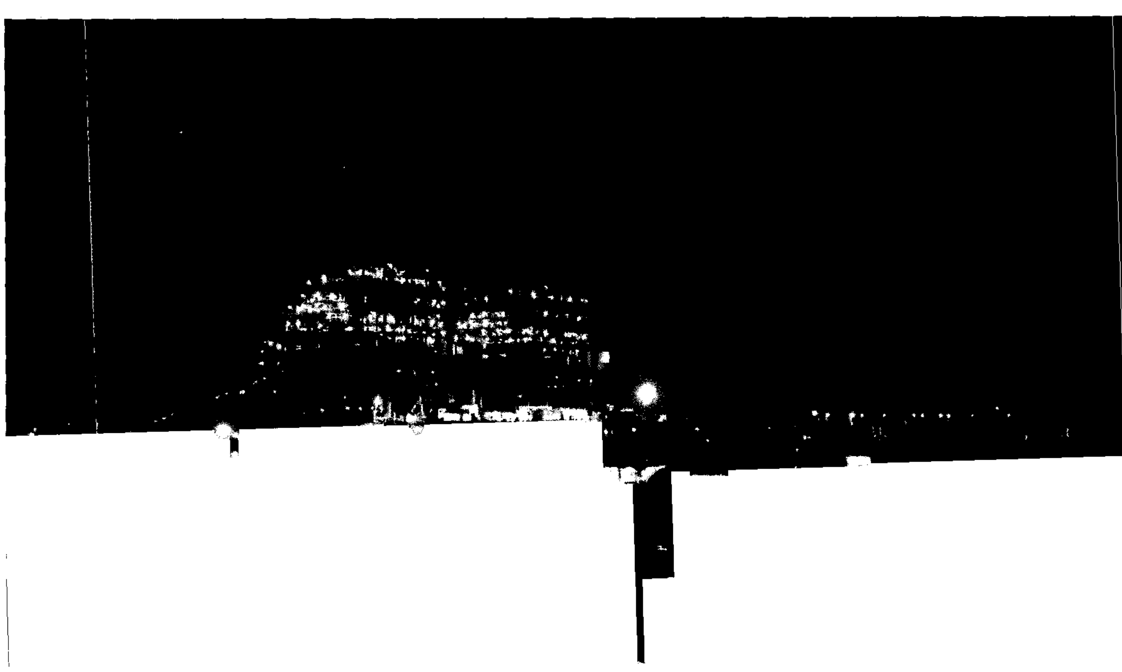
Privatization on a Roll

Governments find they can deliver services better and more cheaply by contracting the work out to private companies and non-profits

The most immediate and lasting way to reduce the size of government and improve the efficiency of public services is to shift the responsibility for producing them from government bureaucrats to private managers. After beginning with a trickle of experiments in the 1980s, privatization has grown into a major global movement. ◉ *Privatizations of former government operations around the globe totaled $86 billion in 1996—an all-time record high. And when World Bank researchers examined the performance of 61 privatized operations in 18 different countries last year, they found that the privatized companies increased their output by 27 percent, on average, and their profitability by 45 percent. Two-thirds of the privatized firms also hired more workers after they were spun off from the government; overall employment rose 6 percent.* ◉ *There is rising awareness in the U.S.—even among politicians—that competition and privatization produce better results than government monopolies. The National League of Cities recently surveyed 500 local elected officials and found that of the 70 percent who had had experience with privatization, 74 percent said it was a success.* ◉ *The Los Angeles-based Reason Foundation, the country's leading research institute on this subject, has issued an annual report on privatization since the mid-1980s. Following are excerpts from their just-released 1997 installment, which was edited by Adrian T. Moore.*



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The 104th Congress was the most pro-privatization Congress in U.S. history. Privatization caucuses were created in both the House and Senate, serious bills to sell off federal assets and enterprises were debated (and a few passed), and more federal functions were outsourced. Still, compared to most other countries, our federal privatization effort remains very small.

Congress enacted legislation to sell off two federal assets and two federal enterprises. The assets are the $1.5 billion Naval Petroleum Reserve in Elk Hills, California, and the tiny Helium Reserve in Texas. The enterprises are the $1.5 billion U.S. Enrichment Corporation and the tiny Alaska Power Marketing Administration, whose assets are being purchased by local electricity co-ops. A bill to sell three of the other four federally owned power authorities fell victim to heavy lobbying by special interests.

