Focus on Water and Wastewater

Privatization Watch

Analyzing privatization developments since 1976

Vol. 28, No. 2, 2004

A Project of the Reason Public Policy Institute, the World Leader in Privatization

Watering the West

Privatization Watch

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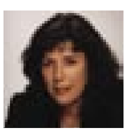

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Water Privatization: Learning from Atlanta

By Geoffrey F. Segal

In early 2003 the city of Atlanta canceled its contract with United Water and took back water system operations. During the past year, many people have weighed in on the question of "What went wrong?" Although much can be learned from considering this question, we first must think clearly about two issues central to any privatization effort—performance and cost.

The city terminated United's contract for poor performance, but how did the firm's performance compare to the city's? While far from perfect, United's performance was significantly better—and much cheaper—than what the city had been providing for years. In just a short time, United was rehabilitating the water system and completing more repairs than were ever completed under city operation.

Critics also claimed United failed to save the city money. A city audit that found millions in savings claimed this wasn't really savings at all, since the money was "subsidizing other government functions." Before privatization the city spent approximately $40 million on municipal water operations. United received a service fee of approximately $21.5 million, amounting to a difference of $18.5 million. Only very creative accounting practices can overlook the cost savings. Moreover, United had no control over how the city manages its money and if it decides to divert savings elsewhere.

Learning from Atlanta

Public officials can improve future privatizations by examining what happened—or what failed to happen—in Atlanta:

1. Communication is essential.

A lack of understanding or agreement about performance expectations can lead to disputes and even termination. Establishing a trust relationship requires structuring the right risks, rewards, benefits and opportunities early in the contract negotiation stage. Also, the more that the expectations of the contract are based on measurable outcomes and outputs (costs, quality, reliability), rather than inputs (like work levels, hours, personnel, etc.), the less subjective everyone's assessment will be, and the less likely conflicts will arise.

Expectations and definitions need to be clearly established

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Watering the West
The status quo versus water pricing

By Wayne Lusvardi and Charles B. Warren

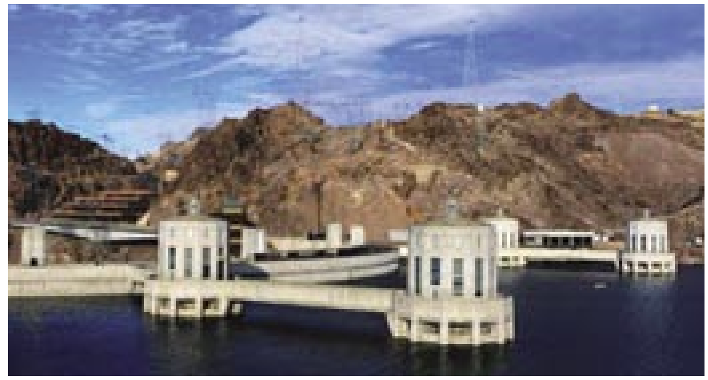
It has often been said that the West faces a perpetual water crisis. But is it because water is always in short supply, or could it be because there is too much cheap water? Government-subsidized water and crops allow farmers to grow rice, cotton, alfalfa and other water-hungry crops that suck up 75 percent of raw water supplies. Contrary to popular opinion water is priced so low that about 90 percent of it goes to irrigating urban greenscapes with only about 10 percent needed for the essentials of living—drinking, cooking, washing, and industrial uses. The water crisis in California is not a misfortune of nature or the failings of the market—it is a social and political creation.

A potential solution may have bubbled to the surface during California's recent electricity crisis. When policymakers ineptly tried to deregulate electricity, water agencies briefly followed suit—only to abandon such efforts when they saw what a mess politicians made of electricity deregulation (See *How to Keep the Lights On*, Oct. 2003). Politicians got cold feet at the notion of privatizing water, but maybe they should have at least considered "price-a-tizing" the system.

Because the cost of wholesale water is socialized and thus underpriced, consumers may exploit it for "wasteful" uses such as lawns, golf courses, gardens, and non-native vegetation. Newer command-and-control water conservation policies that seek to solve the problem by drought landscaping (xeriscaping) get more to the core of the ongoing urban water crisis. But without an economic structure, xeriscaping is bound to offer mere drops in the big regional water policy mud puddle. As with electric power, the most promising solution to the long-term water crisis in California is full-cost pricing.

How the system operates

The government industrial water system at the wholesale level is comprised of a backbone of massive aqueducts, reservoirs, pipelines, and pumping and treatment plants that draw and filter water from snowpack-fed rivers, lakes, and deltas. Urbanization and corporate agriculture in the western United States depend on this huge water hydraulic system. Most of this water infrastructure was put into place under Works-Progress Administration Programs in the Depression Era. Water supply



at the local level is comprised of ground water and/or water purchased from wholesale government water suppliers.

Water is handled by a dizzying array of both small and large agencies, districts, departments, private regulated companies, mutual water companies, and agricultural water-stock cooperatives. At the bottom of the cascade of water entities is the small mutual water company that may serve only a neighborhood (e.g. Rubio Canyon) or a small city (e.g., Sierra Madre) at a price of say $50 per acre-foot. This compares to government-supplied "manufactured" water that may be purchased for around $500 per acre-foot, a ten-fold price difference! (An acre-foot supplies about two families for one year.)

At the after-market level in Southern California, water is recaptured, retreated, and recharged into groundwater basins. Urban storm water is controlled in flood channels, catch basins, and settlement basins to avert floods and replenish local aquifers. Wastewater is recycled through sewer plants and reclamation facilities. In many cases all that municipal water departments do is serve as a mere distributor of water purchased from government wholesalers. In other cases, such as the city of Los Angeles, the water department may hold a monopoly as a wholesaler, retailer, and recycler.

Water is free, getting it isn't

Like air, water is a free natural good, but the cost to dam, pump, treat, and deliver it is what reflects its cost to the consumer. For example, the cost to pump water from Parker Dam on the Colorado River through the Colorado River Aqueduct mostly reflects the huge pumping costs needed to lift the water across the mountains of the Mojave Desert to a point east of Palm Springs where it can flow by gravity into Southern California.

Ironically, the Coachella and All American Canals also take water from the Colorado River at a spot south of Parker Dam for agricultural irrigation purposes and transport it by

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Milwaukee Water Contractor Scores Well on Audit

By Ted Balaker

An independent performance audit gave Milwaukee's wastewater contractor good marks.

