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MUNICIPAL SERVICES: THE PRIVATIZATION OPTION

INTRODUCTION

Strong criticism of the Administration's New Federalism initiative has come from the nation's city officials. They assume that the transfer of many programs to the states, in the form of scaled down block grants, will mean less spending on urban areas. The usual response of city officials to funding cutbacks is to present local citizens with an unappealing choice: either put up with increases in local taxes or face drastic cuts in public services. Both alternatives pose political and economic risks. Politically, the mood of the country is still against tax increases; Propositions 2½ (Massachusetts) and 13 (California) still command large majorities in their favor. Yet citizens also tend to resist cutbacks in local public services. Unlike many federal government activities, they are generally not perceived as wasteful.

This dismal analysis of the situation overlooks another alternative--privatization. Here and there around the United States, cities have been discovering that public services do not necessarily have to be produced by government or paid for by taxes. Once the government-production/ tax-funding constraint is lifted, a whole range of possibilities for alternative service delivery opens up. And the evidence to date indicates that services provided via privatization are generally produced more cost effectively than services provided by tax funded local monopolies. Privatization, therefore, offers cities a way out of the dilemma posed by the New Federalism, and is an effective mechanism to allow cutting the size of the federal budget while maintaining--or even improving--the quality of many services at the local level.

THE DILEMMA

To understand why the New Federalism proposals have been met with such cries of alarm from local officials, it is necessary to understand the extent to which local governments have become dependent on the federal government. Ever since the New Deal, local governments have relied on various forms of "intergovernmental revenue" for a significant fraction of their income. This fraction increased gradually from 1940 to 1970, growing from one quarter of local revenues to one third--an increase of 8 percent in thirty years. But during the 1970s, such aid leaped by another 7 percent, mounting to 40 percent of all local revenue.

As Table 1 reveals, the principal shift has been for outside aid to offset local property tax revenue. Whereas property taxes accounted for 54.5 percent of local government revenue in 1940 and remained in the 40 percent range throughout the 1950s and 1960s, they had shrunk to 30.7 percent in 1977, the year before Proposition 13 and subsequent grass-roots revolts against property taxes.

Table 1 combines federal and state aid to local governments into a single category. While it is true that the fraction of this total going directly from the federal government to local entities had grown from only about 5 percent in 1950 to 22 percent by the end of the 1970s, this figure by itself is not very meaningful because a large fraction of state aid to local governments also is federal in origin. From the local officials' viewpoint, what is most relevant is the total revenue available from outside sources. Direct aid from Washington is often preferred, since competing interests within the state do not then have access to the money. But New Federalism threatens the level of all nonlocal revenue.

President Reagan's New Federalism proposes to reduce, in absolute terms, the amount of federal aid that has been going to state and local governments. The original (February 1982) plan called for turning over sixty-one federal aid programs to the states, in five categories: education and training, social services, transportation, community development, and revenue sharing. Although the turnback of programs has been reduced in scope, real cuts in aid are planned. This small but definite reduction in the role and outlays of the federal government represents a dramatic reversal of the trend of the last forty years, and especially of the past decade.

Regardless of how the details of New Federalism are finally ironed out, it seems clear that cities are going to end up with significantly less outside aid over the next decade. Their direct federal aid via such categorical programs as social services and community development will be cut. And their state aid, much of it paid for with federal funds, will also shrink. Cities are faced, therefore, with a painful dilemma: Do they raise taxes or cut services? Either action is politically risky. Or will they

Table 1
Trends in Local Government Revenues ($billions)

