Focus on Trends in Privatization and Goverment Reform

Privatization Watch

Analyzing privatization developments since 1976

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If it can make it there, it can make it anywhere

Privatization in New York City

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Privatization Watch

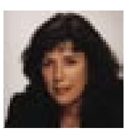
Editor

Ted Balaker (ted.balaker@reason.org)
Reason's Jacobs Fellow spent five years with ABC Network News producing pieces on government reform, regulation, and privatization.

Writers

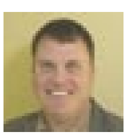
Robert W. Poole, Jr. (robert.poole@reason.org)
A pioneer in privatization and transportation policy, Poole has advised several presidential administrations. His transportation work has spurred innovations in toll roads, congestion pricing, airport privatization and air traffic control corporatization.

Geoffrey F. Segal (geoffrey.segal@reason.org)
As Director of Privatization and Government Reform Policy at Reason, Segal has authored many studies on privatization, competitive sourcing, and government management.



Lisa Snell (lisa.snell@reason.org)
A leader in education policy research, Snell has authored many studies and articles on education reform and child welfare.

Vice President, Reason Foundation



Adrian T. Moore (adrian.moore@reason.org)
Frequently cited by journalists and sought after by policymakers, Moore is one of privatization's leading authorities.

President, Reason Foundation

David Nott (david.nott@reason.org) Nott leads Reason Foundation, a national organization dedicated to advancing a free society through the promotion of choice and competition.

Published by Reason Foundation
3415 S. Sepulveda Blvd., Suite 400
Los Angeles, CA 90034
800/391-2245; 310/391-4395 (fax)
www.reason.org

Annual Privatization Report 2005

Privatization is hard to pin down. Although it's spreading quite quickly, it's not a practice that advances in a systematic way. Certain governments are quick to adopt it for certain service areas. Sometimes new technology creates new opportunities (See "The Era of Personal Spaceflight Has Begun," Page 15). Sometimes old concepts of accountability and competition offer new hope (See "Charter Schools Take Off," Page 14). Sometimes a skilled leader brings a comprehensive program to fruition in one place, like New York City (See "If It Can Make It There, It Can Make It Anywhere," Page 4).

The fact that privatization spreads quickly and unpredictably makes trend-spotting all the more important. Elected officials, service providers, journalists, and voters want to make sense of it all. What has become of the federal government's competitive sourcing push? Is offshore outsourcing the juggernaut it's made out to be? How are other nations approaching privatization and government reform?

For the past 19 years Reason's *Annual Privatization Report* has chronicled and analyzed the most important developments in privatization, outsourcing, and government reform. This year's report addresses issues ranging from Social Security, housing, wildlife conservation, and surface, air and space transportation, to health care, education, and much more. This issue of *Privatization Watch* is meant to give our readers a sample of what's available inside *Annual Privatization Report 2005*. If you like what you see here and want more, you can access the entire report online: reason.org/apr2005/ ■

Privatization Briefs

Space Tourists Already Getting More Choices

Say the year is 2008 and you have a hankering for space travel. If you have $200,000 you could fly into suborbital space via Virgin Galactic. Then again, if you want to go all out you could write a check for $100 million and take a trip around the moon.

The day after the shuttle Discovery returned to earth a private company announced plans to take tourists around the moon. Space Adventures, a Virginia-based company, plans to team up with Russian space officials and send passengers, two at a time, on voyages that will last between 10 and 21 days. The company organized the trips for the world's first space tourists, Dennis Tito and Mark Shuttleworth.

Space Adventures also recently finalized an exclusive marketing partnership with the Tokyo-based travel agency, JTB Corporation. JTB will market the trips around the moon and other Space Adventures services to the Japanese public.

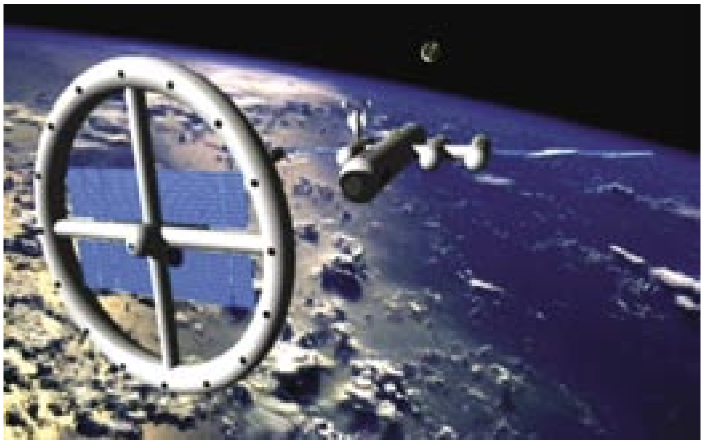
The formation of The Spaceship Company, a new Burt Rutan-Richard Branson venture, signaled more good news for would-be space tourists. The new aerospace production company will build ships for companies just beyond Branson's Virgin Galactic and Rutan expects the burgeoning competition to drop prices. It won't be long, he says, before a suborbital jaunt will be comparable in price to a fancy ocean cruise. (For more, see "The Era of Personal Spaceflight Has Begun, page 15).

Water Privatization Comes Clean

The debate over water privatization has long hinged on anecdotal evidence. That's beginning to change. The Water Partnership Council, an organization of water and wastewater service providers, recently released the results of 31 interviews with representatives of public agencies that contract out for water and/or wastewater services. The agencies serve populations ranging in size from 4,000 to 1.2 million.

Some results:

- 74 percent reported that privatization improved regulatory compliance.
- 92 percent achieved their cost savings targets. The remaining 8 percent said it was too early in the contract term to evaluate savings.
- 93 percent noted that involuntary employee turnover either declined or remained the same.



- In terms of overall satisfaction, 50 percent said they were "extremely satisfied" with the partnership and no respondent reported a rating lower than "satisfied."

The high satisfaction rate jibes with a recent *Public Works Financing* survey that found that over 92 percent of the 560 governmental contracts up for renewal in 2004 were again outsourced to the incumbent or another private provider.

The Water Partnership Council report is available online: waterpartnership.org/PDF/IndustrySurvey2005.pdf

Why do some privatizations succeed and others fail?

This was just one of the many questions considered in the *2005 Municipal Yearbook*, published by the International City/County Management Association.

The authors, Sergio Fernandez of Indiana University and Hal Rainey of the University of Georgia, surveyed 439 specific contracts between local governments and private providers. The authors asked about everything from contracts to performance measures to outcomes. Perhaps the most important general finding is that privatization is overwhelmingly successful—85 percent of respondents rated contractors' performance as very good or excellent.

