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MICHIGAN Privatization REPORT

A Quarterly Publication on Privatization Initiatives throughout the State • Mackinac Center for Public Policy • No. 2002-03 / Summer 2002

Industrial Policy: Can Government Really "Create" Jobs?

The Next Energy Boondoggle

and more...

If You Build It They Won't Come

MICHIGAN PRIVATIZATION REPORT

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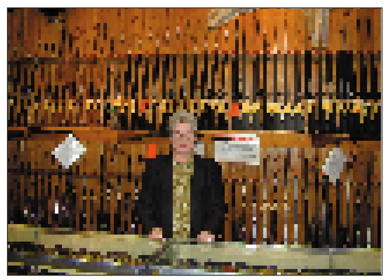
FEATURES



DEPARTMENTS

ADVERTISERS:

Feature

An Open Letter to Michigan Legislators: Privatize Economic Development

By Samuel R. Staley, Ph.D.

Dear Legislator:

I am very pleased to introduce this special edition of *Michigan Privatization Report*, dedicated to economic development policy. As an economist who has studied urban and regional economic development policy for almost 20 years, I am heartened to see the Mackinac Center take on these issues with such focus and thoroughness.

State economic development policy should focus on creating a favorable climate for *all* investment and job creation.

Historically, government's role in economic development has focused primarily on providing "public goods"—products and services such as roads or sewer systems that have typically not been provided by the private sector. In recent years, governments at all levels have embarked on a new strategy: giving money and tax relief to specific companies for specific purposes.

While government-driven state and local "economic development" policy schemes have been used in the United States for more than a century, the scale of recent economic development efforts is unprecedented. Many states have created dozens of programs that, in effect, give some officially approved businesses preferential status over other, similar businesses. These programs, as shown in the page 8 story on Cabela's Retail, result in direct government subsidies to competitors.

Government programs often start out with good intentions. They are billed as tools to encourage job creation and investment. They also provide a visible political benefit as elected officials cut the ribbon on a brand new factory or store presumably subsidized by one of the economic development programs.

But these programs, in turns out, have an Achilles' heel that works against their effectiveness. The effects of targeted tax incentive programs are zero-sum: Luring a company from one locality to another simply displaces jobs and investment. The programs don't create wealth, they simply redistribute it.

In addition, the programs are not costless: Someone is paying higher taxes to offset the tax break given to someone else. In short, one business's tax relief is another resident's tax burden.

Not surprisingly, most academic studies have concluded that targeted business incentive programs have little impact on economic growth or development. To the extent they have an impact, the programs offset anticompetitive features of the local tax system. Many states and localities, for example, grant tax abatements because property tax rates are high relative to their competitors. Unfortunately, with selective economic development programs, the reforms aren't broad-based—only a few companies capable of managing the political bureaucracy and approval process benefit.

These programs, however, face other problems that further limit their effectiveness. Economic development officials are not endowed with a unique or specialized understanding of how the economy works. They cannot reliably predict which businesses will succeed and which ones will fail.

Yet, that government bureaucrats can divine a level of knowledge unavailable to the most savvy Wall Street analyst is the underlying assumption upon which economic development programs are based. Economic development agencies are expected to grant selective incentives based on their belief that a business will do well. They must pick "winners" and "losers."

Even this issue fails to grapple with the most salient weakness of these programs—equity. These programs are inherently unfair. In fact, their very nature is to discriminate—to select some business for advantage over others no less worthy.

Businesses do not have equal access to the process by which these decisions are made. Indeed, the vast majority of businesses will never even have the opportunity to submit an application for special tax favors. Only those businesses knowledgeable of the state's application process, which possess staffs able to fill out the many forms involved, lobby state legislators and bureaucrats, and negotiate favorable terms, have a reasonable chance of securing the benefits. The vast majority of small- and medium-sized businesses lose out with these programs. They pay higher taxes to support the state's subsidy of their competitors.

Instead, state economic development policy should focus on creating a favorable climate for *all* investment and job creation. A state-orchestrated industrial policy—where public officials determine which investors and businesses deserve preferable treatment—will not achieve this goal. An economic development policy that relies on bestowing benefits on some businesses may create a "favorable" environment for those businesses, but this will be at the expense of the vast majority of Michigan businesses.

Michigan residents should recognize the limited benefits and inequities inherent in an economic development policy focused on giving tax breaks and subsidies to a select few businesses. Instead, they should look toward broad-based tax and regulatory reform to create a business climate that encourages statewide investment and job creation.

Michigan legislators would do well to consider the recommendations in this MPR and privatize targeted economic development programs in favor of continued overall tax and regulatory relief. MPR!

Dr. Staley is president of The Buckeye Institute for Public Policy Solutions in Ohio and an adjunct scholar with the Mackinac Center for Public Policy.

Make Michigan One Big Renaissance Zone

By Martin Wing, Ph.D. and Michael LaFaive

For two decades, governments around the country have been experimenting with an economic development device commonly known as "enterprise zones." The 24 zones in Michigan, usually drawn around economically "distressed" areas, are between 120 and 2,900 acres in size, and are designed to provide special tax relief to businesses and people who operate (and sometimes live) in the zone.

