Privatization Watch

Analyzing privatization developments since 1976

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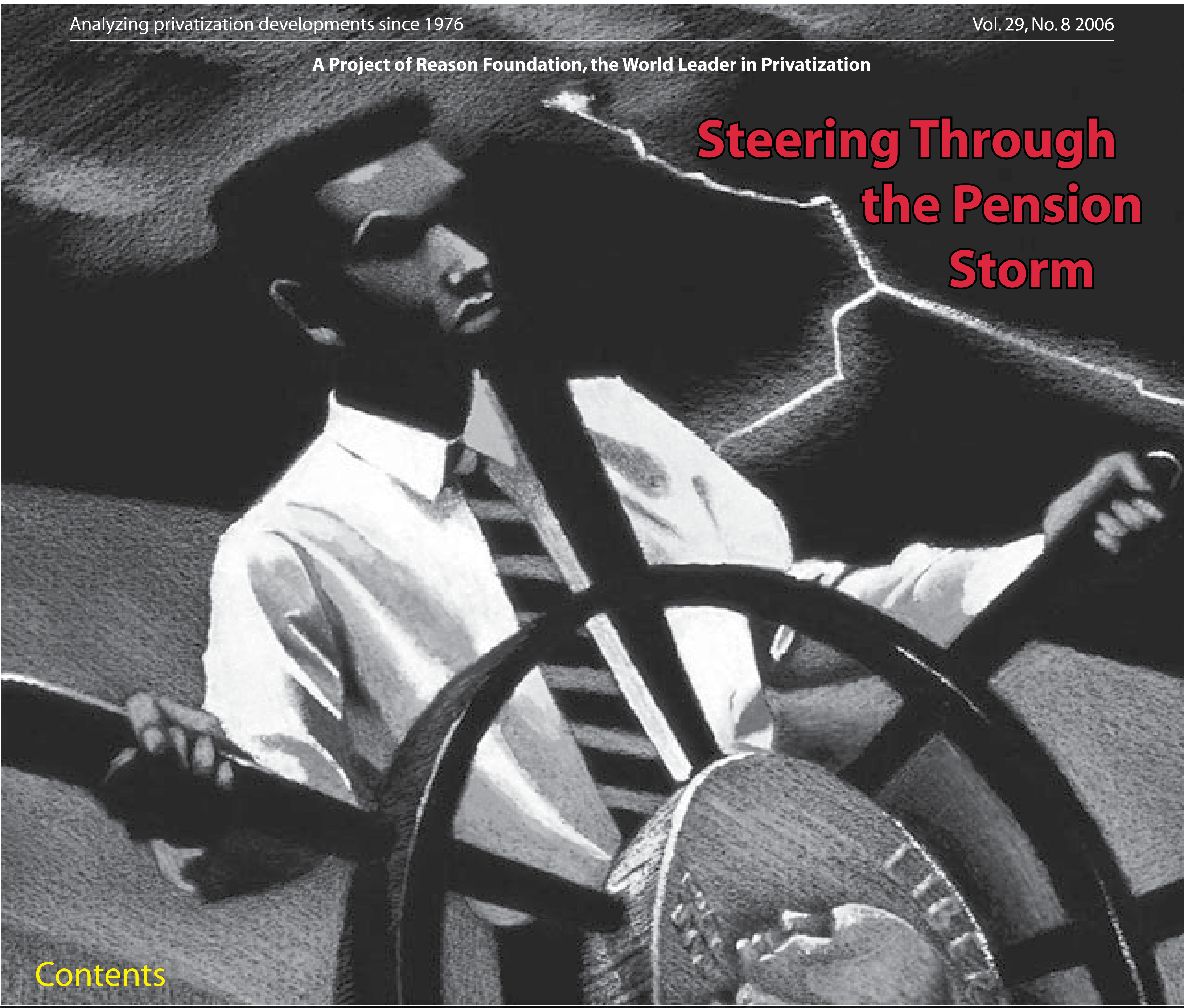

Steering Through the Pension Storm

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Privatization Watch

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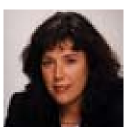

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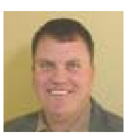

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Pension Reform—Why Does It Matter?

Even if the public is aware that a pension-funding problem exists—that huge debts are piling up—the question remains unanswered as to why it really matters. Sadly, governmental debt has become an all-too-common situation, arguably dulling the public's concern over it.

Some will remember, for instance, that California has faced a severe budget deficit for many years and, in the eyes of the public, seems to be surviving. In fact, the state in 2004 voluntarily racked up billions of dollars in additional debt through the passage of a stem-cell research bond.

So why should these pension liabilities matter?

Ballooning pension obligations necessarily draw resources away from other quality-of-life priorities like transportation, education, and public safety. In California, for instance, the state's obligations to its government-employee pension system have skyrocketed from $160 million to $2.6 billion annually just since 2000.

That increase could build hundreds of miles of new freeway capacity to tackle California congestion. It could pay the full cost of more than 25,000 teachers. It could offer significant tax relief to a high-tax state. Any political philosophy could find a better use for the money. ■

Privatization Briefs

Zoning Out the Amish

Amish farmers in a small Ohio town are confronting the declining profitability of their small, family-run farms. Instead of asking for handouts or taxpayer subsidies, the Amish want to adapt to the market by opening woodworking shops and other small businesses as they shift away from agriculture. Rather than commute into the nearest big city (the Amish do not drive), they want to start up new businesses on their farms.

One would think these aspirations would be welcome in an era of smart growth, where professional planners and environmentalists are scrambling for ways to get people out of their cars and preserve open space. But the home-based businesses the Amish want to start—carpentry, custom cabinet-making—don't fit the tidy little boxes of land uses allowed in the local zoning code. Local zoning laws say home-based businesses can't be bigger than 1,000 square feet.

Their neighbors don't object to the new business plans at all. But zoning and conventional planning is keeping the Amish woodworkers from remaining an economically and culturally viable part of the community.

Looking Back on School Choice

A half-century ago, Nobel Prize-winning economist Milton Friedman wrote a seminal article titled, "The Role of Government in Education." Friedman argued that universal vouchers would spark experimentation, innovation, and improvement. With that article the modern voucher movement was born.

