



**MICHIGAN**

# Privatization

**REPORT**

A Quarterly Publication on Privatization

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Privatization: The Motor City's Renaissance Engine

The Conventions of Privatization

For Whom the Private "Belle" Tolls

Water Privatization Can Help Detroit Avoid Drowning in Debt

Privatization Should Drive Detroit Transportation

Looking over Private Inspections

and more...

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### MICHIGAN PRIVATIZATION REPORT

- Editor:* David Bardallis  
*Managing Editor:* Michael LaFaive  
*Assistant Editor:* Samuel Walker  
*Graphic Designer:* Daniel Montgomery  
*Circulation Manager:* Amy Kellogg

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# Privatization

## MICHIGAN REPORT

A Quarterly Publication on Privatization Initiatives Throughout the State • Mackinac Center for Public Policy • No. 2000-04 / Winter 2001

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# Feature

## Privatization: The Motor City's Renaissance Engine

■ By Michael LaFaive

Antoine de la Mothe Cadillac never could have guessed that the small fort he established in 1701 along the strait between Lake St. Clair and Lake Erie would become home to millions of people—including people like Henry Ford, whose vision transformed the entire world.

Indeed, Detroit has nearly three hundred glorious years of history to look back upon with pride, but it is the city's

businesses. In short, Detroit needs a comprehensive privatization program.

### Heavy burden of government

Since 1950, Detroit has lost 46 percent of its population to its suburbs, other Michigan communities, and other states. While its tax base has eroded, the size of city government has not decreased correspondingly: The number of city employees has shrunk only 30 percent. Remaining residents are left to shoulder a heavier tax burden.

structure personal and corporate income taxes. The sale of certain city-owned assets also could generate an enormous windfall of **\$2.4 billion**, and annual property tax revenues from the subsequent private ownership of Belle Isle and Cobo Arena alone could total over **\$15 million**.

Critics of many of these proposals likely will argue they are too “radical” or that they will harm city employees.

However, these criticisms are either overblown or unfounded. First, to complain of the boldness of a measure is not to refute its efficacy. And second, while it may be true that some city employees will be adversely affected by change—in the short term, as the city's economy adjusts to better, more efficient ways—in the long term, all Detroit workers will benefit from living and working in a city that promotes and encourages economic prosperity, rather than strangling it.

Detroit has many talented and caring people who are just waiting for the city's mind-boggling maze of tax and regulatory barriers to be removed so that they can unleash their creative powers to build better lives for themselves, their families, and their neighbors.

*Michigan Privatization Report* is dedicated to a bold vision that will inspire the kind of financial and cultural renaissance that many have long hoped Michigan's largest city would experience. Failure to act can mean only that Detroit's people will continue to depart, taking their money and entrepreneurial and artistic talents with them. MPRI

*Michael LaFaive is managing editor of Michigan Privatization Report.*

future that is the focus of this issue of *Michigan Privatization Report*. And that future is in some doubt.

When Mayor Dennis Archer took office in 1993, public officials and media figures heralded the dawn of a “Detroit renaissance” that would dramatically improve the city and its negative image. Today, while there is some good news to report, crime and tax rates remain high and poor schools and a crumbling infrastructure continue to pose barriers to a full-fledged economic recovery.

What is needed in Detroit is nothing short of a fiscal-policy and public-management revolution; one that cuts wasteful spending and punitive taxes across the board, reduces bureaucratic regulation, and improves services for the city's residents and

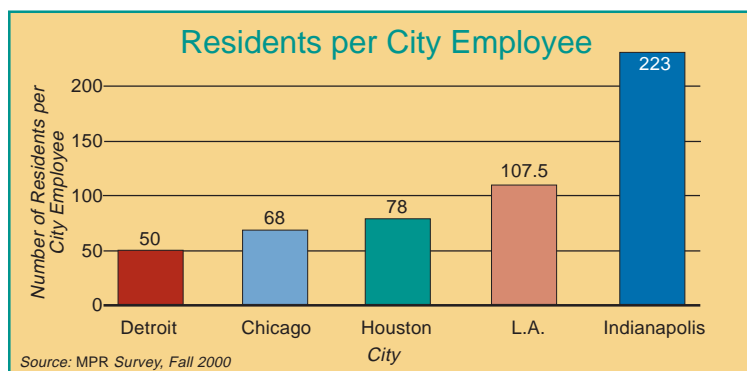
burden on city taxpayers.

To reverse the flow of people, jobs, and entrepreneurial talent out of the city, Detroit officials must work to dramatically reduce the crushing tax and regulatory burden on citizens and businesses. If they do not, the next recession could bring financial disaster in the absence of a state or federal bailout.

### What can privatization do?

This issue of *Michigan Privatization Report* is divided into two major sections that detail ways Detroit can set its financial house in order: divestiture (selling city assets outright) and outsourcing (contracting out for particular services). Proposals show how officials could cut spending by more than **\$207 million**, allowing the city to reduce onerous and economically de-

The city government is in fact the second-largest employer in Detroit, behind only Detroit Public Schools. Of the city's 25 biggest employers, state, county and city governments provide a combined 40 percent of jobs. By contrast, the same government units provide only 30 percent of jobs in Chicago. This top-heavy bureaucracy has placed an enormous



The city of Detroit has a very low municipal resident-per-employee ratio (50 to 1). This should suggest that city residents are getting the very best services for their tax dollars, but it would be hard to make that case.

## Motor City Needs Budget Boost: Privatizing Detroit City Services

■ By Michael LaFaive

The charter of Detroit requires that the city have not only a budget plan for proposed spending, but also a report showing what was actually spent after a particular year's budget has been closed out. This latter document is known as the Consolidated Annual Financial Report (CAFR).

An examination of Detroit's CAFR for the fiscal year (FY) ending June 1999 and the current FY 2000-2001 city budget shows some good news, but unfortunately, that news is outweighed by other issues that may signal rough financial times ahead for the city and its residents.

The following is a snapshot of the current state of Detroit's financial health:

- The "unreserved equity" (i.e., money available for general operating uses) of the city's General Fund is declining. It dropped from \$102 million in 1998 to \$71 million the following year. This fact is significant because the status of the General Fund, which offers city leaders the greatest spending discretion, is often used by public accountants as a benchmark for a government unit's overall fiscal integrity. A declining General Fund may indicate poor fiscal health. At the very least it may reveal a city's inability to cope with future emergencies.
- The city's Airport and Transportation Funds have deficits of \$4.5 million and \$15.9 million, respectively. Both deficits have remained unresolved for quite some time and have been increasing in recent years. A recent bankruptcy of city airport's principal commercial carrier will exacerbate this situation. Fuel price increases will also adversely impact Transportation Fund operations. These two deficits exceed the entire "unreserved equity" of the General Fund by a substantial amount.

- Detroit's Housing Fund and Resource Recovery Authority also have deficits. The Housing Fund deficit should be made up by money from various federal programs over a period of time. Meanwhile, the Resource Recovery Authority's deficit has actually been reduced from 1998 to 1999, in part, due to subsidies from the General Fund.

- In 1999, the Detroit Fire and Police Departments as well as the 36<sup>th</sup> District Court and other public protection agencies spent a combined \$69 million less than their revised operating budgets, which totaled \$570.5 million. The slightly more than \$501 million spent for public protection in 1999 was almost exactly the amount expended in 1990 (\$501.1 million). This means that real spending on public protection in the city dropped during the 1990s.

- Detroit lost an estimated a \$294 million worth of residential property to fire in 1999, *more than the combined economic value of all new residential construction in the city for the previous decade.*

- Detroit relies excessively upon two sources of income: municipal income taxes and the shared taxes and grants from the state of Michigan and the federal government. These two sources represent 78 percent of General Fund revenues, which is \$1.26 billion for the Fiscal Year 2000-2001. Should America and Michigan suffer even the slightest economic downturn, the city's ability to finance its operations would be in doubt.

- Pension plans for some city employees are in good shape. Police and fire

pensions are fully funded with excess assets of \$349 million.

- The city's health insurance plan for retirees, on the other hand, is not actuarially sound. It is funded on a pay-as-you-go basis. There are presently 19,800 retirees, 118 percent more than in 1950, when city employment was at its peak. The liability that has accrued to the city for Detroit's current and future retirees for health care lies between \$1.75 billion and \$3 billion.

- The City of Detroit Library Fund is doing well, with \$8.2 million in eq-



*In 1999 Detroit's public protection agencies spent a combined \$69 million less than their revised operating budgets. After adjusting for inflation, Detroit is spending less on public protection today than it spent ten years ago.*

uity and an additional reserve for inventory (more books, for instance) of \$3 million. These figures represent a healthy 27 percent of revenues.

- The Water and Sewer Fund operations will have to expend billions over the next decade to upgrade the system to comply with new federal mandates. The infrastructure (drain, water, and sewer pipes) are aging and

See "Budget Boost" on page 13



## Asset Sales: Accounting for Privatization

■ By Adrian Moore

On a given day, somewhere in the world there is an electric utility, a telecommunications company, an airline, a road, a building, or other former publicly owned entity on the private auction block. Overseas, by far the dominant form of privatization is selling assets outright.

By contrast, federal, state, and local governments in the United States have never owned whole industries the way most foreign governments have. Therefore, privatization here more often involves service contracting than asset sales.

utilities, buildings, unused land, jails, tax liens, and more.

Studies, articles, and even books have examined government asset sales and usually extolled their virtues, which include cash infusions for governmental units and an increase in the productive value of the assets. In 1992, the Bush Administration recognized the value of government asset sales, too. President Bush issued an Executive Order on Infrastructure Privatization that reformed a practice regarding federal grants that was serving as a disincentive to selling off government assets. When state and local governments sell assets that were partly funded by federal grants, the grants have to be repaid. The Executive Order allowed the value of the grants to be sensibly depreciated so that the obligation to pay them back in full would no longer discourage asset sales. The order also directed the relevant federal agencies to adjust their policies to facilitate state and local efforts to sell or lease assets.

those assets. The choice, on each and every item, will be: Spend money to maintain it, ratchet its value downward another year, or sell it to avoid the first two choices. For the first time, all across the country, choice number three will be on the table for every asset, every year.

In the political and economic tradeoffs that ensue, the tendency to entertain the idea of selling assets as a kind of afterthought to the budget process will become a thing of the past. Government pros and cons of selling assets, listed in the table accompanying this article, will play a role in the decision to fund each budget item. In the past, without asset values or costs on their balance sheets, for most governments the cons outweighed the pros. But with the new accounting standards, this may change dramatically.

