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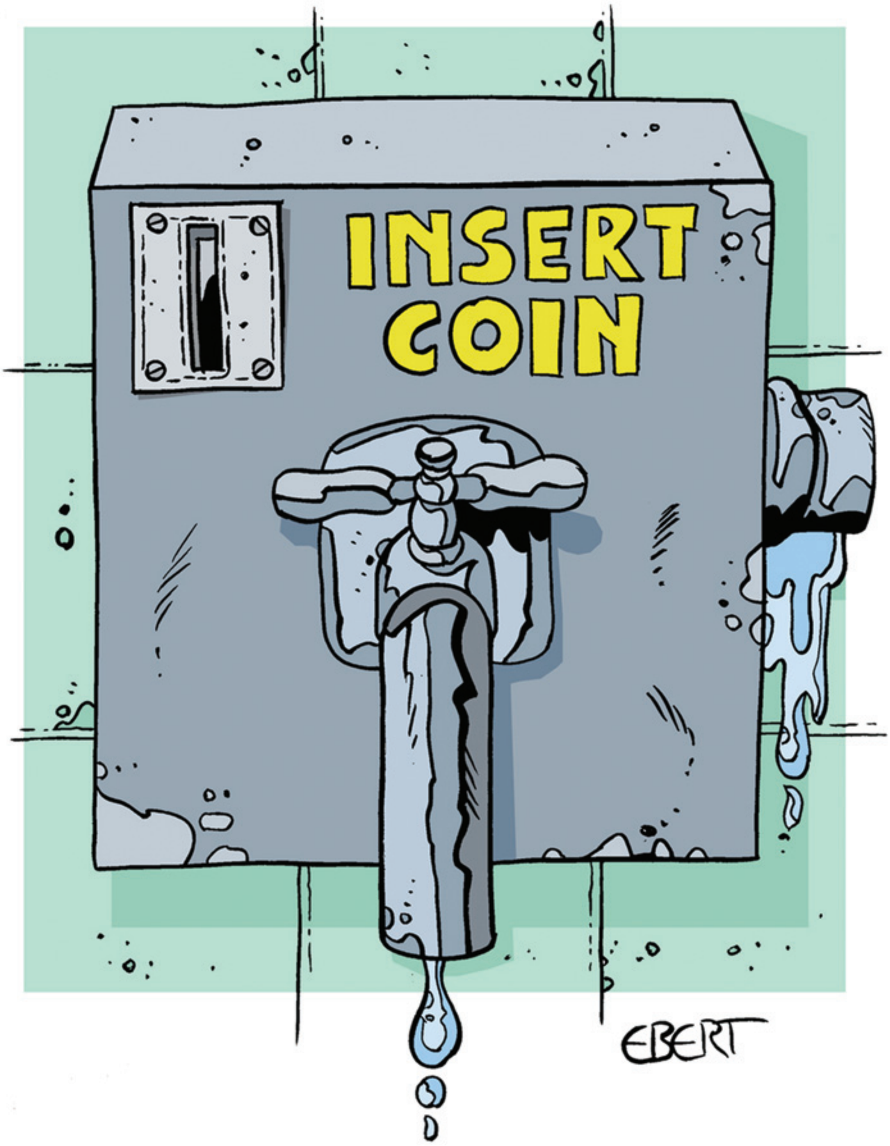

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Looting the Urban Commonwealth: Privatization and the Politics of Austerity

Elliott Sclar[1]

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Privatization, the turning over of *operational control* of socially important goods to private parties, has far larger social costs than are recognized in the way its promoters frame the debate. They present privatization proposals in abstract terms that mask their true complexity: for example, contracting out the delivery of public education to charter schools is portrayed as little different, as a matter of market-based competition, from seeking a contractor for the delivery of office supplies. But measured in terms of social import, there is a vast difference between the purchase of a ream of paper and the education of the citizenry. The former is a commonplace transaction with little impact beyond the money for goods exchanged between buyer and seller. The latter is a core government responsibility, integral to the public sector's primary duty to promote the general welfare. Social goods, such as public education, differ vastly from private goods such as office supplies because their full value to society is not captured in the dollar value of the market transaction between the buyer and seller. When goods that create these powerful and broad indirect benefits, called social goods, are left to the vagaries of private markets, it is well known that they will be under-produced relative to their social value.

