



Privatization

REPORT

A Quarterly Publication on Privatization Initiatives throughout the State • Mackinac Center for Public Policy • No. 2002-01 / Winter 2002



**Worldwide Study Praises
Private Education for the Poor**

**Michigan Civil Service Rules are
Amenable to Outsourcing**

**Granite Island Lighthouse
Privatization Shines**

Privatization and the Blues

Ambulance Wars

Privatization Might Save Passenger Rail

HOW TO

LOWER

EXPENSES



The report contains the state budget, which is a key document for the public. It details the state's financial plan, including revenue sources and spending priorities. The report is essential for understanding the state's fiscal health and the impact of various policies on the budget. It provides a comprehensive overview of the state's financial operations and the challenges it faces. The report is a valuable resource for citizens, policymakers, and the media. It is published quarterly and is available to the public. The report is a key document for the public and is essential for understanding the state's financial health.



A **tyco** INTERNATIONAL LTD. COMPANY

800-748-0199

5555 Glenwood Hills Parkway Southeast, Grand Rapids, Michigan 49512

MICHIGAN PRIVATIZATION REPORT

Editor: David Bardallis

Senior Managing Editor: Michael LaFaive

Assistant Editor: Samuel Walker

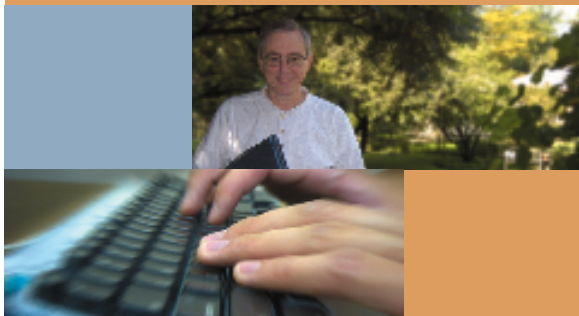
Graphic Designer: Daniel Montgomery

Circulation Manager: Amy Kellogg

Michigan Privatization Report is published quarterly by the Mackinac Center for Public Policy, a nonprofit, nonpartisan, tax-exempt research and educational organization devoted to analyzing Michigan public policy issues. *Michigan Privatization Report* is distributed to state senators and representatives and policy staff; department directors and staff; municipal officials and administrators; school superintendents and school board members. Additional copies are sent to Michigan radio and television news directors, print news editors and select industry leaders. Total circulation is over 14,000. Copyright © 2001 by the Mackinac Center. All rights reserved. Permission to excerpt or reprint is hereby granted provided that *Michigan Privatization Report*, the author, and the Mackinac Center for Public Policy are properly cited, and a copy of excerpt or reprint is sent to the editor. Please contact the Mackinac Center for Public Policy at 140 West Main Street, P.O. Box 568, Midland, MI 48640; Phone: (989) 631-0900; Fax: (989) 631-0964; e-mail: mcpp@mackinac.org; or World Wide Web: <http://www.mackinac.org> if you wish to receive *Michigan Privatization Report*.

MichiganVotes.org

Being an informed citizen has never been this easy.



Your legislator's entire voting record is at your fingertips, 24 hours a day.

Michigan Privatization REPORT

A Quarterly Publication on Privatization Initiatives throughout the State • Mackinac Center for Public Policy • No. 2001-04 / Winter 2002

FEATURES

4 Worldwide Study Praises Private Education for the Poor

When people try to come up with the best way to deliver education to the poor, rarely do they think of private schools. Even more rarely do they consider that the profit motive might be a useful tool for accomplishing the task. In fact, many people believe that only government can provide low-income children with adequate educational opportunities. A new study makes the opposite case.

5 Michigan's Civil Service Rules are Amenable to Outsourcing

Contrary to what one might expect, the laws of the state of Michigan are surprisingly fair and even-handed when it comes to contracting out public services to private contractors.

7 Granite Island Lighthouse Privatization Shines

In 1996, the Mackinac Center for Public Policy suggested that the federal government sell off its lighthouse



properties. One such property was sold to an entrepreneur for \$86,000. What has he done with the property since? The short answer is, "a lot."

10 Privatization and The Blues

Blue Cross/Blue Shield of Michigan (BCBSM) is a quasi-public, nonprofit health insurance firm that controls over 50 percent of the health-insurance market in Michigan. It has been insulated from the rigors of a truly competitive market, thanks to Michigan's Public Act 350 of 1980, a law that exempts it from state taxes. It should lose this protection and be converted to an investor-owned, private company.



DEPARTMENTS

12 NATIONAL PERSPECTIVE Ambulance Wars

In the 1990s, "ambulance wars" broke out when private and public emergency medical service (EMS) providers began battling over responsibility for ambulance services across the country. These wars became especially intense in California and Florida, with separate public and private crews sometimes arriving simultaneously at accident sites. What has been the result?

16 NATIONAL PERSPECTIVE Privatization Might Save Passenger Rail

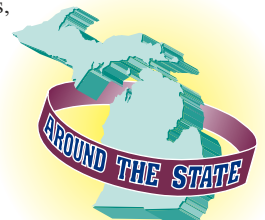


The airport shutdowns and fear of flying that followed the Sept. 11 terrorist attacks gave Amtrak a surge in ridership, especially

in America's northeast corridor. The nationalized passenger railway responded by increasing capacity, the number of trains conveying passengers, and was forced to require more reservations from customers. It will not be enough to save Amtrak's passenger rail service, but privatization might be.

14 AROUND THE STATE

An update of privatization initiatives, opportunities, and controversies from around the Great Lakes State.



ADVERTISERS:

| | |
|-------------------------------|---|
| Earth Tech Operation Services | 2 |
| MichiganVotes.org | 2 |
| Educlean Services | 6 |



Feature

Worldwide Study Praises Private Education for Poor

■ **By Matthew J. Brouillette**

When people examine the best way to deliver education to the poor, rarely do they think of private schools. Even more rarely do they consider that the profit motive might be a useful tool for accomplishing the task. In fact, many people believe that only government can provide low-income children with adequate educational opportunities.

However, the findings of Dr. James Tooley, professor of education policy at the University of Newcastle (UK) and director of the Education Programme at London's Institute of Economic Affairs, make one wonder whether this may have only been a prejudice. In his study, entitled "The Global Education Industry: Lessons from Private Education in Developing Countries" (2nd Edition, 2001), Tooley finds that private, for-profit education in many developing countries is better serving the educational needs of disadvantaged children than are state-run schools, thereby lifting them out of poverty.