And that is a good thing. Selling assets shifts resources from government, where assets are harder to measure in terms of value, to a realm of private ownership in competitive markets. This creates opportunities where before there were none: Governments rarely receive market signals such as prices for assets or proposals for alternative uses until they set about selling them. An asset auctioned to private buyers is scrutinized for possible uses, and the value of these is reflected in bid prices.

In the end, government asset sales shift assets away from non-productive political uses and toward their most productive economic uses. At the same time, such sales reduce the costs taxpayers must pay for the maintenance and improvement of government-owned facilities. Government asset sales are just one of privatization's many win-win scenarios.

**MPRI**

*Adrian Moore is director of privatization and government reform at the Reason Public Policy Institute, a nonprofit research organization based in Los Angeles.*

### Pros and Cons of Asset Sales

*(From the Government's Perspective)*

PROS	CONS
Receive value of asset as immediate cash for other uses	Lose control of the asset
Reduce risks and liabilities	Lose control of development and planning related to asset
Reduce annual operating and maintenance costs	Lose organizational knowledge of asset and of related budget expenditures
Receive property, income, and sales tax revenue from use of asset	May have to pay for future use of asset
Reduce responsibility for capital improvements	May retain some long-term liabilities associated with the asset
Reduce problems with not-in-my-backyard (NIMBY) and other pressures that come with undesirable facilities	May have difficulty calculating value of asset
Asset more likely to be put to most productive use	Conducting asset sales require skills and funding

But asset sales still happen. In the last few years, the federal government sold the Elk Hills petroleum reserve in California; USEC (the firm that provides enriched uranium fuel for nuclear power plants); the Alaska Power Administration; and dozens of electric, water, and sewer utilities on military bases. State governments have sold park and recreation facilities, buildings, unused land, and prisons. Local governments have sold landfills, water and sewer

### Accrual accounting

Asset sales will soon become a more important issue for state and local governments. Starting in June 2001, state and local governments will begin switching to new accounting standards based on "accrual accounting." This means the value of assets and liabilities will appear on government balance sheets for the first time. From that time forward, all state and local governments will have to determine the value of all the assets they own and will have to depreciate that value each year unless they allocate sufficient maintenance funds to keep their assets in shape.

When it comes time to do budgets, our elected officials won't simply be looking at revenue and expenditure wish lists. They also will be faced with a list of assets, those assets' respective values, and bottom-line funding requirements that must be met in order to maintain

## The Conventions of Privatization: Selling Cobo Center

■ By Michael LaFaive

When people think of “city services,” a number of things immediately come to mind, such as police, fire protection, and roads. Few, if any, people would imagine convention centers at the top of the list of essential city functions, and yet many municipalities own and operate such centers.

Yet Detroit owns the Cobo Conference/Exhibition Center, a 2.4 million square-foot meeting and convention facility located in downtown. Cobo hosts

tain or improve quality, and end the annual cash bleed?

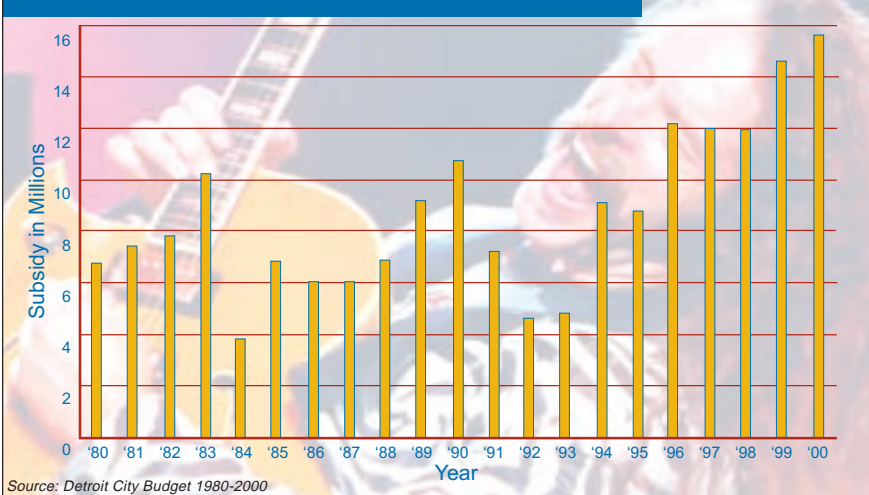
The fact that many hotels and other private businesses own and successfully run their own convention centers suggests that Cobo could indeed be safely entrusted to the private sector. Indeed, nearly every major private hotel chain in America maintains convention center-style accommodations, which include services to host the same types of trade shows, banquets, special events, and cultural events provided by Cobo Center. Cobo maintains five exhibit

gin generating revenue for the city, to the tune of **\$1.9 million** in property taxes annually.

The one Achilles’ heel of this privatization effort is debt. The city owes \$169 million on funds borrowed

Divestiture

Annual Subsidies for Cobo Convention Center



Cobo hosts activities ranging from Ted Nugent’s New Year’s Eve “Whiplash Bash” to business conventions and does so at a loss—every year. Indeed, Cobo operations have required an annual average subsidy of \$9.1 million since 1980.

over 7,000 events each year—everything from the North American International Auto Show to rocker Ted Nugent’s New Year’s Eve “Whiplash Bash.”

Since 1980, the city has spent \$182.5 million to subsidize the Civic Center department, which runs Cobo Center. That works out to an annual average bill to taxpayers of \$9.1 million, and in fiscal year 2000-2001, the city budgeted more than \$15.5 million to subsidize the Civic Center’s operations.

Why does an important and impressive facility such as Cobo lose money each year, and could a private company take over its operations, main-

halls, 84 meeting rooms, and four banquet facilities.

Real estate and urban economics professor Edwin Mills of Northwestern University notes that, “Convention centers are naturally competitive . . . [I] have yet to see a convincing demonstration that the private sector in a given community will fail to supply enough convention center space.”

How much could the city expect to receive in a sale of Cobo? An article in the February 1991 issue of *Detroit* magazine suggested Cobo Center could fetch \$50 million. At that price, a privately owned Cobo could actually be-

for the Civic Center. A sale would not cover the amount owed. Still, selling Cobo at a loss and paying off the debt from the proceeds of other privatization efforts is a better option than the current \$15 million annual drain on the city treasury.

Detroit need not own its own convention center. There are plenty of private businesses who do, or are willing to provide the same service and do it without government subsidies. The city should sell off Cobo Center and use the savings to pay off debt, improve infrastructure, and enhance the truly essential services that citizens and businesses need to bring prosperity back to the Motor City. MPRI

Michael LaFaive is managing editor of Michigan Privatization Report.

## Detroit Could Collect Savings from Privatized Garbage Pickup

■ By Steven T. Khalil

There are many different types of privatization. One of the most common is “contracting out,” or “outsourcing,” a process whereby a unit of government contracts with a private firm to provide some service. Another common form of privatization is when a government gets out of providing a service entirely.

Refuse collection provides good examples of both of these types of privatization. In Traverse City, for example, citizens privately contract with any one of four private, for-profit companies for their garbage collection. In fact, municipalities throughout Michigan and more than 50 percent of U.S. cities contract out some or all of their refuse services.

There is no reason why Detroit couldn't do the same. To save money and improve service, Detroit should either outsource its garbage collection services, shed the responsibility entirely, or piece together some hybrid of these two forms of privatization.

### Collecting the savings

There is a large and growing body of empirical research showing the substantial savings cities can achieve by either outsourcing garbage collection or getting out of the business altogether. The largest study ever conducted on outsourced garbage collection, conducted by the federal government in the 1970s, reported 29 to 37 percent savings in cities with populations over 50,000. A 1994 study by the Reason Foundation discovered that the city of Los Angeles was paying about 30 percent more for garbage collection than its surrounding suburbs, in which private waste haulers were employed. A 1982 study of city garbage collection in Canada discovered an astonishing 50 percent average savings as a result of privatization.

To put things in perspective, shaving 30 percent from Detroit's total refuse collection bill would save the city more than **\$6.4 million** out of an annual budget that currently stands at \$21.3 million.

Even the threat of outsourcing garbage collection can force city services to do better. A great example of this took place in Flint, where bulk pick-up—garbage consisting of large

small and regular sized trash during normal working hours and return on overtime to collect bulk items. In 1994, to end this practice and to save money for the city, Mayor Woodrow Stanley solicited bids to collect and dispose of refuse from five private companies. The bids Stanley received confirmed his suspicion: Privatization could cut the city's total garbage collection cost by about \$2 million.



*The Greater Detroit Resource Recovery Authority (Detroit's trash incinerator) was sold to private investors in 1991 for \$634.9 million.*

and odd-sized items such as mattresses and refrigerators—used to cost the city an additional \$400,000 annually.

Why? Because city public works employees would pick up only

Flint's city employee unions knew the mayor was serious and worked with him to develop a plan that would shave about \$1.4 million from the budget. In addition to agreeing to collect bulk items during





regular working hours, city employees agreed to increase the number of stops on each route, reduce the number of shifts from two to one, cut the sanitation staff, and require workers to work a full eight-hour day instead of going home early as they often had done in the past. The result: better service for less money. Total spending on waste collection dropped 31 percent the first year after the concessions took place.

Another example of the power of privatizing garbage collection took place in Indianapolis in 1993. The city divided itself into 11 waste collection districts and contracted with several private firms for collection. But it also allowed the city's already-in-place waste hauling service to bid for contracts against the private firms. In fulfilling its contract, the city agency outperformed its own bid, saving \$2.1 million more than it had originally believed would be needed to do the job. As a reward, each employee got a cash bonus of more than \$1,700. Citywide, Indianapolis residents had to pay less than \$9.00 per month per household for the service.

If this type of competition can work in Indianapolis and elsewhere, it can work in Detroit.

### Disposing of wasteful spending

According to the International City/County Management Association, which surveys local governments about how they conduct a variety of services every year, in 1997 U.S. municipalities contracted with private firms to dispose of solid-waste 67 percent more often than they did a decade earlier.

The fact that Detroit was not one of those municipalities may account for the fact, reported by an Illinois public-sector consulting firm

hired by the city in 1998, that Detroit taxpayers were forking over more than \$150 per ton in garbage disposal costs alone. That's compared to an urban average of \$33-\$36 per ton. The report went on to state that Detroit's waste disposal ought to cost no more than around \$17 million, yet in actuality cost \$72 million in 1998, a \$55 million overcharge imposed on Detroit taxpayers.

Contrast this with San Diego County, which sold all of its solid waste assets to Allied Waste Industries for \$184 million in 1994. The sale included four landfills, a recycling facility, and 10 rural bin stations. Most of this money was used to pay off high-interest debt, which now saves the county between \$280,000 and \$700,000 annually. While Detroit owns none of its own landfills, it does own valuable assets

that could be sold to private vendors, such as the garbage trucks used for collecting the refuse.

