohibit the outsourcing of any state services, is awaiting a vote in committee. Virginia passed legislation calling for periodic analysis of outsourcing’s feasibility. In addition, any program or activity with privatization potential must now undergo a cost/benefit analysis. The Secretary of Finance must independently certify the results of the comparison of the private and public operations and devise, in consultation with the Secretary of Finance, evaluation criteria to be used in conducting performance reviews of any program or activity that is subject to a privatization recommendation.

C. State Budget Outlook

The 2007 Fiscal Year looks to be a good one for most state budgets, according to the National Conference of State Legislatures

survey of state fiscal officers. Of the 48 states (Texas and Arkansas did not participate) in NCSL’s *State Budget Update, November 2006*, 23 reported their overall revenue collection was above the original forecast. Additionally, 22 states reported their collections on target. Only three states, Maryland, Michigan, and Tennessee, took in less revenue than was forecasted.

When looking at specific taxes, corporate and personal income tax collections were either at or above forecasted levels in most states. However, 14 states reported sales tax collections below projections—at this time last year, only seven states reported underperforming sales tax collections.

For the first time since 2002, the number of states reporting an “optimistic” outlook went down from 26 to 16. In addition, the number of states that are “concerned” tripled from the 2002 survey to six. Officials in the remaining states expect their revenues to be “stable,” leaving no state with a “pessimistic” outlook for the future.

States with deficits also decreased in the latest report. However, some 14 states continue to face a deficit. Historically, this number is down by five from last year and 9 less from 2005. The two most common programs over budget were Medicaid and corrections.

The survey also asked officials to identify the budget priorities for the coming legislative session. Twenty-nine states identified education as the top priority. Medicaid and health care came in second with officials from 23 states calling it a top priority. In this area officials specifically noted debate about funding the uninsured and expanding coverage for all citizens. In addition, corrections, transportation and

Table 8: Notable Tax Changes

Type	State	Action	Result
Sales	New Jersey	1% increase; widening of base	\$1.25 billion and \$300.6 million respectively
Income	Ohio	4.2% decrease	Part of 21% reduction over 5 years
Corporate Income	Pennsylvania	Continued phaseout of capital stock and franchise	Decrease of \$198.2 million
Cigarette	Texas	\$0.41 per pack increase	Increase of \$431.7 million
Gas	New York	Cap	Decrease of \$109 million

Table 9: Tax and Fee Changes in the States

Tax	Number of States	Action
Sales	15	Decrease
Personal Income	18	Decrease
Corporate Income	17	Decrease
Cigarette, Tobacco and Alcohol	4	Increase
Gas	5	Changes resulted in a decrease

public employee retirement will be high on the agenda in a number of states.

FY 2008 revenue growth is forecasted between 0.5 percent (New York) to 6.5 percent (Georgia) growth—while the average growth was pegged at 3.6 percent. Less than half the states provided forecasts for FY 2009, however, the forecast is much more upbeat with the range between 2.5 percent (Maine) and 7.3 percent (Nevada), with an average of 4.7 percent.

The results of the NCSL survey largely mirror the results of the National Association of State Budget Officers/ *National Governors Association Fiscal Survey of the States*. The NASBO/NGA survey only covers general fund spending but found state fiscal conditions had improved in 2006 with only two states forced to make mid-year budget cuts.

The survey anticipates more modest growth in 2007, however, forecasted strong expenditure demand from programs that may have been cut in the past. Further,

pressure will remain in Medicaid programs while looming issues such as pensions and infrastructure will begin to take center stage, an almost exact forecast as the NCSL report.

Spending in FY 2006 grew at a staggering rate—8.7 percent, significantly higher than the 29-year average of 6.4 percent. The survey noted this growth was largely due to states spending in programs that received cuts in recent years. In addition, growth of budget reserves counts as spending and contributed to this growth rate as many states dedicated new revenues into reserves.

FY 2007 spending is forecasted to be closer to the average and achieve a growth rate of 7 percent. Pressure will continue from mandatory programs, especially Medicaid.

The survey also reported that states enacted a net tax and fee decrease of \$2.1 billion in FY 2007. While 15 states enacted net increases, twenty-four had net decreases.



Personal income taxes saw the largest decrease, \$2.32 billion, while sales taxes increased \$622.4 million.

Unlike the NCSL report, the NASBO survey reported that 46 states' revenues exceeded expectations, while the other four were on target. In fact, revenues were 5.9 percent higher than originally estimated, with corporate income taxes coming in almost 21 percent above forecasts. This represents a dramatic swing from FY 2002 when forty-two states reported collecting less revenue than budgeted.

D. State and Local Tax Burdens Hit 25-Year High

According to a new study by the Tax Foundation, state and local taxes will consume a record-setting 11 percent of the nation's income in 2007. Tax burdens have not dipped below 10 percent since 1986 and 2007 marks the first time they've risen above 10.9 percent.

Tax collections have been boosted as personal and corporate incomes have risen for almost four consecutive years. Additionally low unemployment has added

to the surge.

Vermont, Maine and New York had the highest state-local tax burdens, whereas Tennessee, New Hampshire and Alaska had the three lowest. Alaska is helped with large oil reserves that residents occasionally receive royalties from.

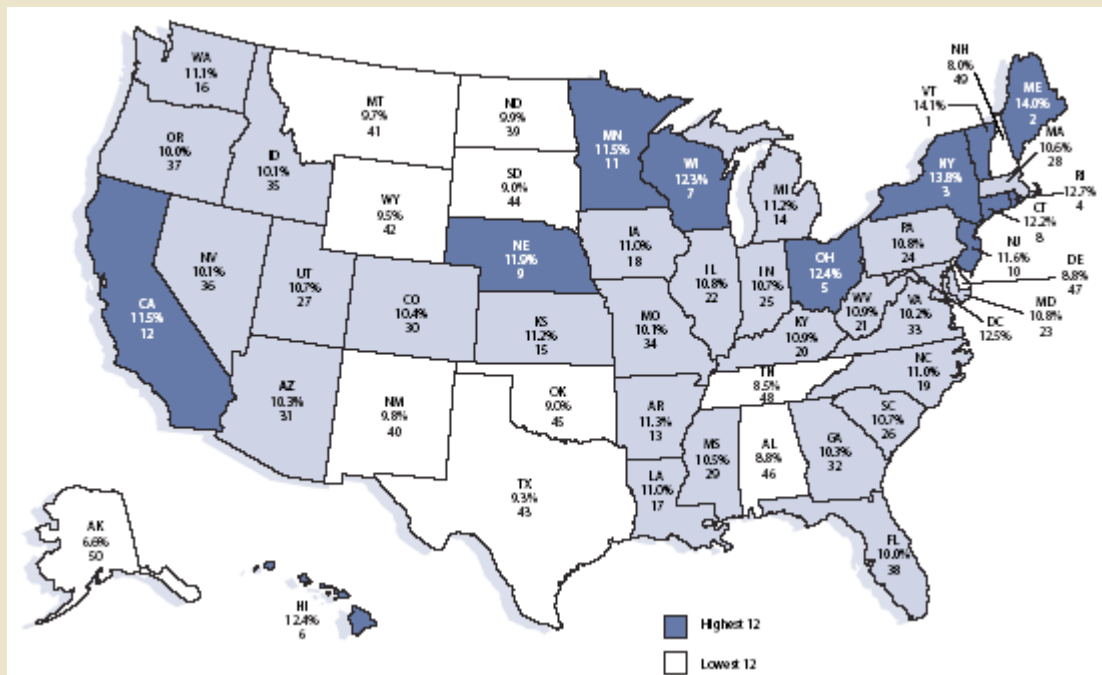
1. How Do Americans Think About Taxes?

It's no surprise that a majority of Americans say the federal income taxes they pay are "too high." Some of the key findings:

- Only 10 percent of Americans say they're willing to pay higher taxes to help eliminate the federal budget deficit.
- 66 percent of Americans favor a complete elimination of the federal death tax.
- 48 percent would support giving up some federal deductions for an across-the-board cut in tax rates.

However, some of the findings from the third annual survey of taxpayer attitudes by the Tax Foundation may be surprising. For example, respondents were asked the maximum level of income someone

Figure 1: State-Local Tax Burden and Ranks (Calendar Year 2007)



Source: Tax Foundation

should be taxed—including federal, state, and local taxes. The result was an average (14.7 percent) that is less than half that of the actual average taxpayer burden (32.7 percent). Additionally, the income group that most favored lower tax rates is those with modest incomes, while those in the highest income brackets favored the highest tax rates. Education level also factored into what people’s attitudes about tax rates should be. The lower the education level, the lower the tax rate. Conversely, as education level increased, so did the opinions about what tax rates should be.

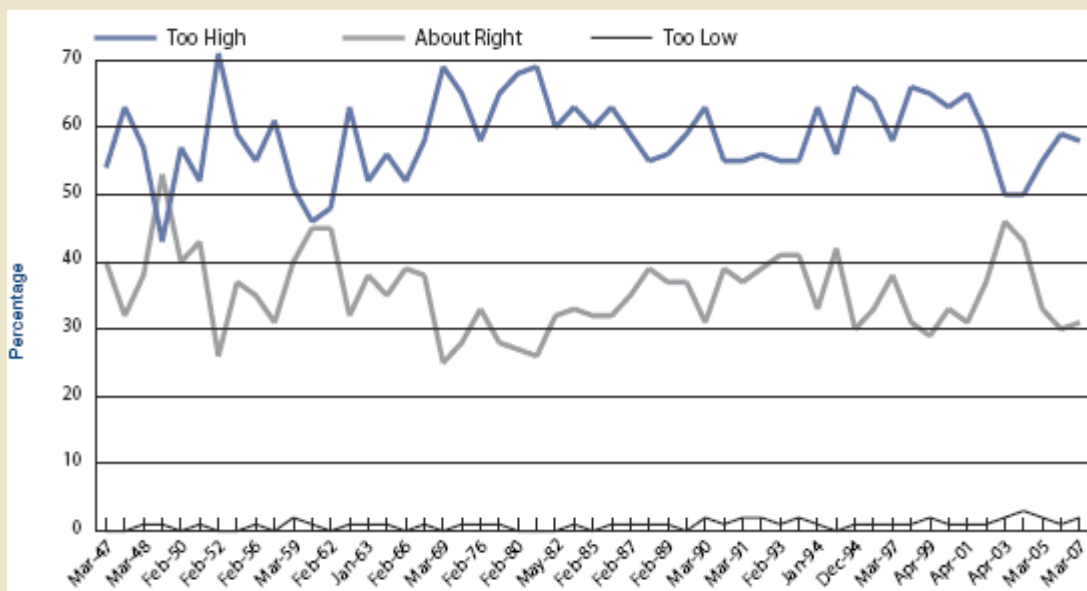
The federal death tax was deemed the most “unfair,” followed by gas and income taxes. Locally, gas taxes were considered the most unfair, followed by property and motor vehicle taxes

E. New Accounting Rule Shines Light on Government Liabilities

An accounting rule set in 2004 by the Governmental Accounting Standards Board (GASB) goes into effect this year. The rule, GASB 45, effects state and local governments and how they account for employee benefits. Before GASB 45 governments used cash accounting to account only for that year’s expense. Now, governments will have to shift to accrual accounting and to account for long-term promises as incurred costs or liabilities.

A Credit Suisse report issued in March 2007 estimates that state and local governments have amassed more than \$1.5 trillion in unfunded pension and employee benefit liabilities. Almost \$1 trillion of that is held at the local level. To put that

Figure 2: Do You Consider the Amount of Federal Income Tax You Have to Pay as Too High, Too Low, or About Right?



Source: Tax Foundation

into perspective the entire municipal bond market was \$2.4 trillion at the end of 2006. Furthermore, the companies in the S&P 500 “only” had an unfunded liability of \$326 billion.

Only three states—Mississippi, Nebraska, and Wisconsin—have no unfunded pension liabilities. California, New Jersey and New York likely face liabilities of \$70, \$60, and \$54 billion respectively. At the local level, Jacksonville, Indianapolis and San Jose have the three lowest liabilities among U.S. major cities. Detroit, San Francisco and Philadelphia are at the other end of the spectrum. New York City faces a deficit of \$50 billion if you account for all public employees, including teachers.

When this picture is painted, government balance sheets look a lot darker. In fact,

in a recent budget address New Jersey Governor Jon Corzine said “the constant focus on short-term priorities without consideration of long-term costs has led to financing decisions that hang over the state today, tomorrow, and far into the future.” GASB 45 is a very rude awakening for many in government and taxpayers alike. Given this reality many governments are left with few options:

- Shift to defined contribution plans (although promises made will still have to be funded, but the bleeding can be stopped);
- Cut benefits;
- Raise taxes;
- Cut services; or,
- Privatize

Surface Transportation

Contents

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A. Building Roads to Reduce Traffic Congestion in America's Cities: How Much and at What Cost?

By David T. Hartgen, Ph.D., P.E. and M. Gregory Fields

Reason Foundation's August 2006 study, *Building Roads to Reduce Traffic Congestion in America's Cities: How Much and at What Cost?* (available at www.reason.org/ps346/index.shtml), quantifies the magnitude of traffic congestion and the cost of its removal through the provision of additional capacity. The study defines and quantifies severe congestion, in which peak-hour traffic volumes exceed road capacity, and estimates future congestion if trends continue.

With the help of 32 participating urbanized areas, the study uses sophisticated traffic modeling techniques to determine

how much additional capacity will be needed to relieve severe congestion. These findings are then extended to all 403 urbanized areas. The report then estimates the cost of providing that additional capacity.

These costs include construction in each state, major bridge widenings, adjustments for induced travel, and requirements for some elevated or tunnel sections. Detailed results are provided for each city and state. The study also provides a simplified state-level assessment for rural areas and for moderate urban congestion.

The study finds that severe traffic congestion is pervasive in large regions and is worsening throughout the United States. In the future even small, urbanized areas are likely to experience congestion common in mid-sized areas today. The cause of this increase is not wastefulness but increasing

Figure 3: An Overview of the Congestion Problem

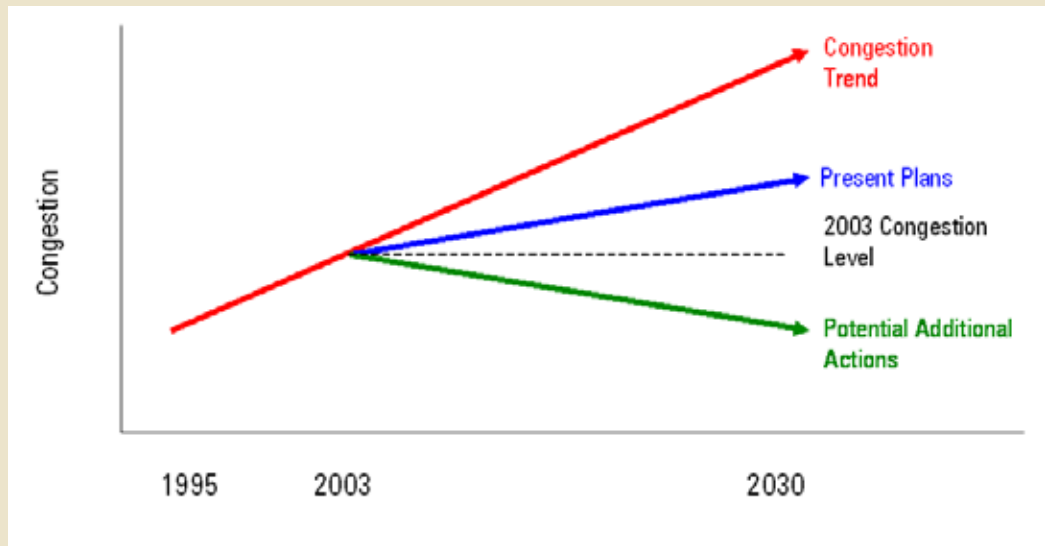


Figure 4: Urban Areas in the United States Requiring Congestion Relief with Costs to Relieve Congestion

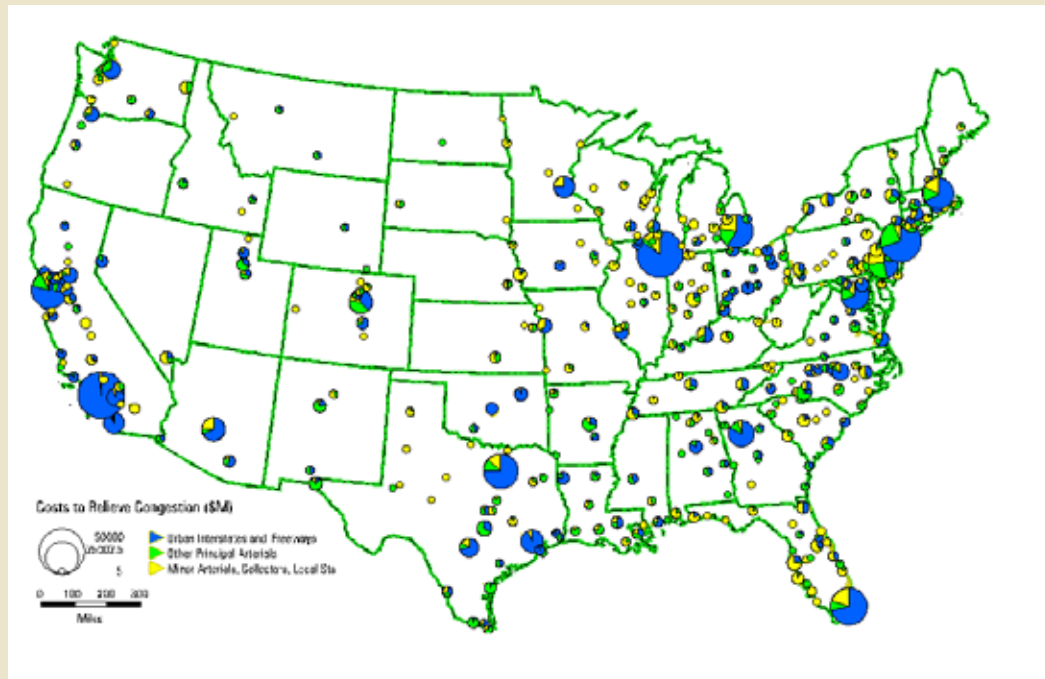


Table 10: Cities with 2030 Travel Time Delays Worse Than Today's Los Angeles

City	Population in 2030 (000s)	Congestion Index in 2030
Los Angeles-Long Beach	15,652	1.94
Chicago	9,522	1.88
Washington	5,973	1.87
San Francisco-Oakland	4,968	1.86
Atlanta	5,009	1.85
Miami	7,551	1.84
Denver-Aurora	3,210	1.80
Seattle-Tacoma, WA	3,963	1.79
Las Vegas	1,029	1.79
Minneapolis-St. Paul	3,370	1.76
Baltimore	2,437	1.75
Portland	2,513	1.75

population and preferences for private mobility, combined with limited additions to road capacity. Nationwide, the number of lane-miles of severely congested roads is expected to increase from about 39,500 in 2003 to 59,700 in 2030. To relieve severe congestion by providing additional capacity, an additional 104,000 lane-miles of capacity (about 6.2 percent of current lane-miles) will be needed, costing about \$533 billion over 25 years, in 2005 dollars. The amount needed—about \$21 billion per year—is about 10-15 percent of the federal highway program over 25 years, about 28 percent of the cost of present urban transportation plans, and about 39 cents per day per commuter trip. However, the travel time savings are estimated at about 7.7 billion hours annually, so the cost per hour of delay saved is about \$2.76. If moderate congestion and rural congestion are also to be addressed, an additional \$304 billion will be needed.

The study also finds that congestion relief through provision of additional capacity is quite feasible, given current

budgets. The benefits of an investment in additional capacity would be substantial. In addition to reduced travel time, other benefits include smoother traffic flow, reduced accidents, improved air quality through lower emissions, lower fuel use and operating costs, more reliable travel, lower logistical costs for manufacturing and delivery, more choices of jobs for workers and businesses and wider choices for consumers.

David T. Hartgen, Ph.D., P.E. is a professor of transportation studies at the University of North Carolina at Charlotte. **M. Gregory Fields** is a graduate student at the University of North Carolina at Charlotte pursuing masters degrees in Geography (Transportation), Earth Sciences (Environmental Monitoring) and Sociology. The above article is a summary of Reason's August 2006 study, *Building Roads to Reduce Traffic Congestion in America's Cities: How Much and at What Cost?* The full study, detailed appendices, interactive maps, and overviews of state-by-state congestion data and road capacity needs are available at www.reason.org/ps346/index.shtml.

B. Long-Term Toll Road Concessions: An Overview

1. Introduction & Overview

From the perspective of U.S. transportation history, 2006 will be noted as the year in which long-term toll highway concessions emerged as a major new alternative. The lease of the Indiana Toll Road for \$3.86 billion in June 2006 garnered much of the attention, but the longer-term story is the potential for using the concession mechanism to meet a significant share of the need for new highway capacity, both on urban freeways and on long-distance Interstates. That's why a growing number of states are either enacting first-time public-private partnership (PPP) legislation or amending existing laws to ensure that they are conducive to concession-type PPP agreements.

The basic concession model works as follows. For a given large-scale roadway project, the state selects a winning bidder that will design, finance, build, operate, and maintain the project over a sufficiently long term to have a reasonable likelihood of achieving a competitive (double-digit) return on its investment. The state's commitment, by signing a legally binding long-term concession agreement, provides the means by which the company can raise the needed funds to build the project (assuming the underlying economics are sound). Typically, such deals transfer at least three risks from the state to the private partner:

- The risk of construction cost over-runs;
- The risk of delays in project completion;
- The risk of inadequate traffic and revenue.

For mega-projects, in particular, shifting those risks from taxpayers to investors can be a major benefit of the long-term concession approach.

The other major benefit of long-term toll concessions is the mobilization of large new sums to be invested in much-needed highway improvements. There are other forms of "innovative finance," including issuing bonds backed by future fuel-tax revenues. But while such mechanisms shift the timing of funds to permit some projects to be built sooner, they do not add to the total amount of highway investment. Only the introduction of tolls adds new capital investment, making possible large-scale new projects.

The Federal Highway Administration's 2006 report on highway conditions and performance, released early in 2007, finds that capital investment by all levels of government averaged \$70 billion in the most recent year for which data were available (2004). To maintain pavement conditions and current congestion levels (i.e., prevent things getting even worse) would require an additional \$9 billion per year. To improve conditions, including actually reducing congestion below today's levels by removing bottlenecks and otherwise adding capacity, would require a total annual investment of \$132 billion, i.e., \$61 billion per year more than current levels. (This calculation was based on doing all proposed highway projects whose benefits exceed their costs.)

There are several other national investment needs studies, by groups like the American Association of State Highway & Transportation Officials and the U.S. Chamber of Commerce. While their numbers differ, all agree that the United States faces a major shortfall in highway

capital investment over the next several decades, with serious consequences for both goods movement and personal mobility. This is the context in which the introduction of the long-term toll concession model to the United States must be assessed.

2. Capital Markets and Companies

Fortunately, the global capital markets have now “discovered” the United States. As *The Economist* (Jan. 20, 2007) noted recently, “America is catching up with a trend that was pioneered elsewhere—in this case as far away as Australia. Infrastructure has become the most fashionable of asset classes, as governments desperate for cash link up with pension funds desperate to diversify out of shares and bonds.” The article cited the estimate of Michael Wilkins of Standard & Poor’s that \$100-150 billion was raised in 2006, worldwide, for infrastructure investment.

Table 10 lists new equity funds for infrastructure created during the past year. As can be seen, major U.S. investment banks and private equity companies have entered the field, alongside European and Australian capital. The total of these new funds is estimated to be \$29–37 billion. This is equity investment. Assuming that a toll road concession project is funded 30 percent by equity and 70 percent by debt, the total investment these funds could generate would be in the \$100-125 billion range.

In Australia, Canada, and Europe, both public-sector and private-sector pension funds now invest in infrastructure, including toll roads. *Innovation Briefs* reported in March that U.S. pension funds are seriously considering entering this field. The huge CalPERS (California Public Employees’ Retirement System) intends to

add infrastructure as a new asset class for its \$230 billion fund. Russell Read, chief investment officer, has mentioned toll roads as one type of infrastructure that might qualify for CalPERS support.

Fund	Size (\$billions)
Goldman Sachs	\$6-7
Citigroup and Blackstone	\$5
Macquarie European Investment Fund II	\$4-5
DRIVE (Transurban)	\$2.8
Macquarie Infrastructure Partners	\$2-3
CSFB/GE Capital	\$1-2
AECOM	\$1-2
Morgan Stanley	\$1-2
Carlyle Group	\$1-2
Reef	\$1-2
Babcock & Brown	\$1-2
Fondo Italiano (F2i)	\$1.5
BNP Paribas	\$1-2
HSBC	\$1
Bahrain	\$1
Total potential size:	\$29-37

Source: Macquarie Research, Feb. 2007, as reported in *Public Works Financing*.

At this point in time, the investor-owned toll roads industry in the United States is still predominantly made up of overseas companies. That’s because no such industry emerged in 20th-century America, as toll roads were developed and operated almost exclusively by government toll authorities at the state or local level. Adding to the preference for state dominance of this field was the availability of tax-exempt toll revenue bonds, available only to government entities. Long-term toll concessions today are offering serious competition to the state-only model, thanks in part to greater willingness and ability of the private firms

Company	Market Capitalization*	Miles of Toll Road**
Abertis	\$10.4 billion	915
ACS	\$ 7.7 billion	See note***
Autostrade	\$10.4 billion	2,080
BRISA	\$ 4.0 billion	610
CINTRA	\$ 2.0 billion	1,000
Cofiroute	\$ 1.5 billion	577
Macquarie	\$ 5.5 billion	930
SyV	\$ 4.3 billion	1,609

*Market capitalization is for the most recent available year and is for the whole company. In some cases, toll road activity is a small part of the total while in others it is the major or total business activity. Euros are converted to U.S. dollars at \$1.30 = €1, and Australian dollars at A\$ = \$0.80.

**Many private toll roads have multiple owners. The list presented here is the miles of toll road in which the company reports some share of ownership; hence, there is some degree of double-counting.

***ACS does not break out mileage numbers, but reports that it has “more than 50 toll concessions.”

to take on traffic and revenue risk (given sufficiently long terms) plus the new availability of tax-exempt private activity bonds (PABs) for public-private toll roads under the federal SAFETEA-LU legislation.

Table 11 lists the major global toll road companies as of 2006. This table is drawn from a 2005 Reason Foundation policy study which includes brief profiles of each of the companies (see reason.org/ps334.pdf). Since this table was created, the two largest companies, Abertis and Autostrade, have proposed to merge. Although the merger was initially turned down by Italian authorities, the European Commission overturned that decision, and in early 2007 the companies were still considering it. Separately, Spain’s ACS in March 2007 announced plans to acquire a controlling stake in Germany’s Hochtief AG and its U.S. construction arm Turner Corp. That would further a trend in which global toll-concession companies are partnering with U.S. firms—e.g. Fluor/Transurban, Cintra/Zachry, and Kiewit/Macquarie. The emergence of a purely U.S. toll concession company seems only a matter of time.

3. Controversy Over Concessions

Both the leasing of existing toll roads and the use of concessions for new tolled highway capacity have provoked opposition. Although the long-term lease of the Chicago Skyway sailed through the Chicago City Council with little opposition, the legislation to approve the lease of the Indiana Toll Road passed on a close vote; some even attributed the subsequent defeat of several Republican legislators in November 2006 to their votes in favor of the deal. And in early 2007, controversy over the specifics of toll road concessions for new projects in Texas culminated in the passage of a bill to impose a two-year moratorium on such projects (though most toll concession projects already in the pipeline were exempted from the bill’s provisions).

Several of the concerns raised by critics apply to both existing and new projects. They include:

- Foreign companies;
- The long length of the concessions;
- Adequacy of caps on annual toll rate increases;

- Details of provisions limiting the extent of state competition, via new “free” roads.

Discussions of these and other issues will be found in two sets of Frequently Asked Questions published in early 2007 by Reason Foundation (available at reason.org/pb58_building_new_roads.pdf and reason.org/pb60_leasing_state_toll_roads.pdf). In this space, we can provide only brief summary arguments on these points. They are also addressed in Robert Poole’s testimony before the U.S. House Subcommittee on Highways & Transit, Feb. 13, 2007 (available at reason.org/commentaries/poole_20070213.shtml).