Michigan state and local units of government have access to all sorts of zones. For instance, there are "empowerment zones," "smart zones," and "hub zones" depending on location, needs, and political leadership. Each designation signifies characteristics that make it slightly different from the others.

In Michigan, enterprise zones are referred to as "renaissance zones," which can offer significant tax relief for 15 years. While privatization is typically understood as a private assumption of functions formerly performed by government, in the case of renaissance zones, privatization would mean ending public interference in the state's economy. It would mean abolishing the practice of offering special favors to some businesses at the expense of others.

The state should privatize the renaissance zone program and its offshoot, the Agricultural Processing Renaissance-Zone. Instead, it should provide greater tax relief for all Michigan businesses and citizens, not just those lucky enough to live in a tiny geographic box drawn by politically appointed central planners.

Every county in the state is allowed to apply for a zone designation for economically distressed areas. According to the Michigan Economic Development Corporation, the nine-member board of the Michigan Strategic Fund (MSF) recommends zone applicants to the State Administrative Board (SAB), which makes the final decision. The MSF was created in 1984 to help businesses "obtain additional sources of financing." The SAB provides general oversight of state department activities, including the approval of contracts. If an existing business is operating in an area designated as a renaissance zone, it is exempt from the Single Business Tax, state property tax, local personal property tax, utility tax, local property tax, and special millages. Individuals get the same basic package of relief, minus the break on the business tax, which doesn't apply to them.

Nationwide, research indicates that enterprise zones have had a negligible impact on economic growth and development. Professors Thomas Lambert and Paul Coomes of Spalding University and University of Louisville, respectively, studied one of the nation's oldest and biggest enterprise zones in Louisville, Ky., and used "many measures to try and give the program every chance of success." Yet the evidence, published last May, showed that after 14 years "it is difficult to document that this program has been effective."

Other studies concur. In their paper, "Enterprise Zones and Local Employment: Evidence from the States' Programs," published in Regional Science and Urban Economics, Daniele Bondonio and John Engberg found "zero impact" on local employment from enterprise zones and that "the level of the monetary value of the incentives awarded to zone businesses does not noticeably contribute toward enhancing the impact on local employment."

The newest type of renaissance zone in Michigan is known as "Agricultural Processing Renaissance Zones," of which there are three, two in Oceana County and one in Ionia. All underscore two basic problems with state favoritism in the name of "economic development": 1) It's unfair to businesses that do not receive the tax advantages offered; and 2) Officials can't prove that the development they claim as proof of the zone's success wouldn't have taken place without their interference.

Targeted tax relief places at a competitive disadvantage those businesses that do not get the state favors. This is why Michigan agricultural companies, in January 2001, actively opposed zones being granted around the properties of their competitors, Peterson Farms, near Shelby, and Gray & Company in Hart.

Targeted tax relief places at a competitive disadvantage those businesses that do not get the state favors.

One of the zones' critics, who asked to remain anonymous for fear of state retribution, told *Michigan Privatization Report*, "The state has put me at a terrible disadvantage by giving my competition substantial tax relief. How can Lansing bureaucrats possibly believe that hurting me will help the economy?" This was generally the nature of other processing companies' opposition, though several firms' officers noted that they were not opposed to the idea of helping the agricultural industry. The state took testimony in person and by letter from businesses opposed to the way these zones were being used, but plowed ahead anyway.

Unfortunately, this is not the first time this northern Michigan entrepreneur has been stung by central planners. Just over a year ago, a local and publicly funded economic development agency helped one of his nearby competitors obtain a $350,000 loan to upgrade its facility. Shortly after the improvements were made, the competitor won a contract from an ice cream firm for cherries that had been with his firm for more than a decade. The contract represented 50 percent ($5 million) of the entrepreneur's business. To add insult to economic injury, once the contract was secure, his competitor

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"One Big Renaissance Zone" continued from page 5

hired away five employees from his business.

Perhaps the loan and subsequent loss of contract was just a coincidence, but that is beside the point. Whether it's through renaissance zones or special favors offered directly to individual companies, government simply has no business picking winners and losers in the marketplace.

Everything in the world has a cost, even if it is an "opportunity cost." An opportunity cost is the next best alternative forgone. By creating political programs that allow officials to pick projects or geographic areas that deserve tax relief, government makes it more difficult for everyone to have tax relief. Furthermore, it hurts people and businesses not lucky enough to have favor with Lansing's economic wizards.

All of this might be tolerable if state officials could prove that renaissance zones actually produce a positive net benefit to the economy. But the literature on the subject is very clear: Enterprise zones have no measurable impact on economic growth and employment—but they do have huge costs.

It's time to end such special treatment and make all of the Great Lakes State one big renaissance zone by making the same tax relief available to everyone.

Dr. Martin Wing is an assistant professor of economics at Kettering University in Flint. Michael LaFaive is an economist and senior managing editor of Michigan Privatization Report.

The Next Energy Boondoggle

By Diane Katz

Citing a threat to national security from U.S. dependence on foreign oil, Gov. John Engler recently instituted state management of alternative energy research and development. A newly created agency and a variety of subsidies supposedly will enhance development of non-fossil fuel technologies.

But even the best of intentions don't necessarily produce sound policy, and the governor's "NextEnergy" initiative is, unfortunately, flawed.