Cities from around the state of Michigan—and around the country—are saving taxpayers millions of dollars by turning to the private sector to provide municipal services. Detroit officials must be willing to make the tough political decisions necessary to improve city services and to relieve citizens and businesses of unnecessary expenses and poor service. Privatizing refuse collection and disposal would be a great place to start.

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*Steven T. Khalil is a Detroit businessman, freelance writer, and adjunct scholar with the Mackinac Center for Public Policy.*

## Privatization Sidebar

The city of Detroit houses its refuse collection and disposal within the confines of its Department of Public Works (DPW). The "net tax cost" to the city for operating this entire department is \$136.5 million. There is no reason why other services provided by DPW could not also be provided by a for-profit firm.

DPW functions are contracted out in their entirety with great frequency. The suburb of Pleasant Ridge, in Oakland County, improved its services while saving 22 percent in each of its first two years by contracting out with for-profit City Municipal Services. Shaving just 20 percent from Detroit's DPW bill would yield an annual savings of \$27.3 million.

One function of note in this fiscal year's budget is a \$1.3 million appropriation for "rodent control." According to the International City/County Management Association, municipal contracting for rodent control increased 90 percent from 1989 to 1999, by far the largest area of growth in municipal outsourcing during this 10-year period.

# Feature

## For Whom the Private Belle Tolls: Is It Time to Sell Belle Isle?

■ By Michael LaFaive

Of all of Detroit's assets, Belle Isle, the 985-acre island park situated in the Detroit River just inside the U.S. border with Canada, could very well be the city's most attractive privatization opportunity.

The park was designed by Fredrick Law Olmstead (designer of New York's Central Park) in the late 1800s. Once referred to as "Detroit's Jewel," Belle Isle fell prey to neglect during the 1970s and 80s. Poor stewardship on the government's part nearly destroyed the park until recent efforts were made to restore its original beauty. Today, dredging and cleaning

But the island has so much more to offer. Handled properly, Belle Isle could become one of the great "right decisions" Detroit's leaders make on the road to revitalizing the city. Those who would disparage the idea of privatizing the island and opening it to commercial developers forget that some of America's most beautiful landscapes are kept and maintained in their pristine condition precisely because that's what the market demands.

Currently, the island contains four marinas, two pavilions, two city-owned golf courses, a driving range, a conservatory, a beach area, a zoo, and a 32,000 gallon aquarium with 146 species of sea life (by contrast, Shedd Aquarium in

If a private developer or group of developers purchase the island outright, this would provide a huge one-time cash infusion for the city of Detroit. They could then divide the island into an appropriate mix of commercial, retail, and residential properties. As these smaller lots were purchased and improved, a steady stream of property tax revenue would begin to flow into city coffers on an ongoing basis.

Indeed, Belle Isle could become the private-sector equivalent of Chicago's Navy Pier, complete with a built-in Shedd-style aquarium, and perhaps even a special theatre district, which might include a Shakespeare theatre, opera house, and permanent Cirque du Soleil facility, similar to that adorning Disney World in Florida. The possibilities are endless. Allow for unlimited gaming (casino and sports books) and Belle Isle could become a Midwest Monaco.

How could the city facilitate such growth and development? By exempting the island from the host of economically debilitating regulations that hamper the rapid growth of businesses elsewhere in the city.

It would not be the first time Detroit got out of the island-running business. In 1920 the (then) 52-year-old Detroit Yacht Club received the right to build on a small island just off of Belle Isle. The Yacht Club became the official owner of the land in a land-swapping deal with the city. The club operates there to this day and pays a steady stream of property taxes to the city.

Island sales are not unheard of in this day and age. The privately owned Grass Island, a 45-acre undeveloped island in the Detroit River near the Ambassador Bridge, is being sold by a Canadian family for at least \$192,000, according to reports. Worldwide there are 100 islands currently for sale.

operations are helping restore the series of inland lakes and waterways, and native fish are being restocked and managed. Statues and sculptures are being cleaned and repaired.

Chicago has 600 species). Most of these components would enhance the overall sales value of the island, particularly if sold to a developer interested in building an entertainment/tourism mecca.

### Belle Isle Land Value Estimate



	Acres	Sale Value per acre	Improvement costs per acre	Net value per acre	Total value*
<b>Residential (60%)</b>					
Single Family (20%)	197	\$500,000 <sup>1</sup>	\$75,000	\$425,000	\$82.45
Condominium (30%)	296	750,000 <sup>2</sup>	100,000	650,000	188.50
Apartments (10%)	96	350,000 <sup>3</sup>	100,000	250,000	24.00
<b>Commercial (20%)</b>					
Retail (10%)	96	435,000 <sup>4</sup>	incl	435,000	41.76
Office (10%)	96	350,000 <sup>5</sup>	incl	350,000	33.60
<b>Roads, Walkways, etc. (12%)</b>					
	118		incl		
<b>Parks (8%)</b>					
	79		incl		
<b>Total</b>	<b>985**</b>				<b>\$370.31</b>

Notes:  
<sup>1</sup> Sale price per lot of \$250,000 at 2 lots per acre <sup>2</sup> Sale price per site of \$150,000 at 5 units per acre <sup>3</sup> Sale price per unit of \$20,000 at 17.5 units per acre <sup>4</sup> \$10.00 per square foot, plus improvements <sup>5</sup> \$8.00 per square foot, plus improvements <sup>6</sup> Above prices are based on typical pricing in upscale neighborhoods. Reduction in government services in favor of private ones could significantly increase these estimates. \*In millions.  
 \*\*Numbers do not add to 985 due to rounding.

The table shown above lists possible values for the sale of land on Belle Isle. These are conservative estimates because they do not take into consideration assets that would come with the island (such as two golf courses) if it were sold to a private investor.





How much might Belle Isle sell for? A conservative estimate would be **about \$370 million**. To come up with that number, Mackinac Center for Public Policy analysts examined the land and measured it against the local real-estate markets. The table on the previous page shows the results.

These estimates should be regarded as conservative for a couple of reasons. First, there are assets on Belle Isle including the two golf courses, a driving range, and several buildings that are not included in the estimated valuation. Second, the city of Detroit recently raised its offer to purchase a six-acre site on the Detroit River for \$2.1 million per acre. This suggests a far higher value for island acreage than is reflected in the economic assumptions used by the Center's real estate analysis.

But working with the \$370 million figure, without any development on the island whatsoever, Belle Isle would generate **\$13.8 million** (at current millage rates) in property taxes per year. With development of the kind discussed in this article, that figure could easily double. By law, the way sales of city property are divvied up among Detroit's spending priorities, \$13.8 million in new property taxes each year would mean \$488,000 more for city libraries, \$2 million for Wayne County, \$4.4 million for Detroit Public Schools, \$1.1 million for the state of Michigan, and \$5.8 million more each year for the city of Detroit to do with as it pleases. The city also would also be relieved of its **\$6.6 million** annual appropriation for Belle Isle.

Author and American Enterprise Institute scholar Charles Murray offers an intriguing plan for deregulation that, if it were adopted for Belle Isle, could turn the island into a showplace for the benefits of privatization and deregulation. Applied to Belle Isle, the idea would work out something like this:

*A private Belle Isle need not be a fantasy. Ricardo Montalbon from the famed seventies show "Fantasy Island" raises a glass to his guests (and to privatization, we hope).*



*The Belle Isle Conservatory needs drastic improvements. The city had promised to spend \$1 million restoring its splendor, but has failed to live up to that promise.*

- The island could be sold to a builder or group of builders under a guarantee that the city of Detroit would exempt all commercial activity on the island from past or future city regulation.
- The owner(s) could then prominently advertise to interested businesses and the general public the island's freedom from city regulation. Patrons coming to the island would do so with the knowledge that they were voluntarily entering upon unregulated territory. The attraction: bargain basement prices for virtually all goods and services.
- Specific deed restrictions could be placed in each sales or lease contract, mandating a minimum level of public safety and health necessities. For example, one deed might mandate that every building or homeowner must contract directly with a fire and rescue service rather than having one blanket, city provision. Similar deed restrictions could mandate that each owner contract out for refuse collection and other services.
- The owner or owners also could draw up zoning ordinances and island speed and noise limits, and hire a private security force, possibly through Wackenhut Corporation, a private, for-profit security firm already under contract with the federal government. A Belle Isle private police force could be armed, make arrests, and book suspects where necessary, just as city law enforcement does now. Serious crimes, such as homicide, could be handed over for adjudication by city police.

continued on next page

**Worldwide there are 100 islands currently for sale.**



“Belle Isle” continued from page 11



The Detroit skyline graces a good portion of Belle Isle's shore, raising the value of its property. This photo was taken from the bridge of the Detroit Yacht Club, which owns land just off Belle Isle and pays property taxes to the city.

One added benefit of a private police force is that its officers are not exempt from liability to the same degree government police are. Private police officers, for example, likely would be far more careful in their handling of altercations than Detroit city police have been in several well publicized tragedies. (For more on private security, see the winter 1996 and winter 1998 issues of *Michigan Privatization Report* at [www.mackinac.org](http://www.mackinac.org)).

- Another deed restriction the island's owner or owners could insist upon is that businesses operating on the island handle civil disputes with other commercial vendors using only the mechanism of arbitration. The lack of the threat of lawsuits would dramatically lower the cost of doing business on Belle Isle and provide further incentive for entrepreneurs to locate there.

The list of options for turning the neglected Belle Isle into a thriving spot for play, entertainment, and tourism is

practically endless. Privatization and the curtailment or elimination of Detroit's onerous regulations could turn the island into a commercial giant. Indeed, Belle Isle could quickly



A recent study by Hamilton Anderson Associates, Inc. of Detroit reported that about \$180 million is needed for the city to improve Belle Isle. One improvement may be the removal of eyesores such as this abandoned horse stable. A private owner would have incentive to tear this down without a cost to the city.

become for Detroit what Hong Kong is to China, or what Manhattan is to the rest of New York.

All it would take is courage on the part of policy-makers to champion a great idea and allow the private sector to find the best and most productive use of the city's underperforming assets.

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The owner or owners also could draw up zoning ordinances, island speed and noise limits, and hire a private security force.





**“Budget Boost”** continued from page 5

also will require replacement, adding more expenses to the city’s remaining residents and commercial establishments.