"In many developing countries," says Tooley, "government schools are in a parlous state. But the poor don't just sit by, waiting for the government to make their schools better. Some of the most disadvantaged people on this planet vote with their feet, exit the state schools and move their children to private schools, set up by educational entrepreneurs to cater to their needs." Contrary to the image commonly portrayed of private schooling, Tooley found that many schools in developing countries are "open to some of the poorest people, including children of rickshaw pullers and costermongers."

Tooley worked with a team of researchers from 12 developing countries and 18 private education companies, schools and/or universities in those countries. Funded by the International Finance Corporation (IFC), the private finance arm of the World Bank, "The

Global Education Industry" found richly innovative approaches to education that tailor programs to the needs of children from all points on the socio-economic spectrum. (The full report is available on the Internet at www.iea.org.uk/books/hp141.htm.)

One company highlighted in the IFC report, SABIS Educational Systems Inc., operates 28 schools in more than 11 countries on four continents and serves approximately 20,000 students. In the United States, the company runs eight schools, in Massachusetts, Minnesota, Ohio, Arizona, North Carolina, and here at home in Flint, Michigan. Founded in 1886, in the village of Choueifat, a suburb of Beirut, Lebanon, SABIS is a family-run business that emphasizes English, math, science and world languages as the gateways to advanced learning.

Contrary to the typical image of private education, "practically any student who is willing to learn is accepted" at SABIS schools. At SABIS, grade placement is based upon academic attainment rather than putting all children of the same age together in the same classroom, which imposes an arbitrary age standard on the learning process. Thus, it is possible, in a SABIS school, to find as much as a three-year age range in the same classroom.

The International Academy of Flint is part of the SABIS School Network. The Academy opened as a charter school in September of 1999, and today serves nearly 800 students in grades kindergarten through 9th grade.

More than 70 percent of the students at the International Academy are African American, while nearly 80 percent qualify for free- or reduced-price lunches. Many special education students also attend the school, and many students entering the academy are one to two grade levels behind in both reading and math.

Despite being from low-income, disadvantaged families, the students at the International Academy of Flint are making significant academic gains. Michigan Educational Assessment Program scores for 4th graders demonstrate substantial improvements in reading and math in 2001. Whereas only 27.8 and 22.2 percent achieved "satisfactory" results in math and reading, respectively, in 2000, those same scores improved to 45.2 percent and 36.1 percent in 2001.

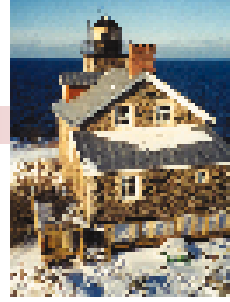
One reason for such dramatic gains is SABIS' use of a computerized Academic Monitoring System™ to track individual student and class progress. Students take weekly tests and teachers are given reports that check mastery and retention of learned concepts and detect gaps that may form in children's learning and/or skills. This feedback helps teachers and students pinpoint areas that need emphasis before new material is introduced.

School principal Mark Weinberg is quick to point out that students still have a long way to go in order to meet the expectations of parents and the standards set by SABIS. "It takes time to make up that lost ground," he says. "We're doing all this with an eye on the fact that our mission is to prepare these children for college."

Examples like SABIS Educational Systems and its Michigan outpost in Flint are showing that for-profit education can improve educational opportunities for economically disadvantaged children. Far from exacerbating inequality in education, private education companies are providing children with greater educational opportunities throughout the world. MPRI

Matthew Brouillette is director of education policy at the Mackinac Center for Public Policy.

Despite being from low-income, disadvantaged families, the students at the International Academy of Flint are making significant academic gains.



Michigan's Civil Service Rules are Amenable to Outsourcing

■ By Robert P. Hunter

Contrary to what one might expect, the laws of the state of Michigan are surprisingly fair and evenhanded when it comes to contracting out public services to private contractors.

The state Constitution stipulates that no state executive agency can pay any employee or independent contractor for services without the approval of the Michigan Civil Service Commission. The Constitution further stipulates that almost all employees of state executive agencies must be hired, compensated, promoted, and disciplined according to Civil Service Commission rules.

This means that with regard to contracting out services to private vendors, the Michigan Civil Service Commission calls the shots.

Since Commission rules clearly stipulate that the duties listed above must be dealt with according to merit—not according to political patronage—the legal door is open to the possibility that a private vendor may be best qualified to handle a particular public service.

While state agencies generally provide their services through Michigan's 62,000 career civil service employees, as a member of the Commission I can tell you that the body clearly recognizes that it is not always practical or efficient to use civil service employees.

This is why, in fiscal year 1999-2000, state agencies paid \$925 million for contracted services.

State Standards for Contracting with Private Vendors

According to the rules of the Michigan Civil Service Commission, before an agency can use private

contractors instead of civil service employees to perform a service, it must obtain permission from the Department of Civil Service.

To obtain such permission, the agency must demonstrate a need that meets *one or more* of the following standards:

- **Standard A.** The service needed is temporary, intermittent, or irregular (and, hence, does not lend itself

compared to the cost of using civil service employees).

If the Department of Civil Service gives permission to a state agency to hire a private contractor based on these standards, the agency may then obtain bids from vendors, negotiate the necessary contracts, and make the necessary monetary disbursements to the contract employees or independent contractors.



Robert Hunter, shown above, at a Michigan Civil Service Commission meeting.

to the use of regularly employed career civil service workers);

- **Standard B.** The service is so specialized that it is not recognized as normal to civil service, or the state agency cannot attract enough qualified candidates willing to accept a civil service position that would perform the service;
- **Standard C.** The services involve the use of equipment or materials not reasonably available to the state agency and the cost to obtain the equipment or materials and establish the needed civil service positions would be disproportionate to the contract cost; and
- **Standard D.** The services can be provided under contract at "substantial savings" to the state (when

But for many proposed contracts, an agency must file an individual request with, and receive written permission from, the Department of Civil Service before making any disbursements of state funds. If, in such cases, the agency or a union disagrees with the Department's decision to approve or disapprove the proposed payments, an appeal may be taken to the Civil Service Commission.

In other cases, the Department of Civil Service has identified services that clearly meet one or more of its four standards and therefore *preauthorizes* agencies to contract out for these. For example, an agency may contract

continued on next page

This means that with regard to contracting out services to private vendors, the Michigan Civil Service Commission calls the shots.



Feature

“Civil Service” continued from page 5

any services up to \$5,000 in a fiscal year because such services clearly are temporary and thereby meet Standard A. In addition, agencies can disburse state funds without prior approval for any services for up to 28 days when an emergency occurs.