In unveiling his proposal in April, Engler vowed to position Michigan as the "world leader" in alternative energy sources such as hydrogen fuel cells to power vehicles. Absent state intervention in automotive re-engineering, he said, Michigan risks the loss of 200,000 manufacturing jobs.

Promoting energy R&D in Michigan does not require yet another government bureaucracy allocating favors to select firms. Privatization of state and federal research programs would make Michigan the economic powerhouse the governor envisions.

It's true that the United States imports more petroleum today than 30 years ago—54 percent of American consumption compared to 35 percent in the 1970s. But more oil is now available from a wider variety of sources than ever before. To artificially restrict energy to domestic or so-called renewable sources in the name of "security" would only make the United States more vulnerable to energy disruptions, not less. And to embrace the notion of an energy crisis when none actually exists imperils Michigan jobs by emboldening the automobile bashers.

Regardless of the supply outlook, the immediate issue is whether the NextEnergy initiative will advance R&D. The state's new authority will be governed by a hand-picked board to finance, direct, or otherwise aid in the central planning, construction, and design of alternative energy technology business and infrastructure. The authority is also empowered to issue revenue bonds and grant a variety of tax credits and exemptions based on very broad criteria.

To generate operating revenue for the venture, the Legislature has transferred to the authority control of more than 700 prime acres in Washtenaw County that can be leased or sold to energy-related enterprises. However, should the authority run short of cash with which to repay the notes or bonds sold to underwrite its projects, the taxpayers would have to cover the debt.

BUSINESS COSTS

State	National Rank	Score
Texas	1	81.7
Virginia	4	77.9
Florida	5	70.0
Colorado	7	67.4
Georgia	9	66.6
Washington	13	63.7
Arizona	24	54.4
Indiana	26	51.7
Maryland	27	51.1
North Carolina	30	50.5
Pennsylvania	31	48.8
Ohio	34	42.6
Illinois	36	41.9
Massachusetts	37	40.2
Minnesota	38	40.1
Wisconsin	40	36.2
Michigan	42	33.8
California	46	26.9
Benchmark State Average		52.5
U.S. Average		50.0

Scores are out of a possible 100 points.

Michigan ranks second-to-last among peer states in business cost competitiveness.

Government involvement in R&D is well established. National labs with multi-billion dollar budgets have long augmented academic and commercial research. But states and the federal government have largely failed in attempts to commercialize nascent technology—despite trillions of dollars in public R&D expenditures.

In the 1970s, for example, the Carter administration created the Synthetic Fuels Corp. to develop renewable energy sources (in the name of energy independence). But the Synfuels program was discontinued in 1982 without generating a dime's worth of new power—despite taxpayers' $1 billion bill. Congress then formed the Partnership for a New Generation of Vehicles with the intent of producing an affordable zero-emissions family sedan by 2004. Despite $2.5 billion from taxpayers and The Big Three, the program's chief goal was ultimately deemed unrealistic by the National Academy of Sciences.

The incentives under which government scientists operate can make it harder for them to distinguish between pipe dreams and real technological promise.

The U.S. Department of Energy, meanwhile, administers a variety of alternative energy programs upon which hundreds of billions of dollars are annually lavished.

Myriad institutional problems confound government R&D—foremost among them the aversion to risk generally found in government ranks. The incentives under which well-intentioned government scientists operate can make it harder for them to distinguish between pipe dreams and real technological promise. Officials routinely allocate public funds to the least-risky projects in order to minimize the potential failure of pet bureaucracies. But those tend to be the projects most likely to draw private capital, thus supplanting privately funded R&D.

As it is, the automotive industry already is heavily invested in fuel-cell research. BusinessWeek reports that General Motors Corp. hopes to unveil its "Autonomy" prototype by 2010, while DaimlerChrysler is testing hydrogen powered busses in 10 European cities while perfecting its "Natrium" minivan.

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Feature

A Tale of Two Sporting Goods Stores

By Michael LaFaive

Imagine for a moment that you own the Detroit Tigers. You and your spouse made great sacrifices to purchase and develop the team, but with luck and pluck managed to build the Tigers into a popular and beloved institution among sports enthusiasts.

Now imagine that prior to the championship game, the baseball commissioner makes an announcement that astonishes you. He says that, to make up for the home team advantage, the team coming from out of state to play in Detroit will have a few "perks" just so they'll feel like coming back. What he means is that the rules will be altered, just for their side. He says, for example, that the other team's batters will be walked on three balls instead of four, and will be awarded a home run if they hit the ball into the outfield.

Would you sit still for this as the owner of the team—or even as a fan? I wouldn't. So why does the state of Michigan consent to a similar changing of "the rules of the game"—one that involves not just a game, but real economic life out there, in which people's livelihoods are at stake?

Unfortunately, the state did not stop at assisting Cabela's with convenient access to a highway and new sewers.

State and local officials right here in Michigan have created a taxpayer funded entity—the Michigan Economic Development Corporation (MEDC)—that uses taxpayer dollars to entice out-of-state businesses to locate and compete in our state. Ostensibly, the goal is to "create jobs." What it actually does is shift jobs and create an unfair playing field, which increases the relative startup costs of rival, taxpaying, homegrown businesses.