Because social value is almost never captured in the prices that the direct beneficiaries are able or willing to pay, questions of public finance and cost recovery become especially important. Here, too, privatization promoters seek to muddy the waters. There is no theoretical reason, they argue, that social goods cannot be provided by private contractors through properly written contracts. However, when the real-world practicalities of meaningful public oversight, inevitable uncertainty about changing events, and/or necessary public subsidies are considered, the prospect as even a purely economic proposition becomes less appealing. Nonetheless, it is upon this theoretic abstraction that the entire edifice of privatization promotion stands. Whether privatization is implemented through a service delivery contract (charter schools) or a long-term contractual obligation to maintaining a revenue-producing item of public infrastructure via a "public private partnership" or "P3" (tolled highways), the underlying promotional argument remains the same; a contractual private provider will somehow, thanks to "market competition," provide the publicly required goods better, faster, and less expensively than could the public sector through direct production.

> ***The country is presently awash in proposals for the privatization of water and wastewater systems.***

That is the theory; practice over several decades has proven to be an entirely different matter. By now we have, literally, file drawers full of case-based evidence and studies[1] that document that privatization does not work as

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predicted, too often providing inferior goods at higher prices with more delays. Despite this, the drive to privatize continues. The reason is simple. Regardless of how poorly any venture turns out, virtually all of them are profitable for the promoters and providers. The structural cause of this situation can be summed up simply: privatization invariably privileges the profit needs of private providers over the vital social goods needs of society.

Down the Drain

These failures are particularly evident in the case of water and wastewater services. Because of the impact of the fiscal crisis on municipal budgets and a desire not to raise taxes, the upfront sale of public assets with revenue streams attached has become an attractive alternative for local officials. This is the core idea behind the current popularity of P3s. The most sought after assets by private investors are ones where fees are already charged for use. That is why the country is presently awash in proposals for the privatization of water and wastewater systems. But there are no free lunches in these deals. Essentially, they are nothing more than an exchange of cash in the present for higher payments in the future, little different from the payday loans that often ensnare poor people. George Marlin, director of the Nassau County Interim Finance Authority,[2] said about the local County Executive's proposal to privatize wastewater treatment via a P3 that in his thirty-five years as an investment banker, "I have never come across such an ill-conceived plan." Marlin explained,

> The County expects to select a private investor who will finance $850 million to pay down existing low interest cost tax-exempt sewer debt and County debt. *This is a form of backdoor borrowing.* Potential financial investors who invest money to Public–Private Partnerships (P3s) expect annual returns of 10 percent to 15 percent. . . . To use such costly funds to pay down low interest tax-exempt County and sewer debt makes no sense. *This would be like drawing down the credit line on one's VISA card at 15 percent interest per year to pay down one's home mortgage, which has a 4 percent annual interest rate.* Sheer folly![3]

If it were simply a matter of evidence-based policymaking, using examples such as the Nassau County situation, progressives and organized labor would have won this public policy battle long ago. Instead, if we are to have any hope of restoring vital public sector capabilities to provide socially necessary goods, we must drastically reframe the discussion. Merely showing the multiple failures of privatization is a necessary condition. Sufficiency requires that we expand the debate to ensure that it includes a fuller understanding of the organizational and economic contribution that a robust public sector makes to the survival of a democratic society. Lost in the purely economic-market terms of debate are the countless organizational ways that the service rearrangement not only undermines important public sector functions but also, more importantly, destroys the quality of life in American society.