Finally, the authors scoured through the survey responses to try to determine what contract elements seem to lead to successful contractual relationships. They conclude that success is most often seen when:

- The parties work together to arrive at solutions to problems that arise during the life of the contract;
- The parties trust each other; and
- Public managers and employees support (or do not oppose) the contracting initiative.

For more on the *2005 Municipal Yearbook*, visit: reason.org/apr2005/contract_management.pdf ■

If It Can Make It There, It Can Make It Anywhere

Privatization in New York City

Interviewed by Ted Balaker

Privatization has a way of popping up in some unexpected places. Sweden is known for its lavish government programs. Who would have thought health care privatization would take hold there? France is famously skeptical of the free market and yet that nation's roadway system, with its tolling and public-private partnerships, is more market-based than the United States'. Even Azerbaijan, a former Soviet satellite, has corporatized its air traffic control system. One can even find surprises in the United States. New York City's political culture wouldn't normally nurture this sort of thing, and yet somehow former Mayor Rudy Giuliani's ambitious privatization agenda flourished in the Big Apple.

E.S. Savas

In his latest book, *Privatization in the City: Successes, Failures, Lessons* (CQ Press), Baruch College Professor E.S. Savas examines how privatization transformed city services in New York. But Savas doesn't stop at the Hudson River. He continues on to investigate privatization efforts in Indianapolis, Phoenix, and many other American cities. And the reader is in good hands. Savas has studied privatization from many different vantage points—in academia, as an elected official in local government, and as a former assistant secretary of the U.S. Department of Housing and Urban Development.

Recently, *PW* Editor Ted Balaker interviewed Professor Savas via email.

How extensive was Giuliani's privatization program?

Mayor Giuliani proposed 82 privatization initiatives, carried out 66 of them, and was thwarted on 16. The 82 initiatives included 15 divestments, of which 11 were carried out. Contracting was proposed for 40 services and 32 were carried out. The other 27 initiatives involved franchising, vouchers, public-private partnerships, voluntarism, and mixed methods of privatization; all but four were carried out.

The city sold tax liens (as Mayor Bret Schundler did in

Jersey City), its city-owned radio and TV stations (for $20 million and $207 million respectively), parking lots and garages, the city-owned land under the United Nations Plaza Hotel, and most of the 52,000 housing units in the 5,458 residential buildings.

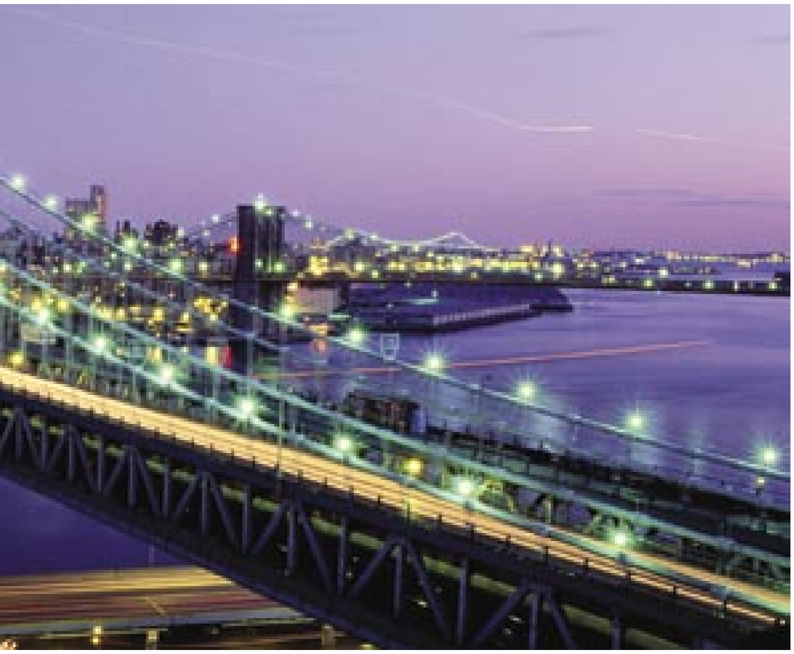
The city contracted with a non-profit organization to improve and maintain Central Park. It entered into performance-based contracts for placing welfare applicants and recipients in jobs (as part of the welfare reform program), and contracted for park maintenance, vehicle maintenance, operation of red-light cameras, operation of homeless shelters, and water-meter reading.

With its strong union presence New York seems like the last place where a large-scale privatization effort would take root. How did it happen?

Firm and unwavering commitment by Giuliani. He had all his commissioners press forward with detailed privatization plans. He used a combination of threats and rewards in dealing with the major unions. No layoffs. He avoided trying to privatize in those agencies that had large, powerful unions; for example, he did not attempt to privatize solid waste collection or the operation of water treatment plants or wastewater treatment plants, which have aroused strong opposition elsewhere. He fought efforts by the city council to block the privatization of municipal hospitals and jails, but he was unable to prevail in those cases.

How successful has the program been?

The city saved an estimated $6.2 billion over the course of Mayor Giuliani's eight years in office, or $776 million



annually. Of that total, one-time revenues—mostly by from divestments—totaled $2.3 billion, and recurring monetary savings from contracts and other privatization methods were an estimated $3.9 billion. All in all, this amounted to 2.2 percent of the average annual city budget during that period. Putting it another way, the savings were $824 per resident during the Giuliani administration, or $3,296 for a family of four.

But city budget savings are far from the whole story. Services to the public were improved by contracting with a check-cashing company to allow people to pay their municipal bills at scores of convenient locations. A private contractor investigated applicants for public housing to confirm their eligibility, thereby preserving those dwelling units for people who were really eligible. Contracts with private custodial services in schools required the contractor to make the school available off hours for community groups at no extra charge. Privatizing waste disposal enabled the city to close the last landfill within city limits, to the great relief of local residents. Moreover restructuring the private commercial waste collection industry to eliminate illegal cartelization and increase competition resulted in direct savings of an estimated $400 million for local businesses.

What are the lessons that other cities should take away from New York's experience?

Strong commitment from the very top and constant follow-up by senior staff is indispensable for success. Don't be afraid to battle for what you believe is right; don't seek fights, but don't be intimidated by political opponents. Give employees a fair chance to compete against private bidders.

How common is it for services to get un-privatized?

This was not at all common, but here is one interesting case where a service was "unprivatized," or "municipalized": The mayor's highly successful reform of welfare started with the Work Experience Program (WEP), in which able-bodied welfare recipients and welfare applicants worked in city agencies and earned their welfare payments at the minimum wage rate. Many people therefore became available to work in the city parks, for example, and so they displaced a contractor who was hired competitively to do park maintenance. It was less expensive for the city to use these workers, whose minimum-wage compensation was charged to the welfare budget, than to continue with the private contractor. The latter was doing a good job and saving the city money, but it was even less costly for the city to use WEP workers.