Year	Total Revenue	Property Tax		Other Taxes		User Fees & Utility		Miscellaneous		State & Fed. Aid	
		$	%	$	%	$	%	$	%	$	%
1940	7.7	4.2	54.5	0.3	3.9	1.2	15.6	0.1	1.3	1.9	24.7
1950	16.1	7.0	43.5	0.9	5.6	3.4	21.1	0.3	1.9	4.4	27.3
1960	37.3	15.8	42.4	2.3	6.2	8.4	22.5	0.7	1.9	10.1	27.1
1965	53.4	21.8	40.8	3.3	6.2	12.2	22.8	1.0	1.9	15.2	28.5
1970	89.1	33.0	37.0	5.9	6.6	19.2	21.5	1.6	1.8	29.5	33.1
1975	159.7	50.0	31.3	11.3	7.1	33.9	21.2	2.5	1.6	62.0	38.8
1976	178.3	54.9	30.8	12.7	7.1	38.2	21.4	2.8	1.6	69.7	39.1
1977	196.5	60.3	30.7	14.6	7.4	41.7	21.2	3.1	1.6	76.8	39.1
1978	214.5	64.0	29.8	16.3	7.6	46.6	21.7	3.4	1.6	84.0	39.2
1979	234.6	62.4	26.6	18.2	7.8	55.2	23.5	4.0	1.7	94.8	40.4

Source: Facts and Figures on Government Finance, 1981, Washington, D.C.: The Tax Foundation, Inc., 1981 have the imagination and courage to seek more efficient ways of providing public services?

ANOTHER ALTERNATIVE: PRIVATIZATION

The conventional approach to providing municipal services is for the local government to collect the revenues needed for the service and to deliver the service as well. The implicit premise in this view is that local public services are all "public goods"--i.e., goods or services that can only be produced and paid for collectively. Yet the fact is that most local public services (other than strictly wealth-transfer functions) have few attributes of true public goods. Most of them--including garbage collection, park and recreation services, libraries, airports, transit, and aspects of police and fire protection--have specific, identifiable users, who are the services' principal beneficiaries. To the extent that discrete user/beneficiaries can be identified, user fees become a viable alternative to taxation as a source of revenue. Moreover, even for services that are closer to being pure public goods, it is not at all clear that government must be the provider. Even where the revenue is best obtained via taxation, the service can be produced by (a) a private, for-profit firm, (b) a nonprofit organization, or (c) some other government jurisdiction that may be able to do the job more efficiently.

Shifting to an alternative means of public service delivery is often referred to as privatization.[1] Three variants of privatization are of particular significance in the case of municipal services, namely user fees, contracting out, and load shedding.

1) User fees

To the extent that a service is shifted from tax funding to user fees, the tax increase dilemma for revenue squeezed local governments is eased. Moreover, there is much economic evidence that services will be produced more efficiently and responsively when users provide direct feedback through utilization according to the price charged than when they provide only indirect feedback via the political process.

2) Contracting out

Contracting out refers to a variety of situations in which local government remains responsible for the funding of a service, but selects one or more providers by a process of competitive

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[1] See, for example, E.S. Savas, Privatizing the Public Sector (Chatham, N.J.: Chatham House, 1982); James T. Bennett and Manuel H. Johnson, Better Government at Half the Price (Ottawa, Ill: Caroline House, 1981); and Robert W. Poole, Jr., Cutting Back City Hall (New York: Universe Books, 1980).

bidding. There are several reasons why this alternative to traditional city provision usually leads to less costly, more responsive services. First, it is not likely that the area defined by a city's jurisdictional limits will coincide with the optimum area for most public services, since economies of scale vary dramatically among public services. A city that is the ideal size for the most efficient garbage collection system is probably far too small to provide a water or sewer system at the least cost to residents. Contracting for services permits selection of least cost producers without regard to jurisdictional boundaries.

Second, the need to compete for the contract changes the incentives facing the provider. In contrast to a conventional monopoly city agency, a private firm or a nonprofit agency which must compete with other providers for, say, a three-year garbage contract, has powerful incentives to rethink its use of personnel and equipment in order to deliver the required services in the most efficient manner.

c) Load shedding

This third form of privatization refers to a decision by local government to step back and allow the private sector to produce the service and offer it directly to consumers. Common examples are commercial and industrial (but usually not residential) refuse collection and personalized transit services (taxis). Both are usually left to the marketplace to provide on a voluntary basis, albeit usually with some degree of municipal regulation. Studies of privatization via load shedding suggest that additional current municipal services could be provided this way and that local governments' budget problems would be further eased.