Congress also authorized the sale of 14 percent of Connie Lee (which guarantees loans to colleges and hospitals) and the privatization of Sallie Mae (the college student-loan marketing agency). Efforts to privatize the U.S. Postal Service, however, went nowhere.

Federal auctions of radio spectrum amounted to $11 billion in 1996. What has been auctioned, however, is not the actual spectrum, but merely the renewable right to use a particular bandwidth for a certain number of years. Full ownership would be worth considerably more.

A final 1996 divestiture was the background-investigation unit of the Office of Personnel Management. With financing from Marine Midland Bank, the unit became an employee-owned company, U.S. Investigations Service, and was given a three-year contract to continue doing background checks on potential federal hires. This was the first federal privatization to make use of an employee stock-ownership plan.

Several highly visible federal operations were also contracted out during 1996. The private United Space Alliance was awarded a six-year, $7 billion contract to operate NASA's space shuttle. The contract includes preparing shuttles for flight, astronaut training, and Mission Control operations. NASA will continue to direct the missions and make major launch and in-flight decisions.

The U.S. Postal Service signed the first of six planned contracts to outsource its regional information centers. Teletech Facilities Management won a $67 million agreement to operate the center in Denver—despite strong protests by postal-worker unions. The Postal Service plans to contract out the remaining five centers soon.

The Department of Defense has privatized some bases that are in the process of being closed. In 1996, the Naval Air Warfare Center was given to the city of Indianapolis, which held a competition for a 10-year lease on the facility. The winner was Hughes Technical Services, which will hire virtually all 2,500 base employees but save the Pentagon an estimated $1 billion over a decade. A similar privatization was arranged for the Naval Ordnance Station in Louisville, Kentucky, where United Defense and Hughes Missile Systems took over the station's work.

Welfare

State governments now spend nearly $30 billion a year just to *administer* welfare programs. Federal legislation passed in August 1996 now allows states considerable flexibility in using private contractors to deliver welfare services, and many are hoping that private companies will help them cut costs. The American Public Welfare Association reports that over 30 states are considering or have already contracted with private companies for tasks ranging from screening welfare applicants to running work programs.

In California, Governor Pete Wilson included a section in his welfare-reform plan that would allow counties to "enter into performance-based contracts with nonprofit or for-profit companies to operate all or parts of their welfare programs." Private contractors have already been used in California's welfare system to handle bookkeeping, collect delinquent child support, and computerize record management.

Wisconsin is privatizing welfare using methods similar to California's. Milwaukee was carved into six regions and contractors were invited to submit bids to administer aid, with each contractor paid a flat amount to screen, train, and place clients in jobs. This provides a strong incentive to find work for the clients, because otherwise the contractor could lose money.

Since July 1996, Fairfax County, Wisconsin, has been contracting with a for-profit firm called Maximus for case management and work services. The company has placed 600 out of 630 recipients of Aid to Families with Dependent Children in jobs, with 570 of them still holding their jobs by year's end. Maximus was able to begin its program less than two months after winning the contract, as it didn't have to follow onerous civil service or procurement rules.

Texas has put out to bid a five-year contract to run its $550 million per-year state welfare system. The state hopes to cut the costs of managing 30 social programs and 690,000 recipients through competition. Service quality is also expected to improve because the winning bidder will be required to offer "one-stop shopping" for services like food stamps, welfare payments, and health care. "If you've got 20 different programs that are income-based, you've got to know the person's name and Social Security number, and it makes perfectly good sense to ask these questions once instead of 20 times," Human Services Commissioner Michael McKinney told the *Washington Post*.

Some cities are also privatizing management of their programs. In June 1996, Newport, New Hampshire (population 6,100), contracted with Community Alliance of Human Services, a local nonprofit, to run its welfare department. The contract has reduced the city's welfare costs by 50 percent.

Welfare-to-work programs provide another promising area for privatization. Typically, these contracts are performance-based, meaning the state pays the firm only for clients actually placed in jobs. For example, America Works receives about $1,000 when a welfare recipient is placed in a job, and $4,500 if the recipient stays on a full-time job for at least six months.

Since 1990, Kenosha County, Wisconsin, has funded a multi-provider job center for welfare recipients that offers job training, placement, and retention programs. The 18 providers at the center compete against each other for contracts.

In San Francisco, welfare recipients without small children are now required to attend an employment training program administered by the private firm Curtis and Associates. Each month, from 40 to 60 percent of the people in the program are placed in jobs, and the program has a dropout rate less than half what it was when the city ran the program.