After an agency has received permission from the Department of Civil Service to contract with a private vendor for a service, the Department does not review or approve the contracts themselves or monitor vendor performance. However, if an agency later makes any payments that violate the limits established by the Department of Civil Service—such as

spending more money than the Department authorized—the State Personnel Director may disallow the payments.

The Civil Service Commission has carefully crafted its rules to provide a balance between the use of career civil servants with the use of private contract services, so that taxpayers get the most effective and cost-efficient state services possible.

The Michigan Civil Service rules and regulations are available on-line at www.state.mi.us/mdcs.

MPRI

Robert P. Hunter, is a former

member of the National Labor Relations Board, is director of labor policy at the Mackinac Center for Public Policy and a member of the Michigan Civil Service Commission.

CLEANING... FOR KIDS

We're dedicated to maintaining a healthy academic environment for students. Allow us to design a housekeeping program specifically for your school.

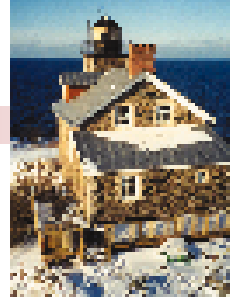
One call to Educlean Services brings over 150 combined years of cleaning experience to your management team.

We're nearby and hands-on...chances are that our regional offices are located just a short drive from your facility.

EDUCLEAN SERVICES GROUP

Flint • Detroit • Ann Arbor • Kalamazoo • Battle Creek • Grand Rapids
Saginaw • Lansing • Bay City • Marquette • Traverse City • Midland • Holland

800-632-1221



Granite Island Lighthouse Privatization Shines

■ By Michael LaFaive

In 1996, the Mackinac Center for Public Policy published an article entitled “Would You Like to Buy a Lighthouse?” In it, Mackinac Center Senior Fellow for Economic Education Burton Folsom suggested that the federal government sell off its lighthouse properties. More than 100 lighthouses dot the Great Lakes coastlines of the state of Michigan.

Folsom wrote that selling the lighthouses could be a win-win situation for all. Private investors would have a greater incentive to care for these historic treasures, the government would make money on the sales, and taxpayers could be relieved of subsidizing the properties, many of which are in a state of disrepair and decay.

What has happened since? The short answer is, “a lot.”

In 1999, the U.S. Coast Guard placed a single Michigan lighthouse up for sale, presumably to test the waters for possible future sales. The Granite Island Lighthouse was sold to Freeland, Mich. entrepreneur, Scott Holman, for \$86,000.

Granite Island is a forbidding rock located in Lake Superior, about 10 miles north of Marquette. Its first owner was a private citizen, Henry B. Lathrup, who had it forcibly taken from him by the state of Michigan in the 1860s for purposes of transferring it to federal ownership so Washington could build a lighthouse there.

After acquiring the island, Holman and his wife, French-born Martine, began planning its refurbishment. They hired a videographer, a photographer and a project manager to document the current condition of the lighthouse. The Holmans studied period lighthouses in great detail, hoping to recreate an authentic 19th-Century version.

As part of their research, they visited the National Archives in Washington D.C. and asked the United States Park Service for information on the structure

there was only one salvageable door. The roof that had survived the decades was made of asbestos, and would need to be replaced. A hole in the roof



Granite Island lighthouse is located in Lake Superior and is pounded by harsh weather (including ninety-plus mile per hour winds) at least six months of every year. Last November a Nor'easter (storm moving northeast) ripped the island's dock and stairs from rock in which it was embedded.

of original lighthouses. In addition, they studied reams of lighthouse documents, including old pictures, drawings and books. They also worked closely with the Michigan's Historical Preservation Office and with private citizens interested in lighthouse preservation.

had managed to replicate itself down through every level of the lighthouse, all the way to the basement. The roof would eventually be replaced using shingles chosen to replicate the original look.

continued on next page

On April 27, 2000, Scott Holman made his first visit as owner of Granite Island. It wasn't the first time he had set foot there. Holman grew up in the Upper Peninsula, attended Northern Michigan University, and owned and ran a scuba diving store in Marquette from 1960 to 1965. When he lived in the area he visited Granite Island often, making his last visit 35 years ago. According to Holman, the lighthouse was in bad shape then. What would it look like in 2000?

The interior of the lighthouse was a mess. Cracked roof plaster was falling from the walls, there was no glass in any of its window frames, and



The majority of the lighthouse's insides were gutted, though most of the original floor work was saved and refurbished. This interior photo shows two rooms after being cleared of debris.



The photo above shows what the roof looked like prior to its replacement. The new roof was made of shingles to replicate the original appearance.

Armed with something the government didn't have—a private owner's incentive to improve the place—Holman and his team went to work. The Holmans had to remove more than 260 bags full of fallen plaster from the lighthouse before builders could install new drywall. Since there is no dump on the small island, garbage generated by the restoration had to be hauled ashore and disposed of properly—especially in the case of asbestos shingles, which were handled by Superior Environmental of Marquette.



New roofing tiles made of zinc being added to the lighthouse.

From July through September of this year more than 500 trips were made to and from the island by three vessels carrying refuse from the lighthouse restoration. A single leg of the journey can take between 15 and 90 minutes, depending on the weather. On one such trip, the barge carrying old plaster to shore sank and Holman and com-

pany had to scuba dive to depths up to 70 feet to retrieve every bag. Thankfully, none of the heavy industrial bags spilled its contents.

Another task was to haul propane, batteries and a water pump ashore to provide basic energy needs. The 96-year old derrick, which was needed to hoist supplies from boats to the island, had to be repaired. An entirely new set of 420 steps had to be built from the base of the island up to the lighthouse itself. The primary work crew lived in a large tent from Monday through Thursday, working 12-hour shifts. A portable, wall-less commode (similar to an RV chemical toilet) was hauled to the island for workers' convenience and placed on the north end of the island to ensure "picturesque views" for its users.

After removing what could not be saved, workmen outfitted the island with new electrical wiring, fuse boxes, batteries (which are charged by solar panels and wind generators) and high-speed Internet access, downloaded via satellite. The next step was to install nearly 10,000 square feet of new drywall. Workers then prepped the door and window areas for brand new, custom-made windows on the outside of the lighthouse and new doors on the inside, including an exquisite set of French doors. Most of the floors were salvaged

by the renovators, cleaned and refinished after the drywall had been painted and other carpentry work done.

When the work of restoration was complete, the Holmans opened their property to several public uses. Its first public function was a fundraising event for a theatre group from Marquette in June, 2001. They also allowed the National Oceanic Aerospace Administration to place webcams around the island to observe ice formation on Lake Superior. The Holmans have also hosted a nonprofit corporation's board meeting



Custom-made windows were installed throughout the lighthouse to replace the originals, all of which were broken by weather or vandals during decades of government ownership.