EXAMPLES OF PRIVATIZATION

A close look at the variety of ways in which public services are delivered across the country reveals numerous examples of successful privatization. And where studies of cost effectiveness have been completed, the evidence strongly supports the theoretical case for significant cost savings.

Garbage Collection

Garbage collection is a service that provides examples of all three types of privatization.

Commercial and industrial refuse collection is largely a function of the private sector. In large central cities, it is still common for residential collection to be a function of a city sanitation department, and the service is generally provided without charge. But over the last five years a number of cities (e.g., El Paso and Fort Worth, Texas) have instituted specific fees to pay exclusively for garbage service.

The most important trend over the past decade has been the move toward contracting out residential collection. Nationwide studies in the United States, Canada, and Switzerland, as well as regional studies in Connecticut and the Midwest, have shown that government garbage collection is 29 to 37 percent more costly than private contract collection.[2] These comparisons actually underestimate the true disparity in the United States. A study by E. S. Savas found that municipal sanitation department budget practices understate the true cost of service by an average of 23 percent.[3] As these cost data have become better known, more and more cities have shifted some or all their residential garbage collection to a contract basis. Among those doing so in the past decade are Boston, Dallas, Gainesville (Florida), Jackson (Mississippi), Minneapolis, Oklahoma City, Omaha, St. Paul, and Utica (New York).

There are also a few examples of load shedding where cities decide to get out of the refuse collection business altogether. One such case is Wichita. Until 1978 that city's municipal sanitation department provided residential collection in part of the city, while the rest was served by private firms which contracted with individual homeowners. In the wake of a strike by city sanitation workers in 1978, however, the city decided to cease providing garbage services. Resisting pleas to divide the city into districts and franchise a single firm to operate in each on a monopoly basis, city officials instead stepped back and allowed the marketplace to function. Today there are dozens of companies in the Wichita market; in any given neighborhood, residents have a choice of several firms offering various combinations of price and service. The city's only responsibility is to ensure that each household makes some provision for disposing properly of its garbage.

Fire Services

Although most people do not realize it, fire protection also provides illustrations of all three types of privatization. In the wake of Proposition 13 in California, several cities passed legislation providing for a fire service fee to pay for a portion of the fire department's costs. In so doing they were supported by the analysis of such economists as Urban Institute researcher William Pollak, who concluded a decade ago that government provision of fire suppression services at no charge had led to an underinvest-

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2 E.S. Savas, "Public vs. Private Refuse Collection: A Critical Review of the Evidence," Journal of Urban Analysis, Vol. 6, 1979.

3 E.S. Savas, "Policy Analysis for Local Government: Public vs. Private Collection," Policy Analysis, Vol. 3, No. 1 (Winter 1977).

ment in fire prevention efforts by building owners.[4] A fire service fee, based on the extent to which a building places a demand on the fire suppression system, provides positive incentives to invest in alarm systems, sprinklers, and other preventive measures.

Inglewood, California, in 1978, was the first city to actually implement a fire service fee. The plan was for only "basic" fire protection to be funded from property taxes, with a business service financed by fees based on the calculated "fire blow" requirements of each commercial and industrial structure. The fee system was put into effect in the summer of 1978, but it proved politically unpopular, and it was suspended after the first year.

Faced with the fiscal stress of Proposition 2½, Boston officials introduced a fire service fee in July 1982. Like the Inglewood fee, it is applicable only to larger commercial and industrial buildings, and is expected to bring in some $8 million a year. But there is already talk of a court challenge by the real estate industry. Fire service fees obviously have a long way to go to gain general acceptance.