Child Welfare Services

It's clear that many state-run foster care systems are badly run. Three locales now offer promising models for states and counties interested in making improvements.

Michigan's Department of Social Services is required to place foster children with a private agency unless there is a religious conflict or no qualified private agency is available. As a result, about two-thirds of foster care and adoption placements in Michigan are now made by private agencies. Michigan uses financial incentives to reward and penalize these groups. If an agency fails to place a child in a qualified home within eight months after the child has been freed for adoption, it loses over $2,000 in payments from the state. If an agency finds a home for a difficult-to-place special-needs child, it receives a bonus of $3,000.

In 1996, Kansas became the first state to privatize all of its adoption, foster care, and family preservation sector—by contracting them out to a 13-agency consortium led by Lutheran Social Services. The nonprofits in the consortium are confident that over time they will vastly improve on the state's performance.

Sarasota County, Florida, has also turned over its foster care and adoption programs to a group of nonprofits led by the Sarasota YMCA. The coalition also provides services for abused, troubled, and drug- and alcohol-addicted children. The Sarasota County Human Services Department will buy and monitor child welfare services, but will not administer them. Separating the purchasing and providing of these services is expected to increase accountability. This privatization came partly in response to a 1996 state law that encourages the contracting-out of human services to community agencies.

Education

According to John McLaughlin, editor of the *Education Industry Report*, the private education industry grew by 20 percent in 1996. The stock price of 30 publicly traded education companies rose by 60 percent last year, according to EduVentures, compared with a 26 percent rise in the Dow Jones Industrial Average.

In some cities, children are being steered to private schools to reduce demand for construction of new public schools. Homebuyers in the Patterson Park section of Baltimore, for example, are provided with up to nine years of free education at St. Elizabeth School, thanks to the East Fayette Street Community Development Corporation and the Abell Foundation.

There continues to be a trend toward sending difficult-to-educate students to private schools. Reason Public Policy Institute analyst Janet Beales reports that more than 10,000 difficult-to-educate students now obtain public money to attend private schools. For example, four Massachusetts public school systems contract with a single private high school to handle the lowest-performing 10 percent of their students.

Meanwhile, school choice programs continue to expand. In fall 1996, 2,000 students participating in the Cleveland scholarship and tutorial program enrolled in private schools. Low-income students in kindergarten through third grade are eligible for scholarships worth 90 percent of tuition costs, up to $2,250. (Parents must pay the remaining 10 percent.) Over 6,000 students applied for the 2,000 scholarships, which were awarded by lottery. The Cleveland program allows students to redeem their vouchers at religious schools, and 31 of the 51 private schools participating in the program last year were Catholic parochial schools. Meanwhile, Milwaukee's school choice program, now in its eighth year, annually funds 1,500 low-income students in private school slots. (Both the Cleveland and Milwaukee programs are being attacked in the courts by opponents.)

The Edison Project continues its effort to be a contractor for public schools. The project now runs 12 schools nationwide and has spent more than $45 million for curriculum development and school management. The schools are in Boston, Kansas, Colorado, Florida, Michigan, and Texas. The project hires its own teachers and administrators, most of whom are not members of any union. Enrollment at Edison Project schools is dominated by minorities and children from disadvantaged and middle-class families, often with mediocre academic records or chronic learning problems.

Charter schools, where teachers, nonprofits, and for-profit organizations manage public schools, continued to expand in 1996. The Center for Education Reform reports there were 480 charter schools in operation as of November 1996. There were 214 new charter schools in nine states opened that year, and fresh charter-school laws were adopted in Connecticut, Illinois, New Jersey, North Carolina, South Carolina, and the District of Columbia. Arizona led the nation with 164 charter schools, followed by California (109) and Michigan (76).

Many of the new charter schools are operated by private companies. Education Alternatives, while losing contracts to manage the Hartford and Baltimore schools, has contracted with home developers to build 12 schools in Phoenix over the next three years. In addition, some of the Edison Project schools are operated as charter schools.

Prisons

The number of private prisons in the U.S. rose from 104 in 1995 to 132 in 1996. The number of inmates in these facilities rose from 63,595 to 85,201.

One of the most talked-about prison privatizations was in the District of Columbia. The District agreed to sell one of its penitentiaries to Corrections Corporation of America (CCA) for $52 million. The contract requires CCA to achieve American Corrections Association accreditation for the facility (which it currently lacks) within 24 months. The contract also requires almost $4 million in capital improvements to the 800-bed medium-security facility.