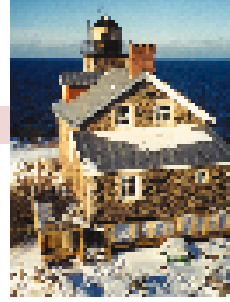
and visits by two state senators and three state representatives to Granite Island since buying and refurbishing the property.

In addition, the Holmans have installed equipment to record wind speeds, temperature and other weather-related data. These are fed into a computer that frequently updates the weather portion of the Holman's web site, **graniteisland.com**. The site's weather page is very popular among Marquette fishermen and leisure boaters.

Lighthouses Are Hard To Buy Again

Unfortunately, rather than take Granite Island as an example of the benefits to be derived from allowing private ownership of lighthouses, state and federal leaders are back to responding to calls for lighthouse preservation

After removing what could not be saved, workmen outfitted the island with new electrical wiring, fuse boxes, batteries and high-speed Internet access, downloaded



The dining area (top) and master bedroom (bottom) are shown here after being refurbished by the Holmans. The floors are original, every other item was either purchased or custom built to replicate the original.

in the usual way: by expanding the government's role.

In 1999, the state of Michigan budgeted more than \$3 million for upkeep and restoration of lighthouses through its Clean Michigan Initiative and in succeeding years appropriated \$300,000 for the Michigan Lighthouse Assistance Program, which assists local groups in preserving and protecting lighthouses. In addition, Michigan's Historic Preservation Office doles out about \$90,000 annually in grants for lighthouse projects.

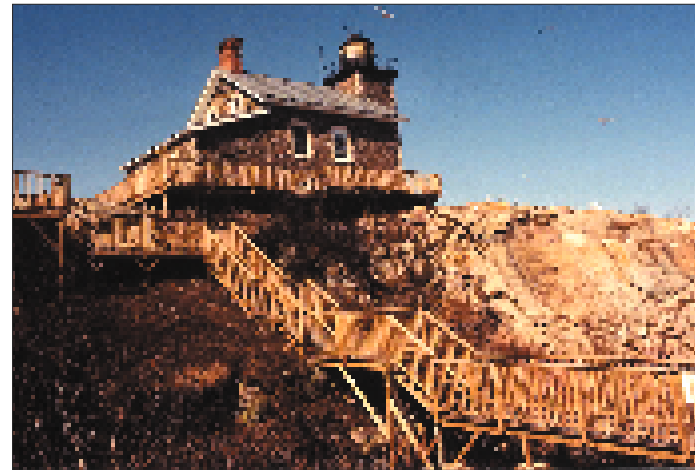
At the federal level, Sen. Carl Levin, D-Mich., introduced a bill entitled the "National Historic Lighthouse Preservation Act," which passed on Jan. 24, 2000, just months after Holman purchased Granite Island. This sweeping legislation gives non-profits the best shot at buying the facilities through a mandated process of ownership transfer.

Under the Levin bill, the U.S. Coast Guard will transfer title of a lighthouse to the U.S. General Services Administration, which will then advertise a "Notice of Availability" alerting governments, other federal agencies, and interested nonprofits of an available lighthouse.

With the new law in effect, private nonprofits will be able to compete for these properties without bidding against private citizens for the right to hold title. Only if no government agencies or nonprofits express interest in buying the lighthouse in question will it be offered to a private buyer. Of course, the idea behind the legislation is to keep lighthouses as part of the public

domain so everyone may have access to these historic buildings.

Intentionally or not, the U.S. government has opened the door—even

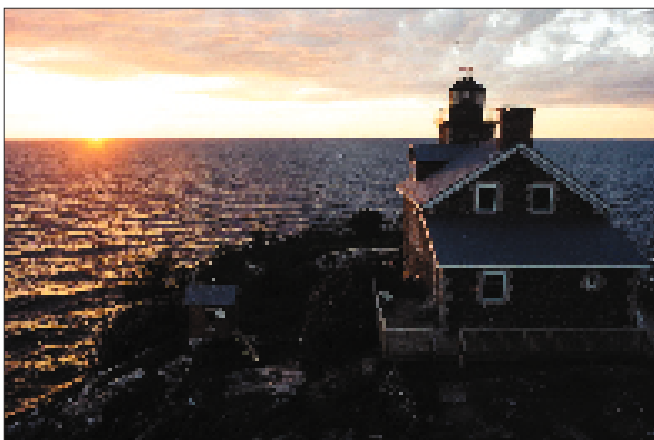


A lengthy staircase was installed to facilitate the movement of people and construction materials from the dock to the lighthouse itself. No taxpayer money was used by the Holmans to construct or refurbish this or any other component of the lighthouse.

if just a crack—to private-sector restoration of Michigan's lighthouses. But, it is counterproductive to turn around and make it harder for the Scott Holmans of the world to obtain these historic treasures. It is tantamount to saying we would rather these historic landmarks die of neglect than allow the private sector to renovate them. We seriously doubt the taxpaying citizens of Michigan would agree with such a formulation.

Hopefully, policy-makers will remember that what people own they take care of, while what belongs to everyone tends to fall into disrepair. The state, as author of the problem, should reduce its role in lighthouse preservation, not increase it. To gain confidence in what can be accomplished with a little private incentive and hard work, all it needs to do is consult Scott and Martine Holman. MPRI

Michael LaFaive is senior managing editor of Michigan Privatization Report.



Sunset on Lake Superior. The lighthouse tower (right, foreground) makes for an ideal perch on evenings such as this.



Feature

Privatization and The Blues

■ **By Frank Webster**

Blue Cross/Blue Shield of Michigan (BCBSM) is a quasi-public, non-profit health insurance firm that controls over 50 percent of the health-insurance market in Michigan. It has been insulated from the rigors of a truly competitive market, thanks to Michigan's Public Act 350 of 1980, a law that exempts it from state taxes.

What this means is that taxpayers who do not have BCBS insurance are subsidizing health insurance for the rest, which are paying higher premiums than they should. Although it has the opportunity to do so, BCBSM has not moved from its highly protected position toward an investor-owned, private, for-profit business model. Doing so would not only help Michigan consumers, but would also help BCBSM stay competitive, raise needed financial capital and offer management flexibility that is impossible under the current setup.

What is Blue Cross/Blue Shield?

Members of the Blue Cross/Blue Shield Association (BCBSA) have provided health insurance to consumers, business and governments nationwide for more than 70 years. The first Blue Shield insurance plan was founded in California in 1939 and was patterned along the same lines as pre-paid "medical service bureaus" (which were composed of groups of doctors), created for employees of lumber and mining camps in the Pacific Northwest.