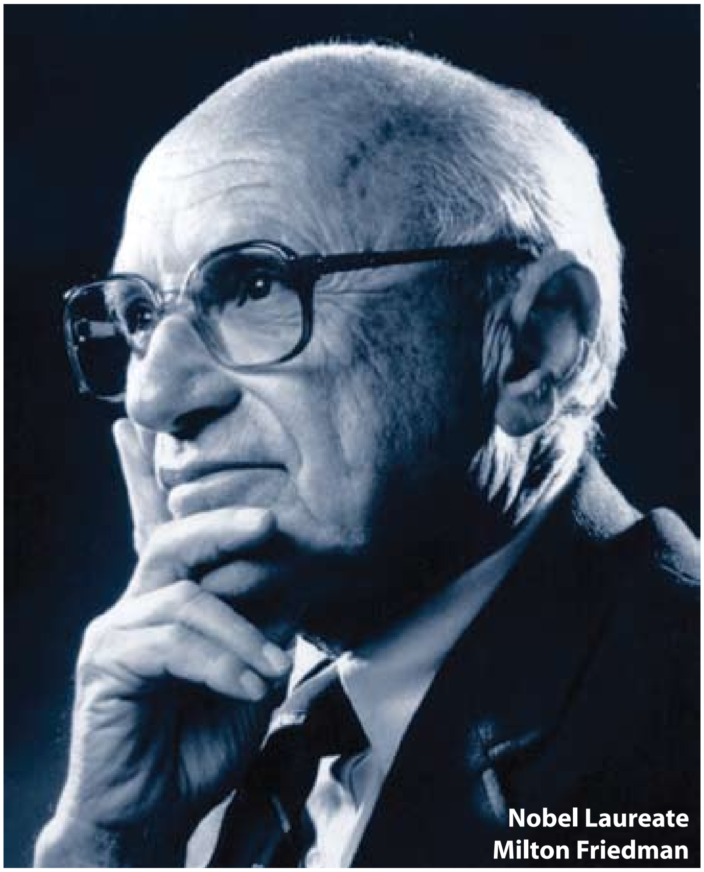
Recently, Friedman looked back on his legacy in an interview with *Reason* Editor-in-Chief Nick Gillespie.

Friedman on the benefits of universal vouchers:

> *[E]mpowering parents would generate a competitive education market, which would lead to a burst of innovation and improvement, as competition has done in so many other areas. There's nothing that would do so much to avoid the danger of a two-tiered society, of a class-based society. And there's nothing that would do so much to ensure a skilled and educated workforce.*

Friedman on why vouchers would benefit teachers:

> *[Contrary to conventional wisdom] teachers would be among the main beneficiaries. We know that in government schools not much more than half of the money spent goes to the classroom [See, "Driving More Money into the Classroom, P. 8]. Almost half goes to administrators, bureaucrats, and the like. In private schools, a much larger fraction goes to the classroom. In addition, we know that working conditions are much more attractive in private schools. Despite lower average wages, the turnover rate [among teachers] is much lower in private schools than it is in government schools.*



Nobel Laureate
Milton Friedman

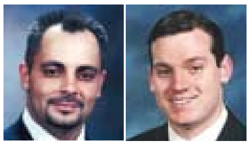
The entire interview is available online: reason.com/0512/fe.ng.the.shtml

And Now the Philippines

Shortly after Japan moved to privatize its massive Japan Post (see "Japan's Massive Postal Privatization," *Privatization Watch* Vol. 29, No. 6), the Philippine government has decided to follow suit. The government will privatize the Philippine Postal Corp (Philpost) through a direct sale of government shares, the *Philippine Daily Inquirer* reports. Unlike its century-old Japanese counterpart, Philpost is a relatively recent creation, having been established in 1992. The sale is part of a larger 2005 privatization plan that will also include RPN Channel 9, IBC Channel 13 and the PNOC-Energy Development Corp. ■

Steering Through the Pension Storm:
The Looming Disaster of Government Pension Plans

by George Passantino and Adam B. Summers



The following has been excerpted from the Reason policy study, The Gathering Pension Storm, *by George Passantino and Adam B. Summers. The entire study is available online: reason.org/ps335.pdf.*

An ominous storm cloud is gathering across the horizon as American governments try to pay for the lucrative pension promises made to their employees. And these clouds are not just over a few skies. They are virtually everywhere. Government employee pension systems across the nation are in crisis.

The city of San Diego is now embroiled in its worst financial crisis ever, with more than $2 billion in unfunded pensions and retiree healthcare costs. The financial mismanagement led *TIME* Magazine to name Mayor Dick Murphy one of the nation's three worst mayors, and eventually resulted in Murphy's resignation less than five months into his second term. In Illinois, taxpayers face a $35 billion pension deficit—the worst in the nation. The state of West Virginia faces a $5.5 billion pension deficit and an additional $3.3 billion in unfunded workers' compensation liabilities—a deficit nearly three times the state's annual $3.1 billion general fund budget. And in California, where government pension funds have become synonymous with investment activism, the California teachers' retirement system faces a $24 billion shortfall and the state pays more than $3 billion each year to keep its retirement funds afloat.

For each government pension system in crisis, another dozen could be listed, as this is clearly a national, systemic problem. Combined, taxpayers are exposed to more than $350 billion in unfunded pension liabilities.

The recent downturn in the stock market is often blamed for these shortfalls. After all, the market suffered a sharp decline beginning in 2000. But is this a fair defense or is it an incomplete answer provided by government officials hoping to rationalize the major run-up of government debt?

While market losses certainly played a role, the declines only unveiled the weaknesses in government pension systems—weaknesses previously masked by the historic investment gains of the late 1990s. The fact that a retirement system could turn so quickly from investment nirvana to debt nightmares should give taxpayers and lawmakers cause for major concern. Moreover, blaming the market ignores the many policy decisions that have created the crisis.

At the heart of the pension crisis is a set of incentives that encourages policymakers to make decisions for which they do not have to bear the consequences.

At the heart of the pension crisis is a set of incentives that encourage policymakers to make decisions for which they do not have to bear the consequences. Since corporate executives, lawmakers, and union officials will not bear the costs of the benefit increases they preside over, there is no incentive for them to show fiscal restraint.