Foreign Ownership: CNN’s Lou Dobbs and various elected officials have decried “the sale of tax-funded roadways to foreign companies.” This is doubly misleading, since no actual or proposed concession deal involves the sale; all—whether for existing or new toll roads—involve long-term leases. Second, none of the roadways involved was built with tax money; these are toll roads, financed based on toll revenues. As for the foreign-ness of the companies, as noted previously, the only companies with competence and a track record of long-term development, operation, and management of toll roads are from Europe and Australia, where such industries have been encouraged by government policy. Joint ventures are already emerging between U.S. and foreign companies, and (assuming politicians don’t stifle this emerging U.S. market), we are likely to see purely U.S. toll road companies emerge over the next five to 10 years.

Long Concession Length: Critics point to Europe as having concession lengths of 30 years and suggest that 50 or 75-year terms in some recent and proposed U.S.

deals are just too long. But the European terms cited are for basic, rural, inter-city toll roads built in the 1960s, ‘70s, and ‘80s. More complex, costly, and riskier European toll projects involve longer terms (e.g., 70 years for the A86 West tunnel near Paris and 78 years for the Millau Viaduct, the world’s highest toll bridge). Under U.S. tax law, road and bridge assets of existing toll projects may only receive depreciation write-offs if the concession term is greater than the useful life of the asset. That was a key factor in the long terms of the Chicago Skyway and Indiana Toll Road. (Companies were willing to bid more for a concession agreement that permitted depreciation write-offs.) For new toll facilities, depreciation write-offs are available in any case; hence, Texas has not had trouble getting serious bids to develop billion-dollar-scale new toll road projects despite a legal limit of 50 years for concession length.

Cap on Toll Increases: Rep. Peter DeFazio (D, OR), chairing his Feb 13, 2007 hearing on long-term concessions, repeatedly asserted that the cap on annual toll rate increases in recent agreements was “a floor, not a ceiling.” By that he meant that a toll road company would always select the index (GDP per capita) that permitted the largest annual increase, and would raise tolls to that level without fail. But this completely ignores what economists call “elasticity of demand”: you cannot charge whatever you want, because customers have options and will balk at paying rates they consider more than the value they get from using the toll road. That’s why prospective toll road developers (public or private) pay upwards of a million dollars for investment-grade traffic and revenue studies—to determine what toll rate in each future year would

maximize revenue. (Hint: it's never the highest rate one could imagine.) To be sure, states could adopt lower annual caps (such as the CPI), and many deals would still get done. But either the up-front payment or the future revenue-sharing with the state would be lower, as a consequence. These are policy choices that can be made in any concession agreement.

Competition Provisions: Whether public-sector or private-sector, toll roads are vulnerable to unexpected competition from large amounts of new “free” roadway capacity. Banks and bond-buyers historically have asked for limits on such competition, and generally state DOTs have cooperated, agreeing to certain, limited restrictions which get incorporated into bond covenants. With concession projects, such limitations become part of the concession agreement. These days, it is rare for such provisions to ban parallel free roadways. Generally, the agreements only define certain types of competing roads as subject to compensation, if they can be shown to have diverted traffic from the toll road and thereby reduced its revenues. Excluded from such provisions are all roads that are part of current long-range transportation plans and all roads more than X miles on either side of the toll road. As with toll rate caps, the details of such provisions are negotiable, though provisions offering very little protection may reduce either the up-front payment or future revenue sharing.

4. Conclusion

In the 20th century, America showed the world that investor-owned electric, gas, and telecommunications utilities worked better than the state-owned utilities in carrying out these functions. Nearly every

developed country has since privatized those utilities, learning from the U.S. model. But even before doing that, those countries had developed the concession model for investor-owned roadway utilities, mobilizing billions in private capital to develop high-quality toll motorway systems, both urban and intercity.

Transportation officials and policymakers are beginning to learn from their counterparts overseas, adapting the equity-based, long-term concession model to U.S. highway needs. The global capital markets have come to view the U.S. highway market as an untapped business opportunity, just as consensus was developing that we have a major shortfall of highway investment. The sections that follow detail recent developments in long-term concessions and toll road PPPs, both domestic and abroad.

C. Privatization of Existing Toll Roads

1. Leases Accomplished or Rejected

As of the end of 2006, three existing toll roads had been leased to the private sector under long-term concession agreements. The Chicago Skyway deal closed in January 2005, and the Indiana Toll Road deal closed in June 2006, shortly after Gov. Mitch Daniels signed the enabling legislation. And that same month, Transurban closed a deal for a 99-year lease with the Virginia DOT to rescue the ailing Pocahontas Parkway, one of two new toll roads developed under a kind of non-profit public-private partnership during the 1990s. The Parkway, located in Virginia, had attracted only about 60 percent of the projected traffic and revenue during its early years, and was at serious risk of defaulting on its toll revenue bonds.

Under the deal, Transurban will defease the existing bonds, refinancing the Parkway. It will also build a planned extension to the Richmond airport, which will likely increase traffic and revenue. Although there was no up-front payment (given the parlous state of the Parkway's finances), if the road does well enough over the long term, the concession deal provides for revenue sharing with VDOT.

Several other ailing start-up toll roads would be logical candidates for such rescues. Another nonprofit PPP toll road is the Southern Connector in Greenville, SC. Like the Pocahontas Parkway, its traffic and revenue are far below projections, but thus far no offers from the private sector have materialized (or if they have, they have not been disclosed). Yet another ailing toll road is the Northwest Parkway, opened in 2003 as the northwestern portion of greater Denver's beltway (of which the E-470 toll road forms the eastern half). In this case, the toll agency that was created to do the toll road has gone out to bid for a concession-based rescue. In April 2007, the Northwest Parkway Public Highway Authority selected from among 11 bidders the proposal of Brisa/CCR to negotiate a long-term concession agreement.

In three other cases thus far, proposed leases of existing toll roads have been rejected. Virginia had received five proposals to lease its Dulles Toll Road in October 2005, in amounts ranging up to \$5.7 billion. But the new administration that took office in early 2006 decided to reject them, opting instead to have the Metropolitan Washington Airports Authority (which operates Dulles Airport) take over the toll road and use a planned increase in toll revenues to help finance an extension of the

Metro heavy-rail system from the Virginia suburbs to the airport.

Macquarie made an informal proposal to the San Joaquin Hills Transportation Corridor Agency in Orange County, California in 2005, but the offer failed to generate enough political support to go forward. That toll road (the San Joaquin Hills Toll Road, SR 73) is also at some risk of default, though its traffic is in the 80 percent range of its projections.

Another rejection was in Houston. The Harris County Commission in early 2006 commissioned three outside studies on possible changes to the Harris County Toll Road Authority's system (consisting of the Hardy, Sam Houston, and Westpark toll roads). The J.P. Morgan team studied a possible sale of the system, estimating that the county might net as much as \$20 billion by doing so. The Goldman Sachs team analyzed a long-term lease, finding that this could yield between \$7.5 billion and \$13 billion, depending on the length of the term. And the Citigroup team studied ways of leveraging the system's revenues, while keeping it in county control. The commissioners liked the third option, voting unanimously in June 2006 to reject lease or sale. No written explanation was provided as to the basis for the decision.

2. Leases Under Consideration

As of this writing, in spring 2007, the most likely major toll road lease candidate is the Pennsylvania Turnpike. This proposal, subject to enactment of the necessary legislation, has the strong support of Gov. Ed Rendell and of some leaders of both parties in the state legislature. It also faces opposition, not only from those opposed to tolling and to foreign companies but also

from the Pennsylvania Turnpike Authority. In response to criticisms of other actual and proposed leases, Gov. Rendell has crafted a proposal that would (1) limit the term of the lease to 30 years, and (2) dedicate 100 percent of the proceeds to transportation, by creating a permanent fund whose earnings would be used for both highway and transit projects statewide. As of this writing, the proposal was favored by voters, 49 to 41 percent, in a Quinnipiac University poll.

The Turnpike Authority has attacked the governor's plan, contending that it could raise just as much money as the proposed lease would raise. But a close look at the Turnpike's plan reveals that it would raise a large fraction of its total by (somehow) putting tolls on the parallel I-80, a low-probability outcome. It has also not made a credible case for how it would prevent future governors or legislatures from preventing the regular toll increases its own plan calls for (which would be legally permitted for the life of a private concession, if that alternative is voted in). And it ignores one of the issues that has helped lead to majority voter support for the lease: endemic corruption at the Turnpike Authority, as attested to in numerous media accounts and by the governor himself, at the White House Surface Transportation Legislative Leadership Summit, Feb. 9, 2007.

Leasing of existing toll roads or systems is also on the agenda in Illinois and New Jersey. In the former, the impetus has come from the legislature, where Sen. Jeffrey Schoenberg has publicized the idea of leasing the Illinois Tollway system. At his urging, the legislature commissioned a study of the idea by Credit Suisse. That report, submitted in August 2006, estimated that leasing the system for 75 years could yield \$5.8 to \$8.4

billion if tolls were adjusted annually for inflation. Other lease assumptions produced proceeds as high as \$17-24 billion for a 75-year lease. Schoenberg, who chairs the Senate Appropriations Committee and a revenue-forecasting commission, proposes that all proceeds be used for transportation investment and to bail out the state's underfunded public employee pension system. As of this writing, the idea is on hold, with the governor focused on leasing the state lottery.

New Jersey's Gov. Jon Corzine has cautiously proposed leasing a number of state-owned assets, primarily to reduce the state's severe debt problems. A report by UBS Investment Bank identified a number of possible lease candidates, including the New Jersey Turnpike Authority and its individual toll roads. Enabling legislation was introduced by an ally of the governor, but legislative hearings exposed a considerable amount of bipartisan opposition, and few other supporters.

As of early 2007, Delaware DOT was looking into the possibility of leasing its toll roads, I-95 and Del. 1. The state has a \$2.7 billion shortfall in its transportation budget over the next six years; by some estimates, leasing the toll roads could generate \$4 billion. Delaware already has PPP legislation on its books, under which a lease could be offered.

D. New PPP Toll Roads & Toll Lanes

1. PPP Enabling Legislation

According to a report in the March 2007 issue of *Public Works Financing*, measures are pending in nine states to permit toll road PPP agreements, generally including long-term concessions. Two other pending laws—

New Jersey and Pennsylvania—have been discussed above, and are focused primarily or exclusively on the lease of existing toll roads.

The new measures are broader, and focus mostly or entirely on using toll PPP arrangements to develop new roadways and bridges.

Arizona: Competing bills on PPPs were in the Senate rules committee as of March 2007, making passage unlikely this year. Bills authorizing HOT lanes and PPPs did pass the Senate Transportation Committee in February.

California: Since the pilot program law enacted in 2006 has been judged unworkable by the private sector, the governor's office has drafted a revised version that deletes the objectionable provisions (the legislative veto of negotiated agreements and the limitation of tolling to commercial vehicles). The bill has been introduced by Sen. George Runner, and informational hearings have been held thus far in early 2007.

Florida: A bill revising the state's current PPP law to permit the lease of existing toll roads (except the Florida Turnpike) passed the House in March 2007. It would also add some concession-related provisions to the existing PPP law, for example to limit terms to 50 years unless the state DOT shows that a longer term (up to 75 years) is needed. It would also permit mixed (public/private) funding for projects that are part of the state highway system.

Hawaii: A bill permitting PPPs passed the House, but was killed by the chairman of the Senate transportation committee, who failed to hold a hearing by the required March 23, 2007 deadline. But apparently

the Senate could pick up the bill again next January.

Indiana: Gov. Mitch Daniels in late March 2007 withdrew his proposal for two new PPP highways, one a beltway around Indianapolis and the other a joint project with Illinois. In both cases, strong opposition arose from landowners, which would likely have been the case regardless of whether the roads were proposed as toll roads or not.

Mississippi: The legislature in March 2007 passed a new PPP enabling act, which will make that state the 22nd with such a law on its books. It permits the government or private contractors to design, finance, build, and operate new toll roads and bridges. Free alternative routes must be available, and the tolls must be removed after the construction debt has been paid off.

Nevada: As of this writing, bills were pending in both houses to allow both state and local governments to build and operate toll roads, including via private concessions.

Tennessee: In February 2007, both the Democratic chair of the House transportation committee and the Republican chair of the Senate transportation committee introduced PPP enabling legislation. Separate bills are also in motion permitting toll roads in the state.

Virginia: The legislature passed a measure to amend the state's existing PPP law to permit a local agency, the Northern Virginia Transportation Authority, to levy tolls and pursue toll concessions. Previously, only Virginia DOT had such authority.

PPP legislation is also under discussion in Kentucky, Michigan, Oklahoma, and Puerto Rico, as of spring 2007.

2. New PPP Toll Roads

Most states with existing or pending PPP legislation have one or more projects in the works, generally new toll roads. The following section offers a brief recap.

Arizona: A new \$900 million toll road in Pinal County, in the fast-growing southeastern suburbs of Phoenix, seems to be the focal point of attention as the legislature debates a PPP toll roads bill. Also on the agenda, via separate legislation, is the proposed conversion of HOV lanes on I-17 to HOT lanes.

California: The Golden State first authorized concession toll pilot projects with legislation in 1989, and the second of two such projects under that (since-repealed) law is due to open in the second half of 2007: the South Bay Expressway (SR 125 South) running north-south through the eastern suburbs of San Diego. The main potential concession projects, thus far, are all in the greater Los Angeles area. The most ambitious is a toll truckway system, built along I-710 and SR 60 to get short-haul drayage trucks from the Ports of Long Beach and Los Angeles to the distribution centers located in Riverside County. Three other proposed projects are long-distance, deep-bored tunnels: one beneath South Pasadena to complete a missing link on I-710, another between Glendale and Palmdale to significantly shorten driving distance and time between those two cities, and the Riverside/Orange County tunnel providing a new east-west link between the inland bedroom communities and coastal Orange County.

Colorado: The Colorado DOT's Colorado Tolling Enterprise has done a large-scale feasibility study of possible toll roads and toll lanes, mostly in the Denver

metro area. But most current PPP interest centers on a proposed \$575 million toll road around the east side of Colorado Springs. The 33-mile project's initial feasibility study found it to be financeable solely with toll revenues.

Florida: With its well-established public toll authorities at the state and metro-area levels, Florida might seem to have little need of PPP toll roads. But what appears to be emerging is the use of concessions for riskier projects that don't fit the conservative funding criteria used by the toll agencies. The Tampa Hillsborough Expressway Authority, for example, has gone out to bid for its new East-West Road, a short but costly connector between fast-growing New Tampa and I-275. Though only 3.1 miles long, the project is expected to cost \$150 million because much of it must bridge the Cypress Creek swamp. Elsewhere, concession projects are being considered for a new 46-mile Outer Beltway around Jacksonville and for proposed elevated express toll lanes on I-95 in Miami and I-595 in Ft. Lauderdale. Florida is also using a concession for the \$1.2 billion Miami Port Tunnel, though in this case the revenue stream will be availability payments from state and local agencies rather than tolls.

Georgia: Although the state has received and is moving forward with PPP proposals for three toll lanes projects (Georgia 400, I-75 North, and I-285 West), none of these involves concessions. But in February 2007 Georgia DOT announced a major new 10-year proposal for statewide transportation improvements. Included would be four mega-projects in the Atlanta area: a network of express toll lanes, a tunnel beneath downtown (to relieve congestion on the I-75/85 Downtown Connector), a new east-

west toll road in the northern suburbs, and a separate truck tollway system. All four are potential candidates for long-term toll concessions.

Hawaii: The principal focus of proposed PPP legislation is the development of reversible elevated express toll lanes to provide a bus and motorist congestion-relief alternative to the congested H-1 freeway.

Indiana: Gov. Mitch Daniels proposed two major toll concession projects. The Indiana Commerce Connector was a 75-mile outer beltway around most of Indianapolis, to relieve congestion on the region's numerous Interstates. The other was called the Illiana Expressway, a truck-oriented connector between northwestern Indiana and northeastern Illinois. In both cases, vocal local opposition from property owners proved to be sufficiently powerful to cause Daniels to withdraw the proposals in early 2007.

Kentucky: A massive \$3.9 billion Ohio River bridges project is the impetus behind consideration of a PPP toll roads law for this state. The cost of the two bridges plus interchanges has ballooned from \$2.5 billion, and the longer the delay in going forward, the higher inflation is expected to boost the cost.

New York: Although former Gov. George Pataki twice tried and failed to get PPP enabling legislation enacted, there are indications that new Gov. Eliot Spitzer is receptive to the idea of a PPP concession approach to fund the replacement of the obsolete Tappan Zee Bridge across the Hudson River, north of the New York City metro area.

Oregon: Under a unique contractual approach, Macquarie Infrastructure Group is doing feasibility studies for Oregon DOT

of three possible toll projects in the Portland area. In January 2007, MIG announced that two of the three are potentially feasible. The two are the widening of South I-205 and a proposed Newberg-Dundee bypass toll road.

Texas: Texas DOT negotiated its first two long-term concession deals (called Comprehensive Development Agreements under Texas law). Cintra/Zachry will develop segments 5 and 6 of SH 130, the new toll road between Austin and San Antonio. TxDOT's internal toll feasibility study found that conventional toll financing could cover less than half the project's estimated \$1.3 billion cost, but Cintra/Zachry will do the entire project at no taxpayer cost under a 50-year concession. For SH 121 in the Dallas suburbs, the fundamentals were so strong that Cintra agreed to build the \$560 million toll road but also to provide an up-front concession fee of \$2.1 billion. However, that project has been entangled in controversies over whether CDAs, as currently defined, actually serve the public interest, and also complicated by a late proposal submission from the North Texas Tollway Authority, operator of several existing Dallas-area toll roads. Despite the passage of Senate Bill 792 in June 2007—which places a two-year moratorium on CDAs, gives local toll authorities the first option on new toll projects, and creates a new market valuation process for new projects—approximately a dozen other CDA projects under development statewide were explicitly exempted from the moratorium and will still proceed forward.

Utah: Although Utah's legislature enacted a comprehensive PPP toll roads act in 2006, no actual toll road projects have emerged yet. The most likely project is a 35-

mile Mountain View toll road, estimated to cost \$2.5 billion. Running generally north-south, it would relieve congestion on surface streets in the western Salt Lake City suburbs and provide an alternative route to the Salt Lake City airport. Utah's first toll project of any kind is the new HOT lanes on I-15, opened in 2006 by converting former HOV lanes.

Virginia: Final approvals are near for the Fluor/Transurban concession to add two HOT lanes in each direction to the southwest quadrant of the Beltway (I-495) in northern Virginia. The same team has also been selected to convert the existing HOV lanes on I-95/I-395 into HOT lanes. Virginia DOT has also received three proposals in response to its RFP to add 55 miles to US460. The project would be funded partly by tolls and partly by state funds.

Washington: The state released a major tolling study, building on the state DOT's frequently expressed view that current funding sources, despite a recent gas tax increase, will permit very little increase in highway capacity. Legislators enacted a PPP law in 2005, but thus far no specific projects have emerged. Gov. Christine Gregoire has suggested new toll bridges, such as on I-90 in Snoqualmie Pass and on I-5 at the Oregon line. Others have suggested tolls and PPPs to replace the Alaskan Way Viaduct and the SR 520 Bridge.

E. International Toll Road Developments

1. Large Urban Tunnels

One of the most notable global trends in recent years is the development of large new urban roadway tunnels, generally

toll-financed and usually done as long-term concession projects. In many such cases, a key enabling technology is the tunnel boring machine—a giant, self-contained structure with a rotating drill head up to 50 feet in diameter—and machinery to erect the tunnel walls as the drill moves forward to bore the tunnel.

Sydney, Australia is a prime example of a major city that has made use of tunnels as a critical element in developing a region-wide toll motorway system. Tunnels made feasible key links in the M1 Eastern Distributor (downtown to the airport) and the M2, M4, and M5 toll motorways, as well as providing new tunnel capacity parallel to the landmark harbor bridge. The only Sydney tunnel that has not been a financial success is the Cross City Tunnel, a 1.3 mile route that permits downtown traffic to bypass many signalized intersections. Over-optimistic traffic projections misled investors, and the tunnel company filed for bankruptcy at the end of 2006. However, taxpayers are not at risk, and the receiver is keeping the tunnel in operation. Sydney's success has led concession companies to incorporate large tunnels in Melbourne's first two tolled motorways, and now Brisbane is doing likewise, with its first two projects being the A\$2 billion North-South Bypass Tunnel and the A\$1.2 billion Airport Link tunnel.

Other notable urban tunnel projects are as follows:

Paris's A86 West. French toll road company Cofiroute is nearing completion of the first of two large tunnels (34-foot inside diameter) that will fill in a long-missing-link on the A86 ring road around Paris. Local opposition had held up the planned surface route for decades, since it would

have bisected historic Versailles. Cofiroute made an unsolicited proposal to the French government to finance, build, and operate the project as tunnels created via tunnel boring machines. The first \$2 billion tunnel is nearing completion; at 6.3 miles long, it will provide for two decks, each able to accommodate three lanes of auto-size vehicles (no trucks). A parallel tube, to be built subsequently, will have a single deck and one lane each way for truck-size vehicles. The project cost is being financed based on projected toll revenues, without government guarantees. The concession term is 70 years.

Madrid's M-30 tunnels. Madrid's inner ring road, the M-30, is heavily congested and in need of additional capacity. Due to land-use constraints and costs, a tunnel solution was judged to be the best approach. The most spectacular portion of the overall M-30 expansion is the South By-Pass. Twin tunnels of 49-foot diameter have been constructed via tunnel boring machines, creating a bypass route that is almost a mile shorter than the existing M-30 route. The tunnels average 2.2 miles in length, and are connected every 650 feet by cross-passages. Each tunnel provides a single main deck with three full-size lanes accommodating all types of vehicles, plus a lower deck for emergency vehicles (including full-size fire/rescue trucks). The M-30 tunnels were scheduled to open in spring 2007.

Kuala Lumpur's SMART Tunnel. This large project (about \$650 million), in the capital city of Malaysia, is the world's first combined stormwater and roadway tunnel. It combines a 6-mile stormwater tunnel with a 1.9-mile double-deck roadway (two lanes each deck), all within a 37-foot diameter tunnel created via tunnel boring machines.

Under normal conditions, the lowest level will be empty of water and traffic will flow on the two vehicle decks. Under certain conditions of heavy rainfall, water will be diverted into the tunnel's lowest level, with traffic continuing to flow on both vehicle decks. Only under full stormwater operations—expected to be once or twice a year—will the tunnel be closed to traffic so that its full capacity can be devoted to flood control. As of this writing, basic construction had been completed. The tunnel opened in May 2007.

Yangtze River Tunnels. Under construction currently in Shanghai are twin 50' 6" roadway tunnels, being excavated by the world's largest tunnel boring machines. The tunnels will be 5.6 miles long when completed; they are key components of the Shanghai Yangtze River Tunnel & Bridge Highway, whose total cost is \$1.6 billion, including both the tunnels and two major bridges. The overall highway is nearly 16 miles long. This is but one of dozens of large tunnel projects currently under way in China. Another crossing of the Yangtze River is taking place at Nanjing, using a 49-foot diameter tunnel boring machine. A third tunnel crossing is at Wuhan, using a 37-foot diameter tunnel boring machine. The German firm Herrenknecht, the world's leading tunnel boring machine producer, told *Engineering News-Record* in March 2007 that it had supplied nearly 40 tunnel boring machines for projects in China, and estimates that another 10 from other manufacturers are also at work in China.

City Ring Brussels Tunnel. This proposed tunnel would be 6.2 miles in length, with three lanes on each of two decks, within a 45-foot diameter. Its dimensions would permit buses as well as

cars, but not heavy trucks.

Buenos Aires Tunnel. This proposed tunnel would run 150 feet below the surface of 9 de Julio Avenue in the center of the Argentine capital. Twin double-deck tubes are proposed, each with four lanes. This project, along with a planned riverside highway, is intended to relieve congestion on the city's streets.

2. Other PPP Toll Roads

As noted in previous editions of this report, the use of long-term concessions has become standard practice for large-scale highway, bridge, and tunnel projects in most of Europe, the urban areas of Australia, and parts of South America. Generally speaking, in Europe and Australia, most such projects use toll finance, with concession terms of from 30 to 75 years. Several European countries have used "shadow tolling" for some of their roadway projects, notably Spain, Portugal, and the United Kingdom. In politically stable countries with the rule of law, investors are willing to finance such projects based on the government's pledge to make annual payments over the life of the concession term, based either on traffic counts or some other formula. In developing countries, little use has been made of shadow tolling thus far. Instead, where new roads (or major upgrading of existing roads) are needed, but toll revenues are insufficient to cover the capital and operating costs, the typical model is one of mixed funding. The government (perhaps aided by development banks) puts up a portion of the capital costs; then the balance is raised via toll financing.

Below are some highlights of notable developments during 2006 and early 2007 in selected countries.

Australia: The country's fastest-growing

state, Queensland, has now embarked on a major roadway expansion effort: the South East Queensland Infrastructure Plan & Programme (SEQIPP). It envisages spending A\$66 billion over the next two decades, nearly half of it on transportation infrastructure. Besides the Brisbane toll tunnel projects mentioned previously, others include a twin span for Brisbane's Gateway Bridge, a A\$2 billion Northern Busway, and the A\$543 million Tugun Bypass. Queensland is following the trail blazed by New South Wales (Sydney) and Victoria (Melbourne) in making use of long-term toll concessions.

Brazil: South America's largest country is also its leading practitioner of toll concession projects, with over 5,500 miles of highway operating under 36 federal concession agreements. In early 2006, the government announced an expansion of the program; however, it got entangled in politics and was put on hold for most of the year. In January 2007, however, new rules were issued to get the program moving forward again. The projected seven new concessions would cover up to 1600 miles of additional highway, involving up to \$9 billion in investment. Two other firsts for Brazil: the first state-authorized toll concession (a \$300 million upgrade of an existing highway in Minas Gerais) and the country's first express toll lanes (on a 7.5 mile highway in Sao Paulo), to be done as a \$564 million concession.

Britain: With only one real toll road concession project (the successful M6Toll), Britain in 2006 continued to pursue its own form of shadow tolling—design, build, finance, operate (DBFO) concessions in which the government commits to "availability payments" over the life of the

concession. The largest of these will soon request proposals from five short-listed teams for the \$8.9 billion project to widen and operate London's M25 ring road, under a 30-year concession. The award is expected in 2008 with construction beginning in 2009. Meanwhile, debate continues over government proposals to institute nationwide road pricing.

Canada: Our neighbor country has only one significant toll road, the privatized (via 99-year concession) Highway 407 in Toronto. Most of the concession activity these days is along British DBFO lines. That is true of recently awarded concessions for the Sea-to-Sky Highway and Golden Ears Bridge projects in British Columbia (though the latter will charge real tolls, to be paid to the government, which in turn will pay the concessionaire). It's also true of several roadway projects in Alberta. However, two notable exceptions are now under way. In Quebec, the 26-mile A30 project will be a toll road concession, for which three teams have been short-listed and invited to submit proposals. At the federal level, the transport minister has proposed a toll concession for a new crossing of the Detroit River, linking Detroit and Windsor.

Chile: This country continues to have one of the most advanced toll concession systems in the world. In 2006 the four concession companies that have developed a fully interoperable system of toll roads in Santiago received legal permission to institute peak/off-peak tolling differentials, to enable them to better manage traffic flow so as to minimize congestion. The system includes nearly 100 miles of new toll motorway.

Greece: In December 2006 the Greek government signed its then-largest toll

concession agreement. The \$1.6 billion project includes 235 miles of toll road, on two separate north-south routes along the country's east and west coasts. It is one of seven major toll concessions comprising a major upgrade of the country's highway system. Two additional concession contracts were signed in January 2007 and the winner of another announced in February. The latter is a 228-mile, \$3.5 billion project that includes a 10.5-mile bored tunnel.

India: This fast-growing country continues to move forward on its \$13 billion National Highways Development Project, much of which is being carried out via toll concessions. Following completion of the first phase—the Golden Quadrilateral, linking Delhi, Kolkata, Chennai, and Mumbai—the second phase is moving forward smartly with new concession projects being awarded in most parts of the country.