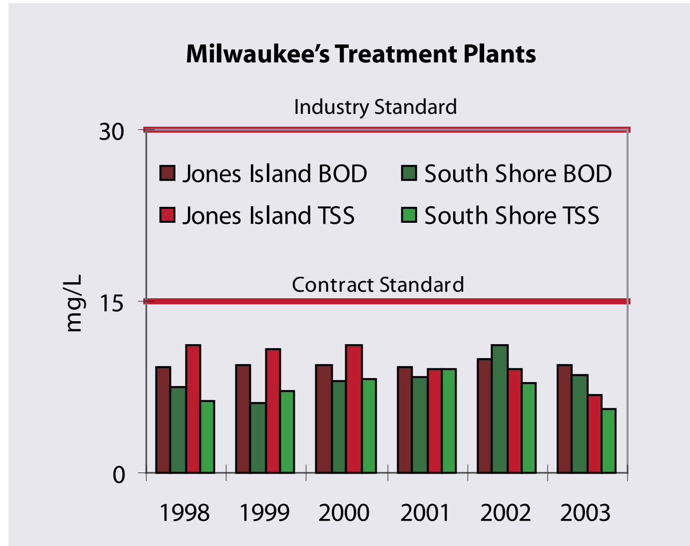
Speculation about quality oversights prompted the Milwaukee Metropolitan Sewerage District to carefully examine its contractor, United Water. MMSD Executive Director Kevin Shafer hired a Seattle sewerage district manager to head the audit.

The 2003 audit—which took nine months and cost $157,000—found generally high levels of quality: "The treatment performance levels place the system in the top rank of systems in the nation. The number and volumes of combined sewer and separated system overflows are much lower than in similar systems."

New Jersey-based United Water took over wastewater operations in 1998, when it entered into a 10-year agreement with MMSD. A service area population of 1.1 million made the Milwaukee contract the nation's largest wastewater public-private partnership, and other features made it the most complex. The Milwaukee facility has a biosolids program, two wastewater treatment plants, an inline storage system and a 30-megawatt power plant. Most facilities would not, for example, have their own power plant.

The audit gave especially strong marks to the two wastewater treatment plants, noting that special recognition by the Association of Metropolitan Sewerage Agencies demonstrates that "the treatment system in particular is being operated in a very good manner." Both treatment plants have received AMSA's Platinum Award, given to agencies that go five or more consecutive years with no discharge violations. Prior to the United Water contract, the wastewater system had never received the platinum distinction. The audit goes on to note that United Water has also "consistently been awarded the incentives for superior effluent quality" contained in the contract.

Systems often gauge quality on TSS (total suspended solids) and BOD (biochemical oxygen demand) levels, with TSS and BOD levels measured in milligrams per liter. A TSS/BOD standard of 30/30 is considered typical. However, United Water Project Manager Terry Tobel points out that the Milwaukee contract sets a more stringent 15/15 standard, and that his company's 9/9 performance has bettered even that.



Although the audit was mostly complimentary of United Water and described MMDS as "generally well run," the report did include some concerns, such as the maintenance of non-critical equipment and the contractor's relatively low staffing levels.

Tobel thinks such criticisms put too much faith in previous management models. "There are those who don't understand privatization and think that we don't have enough people, but that's just because we do our business so differently," he says. "We've downsized by about a third, and at the same time we've had an increase in water quality."

Since United Water guaranteed there would be no layoffs, the company has downsized through attrition. When an employee leaves, United Water reviews the position and decides whether or not to find a replacement.

A different approach to staffing and the implementation of other efficiencies have allowed United Water to stay on pace with the goal of saving 30 percent ($140 million) over the term

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The Milwaukee System

Thirsty for Sound Policy

The president's top water official on quenching a growing nation.

Interview by Ted Balaker

Bennett Raley
Assistant Secretary for Water and Science
Department of the Interior

As government grows less choosy about what its duties should be, more and more officials find themselves overseeing issues that are increasingly trivial and obscure. Then there's Bennett Raley. The Bush administration's top water official must answer one of the nation's most pressing policy questions: How can we provide water to an ever-growing population?

The question becomes even more crucial when you add environmental lawsuits that divert water for wildlife and Mother Nature's dwindling contributions. Five years of drought have left Lake Mead—the huge reservoir behind Hoover Dam—at its lowest point since 1968. The federal government may even have to stop delivering surplus Colorado River water to California and Nevada. Since there's no way to know if and when the drought will let up, sound policy grows all the more important.

PW Editor Ted Balaker interviewed Bennett Raley in February.

It took over a year to reach an agreement to transfer water from California's Imperial Valley to San Diego. How might we avoid these problems in the future?*

Large-scale water transfers between competing economic regions within a state, like the Imperial to San Diego transfer, have always been and will always be contentious. I do not view the vigorous participation in this complex issue by citizens and local governments to be a "problem" that needs to be avoided, as doing so would inevitably lead to greater centralized and concentration of government authority.

Is there really a shortage of water in the West, or is there just a shortage of rational allocation?

If we define "shortage" to mean that all demands cannot be met all of the time, there is a shortage of water in most, if not all, basins in the American West. In general, the West has a very rational allocation system in place—the doctrine of prior appropriation—that allocates water based on relative seniority or lack thereof. This allocation system, when combined with the ability to sell or lease a particular priority, provides far more certainty and reliability than would the other allocation methodologies that have been suggested. I find that when people complain about a "shortage of rational allocation" they most often mean that their preferred uses are not given a priority, which is different than a lack of a rational system.

Would you please explain the term "beneficial use" as it relates to water rights?

Sure. At its core the requirement of beneficial use is a prohibition against waste or speculative (nonproductive) holding of an asset that would otherwise be a public good. This principle, which is embedded in the DNA of western water rights, is a recognition of the reality that water is scarce in the West and that the common good requires that the holder of a right to use this resource has a duty to use it for a socially recognized and accepted purpose.

Some say that stronger water rights—for example, extending the definition of beneficial use to include environmental purposes—could spur coalitions between farmers and environmentalists. Do you see private water rights getting stronger, or do you see more state and federal controls over how and where water may be used?

At an abstract level I fear that the attacks on the priority system by governments (which over the long run tend to prefer to have the ability to make ad hoc decisions to benefit the preferred sectors of the moment) and the environmental community (which typically attacks water rights because its preferred uses are not sufficiently senior in priority) are threatening the viability of both state and federal water rights. There is no reason why environmentally preferred uses cannot and should not be allowed as a basis for a water right, and in fact most, if not all, of the western states now recognize the legitimacy environmentally based water rights claim. However, the difficult issue is whether private citizens should be able to hold instream flow water rights, which typically do not have any "entry" or investment costs that would otherwise serve as a counter to attempts to monopolize the resource. [Editor's note: "instream flow" is the water left in a stream to maintain the existing aquatic resources and associated wildlife.]