Other privatized services reverted to municipal operation after city employees learned from the contractor how to improve the function, and the city then concluded that it was less expensive to do the work in house. This was done with the management of rentals of city property, for example, where the contractor organized the work and set up a systematic process to keep track of rentals when they were due.

Most people would never agree to patronize the same mechanic forever, regardless of how he performed. Yet many of those same people don't mind if City Hall services its vehicles that way. Why are people so appreciative of competition in their private lives but not in government?

That's an awfully good question. The mindless answer, I'm afraid, is "We've always done it this way." The public has no memory of earlier practices in city services and reflexively assumes that a municipal service must be provided by municipal employees. This public attitude—based on thoughtless habit—is particularly true in big cities. Look at solid waste collection and bus operations, for instance. These are unthinkingly assumed to require public employees.

What do you think the future will hold for privatization in New York and other cities?

Privatization is no longer an ideological issue. It's an ordinary management tool used in communist, socialist, and capitalistic countries and in democracies and dictatorships. In the United States it is being practiced by liberals and conservatives, white and black mayors, and by Democrats and Republicans. It will continue to expand slowly, sensibly, and inexorably as budget pressures continue to squeeze cities and as the public demands good and efficient services and accepts privatization. ■

Tax and Spending Limitations

By John Berthoud

There's a slightly funny-sounding new word increasingly at the center of state budgetary politics: "TABOR," which is an acronym for Taxpayer's Bill of Rights. For both supporters of expanded government and proponents of limited government, TABOR has become a lightning rod in the fight over public policy.

The TABOR story starts in Colorado. After having been defeated twice, TABOR was once again on the ballot in 1992. Recognizing the potency of TABOR, pro-government forces left no stone unturned in their scare campaign. Leading the opposition was Gov. Roy Romer, who said that stopping TABOR was the "moral equivalent of defeating the Nazis at the Battle of the Bulge." Lead TABOR proponent Douglas Bruce was vilified and labeled by Romer as "a terrorist who would lob a hand grenade into a schoolyard full of children." Despite this demagoguery, TABOR was approved by voters. As a footnote to this bitter campaign, Romer was later appointed Chairman of the DNC by Bill Clinton at about the time the Democratic Party was making a push to civilize political discourse.

Colorado's TABOR contains the most comprehensive fiscal limits in the nation, including requirements for voter approval before higher state or local taxes or debts may be enacted, a ban on local income taxes and state property taxes, a flat-rate income tax, emergency reserves and comprehensive state and local spending limits tied to inflation increases and population growth. Any surplus revenues must be returned to taxpayers.

The greatest fear of opponents is that TABOR would do exactly what it promised: create some reasonable restraints on the growth of government. TABOR has indeed done this. Dr. Michael New, an academic who has studied state tax limits, summarizes, "Colorado's Taxpayer Bill of Rights has quietly become America's most effective limitation on government. It has kept spending in check, provided tax relief to Colorado residents, and deserves a great deal of credit for Colorado's strong fiscal position."

The most repeated (substantive) claim of TABOR opponents has been about economics. Supposedly, TABOR was going to destroy Colorado's economy. Romer and others claimed that TABOR would lead to the posting of signs on Colorado's borders that "Colorado is closed for business." But the results have been exactly opposite of these claims:

- TABOR has enabled Colorado to lead the nation in cutting taxes. From 1997-2001, TABOR returned $3.25 billion to taxpayers (about $3,200 for a family of four).
- Colorado has not passed a single tax increase at the state level since enacting TABOR.
- Between 1995 and 2000, Colorado was first in the nation in growth of gross state product, and second in personal income growth.

There have been non-economic benefits too. Accountability is one. Dee Hodges of the Maryland Taxpayers Association offers this summary of the fiscal benefits of Colorado's TABOR: "TABOR works because it forces state and local governments to live within a budget, to set public priorities, to make wiser choices, and to find ways to meet state goals—not by spending more—but by spending smarter."

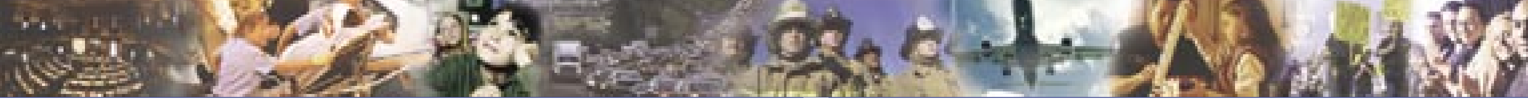
Citizen involvement is another. As the new Democratic Speaker of the Colorado House of Representatives Andrew Romanoff has bluntly stated, "Voter approval of tax increases is extremely popular, and politically untouchable." Opponents rarely criticize this aspect of TABOR, instead focusing on how it limits the growth of government.

And ultimately, TABOR has proven popular with voters (if not special interests seeking more government funding). A recent survey showed that over 70 percent of Coloradans back TABOR—that's greater support than when it was enacted 13 years ago.

Reaction in Colorado

TABOR's strong impact on Colorado fiscal policy (and economy) has earned it admirers and detractors. The former camp has sought to spread the TABOR concept across America. The latter group has sought not just to stop TABOR elsewhere but to gut it in Colorado.

In Colorado, because TABOR is now forcing some tough budgetary choices, Gov. Bill Owens (formerly a TABOR champion) has teamed with the Democrat-controlled legislature to put Referendum C on this fall's ballot. The measure would suspend TABOR for five years. The effects would be two-fold: first, it would mean Coloradans would have $3.1 billion less than they otherwise would have. And second, it probably would mean the end of TABOR. If TABOR gets waived for five years, the political class would certainly seek sometime during that time period to finish it off entirely. The aforementioned popularity of TABOR makes a head-on repeal



effort impossible. So opponents are trying to slay Colorado's TABOR in a way that they can claim they are "reforming" and "preserving" it.

Not unexpectedly, public employee unions and others who benefit from government largesse are funding a multi-million dollar campaign in support of Referendum C. As Jon Caldara of the Independence Institute has observed, "The tax-and-spending lobby wants to have a victory against TABOR so they can run around the country and scare other states about the 'Colorado Experience.'"