The Contractual Trap

When governments enter into contractual arrangements for the production of public services, they irrevocably limit their capacity to serve the public. There is almost never an easy or inexpensive way to undo a bad deal: the public sector often cannot pay the costs and penalties for dissolving the contract, and the longer the elapsed time the more difficult it becomes to restore public sector capacity to undertake the work. In 1995, for example, California agreed to lease a ten-mile strip of median on State Route 91[4] to the California Private Transportation Company (CPTC), permitting it to construct a toll lane that would permit those willing to pay more to get a faster trip on what was becoming a highly congested "free" route. To ensure revenue for the CPTC, the state agreed to a non-compete clause preventing any improvements along thirty miles of SR91. As this kept it from important regional transport upgrading, the state was, in 2003, forced to buy out the contract at a cost of $207.5 million.[5,6]

More insidious than the loss of public capacity has been the growing dependence of private capital on public revenues. A recent report from J. P. Morgan asset management ("for institutional and professional investor use only") shows why:

> . . . we believe we are rapidly approaching a tipping point where institutional investors searching for income, frustrated by lackluster economic growth prospects and dissatisfied with the volatility of public equity markets, are turning to infrastructure in larger numbers and with greater allocations.[7]

The attraction for private investors is the public sector's ability to generate guaranteed revenue streams from fees, tolls, and taxes. As a result, capital markets are increasingly dependent upon the expansion of privatization efforts into more areas of public life. It is the predictable outcome of the continuing search by investors for large and low-risk returns on their wealth in an age of stagnant growth and large accumulations of private capital. Wall Street enthusiasm is easy to understand.

> In the past year, banks and private investment firms have fallen in love with public infrastructure. They're smitten by the rich cash flows that roads, bridges, airports, parking garages, and shipping ports generate—*and the monopolistic advantages that keep those cash flows as steady as a beating heart.* Firms are so enamored, in fact, that they're beginning to consider infrastructure a brand new asset class in itself.[8]
>
> Infrastructure is ultra-low-risk because competition is limited by a host of forces that make it difficult to build, say, a rival toll road. With captive customers, the cash flows are virtually guaranteed. The only major variables are the initial prices paid, the amount of debt used for financing, and the pace and magnitude of toll hikes—easy things for Wall Street to model.[9]

The ongoing impairment of public sector capacity combined with the growing dependence of private investors on public revenue sources make the political and economic challenge of economic efficiency and social justice far more difficult.

On-Street Parking in Chicago

To illustrate how this operates, consider Chicago's experience with on-street parking. In a deal put together by Morgan Stanley and then-mayor Richard Daley, Chicago leased its entire system of thirty-six thousand metered parking spaces to a private company created solely to administer the city's on-street parking and capture the parking revenue in return. The lease was set at seventy-five years or about three generations, in return for which a new corporate entity, Chicago Parking Meters LLC, owned by Morgan Stanley and other investors,[10] made an upfront payment of $1.157 billion to the city. The entire period of public consideration went from the mayor's public announcement of the proposal on December 2, 2008, to final City Council approval (by a vote of forty to five) on December 5, with no real analysis of the details or debate about alternatives. The result, from a public point of view, was a complete economic debacle.

The service rearrangement not only undermines important public sector functions, it destroys the quality of life in American society.

In June 2009, a report by the city's Inspector General concluded that the government failed to fully assess the costs and benefits of the arrangement. More importantly, the City entered into this arrangement to cover a short-term budget gap rather than for the long-term advantage that P3s are supposed to provide. It concluded that

> . . . if the City were to keep control of the parking-meter system and operate it under the same terms as the private

> company, the system would be worth approximately $2.13 billion to the City over 75 years. In other words, by giving up control of the parking-meter system for 75 years, the City relinquished future parking-meter revenue that has a present value of approximately $2.13 billion.[11]

To fully appreciate how bad this was, consider the following. Chicago is now reputed to have the highest on-street parking rates in the country.[12] In 2008, the last year the city operated the thirty-six thousand old-fashioned parking meters, they yielded just over $23 million in revenues. In 2011, parkers paid Chicago Parking Meters LLC more than $109 million in fees,[13] a revenue increase of 374 percent in four years. It is not "the city" that is paying this money to the investment banker and their bondholders; rather the money is, in effect, a publicly enforced but privately collected "tax" on drivers, many of whom do not have alternatives. It means, in essence, that Morgan Stanley and its partners are getting returns on their investment through their ability to squeeze revenue from people of modest means for the privilege of using public streets that they already paid for.