The "defined-benefit" pension plan, also referred to as the "traditional" plan, guarantees employees a pre-set benefit upon retirement. The amount of the benefit is calculated by multiplying a fixed percentage by the number of years that the employee worked for the firm or government agency by the employee's final compensation (or some average of the employee's highest earnings). The employer invests money to ensure that these promises can be kept. If the investment returns do not match up, taxpayers are obligated to make up the difference. Alarmingly, once benefits are bestowed via a defined-benefit plan, the courts have ruled they cannot be taken away.

Because of this reality, taxpayers have been abused to promote political agendas that promise extravagant retirement benefits to government workers—even as the taxpayers themselves must work longer to prepare for their own retirement. Significant benefit increases, such as "3 percent at 50" plans, have proven themselves unsustainable. These excessive benefit levels and a variety of government policies have encouraged premature retirement and pension spiking, driving up costs even further. And as courts have ruled, they cannot be rescinded.

The mistake of offering greater benefits that governments cannot afford is regularly compounded by poor financial planning. The lack of long-term averaging of investment returns leaves governments susceptible to volatile swings in pension contribution payments. The issuance of pension obligation bonds is little more than an expensive gamble that will saddle taxpayers for years to come. And the very assumptions on which these pension promises are theoretically built can easily be manipulated to the taxpayers' demise. For instance, if a pension fund assumes an overly generous rate of return on its investments or understates the full actuarial costs of benefits, the taxpayers are exposed to a significantly greater risk.

Over the past several decades, the private sector has rapidly shifted away from defined-benefit plans and toward defined-contribution plans for good reason—traditional plans are expensive, unpredictable, and unsustainable in the long run.

The government has been slow to follow the private sector's lead. But this is not only a reasonable course of action for governments—it also represents significant benefits to workers too.

As the name implies, the main difference between defined-contribution pension plans and defined-benefit plans is that defined-contribution plans spell out the level of contributions employers and employees will make to the retirement system—not the level of benefit they will receive at retirement. Instead, the level of benefit the employee receives upon retirement depends on the performance of his or her investment portfolio, as well as his or her level of participation. Employees bear the risk of their investments but also get to maintain control of these investments.

One of the greatest benefits of a defined-contribution plan, from a government employer's perspective, is that it provides a great deal of stability since contribution levels are known in advance and do not change much from year to year. This is a sharp contrast to the volatility in contribution levels experienced under defined-benefit plans.

While the stability/predictability argument offers one of the strongest *practical* benefits of defined-contribution plans, perhaps the greatest *moral* benefit is that it allows employees the freedom to manage their own retirement accounts and invest their own money as they see fit.

The Gathering Pension Storm

George Passantino and
Adam B. Summers

reason.org/ps335.pdf

Defined-contribution plan participants have the freedom to invest their money as they choose and the critical ability to take that entire investment with them from job to job—something defined-benefit plans lack. This portability is extremely appealing to employees in an age where the average worker switches jobs numerous times during his or her career.

Moreover, risk levels and investment strategies change with age and defined-benefit plans allow for that. Defined-contribution plans allow employees to choose more aggressive investments when they are young and switch to more conservative investments as they approach retirement.

Under a defined-contribution plan, lawmakers can still make very appealing retirement packages, including attractive matching options. The defined-contribution plan structure simply requires that these costs be recognized and dealt with in the current year as one of the government's many priorities. Defined-contribution plans prevent lawmakers from creating actuarial liabilities by pushing hidden costs off into the future. This should be reason enough for taxpayers to embrace such a reform.

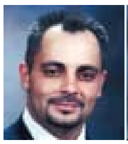
In addition, there are numerous other steps governments must take to address the pension deficit problem and improve overall financial management of the state to ensure that the current pension crisis does not have a spillover effect.

It is time that governments learn what the private sector concluded decades ago: that defined-benefit plans, typified by exorbitant benefit levels, are simply unsustainable. They should adopt the private-sector model and switch to defined-contribution systems for all future government workers to ensure more responsible fiscal management that rightly places a focus on providing high quality services. While few governments have made the leap, a number are moving in that direction. This report explores that shift and offers new insights on how it can benefit taxpayers, government agencies, and government employees alike.

George Passantino is a Senior Fellow at Reason Foundation. In 2004, Passantino served as a director of Gov. Arnold Schwarzenegger's California Performance Review. Adam B. Summers is a policy analyst at Reason Foundation. ■

Defined Contribution Plans—Part of the Solution

By George Passantino and Adam B. Summers




As the name implies, the main difference between defined-contribution pension plans and defined-benefit plans is that defined-contribution plans spell out the level of contributions employers and employees will make to the retirement system, while defined-benefit plans detail the level of benefits employers will be required to provide employees upon retirement. Therefore, in contrast to defined-benefit plans, defined-contribution plans do not offer employees any guaranteed level of benefits. Instead, both the employer and employee make tax-deferred contributions to individual retirement accounts that the employee controls. The level of benefits the employee receives upon retirement depends on the performance of his or her investment portfolio, as well as his or her level of participation. Employees thus bear the risk of their investments, but also get to maintain control of these investments, assigning their own levels of risk and relying upon whichever financial professionals they choose, if any, for financial advice and portfolio management. Note also that, under a defined-contribution plan, when investments perform especially well, beneficiaries realize higher benefits. Under a defined-benefit plan, by contrast, better investment performance merely means that employers and employees invest less in the system (through contributions).

Under a defined-contribution plan, when investments perform especially well, beneficiaries realize higher benefits.

After the employee is vested in the plan (defined-contribution plans typically have a shorter vesting period than defined-benefit plans), the employee may transfer, or "roll over," his retirement account to future jobs. Upon the retiree's death, the retirement account's assets may be passed on to the retiree's heirs. It is also worth noting that defined-contribution plan participants are eligible to receive Social Security benefits on top of their individual retirement accounts, whereas many defined-benefit plan participants are not.

Trends

Private-sector pension plans have had to face the same demographic pressures and rising pension and health-care costs as have government plans. The difference has been in how they have reacted to these rising costs. While private-sector firms must compete with each other and offer attractive compensation packages—including pension benefits—to entice the best-qualified workers to work for them, they are also constrained by the need to control costs and maintain profitability. Government does not face this efficiency/profitability constraint, as governments can simply raise taxes, issue bonds, or sacrifice service quality (government is the ultimate monopolist and generally does not face any competition to maintain any particular level of service; service quality is determined instead by available budgetary resources and public officials' tolerance for public complaints). Hence, governments have been much slower than the private sector to react to rising pension costs.