If Detroit’s future expenditures were relatively stable, this financial snapshot still would be cause for concern. But the city is looking at two new outlays of monstrous proportions: funding the pension obligations of current and future city employees, which could cost up to \$3 billion, and fulfilling requirements under several federal environmental acts, which will cost billions more. Indeed, Mayor Archer has noted that upgrading the city’s water and wastewater infrastructure could cost as much as \$10 billion over the next ten years.

With less than \$500 million in legal debt margin left, the Motor City may soon have its financial back to the wall. If there is one thing we know from history, it is that recessions happen. A recession for the rest of the nation, combined with demands on the city to comply with huge federal environmental mandates, could spell trouble for Detroit.

If properly implemented, an aggressive privatization campaign including sales of city assets could provide Detroit with the revenue it needs to pay creditors, improve services, and maintain its infrastructure during the next decade. Privatization of city services also could prevent Detroit from becoming the first major American city to have

its democratically elected leadership replaced with an appointed financial oversight panel—a fate that befell one of its suburbs, Ecorse, in the 1980s.

Detroit holds its future in its hands. Will public officials and citizens cling to the status quo, or will they embrace privatization as the engine that drives the Motor City to a new era of financial security and economic prosperity? MPRI

*Michael LaFaive is managing editor of Michigan Privatization Report.*

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## Water Privatization Can Help Detroit Avoid Drowning in Debt

■ By Brennan Brown

Water may be essential to human life, but is it essential that municipal governments own and operate water distribution systems and departments?

There is little question that a centralized source of water distribution is an efficient and effective way for people to obtain this life-sustaining resource. It need not, however, be a full-time job for the city of Detroit.

Detroit's water system services approximately 4.2 million people in 122 Michigan communities, pumping as much as 700 million gallons of water per day through 3,400 miles of transmission and distribution mains, all over a service area of 981 square miles. There are 15 pumping stations and five booster stations in the system, according to the Detroit Water and Sewerage Department's Web site.

Contracting out the city's water supply operations—even selling them to a

the International City/County Management Association between 1988 and 1997 showed that the service of water distribution by private companies (operating under contract or as an investor-owned utility) increased 84 percent.

There are even government-owned water utilities that are paying themselves "profits" out of the equity earned by the utility. That is, they operate very much like a private company. Cities with such an arrangement include Cincinnati, Ohio; Lancaster and Bethlehem, Pa.; Baltimore, Md.; and Edmonton, Alberta.

By several measures, Detroit's water distribution system is operating inefficiently. Consider how Detroit compares with Chicago, according to several commonly used standards of efficiency. Detroit produces an average of 673 million gallons of water per day. That works out to approximately 3.5 water department employees per million gallons daily (MGD). By contrast, Chicago produces 1 billion gallons of water per day. Its number of employees per million gallons daily is a mere two. Economies of scale probably account for some of Chicago's superior efficiency, but Philadelphia's water system is half the size of Detroit's and still outperforms Detroit's department.

The National Association of Water Companies reverses the above ratio to measure efficiency. That is, it divides the number of employees into the millions of gallons per day figure (see Table 1.)

Some observers note that Detroit charges less money per gallon of water than other major cities, such as Philadelphia or Boston, which charge \$15 and \$20 per 7,500 gallons, respectively. But utility expert and consultant Hank Mulle of H.G. Mulle and Associates doesn't

believe this necessarily indicates greater efficiency. He notes that every system treats its water differently, depending upon local environmental factors. Philadelphia, for instance, has severe purification problems and Boston's well fields suffer from saltwater intrusion. The costs for treating these unique geographical distinctions are passed along to consumers in the form of higher rates.

One way for Detroit to operate a more efficient, money-saving water distribution system would be to retain ownership of the system but contract out for the various services it involves. There is no shortage of examples of how this might be done. As of 1997, there were over 400 privately operated but publicly owned water utilities in America. There are 10 in Michigan. These are based on contractual arrangements between municipalities and private companies for operations and management services such as maintenance and billing. The Los Angeles-based Reason Foundation reports that savings from such contracts average between 10 and 25 percent. Shaving just 20 percent from Detroit's \$236 million water budget could save **\$47.2 million** annually, assuming water rates and fees remain the same.

Earth Tech, Michigan's largest private water and wastewater management firm, might be a good place to start. It holds seven water distribution contracts in the state. Typically, Earth Tech has saved its Michigan clients between 10 and 30 percent on water distribution. The company's largest Michigan client, the city of Portage, contracts for water and wastewater operations. The firm operates the entire system with only 22 employees. This works out to an employee-to-millions of gallons per day ratio of 1.1, far below Detroit's 3.5. Earth Tech also handles 13 wastewater contracts in Michigan and performs billing for three clients.

Another option for Detroit officials would be to sell off the water sys-

**Table 1**

**Municipally Run Water Comparisons**

Location	Detroit	Philadelphia	Chicago
Employees per MGD*	3.47	3.41	2
Customers per Employee	113.5	510	250
MGD* per Employee	288,000	293,000	500,000

\*Millions of Gallons per Day

private utility provider—could result in lower water bill rates and improved, more efficient services that save the city much-needed dollars. Detroit could best serve its many customers by either contracting out for operation and management of the water system or by selling the system to an investor-owned utility and relinquishing the role of water provider altogether.

Privatization of water systems is nothing new. Nationwide, the practice of involving the private sector in municipal management has grown substantially. Indeed, a series of surveys conducted by





These giant pumps at Detroit's northeastern water plant move treated water from the plant to consumers.

penses per connection, and employees per connection. As the data suggests, Detroit could be able to improve its efficiency dramatically if it would sell the system to a private concern.

Using industry norms for calculating value and subtracting liabilities, the Mackinac Center for Public Policy calculates that Detroit's water system would sell for a price ranging anywhere from **\$1.775 billion** and **\$2.285 billion**. The size of such a sale would probably limit potential bidders to America's Earth Tech and several European companies.

tem to private investors in the form of a utility. As of 1997, 15 percent of the American population got its water from investor-owned utilities. The nearest examples are the water distribution systems in Indianapolis, Ind., and Calumet, Mich. In France and Britain, a respective 75 and 100 percent of citizens get their water from investor-owned companies. Firms in both countries have been trying to get a foothold in the giant \$300 billion American water distribution industry, and currently own water utilities in New Jersey, Connecticut, and portions of utilities in other locales.

Detroit's water efficiency does not stack up well against other municipalities. How does it fare against investor-owned utilities? The first two columns in Table 2 represent data from a 1996 Reason Foundation study entitled, *Restructuring America's Water Industry: Comparing Investor-Owned and Government-Owned Water Systems*. The third column reports Detroit's water ex-

There are many advantages to selling Detroit's water system. First, it would result in substantial savings for the city. Second, it would create a new source of revenue, since its owners would pay substantial property and income taxes into the municipal treasury. Third, it would mitigate the city's need

to borrow money for any kind to support repairs and upkeep, much of which is mandated by the federal government.

The latter reason is all the more important to Detroit because the city will soon be forced to upgrade its water operations in order to comply with new environmental legislation. At a Sept. 12 federal court hearing on water compliance, Jim Murray, director of Wayne County's Department of Environment, said it would cost \$3 billion to bring the city's water system into compliance with federal mandates emanating from the Clean Water Act.

Mayor Archer reported in a speech earlier this year that Detroit's water system would need an annual investment of \$1 billion per year for the next 10 years to comply with these mandates and to maintain or improve infrastructure not covered by federal mandates.

Detroit is not the only city suffering from the burden of these new federal mandates. The Environmental Protection Agency and other organizations estimate that municipalities nationwide will have to spend over \$500 billion to \$1 trillion in compliance costs by 2005.

However, a tax increase on Detroit citizens to pay for environmental mandates is unlikely because the city does not fund its water operations from property taxes and because two-thirds of those using the city water system live outside the city limits. Therefore, the most likely source of funds will come from a rate hike. But this would be tantamount to forcing nonresidents to subsidize city

residents because suburban water-supply systems require much less work.

These factors make water privatization far more than just an option for the city of Detroit. To deal with the costs that loom on the horizon, the Motor City will have to do everything in its power to save money. Privatization offers not only a way to do this, but opens up possibilities for more efficient and better water service for the city and its suburbs. MPRI

*Brennan Brown is pursuing his master's degree in business administration from Central Michigan University.*

Location and Type of Operation	Investor-owned (California)	Government-owned (California)	Government-owned (Detroit)
Total Operating Expense Per Connection	\$273	\$330	\$475
Employees per 1,000 Connections	1.62	3.49	8.80
Salaries as percent of operating revenue	13.4 percent	37.13 percent	Not Available



## Privatization Should Drive Detroit Transportation

■ By Wendell Cox

With any government service, the public is best served when quality is provided at a cost that is no higher than necessary. Sadly, this is not the case with respect to the Detroit Department of Transportation, a city-run system of buses that operates inefficiently at great cost to Detroit's struggling taxpayers. But this need not be.

employees by making them owners through a stock ownership plan.

### Background

The Detroit Department of Transportation (D-DOT) is the largest public transit system in Michigan. It operates approximately 450 buses that span 1,300 route miles throughout the city. Each year the fleet travels 23

Suburban Mobile Authority for Regional Transportation (SMART) bus system, which serves suburban counties with routes largely radiating from Detroit's downtown and New Center areas. A merger is also supported by state legislators who have threatened to withhold state funds to each transportation system unless a merger takes place.

However, the merger has been deemed inadvisable by KPMG, an international accounting and consulting firm called in to determine the feasible operating alternatives. KPMG's judgment has been endorsed by six transit-expert evaluators hired to assess KPMG's finding. This is the same advice provided by this author while under retainer to Oakland County Executive Daniel Murphy in 1985, which became the basis for the policy against merger that lasted into the 1990s.

### Privatization on wheels

So how can D-DOT be made more cost-effective and reliable? There are four privatization options city officials might consider:

**Option 1: Competitive Franchising.** The city could competitively franchise the entire bus system to one of a number of large bus companies, for a period of up to 20 years. Under such an arrangement, the private company would provide a basic level of service specified by the city of Detroit, charge fares within a broad range authorized by the city, and renew the bus fleet and facilities. Like D-DOT today, the private company would have an exclusive right to operate service along the city's routes.

Melbourne, Australia, recently implemented such a program. The franchises began officially in 1999. Each of two competitively selected firms now have 20-year contracts to provide expanded and upgraded transit services for a fixed fee—an amount less than it



*The People Mover is just one component of Detroit's overall transportation system. It should be eliminated in favor of jitney cabs or some other form of transportation. Published reports indicate that Detroit must subsidize each passenger fare by \$3.44. In 1999 the total People Mover subsidy was \$9.3 million.*

Privatizing Detroit's public transportation system could result in vastly improved service and could even reduce overall operating costs by as much as 40 percent.