Supporters of Referendum C include others who, like Owens, probably used to count themselves among supporters of limited government. One such person is Bruce Benson, a Republican "Super Ranger" (big dollar fundraiser), who will be spearheading the drive for Referendum C. Despite his advocacy of this $3.1 billion tax hike, Benson nonetheless professes, "I like smaller government and lean government." The added $3.1 billion for government coffers led House Republican leader Joe Stengel to observe that Referendum C will be "a five-year spending spree."

Reaction Elsewhere

Colorado's limitation may be the best in the nation, but many other states have limitation provisions of some sort. Twenty-six states have enacted some variant of a Tax and Expenditure Limitation (TEL). More than a dozen states incorporate voter approval or legislative "supermajority" mechanisms in their tax policies. And roughly two dozen states limit all or part of their budget increases to economic measurements such as inflation or personal income growth.

In 2005, a large number of states have begun the process of taking a look at the benefits of enacting the full array of protections embodied in TABOR. Efforts for enacting a Taxpayer's Bill of Rights have begun across the nation. A typical TABOR bill is that of Maryland Delegate Herb McMillan. McMillan's measure (HB 1206) would require voter approval of any state or local tax increase. Under the bill, state and local spending could not rise by more than the growth of inflation and population (adjusted for approved revenue changes). The measure would create a rainy day fund and also stipulate that if general fund revenues exceed projected revenues by at least 2 percent, the total amount of the excess (minus administrative costs) must be returned to taxpayers.

There are several key themes driving the move for TABOR around the country:

- Citizen Involvement. Voters like the idea that they should be asked before government takes more of their money. In a poll of Virginia residents last year, the National Taxpayers Union found strong support (76 percent to 19 percent) for the idea that citizens should be given "the right to vote directly on most tax increase proposals by the Virginia State Legislature."
- Tax Relief for Families. Under the leadership of State Representative Frank Lasee, the idea of TABOR is moving forward in Wisconsin. Central to Lasee's argument for a Wisconsin TABOR has been the increasing tax burdens on families at all income levels in Wisconsin. By one estimate, if a TABOR had been in place in Wisconsin from 1990-2001, Wisconsin families would have saved a total of $10,241 per household.
- Economic Growth. Again, the TABOR era has been part of a great economic success story in Colorado. Making the case for enacting a TABOR in Kansas, Dr. Barry Poulson argues, "The contrast between Colorado and Kansas in that time is striking: while the two states experienced similar economic trends in the 1970s and 1980s, there was a major divergence in the 90s, when income per capita increased 70 percent in Colorado, while it only increased 53 percent in Kansas."

TABOR has even gone to Washington, D.C. The Heritage Foundation, the Tax Foundation, and other groups are now actively promoting the idea of a federal version of TABOR to rein in Washington's excesses. The federal government is in need of spending restraint as much as any state government. The President's Office of Management and Budget is projecting that total FY 2005 outlays will be a stunning 33 percent higher than outlays in FY 2001. The biggest obstacle facing this effort is the inability of voters to act directly to affect federal policy. Research by the National Taxpayers Union Foundation has shown that citizen-driven tax and spending limits are far more effective than those emerging from the legislative process.

Prospects

The battle in Colorado this fall will be herculean. While opponents recognize that well-heeled supporters of Referendum C will handily outspend them, each side will bring substantial resources to the fight. At stake is whether Colorado citizens can put a limit on the size and scope of government. And ultimately, what happens in Colorado this November could have far-reaching consequences in state capitals around the nation.

John Berthoud is President of the National Taxpayers Union (ntu.org). ■

Spotlight South Carolina

By Geoffrey F. Segal

Under Gov. Mark Sanford's leadership, the governor's office offered a new approach to budgeting. It's a process that focuses on outcomes and achieving state priorities and goals. Fifteen hundred different activities were divided into purchasing priorities regardless of the agency performing them. By focusing on the programs that delivered the greatest results, and purchasing those, the administration was able to shave $160 million from the budget (based on a total annual budget of $16.9 billion) resulting in the suspension or elimination of about 67 activities (or 4.4 percent of the total number of activities) currently performed by government.

Essentially, available dollars are spread across the goal and priorities areas (i.e., what the state wants to purchase or achieve). Spending was allocated from the top of the priority list working down until they "ran out of money." Using this approach, some activities and programs will not be funded or fall below the "spending line." In other words, they do not provide as good a public investment relative to other programs. Some will disagree with this method of prioritizing spending. However, it is the most responsible way to spend taxpayers' dollars.

Unfortunately for Sanford, the legislature doesn't see eye to eye with his administration's effort. In fact, the legislature passed a budget that swelled with pet projects or "pork," leading one state senator to describe the budget as having more pork than a bar-b-que. With his emphasis remaining on fiscal restraint, Sanford issued another 163 budget vetoes of $96 million. While the method starkly contrasted the previous year's budget veto process, the outcome was the same. All but 10 of the governor's vetoes were overridden in a very slow, methodical process (compared to the previous year where 105 of 106 vetoes were overridden in only 99 minutes).

In addition to the budget, the legislature took up other measures to limit the governor's authority and ability to use alternatives to current service delivery—primarily competitive sourcing and privatization.

One of the veto overrides severely limits the administrative flexibility and management options of the state Parks, Recreation, and Tourism (PRT) department. A budget proviso requires the agency to seek approval from the legislature and budget control board before moving forward with a competitive sourcing initiative. The proviso was introduced in reaction to an RFP issued by PRT to explore the feasibility of contracting-out the operation of a golf course at Cheraw State Park.

Geoffrey F. Segal with Gov. Sanford

In his veto message, Gov. Sanford argued that this reaction to one proposal "would tie the hands of the agency from pursuing any kind of competitive sourcing arrangement for any activity, no matter how minor, at any of its parks."

Prior to this proviso, PRT had contracted out the campsite and cabin reservation system state-wide. The new system was developed by ReserveAmerica, which also provides reservation services for the National Forest Service and the U.S. Army Corps of Engineers. The reaction from most of the park's customers has been positive as the contractor has improved services, lowered costs, and led to higher revenue for the state.

Last year, a task force was formed to study the feasibility of privatizing the state's school bus fleet. South Carolina is the only state in the union that owns and operates the entire school bus fleet (two individual districts have privatized their fleet). After months of study and careful review the school bus privatization task force determined that privatization was feasible in South Carolina school districts. The recommendation requires the legislature to move on the recommendation—only one house has passed the initiative at press time.