Taxpayers have become increasingly upset with lawmakers granting significant benefit increases to government employees—and saddling them with the bills for these increases—while they have been forced to do with less. As Steve Frates of the Rose Institute for State and Local Government at Claremont McKenna College offers, "People are looking next door, seeing that their 50-year-old neighbor who is in good health and works for the government is retiring with a pension of $80,000 or $90,000 for the rest of his life. That is sticking many taxpayers in the craw."


Steve Frates

Many states—including Colorado, Florida, Louisiana, Maine, Michigan, Montana, Ohio, Oregon, South Carolina, Vermont, Virginia, and Washington—already offer defined-contribution plans to at least some of their state employees. Some states have switched completely from their traditional plans to defined-contribution plans while others offer defined-contribution plans as an option in addition to existing defined-benefit plans. Consider the following examples of government defined-contribution plans:

1. Michigan. All employees hired after March 3, 1997 have belonged to a defined-contribution plan in Michigan. The government employers (departments, agencies, etc.) contribute 4 percent of the employee's salary to the plan and will match employee contributions of an additional 3 percent.

2. Florida. Florida began offering a defined-contribution plan in addition to its traditional plan in 2002. Employees were given the option of remaining in the existing defined-benefit plan, transferring accumulated benefits to the defined-contribution plan, or keeping their accrued balance in the old

See PENSION on Page 11

Coping with Existing Pension Obligations

By George Passantino and Adam B. Summers

Shifting new employees into defined-contribution systems only addresses a portion of the problem. Doing so does nothing to confront the challenges related to employees already in the current system, such as how to cope with existing debts or how to avoid racking up additional debts in the future. Shifting to a defined-contribution system also does nothing to ensure that existing obligations do not threaten other areas of the budget. To make existing defined-benefit systems stronger and less costly, lawmakers must consult a wide range of options, including the following:

1. Enact constitutional or charter amendments to require voter approval of all government employee benefit increases.

Historically, pension benefits have been upheld as constitutionally guaranteed in both the U.S. Constitution as well as state constitutions. As such, they have virtually the same long-term fiscal impact as a general obligation bond, which very frequently requires a vote of the public.

When lawmakers approve benefit increases, they are committing the taxpayer to a long-term obligation that must be paid for into the future. In the event that payments into the system or investment returns do not fully fund these benefit increases, the taxpayers must make up the difference. Thus, approval of enhanced pension benefits should be subject to a vote of the general public just like a general obligation bond. A voter approval requirement ensures that the taxpayers who pay government employees' salaries can operate as a final check against overly generous deals.

2. Establish long-term averages of investment returns for the purpose of calculating government employer contributions.

Establishing long-term averages for the calculation of investment returns will help to "smooth out" government employers' annual contributions and prevent the volatility that has, at times, provided unpleasant surprises and funding emergencies. Calculating assets and liabilities on this basis will allow the ups and downs of the stock market to even out and, in turn, provide governments with more stable pension contribution schedules. In addition, governments should eliminate "contribution holidays" and "13th Check" distributions, as these undermine long-term stability and worsen the moral hazard problem by practicing why-pay-today-when-someone-else-can-pay-tomorrow ethics.

3. Adopt, adhere to, and frequently re-evaluate sound actuarial assumptions.

In some cases, such as in Contra Costa County, California, sound actuarial advice was simply ignored. Governments should impose strict penalties (i.e., fines, removal from office, and jail time) on pension board trustees or politicians that are negligent in their fiduciary duties to pension beneficiaries and responsibilities to taxpayers. It is often said that government management failures, and accounting in particular, would be criminal if performed as such in the private sector. There should be no double standard. Public officials should adhere to the same standards as corporate CEOs and be subject to the same consequences.

In addition, states and municipalities should consider enacting measures similar to H.B. 109 in Texas, which requires an independent analysis of any legislation or other changes that could alter the actuarial soundness of a municipal pension fund, in addition to the municipality's internal analysis.

4. Scale back, or "sunset," realized benefit increases for new employees.

The benefit increases that were put in place during the height of the stock market rally, when pension portfolios were realizing historic returns, proved unsustainable when the market resumed more reasonable levels. While those enhanced benefits realized by government employees may have been locked in, governments can still adopt reduced benefits for future employees. The advantage of this option is that it can be taken immediately (without having to wait for union contracts to expire and the collective bargaining process to play out), offering savings in the short term.

5. Strictly limit vacation time sell-back programs.

Vacation time sell-backs can be a significant means of pension spiking, even though they were created to eliminate another obligation—massive build ups in vacation accounts. Governments must assure that this system is kept within reason and does not undermine fiscal stability. Stricter limits on the amount of vacation time that can be "sold back" each year will help keep these expenses in check. ■

Driving More Money into the Classroom: The Benefits of Shared Services

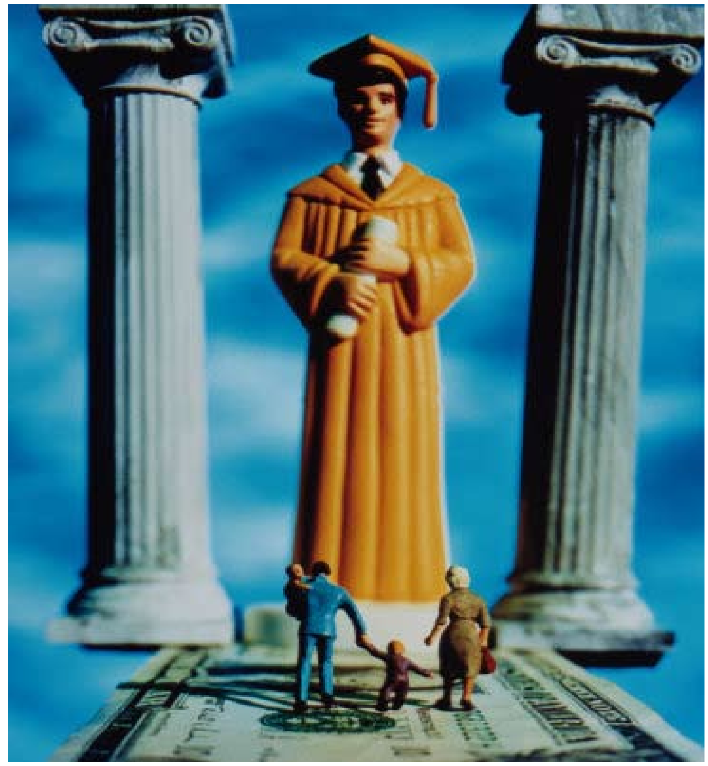
by William D. Eggers, et al.