Certain California crops like cotton and rice would surely leave the state without heavy water subsidies. What, if anything, should be done about water subsidies?

At the domestic level governments do two things: reallocate wealth and regulate conduct. One could say that 501(c)(3) entities like RPPI (Reason Public Policy Institute) are sub-

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Don’t Believe the Hype

Successful water privatization is the norm

Commentary by Adrian T. Moore

If private involvement in water provision were the high-risk endeavor that critics claim, we would see disaster all around us. After all, water privatization is more common than most people realize.

- 2 of every 5 drinking water systems nationwide are privately owned, regulated utility systems.
- 1 of every 6 Americans gets drinking water from privately owned, regulated utility systems.
- Roughly 1 of every 25 communities in the rest of the nation has a government-owned and privately operated water utility.

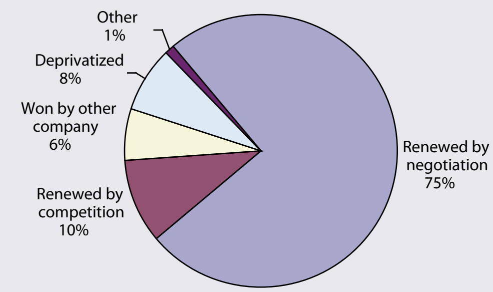
Of course, we aren’t sinking in disasters. In fact, when the anti-privatization group Public Citizen set out to report the most heinous examples of privatization gone bad they came up with only one substantiated case of a private operator running amok, buried in the midst of stories of such terrible things as the publicly appointed utilities commissions granting rate increases.

In a rich irony, the researcher for Public Citizen who wrote that report and their other early attacks on privatization quit soon after. He came out publicly to explain that his work had taught him that privatization works when done right, and that critics have failed to show any problems with it beyond a few anecdotes. [See: rppi.org/pb22.pdf]

Widespread support

Privatization has bipartisan support as a means of improving the environment and the health of citizens. In a 1999 study President Clinton’s EPA endorsed privatization as a means by which local governments could meet environmental standards. Indeed the EPA wrote that privatization creates a classic “win-win” situation. The former Public Citizen researcher now says that his work to dig up dirt on private operators convinced him that “private operators have a respectable record of providing quality water and complying with environmental standards.” Comparisons of compliance performance all find that privately operated utilities are less likely to violate safe drinking water standards.

Outcome of Water/Wastewater Privatization Contract Renewals 1998-2001



Public Works Financing

Satisfied customers

At renewal time, 91 percent of communities choose to continue privatization. And this is not because they are captive to the private firms—6 percent of communities switch to another private company when existing contracts are up, and each year about 10 communities bring services back in house. Ninety-four percent of communities say they would recommend their private water manager to other communities.

Common concerns

Even after 1500 contracts, some people still misunderstand privatization’s real record. They may worry about accountability for private operators: Will contractors put the bottom line before quality?

However, the market provides us food and medicine, child seats for our cars—in fact, most of the things we put in our bodies or use to make us safer come from the private sector. And—as noted earlier—for many Americans that includes water. Just as with government-run facilities, employees and managers, and their families, live in the community and drink the water. And companies that consistently fail to deliver expected service will soon find no more willing customers.

Others have different accountability concerns—they may, for example, raise the specter of foreign ownership. However, like the private sector in general, most of us already seem quite comfortable with foreign ownership. We trust foreign-made cars with our lives—and they are far more likely to be the cause of our death than our water is. We ingest foreign-made pharmaceuticals, we eat imported foods, we strap our children into foreign-made car seats, all without really worrying about where they are made. Why? Because there is a system for ensuring they are safe products. Privatization of water and wastewater services does not change the system for ensuring

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Trouble in Stockton

When halting privatization harms the environment

Commentary by Geoffrey F. Segal

In one fell swoop Superior Court Judge Bob McNatt hijacked California's Environmental Quality Act (CEQA). CEQA was intended for environmental protection, but now in San Joaquin County, it has now become a tool to put politics ahead of sound economics and sensible public policy decisions.

McNatt questioned whether the city of Stockton had properly considered environmental concerns when it decided to outsource its water and wastewater services to OMI-Thames Water. On December 5th the judge reached a decision. He voided the $600-million contract, prompting the city and OMI-Thames to appeal.

In ruling that the city had failed to properly scrutinize the potential environmental effects, McNatt determined that the mere existence of a profit motive was enough to invalidate the contract, despite roughly 30 years of water and wastewater contracting experience in California where such a challenge has never held up in court.

What's worse is the basic misunderstanding of the power of contracts. Under the agreement, OMI-Thames is actually held to higher, stricter environmental standards than what the city had held itself to before contracting.

Yes, a profit motive exists—however, it is that motive that helps ensure that the work of OMI-Thames meets environmental standards. If the firm neglected its duty to maintain high environmental quality, it would face severe penalties that would remove much of the profit it would receive. Ultimately, if OMI-Thames constantly put profits ahead of environmental quality, it would be fired; the city has total authority to walk from the contract at any minute.

Here the plaintiff—the Sierra Club—walks a tightrope. On the one hand, it knows that the Regional Water Quality Control Board requires the city to upgrade its wastewater facilities to protect the San Joaquin River. It also knows that the greatest innovation and cost savings for such facilities will come through the application of design/build delivery methods for the city's capital improvements which can be included in the operations contract. Additionally, it knows that the city is preparing Environmental Impact Reports and other CEQA-required documents for each capital improvement before it approves or authorizes the improvement. On the other hand,

the Sierra Club knows that its friends in public employee unions want to stop this outsourcing, and it is prepared to delay these environmental improvements to satisfy them. And environmental quality is not the only aspect of the water debate that has been muddied.

The economic benefits of privatization have also been misrepresented. For example, if the contract is terminated the citizens of Stockton will face a double-digit percentage rate increase! It is common for cities to save upwards of 20 percent of their operating budgets when they outsource water and wastewater services. These savings would directly benefit taxpayers and the water customers.

Let us hope that when Judge McNatt has the opportunity to reconsider his opinion, he will re-read CEQA and conclude that his diversion of the Act from true environmental considerations to matters of municipal economic and social policy is unwarranted. If the decision holds through the appeals process, it would have a profound effect on California cities' ability to improve quality, efficiency and productivity in municipal operations.