For updates on Florida, Georgia, Indiana, Kentucky, Pennsylvania, and Virginia, visit: reason.org/apr2005/state_update.shtml ■

Competitive Sourcing Continues to Save Billions

By Geoffrey F. Segal

The Office of Management and Budget released data on public-private competitions in FY2004, with impressive findings. Federal agencies completed 217 competitions involving 12,573 full-time-equivalent employees (FTEs). An additional 76 competitions have been announced but not yet completed. The competitions are estimated to generate net savings or cost avoidances totaling approximately $1.4 billion over five years. When combined with the $1.1 billion savings from last year, competitive sourcing has saved more than $2.5 billion. This equates to about $552 million in annualized gross savings. One-time, out-of-pocket expenses for conducting competitions were $74 million. This represents a return of $20 for every dollar spent on conducting competitions.

What's more impressive is the greater potential for savings. Competitions resulted in savings of $22,000 per position studied—nearly double the estimated net savings from FY2003—yielding more than 27 percent in savings. Given the number of commercial positions in the federal government, competitive sourcing can potentially generate in excess of $5 billion in annual savings and/or cost avoidance.

The report also identified steps that OMB was taking to better incorporate competitive sourcing with strategic human capital management, for example, identifying and creating appropriate crosswalks between the human capital and competitive sourcing standards for success. In addition, OMB will work with the Office of Personnel Management's Human Capital Officers and other human resources officials to identify practices for leveraging the shared interests of the human capital and competitive sourcing initiatives.

Reason originally outlined the need for such linkages in a 2003 study Getting the Right People for the Right Job: Solving Human Capital Challenges With Competitive Sourcing*: reason.org/ps312.pdf* ■

What Now for Airport Security?

By Robert W. Poole, Jr.

In May 2005, the Government Accountability Office released classified and unclassified versions of an assessment of the performance of airport passenger screeners. Although no numbers were included in the unclassified version, the overall conclusion was that screening performance today, after several years of operation by federal Transportation Security Administration (TSA) screeners, was little or no better than the performance of minimum-wage private-contract screeners in place at the time of the 9/11 attacks. Moreover, the performance of the new private screeners at the five pilot-program airports called for by Congress (San Francisco, Kansas City, Rochester, Tupelo, and Jackson Hole) was better than that of TSA screeners.

These results raised concerns in Congress and the news media over the value gained by tripling the cost of airport screening by "federalizing" it. And they also suggested that, to the extent that the new federal mandates remain in place, it might be more cost-effective to phase out TSA as the operator of screening in favor of a performance-contracting approach. Just such a change has been advocated by Rep. John Mica (R, FL), chairman of the House Aviation Subcommittee.

Under current law, all airports have been permitted, since November 2004, to opt out of TSA-provided screening, making use of a TSA-certified contractor instead. As of May 2005, however, only two small airports had applied to do so. This is in part because of continued airport concerns over liability if TSA is not the provider. But it also reflects on the centralized nature of the TSA's opt-out program. If an airport decides to opt out, it is not allowed to seek bids from a set of TSA-certified contractors, hire the most responsive one, and then integrate its operations into the overall airport security program. Instead, it must apply to TSA, and TSA assigns it a contractor, hired by and supervised by TSA. Thus, most airport directors see little value in such a minor change.

During 2004, the TSA began a five-airport pilot test of a Registered Traveler program, under which frequent flyers can volunteer to become pre-cleared and receive a biometrically encoded ID card. When they arrive at the passenger checkpoint, the idea is that they will proceed through a special lane, for expedited processing, after verifying their identity by showing that their physical feature (fingerprint, iris scan) matches

See AIRPORT SECURITY on Page 13

Federal Bill Boosts Tolling, Pricing

By Robert W. Poole, Jr.

In late July Congress finally passed the long-delayed bill to reauthorize the federal surface transportation program, which the president signed. The good news for advocates of road pricing and public-private partnerships (PPPs) is that these concepts will be more widely applied thanks to provisions in the new law.

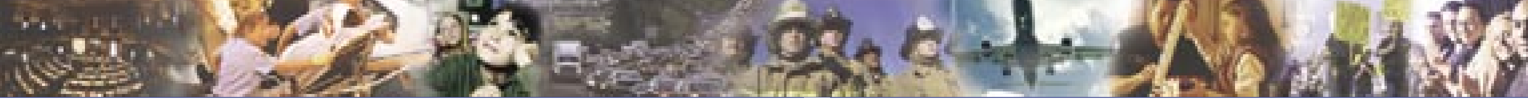
In a nutshell, the bill provides three ways under which value-priced lanes can be added to federally aided highways, including Interstates. It also permits three states to develop brand-new Interstates funded with tolls. And private firms developing toll projects under PPP agreements are now allowed to issue tax-exempt toll revenue bonds on the same basis as state toll agencies.

For adding priced lanes, the new law (called SAFETEA-LU) continues the Value Pricing Pilot Program (VPPP) for the existing 15 "project partner" state DOTs. Thus, states like Florida, Minnesota, Texas, and Virginia that have already been doing such projects under TEA-21 can continue to expand them and do more such projects. In addition, Congress has created a new Express Lanes Demonstration Program, under which tolled express lanes may be added to Interstate highways in 15 cases. This opens the door to states (like Wisconsin) that are not VPPP partners to do such projects. For this program, tolls must be collected electronically, and the purpose can be to reduce congestion and/or to reduce emissions. In addition, the HOV section of the bill permits the conversion of HOV lanes to HOT lanes without limits on the number of such projects, and without having to be part of the VPPP. Also, none of these programs requires the tolls to be removed at some future date, as was proposed in Rep. Mark Kennedy's FAST Lanes amendment.

The good news for advocates of road pricing and public-private partnerships (PPPs) is that these concepts will be more widely applied thanks to provisions in the new law.

Another section of the law creates an Interstate System Construction Toll Pilot Program. Under this provision, up to three new Interstate highway projects may be developed using toll financing. The Interstate system, which celebrates its 50th anniversary, is often referred to as "finished." What that statement means is that all the routes needed for 1950s America have been built. But since the country's population, settlement patterns, and commerce have changed greatly in the past 50 years, there are some significant gaps in the Interstate system. For example, there is no Interstate route between Las Vegas and Phoenix, two of the country's fastest-growing metro areas (but practically cow towns in 1950). One of the first projects likely to go forward under this program is the long-discussed I-69 extension from Indianapolis to Texas.

Finally, Section 1143 of Title XI, Subtitle C provides for Private Activity Bonds for Highways and Surface Freight Transfer Facilities. This provision corrects a serious inequity in the federal tax code. For nearly all other infrastructure modes, including airports, seaports, and rail systems, if the private sector develops a new facility for public use, it can issue tax-exempt revenue bonds to finance it. Highways have been a conspicuous exception; in a PPP toll road project, the private sector could only make use of taxable bonds, carrying a higher interest rate. The increased debt service costs made many toll projects not "pencil out." The new provision permits up to $15 billion in tax-exempt revenue bonds to be issued on behalf of PPP projects to develop toll roads, toll lanes, and intermodal (truck-rail) facilities during the life of SAFETEA-LU. The provision applies only to projects receiving federal aid under Title 23; hence, the usual federal baggage (Davis-Bacon prevailing wage requirements, Buy America, etc.) applies. But since many large toll projects would be in this category anyway, the provision seems likely to be very useful. ■



Texas and Beyond: PPP Toll Road Projects

By Robert W. Poole, Jr.