The following was excerpted from the Reason study, Driving More Money into the Classroom: The Promise of Share Services, *by William D. Eggers, Lisa Snell, Robert Wavra, and Adrian T. Moore. The entire study is available online: reason.org/ps339.pdf*

Education spending constitutes up to half of many state's budgets. Ranging from teachers' salaries to building costs, these budget dollars have in the past mostly escaped the chopping block of the yearly budget cutting process. In recent years, however, states and school districts are under increasing pressure to reduce education costs, particularly of non-instructional services.

In most states, anywhere from one-third to one-half of every dollar spent on education never makes it into a classroom. The money goes to administration, support services, and operations. Lacking economies of scale—and often sufficient managerial expertise—many small and medium-sized districts find it extraordinarily expensive to provide the full array of support and administrative services in-house. At the same time, many large districts suffer from duplicative or inefficient administrative systems due to layer upon layer of bureaucracy grown over time. For example, in many states, teachers make up a little more than half of all school district staff. In contrast, teachers account for between 60 and 80 percent of all school staffing in Europe. The resulting high per-student costs in the United States constitute a significant drain on budgets.

The U.S. Department of Education has found that approximately 39 percent of state education budgets is used for non-instructional purposes. More detailed analyses at the state level suggest that the federal statistics may even understate the actual amount going to non-instructional costs. The state of Texas has one of the most detailed systems of school cost accountability. It offers an instructive example for taking a closer look at education spending. Data from the Texas Education Agency (TEA) show that during 2004-2005, Texas school districts devoted only 59 cents of every tax dollar to classroom instruction. The remaining 41 cents went to support functions such as student transportation, food services, facilities maintenance and operations, and general administration. Meanwhile, in California, only 54 percent of per-pupil spending goes to instruction costs, while in Illinois classroom expenditures represent only 46 percent of the budget compared to 44 percent for support services.



How can states and school districts respond to these fiscal pressures without adversely impacting educational performance? One promising approach is by reducing non-instructional spending costs through shared services. Whether a district has a surplus or deficit, a budgetary feast or famine, arrangements with other school districts, within large school districts, or with outside entities to share services such as transportation, food services, human resources, finances and purchasing can help realize significant cost reductions without negatively impacting student outcomes.

Where to Share?

Transportation. Large districts have the flexibility to incorporate sharing in a number of creative ways. The simplest involve internally sharing resources, time, or space, such as when a handful of neighboring schools band together to host a recruiting fair. Even more interesting, though, are examples of well-planned, formal, shared services agreements. Two school boards in Ontario, Canada have joined together to share bus transportation services and audio-visual resources. By creating a single bus system, the two boards will save $8 million in administrative, capital, and fuel costs over three years. The boards' shared AV library serves classrooms in both districts, saving $300,000 annually.

See EDUCATION on Page 15

That Fighting Spirit:
Steve Wyatt Rolls Up His Sleeves and Turns Budgets Around

Steve Wyatt grew up in the mountains and developed a fighting spirit by observing those around him. His father fought to take care of the family, sometimes working as many as three jobs at once. He grew up around a lot of World War II veterans, listening to their stories about courage and tenacity. "Those guys were my heroes," he says. "I thought about what I could do to make the country a little better place." Now as County Manager for Moore County, North Carolina he's earned a reputation as someone who stands strong when times get tough. He's learned how to turn around struggling local governments by unlocking the power of incentives and performance-based management.

He first studied psychology in college, but then found he was drawn to economics and government. "I never really looked back," he says. Wyatt has changed vocations and held many jobs in government, but that fighting spirit has always come in handy.

What follows is an abridged version of an interview conducted by Chad Adams of the Center for Local Innovation. If you'd like to learn more about Wyatt's approach to government, the entire exchange is available online: localinnovation.org/interview/article.html?id=1651

Adams: Where was your first government job?

Wyatt: I did an internship with the town of Hamlet. I went to work with an Appalachian guy down there. Then I went with the town of Chadbourn, as the manager there and then went to Polk County as a county manager. I was the first manager ever to survive a transition in party control of the Board. I was hired by a Democrat and retained by Republicans. I showed them that I was not going to make political decisions. A manager shouldn't—you have to work in a political environment. Good policy is good politics.

Adams: What would you say is something you did there? At some point you had to start taking innovative approaches. What was something you brought to the table?

Wyatt: I got there [Polk] and not unlike [many counties], they were broke. The first thing we had to do was—we couldn't play favorites. You've got to collect taxes. If you are going to levy a tax, you collect that tax. If you are going to enact a law, an ordinance in our case, you are going to enforce that law or that ordinance. You are going to do it in such a way where it applies to everybody. You aren't going to be selective in that.

Recipe for a Successful Government Turnaround

1. Think good policy not politics
2. Collect fees and taxes without favoritism
3. Cut costs by outsourcing or privatizing
4. Recognize and reward good results

What I did in those two small communities is we basically had to take apart everything that we were doing to try to save money—collect the fees, collect the taxes and save money. We went to once a week, curbside garbage pick up. We were able to cut the sanitation budget 40 percent.

Adams: You increased service and cut expenses?

Wyatt: Actually, I can't say we improved service. We were going twice a week, back door. That is incredibly inefficient. So we got some grant money, actually, it was the last of the revenue-sharing money. We bought everybody in the town a 90-gallon rollout and went to once a week curbside.

The council voted it in one time and then backed off of it. It took me about eight more months and cost us money in that lag period. I contracted out and I privatized some stuff. This was a Reagan-type concept. What is the mission of government? What should government do? What should the private sector do? If the private sector can do it better or more efficiently, who is served? The public is served. I privatized the utility system there, basically.

It was a matter of survival, I'm not going to kid you. But we saved money and we met the requirements. It was controversial.

Adams: Tell me more about the performance management concept you are trying to bring into Moore County. I know other people are looking at that as a model.

Wyatt: I hate bureaucracy. Bureaucracy is not reality. A mentality of bureaucracy is just not right. Again, just because we've got this monopoly, who cares? It is just not right, so let's break it. The rules say you do this. So what? Why are those rules in existence? If you can't tell me why that rule is in existence, and don't tell me it is because we've always done it that way, I'll sit down and say, "Let's chat." What you've got to do is challenge those old ways of doing things.