Indonesia: As part of a series of good-government reforms, Indonesia has joined the move to privatize existing toll roads. The government's toll road agency, PT Jasa Marga, announced in March 2007 that it would lease all 16 of its existing toll roads to concession companies, so as to raise cash to develop new projects. Jasa Marga is the largest toll road operator in Indonesia; the country's other toll roads were developed and are operated by concessionaires.

Mexico: This country is widely known for failed private toll road projects in the 1980s and 1990s, in which bids were won by the company that offered the shortest concession period and subsequently attempted to charge unrealistically high tolls. Those projects were nearly all taken over by the government after failing financially. But having learned from its

mistakes, the country's Secretaria de Transportes y Comunicaciones (SCT) is trying again. In 2006 it began offering new toll road concession projects, on more realistic terms. And in 2007 it is beginning to "re-privatize" some of the toll roads it nationalized previously. An initial four, totaling 346 miles, will be offered via two concessions this year, under standard 30-year toll concessions. SCT is also offering several hybrid projects, combining tolled and shadow-tolled stretches, on 20-year concessions.

Panama: Thirteen years ago the government awarded a concession to a Mexican firm to develop a 36-mile toll road parallel to the Panama Canal. That firm failed after completing only one-fourth of the project. Now Brazilian developer Odebrecht has bought out the concession and will complete the project, investing \$215 million.

Peru: A \$1.3 billion InterOcean Highway project is under way to link Brazil with Peru. The Brazilian portion is already completed, but the Peruvian portion, crossing the Andes, has proved more difficult. It has been divided into five sections, each one awarded as a 25-year toll concession. As of January 2007, three of the five were under construction. The other two, which involve upgrading existing paved roads leading to coastal cities, are to be awarded in the first half of 2007. When completed, the highway will permit ocean-to-ocean trips in four days.

Russia: The government is supporting a bill in the State Duma to provide a legal framework for toll road concessions, with the aim of upgrading Russia's dilapidated highways. The bill includes a requirement that there be parallel free routes. *Public*

Works Financing in March 2007 reported that four international teams have been qualified to bid for the first such project, the west section of a new St. Petersburg beltway. Studies are under way on the second project, the M10 between Moscow and St. Petersburg.

F. Answers to the Most Common Objections to PPPs

By William D. Eggers

Objections to public-private partnerships (PPPs) tend to be markedly similar across countries. For the most part, the main objections simply reflect a sincere desire to protect the public purpose and get the most value for taxpayers. Nevertheless, some of the concerns are driven by a misunderstanding of PPPs, while others are based on outdated or incomplete information. Following are answers to the most common concerns.

1. Higher Cost of Capital

Objection: Government-issued debt is cheaper than the private sector's, making private financing and development a bad deal for taxpayers.

This is perhaps the major objection to PPPs. This line of argument contains some truth, but it also overlooks several important points.

Difference between cost of capital and cost of debt. First, the argument assumes that the cost of capital and the cost of debt are one and the same. However, a government's risk-adjusted average cost of capital typically exceeds its cost of debt because the public sector takes on project-specific risks such as cost overruns and

delays that need to be factored into the cost of capital for each project it undertakes. Moreover, even though the private sector takes on some of the risks of construction, time overruns, and project performance, it can better control its capital costs by making efficient use of resources. The comparison should therefore be between the public sector's cost of capital (to which a risk premium must be added) and the private sector's cost of capital (which amounts to the weighted average of its cost of debt and equity), not between the two sectors' different costs of borrowing. Moreover, the benefits achieved in terms of superior service delivery alone are often worth the extra costs to the government.

Gap Narrowing. Second, as the private infrastructure market has grown and financing mechanisms have become more sophisticated, the gap between the public and the private sector's cost of debt has narrowed. For example, with the maturing of the private finance market in the United Kingdom, the financing costs difference between the private cost of capital and public borrowing is now in the range of only 1-3 percentage points. As Allen Grahame notes, the additional cost to the public sector should not be significant enough to risk losing the value for money of the project, provided the private sector can deliver savings in other aspects of the project.

Creative Financing Models. Last, a variety of financing approaches enables governments to combine their ability to obtain lower interest rates with the benefits of private financing and development. In the United Kingdom, the Treasury launched a program called Credit Guarantee Finance (CGF) to reduce the costs of borrowing

to finance PFI (Private Finance Initiative) schemes. Under the credit guarantee program, the government provides funds to the PFI project through cash advances governed under the terms of a loan agreement. The private firm repays these loans to the government after completing the project. Also the government receives an unconditional repayment guarantee from the private financier for providing this loan facility in return for a fee.

In the United States, the Department of Transportation has allocated \$15 billion in tax-exempt private activity bonds for qualifying PPP highway and intermodal freight facilities. This approach lowers the private sector's cost of capital significantly, enhancing the investment prospects.

2. Failure to Realize Value for Money

Objection: When you combine the higher borrowing costs of private financing with the often higher transaction costs—and subsequent monitoring costs—of engaging in these kinds of deals, the taxpayers end up paying far more than they would have under more traditional public financing.

The issue of value for money should be an important feature of any public infrastructure project, though it gets more emphasis with PPPs. Value for money is based on the theory that the private sector brings in benefits and efficiencies that outweigh its higher borrowing costs. In analyzing value for money, it must be recognized that lowest price does not always mean best value. Value for money is a function of, among other things, price, quality, and the degree of risk transfer. UK government officials consistently rate PPPs as a good value for money. In a survey of 98 projects by the UK National Audit Office

Table 13

Category	Financing Type	Characteristics
User fees, revenue sources	Tolls	Tolls (or similar user charges for use of a facility) are considered a revenue source for a project, thereby providing a stream of payments that the bidders can use to determine their return on investment and to obtain financing.
	Shadow tolls	Shadow tolls are typically a means by which the government sponsor can make payment, based on usage of the facility, to the private sector operator.
	Availability	Availability payments are financial payments from the government to the private partner stipulated in a transaction to make up the difference between the government-imposed user fee (if any) and the cost of usage of the delivered service. Such payments can be in the form of tranches or in one lump sum (such as at the successful completion of the facility or for the agreed-upon maintenance requirements of the facility).

in 2001, for example, 81 percent of the public authorities said they were achieving satisfactory or better value for money from their PFI contracts, while only 4 percent described value for money as “poor.” Last, conventional procurement has resulted in very poor value for money, thanks to cost overruns, delays, and so on.

Several factors contribute to value for money, but primary among them is efficient risk allocation. Risk allocation is based on the premise that risk should be transferred to the party that is best suited to manage it. Optimal risk allocation leads to reduced cost associated with risk, which in turn leads to better value for money.

Evidence supports the view that PPPs transfer construction and maintenance risk to the private sector more effectively than traditional methods and are likely to deliver value for money where competition is strong and the projects are large. A review of eight Partnerships Victoria projects found a weighted average savings of 9 percent against the risk-adjusted Public Sector Comparator. In the case of smaller projects,

“bundling” helps to spread procurement costs across several discrete projects.

3. Windfall Profits to the Private Sector

Objection: The private sector sees the opportunity to make windfall profits from infrastructure investments—particularly investment banks and financiers who often receive big upfront fees from refinancing the debt.

Indeed, concession holders will likely seek to refinance their project debt on more favorable terms with a greater amount of leverage. However, this need not necessarily prove a particular problem for governments. For one thing, some of the biggest refinancing gains from PPP transactions came in the early stages of PPP development when the market was less mature and interest rates dropped worldwide to historically low levels. With market maturity, the likelihood of the private sector making huge gains from refinancing falls.

Second, where it makes sense, governments have the option to negotiate with their private partners to share

in refinancing gains. Gain clauses can be included in contracts, where the government's share can be either taken as a cash lump-sum at the time of the refinancing or in the form of reduced service charges. It is important to recognize, however, that such "clawback" mechanisms, while they may make the profits more politically acceptable, may also result in more expensive contracts upfront.

Third, explicit sharing mechanisms don't necessarily have to be built into the contract for the public sector to share in the gains. General approval rights over changes in contracts or financing arrangements, such as termination liabilities, should put the public sector in a strong negotiating position. In numerous cases, government agencies have capped the rate of return of the provider and negotiated revenue sharing arrangements. Both can help in certain cases to enhance the long term political viability of the partnership.

When refinancing gains are not shared, such benefits should reflect reward for effectively managing risk and costs rather than a pure windfall gain. The key thing is to seek an equitable outcome that protects the interests of the taxpayer and is defensible publicly.

Governments have several options to limit excessive fee increases and protect consumers of the infrastructure.

4. Customers of the Service Will End Up on the Short End of the Stick

Objection: Since the infrastructure facilities often are monopolies, the private sector can raise charges as much as they wish on consumers who end up disadvantaged by PPPs.

This is a complicated issue because historically political considerations have often meant that increases in user fees did not keep pace with the rate of inflation for toll roads and other public infrastructure and their associated operational and maintenance costs. This gap contributes to funding shortfalls and deferred maintenance. One goal for many governments in using PPPs—whether explicit or implicit—has been to move the issue of fee increases away from the political realm so that market, rather than political, considerations can guide fee increases.

That said, governments have several options to limit excessive fee increases and protect consumers of the infrastructure. First, fee increases can be limited by contract to the rate of inflation or some other predetermined rate, a common practice for toll road projects, or the government can retain the power to set rates based on objective criteria.

Second, private investment presupposes a revenue stream from which the private investor can earn a return. The revenue stream, however, does not have to consist solely of an interest in tolls or other fees imposed directly on users of the project. In cases where governments want a toll lower than what is needed to service/repay project debt, they can pay an "availability fee" to the private sector to make up for the difference. Great Britain likewise has used "shadow tolling" to support its PFI program.

Governments can also link the payment for the use of the infrastructure to the user's ability to pay. To offset the hardship that particular groups might experience from toll charges, for example, public officials can consider transportation vouchers or

other mechanisms, like subsidies, to ease the financial burden, understanding that this will bring in less revenue.

For sectors where future needs are less certain, like water and waste, the public sector can enter into an arrangement where it buys back the facility from the private partner immediately after it is completed. The public sector can then enter into a long-term leasing agreement with the private sector to operate the facility and sell water to customers at a fixed price. Both the public and the private sector gain from this arrangement and the customer is not adversely affected. The public sector gains ownership of the facility without having to make upfront capital investments; the private sector gains more certainty about its future revenue.

5. The Government Is Forced to Bail Out PPP Projects When Demand Fails to Meet Projections

Objection: Underestimating future demand jeopardizes project returns and the fiscal solvency of the project itself.

As explained earlier, shifting risk to the private sector is a major part of the rationale for PPPs. In the United States, most road PPPs transfer all or most of the demand risk to the private sector. Down under,

Melbourne's EastLink project transfers 100 percent of the project risk to the private sector. To be sure, when the private provider faces problems with demand and is unable to continue the contract, it may terminate the partnership, but it cannot take the facility with it. In most cases, the facility reverts to the public sector.

A variation on the conventional DBFO/M is the DB/FO/M model, a two-stage model used in the Highway 407 project in Canada, which has been successful in bringing projects with uncertain revenue streams to the market. The model is usually employed in situations when there is uncertainty about the future needs. Initially the public sector finances a design build project undertaken by the private partner and later sells the completed facility to a private consortium responsible for its operations. This model is dependent, however, on the availability of public funds.

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



Air Transportation

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A. Global Airport Privatization

Although airport privatization is scarcely on the radar screen in the United States, it was a banner year for such privatization around the world. According to the Centre for Asia Pacific Aviation, there were 15 major airports or airport groups privatized in 2006, the second-highest ever; 1998 was the highest on record, with 21 such deals. David Bentley, author of the Centre's Global Airport Privatization report, cited two key factors in the growth of this market.

In developed countries, privatization helps avoid additional debt on government balance sheets, transfers risks to the private sector, and introduces efficiencies in airport operations that may be difficult to achieve in the public sector. In developing countries, privatization can tap global (as well as domestic) capital markets to fund large-scale projects, reducing the financing requirements on national governments.

Airport privatization began in 1987 when the U.K. government of Margaret Thatcher privatized the British Airports

Authority via an initial public offering. That sale of 100 percent of BAA netted the government \$2.3 billion. Since then, BAA acquired partial ownership stakes in the overseas airports of Budapest and Sydney, but its principal assets remained the three major London airports. When it was bought by Spain's Ferrovial in 2006, BAA's market value was \$18 billion.

Table 14 summarizes a number of airport privatization transactions from 2001 to 2005, with the value of the airport given in local currency. To provide some indication of how to value airports that might be considered for future privatization, the last column divides the sale price by a financial measure called EBITDA (earnings before interest, taxation, depreciation, and amortization). As can be seen, depending on a number of specifics that are unique to each airport, investors paid anywhere from 7.5 to 31.9 times EBITDA for airports in this time period, with the average being around 15.

There has been considerable change since 2000 in the composition of the global airports industry. A number of privatized

Table 14: Market Value of Recently Privatized Airports

Airport Company	Acquirer	Year	Stake Purchased	Currency	Value (M)	Value/EBITDA
Budapest	BAA	2005	75.0%	Euro	1,957.0	31.9
Copenhagen	Macquarie	2005	37.7%	DKK	15,075.0	10.2
Airport Co. of S. Africa	Public Investment Corp.	2005	20.0%	Rand	8,607.8	7.5
Hochtief European airports	Hochtief Airport Capital	2005	100.0%	Euro	432.3	9.7
TBI	ACDL (Abertis/ AENA)	2004	100.0%	GBP	685.0	14.8
Brussels	Macquarie	2004	70%	Euro	1,635.0	12.3
London Luton	TBI	2004	28.6%	GBP	351.3	15.9
Firenze	Acquisizione Prima	2003	29.0%	Euro	99.3	14.3
Belfast City Airport	Ferrovial	2003	100.0%	GBP	35.0	14.5
Hainan Mellan	Copenhagen Airports	2002	20%	HK\$	1,907.2	11.3
Aeroporti di Roma	Macquarie	2002	44.7%	Euro	2,680.8	14.3
Sydney	So. Cross (Macquarie)	2002	100.0%	A\$	5,588.0	17.7
Auckland	Institutionals	2001	7.1%	NZ\$	1,828.3	13.1
Birmingham	Macquarie	2001	24.1%	GBP	417.5	10.1
Newcastle	Copenhagen Airports	2001	49.0%	GBP	293.8	17.5
London Luton	TBI	2001	46.4%	GBP	195.0	26.8
East Midlands	Manchester Airport	2001	100.0%	GBP	241.0	13.8
Bournemouth & Glasgow	Infratil	2001	100%	GBP	40.4	28.4
Bristol	Macquarie	2000	100.0%	GBP	234.0	16.4
Hamburg	Hochtief & Air Rianta	2000	36.0%	Euro	804.5	8.6
Aeroporti di Roma	Leonardo	2000	51.2%	Euro	2,591.6	17.4
Centro Norte (Mexico)	ADP consortium	2000	15.0%	US\$	606.7	11.2
Beijing Capital	ADP Management	2000	10.0%	HK\$	12,688.0	17.4
High						31.9
Low						7.5
Average						15.6
Median						14.5

Source: Macquarie

airports have even become acquirers of stakes in airports being privatized, only to be acquired themselves by other firms (e.g., BAA, Copenhagen). As of 2007, there are six major global airport firms with annual revenues in excess of \$1 billion, plus a number of smaller players. The six majors are as follows:

- **Ferrovial/BAA (\$4.04 billion BAA + \$0.9 billion Ferrovial revenues in 2005):** This combined company owns Heathrow, Gatwick, and Stansted plus a number of smaller U.K. airports (e.g.,

Bristol, Glasgow, Belfast City). Since being acquired by Ferrovial, BAA has been selling off its non-UK airports (e.g., Budapest).

- **AENA (\$2.9 billion in 2005):** Although still government-owned, AENA operates commercially. It owns 47 airports in Spain and has ownership stakes and/or management contracts for 29 others in seven countries including several major airports in Colombia and a stake in one of four regional Mexican airport

groups, GAP. In a joint venture with Abertis, it bought U.K. airport company TBI in 2004, thereby acquiring airport management contracts in the United States and Bolivia, as well as the U.K.

- **Fraport (\$2.65 billion in 2005):** The parent company of Germany's Frankfurt Airport, Fraport was privatized in 2001 though state and municipal governments still hold stakes. Fraport owns major portions of Hahn and Hanover airports in Germany, Lima airport in Peru, New Delhi airport in India, and one of the Mexican regional airport groups.
- **Aeroports de Paris (\$1.44 billion):** The French government sold a minority stake in ADP in June 2006. The company owns the two major Paris Airports (De Gaulle and Orly) and a part interest in Liege airport in Belgium; it is selling its 33 percent stake in Beijing Capitol Airport. ADP also has management contracts and joint venture interests in other airport services.
- **Schiphol Group (\$1.17 billion):** The previous Dutch government had planned to privatize Schiphol, but did not complete this action prior to losing power in 2006. Schiphol is fully commercialized, owning the airports in Amsterdam, Rotterdam and Lelystad, plus important stakes in Kennedy Airport's Terminal 4 and Brisbane Airport in Australia.
- **Macquarie Airports (\$1.1 billion):** Macquarie owns the large majority of Sydney Airport, and major stakes in Copenhagen and Rome, plus a number of other U.K. and continental airports.

B. U.S. Airport Privatization

After languishing for a number of years, airport privatization was put back on the U.S. policy agenda in 2006 by Chicago Mayor Richard Daley. After successfully raising several billion dollars via the long-term leasing of the Chicago Skyway and the city's parking garages, Daley proposed to lease Midway, filing an application with the Federal Aviation Administration under the terms of the 1996 federal Airport Privatization Pilot Program.

The pending lease hit some bumps in the road early in 2007. *Crain's Chicago Business* reported that Southwest Airlines, which has the lion's share of service at the airport, is thus far not persuaded that the deal would give it any significant benefits. After the city shared with the airlines an outline of the financial details of a possible lease—basically offering operating cost savings and controls on rate increases—Southwest hired Citibank to analyze the plan. After this review, the airline sent a letter to the city in February 2007 stating that “While new information could change our minds, presently we believe that privatization is threatening to the interests of [Midway] and the airlines and passengers who rely upon it.”

This matters, because under the terms of the federal Airport Privatization Pilot Program, in order for the city to make use of lease revenues from such a deal for general city purposes, the lease must receive the approval of both 65 percent of the airlines operating at Midway and airlines representing 65 percent of the annual landed weight. That gives all Midway carriers, and especially Southwest, considerable

bargaining power. The potential attraction of such a lease is reduced operating costs and more predictable rates and charges for using the airport. Under the current arrangements at Midway, those rates depend on each year's airport operating results, and can differ considerably from year to year.

If the Midway privatization succeeds, it is likely to stimulate interest in doing likewise in other cities. Officials in Milwaukee and Austin have raised the issue in their communities, as has a candidate for mayor in Philadelphia. Just as Mayor Daley set off an earthquake in the toll road field by leasing the Chicago Skyway for \$1.86 billion, so would a win-win lease deal for Midway Airport.

Yet the current Airport Privatization Pilot Program would restrict other cities' options. There are only five "slots" in the program, and only one can be a large hub, as defined by the FAA. Since Midway meets this definition, none of the other 29 large hubs would be eligible (though both Austin and Milwaukee, as medium hubs, would be). The FAA's reauthorization proposal, introduced in February 2007, would remove that restriction, while expanding the number of slots to 15. It would also remove the 65 percent airline approval requirement, which some have dubbed the airlines' poison pill.

There is also a chance Midway will be leased without the airlines' OK. That would not be as good a precedent (unless Congress removes the poison pill), but what some people forget is that the 65 percent approval is only needed for the city to use the lease proceeds for general-fund purposes. When New York State leased Stewart Airport in 2000, it did not win airline approval. So it was required to use all the lease proceeds for airport-related purposes—at Stewart and

other state-owned airports. Chicago just happens to own a second airport, O'Hare. And O'Hare just happens to have a \$15 billion expansion under way, not all of it funded. That should give Mayor Daley an excellent fallback position in negotiating with Southwest (which has no presence at O'Hare).

Ironically, Stewart (thus far the only airport to be privatized under the Pilot Program) was "de-privatized" in 2006, not by design but due to circumstances. The company that won the bidding in 2000 was National Express, a diversified U.K.-based transportation company. Within a few years of acquiring the 99-year lease of Stewart (its first airport acquisition), National Express made a corporate decision to refocus the business on its bus and rail operations—thereby making Stewart an orphan business. By the start of 2006, it has decided to sell its leasehold. Although other firms were interested, the winning bid was submitted by the Port Authority of New York and New Jersey. PANYNJ seeks to develop Stewart, over the longer term, into the fourth major airport for the greater New York City region. It is also able to cross-subsidize Stewart's development from its overall revenues, in particular improving its ground access to the New York metro area.

In the United States, there are still plenty of skeptics who argue that since this country has tax-exempt revenue bonds and business-like airport authorities, privatization doesn't have much to offer, apart from possible one-time financial windfalls to hard-pressed local governments. But there are still important differences between a business that is accountable to shareholders and a not-for-profit government entity that is not. One way in which this difference may show up is

in willingness to think outside the box to get things done.

These days, one of the hardest things to do is to expand an urban airport. In Germany, Frankfurt has been struggling for years with this problem, needing to acquire land for a fourth runway to keep pace with projected growth. Late in 2006 it announced a breakthrough deal. Fraport will spend \$898 million to move a chemical plant owned by Celanese, to clear the way for the new runway. Celanese had been prepared to engage in costly litigation to prevent the runway from being built, arguing that the plant would be so close to the runway as to pose an unacceptable safety risk. Under the agreement, Celanese will end production at the plant in June 2011, and the whole area now occupied by the plant will be turned over to Fraport by 2015. Fraport hopes to have the runway built and in operation by 2011, and will use the acquired land for purposes compatible with the runway's presence.

C. U.S. Airport Security

In 2006, the Transportation Security Administration finally allowed the private sector to begin rolling out Registered Traveler programs—which allow travelers who have paid for prescreening background checks to bypass onerous airport security lines—though everything seemed to take a long longer than expected. TSA's announced June target date for national roll-out came and went, with TSA later announcing it would only approve a dozen or so airports at first. More than 20 had applied to be in the program by July, yet still the TSA-approved pilot program at Orlando was the only one in operation. It was not until November that Orlando's company, Verified Identity Pass, finally won

TSA certification to go nationwide. So it scrambled to get operations up and running by the first of the year at the airports it had already signed up: Cincinnati, Indianapolis, San Jose, and Terminal 7 at Kennedy. It took until March 2007 for Unisys's competing RT operation, RT Go, to get certified. Two other providers were still working on getting certified as of April 2007.

During the roll-out, Verified introduced its GE-developed shoe scanner at Atlanta. The original idea of Registered Traveler was that TSA's background check would pre-clear RT members, so they would not have to go through all the rigamarole that regular passengers must endure at the checkpoints—remove shoes, remove sweaters and jackets, take out laptop, etc. But no, TSA apparently doesn't trust its own background check (even to the point of insisting that RT members present their easily counterfeited driver's license in addition to their biometrically coded RT membership card!) So the only way RT members can be exempted from any of the checkpoint requirements is if the RT provider employs technology that does the job instead. Hence, Verified's shoe scanner, on which the member stands while having his iris scanned and compared with what's on the membership card. If the scanner detects no metal or explosive particles, the member need not remove his shoes. (Verified is still hoping to develop additional tools to obviate jacket removal; no word yet from TSA about laptops.)

By April a number of other airports were holding competitions to select their RT provider.

The other area of security privatization is the ability of airports to opt-out of TSA-provided passenger and baggage screening. Due to TSA, rather than airport, control

of all the key decisions about selecting and managing a private security firm, and such rigid controls as to make cost savings difficult, very few airports have chosen to exercise this option. The five original pilot program airports (San Francisco, Kansas City, Rochester, Jackson Hole, and Tupelo) have continued with the companies they got used to during the pilot phase. But only one new airport signed up in 2005, Sioux Falls, and just two more in 2006. Both of those (Marathon, Florida and New York's 34th Street Heliport) were airports not previously having scheduled passenger service, so by going with private contractors, they eased TSA's burden of trying to add new airports within their fixed number (43,000, as capped by Congress) of airport screeners. Sonoma County, California was set to do likewise in spring 2007.

In one other area private security firms have emerged: airport worker screening. Attention was focused on Orlando Airport early in 2007 after airport workers sneaked through an unguarded entrance into a secure area after hours as part of smuggling guns to Puerto Rico on a next day's flight. The airport's board voted in March to physically screen 100 percent of workers with access to secure areas, whether employed by the airport, airlines, tenants, or vendors. Since TSA has no screeners to spare (and did not mandate worker screening), the airport allocated \$5 million to hire Covenant Aviation Security (a TSA-approved screening company) to do the worker screening.

Orlando was not the first. Since 1998, Miami International has been screening 100 percent of airport workers with access to secure areas, as part of combating a serious drug-smuggling problem. It, too, uses private security firms to carry out this screening.

D. Global Air Traffic Control

The move toward transforming government air traffic control departments into financially self-supporting ATC corporations continued during the past year. The number of full members of the Civil Air Navigation Services Organization (CANSO) reached 45 by year-end, with the addition during 2006 of France, Iceland, and Tunisia, among others. Most of these are government corporations, analogous to the U.S. Postal Service and the Tennessee Valley Authority. Like those familiar entities, the air navigation service providers (ANSPs) do not receive their funds out of the national government's budget; instead, they are paid directly by their customers, and can go to the bond market to raise funds for large-scale modernization projects.

Two of these ANSPs won awards from the International Air Transport Association for outstanding service to their member airlines. Sweden's commercialized LFV won IATA's 2006 Eagle Award, and the runner-up was Denmark's NAVIAIR. At year-end, IATA singled out Airservices Australia, Austrocontrol, Nav Canada, and ROMATSA (Romania) for excellent cooperation with airlines on issues such as charging and modernization. Nav Canada, which celebrated its 10th anniversary in 2006, is a previous winner of the Eagle Award.

Germany's commercialized ANSP, DFS, had been slated for privatization in 2006, with the government planning to sell 75 percent to investors. But late in the year the German president vetoed the sale (which had been approved by the parliament earlier in the year), contending that the legislation was counter to constitutional provisions

requiring ATC to be carried out by a state organization. The government is expected to try to amend that provision.

Two new studies of the performance of this new generation of self-supporting ANSPs were published in 2006. One was conducted by a Canadian consulting firm in conjunction with three universities. The other was sponsored and published by the IBM Center on the Business of Government.

1. The MBS Ottawa Study

MBS Ottawa, in conjunction with George Mason University, Syracuse University, and McGill University, published its study, *Air Traffic Control Commercialization Policy: Has It Been Effective?* (available at mbsottowa.com), in January 2006. The project was overseen by a 15-member international advisory committee. The project team made site visits to, and collected detailed quantitative data from, the 10 commercialized ANSPs listed in Table 14. In addition to documenting the performance of the ANSPs since they were commercialized, the study (and its appendix) provides considerable detail on the governance structure and institutional framework of each.

Overall, the study judged ATC commercialization to be a success. Trend analysis found the following with respect to commercialization's impact on key performance measures:

- Safety: neutral or enhanced;
- Modernization: greatly improved;
- Service quality: improved;
- Costs: generally reduced, significantly in some cases;
- Financial stability: maintained;
- Public interest: most areas neutral or

positive.

“The major finding is that commercialization models that provide the right balance of incentives have resulted in significant cost reductions, dramatic improvements in modernization, and major improvements in service quality, while improving safety.”

One of the most interesting findings is that “Providing more autonomy for the ANSP has tended to cause a reorientation from treating government as the primary client to responding to the needs of the aviation community. There is no longer any doubt as to who the customer is. Commercial ANSPs have demonstrated enhanced ability to respond quickly to customer needs.” Along with this, “there has been a . . . clarification of the government's role. Governments have ensured the public interest through effective safety and economic oversight, financial regulations, environmental laws, protection of consumer rights, and recourse through the legal system.”