North Carolina completed a deal with U.S. Corrections to build two 500-bed medium-security private prisons. The $140

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million contract requires U.S. Corrections to build and operate the facilities for 10 years.

In Arkansas, the state signed a deal with Wackenhut Correction to build and operate the state's first two private prisons. The two 600-bed facilities will cost a total of $39 million to construct and are expected to open in late 1997. The state is financing the construction with tax-exempt bonds and is leasing the facilities to the Arkansas Department of Corrections. The bonds will be paid off with revenue from state prison farms, which earn over $4.5 million a year. Once the bonds are paid, the Department of Corrections will own the facilities.

The city of Appleton, Minnesota is finally seeing some success with its local prison. Five years ago, the city spent $28 million to build the 500-bed prison in the hopes of cashing in on other states' excess prisoners. At first the city had trouble finding inmates to house and could not make their bond payments. Then, when they did find prisoners, their inexperienced staff had trouble keeping order. In the fall of 1996, Corrections Corporation of America paid off the bonds for the prison and immediately began a $25 million expansion. When work is completed this July, the facility will house over 1,000 inmates. Local officials point out that CCA is only taking one year and $25 million to complete 512 new beds, while a nearby state prison is taking eight years and $89 million to provide 950 beds.

Emergency Services

Two more municipalities in 1996 turned over their firefighting responsibilities to the private sector. In Rye Brook, New York, Rural/Metro signed a multi-year contract to provide fire service. Wackenhut Services signed a three-year, $17 million contract to provide protection for part of Lee County, Florida. The fire commission says that the contract will save the district more than $550,000 over that period.

Meanwhile, a few communities contracted for private ambulance services in 1996, including Gila Bend, Arizona, and parts of Augusta, Georgia. In San Diego, Rural/Metro won a five-year contract in March 1997 to run the city's ambulance service in concert with the fire department.

Police departments are increasingly turning to volunteers to expand community-policing programs. The San Diego Police Department uses 800 volunteers for a variety of purposes, including house checks for people on vacation, fingerprinting, marking abandoned cars, and providing support to victims, witnesses, and other survivors of traumatic situations. The department estimates that at least $1.5 million is saved annually through volunteer work. Volunteer police programs also exist in Atlanta, Denver, Phoenix, Orlando, Charleston, S.C., and other cities.

Private security firms are receiving a boost from the growing number of business improvement districts (BIDs), where merchants pay fees for extra security, cleaning, and other services. About 1,000 BIDs existed in the U.S. in 1996, and, among other successes, they have helped reduce crime. In the Los Angeles garment district BID, brightly dressed security guards on bicycles have trimmed local incidents by 20 percent. The Grand Central BID in New York City has hired private security patrols and produced a 60 percent drop in area crime.

Some private security services are raising guard pay and spending more time training and equipping them. The firm Critical Intervention Services, for example, provides security to over 50 low-income apartment complexes in Florida using armed guards in bulletproof vests. CIS officers work closely with local residents and landlords, and have achieved an average 50 percent drop in crime in the complexes they patrol. Local police declare they find CIS guards reliable and helpful.

Zoos

Today, fully 60 percent of the nation's 172 accredited city zoos are privately run to some extent. The Pittsburgh Zoo, which became privately managed in 1994, is an example. It has tripled its annual budget from $2.3 million in city funds in 1994 to $7 million in private funds in 1996. Since privatization, the zoo has created 40 new jobs, opened the first part of a $5.2 million children's zoo, and increased its animal collection to 4,500, adding new endangered species.

Private zoos tend to attract generous donations from the private sector. The Norfolk Botanical Gardens in Virginia received a $1 million donation the day it stopped being a government entity and went private. In San Francisco, the nonprofit San Francisco Zoological Society raised $12 million after the city's zoo was privatized. In Walnut Creek, California, the Lindsay Museum of Nature and Wildlife gradually became private in the 1990s. According to museum officials, they now have more than 3,000 individual and corporate donors and "wouldn't have gotten a lot of these grants if we had become city-funded."

Airports

In 1996, Congress passed a bill that permits up to five government-owned airports nationwide to be sold or leased to private firms. At least one of the five airports must be a general aviation airport, and only one can be a "large hub" airport. Success at these pilot locations could bring widespread privatizations of government-owned airports elsewhere.