Adams: When you do that, it instantly makes you a

See WYATT on Page 14

Fed Study Keen on Private Prison

By Geoffrey F. Segal

Recently, the Justice Department's National Institute of Justice released a study, *Contracting for Imprisonment in the Federal Prison System: Cost and Performance of the Privately Operated Taft Correctional Institution* (ncjrs.gov/pdffiles1/nij/grants/211990.pdf). The researchers set out to determine whether the low-security private prison facility located in Taft, California performs as well as publicly operated facilities within the federal prison system. They compared the cost of contracting the operation of Taft Correctional Institution (TCI) to what the federal government would have spent if it had run the facility. This is a hypothetical comparison. It's worth noting that the model used to determine what the cost of public operation would be represents a 'best-case' or 'low-cost' scenario compared to actual data for other facilities.

The researchers also compared the cost of operating TCI to that of other existing low-security federal prisons.

In addition, TCI was evaluated on the basis of the quality of its performance during its first six and one-half years of operation as compared to publicly operated federal prisons over the same period.

The findings:

The private facility SAVED taxpayer money.

The contract at TCI cost the government \$142.1 million, while the estimated cost of government operation cost was between \$151.6 and \$158.6 million. Thus, the private facility saved between 6 and 10 percent or \$9.6 to \$16.5 million. During all five years of the analysis, the net cost of contracting was less than the lowest estimate of direct public operation.

In the hypothetical model for public operation of the Taft facility, the researchers assumed that staffing levels would be the same as the privately operated facility and that pay is at the 'mid-grade' level. In actuality, the private provider employed more employees, but offered a less expensive package of employee benefits. In addition, labor costs (wage and salary) for the private facility were higher than many other public facilities it was compared against. Had the private facility been located in another part of the country with lower prevailing wages, the difference between public and private labor costs would have been much greater. For example, if the facility had been located in Yazoo City, Mississippi (the site of one of the similar federal facilities), the contractor's labor costs would have been 24 percent lower, and savings would have increased as well.

A simple review of per diem rates provides even stronger evidence of cost savings from the private facility. Indeed, TCI

COST SAVINGS	1998	1999	2000	2001	2002
Taft (Private)	52.43	33.82	33.25	36.88	38.37
FCI Elkton	46.59	39.72	39.77	44.75	46.38
FCI Forrest City	44.20	39.46	39.84	41.65	43.61
FCI Yazoo City	44.15	41.46	40.05	43.65	42.15
FCI Ashland	69.96	62.75	63.47	64.12	63.38
FCI Bastrop	56.75	53.75	52.67	57.15	52.97
FCI Big Spring	58.80	54.71	51.03	67.99	70.88
FCI Butner	51.78	45.76	47.04	50.93	54.27
FCI Latuna	58.47	56.47	57.36	71.39	60.02
FCI Loretto	62.59	61.42	63.22	49.32	50.86
FCI Milan	73.93	66.77	62.97	62.56	63.23
FCI Petersburg	65.79	61.79	61.79	56.97	60.59
FCI Safford	58.65	56.51	58.57	58.51	58.69
FCI Seagoville	61.48	59.41	61.03	77.40	75.83
FCI Texarkana	49.29	47.52	49.68	53.34	55.55
Low Savings	-15.79%	16.68%	19.82%	12.93%	9.85%
High Savings	41.01%	97.43%	90.89%	109.87%	97.63%
Average Savings	9.32%	57.87%	60.79%	54.89%	48.63%

housed prisoners at a significantly lower daily per-prisoner cost than the Bureau of Prisons experienced at 14 low-security federally operated prisons.

The private facility had the lowest per diem rate in every year except its start-up year (1998), when costs were higher, as expected. After 1998, TCI had nearly a double-digit advantage in every year over the next lowest per diem in the federal system. The cost savings is even more dramatic when compared against the average and the high cost per diem facility.

The private facility did NOT jeopardize quality.

While cost is important, the quality or performance of a prison facility is critical. The review determined that the contractor delivered what it promised in the contract, and what the contracting agency expected. Indeed, the federal Bureau of Prisons exercised its option to renew the contract after the three-year base period, and has done so in every subsequent year since.

TCI housed prisoners at a significantly lower daily per prisoner cost than the Bureau of Prisons experienced at 14 low-security federally operated prisons.

In addition, the rates of assault are lower at TCI than at the average low-security publicly operated facility. There have not been any homicides at the private facility. While there was one escape, it was followed by immediate remediation and policy changes.

The type and amount of health care was found to be the same, although the private facility used a different staffing model that relied on more doctors and registered nurses. Thus, inmates were more likely to see a doctor at the private facility than in public facilities.

However, not all findings favored TCI. It was found to have higher rates of drug use and a greater number of inmate grievances.

The private facility performed ABOVE minimum compliance and contractual requirements.

On the most comprehensive and in-depth measure of performance—the extent to which the private operator met its performance obligations established in the contract—the firm performed at levels above and beyond mere compliance with these contractual requirements.

With results like these, it is understandable why the Federal Bureau of Prisons continues to seek public-private partnerships to manage a growing federal prisoner population. ■

Continued from Page 6

PENSION

plan but directing all future contributions to the defined-contribution plan. Employees do not contribute anything to either plan. For 2004, state employers contributed 6.2 percent to the defined-benefit plan and 9 percent to the defined-contribution plan for regular employees.

3. Oregon. While Florida began offering its defined-contribution plan mostly to provide its employees a greater choice in their retirement plans, Oregon chose to revamp its pension system to save money. State employees hired after August 29, 2003, participate in both a defined-contribution and a new defined-benefit plan. Now all employee contributions go into the defined-contribution plan and all employer contributions are made to a scaled-down defined-benefit plan. According to legislative analysts, the new pension plan will save an estimated $7 billion over 30 years. Some of these savings are now in doubt with recent court rulings that invalidated portions of the reform.