Case in Point: Jay's Sporting Goods

Jay Poet, a lifelong Michigander and avid outdoorsman, opened Jay's Sporting Goods in 1968 in Clare, Mich. His dream was to create a world-class sporting goods store that both locals and out-of-towners could visit on their way up north. He and his wife, Arlene, worked more than 80 hours a week in the early years, and grew the store into what would become "Michigan's outdoor superstore." By 1989, when Jay died of cancer, he had firmly established his dream, leaving his widow and sons to carry on the family tradition of helping outdoorsmen obtain the products they desired.

It was difficult to operate the business without the founder, father, and husband at the helm, but the family found strength in each other and soldiered on. Today, the family operates Jay's from two locations with over 100,000 square feet of shopping space. For more than three decades, through good times and bad, Jay's has served outdoorsmen from across the state and nation, and the store has done it *without a dime of taxpayer money*.

Cabela's operates a mammoth outdoor store in Dundee and has been the beneficiary of corporate welfare from Lansing's economic central planners.

Enter Cabela's Retail Inc.

The same cannot be said for Jay's new competition, Cabela's Retail Inc. In 1999, the MEDC informed Cabela's that it would offer a package of incentives worth up to $27.8 million for locating a new, 200,000-square-foot store in Dundee, Mich.

Cabela's is a mammoth catalog and retail outlet for everything related to outfitting the outdoor sports enthusiast. It ships over 60 million catalogs to all 50 states and 120 countries every year and maintains seven retail outlets. Cabela's took the offer and opened its Dundee store in October 2000.

The total incentive package that was promised by the MEDC would include funds from federal, state, and local sources. Of course, some of the investments made by officials are more reasonable than others. For instance, $26 million was dedicated to road improvements leading up to the off ramp near the store. As long as government is in the road business, this is a perfectly legitimate expenditure.

In addition, off-ramp improvements worth $11.1 million were made and effectively financed by Cabela's—but these expenses will be deducted from their local tax obligations. Another $1.3 million was earmarked for such things as storm drain construction through the federal government's Community Development Block Grant program, which is designed to assist in local development priorities such as infrastructure improvement.

Unfortunately, the state did not stop at assisting Cabela's with convenient access to a highway and new sewers. It also offered to:

- Purchase $300,000 in catalog advertising from Cabela's over a three-year period;
- Dedicate one full-page ad in the state's tourism publication, "Michigan Travel Ideas," to Cabela's (a $100,000 value);
- Provide Cabela's with full access to the "Travel Michigan" database, which contains the names and addresses of over a million people seeking information about travel in Michigan (an $80,000 value);
- Provide marketing and publicity assistance surrounding the official grand opening ceremony of Cabela's in Dundee (a $25,000 value);
- Give Cabela's free membership in the state's "Circle Michigan" tour promotional organization (a $4,500 value). Circle Michigan is an association that works with bus operators to help increase tours for groups to attend trade shows and other special events.
- Obtain "workforce development" assistance, which would help the retailer hire new employees.

It is important to note that all of these perks and the programs through which they are offered are administered by a host of government employees. These bureaucrats don't work for free, nor do they raise funds by selling Girl Scout cookies. From fiscal year (FY) 1999 through FY 2001-02, the MEDC has received $244 million in General Fund/General Purpose dollars—tax money from the citizens of Michigan. It may receive another $46 million in FY 2002-03, depending on how budget negotiations work out. In other words, it costs money to maintain bureaucracies whose staffs are paid to take money from one person or group and give it to another.

If a thief stole money from a bank in Lansing and spent all the cash at the local mall, the MEDC wouldn't issue a press release celebrating how many jobs were "retained" or "created" at the mall. Officials would recognize that someone had to lose in order for the mall merchants to gain. Yet, for some reason, when central planners offer "incentives" to companies to locate to Michigan, they forget they're hurting businesses like Jay's Sporting Goods. The former Mrs. Poet (now Yost) and her children want to see their businesses grow further but are stymied by bureaucrats who reach into Jay's cash registers and "invest" the loot in firms like Cabela's.

"When I first learned that our competition would get state assistance, I was flabbergasted," recalls Yost. "It sometimes makes you wonder who you are working for." Yost isn't complaining because she knows that her business will thrive despite MEDC's intervention, but she wonders about others. "Will the 'mom-and-pop' outfitters near Dundee survive?" she asks.

Unfortunately, Jay's is not the only sporting goods store that has to watch its competition get an unfair leg up. According to American Business Directories, there are more than 1,000 other Michigan-based businesses with which Cabela's competes in our own state. American Business Directories sells data about businesses from across North America and categorizes businesses by type. How many of these have received favors from state government?

It is doubtful whether any of the MEDC bureaucrats issuing business-related edicts have ever run a successful business. Yet they operate as if they had knowledge every businessman struggles to find out every day, and never completely grasps: Which businesses will flourish and which will not.

There is simply no sound reason to hurt widows like Arlene Yost so companies like Cabela's can fatten their bottom lines. State programs that directly subsidize one business at the expense of their in-state rivals should be privatized to see if there is an actual demand for their services.

Jay's Sporting Good's owner Arlene Yost was shocked when she found out that the MEDC would be subsidizing her competition. "It sometimes makes you wonder who you are working for," she said.

Michael LaFaive is an economist and senior managing editor of Michigan Privatization Report.