The privatization options are multiple. The city could competitively franchise the system, competitively contract individual routes, or simply repeal the prohibition on "jitneys," sell its buses, and contract only for those services not provided by private companies. There also are opportunities to involve em-

million miles delivering 42.5 million passengers.

In the 2000-2001 budget, the city appropriated \$172 million to operate this system, \$68.4 million of which is an operating subsidy that will come from Detroit's cash-strapped General Fund. This is up substantially from \$53 million in 1998.

These financial problems are among the reasons that D-DOT is pushing hard for a full-scale merger with the





would have cost the former government transit agency to provide the same service. The government expects savings to be substantial.

**Option 2: Competitive Contracting.** In England, London Transport, which is twice the size of New York City's public transit system and 15 times the size of D-DOT, competitively bids out to private contractors all of its bus services. Competitive contracting has reduced operating costs 45 percent, inflation adjusted. In addition, service quality and the number of passengers using the system are both higher than before. London Transport maintains its right to establish routes, fares, and service standards. It even tells the private contractors how to paint their buses.

The service is operated through hundreds of individual contracts that are re-bid at least every five years. Service operators are still provided with subsidies, but they are far smaller than when the system was under government operation. In some recent years, no subsidy was required.

London is not the only major urban area to competitively contract its transit services. Other cities that have competitively contracted transit services, or are in the process of doing so, include Stockholm, Sweden; Copenhagen, Denmark; Adelaide and Perth, Australia; and Helsinki, Finland. The European Union is issuing regulations that will require most public transit systems to be subject to competition. In America, the cities of Denver and San Diego have saved 35 percent and 40 percent, respectively, thanks to competitive contracting for transit services.

Detroit could reduce the cost of its operations by at least 40 percent using competitive franchising or competitive contracting. This estimate is based on hourly operating costs. Detroit spends more than \$75 per service-hour per ve-

hicle, whereas competitively contracted buses cost approximately \$45 per hour, a 40-percent difference. Savings of this magnitude could exceed **\$60 million** annually.

Either of these alternatives—competitive franchising or competitive contracting could be implemented in Detroit though skillful design would be necessary to accommodate highly intrusive federal labor regulations.

**Option 3: Employee Stock Ownership Plan (ESOP).** An ESOP is an arrangement like that existing in many corporations, in which employees are issued stock in the company as part of their compensation package. ESOPs have facilitated privatization around the globe.

How do they work? Usually, stock is sold to employees at a discount. In some cases it is given to employees in exchange for their cooperation. Creative approaches could combine an ESOP with competitive franchising or competitive contracting.

The city of Fort Wayne, Ind., considered converting its transit system to an ESOP approximately 10 years ago, but the effort was abandoned due to union opposition. However, a federal report concluded that it was feasible.

**Option 4: Legalize Jitneys.** Detroit outlaws the use of "jitney" services by private vendors. A jitney may be a taxicab, van, or minibus that charges a flat fee while operating along established routes. In New York, jitneys are providing low-cost, flexible service to low income residents that is less costly than transit service and more convenient for many riders. Many will provide door-to-door service for repeat customers. If legalized, they could supplement current transit service, reduce subsidy requirements, and provide a new source of income for city residents who could become jitney entrepreneurs. All of this would benefit the community by increasing employment and providing

higher levels of service to people who do not have ready access to automobiles.

Privatization of Detroit's public transit system should be part of the city's overall campaign to hold down costs and make the city more "user friendly." City officials should get started soon, before the state imposes an intrusive and less effective solution from Lansing.

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*Wendell Cox is principal of Wendell Cox Consultancy, an international public policy firm. He has provided consulting assistance to the United States Department of Transportation, among others.*

**Detroit could reduce the cost of its operations by at least 40 percent using competitive franchising or competitive contracting.**

## Nine Steps to Successful Outsourcing

■ By Michael LaFaive

Whether you run a business or are the head of a public or nonprofit organization, “outsourcing” offers one of the best ways to provide better services for less money.

Outsourcing is simply hiring another company to take over and run a service it can perform better and more efficiently than you can. Private companies can outsource services to other private companies. Public entities such as city governments or government agencies can outsource services to other public agencies, to private for-profit companies, or to private nonprofit companies or organizations.

Outsourcing is growing as a management tool for officials and executives in both government and the private sector. Spending by U.S. organizations—public and private—on outsourced business services is expected to triple

work as debt collection, property tax assessment, housing and community development, legal services, library management, motor vehicle maintenance, janitorial services, refuse collection, security, rodent control, parking meter enforcement, and security, to name a few.

Just the possibility that a city may outsource a service can give government service providers the incentive they need to improve service and efficiency. For example, when Flint Mayor Woodrow Stanley told city refuse collection workers that unnecessary expenses were forcing the city to consider outsourcing, they stopped their practice of picking up bulk items only during overtime, when they were paid more by the city. The Flint city employees increased the number of stops on their rounds and ended up saving the city 31 percent of what it spent on refuse collection the previous year.

But there are right and wrong ways

to outsource services. For example, in order to be successful—that is, in order to save money and provide better services at the same time—the outsourcing process must include open, competitive bidding for contracts that are subject to periodic renewal. The contract terms must be written carefully to incorporate clear and appropriate safeguards. There

also must be effective monitoring of performance to ensure the contract is being carried out as specified. Specifically, there are nine key steps to successful outsourcing, and they are as follows:

**1. Do your homework.** The whole point of outsourcing is to get the most for your money. If you do not pick the service provider that delivers this—and monitor whether the provider has made good on its promise—you will fail. This means designing two systems: a bidding system that delivers the right provider and a monitoring system that tracks performance.

**2. Involve key parties.** Alerting groups that will be affected by privatization—students, parents, teachers, and local public school unions—is essential. When constituencies understand that they are part of the process, they often are more willing to work with administrators.

**3. Issue Requests for Proposals (RFPs).** An RFP is your signal to service providers that you are open for business. It lays out the requirements of the service you need someone to provide, and requests that contractors make bids after assessing how much it would cost them to fulfill the contract requirements. Many top-flight, standard-format RFPs for various services can be found on the Internet. These can be adapted to almost any city’s needs.

**4. Ensure a competitive environment.** Perhaps the most important aspect of outsourcing is ensuring competition among vendors. Aggressively advertising your municipality’s desire to bid out services increases the likelihood of drawing a large number of talented vendors.

**5. Ensure quality work.** Make it clear that the contractor’s work will be inspected. Some contracts specifically enumerate the number of surprise and scheduled inspections a vendor can expect.

**6. Employ a skilled attorney.** In today’s litigious world, you can’t be too careful. The counsel of a business attorney is a sound investment. Too many

See “Nine Steps” on page 24



A November 5 Detroit News report on Detroit’s fire department found that 21 residents of the city lost their lives to poor equipment and closed stations. Outsourcing this function to a private business might save lives and provide the city with management expertise that appears to be lacking.

from its 1996 level of \$100 billion, to \$318 billion by 2001.

Many municipalities routinely contract with private companies for such





# The Power to Privatize

■ By Ronald D. Utt, Ph.D.

Since 1950, the city of Detroit has lost 48 percent of its population to safer, cleaner, and better-serviced suburbs. As it embarks upon a new century, the Motor City would like to polish its image and create the kinds of neighborhoods that might lure families back to safe, wholesome neighborhoods and a congenial atmosphere.

A step in the right direction might be to privatize electrical power. Although many blame factors beyond Detroit's control for the relentless flight of middle-class families and businesses to the suburbs and elsewhere, recent dramatic reversals of fortune in other American cities demonstrate that good government and quality public services are the keys to holding on to people and commerce.

Detroit runs its own electric power company—poorly. Because the city's Public Lighting Department (PLD) operates with far less efficiency than private, investor-owned utilities, it must of necessity feed on the economic lifeblood of the city. This drains funds away from other city services that might otherwise improve. Private utility companies—of which there are many—can do the job far better for less money.

### Detroit's lighting department

Detroit has appropriated \$67 million to fund PLD operations and capital improvements during fiscal year 2000-2001, which includes a \$12.7 million subsidy to cover the shortfall in expected revenues. In other words, far from operating at a profit like a private company must in order to survive, the city currently is operating its power grid at a nearly 19-percent annual loss. This perpetually hemorrhaging arrangement is what generates the more than 318 million kilowatt-hours of electricity that 1,578 public entities and private businesses are forced to use because it is their only choice. Detroit's energy cus-

tomers include city departments, public schools, police stations, fire houses, libraries, the Joe Louis Arena, the Michigan Department of Transportation, Wayne State University, Cobo Center, City Airport, and the People Mover.



*Detroit owns and operates a power company, pictured here. Several of its clients have investigated opting out of the city system. Detroit should sell its plant and get out of the power generation business.*

One 1996 analysis found that the PLD spent \$57 to produce one megawatt-hour of electricity, compared to \$22 spent by private Detroit Edison. This suggests that the city's cost to produce electrical power is as much as 160 percent higher than what it costs in the private sector. One department official only added to the city's embarrassment when, although he could not verify the estimate, he insisted that the PLD's cost per megawatt-hour was really "only" \$36.57, or 66 percent higher than the private-sector cost.

With this kind of attitude, it's no wonder Wayne State University and "other unnamed PLD customers" may "flee" PLD services in favor of investor-owned Detroit Edison, as recently reported in *The Detroit News*. Whichever figure is correct, it is clear that Detroit's citizens are paying more than is necessary for electric power (through high rates and costly tax subsidies) and that these overpayments represent funds that could be better spent on core public functions such as education, police, or road repair.

Moreover, the PLD's claim on the public pocketbook doesn't end with these excessive operating costs. According to a July 2000 article in the *Detroit Free Press*, the PLD will require an additional \$150 million to upgrade a power station and its leadership has requested another \$50 million for new and better equipment. The City Council has since hired an outside consultant to determine if this would be the best use of resources.

### The benefits of privatization

Selling Detroit's electrical power system to an investor-owned utility such as Detroit Edison would benefit the city in several ways. First, sale of the PLD to a private company would generate a huge, one-time influx of much-needed cash. One Detroit utility expert says electric utilities commonly sell for 1.5 to 2.5 times their book value (also known as "equity"), which could place the private sale of Detroit's PLD at between **\$301 million** and **\$501 million**. It should be noted, however, that Detroit's PLD is so inefficient that it likely would sell for somewhat less than what an operation of its type otherwise might go for.

Another benefit of selling the utility would be the steady flow of new revenue into city coffers through property taxes paid by the utility. But perhaps most important of all is that the sale would result in better service to customers, who could rest in the knowledge that those providing their power are doing so on the understanding that failure is not an option, as it unfortunately can be in a public-sector operation, which continues to receive funding regardless of how efficient or inefficient it is.