In 2011, parkers paid Chicago Parking Meters LLC more than $109 million in fees. The money is, in effect, a publicly enforced but privately collected "tax" on drivers, many of whom do not have alternatives.

In terms of the antitax climate of the times, this does not engender much outrage from the Tea Party political right because parking meter rates are called fees and not taxes. Moreover, because the fees go to a private corporation and not the public treasury, these same drivers are squeezed further in their role as taxpayers because they still have to pony up additional money to continue receiving services of deteriorating quality.

Of course, privatization promoters point to Chicago, as they do with all failed privatization efforts, as an anomaly. The standard argument is that when a privatization fails, it is because the public partner lacked either the skill or the proper due diligence to do it correctly. It is not very different from the victim-blaming that accompanies cuts to services or benefits for the poor.[14]

The problem, of course, is that these arguments never address the larger costs that governments incur as they transform themselves from comprehensive agencies of public governance into serial contract managers who operate government on a project-by-project basis. The result is that the contractual obligations to private bondholders quickly come to supersede obligations to serve the public, as government gives over its mandate to serve the general public through the invariably changing conditions that time imposes in service to their contractual obligations. The consultants who promote these deals maintain that if the government goes through a hypothetical exercise of estimating what they call the "value for money" over the life of the project, they can see exactly how much they will save. But as the Government of Ireland, a privatization supporter, admitted, "The overall value for money of a project can only be fully determined at the end of the PPP contract term."[15] Thus, there is really no way before the fact to know whether privatization is cost-effective, giving new meaning to the expression "faith-based initiatives."

There is really no way to know, beforehand, if privatization is cost-effective, giving new meaning to the expression "faith-based initiatives."

In fact, there is simply no good way to forecast the changing conditions that society faces over any significant period of time. It is for that reason that private businesses do not contract out services or facilities critical to their central mission. Yet, the validity of privatization is always presented as if the future can be forecast well if only the proper managerial and accounting techniques had been employed.

Reframing the Issue

In the Chicago example, parking spaces are defined as nothing more than a commodity, and the contract merely a question of the economics and finance of leasing them out. But what the city did in effect was relinquish control over valuable lanes of publicly built street capacity, transforming them into a privately controlled revenue-generating asset for an unaccountable group of private investors.

That contract limits the city's ability to undertake many of the functions that twenty-first century urban life requires, ranging from street repairs and reorganized public transport to such urban quality of life issues as simply closing the streets for street fairs. Any such attempt requires Chicago to either compensate "the owner" of its curbside street lanes or reach some other accommodation with them.

One of the major challenges that today's cities face is improving urban access while cutting carbon emissions, which for older cities especially will require more flexible use of its street lane capacity. For example, bike lanes and bike sharing programs are being rapidly expanded in Chicago as elsewhere, but unlike New York where the city owns the streets, the placement of docking stations is constrained by the parking spaces "owned" by Chicago Parking Meters LLC, as is the ability to turn lanes of street space over to bicyclists.

More important are the implications for the expanded use of public transportation. Cities everywhere are turning to something called Bus Rapid Transit (BRT), which when given exclusive street lane capacity and operated properly can achieve passenger volumes and travel speeds that approach those of metros and subways. Passengers pre-pay at boarding stations along the route and thus quickly board and disembark much as they do on a subway or metro. But this requires a redeployment of street capacity away from the automobile and hence from lane capacity devoted solely to parking. Once again, it is the case that Chicago has plans for some BRT routes, but its ability to create an extensive system is severely limited by its obligations to the bondholders of Chicago Parking Meters LLC.