A version of this piece appeared in the Stockton Record. ■

New HOT Lane Proposals on Both Coasts

By Robert W. Poole, Jr.

One of the places hit hardest by the recession of the past two years is Silicon Valley. And while traffic congestion has eased slightly in that part of California, sales tax revenue has plummeted. That has derailed ambitious plans to address congestion by means of large-scale rail transit additions: a major expansion of the Valley Transit Authority's fledgling light-rail system and multi-billion dollar extension of the heavy-rail BART system down the east side of the Bay to San José. Recent months have seen VTA's light-rail plans gutted, and the BART extension delayed for many years. Yet traffic congestion is still a major problem, and expected to get worse as the economy recovers.

That has led VTA for the first time to begin investigating high occupancy toll (HOT) lanes. As reported in the *San José Mercury News* (Sept. 21, 2003), the VTA has begun to research the possibility of HOT lanes for several Santa Clara County freeways. An initial feasibility study is likely to be approved before the end of the year, probably including portions of US 101, I-880, and SR-87. "I'm just amazed that we have not looked at this sooner," said VTA board member Pat Dando. As a member of the National League of Cities' Transportation and Infrastructure Services Policy Committee, she has visited the 91 Express Lanes in Orange County.

Nearby Alameda County is getting closer to a "go" decision on building planned HOV lanes on the congested Sunol Grade on I-680 as HOT lanes instead. In August the county's Congestion Management Authority released the results of a survey of 800 residents of Alameda, Contra Costa, and San Joaquin Counties. Overall support for the HOT lanes was 58 percent. But in southern Alameda County—where the heaviest concentration of users would most likely be found—support rose to 69 percent. And among those who already have FasTrak transponders to pay bridge tolls, support was 80 percent.

Across the country, a second possible HOT lanes project has emerged in Virginia. Like the HOT lanes now under consideration for the western part of the Capitol Beltway, this proposal also came about as an unsolicited proposal from the private sector, under Virginia's Public Private Transportation Act. The proposal by a three-company consortium would add 50 miles of tolled express lanes on I-95, from Fredericksburg north to the Beltway, where they would interface with Fluor's proposed HOT lanes. The consortium consists of Clark Construction, Shirley Contracting, and Koch Performance Roads.

Across the river in Maryland, where former Gov. Parris Glendening had vetoed a HOT lanes proposal, new Gov. Robert Ehrlich has revived the idea. Maryland DOT is now studying HOT lanes for the Maryland portion of the Beltway, for another route between Baltimore and White Marsh, and between Montgomery and Prince George's Counties. ■

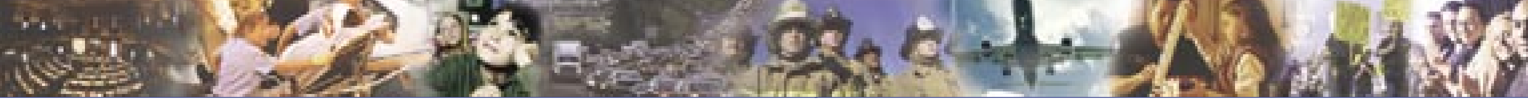
Real-Time Road Pricing Expands

The success of variable pricing (tolls that vary in proportion to the level of traffic) of California's two HOT lane projects (I-15 and 91 Express Lanes) is leading to emulation in other states.

Houston has a new congestion-relief toll road under construction—the Westpark Tollway. Built in a narrow corridor with room for just two lanes in each direction, it will be the first Texas toll road with no toll booths. All toll-paying will be done via transponders, with cars moving at highway speeds. In order to keep traffic moving well at rush hours, the Harris County Toll Road Authority will be able to vary the tolls as needed, with car tolls of between 25 cents and $1.00 and truck tolls between $2.50 and $6.25. The first section of the Westpark will open in March.

Two recently approved HOT lane conversion projects will do likewise, using what is now called dynamic pricing, a la the I-15 model. Minnesota will create its first HOT lanes by converting the underused HOV lanes on I-394. Work recently got under way, and the HOT lanes are set to become operational by the end of 2004. And the Washington State Transportation Commission has approved a similar project in the Seattle area. Assuming the legislature agrees, the HOV lanes on SR 167 will be converted to HOT lanes in a two-year pilot project.

Observers expect a number of other planned HOT lanes projects, such as those being considered for the Washington Beltway (I-495), Dallas's LBJ Freeway (I-635), and Houston's Katy Freeway (I-10), will make use of dynamic pricing rather than pre-set toll schedules, as more experience is gained from other projects. ■



Airport Privatization

By Robert W. Poole, Jr.

Atlanta Debates...

With Atlanta Mayor Shirley Franklin proposing to triple sewer bills to pay for a $3 billion upgrade mandated by the EPA, proposals to pay for that upgrade by leasing giant Hartsfield International Airport have surfaced again. The Atlanta City Council briefly looked into the idea in December 2002, but concluded that because the federal Airport Privatization Pilot Program grants incumbent airlines a veto power over such transactions, the idea could go nowhere.

But in the face of continued opposition to the proposed rate increase, two Republican state legislators have put privatization back on the agenda. Sen. Chuck Clay filed a bill that would create a state airport board with the power to lease any and all parts of the airport to the private sector. And the Fulton County Taxpayers Association, which had launched the debate in 2002, is once again circulating petitions to have the issue put on the ballot in Atlanta to give voters an alternative to the sewer rate increase (which is estimated to cost an average of $2,000 per household per year). The petition needs 28,000 signatures—15 percent of the city's registered voters—to get the measure onto the ballot.

A long-term lease may generate billions of dollars.

The *Atlanta Journal-Constitution* opposes the airport privatization concept, but has given space for opposing views. An alternative paper, *Creative Loafing*, has come out in favor. It quoted Scott Fuller, president of Georgia-based American Airports Corp., as saying that "billions of dollars is the correct estimate" of how much a long-term lease might generate. Such figures would be in line with experience with overseas privatizations, such as the considerably smaller Sydney, Australia airport.

All parties are aware of the airline veto provision of the federal law, and the airport's dominant carrier, Delta, has made its opposition very clear. But Sherman argues that with so much at stake, there should at least be an effort made to find out if anyone credible would actually offer several billion dollars to lease the airport. If so, proponents should then "sit down with the CEO of Delta and ask him, 'What can we do . . . to persuade you to join us?'"

While Asia Embraces It.