"Boondoggle" continued from page 7

Ford Motor Co., meanwhile, has developed its "Focus FC5," which relies on hydrogen extracted from methane.

To the extent that automakers foresee a competitive advantage in fuel-cell technology, they are unlikely to share their research findings. (After all, advocates of alternative energy have insisted for years that the internal combustion engine is headed for extinction.) Appearing last month at a Lansing press conference to tout the NextEnergy plan, Doug Rothwell, head of the Michigan Economic Develop Corp. (MEDC) acknowledged that it's unlikely that GM, DaimlerChrysler, or Ford would directly participate. In other words, the most prominent players in the field prefer to keep their findings out of government's hands.

As the MEDC's own benchmark study recently noted: "True economic competitiveness is the sum result of a state's overall business, social, and economic climate."

The whole notion of "dominance"—whether state or national—is, in fact, largely outdated. Consider, for example, the case of computer chips. As chronicled by Everett Ehrlich in The Globalist, Japan's supposed domination of chip production provoked deep anxiety within the United States. But desperate to cover the enormous capital costs of chip redesign and manufacturing, the Japanese unleashed cheap chips the world over. This allowed the United States to focus instead on powerful, productive, and entertaining software.

As Ehrlich notes: "In a world in which you can have access to any resource, product, service good, input, component, or factor, the key to corporate competitiveness is to determine how best to add value to the assortment. It matters far less to control all the steps along the value chain as long as there is easy access to the various components."

State interference also risks limiting potential advances by effectively endorsing one technology over another through special tax and regulatory treatment. This was precisely the case with California's electric vehicle mandate, which diverted years of attention and billions of R&D dollars from more promising technologies. The Engler plan poses a similar risk in prohibiting subsidization of gasoline or diesel-powered hybrids, for example, while a "bio-diesel" mandate is also pending in the Legislature.

If the governor and lawmakers are adamant about promoting new energy technologies, the more effective approach would be to promote as much experimentation as possible.

This is especially important given the tangled technical challenges facing fuel-cell development, which will take decades to unravel. These challenges include the potential environmental threat caused by increased concentrations of hydrogen in the atmosphere, which could exacerbate the build-up of greenhouse gases. According to the Center for Automotive Research (CAR), "Significant invention and refinement still remain before the fuel cell can be considered a viable candidate for mass production vehicles."

To produce a kilowatt of energy with current fuel cell technology costs about $300. The internal combustion engine does it for $30. And building the fueling infrastructure needed to service a fleet of hydrogen fuel-cell vehicles would cost in excess of $100 billion, according to CAR.

Also to be considered are the consequences of the discriminatory subsidies granted by the Legislature. As it is, Michigan ranks second-to-last among peer states in business cost competitiveness. This is largely a consequence of the state's Single Business Tax. But NextEnergy's implicit subsidies would increase this tax burden for non-favored firms. And there is concern that the credits and exemptions could so deplete the state's "rainy day fund" that the scheduled cuts in the SBT would not take effect. If the governor wishes to underwrite R&D, why not simply sell off surplus state land to fund across-the-board tax cuts? This would eliminate the "need" for a costly new bureaucracy and scores of new tax consultants.

As the MEDC's own benchmark study recently noted, "True economic competitiveness is the sum result of a state's overall business, social, and economic climate."

Alternative energy sources will evolve when the prices of conventional fuels exceed the research and development costs for alternative sources. As Cato Institute scholars Ronald Sutherland and Jerry Taylor have pointed out, private firms may underinvest in "good" R&D, but government is far more likely to overinvest in "bad" R&D.

At the very least, the Michigan Legislature should re-examine the Governor's initiative, although Mr. Engler does have a relative solid overall economic record. Lawmakers must carefully consider whether NextEnergy will be the next energy boondoggle. MPR!

Diane Katz is director of science, environment, and technology policy with the Mackinac Center for Public Policy.

Michigan State Industries Needs Competitive Contracting

By Stephen Dresch, Ph.D. and Michael LaFaive

Michigan State Industries (MSI) is a government program modeled on a federal program called Federal Prison Industries (FPI). Both programs employ inexpensive prison labor in the production of goods made for government bureaucracies. Federal prisoners make clothing, vehicle parts, and dozens of other products, and sometimes compete directly—and unfairly—with private, for-profit businesses. MSI makes products as varied as dairy products and shoes. Both FPI and MSI make furniture in competition with Michigan private industry. Both federal and state governments should privatize these programs, either in part or completely.

Federal Prison Industries alone has over 22,000 inmates at its disposal in more than 100 prisons. Prisoners in the FPI system constitute a captive labor force and are sometimes paid as little as 25 cents per hour. At the federal level, agencies are required to buy goods from FPI. Private suppliers are locked out of the bidding process. The result is that FPI can charge government agencies higher prices than would be charged by private vendors for the same goods—and they do, almost 50 percent of the time. This is according to a General Accounting Office analysis of FPI product prices on 20 representative goods.

As of 2000, MSI operated 29 factories in 18 prisons. It pays prisoners an average of $7.00 per hour. The good news is that MSI must compete on a more open and level field than Federal Prison Industries. If a state agency finds a bid for furniture from Haworth Inc., for example, to be more competitive than one from MSI, the agency can award Haworth the contract.