The idea that the private sector can play a larger and more meaningful role in addressing the nation's transportation funding needs, and better meeting highway users' needs, got a large boost when the U.S. Department of Transportation published its 164-page *Report to Congress on Public-Private Partnerships* (www.fhwa.dot.gov/reports/pppdec2004/) in December 2004. It provides a good overview of the types of PPPs applicable to surface transportation, ranging from outsourced highway maintenance to long-term build-operate-transfer (BOT) concession agreements. It includes profiles of 21 such projects from around the country.

Texas

The biggest single proposed PPP to date was announced in December 2004 when TxDOT announced the winning bidder for TTC-35, the first major project of the Trans-Texas Corridor. A team of CINTRA and Zachry Construction proposed a $7.2 billion project, all privately financed, for the new corridor from north of Dallas to south of San Antonio, parallel to congested I-35. An estimated $6 billion of that total would fund construction of the all-new four-lane toll road; the other $1.2 billion would be a franchise fee, paid out in installments during the construction period, in exchange for the right to toll the project for 50 years.

Texas is also the site of another large proposal, this one unsolicited. A team headed by Kiewit proposed to add tolled managed lanes to the median of the Airport Freeway in Dallas (SH 183 and I-820), a length of 27 miles. The project has an estimated cost of $650 million. The Perot Group has separately proposed adding tolled express lanes on 20 miles of I-35W in downtown Ft. Worth. Also in the DFW Metroplex, the North Central Texas Council of Governments has received a federal Value Pricing Pilot Program grant to plan for and design tolled managed lanes on I-30, another major east-west freeway. The new lanes would extend from Dallas to Arlington.

Yet another unsolicited proposal was submitted in January 2005 by Skanska, for the proposed extension of SH 121 from north of the DFW Airport to US75.

Virginia

The largest proposed PPP project in this state calls for truck-

only toll lanes to be added to the entire 325-mile length of I-81, a major truck route across the state. The project resulted from an unsolicited proposal submitted several years ago by STAR Solutions, a multi-company consortium. Virginia applied for and received preliminary approval to take part in a federal pilot program (under TEA-21) to rebuild selected Interstate highways using toll revenue financing. But the $7 billion project is bitterly opposed by the trucking industry, whose studies project significant diversions of trucks onto other highways if the plan for mandatory truck use of the toll lanes goes through. As of mid-2005, the overall reconstruction of I-81 is still in the environmental review process. The final form that tolling might take is not yet decided.

The northern Virginia suburbs of Washington, D.C. are the location of not one but two private-sector HOT lane projects. The first, proposed by Fluor several years ago, received VDOT approval in April 2005, pending final environmental clearance expected early in 2006. It would add four HOT lanes to the median of the Beltway (I-495) from I-95 on the south to the Dulles Toll Road on the north. Fluor has added Australian firm Transurban to its team as both equity investor and toll-road operator. With an equity-plus-debt funding approach, the entire $900 million project is expected to be supportable with private capital, meeting VDOT's desire for additional ramps without requiring VDOT funds. Instead of an all-debt, 30-year nonprofit corporation approach (which would require about 15 percent public funding), the new approach of debt plus equity would require a 50 to 60-year franchise term, to enable the equity provider to earn a return on its investment.

The second D.C.-suburbs HOT lanes project still has two competing proposals—from Fluor and from Clark/Shirley—in the running. Both would convert the existing HOV lanes on

See TOLL ROAD PROJECTS on Page 13

HOT Lanes Gain Speed

By Robert W. Poole, Jr.

As of the start of 2005, four high occupancy toll (HOT) lanes were in operation in the United States: the 91 Express Lanes in Orange County, California, the SR 125 HOT lanes in San Diego, the reversible HOT lane on the Katy Freeway (I-10) in Houston, and a similar HOT lane on US 290 in Houston. By the end of 2005, there will be two more in operation, in Denver and Minneapolis, both conversions of underutilized HOV lanes.

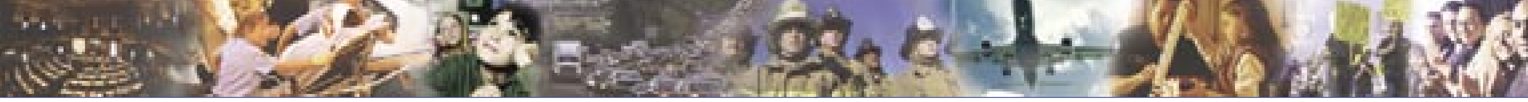
Two more HOT lane projects have received permission to be implemented, both via legislation. In 2004 the California legislature approved a bill to let Alameda County implement a long-planned HOT lane on I-680's Sunol Grade, a major commuter route between Silicon Valley and the East Bay. (The same bill also permits Santa Clara to consider HOT lanes and San Diego County to expand its I-15 HOT lanes.) And in early 2005, the Washington legislature approved WSDOT's plan to convert the underutilized HOV lanes on SR 167 (between Renton and Auburn, paralleling congested I-5) to HOT lanes. This will be the pilot project for a potential network of HOT lanes in the Puget Sound region.

Two large new HOT lanes projects are currently under construction. In Houston, the Katy Freeway (I-10) is being rebuilt in a $1.2 billion project. As part of this, the existing single reversible HOT lane is being replaced by four HOT lanes, two in each direction, with variable pricing. The HOT lanes will be operated by the Harris County Toll Road Authority, which is providing $250 million for their construction. And San Diego is under way on the first phase of expanding the existing I-15 managed lanes project from the current two lanes (reversible) extending eight miles to four lanes (two each direction, with a movable barrier) extending 20 miles.