Equally controversial, but with a longer record of success, is the practice of contracting out fire service. The best-known example is Scottsdale, Arizona, a Phoenix suburb of 90,000 residents, which has been served by private fire services under contract since the city was incorporated in 1952. In 1976 a team of researchers from the California-based Institute for Local Self-Government made a detailed study of the cost and performance of the fire protection system in Scottsdale.[5] Comparing Scottsdale's fire service with that of nearby Glendale, Mesa, and Tempe (which have conventional government fire departments), they found that (1) response time was best in Scottsdale, even though it is the largest in land area, (2) the insurance rating of the fire departments is comparable--homeowners' rates, in particular, are the same in all four cities, (3) average annual fire loss is comparable in all the cities except Tempe (where it was nearly twice as high as in the other three). While the quality of fire protection differed little between Scottsdale and the other three cities, the per capita cost over the 1971-75 period averaged $6.48 in Scottsdale compared with $12.62 in Glendale, $11.43 in Mesa, and $10.68 in Tempe. In other words, by contracting out, Scottsdale was receiving comparable fire protection at only 56 percent of the cost in a city such as Mesa.

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[4] William Pollak, "Pricing Fire Protection Services," in Selma Mushkin (ed.), Public Prices for Public Products (Washington, D.C.: The Urban Institute, 1972).

[5] Alternatives To Traditional Public Safety Delivery Systems: Civilians in Public Safety Services (Berkeley, California: Institute for Local Self-Government, 1977).

Scottsdale is not an isolated example of private fire protection. It is part of a clear trend towards contracting out. The firm providing fire services in Scottsdale, Rural/Metro Fire Department, Inc., also contracts with several other Arizona cities. In 1977 the metro government in Nashville/Davidson County contracted with five small private fire companies to provide fire services in unincorporated areas. Two years later American Emergency Services Corporation won a contract to serve Elk Grove Township, Illinois, adjacent to Chicago's O'Hare Airport. At the same time, Hall County, Georgia, abolished its fire department and contracted out the service to Rural/Metro of Arizona. In January of 1982, the Hall County contract was won by Florida-based Wackenhutt Corporation, the nation's fourth largest private security firm. In addition, Wisconsin-based J.J. Security, Inc., has won fire and crash rescue contracts at the airports in Green Bay and Madison, Wisconsin, Oklahoma City, and Kansas City International Airport. There is even a trade association for private fire companies created in January 1982, the Private Sector Fire Association.

There are also some examples of load shedding in fire protection. In a number of unincorporated communities in Arizona, Georgia, Montana, Oregon, and Tennessee, fire services are provided on a subscription basis by private, profit-making companies. In some cases, these firms are the outgrowth of volunteer fire departments; as an area develops, citizens often demand a higher level of service than that which can be provided by a strictly volunteer organization. Because of the threat of fire spreading from house to house in high density urban areas, subscription fire service is not likely to be acceptable in most cities. But it appears to be a viable alternative for lower density suburbs and unincorporated areas.

Parks and Recreation

There seems to be no clear pattern for changing (or not) the system of park and recreation services. Some cities, such as Washington, D.C., make most of these services available with no user fees at all. At the other extreme are cities like Wheeling, West Virginia, and El Cerrito, and Newark, California, whose recreation programs are entirely supported by user fees.

The principal objection made against recreation program user fees is that they will deprive the poor. There are two important counterarguments. The first is that generally the poor are already paying for such programs--via property taxes (included in their rent payments), sales taxes, and excise taxes. Yet many municipal recreation facilities--tennis courts, golf courses, marinas, etc.--are used largely by middle and upper-income people. Although no definitive studies exist, it is likely that significant wealth transfers from the poor to the nonpoor are taking place in recreation programs funded by taxation, rather than by user charges.