The bad news is that MSI is allowed to see what Haworth or Steelcase, or some other furniture manufacturer, bid on any state contract before it makes its own offer, allowing it to adjust up or down to beat the private vendors and maximize its "profits." In the private sector, this is unethical. In fiscal year 2000, MSI had sales of $42.7 million. While MSI does not require an operating subsidy, the special favors it receives places its private competitors at a distinct disadvantage.

Convict labor serves good and useful purposes. The value of goods and services produced by inmate labor can reduce the net social cost of incarceration; in the absence of prison industries, the forgone product of inmate labor would represent an unnecessary economic loss. In addition, as a result of prison-industry employment, many inmates do leave prison with employable skills and work discipline they lacked upon arrival. Thus, prison industries may well contribute to the prisoners' reintegration into society and reduce recidivism.

Prisoners must earn the right to work in the Michigan State Industries program. One state official described the inmates, who volunteer for this program, as a "warden's best friend," because they are so well behaved. The prisoners left and above are part of the program.

How should we change the system to preserve the social good of voluntary prison labor, while placing the goods it produces on an equitable footing with the markets they serve?

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Feature

"Michigan State Industries" continued from page 11

The solution is simply to create a "free market" for prison labor by allowing businesses to contract for state prison labor.

A bill recently introduced in Congress by Rep. Peter Hoekstra, R-Mich., would allow private companies to compete with FPI based on open and fair competition in the sale of goods to government agencies and prohibit FPI from selling its goods to non-government entities. Michigan legislators should also take action to level the competitive playing field by prohibiting MSI from sneaking a peek at private competitors' bids before submitting the prisoners' bids.

Prisoners make a variety of products, including furniture, which is also produced by several for-profit firms in Michigan.

These ideas would result in a more equitable system. But another way to deal with the problem would be for federal and state governments to allow private firms to competitively bid for the right to use prison labor. In other words, the solution is simply to create a "free market" for prison labor by allowing businesses to contract for state prison labor.

Under such a system, contingent upon their meeting state security mandates, any firm could offer employment to prisoners and would be free to sell the products of prison labor on the open market. Employers would determine wage offers and other applicable conditions of employment.

The costs of security services—for those inmates allowed to work outside the prison—would be borne by the employer, while other incarceration costs (mainly health care and housing) would be borne by the state. Two factors could make up for the extra expense of providing security services: a) wages for such labor will inevitably be lower than for comparable labor on the outside; and b) the state could levy a special payroll tax on prisoner earnings.

Once this, or some similar system, put the economics of prison labor on an even footing with the rest of the labor market, the same thing would happen to this sector that happens with the others: It would eventually find its optimal niche in the labor economy. In other words, removing the unfair advantage prison labor currently holds would, over time, reveal which industries and manufacturers are best able to make use of this unique sector of the labor force. As the system currently operates, this information is prevented from coming to light.

Congressman Pete Hoekstra disagrees with the idea of bidding on prison labor itself, saying "the devil is in the details." He fears that such proposals would scrap safeguards against unfair competition enshrined in today's Prison Industry Enhancement program, which allows for the selling of products made by prison labor in the commercial market under special circumstances. For instance, once a program is certified, prison labor may only be used on projects that would not cause the "displacement of employed workers or be applied in skills, crafts, or trades in which there is a surplus of available gainful labor in the locality, or impair existing contracts for services" among other criteria.

Government should not be able to take unfair advantage of a captive labor force to the disadvantage of hard-working, law-abiding citizens who happen to produce the same kinds of products produced by prison labor. Federal and state prison industries should be reformed to maximize their value to the economy, and to ensure fairness both to prisoners and to law-abiding workers. MPR!

Dr. Stephen Dresch is a Ph.D. economist and a former state legislator who resides in Hancock, Michigan. Michael LaFaive is an economist and senior managing editor of Michigan Privatization Report.

Around the State

Legislation Would Nullify Gains from Privatization

LANSING—The "Public Services Accountability Act" (House Bill 6088) a bill recently introduced in the state Legislature, aims to "create and establish standards of accountability and reliability" for when the government contracts out for the performance of its services.

What it may actually do is make much of the savings that would otherwise be realized by privatization practically impossible.

The bill sets up a requirement that savings of 10 percent be guaranteed in any deal in which government services were to be performed by a private contractor. Then it mandates that companies hired by the government hire workers at rates comparable to government rates. The companies bidding for the privatized services must also operate under the same rules of financial disclosure as government entities, a further cost that cuts down on profitability.

If a company can jump through these hoops and win the bidding process, it still must not try to discourage workers from unionization. It must get the state's permission to subcontract, its books must be open for state agencies to check, and mandatory annual audits would be public information.

After all that, what company would want to take on a government contract? If the measure passes, it will be interesting to see whether there are any takers. To track the progress of this bill, visit **www.michiganvotes.org**.

Will Southfield Privatize the Arts?

SOUTHFIELD—The city of Southfield is considering selling its performing arts center, the Southfield Centre for the Arts, which costs the taxpayers $700,000 in annual subsidies. And no wonder: For many years, the center's ability to help the art community has been in serious doubt. To the great credit of Parks and Recreation Director Bill Waterhouse, he admits that the city can't afford to subsidize an art center and told The Detroit News, "I don't know that you need a special venue to say you're supportive of the arts."