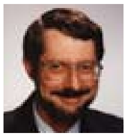
People value the freedom to make their own retirement investment decisions

4. Nebraska. Nebraska became the first state to shift to defined-contribution benefit when the State Employees' Retirement Plan was initiated as a defined-contribution plan in 1964. (Teachers, judges, and highway patrol officers remained on defined-benefit plans.) The state then switched from its defined-contribution plan to a cash-balance plan (a defined-benefit plan with some defined-contribution plan features) in 2002 (effective January 1, 2003) after a study conducted in 2000 revealed that those in the defined-contribution plan achieved a 6 to 7 percent average annual return versus 11 percent for the defined-benefit (state-managed) plans over a 30-year period. It would appear that the three bad years in the stock market (2000-2002) were the final straw. Under the cash-balance plan, beneficiaries are guaranteed a minimum return of the greater of 5 percent or the federal mid-term rate plus 1.5 percent.

Tellingly, however, there has not been an exodus from the defined-contribution plan. In fact, approximately 70 percent of the members of the defined-contribution plan chose to remain under that plan when the cash-balance plan went into effect. If the defined-contribution plan was so disastrous, as critics claimed, many more people would have switched out of the plan. Apparently, people value the freedom to make their own retirement investment decisions. ■

Airport Security—Let Airports Decide

By Robert W. Poole, Jr.



In response to the 9/11 attacks, airport security screening was federalized and the Transportation Security Administration (TSA) was born. In order to address the inefficiencies and conflicts of interest federalization has brought, baggage and passenger screening should be shifted to individual airports, with the TSA retaining regulatory control. Airports would be free to use TSA-certified screening companies or to hire TSA-trained screeners. This devolution—having the federal government delegate these duties—makes sense for at least four reasons.

- Today, the TSA is both the regulator and the provider of some airport security functions. A regulator cannot fairly regulate itself; it must be at arm's length from those it regulates. In Europe, which has decades more experience dealing with terrorism, the responsibility for all airport security is placed at the airport level, with government oversight.
- Second, TSA's screening operations are highly centralized in Washington. Allocation of screeners to individual airports takes place only once a year. But airlines continually change routes and service levels. From month to month, the number of passengers who need screening may fluctuate by 15 percent, 20 percent or more. Much of the time, TSA provides either too few or too many screeners, wasting taxpayer money and travelers' time.
- Third, making airports responsible for screening—as they already are for access control, perimeter security and other functions—would lead to a more integrated security system. Staff could be cross-trained and shifted among functions, reducing boredom and enhancing skills.

- Fourth, if airports got the money TSA now spends on screening, they could easily finance the transition to better technology, such as faster, more efficient in-line explosive detection systems to screen checked baggage. Airports could get the large, high-tech scanners out of ticket lobbies and make them part of the conveyor systems that carry baggage to airplanes. That would reduce the number of required baggage screeners by one-half or more, according to Government Accountability Office studies. The freed-up funds could beef up other aspects of security.

Congress overreacted in creating a costly, inflexible, centralized system for airport screening. The crucial need is for high standards, rigorously enforced. Those did not exist prior to 9/11, but now that we have them, we should let each airport secure its premises, with TSA holding it accountable.

This piece was published in USA TODAY. ■

Boosting Performance by Staying Home

by Ted Balaker

The following was excerpted from the Reason study, The Quiet Success: Telecommuting's Impact on Transportation and Beyond *by Ted Balaker. The entire report is available online: reason.org/ps338.pdf*

Benefits of Telecommuting

1. More productive workers
2. Improved recruitment, lower turnover
3. Lower real estate costs
4. Lower absenteeism (and presenteeism costs)

The decision to forego the daily commute and work from home might not seem particularly revolutionary. Yet telecommuting has a positive impact on a surprisingly wide range of issues.

Telecommuting may be the most cost-effective way to reduce rush-hour traffic. It helps improve air quality and highway safety. It conserves energy, expands opportunities for the handicapped, and—when used as a substitute for offshore outsourcing—it can help allay globalization fears. It can even make organizations, public and private, more productive, which is good news for our nation's managers, many of whom have long been suspicious of telecommuting.

And minds do change. Consider the Defense Logistics Agency. A survey found that three-fourths of the 22,000 employees wanted to be able to telecommute more often, but they often encountered resistance from managers. But eventually DLA managers warmed to telecommuting and now they even embrace it as a way to improve worker satisfaction and productivity and to keep and retain good employees.

Let's have a look at some other benefits of telecommuting

1. More Productive Workers: Managers often regard telecommuters as low-grade scammers, loafing at home when they should be working hard at the office. Yet in many cases telecommuters are actually more productive than their office-bound counterparts.

- Among AT&T telecommuters, 72 percent report that they get more done at home than at work.
- J.D. Edwards found that its telecommuters were 20 to 25 percent more productive than office workers.
- A survey of American Express telecommuters found that they produced 43 percent more business than office workers.

2. Improved Recruitment, Lower Turnover: Offering the option of telecommuting is an inexpensive way for companies to attract and retain good employees. Roughly two-thirds of AT&T managers say that telecommuting is an advantage in keeping and attracting good employees. A Winston Group survey found that over one-third of Americans reported that, if given the choice, they would choose the option to telecommute over a higher salary. An Ohio manager who makes extensive use of telecommuting notes that junior employees work hard to earn the privilege of working at home. Those who do work at home realize that they enjoy a sought-after perk and work hard to keep it. Higher job satisfaction and lower turnover mean that companies do not have to spend as much time and effort in recruitment and training.

3. Lower Real Estate Costs: With fewer employees in the office, telecommuting allows companies to save on real estate costs, and those savings can be substantial. Nortel estimates that telecommuting saves $20 million per year in real estate costs. With $25 million worth of foregone real estate costs, AT&T saves even more. Unisys may represent the best case scenario—telecommuting allowed the company to cut office space by 90 percent.

Those who do work at home realize that they enjoy a sought-after perk and work hard to keep it.

4. Lower Absenteeism (and Presenteeism) Costs: Managers have begun to take note of costs associated with "presenteeism"—when workers are on the job but, because of illness or other medical problems, are not fully functional. Presenteeism costs U.S. companies over $150 billion per year, a figure that far exceeds absenteeism costs. It's no surprise that employees who don't feel well are not as productive as they could be.

But since illnesses often spread through companies quickly, employees who come to work sick can also drag down the productivity of others. Increasingly, the sick worker who downs gallons of cough syrup and heads to work is no longer regarded as a hero, but a liability. (The British call them "mucus troopers.") More and more managers are recognizing this and urging sick workers to stay home.

Yet there is plenty of gray area between sick and well.

See TELECOMMUTING on Page 15

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WYATT

change agent. Implementing change is difficult. Did you have the sense that you were going to be a target when you were trying to do this?