Over the years, the association has evolved from a pre-payer of hospital costs (under the Blue Cross insignia) and physician bills (under the Blue Shield insignia) to a Medicare intermediary, then to a managed-care facilitator, and finally, to an investor-owned business. It operates in all 50 states, Puerto Rico and the District of Columbia.

The BCBSA licenses all so-called "Blue" plans nationwide. That is, it authorizes licensees (essentially franchise owners) to sell insurance to the public under the rubric of Blue Cross and Blue Shield, provided they adhere to Association rules. The Association limits one BCBS license to each geographic area. Consequently, there is one licensee in Michigan and the BCBSA will not grant a second.

More than three-quarters of Fortune 100 companies provide their employees with BCBS coverage, including the Big Three automakers here in Michigan.

Michigan's Public Act 350 and the change in BCBSA rules

The interaction of two factors with Michigan's Blue Cross/Blue Shield chapter add up to overly expensive health insurance for more than half of the state's consumers.

The first is Public Act 350, a law passed in 1980, which regulates nonprofit health-care corporations to "promote an appropriate distribution of health-care services for all residents" of Michigan. Public Act 350 governs how such health insurance corporations operate, i.e., how they elect their boards, how they apply their rates, and a host of other minutiae. It also allows for a review of BCBSM's rates by the state insurance commissioner.

Each such health-care corporation, according to P.A. 350, is dubbed a "charitable and benevolent institution" and, as a result, is exempt from taxes on revenue and property. Until 1994, the harm this law inflicted upon Michigan consumers was to give health-insurance nonprofits an unfair advantage over their market rivals; a market distortion that tends to drive prices higher than they otherwise would rise.

But in 1994, and facing intense competition from for-profit companies

for market share, the BCBS Association authorized its members to become for-profit, public stock companies.

On the whole, this appears to have been a great move for BCBS and its clients. Many regional BCBSA affiliates took advantage of the opportunity to become more competitive in the health insurance market and thereby offer their customers the best service for the lowest possible price.

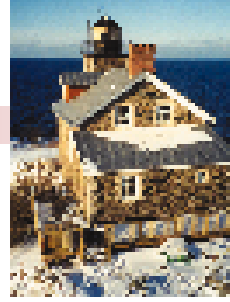
Unfortunately, Michigan's BCBS affiliate chose not to take this opportunity. Why? Because P.A. 350's tax exemption gave it an incentive not to do so. Rather than lose the tax exemption offered by P.A. 350, BCBSM chose not to become a for-profit company. To retain the exemption, BCBSM remained a nonprofit.

Losing tax exemption might be better than remaining semi-public

Blue Cross-Blue Shield of Michigan's most recent triennial report, released Sept. 14, reveals that it lost a whopping \$400 million in the "small group" area of its insurance business over the past five years. Unfortunately, the report does not indicate any desire on the part of BCBSM to forego its tax exemption in order to become a for-profit corporation that could offer competitive rates to small-group consumers. BCBSM wants to retain its status as a nonprofit.

But conversion might be better not just for Michigan consumers, but for BCBSM as well. A big part of the reason the company has become uncompetitive in the market for small-group health insurance is that under P.A. 350 it must offer its services as "insurers of last resort." This means BCBSM subscribers are forced to subsidize Medigap insurance for seniors, for example, and keep rates at lower-than-market levels for high-risk insurance groups.

More than three-quarters of Fortune 100 companies provide their employees with BCBS coverage, including the Big Three automakers here in Michigan.



In addition, under P.A. 350, non-profit health insurers cannot raise capital by selling stock as do private companies. This is especially crippling right now because of the need for technology upgrades that may cost BCBS, according to estimates in the triennial audit, up to \$400 million over the next several years. The new technology is needed to replace hardware and software to better process enrollment, claims processing, billing, actuarial estimates and to work more efficiently with corresponding plans elsewhere.

BCBS of Michigan bringing up the rear

Michigan's BCBS affiliate is the last state-controlled plan of its kind in the nation. Blue Cross/Blue Shield plans covering 14 states have converted to investor-owned companies. The Blue plans in states that surround Michigan—Ohio, Indiana, Illinois and Wisconsin—have all consolidated or become stock companies.

Remaining a state-controlled plan for the foreseeable future means facing increased state regulation, remaining an insurer of last resort, and having a diminished ability to service regional and national businesses because it will not be sharing a common vision, values and strategies with other BCBS plans.

How does this hurt Michigan consumers? Both competition and choice are more limited than they otherwise would be—which sends prices higher—in large part because of BCBSM's dominance in the state, which is derived largely from its P.A. 350 legal privilege. Because of its status as a *de facto* state agency, for example, BCBSM controls almost 100 percent of the health insurance market for public schools, either directly or indirectly through the Michigan Education Special Services Association (MESSA, a subsidiary of the state's largest school employee labor union),



The Accident Fund of Michigan was purchased by Blue Cross Blue Shield of Michigan from the state in 1994. The Mackinac Center supported privatization of the Accident Fund.

or directly through the market.

What should BCBS of Michigan do?

It is highly unlikely that BCBSM will act on its own to step out into a more competitive, investor-owned business model. What will more than likely have to happen is for the state legislature to repeal Public Act 350 and force Blue Cross Blue Shield of Michigan to convert to investor-owned status. Both BCBSM and Michigan's biggest labor unions will strenuously oppose such a move, since both profit from the current setup. The Rolls-Royce coverage provided by BSBSM to autoworkers, for instance, is a generously negotiated package that constitutes a non-cash payment to autoworkers. The above-market-level cost of these is foisted on consumers as higher prices and automobile stockholders as more price per share.

This sort of protected arrangement insulates BCBSM from competition, and officials at the top of such organizations enjoy a privileged status that is difficult to resist. Such leaders are hard to convince, even when the benefit to the

company of throwing off government controls might outweigh the advantages of regulatory protection. The compensation and employment tenure of the current executive staff are protected by retaining the status quo.

On the other hand, if the legislature were to strip BCBSM of its government protection, BCBSM could have the same advantages that other converted plans have: access to capital, more flexibility, the ability to strategically partner with other plans. By partnering with other plans BCBSM could increase its economies of scale and compete in new markets.

Meanwhile, the market is developing in ways that may become too competitive for BCBS plans to be economically viable as non-profits. The Michigan Insurance Commissioner's 2001 audit of BCBSM, recently completed, warns of substantial cash flow problems over the next several years, and premium increases as the only possible remedy—a remedy that is also politically non-viable. While the audit confirms that BCBSM is doing fine for the moment, it also predicts an uncertain future.