What to do about Detroit's lighting and power service has been the subject of ongoing criticism and debate for most of the last decade. Recognizing that a reliable power source is one of the many improvements that must be made if the city is to attract and retain jobs and

See "Power to Privatize" on page 24

**One 1996 analysis found that the PLD spent \$57 to produce one megawatt-hour of electricity, compared to \$22 spent by private Detroit Edison.**

## Looking over Private Inspections

■ By Michael LaFaive

One of the least publicized services that municipal governments hire private companies to perform is mechanical, electrical, plumbing, and building code inspections. In Michigan, regions as diverse as Clinton County and the city of Rockford contract with private inspectors to enforce code regulations.

There are at least seven private, for-profit firms in Michigan that cater to this niche market. Several also conduct city planning and zoning reviews under contract and can issue citations to code violators.

Detroit and other Michigan municipalities should seriously consider the advantages of contracting with the private sector for these services. This would not only save the taxpayers money, it also would alleviate a growing problem with regard to municipalities' use and possible abuse of inspection fees.

For example, one private inspection service owner told *Michigan Privatization Report* that a municipal client mandates that he return an "administration fee" equal to 10 percent of his inspection fee to the municipality that hired him. This is ostensibly being done under the guise of funding court costs when a judge is necessary to enforce building codes, but fees are apparently covering more than costs in many municipalities. The difference—or "kickback" as some would call it—can then be spent on whatever municipal officials fancy.

In March, state treasury officials informed municipalities they would have to establish a special revenue fund to designate how inspection fees are spent. This new demand is being made pursuant to recent changes in the State Construction Code Act, which requires local governments to establish "reasonable fees" which "bear a reasonable relationship" to the cost of operating a code-enforcing agency.

Public Act 245 of 1999 makes clear that fees generated from service may only be used "for operating the agency, the construction board of appeals, or both."

If enough evidence accumulates that local governments are redirecting revenues to purposes unrelated to building safety, the state could order offend-

To the city's credit, it has been working to improve the speed at which inspections are completed. Indeed, officials in Detroit inform *Michigan Privatization Report* that the number of building permits issued by Detroit's Building and Safety Engineering Department increased from 2,500 in 1994 to 8,000 in 1999. The increase in number of building permits issued is impor-



*This Detroit city waiting area is its own argument for privatization. Citizens trying to build or expand their businesses or homes, and reporters trying to obtain public information, can expect to spend mind-numbing hours waiting for government officials to assist them.*

ing municipalities to lower inspection fees. Instead, why not fix the problem and save money at the same time by privatizing inspection services?

For the 2000-2001 fiscal year, Detroit's city budget designates more than \$24.5 million to the Building and Safety Engineering Department. Sixty-seven percent of these funds pay for inspections of a mechanical, electrical, plumbing, or building nature. A sizeable **\$4.2 million** of the total budget appropriation is designated as a "net tax cost" to the city. This means the revenue Detroit is expected to derive from charges for its inspection services doesn't cover the expense of conducting them, to the tune of \$4.2 million this fiscal year. The city simply charges this cost to the taxpayers, who unknowingly suffer the loss.

tant because it suggests that city officials were conducting more inspections.

Privatizing the inspection services currently performed by Detroit's Building and Safety Engineering Department would probably eliminate this net tax cost to city residents and perhaps would reap even greater savings. After all, time is money. And private inspectors who are paid according to how much work they do tend to move faster than government employees who are paid regardless of what speed they work.

By contrast, when builders use private inspectors, they save huge amounts of precious time. The city of Fort Worth, Texas, learned this when it began supplementing its municipal inspectors with private ones in





March 1999. One Fort Worth contractor, Ron Forrnby, reported that privatization caused a dramatic drop in the inspection time required for building plan reviews for 80 to 100 homes. Before privatization the reviews took from 30 to 40 days. After privatization, they took only three to four days.

There is nothing about private, for-profit inspections that would make them of less quality than public ones. Private inspectors simply cannot afford to do shoddy work because it would hurt their profits. Government inspectors, on the other hand, have no such obvious incentive.

One recent case in point was showcased by the *Detroit Free Press* on Oct. 20, 2000. The story, "We Want A Safe House," told of a family that bought a house through a federal program. Both federal and Detroit inspections reported only minor problems with the house and allowed the family to move in. After experiencing prob-

lems with the home, the family hired its own private, for-profit inspection service, which found 181 building code violations. The family moved out after the private inspector told them the house was not safe to live in.

Time savings enable builders to make the same amount of profit on less revenue. This means they can charge municipalities less for their services. Result: The taxpayers save money.

For example, three years ago, the city of Battle Creek contracted with Associated Government Services of Michigan, a private inspection firm, for supplemental plumbing, electrical, mechanical, and building inspection services. To date, Battle Creek has saved roughly \$600,000.

Extrapolating such savings to Detroit, it is possible to conceive of savings to the tune of \$5.1 million per year as a result of contracting out for just half of the city's mechanical, electrical, plumbing, and building inspections.

But why stop there? Detroit could also save the taxpayers even more money by contracting out city planning, zoning and housing responsibilities to competent private-sector experts.

There's no inherent reason why the government should conduct inspections and enforce building and other codes when the private sector can do a better job for less money. This is especially true since the private sector has a more motivating incentive—the economic one—to conscientiously enforce these standards of excellence. MPRI

*Michael LaFaive is managing editor of Michigan Privatization Report.*

**After experiencing problems with the home, the family hired its own private, for-profit inspection service, which found 181 building code violations.**

## Privatization Sidebar

### Private Building Codes?

If private inspection is cheaper and more efficient, why not also privatize the building, plumbing, machine, and electrical codes themselves? Private codes would place a huge area of economic activity off-limits to government regulators, preventing their use as a tool for expansion of government intrusiveness (since 1970, the book that outlines these codes for U.S. developers has more than quadrupled in size).

Who would enforce a private code? Insurance companies have a strong incentive to mandate, as a condition of insurance, that strict codes be enforced. Other interested parties would be the construction industry itself and Underwriters Laboratory, a private, nonprofit standards and testing institution.

Walt Disney World in Florida has largely promulgated its own building and fire code (and enforcement) since 1969. It maintains over 22 million square feet of building space. So successful has Disney been that many of its innovations have been adopted as "model code" for other municipalities.

For more on the concept of a "free market" in building code regulation, see *Building Regulation, Market Alternatives, and Allodial Policy*, by John Cobin.

## Don't Waste Water Treatment Privatization Opportunities

■ By Gary Wolfram, Ph.D.

The time has come for the city of Detroit to privatize its wastewater treatment facilities. The environmental health of the Great Lakes is at stake, to say nothing of the pocketbooks of Metro Detroit citizens.

The *Detroit Free Press* has editorialized that, "It's an embarrassment to the city that for almost two years, until March 1999, the [city treatment] plant dumped untreated sewage into the Detroit River because equipment was too worn out or insufficient to handle the volume of gunk running through it."

U.S. District Court Judge John Feikens appointed a committee to inves-

The city is expected to spend more than \$366 million from July 2000 through July 2001 on operations and management of its wastewater treatment system. It could spend less and meet its own goals for "meet[ing] federal, state, and local requirements for the clean air and clean water standards," which the department lists as its number one goal in the city budget, if it would be willing to contract out for the operations and management of its system.

This past September much of Metro Detroit was underwater because the system couldn't handle the rainfall of a major storm. Although Mayor Dennis Archer has been charged by the U.S. District Court with solving the pollution problems, there is little reason to expect things will get better. City employees have no real economic incentive to provide better wastewater treatment services and there is little the mayor or city council can do about the situation unless privatization becomes an option.

Indeed, besides getting better service for less money, one of the major advantages of privatization is that governments can discover—sometimes for the first time—how much it actually costs to provide a given service. Without private contracting, a mayor must rely solely on city employees and their respective unions for information on the cost of wastewater treatment or any other city service. When city employees are forced to bid against private firms, on the other hand, the mayor or city council can make a more-informed decision as to whether the city should contract out for operation and maintenance or engage in some other form of public-private partnership.

There is a good deal of evidence that privatizing city wastewater treatment service would result in significant savings. The results of a 1999 National Association of Water Companies survey of 29 public-private water-sewer facilities found that: (1) Prior to pri-

vatized contracting, 41 percent of the systems were not in compliance with EPA regulations, while within one year of the contract all were in compliance; (2) All of the privatizations resulted in lower rate increases than were foreseen prior to privatization; (3) In 17 percent of the facilities, cost savings were between 10 percent and 40 percent; (4) Investor-owned facilities improved customer service at a lower cost; and (5) In 24 percent of the facilities, private firms provided investment capital for system improvement or purchased the facilities from the municipalities.

A partnership between Milwaukee's wastewater treatment system and United Water, a private firm, has reduced the system's annual operating costs by 30 percent. This has allowed the city to reduce sewer fees by 15.5 percent, even as it improved discharge compliance 50 percent beyond the Wisconsin Department of Natural Resource's minimum requirements. This earned the company a \$50,000 bonus from the city.

Knocking just 20 percent off the Detroit's current sewerage bill (not including this year's capital expenditures for improving the system) could save the city and/or its rate payers **\$42 million** annually. (*Editor's Note: This figure is based on 1999 revenue figures from city and suburban customers of \$210 million, which can be found in the city's Comprehensive Annual Financial Report .*)

Detroit will be forced to upgrade its wastewater treatment system in the near future to comply with environmental legislation that has been passed by Congress. According to Gary Fajita, assistant director of wastewater operations, capital costs are expected to reach \$2 billion in the next five years alone.

Detroit has little ability to secure such financing at a reasonable cost, given legal constraints on its borrowing capacity and the fact that the city's debt

See "Waste Water" on page 24



The city appropriated \$366 million for the 2000-2001 year to run the Sewerage department. Much more will be needed to make necessary improvements to the system.

tigate the problems of the Detroit Water and Sewerage Department. It found evidence of poor management, chronic delays, inefficient purchasing and hiring rules, lack of training, and a general tardiness and absence of leadership in reacting to problems known to the department.



## Privatization: A Cure for What Ails Detroit's Emergency Medical System?

■ By Charles D. Van Eaton, Ph.D.

It is possible to argue that Errol Shaw, Sr. might be alive today if Detroit's Emergency Medical Services (EMS) system were as efficient as EMS systems in other American cities. The general reports surrounding Mr. Shaw's death following his fatal encounter with Detroit police indicate that EMS response was severely deficient. According to news reports and admissions from city fire officials, an EMS unit did not arrive until 28 minutes after the first 911 calls for help. When an EMS vehicle did arrive, smoke was rolling from under its hood.