In summing up the findings, the report notes the following:

Commercialized ANSPs exhibit three main strengths—sensitivity to customer needs, agility in reaching a decision, and ability to carry it through. These characteristics have led to continuous improvements in efficiency, business discipline that delivers projects on schedule and on budget, and rapid deployment of modern technology to enhance service quality.

2. The IBM Study

The most recent study, *Reforming the Federal Aviation Administration: Lessons*

from Canada and the United Kingdom, was published in mid-2006 by the IBM Center for the Business of Government. Researched and written by Clinton Oster and John Strong, its focus is on applying lessons learned from the commercialization of ATC in Canada and the UK to reform of the U.S. system. Thus, the report provides three parallel studies of ATC reform: the long history of efforts to reform the FAA, plus case studies of the commercialization of Nav Canada and NATS. Since FAA reform will be discussed in the next section, we will focus here on the lessons the authors draw from the Canadian and UK reforms of air traffic control provision.

This report provides considerably more detail on how both Nav Canada and NATS came into being, in an effort to solve long-standing problems in the provision of ATC services. Although the organization models are quite different, and both had to cope with the serious downturn in North Atlantic airline traffic in the several years following the 9/11 attack, the authors conclude that both ANSPs “have emerged from the 2001-2004 period as financially solid organizations that are both well positioned not only to modernize to meet the growing needs of their own airspace, but also to extend their provision of various air traffic management services to other parts of the world.”

Several other lessons specific to Nav Canada are worth highlighting. Unlike most European and Asia-Pacific countries, where ATC user charges have been in effect since at least the end of World War II, Canada was one of the few remaining countries that funded ATC by means of a tax on airline tickets (like the United States still does), prior to ATC commercialization. Reflecting

on that transition, the authors conclude: “The adoption of a user charge system in principle increased the desire for users to play a role in governance. The not-for-profit structure with board representation by stakeholders creates good incentives for cost control and improved capital program management, and reduces the need for economic regulation.” Also, “The customer orientation appears to extend to a capital program and planning approach that has been much better at both modernization and the development of new technology, with respect to cost, delay, and performance.”

Turning to the need for Nav Canada to cope with the economic downturn following 9/11, the authors conclude that “Nav Canada’s organization structure turned out to be an asset The stakeholder model in effect required all parties to make contributions and sacrifices. The nonprofit status established a clear financial objective during the period, while the rate stabilization fund allowed the company to manage the consequences of the downturn over a longer period.”

E. U.S. Air Traffic Control

The Federal Aviation Administration in February 2007 released its long-awaited proposal to revamp the way its activities are funded. As expected, it would shift from taxes on airline tickets to user fees for air traffic control services. It would permit FAA to issue revenue bonds to fund some of the large capital expenditures needed to implement the proposed Next Generation ATC system. And it would attempt to give a stronger voice to its aviation customers via a new advisory board.

The proposal represents the culmination

Table 15: Characteristics of Major Commercialized Air Navigation Service Providers

Country	Date Established	Name	Ownership	Economic Regulation	Safety Regulation
Australia	1995	Airservices Australia	Government corporation	Commission oversight	Separate agency
Canada	1996	Nav Canada	Not-for-profit corporation	Self-regulating per statutory charging principles	Separate agency
France	2005	DSNA	Government department	Approval by Minister	Internal but separate
Germany	1993	DFS	Government corporation	Approval by Minister	Internal but being separated
Ireland	1993	IAA	Government corporation	Regulatory commission	Internal but separate
Netherlands	1993	LVNL	Government agency	Approval by Minister	Separate agency
New Zealand	1987	Airways Corp. of NZ	Government corporation	Self-regulating, per charging principles	Separate agency
South Africa	1993	ATNS	Public company	Ministry of Transport	Separate agency
Switzerland	2001	Skyguide	Not-for-profit company	Approval by Minister	Separate agency
United Kingdom	2001	NATS	Public-private partnership	Commission oversight (price-cap regulation)	Separate agency

Source: Table 4.1 in Air Traffic Control Commercialization Policy: Has It Been Effective? MBS Ottawa, January 2006 (www.mbsottawa.com)

of several years of analysis and rethinking at the agency, led by Administrator Marion Blakey and Air Traffic Organization (ATO) chief Russ Chew. They have learned a lot by studying ATC reform in the rest of the Western world, where virtually all other countries have converted their government ATC departments into self-supporting air navigation service providers (ANSPs) that can operate on a commercial basis, regulated (at arm’s length) for safety and subject to some form of external control over their rates and charges.

The FAA’s proposal rests on an impressive piece of work: the “FY2005 Cost Allocation Report,” January 2007, available at www.faa.gov. The methodology was developed by PriceWaterhouseCoopers, and it was applied by GRA, Inc. to the agency’s FY2004 and 2005 costs. Everyone involved in debating the user fee issue should read this report; it’s the best and fairest FAA cost-allocation study to date—and the first one based on data from the FAA’s new cost accounting system.

Thanks to this study, we now know that

67 percent of the FAA’s budget is accounted for by the ATO, but if you subtract out the safety-related Flight Service Station program, the ATO budget that should be recovered from users is 61 percent. The FAA’s traditional safety regulatory functions account for 7 percent, but adding in FSS boosts that to 13 percent. Nearly all the rest—25 percent—is the airport grants program.

The FAA proposal argues that the government’s general fund should be paying only for those functions that are clearly public interest issues.

Refreshingly, the FAA proposal argues that the government’s general fund should be paying only for those functions that are clearly public interest issues: the safety functions (13 percent) and the use of the system by government users (military and civilian) that Congress has always exempted from paying, another 2.8 percent of the FAA total. So in round numbers, that’s 16 percent of the total that should come from general

taxpayers. (The actual legislative proposal ends up at 19 percent). Airport grants (AIP) should be paid for by some kind of tax on all airport users, and ATC should be paid for by ATC users, in proportion to their use.

The ATC cost allocation study parses the data, based on three underlying principles:

- Different air traffic services have different costs;
- Different types of aircraft affect ATC costs differently (with the main difference being between high-performance/turbine planes and piston/helicopter planes);
- ATC costs vary according to activity volume, with miles flown in the system used to measure en-route activity and the number of operations (landings & takeoffs) used for terminal-area activity.

These principles are applied all over the world by ANSPs, and are reflected in the charging principles promulgated by the International Civil Aviation Organization.

If this proposal were enacted into law, it would represent a far bigger reform than the creation of the ATO three years ago.

The underlying principles for allocating costs take seriously the point made by general aviation groups that some major elements of the system (fixed costs) are there primarily to serve high-performance users, so those fixed costs are allocated entirely to the principal users, with only the variable costs allocated among all users, based on percentage use. There are many more details, but the end result is to break down cost responsibility among high-performance users (commercial, General Aviation, and exempt) and piston users (commercial, GA,



and exempt) for each flight regime: oceanic, en-route, and three types of terminal areas (large hubs, middle terminal, and low-activity tower). The resulting tables and pie charts show how much cost each of these is responsible for.

The legislative proposal would authorize the FAA to charge ATC fees to commercial users only: passenger and cargo airlines plus fractional jet operators and air taxi/charter operators. It also takes seriously the repeated plea from the National Business Aviation Association that its mostly turbine users should continue to pay for their share of costs via a fuel tax, rather than direct fees for service. So, in accordance with the cost allocation study, the fuel tax for all GA (piston and turbine) would be more than tripled to 70 cents/gallon to recover their share. A portion of that—13.6 cents/gal.—



would be the new AIP tax, which would also be paid by airlines.

Overall, this is a solid proposal. It clarifies who should be paying for what—general taxpayers, high-performance users, and low-end (in terms of demands on the system) users. It provides clear funding sources for each major FAA activity. And it authorizes a modest amount of borrowing authority to help pay for the major upcoming capital investments needed to implement the Next Generation system.

What's not to like? Compared with the financially autonomous ANSPs that are the inspiration for these changes, the proposal falls short in several ways. First, the fees would still be paid to the Treasury, and have to be appropriated each year by Congress. That's a long way from financial autonomy, as is now common in Europe's, Canada's, and Australia's ANSPs. Second, by keeping

turbine GA paying fuel taxes for ATC, the proposal further muddies the waters, since user fees paid to the Treasury could eventually be converted to user fees paid to a revamped ATO—but a fuel tax is a tax, and by definition must be appropriated by Congress before it can be spent, creating a stronger barrier to subsequent financial independence. Third, the modest bond funding would allow ATO to access only Treasury borrowing, and only for five years, unlike the access to the private capital markets afforded self-supporting government corporations like the Tennessee Valley Authority and the U.S. Postal Service, let alone virtually every air-carrier airport in the land.

Still, if this proposal were enacted into law, it would represent a far bigger reform than the creation of the ATO three years ago.

Education and Child Welfare

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A. School Choice Update

1. School Empowerment Surges Ahead in 2007

In his 2007 State of the City Address, New York City Mayor Michael Bloomberg called for school empowerment through the “weighted-student formula,” a growing trend in which public funding moves with the child, for all of New York City’s 1,467 schools. One week later, Nevada Gov. Jim Gibbons echoed Bloomberg’s proposal with his own weighted-student formula plan, which would affect more than 100 schools and empower families with greater educational choice. Finally, the Los Angeles Unified School District and union officials have agreed in concept to develop a group of independent small schools in the Pico-Union area, allowing students to choose a campus that best fits their interests. The Belmont Pilot Schools Network would consist of five to ten fully autonomous high schools launched over

the next five years, with a maximum of 400 students each. Principals and teachers at those schools would work under a separate contract that would free them to determine school calendars, curricula, budgets and administrative structures.

By decentralizing school dollars and allowing school funding to move with the child, principals have greater control of their resources and can give innovative teachers more flexibility. In cities like Oakland, Houston, Santa Monica, and Edmonton, Alberta (where the first weighted-student formula program was implemented), schools are offering improved curricula and better instruction. Public schools compete for students by improving the quality of teaching and diversifying their curricula, so that students who are proficient in math can find a school where calculus is offered, or students looking for a language immersion experience can attend a school where they can have classes in Spanish or Tagalog.

Similarly, Nevada Governor Jim

Making Schools Work

In a March 11, 2007 *New York Times* commentary, William Ouchi, a professor of management at the University of California, Los Angeles, and the author of *Making Schools Work*, explains how school empowerment has worked in New York City:

In New York City, Schools Chancellor Joel Klein and Mayor Michael Bloomberg have proposed school empowerment changes that would radically alter financing formulas for the city school system and revolutionize its existing bureaucratic management structure. City lawmakers and the State Board of Regents are nervous, but they shouldn't be.

Despite what the critics say, the changes will work. Over the last five years, my team has visited 66 New York City public schools and 42 of the city's more than 300 empowerment schools. At the empowerment schools, where principals on average control 81 percent of the money spent in their schools, we found fewer administrators, more teachers and an array of unique instructional innovations.

At the regular schools, we found that the average teacher was responsible for 121 students. At empowerment schools, however, the average teacher had 86 students. As a result, the teachers at the empowerment schools were spending more time working directly with their students either in small groups or one on one.

New Yorkers should not underestimate the magnitude of the innovations that the mayor and the chancellor have put forward. The extension of autonomy to all of the city's 1,467 schools is a natural step and one that will almost surely benefit all students. And allowing the money to follow students will remedy inequities of long standing and strengthen the autonomy of each school. Moreover, continuing to give parents a choice in where they send their children creates a powerful incentive for schools to perform and address specific needs.

Gibbons has introduced legislation to decentralize much of the authority that currently rests with districts down to the school level, and give school principals control over nearly a school's entire budget. Empowerment schools also would have authority over hiring and firing staff, and be able to implement pay incentives. They also allow all children zoned for other district schools the opportunity to apply to an empowerment school. Additionally, Gibbon's program provides funding for

100 schools. In addition to Nevada and New York City, statewide adoption of school empowerment plans is now under consideration in Ohio, South Carolina, Delaware, and Florida, though at early stages.

Decentralized districts demonstrate that it is possible to allow parents to choose any school in a district and that the resulting competition and need to attract parents can help improve even the lowest-performing schools and encourage them to adopt

best practices and unique programs that will benefit the children in their schools. Weighted-student formula programs have resulted in positive outcomes in terms of choice and student achievement for students in several districts:

- In 2004 the Oakland Unified School District transformed its budgeting formula from a centralized process to “results-based budgeting.” As reported in a new *Education Trust West* report, “California’s Hidden Teacher Spending Gap,” the Oakland District allocates funding to its schools based on the number and type of students at each school. Oakland gives each school administrator the flexibility to allocate this funding in whatever way fits the school’s instructional needs. Oakland allocates funds to the school in the same

way it receives revenue from the state: unrestricted Average Daily Attendance (ADA) funding is allocated to the schools based on their current year enrollment. According to *Education Week*, Oakland is the only district in the nation that gives principals direct control of their ADA funding. The bottom line for Oakland is that in three years, Oakland went from failure to having the highest academic gain among California’s 33 largest unified districts, urban or otherwise.

- In Boston, pilot schools opened in 1995 as a result of a unique partnership among the Boston mayor, school committee, superintendent and teachers union. Pilot schools are part of the Boston Public School system (BPS), but have autonomy over five key areas:

Large CA District (20,000 or more students tested)	Number Tested 2006	API 2005	API 2006	Growth 2005 to 2006
Oakland Unified	28,689	634	653	19
Rialto Unified	21,890	646	664	18
Fresno Unified	49,687	644	661	17
Montebello Unified	25,467	641	658	17
Pomona Unified	24,313	666	682	16
Garden Grove Unified	36,554	740	756	16
San Jose Unified	22,098	737	752	15
Long Beach Unified	55,984	713	727	14
Compton Unified	21,378	592	605	13
Orange Unified	21,324	765	778	13
Clovis Unified	26,856	806	816	10
Glendale Unified	21,426	794	804	10
Capistrano Unified	38,219	813	823	10
Moreno Valley Unified	25,540	652	662	10
San Francisco Unified	39,547	745	755	10
Fremond Unified	23,786	833	842	9
Los Angeles Unified	502,491	649	658	9

budget, staffing, governance, schedule and curriculum, and assessment. Attendance at pilot schools averaged 95 percent, compared to 89 percent at other schools. The average number of students for high school teachers in the pilot schools is 66 compared to 81 in the traditionally managed schools. Scores on state tests at these pilot schools are 30 percent to 50 percent higher than they are at regular public schools with similar student bodies.

- In 2005 Cincinnati Public Schools, where 70 percent of students are African-American, improved from “Academic Watch” to “Continuous Improvement,” and test scores were up for most students in most grade levels.
- Seattle continues to see increases in student achievement and in 2005

reduced the number of failing schools under No Child Left Behind from 20 to 18, even as the state raised the bar for proficiency.

2. Charter School Enrollment Soars

Charter schools continue to be the largest example of school privatization with more than 4,000 schools holding contracts with government agencies in the 2006-2007 school year, serving more than one million children.

According to a September 2006 study on charter school market share from the National Alliance for Public Charter Schools, in some communities large numbers of students enroll in charter schools:

While charter schools enroll a modest percentage of students nationwide, some communities far exceed national and state averages

Table 17: Charter School Market Share

Community	Charter Market Share	Charter	Non-Charter	All
1. New Orleans, LA	69%	7,815	3,578	11,393
2. Dayton, OH	28%	6,374	16,365	22,739
3. Washington, DC	25%	18,000	54,000	72,000
4. Pontiac, MI	20%	2,563	10,385	12,948
Kansas City, MO	20%	6,457	25,766	32,223
Youngstown, OH	20%	2,326	9,248	11,574
5. Chula Vista, CA	18%	4,640	21,832	26,472
Detroit, MI***	18%	28,047	131,643	159,690
Southfield, MI	18%	2,233	9,907	12,140
Toledo, OH	18%	6,561	30,200	36,761
6. Cincinnati, OH	17%	7,029	35,479	42,508
7. Brighton, CO	16%	1,632	8,818	10,450
Cleveland, OH	16%	10,858	59,035	69,893
Milwaukee, WI	16%	15,059	81,275	96,334
8. Buffalo, NY	15%	6,332	37,000	43,332
Mohave County, AZ	15%	4,315	23,593	27,908
9. Dearborn, MI	14%	3,016	18,094	21,110
Oakland, CA	14%	6,668	41,467	48,135
10. Minneapolis, MN	13%	5,558	38,532	44,090

to enroll high percentages of charter school students. In fact, 19 different communities educate over 13 percent of their public school students in charter schools.

New Orleans leads the pack with 69 percent market share, due primarily to the post-Katrina reconstitution of the schools. Ohio alone has five different communities in the top ten, with Dayton leading the pack at the #2 spot on our countdown with 28 percent. Our nation's capital, Washington D.C., comes in at #3 with 25 percent. And the largest community on the list is Detroit, with 18 percent of its nearly 160,000 students in public charters. As of 2007, Detroit has a 25 percent market share.

Several states and individual communities are demonstrating the impact of charter schools at scale. Let's examine some brief profiles in market share:

Michigan: Enrollment in Michigan charter schools has reached nearly 100,000. The 2006 Michigan Educational Assessment Program (MEAP) tests show that elementary charter school students are matching or outpacing their district counterparts in English and math testing. More importantly, Michigan's charter public schools exceed the average scores of their host districts on 23 of 27 MEAP tests this year. Canton Charter Academy boasts a waiting list of nearly 1,000 children. The 58 charter schools run by Central Michigan University have waiting lists of more than 10,000. Charter school success has spread throughout Michigan and parents are clamoring for a lift of the charter school cap. Perhaps most telling is their success in urban areas. Detroit is the leader in market share in Michigan. The number of children from Detroit enrolled in public charter schools last fall was 42,378,

or 25.3 percent of the 167,490 city students enrolled in district schools. A teachers' strike last fall delayed the start of classes in the Detroit school district, and enrollment fell 9.6 percent, according to the Michigan Department of Education. The district is considering a proposal to close 52 schools by next summer in response to declining enrollment.

New York: In March 2007, New York legislators passed an estimated \$120.9 billion budget, doubling the maximum number of public charter schools to 200, including up to 50 new schools in New York City. A year-long freeze on approvals, however, means the next wave of new charter schools may not open until September 2008. The new legislation requires the Education Department to hold hearings before placing a charter within an existing public school. The bill also bows to union demands by requiring a provision that automatically unionizes the employees of any charter school serving more than 250 students in its first two years. In 2005, charters in New York outperformed non-charters in surrounding schools districts in 4th and 8th grade reading and math. In Buffalo, New York 15 public charter schools serve more than 5,500 students in the city, catering to about 13 percent of public school enrollment. Data gathered by the Buffalo News reveals the city's charter schools achieve better results than traditional public schools despite having a higher proportion of students living in poverty.

Washington D.C.: Charter school enrollment in the District of Columbia has increased by 2,260 over the past year. Charter schools now serve 19,733 students, 26 percent of the city's children. At the same time, enrollment in the D.C. public school

Table 18: Charter School Enrollment and Closures by State

State	Total Schools Operating	Enrollment	Average Enrollment	Closures 1992
Alaska	24	4,814	201	5
Arizona	462	105,422	228	83
Arkansas	15	3,998	267	4
California	637	219,460	345	83
Colorado	132	47,443	359	6
Connecticut	19	3,577	188	4
Delaware	19	7,826	412	2
Washington, D.C.	68	19,143	282	13
Florida	347	96,007	277	53
Georgia	59	25,882	439	4
Hawaii	27	5,538	205	0
Idaho	28	9,384	335	1
Illinois	55	21,343	388	8
Indiana	38	8,274	218	2
Iowa	8	1,249	156	0
Kansas	26	2,588	100	8
Louisiana	6	17,315	376	8
Maryland	23	4,870	342	0
Massachusetts	60	21,987	366	6
Michigan	241	96,200	399	22
Minnesota	137	23,455	171	24
Mississippi	1	367	367	0
Missouri	27	11,134	412	4
Nevada	22	5,979	271	5
New Hampshire	8	388	49	1
New Jersey	53	15,381	290	17
New Mexico	62	10,034	162	2
New York	95	23,972	252	7
North Carolina	99	29,070	294	27
Ohio	301	87,288	289	20
Oklahoma	15	4,606	307	1
Oregon	71	10,105	142	8
Pennsylvania	120	55,760	465	9
Rhode Island	11	2,723	248	0
South Carolina	31	5,844	189	8
Tennessee	12	1,891	158	0
Texas	283	94,429	334	27
Utah	54	18,985	352	1
Virginia	3	241	80	3
Wisconsin	198	32,667	165	18
Wyoming	3	235	78	0
Total	3,940	1,156,874	267	494

Source: The Center for Education Reform, April 2007

system has declined by 2,670 students from the previous school year. Total public school enrollment remained relatively steady, with 75,088 students in 2006-07, compared with 75,498 the year before. Charters outperform non-charter schools in reading and math on the most recent national assessments.

Milwaukee: Not only is Milwaukee home to one of the nation's largest publicly funded voucher programs with almost 15,000 students in the program in 2005-06, it also boasts a robust charter school sector with over 15,000 students in 2005-06. The types of charters in Milwaukee range from district-sponsored charters largely independent of the district, to district-sponsored charters that are still part of the district, to charters authorized by non-district entities (the city or a local university) that are completely independent of the district.

The New Orleans Times-Picayune told parents, "Think of yourselves as consumers in a brand new marketplace."

New Orleans: Although enrollments change daily, enrollment in charters by the fall of 2006 was 69 percent. Schools have dropped residency requirements, so any student living anywhere in the city can register at any school on a first-come, first-served basis. In 2007 students can choose from 31 charter schools, 20 state-run schools, and five schools run by the local district. Twenty-five different organizations, from nonprofits to national charter chains, are running schools, and the options run from comprehensive curricula to niche schools featuring early college, French immersion, Montessori, the arts, and architectural design.

3. Competition Key for Future of New Orleans Schools

One unexpected by-product of Hurricane Katrina: New Orleans is now the only city in America offering unfettered public school choice.

Schools fought to attract customers with radio and TV advertising, enrollment fairs, visits to local churches and community groups, and roadside signs pitching the benefits of their programs. *The New Orleans Times-Picayune* told parents, "Think of yourselves as consumers in a brand new marketplace."

Critics predicted chaos all summer. In August 2006, *The New York Times* ran a negative piece headlined "Rough Start for State's Efforts to Remake Faltering Schools in New Orleans." Tulane University education professor Lance Hill told the Times, "We've created the most balkanized school system in North America. The average parent is mystified."

But as the *Times-Picayune* reported in fall 2006, 53 schools with 34,000 students have opened with relative calm and few snafus. Parents somehow managed to navigate their choices without mass chaos, and now one of America's pre-eminent cities is getting a dose of educational liberty.

All of the schools have a fresh start and a level playing field in terms of accountability and performance outcomes. The schools will have two years of fresh test score data and graduation and attendance rates to establish baseline data for school performance. Schools starting anew this year will not receive their first post-storm performance scores until the fall of 2008.

An inspiring story from the *Times-Picayune* from March 2007 describes a compelling example of the new

opportunities open to all students in New Orleans:

In the city's bold new landscape of charter schools, Science and Math, well-respected before Katrina for producing strong performance from students of a wide range of ability, has expanded to become its own, full-day charter school in Uptown. The school works on a theory that an open-access school—with no admissions standards—can do just as well, if not better, than one with admissions standards—if it commits to focus solely on academics and jettisons the all-too-common stand-and-deliver lecture method. Instead, the school strives for daily lessons that engage students with concepts and require them to wrestle with problems.

Science and Math is, in essence, a thinly veiled challenge to the very existence of the city's selective admissions schools, who by their nature teach fewer low-performing students, and in the case of some, such as the exclusive Ben Franklin High, no low-performing students[...]

At the start of this school year, just 14 percent of its freshman class could read at grade level—some scored as low as second- and third-grade levels. Now, after making use of phonics lessons, 43 percent of freshman read at grade level.

New Orleans schools still have an uphill battle. Implementation issues from teacher shortages to decisions about where to develop new school capacity will be difficult

to sort out. However, this new choice-based system offers students a fresh start and new opportunities for high-quality education.

B. No Choices Left Behind: Restructuring California's Lowest-Performing Schools

The federal No Child Left Behind Act (NCLB) requires states to show that students in every subgroup, including minorities, low-income, and special education students are proficient in reading and math. In 2005, each subgroup in elementary and middle school had to have at least 24.4 percent of students proficient in reading and 26.5 percent proficient in math. In high school each subgroup needs 22.3 percent of students proficient in reading and 20.9 percent of students proficient in math.

A total of 2,215 California schools are listed as “needs improvement” under NCLB and have entered program improvement status. Of these, 355 have been chronically low-performing for more than five years. Process improvements such as class-size reductions, bigger budgets, or threatened sanctions have failed to address the problem.

California needs school improvement legislation requiring schools with five or more years of failure to choose a competitive model that offers students meaningful alternatives to the current low-performing public school including:

1. offering opportunity scholarships to students in failing schools;
2. competitively bidding out low-performing schools to outside operators;
3. restructuring the district to a weighted-student formula system where a student

- could choose any school in the district, or
4. converting the low-performing school to a charter school.

Students need the right of exit from these low-performing schools. School funding needs to be put into the backpacks of children and follow them into the school of their choice. Offering parents and students “buying power” will help inspire excellence in low-performing schools if they have to compete for students in order to receive funding.

The weighted-student formula is a simple and equitable per-pupil funding system that allows money to follow each child. This reform wins out over other competitive reforms because it allows California to develop a stable school funding stream and would put every school provider—whether public, charter, or private—on a level playing field in California.

This piece was adapted from the Reason study, *No Choices Left Behind: Competitive Models to Restructure California’s Lowest-Performing Schools*, which is available online: reason.org/ps354.pdf.

C. Experimenting With School Choice: A Tale of Two California Districts

Policymakers, unlike scientists, don’t have the luxury of conducting controlled experiments to test competing solutions to social problems. But when it comes to reforming failing public schools, something close to that is occurring in two California school districts: Oakland and Compton.

The districts, comparable in many respects, are opting for completely different

approaches to fixing their schools. And so far, Oakland’s policy of giving parents more choice is showing far more success than Compton’s strategy of micromanaging classrooms.

Oakland and Compton are not identical, of course. Compton, located in the outskirts of Los Angeles, does not have the gorgeous San Francisco Bay scenery of Oakland. It has a quarter of Oakland’s population and no wealthy neighbors. But they are both high-crime inner cities. Both have a large Hispanic and black population, and a small Asian and white population. Average family incomes are comparable—about \$40,000 for Oakland and \$33,000 for Compton.

They both became targets of a state takeover and a large financial bailout in the last decade. And the federal No Child Left Behind Act for two years in a row has ranked them both among California’s 162 districts “in need of improvement.”

In short, the two districts have similar student bodies, similar challenges, and—until now—a similar history of failure. But Oakland is beginning to break away from this history, and the reason is the weighted-student-formula program it embraced some years ago and fully implemented last year.

Under this program, kids are not required to attend their neighborhood school, especially if it is failing. Rather, they can pick any regular public or charter school in their district and take their education dollars with them; more students therefore means more revenues for schools. Furthermore, as the name suggests, the revenues are “weighted” based on the difficulty of educating each student, with low-income and special-needs kids commanding more money than smart, well-to-do ones. Schools have to compete

for funding, but the upside is that they have total control over it.

Compton has stuck to a completely different approach that does not involve empowering parents—or decentralizing control to schools. Instead, it has tried to fix its failing schools by mandating “classroom inputs.” To this end, all Compton schools over the last few years have been ordered to reduce class size by 12 percent, improve teachers’ credentials, adopt a tougher curriculum, and even clean up bathrooms.

What are the results so far? Oakland schools have shown a remarkable flexibility in responding to student needs, while Compton has stagnated. In 2003-04, for instance, Oakland’s high schools offered 17 Advanced Placement classes. Last year, they increased this total to 91, or about one AP class for every 143 students. By contrast, Compton’s AP offerings went up by two that year, to one class for every 218 students. Oakland students also are taking high-level math and science courses more frequently. About 800 high school students studied first-year physics last year—nearly triple the number taking the course in the 2004 school year.

Oakland kids have shown major improvement on the California High School Exit Examination.