The city has placed a minimum bid on the property of $3,150,000. It is also willing to lease the center, but financial details of a lease arrangement were not available as *MPR* went to press.

The center never was fully modified from its former use as a synagogue and, since then, has fallen into disrepair. The city didn't spend enough money to properly transform it at its conception and has not been able to allocate enough money for its proper upkeep. The performance stage has no backstage or dressing rooms. Lighting is poor, security poses special problems, and furniture has deteriorated to the point that it is almost useless.

The city tried to salvage the center, renting out some of the space for conferences and other special events. However, the plan never greatly reduced annual subsidies.

But not everyone agrees with privatization. In the March 12 edition of The Detroit News, Collette Gilewicz, director of the Southfield Philharmonic and executive director of Young Audiences of Michigan is quoted as saying the fact that the center is not making a profit is irrelevant, and that other programs such as the public golf course are not making a profit either.

We agree. The golf course should be privatized, too.

Privatization would determine whether there actually is demand in the Southfield community for an arts center, or whether the building or property could be better put to some other use. After all, the Ford Community & Performing Arts Center is practically next-door in Dearborn. It has a $10 million annual operating budget and the building is new.

Blues May Go Private

LANSING—Great minds think alike: In its Winter 2002 issue, *MPR* published "Privatization and the Blues" in which it advocated privatization of Blue Cross Blue Shield of Michigan (BCBSM), a quasi-public, nonprofit health insurance firm that controls over 50 percent of the health-insurance market in Michigan.

In his January State of the State address, Gov. John Engler also announced his desire to see BCBSM change from its current setup into an investor-owned, private, for-profit business model.

This would not only help Michigan consumers, but would also help BCBSM stay competitive, raise needed financial capital, and offer management flexibility that is impossible under the current arrangement. It would also stop the hemorrhaging of funds—BCBSM has lost around $400 million in the past five years.

Around the State

Of course, some oppose the move. In an Ann Arbor News commentary, BCBSM Senior Vice President Richard Cole said the proposal "jeopardizes the Blues' historic mission." But if that were true, Blue Cross as a force on the national health care scene would be in serious trouble. It just so happens that BCBS affiliates in 14 states nationwide have done the very thing Cole says would jeopardize their mission— converted to investor-owned companies—and they're doing better than ever. In fact, Michigan's BCBS affiliate is the last state-controlled plan of its kind in the nation. The Blue plans in states that surround Michigan—those in Ohio, Indiana, Illinois, and Wisconsin—have consolidated or become stock companies.

The only mission privatization jeopardizes is BCBSM's historical tendency to operate in the red. To track the progress of legislation designed to privatize BCBSM (HB 6046) visit **www.michiganvotes.org**.

Calls Heard for DDA's Privatization

FLINT—On April 23, The Flint Journal called for private solutions to Flint's poorly performing Downtown Development Authority (DDA).

According to the Journal, The DDA long ago ceased to be the main locus of activity for downtown development, handing its mission by default to private agencies such as Uptown Reinvestment Corp., which recently began work on a $400,000 plan for downtown improvement. Privatization of the DDA and consolidation of its organization with other private groups would relieve the taxpayers of the subsidy the DDA has been receiving since its inception in 1970.

Flint wouldn't be without examples to follow in this regard. On Feb. 4, Hamtramck's Emergency Financial Manager Louis Schimmel announced that he would dissolve Hamtramck's DDA, citing the authority's inability to get any project done. In announcing the move, Schimmel pointed out that downtown businesses would receive a two-mill tax deduction. While Hamtramck's DDA may return as a formal organization it will have neither taxing power nor its four-member staff as it had before. The DDA has effectively been reduced to a committee that oversees local development projects.

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For more on the nature of local economic development agencies, see "Local Economic Development: Public or Private? in the Summer 1999 edition of *MPR*. If Hamtramck and Flint successfully hand over these duties to the private sector, they will provide a model for others to follow.

Privatize the "Porkies?"

SILVER CITY—People who ski the Porcupine Mountains Downhill Ski Area call it a unique experience, with its breathtaking view of the world's largest freshwater lake. So popular has the resort become that last winter "the Porkies" had its third-best season ever in terms of revenue.

Is ski resort ownership and management a proper function of state government?

It only lost $140,000.

Why the poor performance? It may be because the Porkies resort is state-owned and operated. Any privately owned resort that posted such results might go out of business or be taken over in short order by somebody who could run it at a profit. But when the state mismanages matters that properly belong in the private sector, its government-owned status makes change easier to put off.

Yet, the realities of the marketplace can't be completely ignored, and to the state's great credit it is looking at ways to make the resort more solvent. For instance, state officials have considered closing the resort on weekdays, cutting costs, and raising ticket prices.

At Indianhead Ski Resort, tickets are $36 on weekends or holidays; at Boyne Mountain, they cost $43 on Saturday and $45 on holidays. At the Porkies, the price is $28, and the price last year was $25. Indianhead charges for children older than six; at the Porkies, children ski free until age 12.

Of course it's nice to go to a ski resort that costs much less than usual. What skiers—and the rest of us who don't ski—tend to forget is that state ownership of such recreational facilities

are precisely the kinds of investments that make our tax bills go up.