The other counterargument is that the truly needy can always be exempted from the user fees. The Fairfax County, Virginia, recreation agency distributes sports complex passes to low-income children identified via the school lunch program. The San Juan School District in Sacramento, California, arranges for local businesses to give scholarships for low-income children to attend recreation facilities. And the Los Angeles County Art Museum provides free admission one day per month so that senior citizens and others with low incomes can avoid the (post-Proposition 13) entry fee.[6]

Contracting out is being used increasingly in park and recreation services. California has seen a great increase in the contracting out of park maintenance since Proposition 13. Most cities have dozens of commercial landscaping firms which are well-equipped to take over tree trimming, grass cutting, and other park maintenance chores. The savings typically are 30 percent or more; in Los Angeles County, some initial contracts have yielded 50 percent savings.

The operation of park and recreation facilities has also been contracted out. The contractors may be golf or tennis pros, commercial firms, or nonprofit organizations. In Rohnert Park, California, the city was plagued with a money-losing golf course that had become a considerable drain on the taxpayers. The city went out to bid and ended up with a thirty-year lease to a private firm, which is guaranteeing the city a minimum income of $60,000 a year, in addition to rebuilding the course.[7]

There are even some examples of load shedding in the leisure services area. Long-term leasing of large-scale facilities, such as golf courses, represents de facto load shedding. And the recent adopt-a-park trend on both the east and west coasts (including the San Francisco Bay Area and New York City) is a form of load shedding, whereby citizen groups and/or local businesses voluntarily agree to take over responsibility for maintaining specific parks.

Mass Transit

Nearly all municipal transit is operated on at least a partial user-fee basis. The problem is that the fares typically cover less than half of the cost of operation. The reason has to do with the changes in land-use patterns after World War II.

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6 Other examples of park and recreation user fees, and arguments for their use, can be found in Fees and Charges Handbook (Washington, D.C.: U.S. Department of the Interior, Heritage Conservation and Recreation Service, 1979).

7 Further examples and guidelines can be found in the Contract Services Handbook (Washington, D.C.: U.S. Department of the Interior, Heritage Conservation and Recreation Service, 1979).

In the 1950s most transit operations were private businesses. As people migrated to the suburbs, political pressures and bad business judgment caused the transit systems to spread out after them. But conventional bus systems found it difficult to stay profitable in low density areas, and bus systems began to go bankrupt. Nobel Prize winning economist F. A. Hayek speaks of the market as a giant information system. In this case, the market was telling us that the traditional form of busline was obsolete in the suburbs. But people and politicians refused to listen and cities took over the buslines in an effort to preserve the obsolete structure.

When that became increasingly difficult for cities, the federal response in the 1960s was to provide capital grants to enable cities to buy new buses. The theory was that new equipment would attract new riders and make the systems viable again. When that didn't work, the next major federal program, in the 1970s, provided large subsidies to help pay operating costs. Yet two-thirds of all the increased spending in the 1970s went directly into higher wages for bus drivers,[8] and transit unions resisted strenuously sensible measures to hold down costs--such as using part-time drivers at peak hours.

Simply raising user fees to full-cost levels would leave this inefficient transit system intact. Nor would contracting out make much of a difference, though there are transit management firms that can bring about some modest improvements in efficiency within the constraints of monopoly structure and price controls. Yet, given the cutback in federal operating subsidies, drastic changes are going to be necessary.

Economist James Ramsey has proposed load shedding as the solution for one especially beleaguered transit system--the New York City subways.[9] Pointing out that monopoly structure (and hence monopoly unionism and highly inefficient staffing practices) and price controls are primarily responsible for the system's deterioration, and citing the rising popularity of private express buses at three to four times the subway fare, Ramsey urges that the subway lines be auctioned off to the highest bidder, to be operated free of any government controls.

Other municipal transit monopolies could be treated in the same way. If that were done, the transit "system" that would emerge would be radically decentralized. If anti-jitney laws were repealed, and taxi pricing and entry restrictions decontrolled (as they have been in San Diego), low-density transit in a city

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8 Charles Lave, "Dealing with the Transit Deficit," Journal of Contemporary Studies, Vol. IV, No. 2 (Spring 1981).