More to the point, of course, are student performance measures. Oakland kids have shown major improvement on the California High School Exit Examination, which all students must pass in English and math before graduating from high school. Sixty-two percent of high school students passed the English-language-arts portion, compared with 57 percent in 2005—a 5-point gain—

and 60 percent passed math, a 6-point jump from the year before. By contrast, Compton showed no gains in English—staying stuck at 58 percent—and posted a 2-percentage-point drop in math, from 50 percent to 48 percent.

Similarly, Oakland’s score on the state’s Academic Performance Index—a numeric grade that California assigns to its schools based on the performance of their students on standardized tests—went up by 19 points. Compton, in contrast, gained only 13 points.

Yet even this overstates Compton’s performance, because almost all of its gains came at the elementary level, where students are not so intractable. Compton’s middle schools lost an average of 6 points, while Oakland’s gained an average of 16 points. Meanwhile, half of Compton’s high schools lost points on the API score—including Compton High, where now fewer than 6 percent of males are proficient in reading, and fewer than 1 percent in algebra. Conversely, Oakland high schools gained, on average, 30 points. Even Oakland’s economically disadvantaged and limited-English students have shown major improvements. In 2006, its economically disadvantaged students gained 60 percent more on the performance index than Compton’s, and its English-language learners gained 120 percent more.

Nor is Oakland’s progress in any way anomalous. Oakland borrowed the weighted-student program from San Francisco, where the approach has already had six years of success. San Francisco kids in every grade level in every subject have consistently performed above the state average. Since 2001, its low-income students have posted gains of 83 points,

16 percent more than Los Angeles's and 25 percent more than Compton's. Last year alone, San Francisco students overall earned the highest API test scores of any urban district in California—97 points higher than Los Angeles and 150 points higher than Compton. Even San Francisco's minority, poor, and special education students have shown major improvements. English-language learners, a challenging group, gained 12 points in 2006, compared with zero points for Los Angeles's. Similarly, San Francisco's special education students gained 19 points that year, whereas Los Angeles's gained only 1 point.

What's more, a wide array of schools have cropped up in the city, catering to practically every student need and interest by offering dual-language programs, college-preparatory classes, performing-arts electives, and advanced math and science courses. In fact, every public school in San Francisco is fast developing its own unique blend of size, pedagogic style, and course offerings.

Meanwhile, Oakland hosted a day-long fair last month at which the district's 120-plus schools could vie with each other to entice parents, handing out information about course offerings, highlighting accomplishments, and answering questions. In short, schools are being forced to sell themselves to each and every parent. Compton and the majority of low-performing schools nationwide that can count on a captive audience have no such plans.

What's more remarkable is that Oakland's turnaround happened at a time when the state had initiated a hostile school takeover, triggering protests from the

community and the school board. The state-appointed administrator for the Oakland schools was forced to hire a bodyguard because of threats to his life at community meetings. But because the weighted-student formula decentralized control to individual schools and effectively put parents in charge of enforcing accountability, principals were insulated from this ugly infighting, allowing them to focus on what matters: students. In essence, this mechanism proved stronger than district politics.

The success of the weighted-student formula program has not gone unnoticed. The Washington-based Thomas B. Fordham Foundation last year touted the approach as an important tool for school reform. Former U.S. Secretary of Education Rod Paige has praised it in *The New York Times*. Although most teachers' unions resist handing control of school funds to principals, out of fear that this might dilute their ability to enforce such union work rules as seniority-based promotions, some unions have given cautious approval to the concept.

Nationwide, close to 10,000 schools are considered to be failing under the No Child Left Behind Act, hundreds for more than five years. Yet less than 1 percent of students in these schools manage to transfer to a higher-performing school, even though they have that right under the federal law. Political leaders can change this by building on Oakland and San Francisco's modest experiment in school choice. No student deserves anything less.

A version of this article by Reason's Lisa Snell and Shikha Dalmia appeared in *Education Week*.

D. Child Welfare Privatization Update

In 2007, the privatization of child welfare services received mixed reviews in Florida and Texas and became the subject of a national study on the effectiveness of performance-based contracting for child welfare services.

1. Mixed Reviews on Florida's Child Welfare Privatization

In 2005 Florida became the first state to complete the transfer of all foster care, adoption, and child welfare licensing operations across the state to private agencies, making Florida the first state in the nation to fully privatize its child welfare programs. The state Department of Children and Families (DCF) has 22 contracts—some representing single counties, and others multi-county areas—with a “lead agency” that is responsible for the social work that was once handled by DCF.

Lead agencies, having taken over responsibilities from DCF over the last four years, are responsible for all social services in their area. They typically contract with community providers for most of those services, including substance abuse, case management and foster care.

The 22 community-based care agencies that manage state child welfare services have annual contracts that require them to meet targets for eight performance measures. As of May 2007, none of the lead agencies that manage abused and neglected children in Florida's 22 areas is meeting all eight benchmarks.

A 2006 study (www.oppaga.state.fl.us/reports/pdf/0650rpt.pdf) by Florida's Office of Program Policy Analysis and Government Accountability (OPPAGA) analyzed the

performance of the 22 community-based care lead agencies and found mixed results for the state's child welfare system since fiscal year 1998-99, the year before the state began the transition to outsourcing these services.

Most significantly, the OPPAGA report revealed an increase in the percentage of children who experienced re-abuse over the past six years. It found that 11 percent of children were victims of re-abuse in 2004-05, compared with 8 percent in 1998-99.

Some of the increase in the re-abuse rate can be attributed to a more aggressive focus on child-abuse investigation. In 1999, legislation was passed that broadened the definition of abuse, increased the number of people and agencies responsible for mandatory reporting of child abuse, and increased the penalties for caseworkers who left children in dangerous situations. All of these factors have contributed to an increase in child-abuse reports overall, re-abuse reports, and an increase in the number of children removed from their homes. Therefore, it is somewhat inappropriate to compare current re-abuse rates with pre-1999 rates, which were reported under a completely different legal framework for child abuse and investigations.

Despite the reported increase in re-abuse rates, the OPPAGA report did reveal several other positive trends that should contribute to the future safety of Florida's children:

- The number of children who exit foster care within 12 months increased by 24 percent.
- The number of children reunified with their families within 12 months increased by 20 percent.
- The number of children in licensed foster care decreased by 15 percent.

- Case loads for case managers and case manager vacancy rates both decreased by one-third.
- The number of adoptions finalized by community-based care agencies (CBCs) has more than doubled. Florida has repeatedly been recognized as a national leader in this effort. In 2006, Florida received the highest adoption incentive bonus in the nation from the U.S. Department of Health and Human Services.

One achievement not mentioned in the report is that Florida ranks second in the nation in the visitation of children in foster care, as reported by the U.S. Department of Health and Human Services inspector general. In May, for example, more than 97 percent of these children were seen by case managers.

Two other developments in Florida should lead to even more positive outcomes for children. First, Florida is the first state to accept a waiver from the federal government that reduces some restrictions on how federal child welfare dollars are spent. The U.S. Department of Health and Human Services' Administration for Children and Families (ACF) authorized the five-year waiver under Title IV-E of the Social Security Act, allowing Florida to demonstrate that flexibility in funding will result in improved services for families.

The waiver allows federal foster care funds to be used for any child welfare purpose rather than being restricted to out-of-home care as generally required under federal law. It also enables funds to be used for a wide variety of child welfare services including prevention, intensive in-home services to prevent placement of children outside the home, reunification and

foster care. To measure the effectiveness of the waiver, an independent evaluator will conduct an assessment of the results. Florida will receive federal funding during the course of a five-year period based on what the state would have received under IV-E rules. This amount increases by 3 percent per year over federal foster care funding in the federal fiscal year that ended September 30, 2005. The program puts funding incentives in line with the program goals of maintaining the safety and well-being of children and enhancing permanency by providing services that help families remain intact whenever possible.

The bottom line for Florida is that hundreds of millions of dollars that formerly could be used only to warehouse children in foster care now will be available to fund better alternatives. It also means DCF gets the money as a flat grant—no automatic increases for taking away ever more children.

The second positive development in Florida is a huge improvement in real-time data collection. A data "DashBoard" provides real-time information about all performance-based expectations for child-welfare. Department of Children and Families (DCF) Secretary Lucy D. Hadi today unveiled a new way for Floridians to see a DCF "report card" that can be accessed through a Web-based performance Dashboard at: dcfdashboard.dcf.state.fl.us/

The Dashboard displays over 200 performance measures, so the public can view the most recent and accurate data compiled about adoptions, missing children, abuse investigations, and substance abuse treatment outcomes among others. Concerned citizens can now monitor how well DCF is meeting federal and state

The screenshot shows the Florida Department of Children and Families website. At the top left is the 'myflorida.com' logo. The main header reads 'Florida Department of Children and Families'. Below the header is a navigation menu with links for 'Home | Programs | Districts | Facilities | Publications' and a search box labeled 'Enter Keywords:'. The main content area is titled 'Performance Dashboard Application'. It features a large graphic of a car's rearview mirror reflecting a road, with the text 'DCF DASHBOARD' in the top right corner. Below the graphic are two columns of blue buttons. The left column is titled 'Performance Measures' and includes buttons for 'Critical Few', 'Measures by Strategic Plan', 'Legislative Measures [External Monitoring]', 'Contract Measures', 'Program Performance', 'Geographic Performance', and 'Technical Information'. The right column is titled 'Planning' and includes buttons for 'Strategic Plan DrillDown' and 'Plans'. Below the buttons is a quote: 'It is an immutable law in business that words are words, explanations are explanations, promises are promises — but only performance is reality.' At the bottom left is a 'Mission' section with three bullet points: 'Protect the Vulnerable', 'Promote Strong and Economically Self-sufficient Families', and 'Advance Personal and Family Recovery and Resiliency.' At the bottom right is a 'News' section with a notice: 'The Dashboard is scheduled each night from midnight to 1am for backup and the new day's data load.'

legislative mandated standards for all its programs including substance abuse, mental health, adult services, child welfare, refugee services, homelessness, domestic violence, child care regulation and economic self-sufficiency.

Most reports found on the Dashboard are updated daily, weekly or monthly. The information is displayed by geographic regions and by contracted providers with statewide totals. Definitions of performance measures and descriptions of data sources are also available on the Web site.

Monitoring this significant data enables DCF and its contracted providers

to see trends as they occur and to address concerns before they become problems. DCF managers and providers are held accountable for corrective action if performance expectations are not met.

2. Child Welfare Privatization Slows in Texas

In 2007 Texas has slowed its efforts to completely privatize child welfare services in the state. The House and the Senate passed legislation that would roll back almost all of the privatization of foster care case management that lawmakers ordered in the previous legislative session. News reports about the beating deaths of three foster

children in North Texas since August 2005 have revealed spotty state oversight of foster care contractors and state officials' lack of information about Texas's nearly 10,000 foster homes.

Senate Bill 758 appropriates \$100 million to the Department of Children and Families to increase child protective service workers and to outsource a maximum of 10 percent of the 30,000 children under the Texas foster care system. This bill eliminates the Independent Administrator role for contractors and will require that organizations compete for the Outsourcing Pilot as direct service providers working under the supervision on the State. The legislation must still be signed by the governor.

The 2007 legislation eliminates a 2005 law's call for private contractors to manage each region's supply of foster homes and mandate that all CPS "case management" duties be outsourced by 2011. The new legislation also calls for annual inspections of all foster homes; currently, about one-third are inspected each year. The measure also would require a database be kept on foster parents who have been dismissed by private child-placing agencies. Some lawmakers fear that a small number of foster parents are evading detection by jumping from agency to agency.

3. Reducing the Foster Care Population: the Illinois Model

The experience in Texas with more abuse in foster care and the problems in Florida with the large foster care population reflect a familiar pattern when child welfare services are initially privatized. Child welfare privatization is often called for after horrific examples of child abuse or deaths

that should have been prevented by the state child welfare agency. At the same time states privatize child welfare, they also often increase efforts in child-abuse investigation.

In Florida and Texas privatization resulted in an unexpected and large increase in children entering foster care. This also happened when Kansas implemented its statewide child welfare privatization program in 1996. In each case, privatization freed state social workers from managing foster-care placement and allowed them to focus on investigating child-abuse cases. This results in many more children being removed from their homes, which overwhelms the capacity of the private foster care system.

For example, according to a May 8, 2007 article in the *Dallas Morning News*, improvements to child-abuse investigations ordered by the Texas legislature in 2005 have increased the number of children removed from their birth families, which has increased caseloads for state-employed caseworkers who are currently responsible for permanency placements for foster children.

This has led to two stresses on private foster care agencies. First, there are more children in the system because of increased child-abuse investigation and there are fewer children leaving the system to find permanent placements through adoption or family reunification because of the increased caseloads of state social workers. In Texas, privatization is blamed for a system change that has very little to do with privatization and more to do with large increases in the foster care population.

Similarly in Florida, tougher child-abuse investigation requirements have led to a huge expansion of the foster care

population. It doesn't have to be this way. Performance-based contracting with the correct incentives can reduce the foster care population and bring safe and permanent living arrangements for children in state care. Both Florida and Texas could learn a lesson from Illinois.

Illinois tried a different approach when it privatized its child welfare system. The Illinois Department of Children and Families took steps to reduce the number of children who require foster care. Through new early intervention services, called Front End Redesign, contractors have financial incentives to give families help immediately after their needs become apparent, even before a child-abuse or neglect investigation is completed. These services may help prevent the need for a child to be placed into foster care. In accordance with state and federal laws, an increased emphasis has been placed on early permanency that includes a child's return home, adoption, or guardianship.

Illinois changed its financial incentives to reward contractors for permanency. With so much of Illinois's child welfare system privatized, the renewed focus on securing permanency for children posed unique challenges. Longitudinal data collected by the Department showed that the rate of children exiting the system fell below the rate of new cases coming in system-wide.

A significant part of the problem was inherent in Illinois's basic contracting structure. Contracts based upon a fee-for-child payment can undermine permanency, as once the child welfare issues have been resolved and the child is discharged, an agency faces losing revenue unless the child is replaced with a new referral. This dynamic leads to the predictable practice

of focusing the work on maintaining kids in care rather than aggressively pursuing permanency.

In Illinois the state realigned contracts with financial incentives to secure accountability and reinforce the importance of achieving outcomes over maintaining children in care. Agencies were allowed to use superior performance in moving children to permanency as a way of lowering their caseloads, maintaining their contract level and financially enhancing their program.

This shift was accomplished through redesigning how agencies receive new cases for placement services. Upon the implementation of performance contracting, all agencies were required to accept 24 percent of their caseload in new referrals. Added to this was the expectation that all agencies would move 24 percent of their caseload to permanency—an outcome expectation reflecting a nearly three-fold improvement over the then system-wide average of 8 percent in 1998.

The benefits and potential consequences were immediately apparent to contracted agencies. By exceeding the 24 percent benchmark in permanency expectations, an agency could secure caseload reductions without a loss in revenue. Falling short of the benchmark meant serving more children without a change in the contract level.

Since the implementation of performance contracting, the dramatic increase of children moving to permanency has been nothing less than stunning. At its height in fiscal year 1997, 51,331 Illinois children were living in foster care. Because of an increased emphasis on early intervention and permanency services such as adoption, that number has declined to 16,157 children in April 2007—a 67 percent decline compared

to June 1998.

As notable as these gains are, the single most important accomplishment of performance contracting is the reinvestment made possible through consistent gains in permanency. These reinvestments support better service delivery for children and families in Illinois's child welfare system.

Florida and Texas both have an opportunity to learn from Illinois. The federal waiver in Florida would make it easier to implement an Illinois model of performance-based contracting. If Texas moves at a slower pace in case management privatization, it should make performance-based contracting a crucial component of future pilot projects and new legislation.

4. Projects Underway to Assess Effectiveness of Performance-Based Contracting

At the national level, an effort is underway to extend the lessons learned about the effectiveness of performance-based contracting in child-welfare privatization. The Children's Bureau in the federal Department of Health and Human Services has designed a five-year project to study the effectiveness of performance-based contracting in the privatization of child welfare services. The Quality Improvement Center on the Privatization of Child Welfare Services (QIC PCW) at the University of **Kentucky** will study evidence of the outcomes of performance-based contracting in the provision of child welfare services. The QIC PCW will serve as a resource for information on child welfare privatization efforts and provide lessons learned from these efforts. The center will test innovative strategies for implementing performance-based contracting and quality improvement systems in the private sector.

Through a competitive application process, the QIC PCW and the Children's Bureau selected three performance-based contracting projects for funding for January 1, 2007 through September 30, 2010. These projects will be testing models of performance-based contracting and quality assurance systems.

Florida's Department of Children and Families (DCF) District 13 will be implementing the Performance Based Contracting and Quality Assurance Systems Demonstration Project which is a partnership between DCF / District 13 and Kids Central, Inc. The state intends to demonstrate that a comprehensive planning process leading to the development of performance-based contracts and inclusion of performance measures in the quality assurance process leads to improved outcomes for children in out-of-home care. The local site evaluation will be conducted by Jean K. Elder & Associates.

The **Illinois** Department of Children and Family Services will be partnering with the Child Care Association of Illinois to implement the Striving for Excellence: Extending Performance Based Contracting to Residential and Independent Living Programs project. Its partnership will design, implement and evaluate the extension of the state's existing performance-based contracting and quality assurance system to residential, independent living and transitional living programs in order to improve outcomes for this population of out-of-home care youth. The state agency will examine outcomes that are appropriate to the early adult child welfare population such as increased rates of educational and vocational goal attainment, improved employment experience and stability, and

improved independent living skills. The local site evaluation will be conducted by the Child Welfare Institute.

Missouri's Children's Division is partnering with seven consortiums to implement the Maintenance Needs in Performance-Based Contracting Success: The Missouri Project on Privatization of Out-of-Home Care for Children. This project will examine the long-term maintenance supports and quality assurance processes needed to successfully implement a performance-based contracting system for case management services for out-of-home care and adoption. An independent evaluation will be conducted by the University of Missouri-Columbia School of Social Work.

The three projects will measure child well-being outcomes such as the rate of abuse while in state care, decreased time until permanent living arrangements, increased rates of family re-unification, and reduced rates of re-entry into the child welfare system. These types of outcomes will be measured in an experimental design where some cases are assigned to a treatment with performance-based incentives and disincentives and some cases are handled based on a traditional child welfare contract without performance incentives. Each experiment will measure the effect of performance incentives and disincentives on very specific outcomes for children.

After the individual experiments are completed, the QIC PCW will also complete a cross-site evaluation to report on shared themes and lessons learned across the three child welfare privatization experiments. The findings from the three studies and the cross-site evaluation will be presented at

a national performance-based contracting symposium and in journals such as *Research on Social Work Practice*.

E. The Case for Privatizing University Housing

College students who expect more from their living spaces are forcing universities to come up with creative approaches to resolving housing shortages, renovating dilapidated dorms, and providing appealing on-campus options to compete with off-campus alternatives. Some universities have called upon the expertise of private housing providers to develop comprehensive solutions to these problems. In return, they have reaped the rewards of lower cost, higher-quality student housing.

Despite these success stories, privatization of student housing remains underutilized. A 2005 survey of 73 public universities revealed that less than 14 percent of new residence halls were to be funded with private developer dollars. Only 16.6 percent of new residence halls will be owned by private developers or foundations, and 15.3 percent will be privately managed.

The private sector has shown that it can build, renovate, operate, and maintain higher-quality housing communities at less cost than traditional military construction methods.

Just as apartment-style living spaces and updated buildings are replacing some of the 11 by 14 foot dorm rooms and 1960s residence halls, it is time to replace old notions of government-subsidized construction and management of university

Benefits of Military Housing Privatization

By examining the nature of the benefits that have accrued to military housing as a result of privatization, it is possible to understand how similar partnerships would alleviate most universities' housing woes.

- **Cost Savings:** Private project development is significantly cheaper than government housing construction and management. According to the DoD, it would have cost \$16 billion to make necessary housing improvements based on the traditional military construction (MILCON) program. Privatization is expected to cost only \$14 billion, which represents a savings of \$2 billion. DoD concluded in 2004 that private development is much cheaper:

Life cycle analyses have shown privatization to be less costly than military construction for all projects so far. Our most recent data reflects for the 20 projects we've analyzed thus far, a life cycle advantage for privatization of about 10-15 percent.

Under the Military Housing Privatization Initiative (MHPI), the private developer pays the vast majority of the development costs. DoD policy requires that a privatized housing project must generate at least \$3 of housing development for every \$1 appropriated by Congress to support the project, or a "leverage ratio" of 3 to 1. For the 43 projects awarded as of February 2005, government construction costs totaled \$767 million for developments that would have cost \$11 billion under the traditional MILCON approach. This represents a leverage ratio of over 14 to 1, far exceeding program guidelines and expectations.

- **Speed in Addressing the Housing Shortage:** Not only are private-sector housing developers cheaper than government developers, they are also much faster. Using MILCON, DoD estimates it would have taken another 20 years to fix all of the military's substandard housing. Assuming DoD's budget requests are fulfilled, the Department anticipates eliminating all inadequate military housing units in the United States by the end of FY 2007—and all inadequate units overseas by the end of FY 2009—by allowing the private sector to manage the process.
- **Better Housing Quality:** According to DoD, in January 2001 approximately 180,000 of the Department's 300,000 family housing units worldwide were deemed "inadequate," requiring significant renovation or repair. In 2005, on-base housing had an average age of 33 years, and 25 percent of it was over 40 years old. Primarily because of the military housing privatization program, DoD expects to eliminate all inadequate units by the end of FY 2007. This represents a dramatic improvement from the 60 percent inadequacy rate of just a few years ago.
- **Better Property Management:** Privatized military housing offers better property management and maintenance. For example, private management companies reportedly fix maintenance problems much more quickly. Chris Crennan, Vice-President of Lincoln Military Housing, Mid-Atlantic Region, proudly reported his company's maintenance track record at NAS Patuxent River housing privatization project: It addresses 97 percent of reported problems within 24 hours and meets emergency needs within 30 minutes. At Fort Meade, the base handed over a maintenance backlog of 4,000 repairs to the new private management company, which fixed all problems within eight months.

housing. The innovation and efficiency inspired by privatization benefits students, universities, and the states themselves.

Those who doubt the promise of privatized university housing can look to the U.S. military housing model for reassurance. The Military Housing Privatization Initiative (MHPI) has proven to be a remarkable success since its creation in 1996. In less than a decade, the military services have made impressive strides in utilizing private housing developers to replace inadequate on-base housing. The private sector has shown that it can build, renovate, operate, and maintain higher-quality housing communities at less

cost than traditional military construction methods. Privatization has resulted in greater efficiency for the services and greater quality of life and morale for service members and their families.

Universities that face the challenge of providing new or modernized housing, especially those historically dependent on state appropriations for construction and renovation, can learn a great deal from the success of the Military Housing Privatization Initiative (MHPI). Specifically,



they can use MHPI as a model for harnessing private sector efficiency and innovation to offer students higher-quality housing more quickly and at lower cost. By taking advantage of private sector expertise in delivering housing services, universities will be free to focus more of their attention on their primary mission of providing high-quality education to their students.

This piece was adapted from the Reason study, *Privatizing University Housing*, which is available online: reason.org/ps356.pdf.

Emerging Issues

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B. Government Transparency

A. State Lottery Privatization

Several states including Illinois, Indiana and Texas floated plans to privatize their state lotteries in 2006-07. The plans are fairly similar to toll road concessions: a long-term concession would be signed establishing the guidelines and expectations of both parties, as well as what the state's regulatory role will become.

Since no deal has formally been completed it is not totally clear what a final deal would look like. However, the concessionaire will likely pay an upfront fee (possibly in the billions of dollars) for the right to operate the lottery on behalf of the state. In addition, some states asked for an annual royalty and/or revenue sharing plan on top of the upfront fee.

Like toll roads, there is little doubt that lotteries are valuable assets. They have a fairly stable revenue stream and one that certainly can be maximized under private management. Private operators will likely introduce new, more popular games. Marketing will also be professionalized using the latest technology to target games to markets. Under this arrangement, lotteries

may, for the first time, truly operate as a for-profit business function with the goal of generating more sales.

Several states including California, New York, and Florida have contracted out aspects of their lottery operations; however, this form of lottery privatization is new to the United States. However, it is not new to the world. Leading up to the Athens Olympic Games in 2004, Greece sold off a 5 percent stake in the nation's lottery. Italy's lottery is run under a concession that lasts until 2012. The concessionaire operates 22,000 lottery machines in retail outlets—the machines are also used to pay car taxes, traffic fines, and television license fees. The United Kingdom's lottery also currently operates under a seven-year concession.

In **Indiana**, 10 companies expressed interest in leasing the Hoosier Lottery. Governor Mitch Daniels said that at least half of those are “north of a billion and a half,” with two offers of at least \$2 billion. The state was also requiring concessionaires to commit to an annual \$200 million a year in royalty payments.

Funds would be directed to creation of an ambitious Hoosier Hope Scholarships

program to high school students attending Indiana colleges and universities and then remaining in the state to work at least three years; to bring top researchers and professors to Indiana, and to keep top students in the state; the idea of directing proceeds to pay down public employee retirement fund obligations, reduce the excise tax on automobiles and fund capital building projects

The enabling legislation, SB 577, passed the Senate 27-20. However, the bill did not get a hearing in the House. Daniels said he is putting off the plans to privatize this year—but that it would be back on the table next year. One issue facing the governor is what to do with proceeds nearly twice the anticipated levels.

In **Texas**, Governor Rick Perry suggested using the proceeds from a lottery privatization to develop a host of new government programs in his State of the State speech. With expectations of \$14 billion the governor wanted to use \$2.7 billion for health insurance plans and \$3 billion for cancer research. The balance would be left, earning interest for public schools. However, the enabling legislation (HB 3973) was not moved out of committee during the 2007 legislative session.

Illinois went the furthest with its effort in 2007. Hoping to attract as much as \$10 billion from investors the state issued a request for qualifications in January. Under the plan the state would receive a multibillion-dollar one-time payment, and the lottery's new operators would receive all revenue and profit for 75 years.

During his reelection, Governor Rod Blagojevich called for privatizing the lottery. Under his plan he would provide the schools with \$650 million a year for the next 18

years, slightly more than what they received last year in lottery income.

Colorado was the only state to put forward a proposal generated by the legislative branch. Senator Josh Penry, R-Grand Junction, and Senator Chris Romer, D-Denver, teamed up to offer legislation to allow the Colorado lottery to be privatized. The legislation would have required an upfront payment of at least \$2.2 billion. Of the proceeds, \$1.5 billion would be invested in a trust fund while the remaining \$700 million would be used for veterans' health care, open space acquisition, and college scholarships. The bill was scuttled because of an adverse opinion from the state's Attorney General.

However, a volunteer lobbyist has given second life to the concept. Marvin Meyers, legislative chairman of the United Veterans Committee of Colorado, has filed the paperwork to pursue a citizen-sponsored initiative that would put lottery privatization on the November ballot. Similar to the Penry-Romer bill, Meyers anticipates that the state would receive between \$2.2 and \$2.6 billion upfront. Those funds would also go to veterans' services, buy open space, create a college scholarship fund and fund other projects. The initiative still needs legal approvals, draft ballot language and more than 76,000 signatures.

Governors in **Michigan** and **New Jersey** have also initiated discussions about lottery privatization. Lawmakers in Maryland and the District of Columbia also mulled the idea over without offering concrete plans.

There are serious policy considerations about the use of proceeds from lottery privatization. Again, while similar to road and highway concessions, there are significant differences when it comes to

the allocation of proceeds. Many have expressed concerns about proceeds being used to create new programs or fund ongoing operating expenses.

B. Government Transparency

While transparency has always been coveted, new efforts at both the federal and state level hold promise to add more sunshine on how government operates. In September 2006, President Bush signed the **Federal Funding Accountability and Transparency Act** (S. 2590) into law. This bipartisan legislation was co-sponsored by Senator Tom Coburn (R-OK) and Senator Barack Obama (D-IL) and requires that a free, searchable database be created to include all federal grant and contract funding information on payments over \$25,000 (with exceptions on classified information and individuals' federal assistance). This Web site, www.federalspending.gov, will formally be launched in 2008.

On Tax Day, April 17, 2007, Senator Robert Byrd (D-WV), Chairman of the Senate Appropriations Committee, called for implementation of disclosure on earmarks, since the larger ethics bill, HB 1136, does not look likely to pass. Also known as the Ethics Reform Act of 2007, if passed it would abolish the Committee on Standards of Official Conduct in the House of Representatives and establish an Independent Ethics Commission to perform the same duties.