Wyatt: Government is all process-oriented. Who cares about process? Do the people from Winn Dixie care about the process? What do they want? They want results. They want outcome.

So we came up with what we called outcome-based budgeting. They call it reinventing government or reinventing budget. But I call it outcome. That is the bottom line. I'm a bottom line guy. I've got 600 people here. I'm bottom line. You hire the best people; you train them.

When you go into a business, what do you want? You want your needs met. If you don't have those needs, you'll go someplace else. The problem [in government] is that you don't have any place else to go. Counties and cities are monopolies. We've got this obligation and these opportunities. So when you talk about outcomes, it also gives you the opportunity to look at how your business processes. I hate terms like empowerment, but that is what it does. I'll give you a perfect example. We had to cut business deals with all our departments. We had to put something in it for them. Do you know what works with people? Incentives. Do you know what a good incentive is? That would be money. It works for everybody.

Recognition works and rewards work. I have found that if you measure it, recognize it and reward it, people will try to do it. My child will do that. My dog will do that.

Adams: When you implemented this, your county manager, elected officials and staff had to buy into it. Were you able to see results? Were you able to save any money?

Wyatt: Sure we were able to save money, keep the tax rate down and invest money. It comes back to this empowerment of the individuals. The Health Department is a real-life example. I want to focus on the fact that this was a team effort. Now, was I a maverick saying do this and do this? When they wanted to soften it up I said, "No. If we are going to follow this concept, let's push it! Let's push the limits." Did I push the limits? Yes. That is what I do. Health Department. We cut a deal with them where if they save money in their budgets, they can use some of that money to reward employees, reinvest in services.

Adams: Use it in any way.

Wyatt: Use it any way, basically. So, okay, this starts trickling down to staff. Hazardous waste disposal: Pay by the pound for hazardous waste disposal. Our employees had never had any incentive before to question what they're putting in that little red bin with the funny marker on it, right? Now they are. And they realized they were throwing away packaging and paper, not only the needles and the bloody stuff and they thought, wait a minute. We're paying by weight for disposal.

By thinking about what they were doing they were able to save money and buy more vaccine or reward the employees.

Adams: You linked government waste to their bottom line at a personal level.

Wyatt: Yes. And again, give them some incentives. One of the great challenges in any government is recognizing and rewarding people. That in itself is a huge challenge. Money works. But you've only got so much money. The old bureaucratic model says that everybody gets a 2 percent or 3 percent raise. Well, you know as well as I do you've got some people who are just happy to be here from eight to five, and you've got other people who are tearing it up. You've got everybody in between. Well, what are you paying them for all this time? The golden rule is not "treat everybody alike;" it's "do unto others as you would have them do unto you." I would like to be rewarded when I bust my tail and come up with good answers and good solutions.

So one of the things that we had to do is, again, put these outcomes together and then reward people for going there. And we can do it with the same money. Sure, cost of living is going up, okay. We'll do a COLA to cover that, and then we've got enough money to give everybody in the organization a 1 percent increase. Not a lot of money, but if you've got enough money to give everybody a 1 percent increase, what if you took that same amount of money and gave it to your top 10 performers. ■

Continued from Page 8
EDUCATION

Purchasing. In New Jersey, the Shared Services Program is a cooperative effort among Middlesex County municipalities that supports the towns by providing a way to reduce daily operating expenses through cooperative purchasing. The program began in 1998 by offering towns aggregate natural gas purchasing, resulting in a 5 percent savings on electricity for public buildings during the first year of the program. Currently the municipalities share services for water/wastewater programs and the purchasing of natural gas, electricity, equipment, services, and supplies.

Administration. Seven districts in Connecticut have a shared services arrangement for administrative services that includes the superintendent, director of instruction, federal programs, special education directors, and a legal agent. Meanwhile, in West Texas, Region 17 regional service center located in Lubbock, which serves an area encompassing about 19,000 square miles (close to the size of Pennsylvania), provides payroll and accounting services for a number of rural school districts, saving each over 50 percent a year and some up to 88 percent annually. The service center has also established an insurance co-op, which allows about 20 rural districts to purchase optional health services plans, such as dental insurance, at a much lower rate with better coverage than they could on their own.

Human resources presents another good opportunity for shared provision of administrative services. In 2004, the Massachusetts Human Resources Division (HRD) implemented shared services to streamline human resources for all state agencies. The HRD allowed government agencies to reduce staffing and save the Commonwealth millions of dollars. In the HRD alone, staffing was reduced by 50 percent while handling more complex responsibilities and offering more innovative services to state agencies. For example, the state agencies devised a new shared recruitment process that reduced the time to fill a position from four months to five weeks.

Technology. Districts have vast opportunities to share technology, ranging from shared systems and applications to shared help desk and onsite IT support. Districts across the country have found creative ways to develop payroll and HR systems with municipalities and neighboring schools, to share the cost of software licensing and purchasing applications, and even sharing CIOs with other districts. Sarasota County, New York and the local school district created a shared services partnership for information technology that cut personnel and software costs for the school district. ■

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TELECOMMUTING

Someone in the throes of the flu is clearly sick. But what if that person just has the sniffles? Here telecommuting can help. Although many companies foster a get-to-work-no-matter-what environment, presenteeism research shows that simply being on-site does not make a sick worker fully functional. Those on the verge of sickness would often be better off working from the comfort of their own homes. Telecommuting allows them to be as productive as their condition allows, and staying home will likely quicken their recovery. For example, it would be better for someone feeling under the weather to skip the morning commute and get some extra rest. And, when it comes to getting well, there is no place like home. At home the sick worker can bundle up with blankets, sip soup, and scuttle about in slippers. In this case, telecommuting also benefits the company at large because it quarantines the sick worker, making it less likely his or her illness will ravage the entire staff.

5. Improved Emergency Management: In the event of an emergency—be it a terrorist attack or the more common act of nature—it pays to have telecommuting capabilities. If employees cannot get to the headquarters of a particular business or government agency, that organization can continue operations from remote locations.

Rep. Tom Davis (R-Va), chairman of the House Government Reform Committee, recently highlighted telecommuting's national security benefits. "The decentralization of federal agency functions inherent in a healthy telework strategy can greatly increase the survivability of those agencies in the event of a terrorist attack or other disruptive crisis." ■

Who, What, Where

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