9 James B. Ramsey, "Selling the Subways in New York: Wild-Eyed Radicalism or the Only Feasible Solution?" New York University, Department of Economics, January 1982.

could be provided cost effectively by hundreds (or thousands) of jitneys, minibuses, and shared rides in cabs. Such systems operate profitably in many cities in South America and Southeast Asia.[10] High-density commuter service would be provided by dozens of private express bus companies, of the kind that have sprung up in Southern California, New York City, and Chicago.

Infrastructure

It has become a cliché that the infrastructure--roads, bridges, water and sewer systems--in many cities is decaying. The pressure to "do something" about this has resulted various federal programs to bail out the cities--most recently, of course, the misnamed "repair" plan, to be funded by an increase in the gasoline tax. What most people fail to appreciate, however, is the institutional nature of the underlying problem.

For many years elected officials in the crumbling cities have been balancing budgets by putting off until the next administration needed expenditures on infrastructure maintenance. New York City's water and sewer systems should be being replaced on a 100-year cycle. Instead, they are being replaced on a 300-year cycle. New York's streets are on a 200-year cycle instead of the required twenty to twenty-five years. Needless to say, this cannot go on indefinitely. But politically, it is much easier for officials to heed the pleas of special interest groups for transfer payments and subsidies than to spend money on unglamorous projects like sewer maintenance. Furthermore, federal capital programs for new construction only add to the incentive to allow systems to run down to the point where they must be replaced with the help of Washington, rather than properly maintained by regular city expenditures.

Privatization provides an alternative answer to the infrastructure problem. If specific public works were placed on a self-supporting basis with user fees, the temptation of politicians to divert general fund money away from maintenance would be eliminated. The key to doing this is the creation of legal mechanisms, which separate the user fee revenue and earmark it exclusively for the system that generates it. In California this is frequently accomplished via separate "enterprise funds." In New York City, separate authorities--the Triborough Bridge and Tunnel Authority and the Port Authority of New York and New Jersey--were created for the same purpose. The bridges and tunnels run by the city are in very poor repair; those run by the separate authorities are kept in excellent shape.

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10 See Gabriel Roth and George G. Wynne, Learning from Abroad: Free Enterprise Urban Transportation (Washington, D.C.: Council for International Urban Liaison, 1982).

Although the President referred to it as a "user fee," the recently enacted federal gasoline tax increase is not a true user charge. For one thing, although it is collected from users of roads, one-fifth of the money is to be spent on mass transit systems. More fundamentally, the gasoline tax bears only a crude relationship to the relative share of the cost imposed on the road system by different types of users. In particular, heavy trucks pay only 60 percent of their fair share of highway costs, according to the Federal Highway Administration's cost allocation studies. In contrast, the tolls imposed by turnpike operators--a type of weight-distance charge--accurately reflect the relative costs of serving cars, buses, light trucks, and heavy trucks. Tolls are true user fees: the gasoline tax is not.

Proper user charges--for example, water and sewer bills or bridge tolls--can be the key to solving the infrastructure problem, as long as they can be legally earmarked to prevent diversion. But what about the roads? For over a decade economists have set forth the virtues of tolls on urban expressways. Not only would adequate funds for proper maintenance be assured, but the use of time-of-day pricing would provide economic incentives to reduce rush-hour congestion. In addition to political resistance, however, a principal drawback has been technological. Automated vehicle identification (AVI) systems, which would allow vehicles so equipped to bypass toll booths and be billed once a month, were simply not on the market. The good news is that such systems are nearing commercial feasibility.[11] The New York Port Authority is planning a large-scale test of several systems in the near future. Once such systems are in production, the practical barrier to user fees on urban expressways will be removed.