For more on trends with HOT lanes, visit: reason.org/apr2005/surface_transportation.shtml#feature4 ■

HOT Lanes Recap, 2005

Jurisdiction	In Operation	Under Construction	Approved	Proposed	Feasibility Study	In Long Range Plan
Arizona						
Phoenix					Network of HOT lanes	
California						
Alameda Co.			I-680			
Los Angeles Co.					I-710, SR 60, I-15	I-710, SR 60
Marin Co.					US 101	
Orange Co.	SR-91				SR-57	
San Diego Co.	I-15	I-15 expansion				I-5, I-805, SR-52
Santa Clara Co.					US 101, SR 87, SR 85	
Sonoma Co.					US 101	
Bay Area region						Network of HOT lanes
Colorado						
Denver		I-25N		I-70,C-470	Network of HOT lanes	
Florida						
Miami				I-95	I-95, SR-821, SR-836	SR-836
Orlando					I-4	
Tampa		SR-618				
Georgia						
Atlanta				GA-316, GA-400, I-75, I-285, I-575	HOT lanes	
Maryland						
Baltimore					I-95, I-695	
DC suburbs					I-495, I-270, US-50, ICC	
Minnesota						
Mpls/St. Paul	I-394				Network of HOT lanes	
North Carolina						
Piedmont Triad					I-40	
Research Triangle					I-40	
Oregon						
Portland					I-205, SR 212/224	
Texas						
Dallas			I-635	I-35W, I-820, I-30, SH 183	Network of HOT lanes	
Houston	I-10, US 290	I-10			Network of HOT lanes	
San Antonio					I-35, I-10, SH 160	
Virginia						
Hampton Roads					VPPP study	
D.C. suburbs				I-495, I-95, I-395	VPPP study	
Washington						
Seattle			Sr 167			



Continued from Page 11
TOLL ROAD PROJECTS

I-95 south of the Beltway to HOT lanes, and would extend those lanes farther south. Fluor's would also convert the HOV lanes on the Shirley Highway (I-395) to HOT lanes, all the way to the Potomac River. Preliminary numbers suggest that these projects could also be self-supporting from value-priced toll revenues.

Virginia also has competing private-sector proposals pending for an ambitious project to create a third river crossing in the Hampton Roads area.

Virginia's first modern-day private toll road, the Dulles Greenway, is looking healthier than ever. Though plagued by low traffic in the first few years after it opened (which pushed the toll road into a financial restructuring), the road now faces some degree of congestion, thanks to booming development in Loudon County. In February 2005, after winning approval of a toll rate increase, the company issued new toll revenue bonds to pay for a $72 million expansion to widen the entire 14-mile road from two lanes to three lanes. The expansion will also provide a direct connector ramp to Dulles Airport.

Georgia

Under its 2003 PPP law, Georgia has received three unsolicited proposals thus far. The first, early in 2004, was from the Parkway Group, headed by Washington Group International (WGI). The $800 million project would add a third lane each way to SR 316, from Athens to Atlanta, paid for by turning the entire highway into a toll road. That conversion feature sparked considerable opposition, and in January 2005, the Georgia Transportation Board put the process on hold, until WGI and GDOT have time to assess the impact of the state's revised PPP law.

In November 2004, a second unsolicited proposal was submitted, this time by a team led by Bechtel and Kiewit. The $1.2 billion project would add express toll/bus rapid transit lanes to I-75 and I-575 in the Northwest Corridor. Toll revenues would finance about $500 million of the cost (about 42 percent). Adding truck-only toll lanes would increase the cost to $1.8 billion, but thanks to higher commercial tolls, the fraction of the cost met by tolls would increase to 67 percent.

And in December 2004, WGI submitted a $2.8 billion proposal to widen GA 400 and I-285. All 31 miles of GA 400 would become a toll road (the four miles inside the I-285 perimeter already is tolled). The WGI team would add elevated HOT lanes along 13 miles of I-285. Overall, toll revenues would fund an estimated 80 percent of project costs.

California

A new private-sector proposal emerged in California in April 2005. Macquarie Group proposed to rescue the troubled San Joaquin Hills (SR 73) toll road from possible default, by leasing it for something like 50 years. The company would refinance the road and take on the risk of paying off the debt from toll revenues over the 50-year period, relieving the public-sector Transportation Corridor Agency of that risk. Initial local reaction was mixed.

Maryland

Although it does not have specific PPP-enabling legislation on its books, the Maryland State Highway Administration (SHA) thinks it may be able to use this approach via the parent transportation authority. SHA continues to study the feasibility of adding express toll lanes (with no special HOV privileges) to the Washington and Baltimore Beltways, I-270, and I-95. In addition, they plan to develop the long-postponed InterCounty Connector as a value-priced toll road. ■

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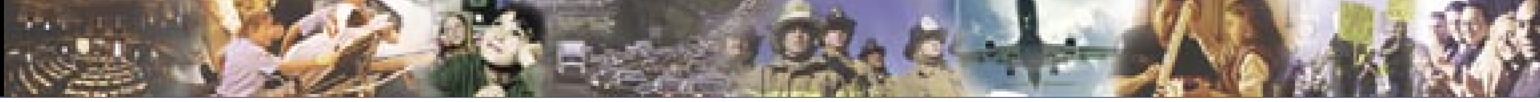
AIRPORT SECURITY

that encoded on the card. By year-end, about 10,000 people were taking part in the program at the five airports. And it appears that instead of expanding the program itself, TSA is willing to accept proposals from private firms, working with airports and airlines, to offer such programs as a feature for frequent flyers. A New York-based company, Verified Identity Pass, Inc., is developing such a service, to be launched at Orlando International Airport this year.

For more air transportation trends, visit: reason.org/apr2005/air_transportation.shtml ■

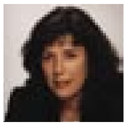
Transportation Security Aggravation
Debating the balance between privacy and safety in a post-9/11 aviation industry

reason.com/0503/fe.rp.transportation.shtml



Charter Schools Take Off

By Lisa Snell



Charter schools continue to be the largest example of school privatization. According to the Center for Education Reform, as of April 2005, approximately 3,400 charter schools are operating across the United States serving close to 1 million children. For the 2004-2005 school year, 459 new charter schools opened serving an additional 76,000 school children. In addition, according to Arizona State University's Profiles of For-Profit Education Management Organizations, as of the 2004-05 school year there were 535 public schools being operated by 59 for-profit management companies in 25 states and the District of Columbia, enrolling approximately 239,766 students. The virtual charter school market is also growing. More than 31,000 students were enrolled in 86 online charter schools in the United States at the end of 2004 year, with 62 of them opening in 2000 or later.

Charter schools have also grown substantially in the nonprofit sector, resulting in specialization and branding of nonprofit charter schools. For example, the New Schools Venture Fund has a $40 million charter school accelerator fund focused on fueling rapid, scalable growth of nonprofit charter systems. In California alone some of the branded nonprofit charter networks include Green Dot Public Schools, Aspire Public Schools, High Tech High, and Leadership Public Schools. In addition, the California Alliance for Student Achievement has begun a new network of College Ready High Schools, and there are well-known national nonprofit brands such as KIPP Academies and the Seed Charter Schools that continue to expand nationally.