Indeed, the Morgan Stanley group could construe almost anything the city does to discourage auto parking as a compensatory event. This spring, Mayor Rahm Emanuel reached an accord with Chicago Parking Meters LLC to mitigate penalties Chicago incurred over the last two years, for such things as hours of operation and parking rates.

> The new contract also provides free parking in many neighborhoods on Sunday, but extends the hours of paid parking on most other nights. The new deal also means that the private company can use the city's database to determine how much it owes for penalties.[16]

A New Social Contract for Labor

When all is said and done, it is also important to remember that privatization is primarily promoted by a powerfully antiunion coalition. For them, it is not just a matter of busting public sector wages; it is perhaps even more a matter of busting the political power that unionization gives public workers. The public sector is, right now, the last stronghold of a trade union movement that, over the course of the twentieth century, delivered a fair share of America's bounty to its vast middle class. Privatization is always an attack on that social equity, whatever else it might be as an economic or political proposition.

Therefore, it is important to avoid getting stuck in a narrow economist framing of the debate as an argument over the design of public contracts. The concern in framing the debate must be with the ideological misuse of contracting. As defined and used by libertarian ideologues and antiunion business interests, contracting cum privatization is intended to disempower the public sector and especially the organized labor within its ranks.

We need to be clear that unions are concerned with enhancing the efficiency of public work to deliver urgently needed high-quality social goods. A promising way forward in this endeavor can be found in the recent efforts of public sector union locals to reach beyond concerns with their working conditions to create a new model of a union with a social service mission. Two recent examples illustrate the point: the Chicago Teachers Union[17] and Local 732 of the Amalgamated Transit Union (ATU) based in Atlanta, Georgia. In both cases, these local unions have effectively linked their concerns with working conditions and compensation to their communities' need for services. To do that, they found ways to make common cause with those they serve. In Chicago, where the teachers union reached out to the students and parents, when the union called a strike last September, they had widespread support in the community. One of the T-shirts worn by the students read: "When you disrespect my teachers, you disrespect me." In Atlanta, the largely African-American ATU membership has joined forces with the ridership of their public transit system, MARTA, to fight efforts by the rural and Republican-controlled state legislature to privatize the system. (Full disclosure: I am a consultant to the ATU in this effort.) Curtis Howard, President of Local 732, speaking at a March 5, 2013 rally at the state capitol after the union and its allies successfully stalled passage of a bill to privatize MARTA, said,

> This is the people's victory, for thirty some years we have given all we have as workers to put our time and resources to make sure our children, the community, the disability groups, and everyone moves safely through the city. We are going to stand up. We ain't gonna take it any more.[18]

For too long, politicians of both parties have been permitted to transform the debate about the proper role of government from a discussion of democracy to a narrow debate on contracting structures. It is time to change the conversation. The positive reactions that these local unions received point toward a promising way forward in creating community and labor coalitions to fight privatization and public sector asset-stripping.

In Atlanta, the ATU has joined forces with [transit riders] to fight efforts by the state legislature to privatize the system.

If labor and community-based organizations are going to break out of the present terms of debate over the delusional pursuit of some abstract ideal of "competitive contracting," the key is going to be the ability to challenge the unquestioned notion that public finance is the real and binding economic constraint. The reality is that it is nothing more than a manufactured political construct to shift the burden of government costs from the rich and onto the middle class. Absent taking on that fight, we are chronically stuck in the position of reactively critiquing the many faults of privatization. While critiquing must continue, it is not sufficient for building a positive movement to defend the importance of public sector work to a vibrant democracy.