New legislation and policy decisions made this summer will transform the ownership and operation of major airports in Hong Kong, Japan, Thailand, India, and China. The transformations—which will occur over the next four years—emulate the process that has already taken place in recent years in Australia and New Zealand.

In August, Hong Kong announced that it would introduce a bill that permits the privatization of the huge Chek Lap Kok International Airport, in late 2004 or early 2005. Opened in 1998 at a cost of $6 billion, the airport is the second busiest and most modern in Asia. The legislation will allow the government to sell shares of CLK on the Hong Kong stock exchange. While the fraction of ownership to be sold has not yet been announced, speculation is that about $3 billion in shares will be sold. The proceeds will be used to help deal with the government's current fiscal problems. One investment banker also predicted that, under investor ownership, the airport would open up greater access to foreign airlines, which would be good news for U.S-based passenger and cargo carriers.

The Hong Kong announcement came just weeks after Japan's Diet (parliament) enacted legislation to privatize the country's main international airport, Tokyo's Narita. The plan calls for a two-stage process. On April 1, 2004, Narita will be transferred from the current airport authority (which will be dissolved) to a new government corporation. That company will subsequently be listed on the Tokyo stock exchange in 2007. To ease Narita's transition into the commercial sector, the government will provide it with a $2.5 billion dowry. Half of that sum is a gift of capital and reserves; the other half is an interest-free loan to be repaid sometime after privatization. If it can increase its share of non-airfield revenue from the current 30 percent to a more commercial 50 percent, there is significant upward potential for Narita as a for-profit business. There would also be major gains if it could overcome landowner opposition to the extension of its second runway, which would make it long enough for jumbo jets.

The Thai government also announced privatization plans in August. The government-owned Airports of Thailand (AOT)—which operates Bangkok and the country's four other international airports—will be privatized via an initial public

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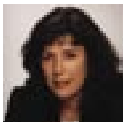
Tax Credits Help Poor Students

By Lisa Snell



In recent years state governments have ramped up education tax credit programs. The programs allow individuals and corporations to make tax-free charitable donations to scholarships for low-income students. Two states have decided to build on their successes by expanding their programs.

Pennsylvania

In May 2001 the Pennsylvania legislature passed the Educational Improvement Tax Credit (EITC) allocating $20 million of tax credits to encourage corporations to donate money to approved scholarship organizations for primary and secondary education. Through this program, businesses can apply to the Department of Community and Economic Development for a tax credit equal to 75 percent of its one-year contribution to a scholarship organization, up to a maximum of $100,000. If the business agrees to provide the same amount for two consecutive years, the tax credit is increased to 90 percent of the contribution made.

Currently more than 20,000 children receive EITC scholarships in 62 of Pennsylvania's 67 counties. More than 1,900 Pennsylvania companies have participated in the EITC programs, contributing to 129 scholarship organizations and 188 educational improvement groups.

A survey completed by parents in the Futuro Educational Scholarship Program—which provides scholarships primarily to the Hispanic community in Philadelphia—showed that parents were extremely pleased with the benefits and results of the tax credit program. As an added benefit, Futuro saved the Philadelphia School District approximately $360,000 last year.

The Pennsylvania legislature approved a 2003-2004 education budget that increased the cap on tax credits from $30 million to $40 million, with over $26 million dedicated to scholarships and more than $13 million to innovative educational programs in public schools. The state also doubled the maximum number of tax credits a company can receive, from $100,000 to $200,000.

Arizona

A tax credit program in Arizona gives individuals a $500 dollar-for-dollar income tax credit for contributions to organizations that give students scholarships to attend private elementary and secondary schools. A report from the Arizona-based Goldwater Institute provides information on the success of Arizona's tax credit program. The study, The Arizona Scholarship Tax Credit: Providing Choice for Arizona Taxpayers and Students, found that since the program's inception, taxpayers have donated $84 million to help send students to schools of their choice. In 2002 alone, 50,000 Arizonans donated more than $26 million to fund scholarships for 19,000 students. More than 5,700 Arizona children are on waiting lists for additional scholarships.

The Goldwater study also found:

- School tuition organizations overwhelmingly consider financial need when they allocate scholarships
- Without the scholarships, approximately 4,000 recipients would have to transfer to public schools
- The savings generated from having those students transfer from public to private school offset much of the cost of the tax credit to the state.

The Goldwater study highlights the important role that donors should play in monitoring charitable contributions for tax credits. "Donors are ultimately responsible for ensuring that their contributions are put to the best use," notes study author Carrie Lukas, Policy Director with the Independent Women's Forum. Too many regulations ultimately limit taxpayer discretion over the allocation of their charitable contributions.

"One of the strengths of the scholarship tax credit is that it puts power in the hands of individuals to allocate resources

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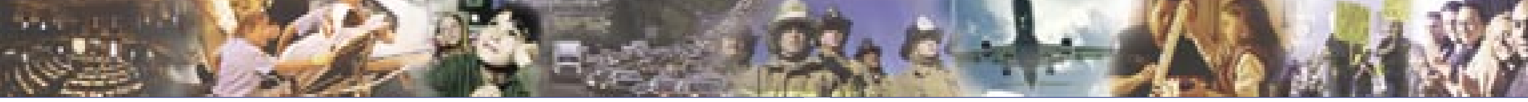
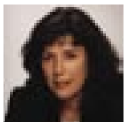


Oversight Problems with Florida's Education Tax Credits

By Lisa Snell



In several negative reports, the *Palm Beach Post* and other local newspapers have recently targeted Florida's education tax credit program's inability to maintain proper oversight. The reports highlighted the state's lack of basic data to match up the amount of tax credit dollars spent with the students who actually received disbursements. An audit report by Florida's Chief Financial Officer Tom Gallagher found that some voucher students were taking money from more than one choice program and that some private schools may have received funds for students they did not enroll. The audit made specific recommendations for improving the fiscal monitoring of the school choice programs.

In 2001, the Florida legislature authorized a corporate tax credit program, which allows corporations that donate to scholarship funding organizations (SFOs) to receive a tax credit on the Florida corporate income tax. The credit is equal to the amount of the contribution up to $5 million per corporation per year. Florida SFOs fund scholarships that allow students who qualify for the federal free and reduced lunch program to attend private schools or pay for transportation to another public school. The private school scholarship is equal to $3,500 or the total tuition of the private school. In the 2002-2003 school year 55,000 students applied for scholarships and approximately 15,000 students received scholarships.