As transparency and accountability efforts sweep the nation, a new Web site was launched in April; www.washingtonwatch.com, is a Web site designed to get citizens the opportunity to post and track pending

federal legislation. It has been designed in a user-friendly manner and allows for access to regular e-mail alerts, information on how the bills if passed into law would affect taxpayers, and a catalog organized by topic. Although it was just launched by the Sunlight Foundation it is quickly becoming a great tool for activists, lobbyists and the public policy community.

Over the past few years, there have been many efforts at the state level calling for similar efforts, commonly known as "Google government"-type databases. These Web sites would make state government more transparent by allowing taxpayers access to spending information and clarity on where their tax dollars are being spent. The governors of **Indiana**, **Florida**, and **Texas** have led the most successful efforts on this issue.

In 2005, **Indiana** Governor Mitch Daniels (R) signed Executive Order 05-07 directing the Department of Administration to post written state contracts on this Web site: www.in.gov/gov/media/eo/EO_05-07_Log_Contracts_On_Internet.pdf.

In January of 2007, **Florida** Governor Charlie Crist issued Executive Order 07-01 which created the Office of Open Government, whose sole purpose is to provide "the Office of the Governor and



each of the executive agencies under his purview with the guidance and tools to serve Florida with integrity and transparency.” SB 2516 was also introduced by Sen. Rhonda Storms (R) calling for the Department of State to create a “Google government” Web site which is now in the Economic Development Appropriations Committee.

At the end of January, 2007, Texas Governor Rick Perry (R) called for government transparency as one component of his “Five Point Budget Reform Plan” calling for all state agencies to publish expenditures online in a clear and consistent format. Believing on leading by example, the governor has already made all of the governor’s office expenditures available online: www.governor.state.tx.us/divisions/press/files/2007Q1_expenditure.pdf

State Comptroller Susan Combs followed suit, posting not only her office’s expenditures, but also those of eight other agencies (available at www.cpa.state.tx.us).

The Texas State Legislature unanimously passed HB 3430, mandating the creation of an easy to search, free database listing state expenditures, including grants and contracts. This will allow Texans to literally open up the state’s checkbook and see for themselves where taxpayer dollars are being spent.

Additional bills were introduced in the Texas legislature. Rep. Ken Paxton (R) sponsored HB 42 which would create a database of all state contracts; this bill was given a public hearing but died at the end of the session. Rep. Bryan Hughes’ (R) HB 640 would have required online posting of expenditures by state agencies, and Rep. Corbin van Arsdale’s (R) HB 1007 would have required the online disclosure of state grant information in a searchable format; both bills were left pending in committee.

Finally, HB 2560, sponsored by Rep. Bill Zedler (R), went a step in a different direction calling for school districts to post their check registers online; it passed out of the House but was left on the Senate calendar.

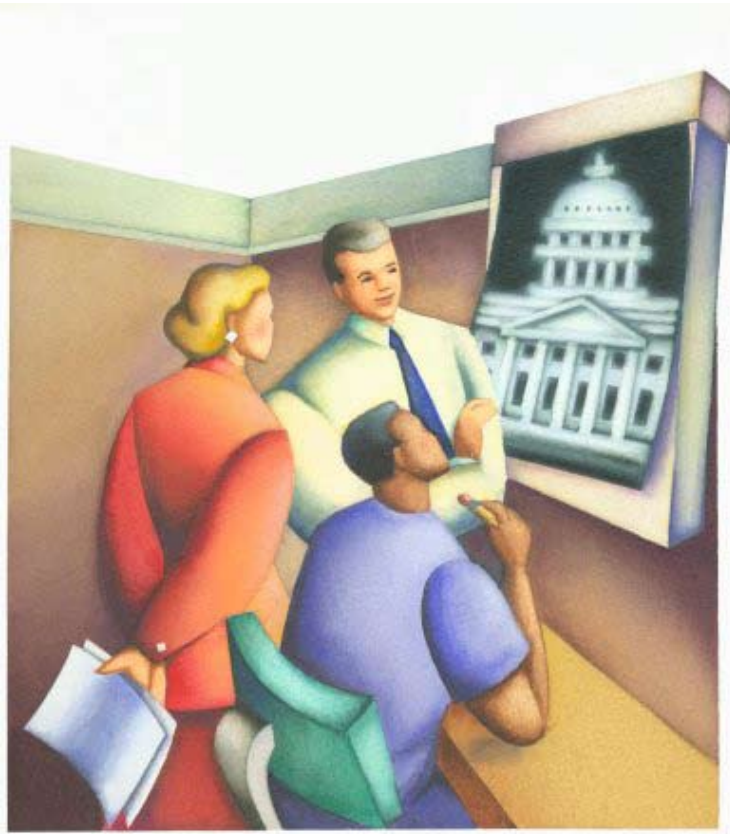
Furthermore, Texas House Joint Resolution 19 was unanimously passed in both chambers giving voters the option of adopting a constitutional amendment requiring a roll-call vote on the final passage of all substantive bills passed through the legislature. If approved by voters on November 6th, no measure could be passed through via an anonymous voice vote.

Missouri Governor Matt Blunt’s office is currently building a “transparency website” that it plans to launch in June. In Georgia, SB 300 sponsored by Sens. Chip Rogers (R) and Chip Pearson would require the Department of Audits and Accounts to create a searchable Web site on the expenditure of state funds; it has been referred to the House.

Arizona has created an online database (www.spirit.az.gov) that provides a searchable database of statewide contracts for its agencies and over 400 colleges and universities, counties, cities, school districts, and qualified non-profits.

Hawaii’s Rep. Marcus Oshiro’s (D) HB 122 passed, requiring the creation of a searchable Web site. Senate versions, SB 157 and SB 1689 would have imposed a \$25,000 threshold.

Illinois Rep. John Fritchey (D) introduced HB 473, the Funding Accountability and Transparency Act, requiring full disclosure of entities and organizations that receive funds from the state. In addition, the Governor’s Office of Management and Budget would have to



establish a searchable Web site; there is a \$25,000 threshold for disclosure. HB 473 passed the House and has been referred to the Senate Rules Committee.

Kansas was the first state in 2007 to sign comprehensive government transparency legislation into law. HB 2457, also known as the Taxpayer Transparency Act, sponsored by Rep. Kasha Kelley (R) in February of 2007, was signed by the governor and became law in April. The Taxpayer Transparency Act requires the Secretary of Administration to develop and maintain an easily searchable Web site containing: certain state and local revenue and expenditures including annual expenditures such as disbursements by state agencies from funds in the state treasury, salaries and wages including compensation paid to individual state employees, contractual services, capital outlay and

commodities. Additionally, Kansas considered HB 2207, which would have created a comprehensive searchable Web site for the state's expenditures, including grants, contracts, subcontracts, tax refunds, rebates and credits, payments made under the Kansas Investments in Major Projects and Comprehensive Training Act, as well as expenditures pursuant to any compact between the governor and any federally recognized Indian tribe or nation in Kansas; this bill was left pending in committee.

Del. Warren Miller (R) sponsored HB 1252 in **Maryland** which would have required the Department of Budget and Management to disclose pertinent information regarding state grants and contracts by the start of 2008; it died in committee.

Minnesota's HF 376 and SF 416 were placed in the State Government Omnibus bill, signed into law by Governor Pawlenty on May 25, 2007. Although, grants and contracts to local government units won't be included, the database will allow Minnesotans to search for detailed information on state grants and contracts which are valued over \$25,000 starting in 2008. This information will be stored online for 10 years.

Although no legislation has been proposed yet, **New Hampshire** Gov. John Lynch has made his monthly spending reports publicly available. Officials expect to make the spending side of the state's budget available soon; citizens can already track what goes into the budget.

In **New Mexico**, both Rep. Kathy McCoy (R) and Rep. Larry Larranaga (R) introduced similar bills calling for the Department of Finance and Administration to create a transparency Web site



showcasing info on state revenues and expenditures. North Dakota's SB 2093 passed the Senate unanimously and recently passed the House; in addition to the creation of a Web site, this bill also calls for transparency of government purchase cards.

Oklahoma state senators modeled legislation after the federal bill and called for creation of a Web site showing all state spending. This bill—unanimously passed in late May and signed into law by the Governor in early June—is known as The Taxpayer Transparency Act. This new “Google government” Web site is scheduled to be launched by January 1, 2008.

In **Ohio**, citizens are able to look-up

information pertaining to supplies and services contracts via a variety of search criteria at www.procure.ohio.gov/proc/index.asp.

Following a large turnover in the General Assembly, **Pennsylvania** has launched www.passopenrecords.org to bring sunshine on the state's expense account records. Currently, the state asks for a burden of proof from a citizen to open a record. This blog points out that the records should be presumed open and that a particular office or agency should have to prove otherwise.

In February of 2007, **Tennessee** Rep. Matthew Hill (R) introduced HB 943, the Transparency in Government Act, which would require the state and its agencies to create a searchable Web site and post the lost revenue report from the previous fiscal year. This bill is still pending in committee.

Although they never moved out of committee, **Kentucky's** HB 159 called for creation of a Web site providing access to most state expenditures, and Washington's HB 2342, would make state budget information available to the public (although Washington's Department of General Administration currently provides information on state-awarded contracts on www.ga.wa.gov). And in **Connecticut**, HB 6809 would have required the Department of Information Technology to create one of these “Google” Web sites with information on state grants, contracts, projects, and loans. **Colorado** also suffered a loss when HB 1164 was killed in committee; the Transparency Act would have created a “Google government” Web site requiring postings within five days of the treasurer receiving the information.

Water & Wastewater

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A. *Public Works Financing* Issues 11th Annual Water Privatization Report

B. U.S. House of Representatives Passes Water Funds

C. World Bank: New Generation of Privatization?

A. *Public Works Financing* Issues 11th Annual Water Privatization Report

Water and wastewater services continued on their path of expansion, although at a slower rate than in recent years, reports the 11th annual water report from *Public Works Financing*. The survey is based on a review of the eight largest water utility operators.

The market has grown steadily by 5 to 12 percent a year since 2000 (total dollar value)—with 2006 reporting as one of the slowest yearly gains in recent years. There are 1,038 wastewater and 746 water facilities under private operation in the United States. In 2006, a total of 1,463 municipal, state, or federal clients outsourced their water or wastewater operations to the private sector; representing a 4.3 percent increase over 2005.

The industry's contract renewal rate remained high, averaging 95 percent over the last four years.

B. U.S. House of Representatives Passes Water Funds

The U.S. House of Representatives passed HR 720, the Water Quality Financing Act of 2007 by a margin of 303-108. The bill dedicates \$14 billion over the next four years for the Clean Water State Revolving Loan Fund.

Another \$1.7 billion in grants over five years was authorized in HR 569, the Water Quality Investment Act of 2007. Both bills await action in the Senate.

While these bills may be a step in the right direction, they fall short of what the U.S. Environmental Protection Agency says is needed. Some \$350 billion or an additional \$22 billion each year in new investment is needed in our water infrastructure. One tool that would be helpful is not included in either of these bills. Last heard in the previous Congress, lifting the cap on Private Activity Bonds (PABs) would offer private service providers access to low-interest loans. HR 1708 (in

the 109th Congress) would have enabled public-private partnerships to flourish for water and wastewater systems, likely resulting in more progress toward closing the investment gap. PABs would make public-private partnerships more attractive because the private sector could offer lower prices because of new access to cheap capital and debt.

C. World Bank: New Generation of Privatization?

A recently published report from the World Bank, *Private Participation in Water: Toward a New Generation of Projects?*, examined the role of the private sector in international water and sewer investment and development.

While private participation has slowed, it has become more concentrated. In

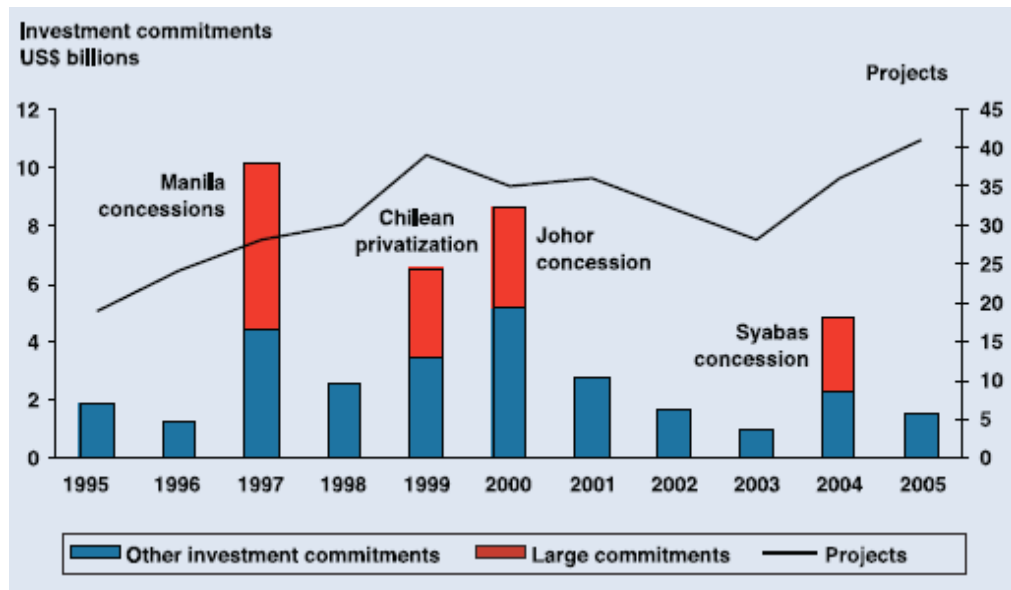
2005 investment totals amounted to \$1.5 billion—comparable to investment levels over the last five years (with the exception of a single \$2.5 billion concession in Malaysia in 2004). Private investment was prominent in China and Algeria.

Forty-one projects were finished in 2005—the most since 1990. So even though total investment, in dollar value, has declined, the private sector remains very active and engaged. There was a shift in the type of investment though—sewer treatment plants saw investment increase significantly, raising their share of investment from 9 to 35 percent.

There were 36 concessions between 2002 and 2005, with most of them granted in Chile, China, Columbia, and Malaysia. Management and lease contracts have been gaining ground—now consisting of a quarter of all private activity.

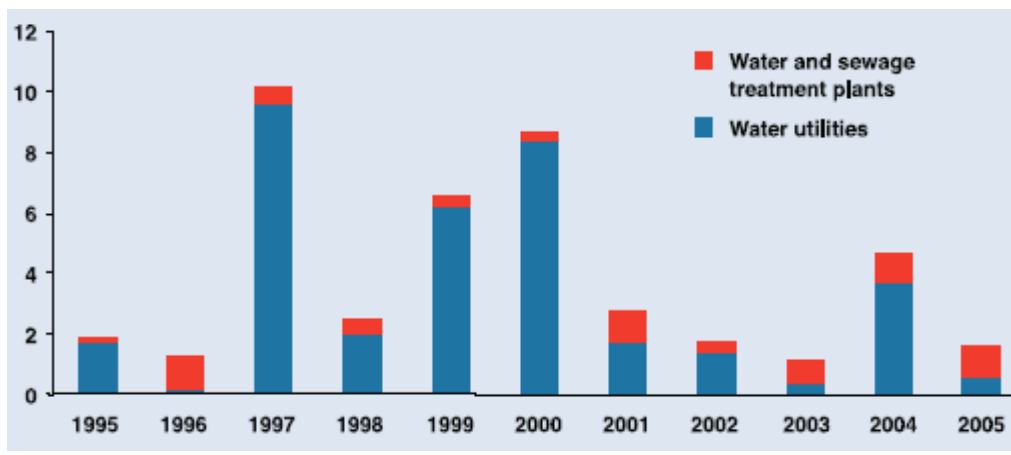


**Figure 5: Investment Commitments Slowing,
Number of Projects Increasing in Recent Years**
(Private Participation in Water Projects in Developing Countries, 1995-2005)



Source: World Bank and PPIAF, PPI Project Database.

Figure 6: A Changing Allocation of Private Activity
(Investment in Water Projects with Private Participation in Developing Countries by Segment, 1995-2005 (US\$ billions))



Source: World Bank and PPIAF, PPI Project Database.

Telecommunications

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A. States Push for Video Franchise Reform

As the consumer benefits become clear, more state legislatures are expected to adopt franchise reform measures over the course of 2007 and 2008 that permit new entrants to apply directly to the state to offer cable TV and cable-like video service.

Video franchises are the revenue-sharing agreements that cable TV companies sign with local governments for the right to offer video services to customers. In return for a portion of the gross video revenues the company pays to the municipality, cable TV companies get use of the city's right of way and a right to sell cable service in the area.

Statewide franchising eliminates the need for applicants to go from municipality to municipality to negotiate individual agreements, a process that can take 24 months or longer. Under current franchising rules, new entrants must negotiate individually with each local

franchising authority—there are 700 of them in Missouri alone, according to the American Legislative Exchange Council (ALEC). Franchise reform also lowers the legal burdens traditionally imposed by local franchise agencies—burdens that have made it costly, time-consuming and difficult for competitors to enter. In addition, statewide franchise reforms restrict or eliminate the sometimes arbitrary concessions imposed by local franchise agencies.

1. Statehouse Groundswell

States are increasingly embracing video franchise reform as a way of accelerating competition for cable TV services. As of mid-May, at least 12 states had introduced legislation to allow new entrants to apply directly to the state for franchising authority, bypassing the need to engage in often costly and time-consuming negotiations with local towns and municipalities.

Of these, the **Missouri** General Assembly was the first to pass franchise reform in 2007. The Missouri House of Representatives voted

March 14 143-4 in favor of the measure, known as the 2007 Video Services Providers Act (SB 284), following a 32-2 vote in favor of the bill in the Senate. Gov. Matt Blunt signed the bill March 22. The law will take affect August 28.

Lawmakers in **Georgia** followed in April, approving statewide franchising by margins of 166-2 and 52-2, respectively, in the state House and Senate. As few weeks later, the Florida legislature passed statewide franchising, and Gov. Charlie Crist signed the bill May 21st. In both states the act became effective July 1.

Elsewhere, **Nevada** Gov. Jim. Gibbons signed AB 526 on June 4, creating a statewide franchising process in the Silver State. Compared to similar legislation in other states, where reform has taken a year or two to happen, Nevada moved rapidly. The bill was introduced on March 23.

The **Illinois** House of Representatives passed a franchise reform bill June 1 by a unanimous 113-0 margin. At presstime, the bill was awaiting vote in the Senate, where it was expected to pass. Once it clears the upper chamber, Gov. Rod Blagojevich is expected to sign the bill.

The only setbacks thus far have in **Tennessee** and **Colorado**, where bills have stalled in committee and are unlikely to come up for vote.

Other states that have introduced statewide video franchising this year are **Iowa**, **Massachusetts**, **New York**, **Utah**, **Washington** and **Wisconsin**.

Opposition to legislation tends to come from municipalities, which fear both loss of franchise revenues and that new entrants will not serve all parts of the community. But the case for competition is proving more compelling, and legislators are responding

by passing statewide franchising bills by wider and wider bipartisan margins. Studies in 2006 by Reason Foundation, the Mercatus Center at George Mason University, and the George Mason University School of Law, among others, looked at the way the local franchising process inhibited competitive entry, and the results that occurred in **Texas** and **Indiana**, which in 2005 and early 2006 became the first two states to create statewide schemes.

After Texas created statewide video franchising in August 2005, Verizon began extending its new FiOS fiber-to-the-home network in Keller, Texas, which had until that point been operating as a pilot project, into surrounding communities in north Texas. By the end of that year, Charter Communications, the incumbent cable company in Keller, had cut some cable rates by 27.5 percent.

As AT&T ramped up its 2006 U-Verse launch in San Antonio, Time Warner Cable boosted the speed of its Road Runner Internet service. Once AT&T went on-line, Time Warner began discounting TV and phone plans, throwing in premium movie channels and faster Internet connections. In October, Time Warner introduced an innovative new service feature called “Start Over” that allows viewers tuning in late to watch their shows from the beginning.

After statewide video franchising took effect this past summer in Indiana, Verizon stepped up FiOS deployment. Comcast responded by increasing the speed of broadband service in Verizon territories such as Howard County to keep up.

In Ft. Wayne, Indiana, Verizon began deployment of FiOS service in the low-income Hanna-Creighton neighborhood. AT&T has rolled out U-Verse service across

all parts of San Antonio, not just the tony neighborhoods.

Where enacted thus far, franchise reform's benefits have been undeniable. Consumers have enjoyed greater choice and a range of new services, including on-demand video and "a la carte" content selection, at lower cost. Incumbent cable providers have responded to new competition by lowering costs and improving service.

2. Bills Differ in Details

Although all the bills introduced so far create statewide video franchising authority, there are some differences.

Most states cap the franchise fees percentage formula at 5 percent of gross video revenues, although some bills, including the one in Illinois, designate an additional 1 percent to fund public, educational, and government (PEG) channels.

The definition of gross video revenues can also differ. All bills consider income from service provision—billings for set-top box rental, monthly service, premium channels and pay-per-view—as video revenue. More controversial has been the inclusion of cable-related income that does not come from consumers, including revenues from local advertising, commissions paid by programmers such as the Home Shopping Network and QVC on sales of merchandise to franchisee customers, and promotional fees paid to franchisees by cable programmers for including their channels on the system. Bills in Colorado and Tennessee use the broader definition, while the Illinois' bill, for example, does not.

Regarding build-out of new services, the

bills currently under consideration vary in the deadlines they impose on new entrants regarding coverage of the entire area.

The Tennessee bill imposes no build-out requirement, allowing new entrants to deploy service in response to market conditions and economies of scale. Illinois and Missouri require that within five years at least 30 percent of households where service is available must qualify as low-income.

Some bills, including those in Colorado and Illinois, require the incumbent cable company to remain bound by its existing local franchise agreement until it expires. Others, such as in Florida, Missouri, and Tennessee, permit incumbents to apply for a statewide franchise upon the entry of a competitor. The Wisconsin bill would permit an incumbent to apply for a statewide franchise with or without competition.

All legislation calls for statewide franchisees to provide PEG channels, usually a minimum of three, often more based on population. Franchisees must provide a means of connection from PEG studio facilities to the head-end.

All the pending legislation prohibits cities from discriminating against some service providers by denying access to rights of way or charging higher prices for access than to other providers.

3. FCC Action

As state action proceeded, the FCC issued a new set of rules and guidelines for local franchise authorities that regulate cable operations within their specified jurisdictions. The rules became effective March 5th, the date the FCC released the order.

The FCC rules, contained in the March

5th Report and Order and Further Notice of Proposed Rulemaking, are designed to strengthen the existing provisions of Section 621(a)(1) of the Communications Act of 1934, as updated over the years, which prohibits franchising authorities from unreasonably refusing to award competitive franchises for the provision of cable services.

The new rules require local authorities to decide on a franchise application within 90 days or the license will be deemed granted. In addition, local authorities can no longer make extraordinary requests from applicants for the deployment of hardware or for requests unrelated to the provision of video service.

The FCC also listed several other practices as an “unreasonable refusal to award a competitive franchise,” including:

- requiring an applicant to agree to unreasonable build-out requirements,
- demanding additional fees and compensation that are not counted toward the statutory 5 percent cap on franchise fees, and
- demanding unreasonable obligations relating to PEG channel and institutional networks.

B. Push for Network Neutrality Regulation Loses Momentum

Both Congress and the states are moving slowly on network neutrality, which would regulate, and perhaps prohibit, the use of network-based techniques to improve the performance of time and error-sensitive Web-based applications, such as two-way voice, video and interactive games.

The push for regulation has lost some momentum from the last half of 2006.

Industry concerns about the effect the exploding amount of video traffic will have on Internet transmission in general have tempered the urge to ban tiered pricing structures that would allow major content and applications providers such as Google, Yahoo, Sony and Disney to upgrade the speed and quality of their commercial services as they cross the Internet.

By way of measurement, the monthly volume of Internet traffic grew by 35 percent between December 2005 and December 2006. The Internet in December 2006 handled about 700 million gigabytes (1 billion bytes), compared to 450 million in December 2005 and 300 million in December 2004. This snowballing growth has technologists coining the term “exaflood.” The word derives from exabyte, which equals 1 quintillion bytes (1 followed by 18 zeros). In terms of equivalency, 700 million gigabytes equals 0.7 exabytes.

In and of itself, the exaflood does not necessarily pose a crisis. Right now the global Internet has the capacity to handle the traffic. The question is, when the amount of Internet data truly begins to reach the capacity of the network, as it inevitably will, how will the industry be able to respond?

Free market proponents argue that deep-pocketed companies will likely be willing to pay for quality guarantees. At the same time, their high-bandwidth applications will be partitioned away from the conventional “best effort” Internet that supports the great majority of Web-based content and applications, allowing these to perform free of the congestion the few big players would otherwise generate. In fact, many of these companies already rely on Web caching, compression and other server-based techniques that enhance the way their Web

sites work and mitigate congestion at the same time. It is not as if today all Web sites operate on neutral footing.

As of mid-May, there had been no movement on a congressional network neutrality bill introduced by Sens. Olympia Snowe (R, Maine) and Byron Dorgan (D, N.D.). Efforts in Maryland and Michigan to enact network neutrality rules at the state level were voted down.

Some early industry proponents of network neutrality, including Microsoft, have backed off. In addition to service providers such as AT&T, Verizon and Comcast, most U.S. telecom manufacturers have urged lawmakers and regulators to deal with any market abuses should they occur, and not pre-empt the market with a new law that addresses no current problem. Even Google, which until now has been among the most vocal corporate backers of neutrality regulation, has started sending mixed messages. Although a spokesman reassured net neutrality supporters at SavetheInternet.com that Google remains committed to the cause, a number of key Google executives have been hedging on their support for government intrusion in the market for network and applications management.

Alan Davidson, Washington policy counsel for Google, said at a Federal Trade Commission workshop in February that not all network management is anti-competitive. Two weeks later, Andrew McLaughlin, Google's head of global public policy, told a Silicon Valley audience that he believed market mechanisms will ultimately solve Internet congestion problems. "None of us want any kind of heavy-handed regulation," he said.

As of early June, proponents were pushing the FCC to attached network

neutrality provisions to the upcoming spectrum auction of frequencies in the 700 MHz band. The FCC opened the band with an eye toward creating more channels for wireless data services. The move is part of a broader effort to push for caveats and restrictions that would bar some groups of companies from participating in the auction. At presstime, it was unclear how these efforts would play out.

C. Problems Emerging with Municipal WiFi

As more cities launch municipal wireless systems, many of the predicted problems are emerging, ranging from higher costs to low usage to poor coverage.

The problems are not limited to purely city-owned and operated systems. Recent news indicates that companies participating in public-private partnerships are revisiting their business models and hedging on their promises.

For example, MetroFi, one of the leading wireless network companies in the municipal space, has told cities it will not offer a tier of free services unless the city agrees to become an anchor tenant on the network. The company said that while a free, advertising-supported tier of wireless access is viable, it cannot by itself support a city-wide network infrastructure. Adrian van Haaftan, MetroFi's vice president of marketing, told *Wireless Week*, an industry trade publication, that revenues from municipalities must be part of the sales "equation."

Both private companies and municipalities are also learning that infrastructure costs are higher than thought. Early studies estimated that a "mesh" of

25 WiFi antennas per square mile would be adequate to assure wide area, in-building coverage. Many cities based their spending plans on these estimates. As WiFi systems build out, engineers are discovering that it takes up to 50 mesh antennas per square mile to assure adequate coverage.

Meanwhile, many municipal wireless systems that were once highly touted are limping along. Lompoc, California, which spent \$3 million on a citywide municipal wireless network reported in April that had signed up a only 281 customers, representing an investment of \$10,676 for every customer. The town's original feasibility study said the system would need 3,000 subscribers to break even.

The wireless system in Foster City, Calif., covered only 60 percent of the town as of early April. The private contractor, MetroFi, had promised residents 95 percent coverage by then. It blames the coverage problems on the layout of homes in Foster City and the geography of the city itself.