Allegheny County, Pennsylvania (which includes Pittsburgh), is gearing up to be one of the first privatizations. In January, local authorities turned over management of the airport on an interim basis to their privatization consultant, Infrastructure Management Group. Somewhat earlier, the Port Authority of New York awarded a $1.1 billion contract to redevelop, expand, and manage the International Arrivals Building at Kennedy Airport to Schiphol, a Dutch airport owner/operator. New Haven, Connecticut, has contracted out the management of its airport to Johnson Controls World Services. Together, these actions brought the number of privately managed U.S. airports to 21.

Transcript

WORDS WORTH REPEATING

LEFT AND RIGHT CALL FOR LESS WASTEFUL GOVERNMENT REGULATION

A statement calling for an end to inefficient government regulation was released recently by scholars from the Brookings Institution (a liberal think tank), the American Enterprise Institute (a conservative think tank), and Resources for the Future (an environmental group). Here are extracts from An Agenda for Federal Regulatory Reform:

Government regulations have grown dramatically in recent decades. The authors of this statement believe that the current approach to federal regulation urgently needs repair.

The problem is not simply that current expenditures mandated by regulation are large—on the order of $200 billion annually for environmental, health, and safety rules alone. A substantial share of those expenditures is ineffective. More intelligent policies could achieve the same social goals at much less cost, or more ambitious goals at the same cost, scholars across the political spectrum now agree. Recent legislative debates have masked a broad consensus among knowledgeable observers on the need for regulatory reform, and we have written this primer in the hope that the current Congress will devote greater attention to fashioning needed reforms.

We do not take the view that all regulation is bad or that all regulation is good. We should judge regulations by their individual benefits and costs. Some regulations like policing against racial discrimination may be desirable regardless of their economic impact. But in an era when regulation imposes very substantial costs in the form of higher consumer prices and lower economic output, carefully assessing the likely benefits and costs of rules has become a central task of responsible government.

While deregulating some specific industries has led to substantial economy-wide gains in recent years, the steady rise in social regulation—which includes environmental, health, and safety standards, plus other government-imposed rights and benefits—has had mixed results. Research shows that some regulations, such as the requirement for safety caps on aspirin bottles, have actually led to increased risks.

We have identified six critical problems in the way regulation is carried out today:

- Congress frequently does not allow agencies to consider costs in developing regulations. Congress almost never requires regulations to pass an explicit benefit-cost test.
- Congress frequently specifies the technical means for achieving regulatory goals instead of letting consumers and firms decide how they can best achieve the goals without wasting resources. Scholars have shown that by designing more flexible rules, regulators could achieve better results at a lower cost.
- Neither Congress nor the regulatory agencies set priorities on a routine basis. As a result, there are wide differences among regulations in the costs of achieving a given benefit (such as lives saved or extended).
- The economic information on which regulations are based and promulgated is often weak and biased. Agencies spend few resources to collect high-quality information on the benefits and costs of regulations. They have an incentive to overstate benefits.
- In recent years, legislators have used regulations as a way of promising voters something without incurring government budgetary costs.
- The federal government regulates, with "one-size-fits-all" rules, many activities that are best left to states and localities.

To address the problems outlined above, we offer some recommendations.

Recommendation: Congress should require that all new regulations costing more than $100 million annually pass a benefit-cost test. Congress should move away from setting uniform standards for things like smokestack emissions or food safety, and instead encourage flexibility so long as overarching goals are achieved. Congress should return to the states responsibility for such local issues as waste disposal and safe drinking water.

Recommendation: The president and Congress should improve the quality of regulatory benefit-cost analysis.

Recommendation: Congress should require regulatory agencies to report each year to the American public on the benefits and costs associated with their rules. Regulatory costs tend to be hidden from view, with consumers rarely aware of the several hundred dollars they pay for pollution control equipment on a new car, for instance, or the costs associated with recent proposals to improve airline safety.

Recommendation: Congress should expand the capacity of the U.S. Office of Management and Budget and the Congressional Budget Office to analyze the economic impacts of major regulations.

Recommendation: Congress needs to scrutinize existing regulations as well as new ones. It should review at least ten important existing regulations each year, with an eye toward modifying them to ensure that they produce benefits in excess of costs. Those regulations that cannot be modified to pass such a test should be eliminated.

Recommendation: Congress should experiment with a regulatory budget that sets annual limits for regulatory costs imposed on society.

Our conclusion is that federal regulation is in urgent need of reform. If Congress continues to allow regulations to be produced without much attention to their economic consequences, there is a very real danger that the standard of living Americans enjoy will erode.