There is solid evidence to support the argument that what happened to Mr. Shaw after being shot by police would not have happened in a similar event in Chicago, Los Angeles, San Diego, or several other large American cities. These cities, and a number of other large cities in America as well, have much faster EMS response times than seems to be the case in Detroit.

Chicago, with a population of 2.8 million, reports EMS response times average 4 to 6 minutes. Los Angeles, now the second largest city in America with a population of 3.8 million, reports EMS response times average 5 to 8 minutes.

Yet, unlike Detroit, these cities have completely restructured their EMS systems to make use of private EMS providers working in concert with traditional public fire departments to assure maximum efficiency. There can be no doubt that this restructuring has not only contributed to more rapid EMS response, but to lower per-capita EMS costs as well.

In response to the charge that Detroit's EMS system is in a state of disrepair, Charles E. Wilson, executive fire commissioner of Detroit's Fire Department—within which all EMS activi-

ties are placed—stated that of the EMS system's 41 vehicles, only 12 were out of service for repair and maintenance and the remaining 29 "revealed no major disrepair or other problems" that would endanger technicians or patients.

But Wilson's response was at variance with official Detroit Fire Department records. Official records show 44 total EMS units with 13 vehicles out of service and 14 in service with problems such as bad brakes; no air-conditioning (considered vital when patients are suffering heart failure), out-of-alignment wheels, and inoperative communication computers (essential to getting reports to and from trauma centers).

The reported cost of providing EMS services, based on official city budget data, is \$21.2 million in positions alone. With a reported 69,600 medical runs in 1999, this comes to \$300 per run. However, these data understate the real cost of operating Detroit's EMS system because, unlike a for-profit entity, governments do not include fringe benefits (including retirement costs), capital costs, or maintenance costs when reporting the costs of running a particular department.

If, as is generally the case in the private sector, complete labor costs are 35 percent greater than simple wage and salary reports, true personnel costs in the EMS division are closer to \$28.6 million. Assuming that capital costs (maintenance and depreciation) are, conservatively, \$1.4 million per year yields a full cost of \$30 million. With reported medical runs of 69,600 in 1999, the true cost per run is closer to \$431.

Detroit has not performed well in collecting for the EMS services it renders. It is averaging a 27 percent collection rate on its EMS billings. With overall operations costs expressed very conservatively at the \$21.2 million personnel cost figure (this excluded maintenance, fuel, medical supplies for each

unit, depreciation on units, and employee fringe benefits, \$300 per-run cost, and a collection rate of only 27 percent), Detroit's taxpayer subsidy of the city's EMS system places the city near the top of the inefficiency scale at \$15.71 per-capita.

### Privatizing EMS

Privatization is one way Detroit could overcome the problems with its EMS system. One of the first issues a city should address when considering whether to wholly or partially privatize a service currently being provided by government is to ask the following question: "Is this a service now being produced by private firms for private customers or by private firms on contract to a public entity?"

The 1993 *Journal of Emergency Medical Services's* annual survey of EMS providers in America's 200 largest cities (also known as "The Almanac") suggests the answer is yes. The survey identified six EMS provider types: fire department; hospital-based; private; public utility model (wherein a regulated monopoly ambulance system contracts with a private provider); and a non-police-or-fire department municipal service funded and operated by a city or county government. In this mix of six possible models, four involve significant or total provision of the EMS service by a private provider and accounted for almost two-thirds of total EMS service provision.

The Almanac reports on how EMS services are provided using either private providers alone or private providers in partnership with public agencies in America's 200 largest cities included a number of Michigan cities. Grand Rapids, the most populated of the Michigan cities listed relies on private providers. Flint used private providers working in concert with the public fire department. Other Michigan cities were

See "EMS" on page 27

Outsourcing

**Detroit has not performed well in collecting for the EMS services it renders. It is averaging a 27 percent collection rate on its EMS billings.**



### “Nine Steps” continued from page 18

deals have soured due to poorly written and/or misunderstood contracts.

**7. Keep good, clear records.** If you don't have a benchmark for where you started and where you expect to go, you can't measure whether you actually got there or whether there could be improvement in the process. Perhaps worst of all, you can't crow about your outsourcing success unless you have a record of what improved and by how much.

**8. Make progress reports.** Periodic progress reports on the contractor's performance should be disseminated not

just within your organization or the contractor's, but with parties that have an interest in the success of your outsourcing venture. It might also be shown to others who might be interested in contracting with the particular vendor.

**9. Do your homework—again!** Successful contracting involves mastering many details. The more you prepare, the better off you will be should criticism emerge or a crisis erupt.

Always remember: Outsourcing is no longer new. You have plenty of successful examples to follow. No

longer is there any reason why city services need to operate on a running deficit, when private contractors are waiting in the wings to provide better services at lower cost.

Detroit officials, take heart—and take note! MPRI

*Michael LaFaive is managing editor of Michigan Privatization Report.*

### “Power to Privatize” continued from page 19

residents, a variety of reforms have been proposed, including some form of privatization. But so far, such discussions have bogged down in haggling over details, including labor issues.

To minimize such resistance to privatization efforts, officials should be very vocal about their intention to accommodate workers displaced by privatization. They should offer guarantees of employment elsewhere in the

city government, and/or generous severance payments and early retirement packages. The cost of follow-through on these promises will be far outweighed by the economic benefits of privatizing the city's power system.

While Detroit already has explored the possibility of “partnering” with private utilities for improving the power system, why tinker around the edges? Private, for-profit utilities suc-

cessfully deliver energy to their clients in many cities across America. MPRI

*Ronald D. Utt, Ph.D. is a senior research fellow with the Heritage Foundation in Washington.*

### “Waste Water” continued from page 22

rating is barely “investment grade.” Some institutions are not allowed to invest in bonds that are not investment grade because those bonds are considered too risky. While the city's rating has been improving, many institutions are still precluded from buying its bonds, which limits its buyers and raises its costs. On the other hand, private firms would be both willing and able to supply the capital needed to replace and repair aging facilities and construct new ones.

The initial political instinct will be for suburban municipalities to attempt to seize control of the wastewater system from Detroit. This push for

suburban takeover will increase as rates for Metro Detroit residents rise to fund system upgrades. The political battle will be divisive, and no matter how it turns out the fundamental problem—the fact that the government holds a monopoly—will not be solved until taxpayers and ratepayers have the opportunity to choose their service provider. Contracting out and competitive bidding for a properly drafted contract will discover what the most efficient mix of private-public ownership and operations is.

This is one of the few issues upon which environmentalists, consumer ad-

vocates, business owners, and ratepayers can agree. Everyone benefits from cleaner water and lower rates. Rather than engage in wasteful and destructive political battles over turf, the mayor and city council of Detroit should begin drawing up contracts for operations and maintenance of the city's wastewater system and let the bidding begin. MPRI

*Gary Wolfram, Ph.D., is George Munson Professor of Political Economy at Hillsdale College in Hillsdale, Michigan.*





## Detroit Quietly Outsources Police Oil Changes

DETROIT—In summer 1998, *Michigan Privatization Report (MPR)* published “Detroit DPW on Cruise Control,” a story based on published reports about the cost of changing oil in Detroit’s police cruisers. It appears as though Detroit officials may have read the work, because shortly after its publication, the city outsourced at least some of its police oil changes to the private firm Urban Management (now called On Site Oil).

Reports had suggested that the Detroit Department of Public Works was spending \$1 million annually to change the oil in 500 police cars. *MPR* editor Joseph G. Lehman estimated then that, if private garages were performing the oil and filter changes, at \$30 per car, every one of Detroit’s 500 units would need its oil changed about 67 times a year to have the service cost \$1 million. In order to need that many oil changes each car would need to drive 200,000 miles annually—an unlikely figure.

Details of the contract are sketchy. Repeated telephone calls to the city police and the Detroit Department of Public Works over a two-week period failed to locate the official who represented Detroit in its contract with On Site Oil. An employee of On Site Oil, however, informed *MPR* that the firm does indeed change the oil in Detroit police cars. *MPR* was unable to determine if On Site Oil is the only contractor to do so.

On Site Oil charges \$32.95 per vehicle per change. The charge includes every service that other private garages perform for civilians. If all 500 police vehicles had their oil changed 10 times each year at On Site Oil, the bill would come to \$164,750, an astounding 507-percent drop in the cost to the city of performing this maintenance operation.

## Detroit Schools Hungry for Food Privatization?

DETROIT—Last summer Detroit school officials issued requests for pro-

posals (RFPs) to private food vendors to take over the district’s food services. The RFPs asked vendors what it would cost the district to provide cafeteria services for students in the Detroit school system. Robert I. Brown, the district’s executive director of special projects, division of business operations, informed *MPR* that, after reviewing the proposals, district officials became convinced that “a fixed price contract was not the way to go.” The district intends to rebid the service. It is expected to issue a new RFP by the middle to the end of November.

## Flint Gives Privatized Arena Management a Sporting Chance

FLINT—The city of Flint may enter into a public-private partnership with businessman and doctor Khaled Shukairy to run its IMA Sports Arena. Under the arrangement the city would receive a \$250,000 annual payment from Shukairy plus 25 percent of all new revenues exceeding \$1.9 million. The partnership would last eight years.

## State Charts Course for Privatization of Boat Inspections

LANSING—State lawmakers on the Senate Hunting, Fishing, and Forestry Committee voted unanimously Oct. 5 to support a bill that would privatize the inspection of charter boats on Michigan waters. The bill was introduced at the request of officials at the Michigan Department of Natural Resources (DNR). “We initiated it,” said Lt. Lyle Belknap, a boating law administrator with the DNR. “It goes along with privatizing government programs better served by the public than by us. There’s a whole host of firms that do this for their livelihood.” The DNR performs about 750 inspections each year, only 25 of which are of a for-profit, commercial nature.

## Hamtramck Avoids State Receivership

HAMTRAMCK—Embattled Mayor Gary Zych of Hamtramck, who wants to solve his city’s financial problems by privatizing many city services, narrowly averted a state takeover of his city’s finances in October after a five-member state review panel decided to give Hamtramck more time to clean up its financial difficulties.

The panel decided Oct. 5 to take no immediate action to remedy the city’s budget troubles, said Fred Headen, chief of the Bureau of Local Government for the state Department of Treasury. Headen also heads the review team, which could have recommended that Hamtramck be put into receivership and that Gov. John Engler name a financial manager for the 17,000-resident city that is \$2 million in debt. The Hamtramck City Council still must cut city spending by \$630,000 during the fiscal year ending June 30, 2001.