In order to prevent fraud and help maintain the fiscal integrity of the programs, the Department of Education has established a student database and instituted additional compliance measures for scholarship organizations and private schools.

The Department of Education also requires all participating private schools to file an online reporting form with basic data about financial viability of the school and criminal background checks of school employees.

In light of the negative reports on the administration of the corporate tax credit program, the Florida legislature voted to rescind a $38 million increase in the program.

Fiscal Integrity without Over-regulation

Florida's troubles have led school choice critics to call for regulating school choice programs far beyond the controls needed to prevent fraud and ensure fiscal integrity. For example, the *Palm Beach Post* and other Florida newspapers have editorialized in favor of requiring testing of all school choice students, adding restrictions to special education vouchers, and imposing credentialing and accreditation regulations on private schools and their staff.

In Pennsylvania, tax credit critics have lamented the lack of data about how the tax credits are being used and Arizona has passed a law requiring school tuition organizations to provide the state government with the total number and amount of contributions received, the total number of children awarded scholarships, the dollar amount of each scholarship, and the names of the schools that received those scholarships.

Key to the future growth of tax credit programs will be their ability to maintain fiscal oversight and prevent fraud while letting parental choice and the rights of exit from an unsatisfactory school continue to be the central mechanisms for ensuring private school accountability. ■

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Students

instead of giving all control to the state," writes Lukas. "Mandated means testing takes discretion away from school tuition organizations and donors."

The Goldwater study suggests creating a Web site sponsored by the Arizona Department of Revenue that would post financial information about school tuition organizations and encourage best practices by rewarding organizations that follow them with greater publicity. A Web site would help empower donors to decide which scholarship organizations are worthy of their support, and such a site would be readily applicable to other tax credit programs. ■

Continued from Page 3

Utilities

gravity flow to almost the same destination as the Colorado River Aqueduct east of Palm Springs, only without the huge pumping costs! Ideally, water conveyance systems should follow gravity flow engineering. Instead water is pumped over mountain chains at enormous cost mainly for political reasons. This proves the popular dictum in water economics that "water flows uphill toward money."

Transforming water and electricity

Water and electric power are reciprocals of one another. Hydroelectric plants generate power. In turn, power lifts water over mountain chains. Without huge pumping plants that run on electric power, the California Aqueduct could not pump water over the Tehachapi Mountains nor could the Colorado River Aqueduct transport water over the mountains of the Mojave Desert.

During the California Energy Crisis of 2000-01, the huge spike in electricity costs amounted to nearly $500,000 in pumping costs per peak hour extra for Southern California water wholesalers. However, this was entirely offset by the hydropower credits generated from shipping nearly double the annual allotment of water through the California Aqueduct to Southern California during that same period. If this had not occurred California would probably have suffered through an energy crisis of greater proportions. In other words, Northern California relies on sending raw water to Southern California in order to generate cheap wholesale hydroelectric power for its own needs. Both electricity and water may find the greatest hope for reform in the same concept—full-cost pricing.

Enter pricing

Full-cost pricing, or congestion pricing, involves a host of measures including lifeline rate pricing and submetering apartments like electricity. Lifeline rates are where the charge for an amount of water service considered to support the essentials of living (sanitary drinking water) is kept low, but much higher charges are levied on "luxury" water consumption beyond that threshold amount (swimming pools). At the very least we know that when prices rise, quantity demand falls and vice versa. The Federal Congressional Budget Office estimates that combined water and sewer bills only average a half percent of income in this nation. Curiously, however, submetering is deemed "selling" water and is subject to the full requirements of the Safe Drinking Water Act.

Some price discrimination already occurs in water policy, but it is not market-based. Urban users typically subsidize the cost for agricultural producers, which results in cheap retail prices of agricultural products subsidized through taxes. This blurs the line between public and private systems and thus hides the true price.

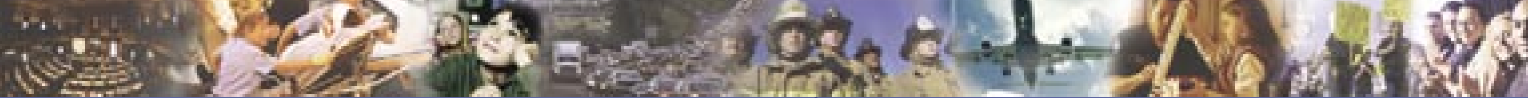
Enter politics

But is full-cost water pricing too risky for public policy makers to consider? Or does the conventional subsidized system result in exploitation and waste of an under-priced natural asset?

The history of California is replete with water policy failures such as the voter rejection of the proposed Peripheral Canal to bring water from the Sacramento Delta to Southern California, the Arizona vs. California Supreme Court case diverting Colorado River Water from Southern California to Arizona, Colorado, and Nevada, and the more recent reclaiming of Owens Lake water from Los Angeles by environmental lawsuit. Recent Southern California water policy efforts to divert political water allocations from farmers, from the Bay Delta, and from the upstream urban users of the Colorado River in Denver, Phoenix, and Las Vegas are equally bound to fail in the long run because they externalize the problem and depend upon shifting political currents. The present supply of Southern California water is a diminishing asset as it is being politically "diced" by ever-growing urban populations in surrounding states and by growing jurisdictions within the state. California is projected to run out of "low-cost" water by 2030. What should policy makers do, wait until this tipping point arrives?

Continuing to depend on political solutions for water policies is like depending on luck—it will eventually run out. Successful privatization of retail water will depend not merely on privatizing municipal water agencies, but on full-cost demand pricing. If water were continuously priced at retail prices to reflect demand and, thus, peak and off-peak prices, then there would be no disparity, no losses and no ongoing crisis. For local water services that will mean more than new computerized meters. It will require the political will to price the commodities rationally. Full-cost pricing of water at the consumer level may even result in a ripple effect of creating more market rigor to the entire larger water pond of the government water system.

Unfortunately, many politicians prefer to tell people that



somehow they don't have to pay the full cost of essential services and utilities. Politicians want the public to believe in such mythical things as free clean air, free clean water, free and clean renewable energy, cheap agricultural water, or that the public will conserve water without an economic incentive.

If California resists reform the political precariousness of water resources may lead to more conflict. For example, in Santa Clarita, California environmentalists have taken over a local water board and have blocked large new tract home developments because they believe water is priced so low that it will result in the natural environment drying up in favor of urban gardens and swimming pools.