Contract operation of public works is also a viable option. A number of cities and special districts have had great difficulty operating modern sewage treatment plants in compliance with EPA requirements. At least two companies--Envirotech Systems, Inc. and Environmental Services, Inc.--have succeeded in winning contracts to operate such facilities for local governments.

There is even a role for load shedding in public works. Both Laredo, Texas, and St. Louis actively encourage residents to purchase neighborhood streets which carry little through traffic. A study by noted urban planner Oscar Newman found that privatized streets in St. Louis, many of them in poor neighborhoods, became islands of tranquility in the midst of chaos. Crime dropped substantially and investment in home repair and maintenance rose, because people who had formed a neighborhood association to

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11 R.S. Taylor-Radford, "Rush-Hour Remedy," Reason, Vol. 13, No. 9 (January 1982).

purchase the street felt very protective about their block.[12]

In addition, serious suggestions have been made that bridges be privatized. A detailed cover story in Technology magazine gave examples of privately owned bridges (e.g. Ambassador Bridge linking Detroit and Windsor, Ontario) and pointed out the financial advantages that accrue to investors--sizable cash flows and huge depreciation write-offs.[13] Full-fledged privatization via load shedding may be the most feasible way of raising the billions of dollars needed to repair America's 200,000 deficient bridges.

IMPLEMENTING PRIVATIZATION

The foregoing discussion has made clear that privatization techniques make it possible to provide more public services for less money, especially less tax money. Why, then, aren't these techniques more widely used? The fact is that certain legal, tax, political, and psychological barriers to privatization must be addressed before the full benefits can be realized.

Legal constraints

Local officials do not always have the legal authority to privatize services. State laws vary in what they allow local government to do. In some states, for example, contracting out public safety services (e.g. police patrol) to private firms is not permitted. Other states impose no such restriction. In other cases, what is permissible for one form of local government (such as charter cities) may not be permissible for others (such as general law cities, special districts). Even the pricing of public services is frequently constrained by legislation. In some cases, charges of any kind may not be imposed; in other cases, shortsighted restrictions on the type of charges (e.g., prohibiting peak-load pricing) may exist.

What is needed at the state level is legal clarification of the right of all units of government to contract out, charge for, and/or simply supervise any and all public services. The federal government could assist by drafting model legislation for consideration by state legislatures. HUD's Division of Governmental Capacity Sharing should be the lead agency for researching and drafting such a model privatization law.

Tax Barriers

Another barrier to privatization--specifically to user charges and load shedding--is tax discrimination. State and local tax payments are deductible from citizens' federal income

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12 Oscar Newman, Community of Interest (New York: Doubleday, 1980).

13 Jeanne McDermott, "Bridges: Back to Private Enterprise?" Technology, Vol. 1, No. 2 (January-February 1982).

tax bills. But direct payments for public services, whether a user fee to local government or a fee paid directly to a private firm, are not deductible. Thus, taxpayers often object to proposals for privatizing services on the grounds that they will have to pay more in federal taxes.

A useful reform at the federal level, therefore, would be to enumerate the public services traditionally provided by local government--police, fire, recreation, parks, garbage collection, --and allow fees for these services, whether public or private, to be deductible from federally taxable income. This would put user-charge funded public services on an equal footing with tax supported, governmentally produced public services.

Another tax barrier exists at the local level. When citizens provide and pay for their own public services (e.g., a neighborhood association takes over responsibility for a street) rather than obtaining them from local government, they usually must continue to shoulder the same local tax burden as citizens who are not providing any of their own services. A sensible local reform would therefore be to provide tax credits against local property taxes for all expenditures by neighborhood or homeowners' associations which, by providing substitute public services, relieve the load on tax supported services. Once again, HUD could research and draft a model ordinance.

A precedent for this approach to privatization exists in Kansas City, Missouri, where, downtown, the garbage service is provided by a city department, and in the suburbs by private firms under contract with the city. In both cases, funding comes from local taxes. But Kansas City allows neighborhood associations and apartment buildings to opt out and hire their own garbage service, for which they receive a per-household rebate on property taxes from the city. As of 1978-1979, some forty-one homeowners' associations had opted out and were being served by twelve different garbage collection firms.