So far, Mayor Zych has been unable to persuade the council to brave the objections of local public employee unions and vote in favor of plans that involve privatization. The city currently owes money to Detroit Edison, Michigan Consolidated Gas Co., and Ameritech, as well as Waste Management, which hauled rubbish to the city dump, and the Detroit Department of Water and Sewerage for water service.

## State Mental Health Plan May Not Meet Federal Competition Requirements

LANSING—Although the federal Health Care Financing Administration (HCFA) has issued rules requiring “free and open” competition among public and private mental health care

continued on next page





providers for Medicaid-funded contracts, the plan submitted Oct. 1 to the HCFA by the state of Michigan backs off from that requirement.

Caving in to pressure from public mental health providers, the state modified its original plan, which called for all-out competition, and instead proposed that it would give “initial consideration” for contracts to “qualified Community Mental Health services (CMH) programs” that serve at least 20,000 Medicaid clients. To save on administrative costs, counties with CMH services serving smaller communities would have to combine with their neighbors in order to receive state funding.

The new proposal also requires CMH programs to meet an extensive list of qualification requirements before being selected for Medicaid funding. These include administrative efficiency, establishing a network of service providers, and offering “consumer choices.” If an existing CMH program can’t meet these requirements, both public and private companies will be allowed to bid on services for that area.

It remains to be seen whether this plan will be approved by the HCFA. Meanwhile, the state has applied for a waiver from all competition requirements, on the grounds that it’s impractical.

## Critics Say Private Prison Company Has a Record

LANSING—Gov. Engler’s attempt to use privatization to control Michigan’s prisoner health care costs—some of the highest in the nation—is coming under fire because of the state’s use of a company that stands accused of failing to provide quality care here and in other states.

The administration recently agreed to pay \$250 million over five years, without bid, to St. Louis-based Correctional Medical Services, Inc. (CMS), in an expansion of the company’s contract critics say is unwarranted because of the company’s track record.

Although inmate health-care costs

have stabilized since 1998 when CMS took over, critics cite numerous lawsuits against the company, both in-state and in 11 other states, alleging medical negligence. Others involved in the controversy say CMS is under fire because the Michigan Legislature granted it the power to privatize government medical jobs under its purview, which threatens the power of public-sector unions.

## Federal, State Governments Squabble over Michigan Public Broadcasting

LANSING—Under an order passed three years ago by the Federal Communications Commission (FCC), Michigan’s 14 public broadcasting stations must convert from analog to a digital broadcast system by 2003.

Why? The feds say it’s because digital systems transmit better pictures, can carry more than one signal at a time, and are easier to transmit to computers, none of which necessitates the switch. The real reason is more likely that communications technology is overtaking the government’s controlled system of broadcast spectrum allocation, and the feds are scrambling to accommodate it. The FCC wants to sell the airwave space public radio and television stations currently occupy to wireless communications companies.

Unfortunately, the public broadcast stations want the state of Michigan—i.e., the taxpayers—to pay for the conversion, which may cost an estimated \$44 million. Gov. Engler so far has refused, blaming stations for not modernizing their facilities the way private stations do in response to market pressures, and the federal government for mandating the upgrade without providing funds for it.

Some observers note it would be easier for the government to simply get out of the broadcast business, open the spectrum market to all bidders, serve as auctioneer, and let the broadcasting market work these issues out in a voluntary fashion.

## States Do Business with Firms Banned from Federal Contracts

LANSING—More than half the states hire private contractors without reviewing whether the companies have been barred from doing business with the federal government, the Associated Press recently found.

Fourteen states, including Michigan, told AP that their contracting offices don’t check the federal government’s Internet-accessible list of companies it says it will not hire because of various infractions. Twenty other states said they consult the list only occasionally, and John Truscott, spokesman for Gov. Engler, said Michigan doesn’t check the list because it conducts its own checks.

Of the 700 Michigan individuals and companies that made the federal list, a computer analysis of state transactions from 1995 to April of 1999 revealed only six that had received any money from the state. Michigan officials claim none currently receives state funds.

About 24,000 companies and individuals are barred from doing business with the federal government for infractions that range from violation of drug-free workplace laws to embezzlement and contract fraud.

## New Detroit Computer Costs Twice As Much, Fails to Solve Problems

DETROIT—When the city of Detroit decided that it was time to do something about rising anger and dissatisfaction over its confused accounting and billing practices, officials decided privatization was too radical.

Instead of turning its accounting system over to a private company that would solve the problems or not get paid, a year and a half ago, city officials decided to buy a new computer system. Today, the \$70-million system has actually cost city taxpayers \$126.5 million and still hasn’t solved the accounting problems.

While the system has eliminated





manual record keeping and other clerical work, it hasn't been able to cause city bills to be paid on time, nor has it resulted in standardized business practices throughout the departments of government.

To cite just one example, the city is still paying some contractors twice for the same job because city employees don't know how to use the system to see if a vendor has already been paid.

## Probe Finds Metro Airport Financial Irregularities Worse Than Expected

ROMULUS—A report by Michigan's auditor general in August found that the management and financial irregularities at Detroit Metro Airport are far worse than even critics expected. Enormous cost overruns were discovered in 23 of the 59 consulting contracts at the airport. One contract was discovered to have gone \$43 million over budget. Vehicle supplies cost 379 percent more than originally budgeted; janitorial supply costs jumped 890 percent; and employee fringe benefits increased 3,949 percent beyond what taxpayers had been told they would cost.

Asked about the overruns, airport officials described them as a "fact of life." Wayne County Executive Edward H. McNamara has called the inquiry a "witch hunt." But documents obtained under threat of a subpoena revealed that the airport's parking garage contract with APCOA/Standard Parking, Inc., had been extended on a month-to-month basis without bids since 1992, in violation of county contracting procedures. And McNamara's brother-in-law, it was discovered, had received several lucrative contracts from the company as well. The company was fired in September for alleged overcharges for shuttle van leases to the tune of \$400,000, and its contract awarded to another company.

In the face of continued resistance by airport officials to producing requested documents, the investigation, sponsored by a Joint Legislative Select Committee of the Michigan Legislature, is ongoing.

## Life Better at Youth Prison Since Privatization, Warden Says

BALDWIN—Officials at Michigan's only privately run prison for violent juvenile offenders told a state House committee in August that there are fewer problems at the facility now than when it opened a year earlier.

Michigan Youth Correctional Facility (MYCF) Warden David Trippett disputed reports in the *Grand Rapids Press* of overextended personnel and incidents of prisoners attacking prison officers, both of which incidents are becoming less frequent, Trippett said.

Marsha Foresman, an official with the state Department of Corrections, which oversees the MYCF contract with Wackenhut Corrections Corp., told lawmakers the prison has the most oversight of any Michigan prison. "I think you will find these prisoners are well-kept," she told the committee.

## Will Edison Run Detroit's Worst Schools?

DETROIT—In August, Edison Schools, the for-profit school management firm, proposed to Detroit Schools

CEO Kenneth Burnley that it manage up to 45 of the district's worst performing schools.

The fact that Burnley himself announced the approach to reporters says not only that he and the district are open to the idea, but that the plan could actually be implemented. The question is, when? Since then, there has been no public word on the plan.

Edison runs 108 public schools nationwide with a total student enrollment of around 59,000 students. The company already runs the Inkster school district, traditional public schools in Flint, Pontiac, Battle Creek, and Mount Clemens, and charter schools in Ferndale, Lansing, and Detroit.

Under contract with Detroit schools, Edison would receive the full per-pupil payment from the state for every child enrolled in a school it managed. Edison has even offered to open a teachers' college in the city "if it were assured of a broad presence in the Detroit school system," according to *The Detroit News*. MPRI

## "EMS" continued from page 23

Sterling Heights, and Ann Arbor. More recently, smaller cities such as Traverse City, Kalamazoo, Grand Ledge, Portage, and Jackson as well as Wexford County have moved to full private provision. Cost savings have been reported as high as 50 percent. Saving 25 percent from Detroit's EMS bill would knock **\$5.3 million** annually from the cost of providing this service.

There is significant room for improvement in the way Detroit provides EMS services. The appropriate redesign of the system should be one that follows the successful path taken by a significant number of other American cities in bringing the expertise and eco-

nomics efficiency of private providers into the overall operations of emergency medical services.

Clearly, the health and well being of many citizens depend upon how well an EMS system operates. Privatization not only can help Detroit save dollars, but even more importantly, it can help the city save more lives. MPRI

*Charles Van Eaton, Ph.D., is professor of economics and public policy at Pepperdine University in Malibu, California.*

# Feature

## Private Group Offers to Manage Westwood Schools

■ By Joseph Lehman

A Detroit-area public school district is suing the state to stop students from transferring to other schools and keep the state money that comes with each pupil. A private group has offered to help the school solve its problems without litigation.

cost it more than \$1 million in per-pupil funding. The district is not required to pay for the education of the pupils who now attend school elsewhere.

Publicity surrounding Westwood's effort to prevent students from crossing its district borders prompted the Mackinac Center for Public Policy to offer to contract with the district to run its operation and stem the loss of students.

Mackinac Center Senior Vice President Joseph Overton said, "Instead of legally barring students from choosing a school, we want to help Westwood become the school that students choose, no matter what district they live in."

In a *Detroit News* story, School Board President Sandra Rich said the board would "certainly have a discussion over this" and added that the district is "always looking for ways to improve." The story did not state what the district is doing to determine why students had left or what might convince them to return.

Overton said his first step in improving the school would be to survey parents to find out why they were sending their children elsewhere. A *Detroit News* editorial urged school officials to meet with the Mackinac Center.

School district attorney Daniel Ferrera told the *News*, "We're becoming a (segregated) district for no reason at all." Overton responded, "If we prevent school choice, parents will simply move out of the district, possibly leaving both the school and the community more segregated."

In addition to public policy research, the nonprofit Mackinac Center offers legal and financial consulting to Michigan schools to help them be more competitive.

This fall, Westwood's neighboring district of Inkster became Michigan's first school system to contract all its operations to a private firm to restore fiscal health and improve educational quality. MPRI

*Joseph Lehman is Executive Vice President of the Mackinac Center for Public Policy.*



The Mackinac Center for Public Policy has offered to help Westwood Schools (pictured) in Dearborn Heights become the school parents choose for their children's education. The district has been losing students to competing schools and wants the migration to end.

Westwood Community Schools district, whose boundaries enclose a racially diverse mixture of 2,200 students, has seen 150 students transfer to charter or other public schools since 1996. The district's attorney claims school choice laws threaten its racial balance and have

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