It's high time for state leaders and Blue Cross and Blue Shield of Michigan to consider the private alternatives to a state-controlled virtual monopoly. They can begin now to move to an investor-owned organizational model, or they can wait until the Legislature does it for them. Either way, the result will probably mean lower premiums for all of Michigan's citizens. MPRI

Frank Webster, a health-care advisor to the Mackinac Center for Public Policy, is a health-care cost management consultant. He is a former Blue Cross and Blue Shield Executive Vice President in Columbus, Ohio, and a former Executive Director of Michigan Education Special Services Association (the largest BCBSM experience-rated group).

It's high time for state leaders and Blue Cross and Blue Shield of Michigan to consider the private alternatives to a state-controlled virtual monopoly.



National Perspective

Ambulance Wars

■ **By Robin Johnson**

In the 1990s, “ambulance wars” broke out when private and public emergency medical service (EMS) providers began battling over responsibility for ambulance services across the country. These “wars” became especially intense in California and Florida, with separate public and private crews sometimes arriving simultaneously at accident sites.

Ambulance wars have been due primarily to fire departments expanding their activities beyond firefighting. Over the past two decades, the number of home and building fires in the United States plunged 40 percent to 1.8 million annually, even as the number of paid firefighters increased 20 percent to 275,000. Because government fire departments are not subject to the same rigors of the marketplace, they needed to expand rescue activities to justify their survival, and so began to encroach upon the turf of EMS providers.

As a result, 90 percent of the emergency calls to firehouses in cities such as Los Angeles, Chicago and Miami today are for auto accidents and other non-fire-related medical emergencies. Private-sector EMS providers currently are doing battle with government’s fire departments for supremacy in large cities such as New York, Denver, and Portland. In 2000, the Journal of Emergency Medical Services’ annual survey of the 200 largest municipalities in the nation found that 188 have fire departments that provide first response for medical emergencies.

Before the full impact of ambulance wars was felt, the private EMS market was fragmented and decentralized, with a large number of “mom-and-pop” operations. Small ambulance firms are still around, but a large number have been bought out by larger firms

as competition from fire departments has intensified.

The trend began in 1992, when four ambulance companies merged into American Medical Response (AMR). In 1997, AMR and another major provider, Laidlaw, merged, narrowing the market down to two national firms: AMR and Rural/Metro. Today, AMR operates in 35 states with 265 operations and a fleet of more than 4,000 vehicles. Rural/Metro serves more than 4,000 communities throughout the United States, including Michigan, and Latin America. Grand Rapids is the most populated of the Michigan cities relying on private providers. Other cities include Sterling Heights, Ann Arbor, Traverse City, Kalamazoo, Grand Ledge, Portage, and Jackson, as well as Wexford County.

Other factors fueled this consolidation of private EMS providers. One was the federal government’s tightening of reimbursements for Medicare in the mid-1990s, which substantially slowed a large source of funds for ambulance providers. New federal guidelines issued under managed care also had the effect of restricting reimbursement of emergency medical transport.

Yet, the ability of private-sector EMS providers to adapt to changing conditions has enabled EMS privatization to expand dramatically in the past decade-and-a-half. In a 1988 survey of municipalities conducted by the International City/County Managers Association (ICMA), none reported the presence of private-sector ambulance services. A similar survey only 9 years later found such services in approximately 16.3 percent of cities nationwide. Such a rate of growth may not be sustainable over the long term, but the results from the ICMA surveys indicate a solid future for EMS privatization.

This growth should come as no surprise—private EMS providers outperform government in several categories.

For example, 70 percent of private agencies have defibrillation devices (used for heart attacks), compared to only 48 percent of city fire-rescue agencies and rescue workers. More private agencies (48 percent) are using advanced technology, such as the automotive vehicle locator, than city fire-rescue agencies (20 percent). Perhaps most important of all, 66 percent of private, for-profit EMS providers are subject to external reviews by their governing municipalities.

Private EMS firms also can provide services less expensively than fire departments. For instance, privately employed paramedics (who make up 34.5 percent of all paramedics) don’t cost as much as government firefighters. Typically, they make about 75 percent of the firefighters wages. And one hook-and-ladder truck used on an EMS run costs more than six ambulances.

In addition, contracts between municipalities and private EMS providers are moving to a performance-based model that ties funding, payment and resource allocation to the performance of the providers. Private firms are also making better use of technology and accessing advanced equipment more quickly than public agencies—and enhanced technology promises to increase efficiency and save lives.

In fact, a hybrid private/public approach is being used in some cities, with evidence of success. Chicago and Los Angeles, for example, use private EMS providers who work in conjunction with fire departments to assure more rapid response times and lower per-capita EMS costs.

In 1997, California’s San Mateo County joined forces with AMR to form San Mateo County Hospital Advanced Life Support Services. Under this public-private partnership, public fire agencies provide the first-response paramedics and AMR provides a second

In fact, a hybrid private/public approach is being used in some cities, with evidence of success.



medic via ambulance as well as all the medical supplies, equipment, training and clinical oversight for both the public and private medics. Both the fire departments and AMR are subject to fines for non-performance under the terms of their contracts, and AMR shares payment with the fire departments for first response.

Since the program's inception, San Mateo County has increased its number of licensed and certified paramedics from approximately 60 to more than 220. Fire department paramedics are responding on time in nearly 98 percent of emergencies and private paramedics are responding on time in 95 percent of emergencies.

Elsewhere, public officials are warming to the idea of allowing open bidding for EMS service contracts. Last year, Pinellas County officials in Florida allowed such bidding between public and private EMS providers to see who could come up with the best deal for the least amount of money. The bid was won by Sunstar Emergency Medical Services, a private, all-paramedic ambulance and emergency response service that has an exclusive performance-based contract with the Pinellas County EMS Authority.

"Rail Travel" continued from page 16

to handle passenger rail service in the first place.

Alternatives to Amtrak do exist. Virgin Rail in Great Britain has taken over lines from British Rail, sparking a passenger rail traffic boom far surpassing anything in Amtrak's history, and has placed a \$3 billion order for new trains, the largest-ever train order in Britain's history. In Japan, privatization has reinvigorated development efforts, and the new railways have designed more experimental trains using more advanced technology than the old national railway would have. Around

Since taking over the county's EMS services, Sunstar has reduced emergency response times by 30 seconds, with 90 percent reliability. It has increased non-emergency (not life-



Many Michigan cities outsource for emergency medical services, including Grand Rapids, Kalamazoo, and Ann Arbor.

threatening) response compliance from 90 percent to 95 percent and instituted a policy under which only paramedics provide pre-arrival lifesaving instructions over the phone to 911 callers with medical emergencies. The company has upgraded equipment and software in its dispatch/communications center and received the National Academy of Emergency Medical Dispatch's Accredited Center of Excellence Award as a result. Sunstar will replace its vehicles

every five years, and is projected to save Pinellas County between \$13 million and \$21 million over the next decade.