Meanwhile an independent evaluation of the municipal wireless system in Portland, Ore., another MetroFi project, found just 50 percent coverage. The evaluation was done by a Portland user group unaffiliated with the city. About two weeks afterward, the city refuted the user group with its own study that it commissioned and funded, which found that 99 percent of the municipal system's hot spots were functioning as specified.

And the latest news from St. Cloud, Fla., reports that the town had to replace every antenna on its network due to water damage. The change-out did not cost the city any money directly, but it did require considerable time from city employees. Last year, the town fell short of its promised in-home coverage. Residents who wanted

access to the city system were required to purchase \$100 signal extenders.

D. Lessons Learned from Provo's Municipal Broadband

After only two years, the municipal broadband system in Provo, Utah has begun to show the pattern seen in other cities that have mounted expensive fiber optic networking projects. With less than half the subscribers expected by this date, iProvo, the \$39.5 million system launched in July 2004, has had to request \$1 million in additional funds from the Provo's electric utility to meet its costs.

The request for additional funding comes after a troubled first 18 months of operation marked by slow growth and a rocky relationship with a retail partner that came to an abrupt end during a heated mayoral campaign. The sole bright spot is that iProvo construction has stayed on schedule. The iProvo Web site reports that all eight construction phases were completed by the initial July 2006 deadline.

iProvo is set up as a city-owned fiber optic network that wholesales capacity to retail service providers. The unit operates under the administration of the Telecommunications Division of Provo City's Energy Department. Construction on the iProvo network began in July 2004. As of December 1, 2005, fiber optic connections were available to more than half of Provo's approximately 27,000 residences and 4,100 small businesses, making it the largest municipal broadband system in the United States to date, according to *Broadband Business Forecast*, an industry newsletter. Local newspaper reports place

the subscriber total at 7,700 as of October 2006. iProvo also owns and operates a cable television distribution facility.

iProvo began with high hopes. But for all the optimism that the city had found a better formula in wholesaling, the experience remains a warning to other cities that municipalities, even when they take a wholesale role, cannot compete with the private market. Despite the advantages it had at the outset, just two years into the project, iProvo is dealing with the same struggles other municipalities have had in the past.

iProvo is behind on its business plan and is being forced to borrow more money. In February 2006, Mayor Billings and iProvo officials asked the Provo City Council to approve a transfer of \$1 million from Provo's electric utility reserve to cover fiscal 2006 costs. In June, iProvo requested and received a line of credit for an additional \$2 million to cover costs in fiscal 2007 and 2008. iProvo officials also said in October that the operation will need 12,000 to 15,000 customers to break even, an increase the original break-even target of 10,000 customers. The original plan had anticipated iProvo achieving 10,000 customers by December 2005. With revenues and customer uptake short of goals, there is mounting pressure on asset value and cash flow. iProvo's "burn rate" (the rate at which expenditures exceed income) in fiscal year 2005 was \$325,000 a week.

iProvo's wholesale plan attracted only one retail partner, HomeNet Communications, in its first year of operation. That relationship proved a disaster that ended with HomeNet pulling out of the market in July 2005 and declaring bankruptcy. Of the some 2,400 customers

HomeNet and iProvo started with, as few as 1,600 were left by the time HomeNet closed up shop. This occurred as Mayor Billings was in the middle of a heated re-election campaign in which iProvo performance was an issue. This put pressure on Billings to find replacements for HomeNet quickly, giving more leverage to would-be partners to extract favorable concessions from the city.

For a project that began as an example of innovative urban planning and pro-active technology policy, iProvo has had an inauspicious 18 months.

Cable and Internet prices charged by iProvo partners are not significantly lower than pricing from Comcast or Qwest. An original goal of iProvo had been to offer broadband services at "affordable" rates, implying the rates charged by private service providers are too high. Yet, when compared with similar service packages from the incumbent cable and telephone companies, iProvo's two current retail partners (Veracity Communications and MStar Metro) do not offer sizable discounts.

There is little evidence to suggest iProvo has generated any significant growth in broadband usage or penetration in Provo. All reports suggest that the great majority of iProvo's 5,000 customers had broadband service prior to iProvo, either as customers of bankrupt Provo Cable or as customers of Veracity and MStar.

iProvo's current retail partners, Veracity and MStar, are two local Internet service providers (ISPs). They replaced HomeNet in August 2005. While the city of Provo funds construction and maintenance of the fiber optic backbone and cable head-ends, fiber-to-the-premises (FTTP) connections to each

home and business are the responsibility of Veracity and MStar, which are principal points of contact for consumers. The two iProvo retailers compete with other broadband and cable TV providers, including Qwest Communications International and Comcast Corp., as well as direct broadcast satellite (DBS) companies and other ISPs. Large users, such as Brigham Young University, do business directly with iProvo. The city of Provo is also a customer of iProvo.

Yet just two years into operation, iProvo has had to call on the city's power of the purse. In the free market, failing companies close shop, and that is the end of the financial loss. In requesting an allocation from the city's electricity reserve, iProvo can do what no private company can: cross-subsidize broadband operations from other utility funds. The electricity reserve fund was created as a hedge against price increases in the cost of electricity, a volatile market as it is. Provo's electricity customers, not its broadband users, pay into it. Although iProvo seeks only \$980,000 of the \$17 million in the reserve, it establishes a precedent and leaves the electric utility, and its customers, that much more vulnerable.

In addition to engaging in overt cross-subsidization, iProvo demonstrates more subtle problems municipal broadband systems create for taxpayers and the local economy when they attempt to compete with the private sector. For example, when the city of Provo sold Provo Cable's customers to HomeNet at 40 percent of true market price, it indirectly subsidized HomeNet's market entry. In selling a key asset for less than what it was worth, Provo cheated both local commercial service providers and Provo taxpayers.

Set up under a wholesale model, iProvo also was touted to be immune from the problems municipalities have had with retail FTTP systems. That has turned out to be a false hope. Indeed, while financial reports looked good in the first year of operation, much of iProvo's revenues were generated from interest accruing on bond funding that had been banked. Although the warning signs were there, namely in the form of poor customer growth, iProvo officials chose to play them down. It was only in its second year, when cash from the bond issue began to deplete, that iProvo's revenue shortfalls and cash flow problems came into high relief.

For a project that began as an example of innovative urban planning and proactive technology policy, iProvo has had an inauspicious 18 months. In its first year, certain aspects of its balance sheet and revenues appeared sound, but they do not stand up on closer examination. Because it calls for a smaller investment, the wholesale model appears more attractive. The wholesale model is getting more consideration as more cities contemplate municipal wireless networks. Yet the cautionary tale of Provo is that operating as a wholesaler is not enough of a hedge against the financial and logistical problems that occur when a city seeks to compete with commercial service providers in a competitive business sector.

The above is the executive summary from Reason's study, *Spinning its Wheels: An Analysis of Lessons Learned from iProvo's First 18 Months of Municipal Broadband*, available online at www.reason.org/ps353.pdf.

E. A Dynamic Perspective on Government Broadband

By Jerry Ellig

Debate over government provision of broadband has generated many of the usual arguments over the pros and cons of government service provision. On the one hand, such initiatives might make broadband more affordable and hasten its adoption. On the other hand, they could also generate significant costs for taxpayers and stunt incentives for cost containment. Such arguments commonly occur when governments consider direct provision of electricity, gas, water, roads, and many other services that tend to be provided by monopolies that invest in long-lived assets.

Less extensively discussed, however, are some unique challenges that arise because broadband is a new, fast-changing technology available from competing suppliers. Policymakers need to consider some unique problems when a government enterprise enters a dynamic market such as the provision of Internet services.

Scholarship on dynamic competition suggests seven new issues that are likely to be significant in municipal provision of Internet service:

1) Competition: Unlike a monopolist, an enterprise that faces competition cannot count on a captive market. In many cases, government-sponsored broadband will have to compete with incumbent firms, such as cable, telephone, and wireless companies that already have a substantial head start. After reviewing many cities' actual experience with cable and broadband enterprises, research concludes that an assumed penetration rate for a municipal system of more than 10 percent in the first

year, or 20-50 percent in subsequent years, appears highly unrealistic in most cases. A wireless system might expect to serve about 25 percent of the residential market and 10-20 percent of the business market. The only exceptions might be small communities serviced only by expensive alternatives, or municipalities willing to commit to very large subsidies for their broadband systems.

2) Performance Competition:

Competitive businesses seek to continually improve performance—or even develop new aspects of performance that were not previously thought capable of improvement. Speed is perhaps the most measurable aspect of performance. Comparing prices and services offered by government-sponsored Internet provision to those in the private sector, the prices and performance of existing government systems are inferior to those of existing private systems. An effective government-owned competitor must be prepared to offer a price/performance combination that a significant number of consumers will prefer to those offered by competitors. If government ignores performance competition, it could end up offering a fairly plain service appealing only to customers who want relatively slow broadband speeds, and may not be willing to pay much for it. While such an approach might be attractive as social policy, it is unlikely to pay for itself over the long term and would likely require ongoing subsidies.

3) Continuous Improvement: One indicator of the extent of change is the pace at which prices of goods and services fall as technology improves, costs fall, or competition intensifies. This has occurred frequently in the market for Internet service, as well as in related or analogous markets

such as wireless communications, telephone equipment, and telecommunications services. Real consumer price indices for wireless, telephone equipment, and long-distance service have fallen even faster—by 45-65 percent. If recent experience is a guide, government broadband operations will need to be prepared to continually improve in the future if they want to keep pace with private sector competitors.

4) Technological Change and Lock-In: “Lock-in” occurs when an initial decision gives one technology a slight edge, then sets in motion a process which leads that technology to dominate the market. If the technology that gets locked in is truly the superior technology, then there’s no harm done. But if an inferior technology gains a temporary edge in market share, some scholars argue that it might remain dominant even though it is inferior. The market gets locked in to the inferior technology due to the decisions of the early adopters, and often has to rely on subsidies to stay afloat when better technology is available elsewhere. Government broadband plans should squarely address the potential for lock-in and explicitly evaluate whether subsidies would give an inferior technology an artificial boost.

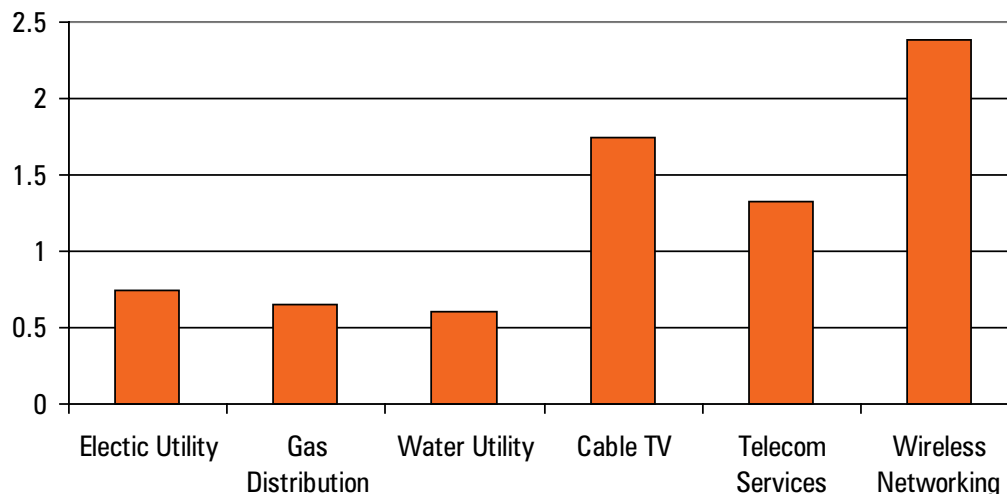
5) Obsolescence: In a dynamically competitive market, networks become obsolete faster. Technology improves more rapidly, and as a result capital investment becomes obsolete more quickly. Business plans for government broadband enterprises need to assume faster depreciation rates, and concomitantly higher prices, than have traditionally been used for government utilities. For example, a workable plan for municipal Wi-Fi needs to assume that revenues will not just cover operating costs

plus interest, but also recover the initial capital outlay in three to five years.

6) Risk: Financially, investment in a dynamic field such as Internet provision is less of a “sure thing” than a conventional government monopoly. That means the cost of capital should carry a higher risk premium than normally considered appropriate for government enterprises. But just how risky is it? Comparing risk levels shows clearly that investments in electric, gas, and water utilities have involved much less risk than investments in firms that sell broadband or wireless data services. Electricity, gas, and water are precisely the types of static, monopolized industries where governments have traditionally invested. In terms of risk, broadband is a whole new ballgame. Investing in broadband is much riskier than investing in the overall stock market. Nevertheless, some governments have financed broadband initiatives as if they were traditional, low-risk investments in infrastructure that provides necessities. A government enterprise that faces an artificially low cost of capital is more likely to waste the public’s money by “investing” in capabilities that produce little value for customers, or do so only after an excessively long time.

7) Uncertainty: A private business firm’s shareholders bear uncertainty as well as risk. The prospect of additional, higher returns entices them to bear that uncertainty. The fact that uncertainty affects shareholders’ financial fortunes gives them strong incentives to seek out management that will exercise sound judgment. The most likely method would be to organize the enterprise as a for-profit company, with explicit expectations from the owner (the government) that it be successful. The

Figure 7: Utility Risk Levels (Beta Coefficients, Where Stock Market = 1)



Source: Aswath Damodaran, http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/Betas.html

most credible way governments make these types of commitments is by enacting a plan to privatize the enterprise. But in this context, a privatization plan would beg the question of why the government is getting into the broadband business to begin with! For government broadband enterprises, taxpayers bear the uncertainty in their role as the ultimate owners. At a minimum, therefore, effective accountability requires that government broadband initiatives should have accountability and transparency for taxpayers at least as good as that which publicly held companies must have for their shareholders. These transparency measures may not be sufficient to make government managers as accountable to uncertainty-bearing taxpayers as corporate managers are to uncertainty-bearing owners. But it is difficult to see how accountability is possible without them.

The factors outlined above need not imply that government-provided broadband is a bad idea. However, no plan for government-sponsored broadband should be considered complete or responsible unless it addresses many factors. Government faces the daunting challenge of entering a market where technological change is swift, the future is uncertain, and competitors' actions are unpredictable—a playing field fundamentally different from the stable, predictable utility markets that have traditionally attracted public investment.

Jerry Ellig is a senior research fellow at the Mercatus Center at George Mason University. The above article is a summary of Reason's December 2006 study, *A Dynamic Perspective on Government Broadband Initiatives*, available online at www.reason.org/ps349.pdf

Land Use and Property Rights

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A. Eminent Domain Reform Update

1. Property Rights Win Big in November 2006 Election

Besides Democrats, the big mid-term election winners in November 2006 were homeowners in the nine states that passed initiatives protecting property rights and reining in government's power to take homes and businesses. These initiatives were sparked by the Supreme Court's controversial ruling in the 2005 *Kelo vs. New London* decision, which gave the government a green light to use eminent domain to take private property and turn it over to developers for "economic development" purposes.

Many Americans were incensed at the notion that government could arbitrarily evict people from their homes, businesses, and churches simply because it could generate more local tax revenue if these properties were redeveloped as condos, offices, and hotels. Traditionally, eminent domain was only used to acquire private

land for clearly defined public uses—such as roads, parks, and public buildings—but *Kelo* opened the door for government to condemn property for almost anything that it could argue had a public "benefit."

The backlash was immediate. Since the *Kelo* ruling over two dozen states have passed legislation to curb eminent domain abuse, and in the November 2006 election, voters passed a variety of measures intended to do the same thing.

Kelo opened the door for government to condemn property for almost anything that it could argue had a public "benefit."

An overwhelming majority of voters in Florida, Georgia, Louisiana, Michigan, New Hampshire, and South Carolina approved constitutional amendments that forbid the use of eminent domain to transfer land from one private party to another for economic development purposes. Similar voter-initiated constitutional amendments passed in both North Dakota and Nevada,

though Nevadans will need to pass the same amendment in 2008 for it to take effect.

Of all states, voters in Oregon have taken one of the strongest stands in recent years to protect their property rights. Measure 39, a statutory initiative that reins in eminent domain abuse, passed in November by more than a two-thirds margin. Moreover, Measure 39 followed on the heels of voters' passage of Measure 37 in 2004, which was designed to protect Oregonians from "regulatory takings," a far more pervasive threat to private property rights than eminent domain abuse.

Local governments routinely pass restrictions the owner's property—without compensating owners.

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. After several decades of enduring egregious regulatory abuse, Oregonians passed Measure 37 to require government to either pay landowners for these "regulatory takings," or waive the regulations.

Voters in Arizona followed Oregon's lead and passed Proposition 207—the Private Property Rights Protection Act—by a 65-35 margin, breaking new ground in the process. Proposition 207 was designed to address both eminent domain abuse and regulatory takings in one comprehensive set of property rights protections in what has come to be known as a "Kelo-Plus" initiative. Untested prior to this election, the passage of Proposition 207 establishes "Kelo-Plus" as a feasible strategy to target

the two biggest threats to property rights in one fell swoop.

However, two similar "Kelo-Plus" measures failed to pass. California's Proposition 90 was defeated by a 52 to 48 margin. Idaho's Proposition 2 also failed to pass. Opponents of these measures—including environmental groups, municipal associations, and urban planners—mounted a vigorous campaign to defeat them, outspending measure proponents by a wide margin. Voters in Washington State also defeated Initiative 933—a regulatory takings measure modeled after Oregon's Measure 37—by a 56-44 percent margin.

Despite the success in Arizona and Oregon, the defeat of the California, Idaho, and Washington measures indicates that regulatory takings reform faces higher hurdles to voter appeal than pure eminent domain measures. Not only do they generate more opposition from a variety of special interests that benefit from government's unfettered ability to regulate, but the issue is inherently complex and largely unfamiliar to voters.

And given that regulatory takings frequently occur in conjunction with zoning regulations preventing development on agricultural land or open space, the issue resonates more with rural voters than city dwellers, as the geographic breakdown of voting for California's Prop 90 suggests. Support for Prop 90 was strongest in the Central Valley, the Northeast, and Southern California, while opposition centered in the Bay Area and Los Angeles County. The key for future campaigns will be to craft a message that more effectively connects with urban voters.

However, viewed in total, the election results indicate that the property rights

Table 19: 2006 Election Summary: Property Rights Ballot Measures

State	Ballot Measure	Status	Scope	%For	%Against
Arizona	Proposition 207	Passed	Eminent Domain/ Regulatory Takings	65%	35%
Florida	Amendment 8	Passed	Eminent Domain	69%	31%
Georgia	Amendment 1	Passed	Eminent Domain	83%	17%
Louisiana	Ballot Measure 5	Passed	Eminent Domain	55%	45%
Michigan	Proposal 06-4	Passed	Eminent Domain	80%	20%
Nevada	Question 2	Passed	Eminent Domain	63%	37%
New Hampshire	Question 1	Passed	Eminent Domain	86%	14%
North Dakota	Initiated Constitutional Amendment 2	Passed	Eminent Domain	67%	33%
Oregon	Measure 39	Passed	Eminent Domain	67%	33%
South Carolina	Amendment 5	Passed	Eminent Domain	86%	14%
California	Proposition 90	Defeated	Eminent Domain/ Regulatory Takings	48%	52%
Idaho	Proposition 2	Defeated	Eminent Domain/ Regulatory Takings	24%	76%
Washington	Initiative 933	Defeated	Regulatory Takings	41%	59%

movement is alive and well. Millions of citizens nationwide sent a clear message to elected officials: they care very deeply about property ownership, and they understand that the government is there to protect their right to that property, not to take it away.

2. 2007 Eminent Domain Reform Legislation

Continuing the trend seen in 2005 and 2006, 11 state legislatures (as of press time) modified their eminent domain laws during the 2007 legislative session. These states include:

Connecticut: After two years at the center of the national eminent domain backlash in the wake of the U.S. Supreme Court’s *Kelo vs. New London*, eminent domain reform finally came to Connecticut in June 2007 when Gov. Jodi Rell signed Senate Bill 167 into law. The bill, passed overwhelmingly in both houses, prevents the use of eminent domain for the primary purpose of increasing local tax revenues. However, in contrast to reforms in other

states, the ban in S.B. 167 does not extend to cover the use of eminent domain for economic development purposes. S.B. 167 makes several other changes to state eminent domain law:

- Requiring a public hearing before a property may be taken and requiring local officials to approve proposed takings by a two-thirds vote;
- Imposing a ten-year deadline for completing a taking;
- Requiring that property owners are to be compensated at 125 percent of the average of two independent property appraisals;
- Giving the former owner of condemned property the right of first refusal to buy it back if it is not used for a public purpose; and
- Allowing homeowners to appeal a taking in state court.

Some lawmakers and property rights advocates complained that S.B. 167

represents weak reform that would not have prevented the taking of homes in the Fort Trumbull neighborhood of New London, the actions which gave rise to the *Kelo* case. According to Michael Cristofaro, whose home was among those condemned in New London, “[t]here’s nothing in [S.B. 167]. No one’s rights are saved yet.”

Maryland: After more than 40 eminent domain bills died in the 2006 legislative session, the 2007 session brought modest eminent domain reform to Maryland. Gov. Martin O’Malley signed Senate Bill 3 on May 8th, increasing the caps on the amount paid to homeowners, tenants, and small business and farm owners who are displaced as a result of a condemnation action. S.B. 3 also requires governments to file condemnation action within four years after the date of the administrative or legislative authorization to acquire the property; governments exceeding the four-year window period would need to obtain a new authorization to proceed with a condemnation action.

Montana: In May 2007 Governor Brian Schweitzer signed Senate Bill 363, sponsored by Sen. Christine Kaufmann (D-Helena), modifying state code to prevent private property condemned for urban renewal projects to be transferred to another private party for economic development and tax revenue generation purposes. According to one of the bill’s supporters, Sen. Dave Lewis (R-Helena), many legislators agreed that the Montana Constitution and state jurisprudence already prevented *Kelo*-style takings, but that S.B. 363 makes it “absolutely clear” that eminent domain should only be used for traditional public use projects. Some supporters felt the clarification was also necessary to prevent

future citizen initiatives like the invalidated Initiative 154 from 2006—a “Kelo-Plus” measure that would have addressed both eminent domain and regulatory takings reform—which some feared would negatively impact local land use planning and zoning.

Nevada: The Nevada Assembly passed two eminent domain bills in 2007 that could supersede a ballot measure—the People’s Initiative to Stop the Taking of Our Land (PISTOL)—passed by Nevada voters in November 2006.

Assembly Joint Resolution 3, a proposed constitutional amendment restricting the use of eminent domain, won final legislative approval in May. Under Nevada law, A.J.R. 3 must pass the legislature again in 2009 before facing voter approval in 2010. Assembly Bill 102, signed into law by Gov. Jim Gibbons, is a statutory companion measure to A.J.R. 3 that takes effect immediately. A.B. 102 was a compromise bill negotiated between PISTOL proponents and opponents concerned that PISTOL would negatively impact government’s ability to complete necessary public works projects.

PISTOL will remain on the 2008 ballot, and if passed by voters, it would supersede the provisions of A.B. 102. If A.J.R. 3 were to then pass in 2010, it would in turn supersede the provisions of PISTOL. PISTOL would require higher compensation payments than A.B. 102, and it would give government five years to complete projects on land taken through eminent domain, in contrast to the 15 years allowed under A.B. 102.

New Mexico: Having been the nation’s first governor to veto eminent domain reform legislation in 2006, New Mexico

Gov. Bill Richardson signed House Bill 393 and Senate Bill 401 in March 2007, repealing statutes allowing governmental entities to redevelop blighted areas and encourage economic development through the use of the power of eminent domain. These bills repeal the state's Community Development Law, most of the Urban Development Law, and provisions in the Metropolitan Redevelopment Code allowing to the use of eminent domain to acquire property for economic development purposes. This legislation was developed to address the key recommendations offered by the eminent domain task force Governor Richardson appointed after his veto of House Bill 746 in early 2006.

North Carolina: Building on statutory eminent domain reforms passed in 2006, the North Carolina House of Representatives overwhelmingly passed House Bill 878 in May 2007, which would place a constitutional amendment on the next statewide ballot to restrict government's ability to use its power of eminent domain.

If passed by the Senate, H.B. 878 would ask voters whether the following language should be inserted into Section 19 of Article I of the North Carolina Constitution: "Private property shall not be taken except for a public use, including preservation for that use. Public use does not include the taking of property for the purpose of thereafter conveying an interest in the property to a third party for economic development. This paragraph does not apply to the taking of blighted properties as defined by general law, nor to takings for access by the owner to property. As used in this paragraph, blight includes only the physical condition of the property taken. Just compensation shall be paid and, if

demanded by the owner, shall be determined by a jury."

Utah: In March 2007, Utah Gov. Jon Huntsman signed House Bill 365, making Utah the first state in the nation since the *Kelo* decision to roll back its eminent domain protections. The legislature approved Senate Bill 184 in the 2005 session, preventing local governments from using eminent domain to acquire property in blighted areas. By contrast, House Bill 365 expands eminent domain authority by allowing redevelopment authorities to condemn property if they receive approval (via petition) from 80 percent of residential property owners or 75 percent of commercial owners in a project area. Redevelopment condemnations could also proceed with approvals from the equivalent of 70 percent of residential property value or 60 percent of commercial value.

Virginia: In April 2007, the Virginia General Assembly approved Gov. Tim Kaine's amendments to House Bill 2954, which limits government's use of eminent domain to traditional public uses (such as roads, schools and public buildings), tightens the state's previously broad definition of "blight," and prevents the seizure of non-blighted properties in "blighted" areas. The bill also provides that a property owner may challenge that a taking is a pretext for an unauthorized use. H.B. 2954 passed overwhelmingly in both chambers, and Gov. Kaine offered mostly minor amendments. However, one amendment exempts the Norfolk Redevelopment and Housing Authority from the provisions of H.B. 2954 until July 2010 while that city builds a new recreational facility.

Washington: On April 17th, Washington Gov. Christine Gregoire signed Substitute

House Bill 1458 into law, requiring governments to provide better notification to citizens whose property is condemned through eminent domain. Condemning authorities will now be required to send notices to property owners by certified mail in advance of the public meeting in which they will issue a final decision on a condemnation action. The bill was a response to a Washington Supreme Court ruling that found that governments could satisfy the state's notice requirement by merely posting notices of condemnation hearings on government Web sites. In addition to certified mailings to property owners, SHB 1458 requires condemning authorities to publish advance notices of public meetings in major area newspapers. SHB 1458 was unanimously passed by both houses of the Washington legislature.

Further eminent domain reform may be on the legislature's 2008 agenda. In January 2007, Attorney General Rob McKenna announced the creation of a task force to review state eminent domain statutes and recommend changes to the 2008 legislature.

Wyoming: In March 2007, Gov. Dave Freudenthal signed House Bill 124, the legislature's response to complaints that Wyoming's current eminent domain law leaves landowners at a disadvantage in negotiations with industry and utilities seeking their land. H.B. 124 requires private companies to provide better notice to landowners, engage in good faith negotiations, and pay fair market value for private land taken by eminent domain for pipelines, utilities and other public use projects.

In other legislative news, eminent domain bills in four states—**Arkansas**, **Hawaii**, **Oklahoma**, and **Mississippi**—were

introduced in the 2007 legislative session but failed to pass. Another eminent domain reform bill passed overwhelmingly in the **Texas** legislature but was vetoed by Gov. Rick Perry after a late amendment raised objections from state and local transportation agencies; these agencies asserted that the amendment would expand landowners' ability to demand compensation for diminished access to private property during road projects, increasing the potential for litigation and bringing billions in new costs. Finally, eminent domain bills were still pending in **Massachusetts**, **New Jersey**, **New York**, **Ohio**, and **Rhode Island** as of press time.

3. California Likely to Face Competing Eminent Domain Measures

Despite the narrow defeat of Proposition 90—the property rights measure on the November 2006 ballot—the push for substantive eminent domain reform remains very much alive in California. In fact, California voters will likely decide the fate of at least two competing ballot measures on eminent domain in 2008.