The continued dependence on such demand-side policies as politicized Colorado river and state delta "water allocations," "agricultural fallowing contracts," and "water transfers" on one hand, and xeriscaping, environmental lawsuits and the political takeover of water boards on the other hand, will only cast the fortunes of politicians to the unpredictable currents and eddies of a political river that is ever drying up. Full-cost water pricing may not be too risky when compared to the long-term political fortunes of those who raft down the rivers of politics.

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Concerns

the water is safe and reliable.

Government remains responsible for establishing and enforcing quality and reliability standards, and with a good contract, contractors have every incentive to ensure the same.

The partnership in a privatization and the contract that binds it must be based on visible, measurable performance, and must reward private companies only if they meet the goals and performance they have promised. Community leaders have to apply the best practices and lessons learned from past privatizations to their own decisions. Communities may even turn to specialized consultants to help them negotiate new contracts with private operators.

Still, water privatization is neither inherently bad nor inherently good. It is not a White Knight that can ride in and rid a city council of all its water utility worries. Privatization does enjoy a solid track record of success, and research and experience shows that—in the right time and place—it is a viable option. ■

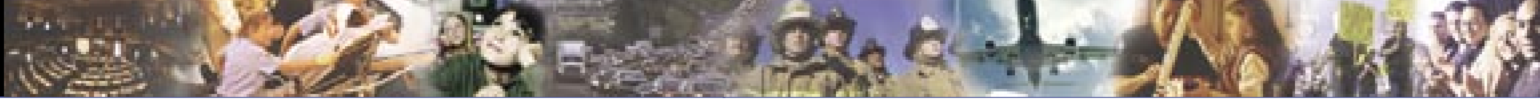
Continued from Page 5

Raley

sidized because others must pay for the taxes not collected from nonprofits. The "subsidies" that you refer to for water are the direct result of a decision made by Congress to have agricultural water users only pay for a portion of the costs of developing and delivering a water supply, with the remainder of the costs being paid by power users. This policy decision is embedded in federal law and contracts between the United States and water users. At the programmatic level it is a "subsidy," if you ignore the fact that power users pick up the difference, or believe that a decision to enter into long-term cost-of-service-based contracts and forgo the opportunity to collect a "profit" is a subsidy.

Don't get me wrong—I am not defending either example of governmentally based preferential treatment. However, the real issue is not "subsidies," but rather how emerging demands for water for cities, recreation, and the environment should be met. Markets, not government fiat disguised in arcane legal arguments or post hoc redefinition of property and contract rights, are the answer.

* For more on the Imperial Valley-San Diego water transfer, see: rppi.org/imperialvalleywaterdeal.html ■



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Atlanta

and understood by both parties. Open and consistent communication both before and during the contract period will help eliminate ambiguities. Both sides must commit to their due diligence, which should be agreed upon and confirmed with data. Additionally, both parties must have a realistic understanding of the condition of the infrastructure.

Communication during the contract period is just as crucial. The first half is really about management and oversight. Few would disagree that accountability is important. A contract is only as strong as the monitoring, reporting and direct oversight that are built into it. Periodic reporting and monitoring are standard in privatization contracts. The higher the risk and uncertainty, the stronger these requirements should be.

How the two parties speak about each other—especially in the media—is also important. Over the last few months of the contract, Atlanta Mayor Shirley Franklin painted herself into a corner leaving her with little room to maneuver even though performance was improving.

2. Contracts should develop appropriate long-term business models.

Atlanta was the first city to take advantage of new legislation that allowed for long-term contracts. This new territory provoked some missteps. The contractors attempted to take the existing operations and maintenance model (typically 3-5 year contracts on individual plants) and simply extend them, both in terms of scope and length. The industry has since recognized that it isn't healthy to simply extend a boilerplate approach, and is now readjusting its approach to long-term contracting.

3. Contracts should be value-based.

Sure saving money is important, but having a well-run system is more important. Thus, cities should avoid low bid or cost-plus contracts that provide little incentive for contractors to hold down their costs.

4. Most privatizations succeed.

Over 90 percent of cities that have privatized do not de-privatize. With the dire status of our nation's water and wastewater infrastructure, privatization will continue to be an important policy tool. Both the Environmental Protection Agency and General Accounting Office recognize privatization's ability to improve services, meet tougher environmental standards and lower costs.

What's next for Atlanta?

Bringing operations back in house will likely mean a return to the days of escalating costs and poor service—the same reasons the city sought out privatization to begin with. The wastewater system requires billions of dollars of improvements, and the many years of poor management and lack of capital funding will soon create additional problems that may be too steep to overcome. Savings from privatization were originally targeted to help fund improvements, but now likely increases in fees or taxes could more than triple rates.

Atlanta residents may again suffer the same expensive, poor-quality service they knew with municipal operation before privatization. ■

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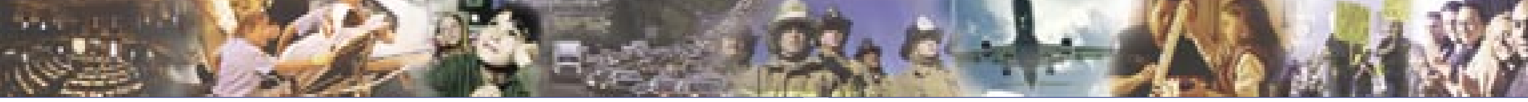
Airports

offering of shares on the Stock Exchange of Thailand. The listing will take place in the first quarter of 2004, and will involve the sale of between 30 and 70 percent of the ownership. Estimates are that this will mean sale proceeds of $300-$500 million. Separately, the government also plans some form of privatization for the 26 provincial airports now operated by the Department of Civil Aviation.

After nearly a decade of debate, airport privatization has finally come to India. A new law passed this summer will privatize the two major international airports—New Delhi and Bombay (Mumbai). The two airports account for 52 percent of all Indian airport passengers. The exact form of privatization is still not clear, but it is expected to be a joint venture between private investors and the Airports Authority of India (AAI). Civil Aviation Secretary K. Roy Paul told the *Financial Times* that "at least 74 percent equity should be opened to private investors in the New Delhi and Bombay airports." The new law also provides a better legal framework for the long-delayed Bangalore International Airport, an all-new airport to be developed and operated by a private consortium.

Finally, August also saw the announcement of a joint venture between government-owned Shanghai Airport Group and Fraport AG, the privatized German company that owns and operates Frankfurt International Airport. The 50/50 deal is for a term of 20 years and will focus on airport consulting and staff training. ■



Privatization Briefs

Argentina Reverses Postal Privatization

Once a pioneer in privatization, lately Argentina has dealt harshly with companies to which it awarded long-term franchises during the 1990s. None has been permitted rate increases to compensate for the massive devaluation of the currency, despite having mostly dollar-denominated debt (which is now much more costly to service). But in November the government struck another blow, canceling the long-term franchise it had awarded to Correo Argentino to operate and manage the country's postal service. Observers fear that franchises awarded in electricity, telecommunications, and water supply may also be cancelled.