As companies like Sunstar continue to enhance their reputations and establish track records for excellence, public officials are likely to become more open to the idea of EMS privatization. While "ambulance wars" may continue in some parts of the nation, trends indicate a brighter future for privatization of emergency medical services.



Robin A. Johnson is Senior Fellow in Reason Public Policy Institute's Privatization Center in Los Angeles. His research focuses on privatization, government reform, and outsourcing, with an emphasis on small and rural municipal governments.

He has also served as president and CEO of the High Speed Rail Association and executive director of the National Association of Railroad Passengers.

Edward L. Hudgins is director of regulatory studies at the Cato Institute in Washington, D.C.

America may wish to do the same.

Editor's Note: A version of this article appeared in National Review Online Oct. 26, 2001



Joseph Vranich, a former spokesman for Amtrak, served on the Amtrak Reform Council from February 1998 to July 2000.

Since taking over the county's EMS services, Sunstar has reduced emergency response times by 30 seconds, with 90 percent reliability.



Around the State

Detroit Metro Airport Scandal: We Told You So

DETROIT—The Detroit News published a December exposé on Detroit Metro Airport, charging that \$331 million-worth of the 44 service contracts placed out for bid last year, or 86 percent of the total, were awarded to political contributors of Wayne County Executive Edward H. McNamara. Even worse, McNamara contributors were the sole bidders or faced only one other bidder in 60 percent of the contracts awarded to them.

While privatization saves money and generates better services—it has to be done right. Doing it wrong *can be worse than not doing it at all.*

As far back as 1997, MPR published *The Ten Principles of Successful Contracting*, in which we clearly laid out safeguards that any public entity must be willing to put in place to avoid the kind of problems being exposed at Detroit Metro.

In the case of Executive McNamara, there appears to have been serious lack of oversight of his running of the bidding process on the part of the Wayne County Commission. Yet, the bidding process is practically the whole ballgame when it comes to the success or failure of a privatization plan.

Had the Commission insisted on implementation of our *Ten Principles*, it's not only highly unlikely that corruption would be ruining both the reputation and the success of a major privatization venture, but Detroit Metro Airport might also be well on its way to being one of the most highly rated instead of being rated by customers as one of the nation's worst.

Allowing the bidding process to be corrupted gives ammunition to those

who oppose any privatization plan.

One example of what shouldn't happen is the contract awarded for the airport shuttle. A \$37.2 million, three-year bus contract was signed with Commuter Express, a company associated with Anthony Soave, an alleged "crony" of County Executive Edward McNamara. The winning bid, in other words, came not from the lowest bidder, but, as the Detroit News opined, "from the best-connected bidder."

The bid from Commuter Express was more than double the \$15.2-million offer from low bidder Detroit Motor Coach. The Soave proposal is also \$19.6 million higher than the bid from Central Parking System, one of two national firms that submitted bids.

In fact, critics question whether a new contract was needed for shuttle service at all. Shuttle service was already being provided for just \$6 million per year by two companies, Commuter Express and Ampco/System Parking Inc. Under the new contract, the county will pay twice that amount to just one company.

Waste Burning Privatized in Detroit

DETROIT—In November, the city of Detroit received state approval to move forward with a \$300 million contract that would pay Minergy Corp. of Milwaukee to burn wastewater sludge.

The 15-year contract to replace the Detroit Water and Sewer Department's wastewater solids incinerators comes in response to a federal court order mandating that the city upgrade its outdated equipment, which was built in the 1940s and 50s.

With state approval, plans now are to begin construction in the Delray area this coming spring of a 15-acre plant costing \$150 million. The plant will burn 500-600 tons of waste daily,

which it will turn into a glass-like material that company officials say will be recycled to make ceramic floor tiles and sand blasting grit.

Minergy believes its incinerator will reduce air pollution emissions from wastewater sludge incineration by 72 percent, and Detroit officials

believe it will save the city about \$50 million over the course of its 15-year contract.

State to sell mental hospital

NORTHVILLE TOWNSHIP—Plans were announced in November to sell one of the Detroit area's last state-owned mental health hospitals. The state will sell Northville Regional Psychiatric Center for around \$65 million, as one of many steps being taken to head off a looming state budget deficit.

While some advocates for the mentally ill consider selling the nearly 500-acre hospital grounds a bad move, others who would like to see the property along the pricey Seven Mile corridor turned into apartments and office buildings, are thrilled. The land-poor community of Northville had already developed a land-use plan in anticipation of the hospital property going on the auction block.

Northville Hospital currently houses about 300 patients, down from 1,500 in the 1980s.

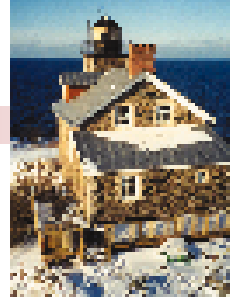
Saginaw County privatizes airport management

The Saginaw County Board of Commissioners voted Nov. 13 to approve a three-year contract to privatize the management of Saginaw's H.W. Browne Airport by handing over management responsibilities to the person best qualified to take over: Alan R. Kaufman, Brown's current publicly employed manager.

County Administration Director



In the case of Executive McNamara, there appears to have been serious lack of oversight of his running of the bidding process on the part of the Wayne County Commission.



Michael E. Thompson says the deal will cut Brown's annual administrative costs by \$31,000 in the first year alone, and will reduce overall costs by around 40 percent per year. "We get to keep the same skilled employees at a lower cost," Thompson told the Saginaw News.

The taxpayer-supported airport has struggled to reduce the flow of red ink during the past year, cutting staff and trimming the airport subsidy from \$288,000 last year to about \$75,000.

And privatization may not stop with the airport, says Thompson. Officials overseeing Saginaw's financially strapped budget may privatize even more services during next spring's budget process. "We're expecting a difficult and contentious budget process," Thompson told the News. "We're open to everything on the table to be reviewed."

Fed up with mixups, Kalkaska County will privatize juror notification

Kalkaska County Clerk Patricia Rodgers will no longer be responsible or contacting prospective jurors; that duty will be privatized following a series of juror mixups that consumed the patience of trial court administrator Rudi Edel.