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Notes

1. See, for example, Germa Bel and Mildred Warner, "Local Privatization and Costs: A Review of Empirical Evidence" (working paper, University of Barcelona and Cornell University, 2007); Graeme Hodge, *Privatization: An International Review of Performance* (Boulder, CO: Westview Press, 2000); Elliott Sclar, *You Don't Always Get What You Pay For: The Economics of Privatization* (New York: Cornell University Press, 2000); George Boyne, "Bureaucratic Theory Meets Reality: Public Choice and Service Contracting in U.S. Local Government," *Public Administration Review* 58, no. 6 (1998): 474-83.
2. An oversight entity created by New York State when Nassau County faced potential bankruptcy.
3. See George J. Marlin, "On the County Sewer Debt Plan," Nassau Interim Finance Authority statement, May 17, 2012, available at http://streetcornerconservative.com/2012/05/21/nifa-statement-on-the-county-sewer-debt-plan-may-17-2012-by-george-j-marlin, emphasis added.
4. State Route 91 runs across Southern California from the coast inland.

5. Marlon G. Boarnet and Joseph F. DiMento, "The Private Sector's Role in Highway Finance: Lessons from SR 91," *Access* (the magazine of the University of California Transportation Center), no. 25 (Fall 2004), available at www.uctc.net/access/25/Access%2025%20-%2005%20-%20Lessons%20From%20SR%2091.pdf.
6. Ibid. According to one estimate, the original construction costs for this lane in the late 1990s was $82 million.
7. "Too Good to Last: Core Infrastructure's Lopsided Rising Risk/Return Premium Expected to Moderate," Investment Insights, May 2013, www.jpmorganinstitutional.com/cm/Satellite?blobcol=urldata&;blobheader=application%2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1321504103203&ssbinary=true (accessed May 20, 2013).
8. Emily Thornton, "Roads to Riches," *Business Week Online*, May 6, 2007, http://www.businessweek.com/stories/2007-05-06/roads-to-riches (accessed August 2009), emphasis added.
9. Ibid.
10. Including the sovereign wealth fund of Abu Dhabi.
11. See City of Chicago, Report of the Inspector General's Finding and Recommendations: An Analysis of the Lease of the City's Parking Meters, June 2, 2009, available at http://chicagoinspectorgeneral.org/wp-content/uploads/2011/03/Parking-Meter-Report.pdf.
12. See Lorene Yue, "Chicago: America's Priciest Downtown Parking Meters," *Crain's Chicago Business*, December 27, 2012, available at www.chicagobusiness.com/article/20121227/NEWS07/121229910/chicago-americas-priciest-downtown-parking-meters.
13. See Carol Marin and Don Moseley, "Company's 2012 Parking Revenue Still Unknown," NBC 5 Chicago, May 7, 2013, available at www.nbcchicago.com/blogs/ward-room/chicago-parking-meters-2012-revenue-206354621.html#ixzz2TebDTHD9.
14. See *Testing Tradition: Assessing the Added Value of Public-Private Partnerships* (Arlington, VA: The National Council for Public-Private Partnerships, 2012), available at www.ncppp.org/wp-content/uploads/2013/03/WhitePaper2012-FinalWeb.pdf.
15. "Value for Money and the Public Private Partnership Procurement Process," Central PPP Unit, Department of Finance, Government of Ireland (October 2007). See http://ppp.gov.ie/wp-content/uploads/file/Value%20for%20Money%20and%20the%20PPP%20Procurement%20Process.doc (accessed on August 6, 2009). It is noteworthy that the term *value for money* does not necessarily mean that the P3 is the least costly way of producing the good; it simply means that the discounted benefits of the P3 *appear* to exceed their discounted costs at the moment that the decision is made. Hence, the use of the term *value for money* is simply meant as assurance to the general public that this ideological approach is not abusing public money even if it is not maximizing efficiency.
16. Caroline Porter, "Chicago Revises Parking-Meter Deal," *Wall Street Journal*, April 29, 2013, available at http://online.wsj.com/article/SB10001424127887323798104578453294122250864.html.
17. Robert Barlett, "Creating a New Model of a Social Union: CORE and the Chicago Teachers Union," *Monthly Review* 65, no. 2 (June 2013).
18. For further information, see Local 732 at http://transitweb.atu.org/sites/South/Local732.

Author Biography

Elliott Sclar is a professor of urban planning at Columbia University. His book *You Don't Always Get What You Pay For: The Economics of Privatization* is published by Cornell University Press.