The state might consider privatizing the resort as a way to save money and ensure that people get access to the ski area. Greg Hokans, tourism director for the Western Upper Peninsula's Big Snow County studied privatization of the "Porkies" ski resort and concluded that its management might be best placed in the hands of a private vendor. "Does the state really belong in the ski business?" he asked.

Social Service Aides Not Fans of Outsourcing

DETROIT—Union leaders and school administrators are speaking out against a proposal by the Detroit school district that it be allowed to contract out for social worker and psychological services in the city's schools. The proposal is part of a larger plan to improve schools by increasing the quality of education while lowering the cost.

The school district has already had success outsourcing food service, maintenance, and lawn care, so why not social services and counseling?

Janna Garrison, president of the Detroit Federation of Teachers, told The Detroit News it was "appalling" that administrators may use private-sector counselors and psychologists for jobs directly affecting students. She and others in the administration believe outside agencies wouldn't have as much of a stake in the school or the students, but would only do what was necessary to collect their reimbursement.

Earlier this year, such reactions scared then-Detroit schools chief Kenneth Burnley into cutting only 24 social workers from the district's payrolls instead of the 49 originally planned.

MGM Grand Bids on Executive Plaza Building

LANSING—The state of Michigan is selling its old Executive Plaza Building on 6th Street in Detroit to the MGM Grand Detroit Casino. On April 12, the MGM bid $12.5 million for the building, surprising many who believed its CEO, John Redmond, who told reporters the night before the deal was consummated that the casino management had made no decision about changing venue.

MGM, along with the Greektown and MotorCity casinos, is required by the city to build more lavish properties, and speculation had long been that MGM might be eying the facility as a permanent location. Even though MGM and the state are still negotiating, since MGM was the sole bidder, the state must accept the bid.

A Spark of Privatization in Flint

FLINT—The city of Flint has sold its IMA Sports Arena to local physician and entrepreneur Khaled Shukairy for $2.2 million. The arena, used by the city for everything from hockey tournaments to cat shows, has been in desperate need of repairs for some years.

As Flint faces takeover from the state for maintaining what may be a $40 million-plus deficit, the council saw little opportunity to maintain the facility. Councilman Lawrence B. Murphy was resigned to the sale, telling the Flint Journal "[W]e truly have a jewel here, but we're going to lose it."

The jewel in question may need as much as $8 million in repairs and renovation to keep it operable. Last winter there were reports of rodent infestation and a heating system that was in such bad repair that basketball fans had to wear their winter parkas indoors during games. The huge space heaters brought in to alleviate the cold often drowned the sounds taking place on the court.

Flint city council members had discussed having Genesee County take over the jewel but found Shukairy's offer to be the best of several alternatives.

"Grocery" continued from page 16

by criminals. If the neighborhood were to change somehow, it might be able to support a grocery store.

But instead of focusing on creating a better overall business climate in this area—by reducing crime and improving roads, for instance—NACD officials are trying to generate "economic development" by forcing taxpayers to support a store in an area already repudiated by shoppers and business alike.

So far, as one might expect, progress on the grocery store has not been good.

When they were approved for the $1 million grant from the state in January, 2001, NACD officials pledged to have the grocery store open by December of that year. Eighteen months later, the proposed site houses only an abandoned industrial building. The NACD needs to raise $4 million in private funds to build the store. To date, it has raised less than a quarter of that amount. Apparently, private-sector investors are more skeptical of this project than central planners at the MEDC.

Then again, private investors are investing their own money. The MEDC is investing yours—the taxpayers'.

Raymond Wilson is a former county commissioner and founding member of the Kalamazoo County Taxpayers Association.

If You Build It, They Won't Come

By Raymond Wilson

What makes government think it can succeed where real entrepreneurs with first-hand knowledge of the grocery business have failed?

Question: If three major grocery chains had set up stores in a particular neighborhood and those stores subsequently went belly up, would you say this represented a whiz-bang of an investment opportunity? Not likely. But then, you're not an official with our state's dispenser of corporate welfare, the Michigan Economic Development Corporation (MEDC). The state should leave investment in private firms in private hands by getting out of the business of picking business winners and losers.

The MEDC has promised $1 million to the Northside Association for Community Development (NACD), a neighborhood association funded in part by the city of Kalamazoo. Why? So the NACD can boldly go where three have failed before: It wants to build a $5 million grocery store in the same neighborhood, on the north side of the city of Kalamazoo, where Meijer Thrifty Acres, Family Foods, and Foodtown have each failed with stores at various times during the 1960s, 1970s, and 1980s. Thus far the MEDC has disbursed $200,000 of the $1 million grant to NACD.

This functioning church building was the site of three previous grocery store attempts that failed in Kalamazoo. The state of Michigan and the Northside Association for Community Development intend to subsidize the construction of a new grocery store nearby.

What makes government think it can succeed where real entrepreneurs with first-hand knowledge of the grocery business have failed? How bad does an investment environment have to be before government bureaucrats lose their faith in subsidies?

The neighborhood into which the NACD wishes to place its grocery store has a higher crime rate and poorer basic infrastructure than the rest of Kalamazoo. It's difficult to attract shoppers to an area where they fear being victimized

see "Grocery" on page 15

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