Assemblyman Hector De La Torre introduced a package of eminent domain legislation in May 2007 entitled The Eminent Domain Reform Act (EDRA) of 2007/2008 that figures to be the main vehicle for eminent domain reform this legislative session. The package includes both statutory changes and a ballot initiative that, according to proponents, would amend the state constitution to prohibit state and local governments from taking homes or small businesses for private developers through eminent domain. Some of the most notable supporters of De La Torre's measure are groups that were strongly opposed to

Proposition 90 and who funded much of the \$14 million campaign against it, including the League of California Cities, California State Association of Counties, labor unions, homeowner, and environmental groups.

Among its provisions, EDRA would:

- Prohibit the use of eminent domain to acquire owner-occupied homes and transfer them to another private person.
- Prohibit the condemnation of small businesses of less than 25 employees and subsequent transfer to a private person, unless the taking is part of a “comprehensive program to eliminate blight.”
- Allow small business owners to avoid condemnation by agreeing to make physical improvements as part of an urban revitalization project.
- Give small businesses opting not to participate in the revitalization plan the choice of either relocating or selling their business. Businesses choosing to relocate would receive fair market value for their properties, moving expenses up to \$50,000, and up to three years of compensation to adjust for higher rents or mortgage payments. The owners of businesses choosing not to relocate would receive fair market value for the property, though they could be eligible to receive 125 percent of the value of their business if it could not be moved and still remain economically viable.
- Allow small businesses and homeowners the right to repurchase their properties if they were condemned for a public use that was ultimately never built.

Property rights advocates contend that the new measure would not go far

enough to protect private property rights. According to an analysis of EDRA prepared by the Institute for Justice, the Act “will do little to prevent the actual taking of property in California—and this flaw is fatal.” Assemblywoman and Proposition 90 proponent Mimi Walters agreed: “This is just an attempt to placate the voters who were outraged by the *Kelo* decision.” Walters introduced a separate eminent domain proposal—Assembly Constitutional Amendment 2—in late 2006, though as of press time the bill had still not been heard in committee.

An analysis prepared by Pacific Legal Foundation attorney Tim Sandefur found that De La Torre’s legislation would offer “virtually no protection for property owners.” According to Sandefur’s analysis, deficiencies in the proposal include:

- **Limited scope:** The Act protects only “owner occupied residences,” not apartment buildings, rental homes, churches, farms, or investment property. Further, the proposal prohibits the taking of property for the benefit of “private persons” but then fails to define “private person.”
- **Weak small business protections:** EDRA proponents claim that the Act protects small businesses, but its protections only extend to small businesses with less than 25 employees. Because California law defines a small business as having less than 100 employees, many small businesses in California would not be protected.
- **Loopholes and vague legal definitions:** The Act’s protections would be undermined by loopholes and weak legal definitions. For instance, California

law defines “blight” so vaguely that virtually any property can be declared blighted and taken through eminent domain proceedings. This is significant, as De La Torre’s proposal allows for small businesses to still be taken as part of a “comprehensive plan to eliminate blight.”

- **No attorney’s fees:** The proposal does not provide for attorney’s fees, so many property owners could find it prohibitively expensive to defend their property against eminent domain abuse.

If California lawmakers approve EDRA, the constitutional amendment would be placed on the ballot in 2008. If EDRA fails to pass, then the California League of Cities has already submitted language to the state Attorney General for a very similar ballot initiative containing many of the same provisions as EDRA. Supporters would need to gather nearly 700,000 signatures to qualify it to go to ballot in 2008.

Property rights advocates critical of the De La Torre and League of California Cities measures are also planning to qualify an eminent domain measure for the 2008 ballot.

The Howard Jarvis Taxpayers Association, California Farm Bureau Federation and the California Alliance to Protect Private Property Rights submitted language to the Attorney General’s Office in May 2007 for the California Property Owners and Farmland Protection Act (CPOFPA), a constitutional amendment ballot measure that could be slated for the June 2008 ballot.

Under CPOFPA, private property could not be seized for economic development purposes, transferred to another private

party, or transferred to a public agency for the same use as that of the private owner. Former owners of condemned property would be offered an option to repurchase their property at the price at which it was taken if the stated public use for the property fails to occur. Required property would be taxed at its pre-condemnation value.

Further, property owners would be entitled to compensation for temporary business losses, relocation expenses and reimbursement of reasonable attorney fees under CPOFPA. It would also entitle property owners to immediate possession of the compensation offered, while maintaining the right to challenge the fair market value determination.

CPOFPA would also phase out existing rent control restrictions on property owners once current tenants vacate the property. Finally, unlike Proposition 90, CPOFPA does not include any regulatory taking provisions to compensate landowners for the impacts of land use regulations that act to reduce the value of private property. Hence, CPOFPA would not affect communities’ ability to enact land-use restrictions and enforce zoning ordinances.

B. Measure 37 Rewrite Sent to Oregon Voters

Since it was passed by 61 percent of state voters in 2004, Oregon’s Measure 37—the landmark regulatory takings measure granting landowners the right to seek compensation for (or exemptions from) land use regulations that restrict the uses of their property—has survived numerous legal challenges (including a

2006 Oregon Supreme Court decision upholding its constitutionality), as well as a sustained media attack from a variety of interest groups interested in thwarting its implementation and dissuading other states from adopting similar measures. However, bills passed during the 2007 legislative session make significant changes to Measure 37 and would send a series of additional changes to voters via ballot measure.

After several failed attempts early in the 2007 session to craft statutory changes to Measure 37, the Oregon legislature passed House Bill 3546B-Engrossed on a party line vote in both houses, with Gov. Ted Kulongoski signing the bill in May 2007. HB 3546B extends the period for governments to process Measure 37 claims submitted after November 1, 2006 from 180 days to 540 days, after which claimants would be entitled to file civil lawsuits for just compensation. Bill proponents argued that the extension was necessary to give governments enough time to process the large number of claims (accounting for half of the nearly 7,000 claims to date) filed immediately before the December 2006 deadline for retroactive Measure 37 claims. Measure 37 proponents counter that the extension represents a de facto moratorium on processing Measure 37 claims. HB 3546B also appropriated \$100,000 from the general fund to the state's Department of Land Conservation and Development to defray Measure 37 claim processing costs.

Next, in June 2007 the legislature passed House Bill 3540C, referring a package of substantial amendments to Measure 37 to voters in a special election to be held in November 2007. Among its changes to Measure 37, HB 3540C would:

- Invalidate all Measure 37 claims

received to date, unless landowners with already-approved claims have vested their development rights (through, for example, substantial financial investments in improvements) before December 2007.

- Establish maximum caps on Measure 37 claims of between 3 and 20 homes (depending on the property location and other factors), with a limit of 10 houses in any contiguous block.
- Place a maximum cap of 20 homes on successful Measure 37 claimants, regardless of how many properties a landowner owns or how many claims they have filed.
- Expedite claims processing for Measure 37 claimants who want to build three or fewer houses, without requiring them to prove losses in property values resulting from land-use regulations.
- Require existing claimants seeking to build between four and 10 houses to demonstrate that the loss of property value due to land use regulations equals or exceeds the value of the homes that would be built.
- Prohibit home sites larger than two acres on high-value farm and forest land and areas with water shortages.
- Allows outside parties to obtain a judicial review of Measure 37 claims, opening the door for lawsuits and lengthy delays in claim resolution.
- Prohibit any Measure 37 claims made on property whose highest and best use was non-residential (e.g., industrial or commercial) at the time the challenged land use regulation was passed.
- Establish that Measure 37 waivers

are transferable to future property owners; however, subsequent property owners are required to build the homes authorized by a waiver within 10 years of the conveyance.

The changes proposed in HB 3540C, if passed by voters, would effectively invalidate the roughly 3,600 existing Measure 37 claims currently being processed and would radically alter Measure 37's provisions. According to State Senator Roger Beyer, "[o]f the over 1,000 words in Measure 37, almost 900 are gone...[y]ou can change terms, deadlines and groups affected, but at the end of the day this is still a repeal of Measure 37." Oregonians in Action (OIA) president and Measure 37 author David Hunnicutt vows to mount a campaign to defeat the legislative ballot measure: "We are going to go forward, tell the public what it does and doesn't do and we are pretty sure the public will reject it—again."

The legislature also passed HB 2640 in the closing days of the session approving a ballot title, vote explanation, and summary for the HB 3540C measure, portraying it as a way to protect private property rights while limiting large developments and protecting farmland, forests, and water resources. This responsibility typically falls to the state Attorney General, but legislators opted to deviate from that process. State Republicans, who unanimously opposed HB 2640, complained that the wording was crafted to deceive voters into approving the measure. According to Hunnicutt, measure proponents have taken a page from OIA's playbook: "What they've realized is, voters in this state care very strongly about their right to own and use their property."

C. Arizona's Proposition 207: the New Standard for Regulatory Takings Reform

On November 7th, over 950,000 Arizonans voted to adopt Proposition 207, one of the strongest sets of property rights protections in the nation. Dubbed the "Private Property Rights Protection Act," Proposition 207 was designed to counter the two biggest threats to private property rights—eminent domain abuse and regulatory takings—in one comprehensive package. In total, 65 percent of Arizona voters, and a majority in all 15 counties, supported Proposition 207.

1. Provisions of Proposition 207

The eminent domain reform component of Proposition 207 is a direct response to the U.S. Supreme Court's 2005 *Kelo vs. New London* decision and was drafted with input from the Institute for Justice, the public interest law firm that defended Suzette Kelo in that case. Changes to Arizona eminent domain law include:

- Prohibiting the use of eminent domain for economic development purposes;
- Narrowly defining the term "public use" to include only (1) use by the general public or by public agencies; (2) uses involving the creation or functioning of utilities; (3) acquisition to eliminate direct threats to public health or safety; and (4) acquisition of abandoned property.
- Requiring determinations of "blight" to occur on a parcel-specific (i.e., property-by-property) basis;
- Requiring that local governments must offer to locate and purchase a

comparable home for landowners whose primary residences are taken through eminent domain, though landowners may instead choose to receive monetary compensation.

The regulatory takings component requires government to compensate landowners when new land use regulations reduce the fair market value of their properties. Similar to Oregon's landmark Measure 37, Proposition 207 gives governments an alternative to compensation—a waiver that exempts the landowner from the provisions of the regulation(s) in question. Proposition 207 exempts several categories of regulations from its provisions: (1) public health and safety regulations; (2) regulations that address historically recognized public nuisances; (3) regulations to limit pornography, liquor sales, and other adult-oriented businesses; (4) laws that establish locations for utility facilities; (5) regulations adopted to fulfill a federal requirement; and (6) all pre-Proposition 207 land use laws.

2. Contrasting Proposition 207 with Oregon's Measure 37

While the regulatory takings provisions in Proposition 207 were modeled after Oregon's Measure 37, it differed in two key ways. First, Measure 37 was designed to be retroactive to the point at which an owner (or his family, if heirs) purchased his property, while Proposition 207 was designed as a prospective-only measure. While retroactivity has a built-in appeal to property rights advocates interested in offering relief to property owners already impacted by regulation, a prospective-only measure may be a more politically pragmatic approach in most contexts.

The November 2006 election demonstrated that a retroactive measure can be a tough political sell. Washington State's Initiative 933 was designed to be retroactive 10 years, opening the door to opponents' claims that such a measure would undo 10 years of planning mandated under that state's Growth Management Act.

By contrast, a prospective-only measure has two key advantages:

- It would undermine opponents' claims that the measure would generate a fiscal impact—if governments do not impose any new regulations that infringe on property owners' rights, then the measure will not impose direct costs to government.
- The merits of a prospective-only measure are easier to convey to citizens; they can be assured that all of the laws currently on the books will stay on the books and that the regulatory takings provisions would only apply to future regulations.

The other key difference between Proposition 207 and Measure 37 is that Proposition 207 has an explicit provision that any waiver issued in lieu of compensation is transferable to future property owners, as opposed to only applying to the current landowner. Measure 37 did not include such a provision, and the issue is still under litigation in Oregon. Put simply, non-transferable waivers would essentially be worthless, as very few property owners would be in a position to finance development projects themselves, and lending institutions used to working with established developers would find such independent ventures extremely risky. Waivers that run with the land provide the mechanism by which landowners can ensure that the resale value of their properties

captures the full range of development rights, including those previously “lost” to regulation.

Proposition 207 is now best regarded as the state-of-the-art model for regulatory takings reform, superseding Measure 37. While the passage of Measure 37 stands alongside the U.S. Supreme Court’s 2005 *Kelo* decision as the two most pivotal and galvanizing forces in the property rights movement in decades, Measure 37 was designed to address a very specific context. It represented the culmination of public discontent with three decades of the most aggressive form of land use regulation in the country—Oregon’s centralized, statewide land use planning system. By contrast, Proposition 207 offers a reform model that may be more appropriate and viable in states that have yet to experience the same degree of regulatory excess as Oregon.

3. Changing the Way Communities Approach Land Use Regulation

In just the first seven months of implementation, there have already been several indications that Proposition 207 is changing the way Arizona communities approach regulation and growth management issues.

For example, in April 2007 the Phoenix City Council voted to repeal a historic designation it had placed on an area in central Phoenix after being threatened with a Proposition 207 challenge from an aggrieved landowner. Scott Haskins bought two blocks of World War II-era, run-down apartments along the north side of McDowell Road in central Phoenix in 2006. Before paying \$5.4 million for the land, Haskins verified that the city’s rules would allow him to raze the apartment

buildings and replace them with luxury condos. In response to complaints from some local NIMBY activists, the city bypassed its normal procedures for historic district designation (which would require approval from two-thirds of affected property owners) and instead declared the area historic in November 2006—over the objections of most affected landowners—to prevent Haskins from demolishing the apartments for a year. After that, he would have been subjected to a far more onerous plan review and design approval process.

Haskins responded by filing a \$40 million lawsuit, claiming that under Proposition 207, the city was lowering the value of his land. City officials were quick to repeal the historic district designation to defuse the issue. According to Phoenix Mayor Phil Gordon, “[the repeal of the historic district] was on the advice of attorneys. I’ve got a fiduciary duty to the citizens not to risk \$40 million.” Haskins’s response to the repeal was especially blunt: “[the City] wanted to play Socialist Republic of Phoenix and got their hands slapped, hard.”

Even the Arizona State Senate has had to factor Proposition 207 into its decision-making. In the 2007 legislative session, Sen. Robert Blendu proposed an amendment to House Bill 2102 which would forbid counties from issuing building permits for houses, churches and schools near two auxiliary airfields of Luke Air Force Base for safety reasons. Other lawmakers countered that the denial of such building permits could run afoul of Proposition 207 by potentially diminishing property values (even though Proposition 207 contains an exemption for public health and safety regulations), and the amendment

subsequently failed.

Some observers predict that the first Proposition 207 lawsuit could arise from a current land use controversy in Tucson. The Tucson City Council is considering the adoption of a neighborhood preservation overlay district designed to change the zoning in a ring surrounding the University of Arizona to protect these areas from the construction of new mini-dorms. The proposed overlay zone would place more stringent restrictions on building heights, setbacks and lot sizes than those contained in current zoning. A group of property owners is opposing the creation of the district on Proposition 207 grounds, arguing that it would restrict the use of their property and decreased its potential value.

In response to these potential legal ramifications, the City Council voted in April to delay its decision on the overlay district until August 2007.

4. Cities Requesting Proposition 207 Waivers

In early 2007, the League of Arizona Cities and Towns began encouraging its member governments to require property owners seeking a rezoning or conditional use permit to sign waivers agreeing not to seek future Proposition 207 claims for the action requested. This came in response to complaints from local government representatives that Proposition 207 contained a loophole that would allow a property owner to request a rezoning and then subsequently file a Proposition 207 claim if the rezoning lowered his property value. Proposition 207 contains a provision allowing agreements between cities and property owners to waive diminution claims, forming the basis of the League's recommendation for a waiver requirement.

Many cities and counties have begun to adopt waiver requirements as a precondition to rezoning and permit approval; however, there is a significant degree of variation in both policy strategies and implementation among local governments.

Some cities and counties, such as Tucson, Marana and Pima County, have confined their approach to asking the property owner to sign waivers stating they will not to sue the city for taking the specific action requested. Other cities are requiring landowners to sign waivers before they will grant routine approvals for activities that have little chance of reducing property values.

Other cities, such as Apache Junction, are going much further by asking for property owners to indemnify the city against future Proposition 207 claims brought by others. In Scottsdale, one developer attempting to gain approval for a new housing development complained that the city asked him to sign a waiver that would have required him to assume legal responsibility for defending the city against Proposition 207 claims from future owners. When the developer balked, the city agreed to change the language in the waiver. The city of Scottsdale has not yet decided on a formal policy of whether it will mandate that applicants sign its waiver before projects can be approved.

In April 2007, Peoria became the first city in Arizona to mandate waivers as a precondition for project approval when it adopted an ordinance clarifying Proposition 207. The ordinance outlines the conditions that constitute a legitimate claim, specifies who is eligible to make them, and prohibits the approval of projects in which applicants refuse to sign a Proposition 207 waiver.

D. Sustainable Development in Urban Planning: The Case for a Market-Based Approach

Sustainability has become part of the orthodoxy of contemporary professional planning. Unfortunately, the concept itself lacks a clear definition or focus, creating opportunities for special interest groups to carry out their own goals. In many U.S. cities, “sustainable” development programs have become little more than thinly veiled attempts to impose a radical environmental agenda that limits consumer choice and market-based innovation. This doesn’t have to be the case.

On the surface, sustainable development seems to be a noble goal—ensure current resource use does not limit the ability of future generations to meet their needs. But what does this mean in practice? Unfortunately, policymakers have little concrete guidance for developing workable sustainable development policies, particularly if they recognize the value markets, entrepreneurship, and private initiative play in creating sustainable economies and communities.

In principle, sustainable development can be achieved through any number of means; in practice, sustainable development has substituted highly centralized and prescriptive planning for decentralized, market decisionmaking. Urban planning shifts decision-making about land use, urban form, energy use, resource conservation and environmental protection away from market-based institutions toward political ones.

The market has advantages over conventional urban planning as an institutional basis for making decisions

about urban development. Unfortunately, these benefits are rarely recognized in urban planning or understood by professional planners. Markets efficiently aggregate and disperse information about resource scarcity across national and global economies through trade, often at lightning speeds. Nowhere is this more evident than in the technology sector of the economy. The rise and fall of global giants such as Motorola, Microsoft and Apple Computer depend on their ability to remain nimble and on the cutting edge of technological innovation since product lifecycles may last less than a year.

This contrasts with the slow, deliberative procedures that bog down public decision making where bureaucracy reigns (by design, as a way to establish public accountability) and petty local politics can stop an innovative idea dead in its tracks for months and years.

Indeed, the Achilles’ heel of sustainable development planning may be its failure to recognize the role markets and private initiative play in fostering innovation and ensuring new technologies spread to the broadest population base possible. Innovation increases a society’s resiliency, flexibility and capacity for self-correction. Markets, not governments, were responsible for economic shifts brought about by new technologies in the face of the rising scarcity of “critical” resources such as wood and whale oil, and virtually eliminated the environmental impact of horse-drawn transportation in urban areas.

In the United States, sustainable development planning is hampered further by a strong cultural emphasis favoring free markets and democratic rule, directly challenging the more top-down,

centrally directed planning implicit in most sustainable development programs. Market-based sustainable development does not require either consensus or majority rule in order to progress.

Local community leaders, policymakers and professional planners who want to encourage sustainable development policies consistent with property rights and markets should consider the following approaches and strategies.

1. Develop strong performance criteria for sustainable development. As in previous planning periods, planning activity, regardless of outcomes, has often been considered evidence of its success. Cities experimenting with sustainable development programs, however, find achieving their goals difficult. The city of Santa Monica—arguably the most aggressive U.S. city adopting a sustainability agenda—has failed to significantly reduce per capita water use, energy use, solid waste and wastewater flows despite increases in recycling and transit use. By making performance criteria explicit, errors and problems with the framework will be more transparent and avenues for reform more evident.

2. Adopt a realistic understanding of the way economic markets work. Prices convey important information about risk and scarcity and are much more dynamic than conventional planning recognizes. Planners cannot possibly assimilate the amount of information markets do on a consistent basis. The key is for planners to recognize and harness that information in order to ensure the effectiveness of public sector planning by complementing market shifts based on changing prices and industrial profitability. Planning has a poor record of overcoming market trends.

3. Recognize the institutional limits of implementing sustainable development programs within a legislative decision-making framework. Sustainable development programs often attempt to take a comprehensive approach to managing land development when in fact they have little control over many factors that influence urban development and growth. Professional planners and local policymakers should adopt a more realistic and open-ended approach to implementing sustainable development principles by resisting the temptation to adopt specific technologies, strategies or approaches to meeting goals, such as mandating specific construction techniques or land uses. Moreover, planners and local public officials should be aware of the trade-offs implicit in their policy making. For example, encouraging public transit use will likely increase commute times and urban congestion, reducing the overall quality of life for many people within the community.

4. Embrace technological innovation as a key component for achieving sustainable development, recognizing that current technologies are likely to evolve or become obsolete as resources become more or less scarce. Planners should avoid relying on straight-line trends to justify changes in public policy, particularly those changes such as sustainable development that attempt to fundamentally alter lifestyles and habits. Technology fundamentally changes the choice set faced by different generations. Planners are limited, as are economists, in predicting the future and anticipating the needs of future generations.

The above article is a summary of a forthcoming Reason Foundation study, *Sustainable Development in Urban Planning: The Case for a Market-Based Approach*.

Public Health and Safety

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A. Corrections Update

1. Private Prison Population Nears 100,000

There are currently 264 private correctional facilities in 34 states housing more than 97,000 inmates. While the bulk of inmates in private facilities are considered medium security, private prisons operate facilities at every security level.

Various federal agencies contract for more than 30,000 private prison beds. Immigration detention centers are considered a strong growth opportunity for private facilities. More than 58,000 beds are contracted at the state level. The remaining private beds are under county or municipal contract.

2. Prison Population to Continue to Grow

A new report by the Pew Charitable Trusts suggests that U.S. prison population will continue to grow. According to *Public Safety, Public Spending: Forecasting America's Prison Population 2007-2011*, state and federal prisons will swell by more than 192,000 inmates over the next five years.

Representing a 13-percent jump would raise the prison population to a total of more than 1.7 million people. The cost to build and operate the needed capacity is significant and leaves a clear role for the private prison industry to play.

3. Israel's First Private Prison to Open in 2009

The Israeli Prison Service has announced that it expects the 800-bed public-private correctional partnership to be ready to receive its first inmates in 2009. The facility is being built by Emerald Correctional Management. According to the IPS, this privatization project will save Israel \$83 million per year for the 25-year period of the agreement. That amount is almost a quarter of the cost of operating an identical facility by the state.

Israel will join the United Kingdom, Australia, Canada (Province of Ontario), New Zealand, South Africa, Germany, France, Japan, Brazil, and the Netherlands in having at least one private prison.

Table 20: Private Prison Capacity by Facility Type

Facility Type	Male	Female	Either	Total
Prison	69544	2762	1289	73595
Detention Center	4356	300	5126	9782
Com./Rel.Center	497	0	1671	2168
Jail	0	0	5765	5765
Treatment/Educ.	1434	521	1950	3905
Mental Health	157	17	652	826
Non-Residential	0	0	1825	1825
Total - All Types	75988	3600	18278	97866

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

Table 21: Private Prison Capacity by Security Type

Security Type	Male	Female	Either	Total
Maximum	7782	1298	7994	17074
Medium	56973	1749	2877	61599
Minimum	9795	388	857	11040
Residential - Secure	1263	260	888	2411
Residential - Open	599	172	1454	2225
Non-Residential	50	39	3428	3517
Total - All Types	76462	3906	17498	97866

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

4. Texas Public and Private Comparison Continues

The Texas Legislative Budget Board (LBB) issued another two-year set of data comparing public and private prisons in Texas. This extends the best historical and trend data of the costs between public and private facilities as well as the impact private facilities and competition can have on a prison system. The average daily cost of operation in a government-run facility was \$40.05 and \$42.54 in 2005 and 2006 respectively. Costs in private facilities under contract in Texas were only \$34.61 and \$35.23, representing savings of 13.5 and 17.2 percent. Savings are even more dramatic when the operational costs of jails are compared.

The LBB completed a second set of

comparisons using a new methodology of comparing prototype facilities. While the savings were not as dramatic, they were still significant at \$2.67 per inmate, per day.

5. Two New Studies on Contracting for Performance

A January 2007 MTC Institute study, *Contracting for Success: Improving Performance in Corrections*, suggests that the debate surrounding prison privatization should not be about who is providing correctional services, but how well the provider is performing. Noting a general public frustration with growing correctional costs, the paper argues that correctional performance needs to be front and center. That correctional performance needs to be measured by established standards to produce desired outcomes; perhaps the most

critical outcome is preparing inmates to rejoin society.

Naturally the paper notes the value of competition but focuses on how accountability can be built into operations. For starters, the report argues that both public and private facilities should be bound by similar contracts or agreements. It outlines the following tools to improve performance:

- #1 Tool – The Contract or Agreement Directs Performance
- #2 Tool – Monitoring Provides Essential Oversight
- #3 Tool – Data Is Collected and Publicly Available
- #4 Tool – Performance-based Budgeting and Contracting
- #5 Tool – Staff Performance Evaluation Systems Create an Important Linkage

The bottom line, according to the report, is that it is essential that programs and facilities be held accountable for the results they produce. Further, it argues that simply spending money on education or career and technical training does not guarantee success—corrections departments need to focus on programs that work. The use of performance contracting elevates and focuses the discussion on who can perform, meet qualitative standards and outcomes, be accountable, and limit costs to the taxpayer.

The study is available at: www.mtctrains.com/institute/publications/ContractingForSuccessReport.pdf

A second MTC Institute study released at the same time, *Contracting Prison Operations: A Plan to Improve Performance*, serves as more of a “how-to guide” for elected officials considering prison privatization. It provides an

overview of the factors that should be weighed when a government is considering privatizing a prison. The study provides elected officials and public policy makers with a planning document containing detailed information about public policy issues (e.g., constitutional, legal and financial), roadblocks, practitioner considerations, and operational information for entities considering contracted correctional services.

The study is available at: www.mtctrains.com/institute/publications/Contracting_Prison_Operations.pdf

B. Journal Releases 200-City EMS Survey

The Journal of Emergency Medical Services released its 2006 Survey of the 200 largest cities in the United States for emergency medical services (EMS) operations. It’s no surprise that there are three dominant forms of EMS service delivery: public fire-based, private, and hospital-based service. Indeed, the public versus private operational model is a relative 50/50 split and has become common for years. Because of this, JEMS suggests this presents an opportunity to stop arguing over which operational model is best, and rather focus on how to establish the best EMS delivery system. However, in making this pronouncement JEMS ignores some key data points in its own report.

First, JEMS examines the relative response time of different models. The survey found that cities with public/private partnerships used patient-centered models, i.e., response time was measured from the instant the patient called for help. About half of the pure private providers also used

this methodology, whereas the other half used another methodology that begins once the EMS unit has been dispatched. Hospital systems were more likely to include call processing in their measurement. Fire-based systems, by a margin of 2-to-1, ignored dispatch time and only counted travel time in their calculation.

Why does this matter? Call processing and dispatch can take upwards of two additional minutes. Therefore response times may seem comparable, even though they truly aren't—or certainly are less accurate than the patient-centered model. Given that more private and public-private partnership operators use this method suggests a higher level of accountability, transparency and performance in their operations. Furthermore, under a contractual arrangement governments set performance standards—this could include patient-centered measurement.

Second, the annual operating budgets between the models point to another major difference. According to the JEMS survey, governmental EMS services average almost

a third higher operating budget than private EMS services. Given that private EMS services are able to operate at acceptable performance levels on a third less budget is significant. This suggests that the debate between which operational model is superior is far from over.

Of the 100 largest U.S. cities only 33 cities used private sector EMS, whereas 58 of the next 100 largest cities do. Large cities generally have more powerful public employee unions, thus preventing contracting out from occurring.

Table 22: Ten Largest U.S. Cities with Private EMS

Houston (partial)
San Diego
San Jose
Indianapolis (partial)
Milwaukee (multiple operators)
Las Vegas
Portland
Tucson (partial)
Albuquerque
Sacramento





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Reason Foundation
3415 S. Sepulveda Blvd., Suite 400
Los Angeles, CA 90034
310/391-2245
310/391-4395 (fax)
www.reason.org