Federal Rules

A third barrier concerns local mass transit agencies. In order to implement the load shedding option, existing local transit agencies must be free to declare bankruptcy and sell off their assets to would-be private enterprise providers. Yet because nearly all of these systems' vehicles have been purchased with 80 percent funding from the Urban Mass Transit Administration, that federal money would have to be returned to UMTA upon dissolution of any of its grantees. Clearly, such a regulation is contrary to the public interest in solving severe transit problems of cities. A helpful reform at the federal level would be to rescind UMTA regulations requiring repayment of the grant funds, provided that the vehicles remained in service to the public under the new ownership following the dissolution of an existing mass transit agency.

Government and Union Obstruction

A fourth type of barrier is political and psychological: the resistance of city officials to privatization. In part, this simply reflects the generally status quo orientation of local politicians and bureaucrats. After all, for decades city department heads have been rewarded in proportion to the size of their departments, not how cost effectively they were operated. City officials are not used to thinking of themselves as facilitators of public service delivery rather than direct producers of the service. So they tend to resist privatization proposals and are skilled at coming up with numerous objections pointing out that while such measures may have worked elsewhere, their city is different.

Reinforcing this natural resistance is the organized opposition of public employee unions, which regard privatization as a threat to their continued growth and power. One such union has produced and widely distributed an extremely biased attack on contracting out services.[14] The unions' main arguments are that contracting out will result in large-scale layoffs of public employees and lead to political corruption in the selection of contractors. If privatization is to spread, the answers to these claims must be made available to local officials.

All of these factors suggest the need for developing and disseminating information on privatization to local officials. In England, the Adam Smith Institute has developed and implemented an extensive privatization information program, including a basic information packet for local officials, a technical manual, a newsletter, and a media campaign. The newsletter is currently being sent to some 18,000 persons, particularly to elected officials in cities considered to be ripe for privatization.

A similar effort would be very effective in this country. It would provide local officials with case studies in privatization, sample contracts, model bidding procedures designed to frustrate attempts at corruption, and perhaps directories of cities where privatized specific services and private firms are available as contractors. Private, nonprofit organizations such as the Reason Foundation's Local Government Center located in Santa Barbara, California, and the Sabre Foundation and the Taxpayers' Foundation (both of Washington, D.C.) have already developed some of the necessary materials.[15]

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14 John D. Hanrahan, Government for Sale: Contracting-Out, the New Patronage (Washington, D.C.: American Federation of State, Country, and Municipal Employees, 1977).

15 The Local Government Center is compiling a Directory of Private Service Providers and publishes a monthly privatization newsletter, "Fiscal Watchdog." The Sabre Foundation has produced a privatization oriented Sourcebook on Enterprise Zones. And the Taxpayers' Foundation published both a handbook, "Private Contracting," and a detailed technical manual on contracting, More for Less.

CONCLUSION

A fundamental change has taken place in the fiscal relationship between the federal government and localities. City officials must face up to the reality that outside aid will shrink, in real terms, over the next decade. Rather than simply accepting the dismal trade-off of either cutting back on public services or raising local taxes, cities would benefit far more by taking full advantage of the various forms of privatization. By contracting out public services, they can shift from high-cost monopoly producers to lower-cost producers who must compete for the business. By changing from taxes to user fees, they can relieve the burden on already strained local tax sources. And by selectively shedding the load of certain services altogether (garbage collection, transit, certain bridges, and streets), they can reduce their public service responsibilities to a more manageable size.

The federal government cannot force cities to make these changes. But it can facilitate the process, by providing the legal research necessary to draft model legislation and ordinances, and by collecting and disseminating information on how to make privatization work. Such modest efforts could make a large contribution to the ultimate success of privatization.

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