The trouble started on Oct. 10 when no jurors showed up for a probate court trial. Then, on Oct. 26, lawyers, witnesses and a judge all showed up for an animal cruelty trial in district court—but no jurors. Then, on Nov. 29, only 10 people out of a jury pool of 32 showed up for a district court trial. Many of the no-shows reportedly had called up the night before and listened to an answering machine message from the Clerk's office, saying the trial had been cancelled.

Rodgers told the Associated Press the mixups were not the fault of her office, and blamed them on the mail and the district court's office. Nevertheless, Edel will contract out this part of the county's jury selection process,

at county expense, and have his own employees carry out related duties.

Thirsty for Privatization?

BIG RAPIDS—Perrier, the Swiss water bottling company, is being accused of trying to "privatize pure water and disconnect it from our lakes and streams or the Great Lakes and sell it elsewhere without paying a dime to the state." These were the words of the Michigan Citizens for Water Conservation (MCWC) spokesman Terry Swier, as reported by the Evert Review.

What has Perrier done to deserve such sweeping condemnation? It is building a water plant eight miles south of Big Rapids, which the company plans to use for pumping 400 gallons of spring water per minute. This water will be sold under the brand name Ice Mountain.

The MCWC believes withdrawing subsurface water from Michigan for resale, as Perrier intends to do, runs contrary to the state's water and public trust law, and wants the Mecosta Circuit Court to agree. The MCWC and its plaintiffs filed a lawsuit in September in Mecosta County Circuit Court against Perrier and Pat and Nancy Bollman, the owners of the Sanctuary Springs property where the spring water may be withdrawn.

The case, to be heard in Mecosta County, is about the question of who owns Michigan's ground water. Perrier is not able to commercially pump water until the summer of 2002, when the case will be tried.

Perrier reportedly has received \$9,594,284 in discriminatory tax incentives from the state of Michigan in order to locate here.

New Tax Law Favors Public/Private Partnerships in School Construction

WASHINGTON, D.C.—A little-noted provision in President Bush's tax cut bill will make it much easier for towns and cities across the nation

to build schools and school facilities. Under the Economic Growth and Tax Relief Reconciliation Act of 2001, passed in June, private real estate investors and developers will be able to do what only municipalities were able to do before the law: issue tax-exempt bonds to finance the building of a public school.

This means public school systems can form partnerships with the private sector in which the developer is able to construct the building for far less than it would usually cost. Then the developer leases the building to the school district on a long-term basis at a predetermined rental rate that is far lower than what it would have cost the community to put up the school on its own.

"All this is," according to Matthew Brouillette, education policy director for the Mackinac Center for Public Policy, "is equity in taxation: allowing private developers the chance to issue bonds tax free for building schools, just like municipalities can. The result takes a lot of the financial pressure off the taxpayers for school construction, and spreads the rest out over a prolonged period."

A common cause of the delays in school construction is the cumbersome public-sector construction process, which often takes as long as five years. Under the new tax law, Michigan communities could finish such projects in as little as one.

Editor's Note: For more on Public/Private Partnerships in school construction see, "Partnerships in School Construction," in the summer 1999 edition of MPR (www.mackinac.org/1782).

Kalkaska County Clerk Patricia Rodgers will no longer be responsible or contacting prospective jurors; that duty will be privatized following a series of juror mixups that used up the patience of trial court administrator Rudi Edel.





National Perspective

Privatization May Save Passenger Rail

By Joseph Vranich and Edward L. Hudgins

The airport shutdowns and fear of flying that followed the Sept. 11 terror-



An Amtrak train arrives in East Lansing on November 16. The Chicago to Port Huron line, which runs through East Lansing, is far from profitable.

ist attacks gave Amtrak a surge in ridership, especially in America's northeast corridor. The nationalized passenger railway responded by running more trains to carry more passengers. But Amtrak is still in terrible economic shape. In fact, on November 9th the Amtrak Reform Council, established by Congress in 1997 to monitor the railroad's financial performance, found that Amtrak will not meet its congressionally-established deadline to break even in its operating budget next year. The Council now is required to submit to Congress within 90 days a plan to reorganize Amtrak so that it will be able to run profitably, and Amtrak itself must submit a plan for its own liquidation. Congress will then decide Amtrak's fate.

But because it is government-owned and operated, Amtrak has no

way of responding to public demand the way a private company could, i.e., in a way that would make it profitable. It can only lose money. In fact, since its creation by Congress 30 years ago, Amtrak has received nearly \$25 billion in taxpayer subsidies, with no prospect that it will ever break even.

While this might seem like a reason to consider privatization, Congress is currently proposing to throw billions of dollars in new subsidies at Amtrak. The railway has requested \$3.2 billion in "disaster aid" even though it has experienced no disaster. Unlike the airlines, which lost customers, Amtrak gained them. As one congressional aide told Reuters, "Amtrak's agenda, as usual, is capitalizing on [the attacks] in a bogus way."

In three decades, Amtrak has been unable to tap into a substantial enough slice of the travel market to justify its existence. While in 2000 Americans made 665 million trips by air, they only made 22.5 by Amtrak, a mere 1 percent of passengers nationwide. Amtrak's punctuality on most routes is terrible, and it covers up this fact by monitoring at a limited number of stops and by scheduling lots of extra time between those stops.

The trains themselves are substandard. Many run far slower today than did trains on the same routes earlier in the 20th century. And Amtrak uses what can charitably be called "creative accounting" to disguise its financial problems. It receives many subsidies from government agencies and has

recently abandoned standard accounting practices to hide operating expenses as capital costs.

And costs are rising faster than revenues. U.S. Department of Transportation Inspector General Kenneth M. Mead told Congress in July that "Amtrak's fiscal year 2000 operating loss of \$944 million, including depreciation was \$28 million more than its 1999 loss and the largest in Amtrak's history. . . . The picture remains bleak into 2001, where in the first eight months revenues grew by \$15 million over the same period a year earlier but cash expenses grew by \$53 million. Moreover, as of Sept. 2000, Amtrak's long-term debt and capital lease obligations totaled \$2.8 billion, an increase of \$1 billion over 1999."

Secretary of Transportation Norman Mineta simply anticipated the Reform Council's finding when he stated in June 2000 that he does not think Amtrak will meet that self-sufficiency deadline.

Although liquidation might seem extreme, let's face the matter squarely: If America needed the passenger train service provided by Amtrak for three decades, the venture would have succeeded. But government planners' judgment as to what the public desires or needs was substituted for the efficiency of the free market, with the usual consequences—and the usual delay in recognizing failure. It would have been far less expensive—and perhaps profitable, in fact—to leave the market

See "Rail Travel" on page 13