The philanthropic community plans on continuing huge investments in branding chains of charter schools. For example, the Philanthropy Roundtable has made a strategic commitment to charter school principles and views charter schools as its main vehicle for school reform. This group includes many business and foundation leaders from the Walton Family Foundation to the Broad Foundation. Some of these leaders are adopting or developing their own specific chains of charter schools—like Frank Baxter with College Ready charter schools.

In addition, the No Child Left Behind Act has created increased opportunities for charters. Urban school districts with large numbers of failing schools are increasing the opportunities for both charter schools and contract schools.

In Philadelphia, 45 of the city's lowest-performing public schools are managed through contracts with independent firms. Test score data for 2004 reveal that these schools have improved academic achievement for the city's most needy students.

In June 2004, Chicago Mayor Richard Daley announced his six-year, $150 million "Renaissance 2010" plan to shut down Chicago's failing public schools and open 100 new schools by 2010. Mayor Daley has more control over Chicago's public schools than other urban school leaders because the state legislature gave him legal control of the schools in 1995.

The plan will allow the creation of 30 new charter schools and 30 new contract schools created by private groups that sign five-year performance contracts with the district. The proposal would sell some school buildings and reconfigure some high schools and elementary schools into smaller schools catering to no more than 350 to 500 students each. The plan will also allow 60 of the 100 schools to operate outside the Chicago Teachers Union contract.

Charter schools have also grown substantially in the nonprofit sector, resulting in specialization and branding of nonprofit charter schools.

The effort will be partially funded with $50 million in private donations. The Civic Committee of the Commercial Club of Chicago, an organization comprised of the leaders of 75 of the Chicago region's largest corporations, professional firms, and universities, played a key role in selling Schools Chief Arne Duncan and Daley on the idea of creating independent schools. The committee is leading the effort to raise $50 million to cover startup costs at the new schools, half of which has already been committed by the Chicago Community Trust, the Gates Foundation, and others.

In fall of 2004, New York City opened eight new charter schools as part of Schools Chancellor Joel Klein's plan to develop 50 new charter schools over the next five years. Three of the new charter schools opened in the Bronx, two were in Brooklyn, two were in upper Manhattan and one opened in Far Rockaway, Queens. New York City has embraced private-sector involvement, where private donors have invested $41 million to help create 50 new charters in the next five years. In a plan similar to Chicago's, New York school officials will give the charter schools space in their buildings and provide start-up funds.

For more education trends, visit: reason.org/apr2005/education.shtml ■

The Era of Personal Spaceflight Has Begun

By Steven J. Fisher

When people look back in the history books, 2005 might be known as the beginning of the era of the Space Entrepreneur. Tremendous progress has been made since last year. The X Prize has been won, the X Prize Cup has been established, and new space ventures were announced. Progress in privatizing space is dependent upon overcoming emerging policy issues to increasing investment in entrepreneurial endeavors.

On October 4, 2004, Space Ship One became the first private manned spacecraft to exceed an altitude of 328,000 feet twice within the span of a 14-day period, thus claiming the $10 million Ansari X Prize. Just as Charles Lindburgh won the Orteig Prize in 1927 to usher in the era of commercial air travel, the X Prize has ushered in the era of commercial space travel.

Granted, Space Adventures was the first to charge a tourist to go into space and it should be recognized for its landmark achievement in helping found the Space Tourism industry. The fundamental difference between the two is that the X Prize was focused on a sub-orbital flight that lasts a few minutes while the first space tourists took an orbital flight lasting a full week. With the price of an orbital experience still around $20 million, it is out of reach of almost everyone. By contrast, the initial cost of a sub-orbital experience is around $200,000 and is projected to go down as more flights and providers launch service.

Most importantly, this has demonstrated to the whole world that the space industry is most productive when privatized and placed in the hands of entrepreneurs. The use of prizes and competition has ignited a market for people to push the envelope and achieve something most people only dream of.

In a move of marketing brilliance, Virgin Galactic sponsored the historic flights and has subsequently licensed the Scaled Composites design and related technology to develop the world's first privately funded spaceships dedicated to carrying commercial passengers on space flights. According to testimony given at a hearing of the House Science Committee's space subcommittee on April 20, Will Whitehorn, president of Virgin Galactic, the subsidiary of Richard Branson's Virgin Group, said as of the date of the hearing that "29,000 people have said they're willing to pay deposits of up to $20,000 for spaceflights within a range of prices of up to $200,000."

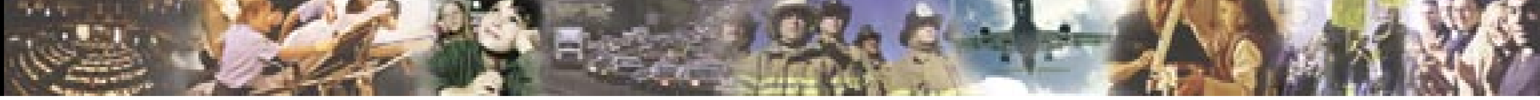
SpaceShipOne, the X Prize winning craft.

He expanded upon that comment saying "100 people have signed contracts with Virgin Galactic to pay the full $200,000 up front."

According to testimony given at that same hearing, Burt Rutan said, "By the twelfth year of operations 50,000 to 100,000 astronauts will have enjoyed that black sky view." This is amazing since, as of the date of this publication, only 500 people have traveled into space. With flights scheduled for 2008 and new competitors preparing to launch service, we can confidently say that the "Era of Personal Spaceflight" has begun.

For more space travel trends, visit: reason.org/apr2005/space_travel.shtml.

Steven J. Fisher is the founder and CEO of SlipStream Air. ■



Who, What, Where

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The Gathering Pension Storm: How Government Pension Plans are Breaking the Bank and Strategies for Reform, George Passantino and Adam B. Summers, Policy Study No. 335: reason.org/ps335.pdf

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The End of the Beginning: The Health Care Revolution in Sweden, Part II, Johan Hjertqvist, Timbro Health Policy Unit: health.timbro.se

Events

Transportation Finance Summit, International Bridge, Tunnel and Turnpike Association, Washington, D.C., November 15-17: ibtta.org

Performance Measurement and Budgeting in Utah State & Local Government, Performance Institute, Salt Lake City, December 5-6: performanceweb.org

2005 States & Nation Policy Summit, American Legislative Exchange Council, Washington, D.C., December 8-10: alec.org

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Reason Foundation
3415 S. Sepulveda Blvd., Suite 400
Los Angeles, CA 90034
www.reason.org