Railroad Sale in Canada

British Columbia has privatized BC Rail, a 2,000-mile regional railroad that is the third largest in Canada. The winning bidder was Canadian National, a formerly state-owned company that operates one of two transcontinental railroad systems in the country. CN bid $770 million for a 60-year lease of the system, whose underlying right of way will remained government-owned. After the deal was announced in November, two Vancouver-based rail companies said they would bid to operate tourist-oriented passenger service over BC Rail's lines (which the company had shut down last year due to losses). Both Whistler Rail Tour and Rocky Mountaineer already operate rail tourism services in British Columbia.

Sinking Cities

Cities continue to flounder in financial messes of their own making. According to a survey of 328 cities by the National League of Cities, more than four out of five finance directors said their cities were less able to meet financial needs compared with the previous year, the largest proportion since 1990. Cities continued to spend beyond their means, and the most common response to fiscal distress was raising existing taxes and fees or creating new ones. And what were the biggest negative factors affecting budgets?

- Costs of city workers' health benefits (cited by 63 percent of respondents)
- Costs of city workers' pensions (30 percent)
- Reduction in state aid (29 percent)
- The local economy (25 percent)
- Infrastructure needs (25 percent)

Energy Stays In-House, Forest Service Goes Out

Energy department employees won a competition for the provision of financial services.

The 181 employees won by agreeing to eliminate 63 positions and restructuring other areas, including consolidating 15 accounting centers down to two. Meanwhile, at the U.S. Forest Service, Serco Management Services Inc. defeated federal workers in a competition to provide vehicle fleet maintenance in the Forest Services California section.

However, the Forest Service will retain some defeated employees to help administer the contract. Analysis by Reason Foundation and others consistently finds that defeated employees often hold a grudge, and work to undermine the contractor and prove that the outsourcing was a mistake.

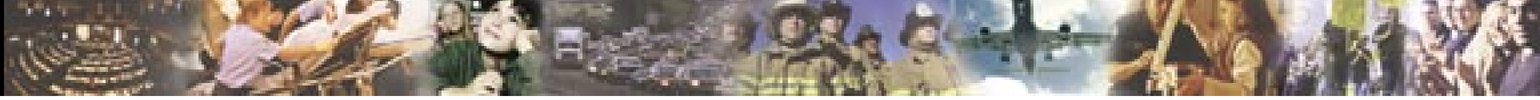
For daily privatization briefs, visit rppi.org/outofcontrol ■

Continued from Page 4
Milwaukee

of the contract. Customers have felt efficiency gains in the form of lighter water bills—rates have dropped 16 percent.

New maintenance strategies demonstrate how efficiency can serve quality. "Before there were three separate maintenance systems," says Tobel, "and we brought it down to one." A computerized maintenance system called MAXIMO has improved tracking and allowed for the development of a predictive maintenance program. Meanwhile, an internal program known as Performax evaluates factors such as water quality, maintenance, cost and energy use on a daily, weekly and monthly basis.

Because the right information allows employees in the field to perform more effectively, Tobel credits Performax with helping to foster continuous improvement. "They know how much energy or how much chemicals they should be using," notes Tobel. "We review so often because you don't wait a month and realize you've used too much chemicals." ■



Who, What, Where

Reason Studies

Frequently Asked Questions about Water/ Wastewater Privatization, Geoffrey F. Segal and Adrian T. Moore. Project Director: Adrian T. Moore. Policy Brief No. 26: rppi.org/pb26.pdf

Removing Muck with Markets: A Case Study on Pollutant Trading for Cleaner Water, Michael DeAlissi. Policy Brief No. 24: rppi.org/pb24.pdf

Revisiting the Public Interest in Private Water, Alexei Tsybine and Don. S. Evans. Policy Brief No. 22: rppi.org/pb22.pdf

Long-term Contracting for Water and Wastewater Services, Robin A. Johnson, John McCormally and Adrian T. Moore. How-to-Guide No. 19: rppi.org/htg19.html

Restructuring California's School Finance System, Lisa Snell, rppi.org/schoolfinance.shtml

Are We Paving Paradise? Randal O'Toole. Policy Brief No. 17: rppi.org/pb17.pdf

A Federal Ethanol Mandate: Is it worth it? If not, why is it so popular? Matthew McCormick, Scott Feifeld and Lynne Kiesling. Project Director: Adrian T. Moore. Policy Summary No. 315: rppi.org/ps315.pdf

Privatization Watch Back Issues available at rppi.org/privwatch.html

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Water Permit Transfers: Bridging the Misinformation Gap, Georgia Public Policy Foundation: gppf.org

Marketing Water, Marketing Reform: Lessons from the Chilean Experience, Carl Bauer. Resources for the Future: rff.org

Water Management Policy in Florida: Regional Politics and Market Development, Kimble F. Ainslie: James Madison Institute: jamesmadison.org

Saving Our Streams Through Water Markets: A Practical Guide, Clay J. Landry. Property and Environment Research Center: perc.org

Continental Water Marketing, Terry L. Anderson, Ed. Pacific Research Institute: pacificresearch.org

Pricing Irrigation Water: Principles and Cases from Developing Countries, Yacov Tsur, Terry Roe, Rachid Doukkaili and Ariel Dinar. Resources for the Future: rff.org

Competitive Contracting for Highway Maintenance: Lessons from National Experience, Geoffrey F. Segal and Eric Montague. Washington Policy Center: rppi.org/highwaymain.shtml

Private Competition for Public Services: Unfinished Agenda in New York State, E.J. McMahon, Adrian Moore and Geoffrey F. Segal. Manhattan Institute: rppi.org/civicreport.pdf

Conferences

The 2004 Preserving the American Dream Conference, April 16-18, Portland, OR. The Thoreau Institute: ti.org

A-76 Competitive Sourcing in Government, April 19-20, Arlington, VA. Performance Institute: performanceweb.org

Resource Bank Meeting, April 29-30. Chicago, IL. Heritage Foundation: heritage.org

2004 Best Practices Forum: Performance-Based Budgeting and PART Simulation, May 3-4, Arlington, VA. Performance Institute: performanceweb.org

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