EMERGING LEADERS PERSPECTIVES

Global Era • Different Challenges • New Priorities

No Free Money: Is the Privatization of Infrastructure in the Public Interest?

September 2010

THE CHICAGO COUNCIL ON GLOBAL AFFAIRS

EMERGING LEADERS PERSPECTIVES

Global Era • Different Challenges • New Priorities

No Free Money: Is the Privatization of Infrastructure in the Public Interest?

September 2010

SPONSORED BY

THE CHICAGO COUNCIL
ON GLOBAL AFFAIRS

The Chicago Council on Global Affairs is a leading independent, nonpartisan organization committed to influencing the discourse on global issues through contributions to opinion and policy formation, leadership dialogue, and public learning.

The Chicago Council provides members, specialized groups, and the general public with a forum for the consideration of significant international issues and their bearing on American foreign policy.

For further information about The Chicago Council or reports, please write to The Chicago Council on Global Affairs, 332 South Michigan Avenue, Suite 1100, Chicago, Illinois, 60604; email info@thechicagocouncil.org; or visit www.thechicagocouncil.org.

Printed in the United States of America.

Table of Contents

Foreword

Half of the world's population currently lives in urban areas, and projections suggest that ratio will increase significantly over time. Urbanization and cities are the future, and leaders worldwide are struggling to finance the expensive and essential costs for maintaining and updating aging infrastructure. As policymakers consider all options for raising new sources of revenue, the issue of privatizing government-owned assets is increasingly raised. Privatization has been popular in Europe for decades, but the United States is just now giving it the serious attention that it deserves.

Chicago has been identified as a leader in the United States when it comes to privatizing initiatives, and deals involving Midway Airport, parking meters, and the Chicago Skyway toll bridge have placed our great city at the forefront of both creativity and criticism. Chicago has much to learn from its international counterparts about the challenges and opportunities of using this policy tool to facilitate investments, particularly in regard to the equity of the deals to future generations; but the city can also share its experience with other U.S. cities looking to revitalize their local economies.

Foreign policy organizations such as The Chicago Council typically do not address this kind of issue, but the Council began grappling with urban financing and infrastructure investments in its 2007 study group report, *The Global Edge: An Agenda for Chicago's Future*. The study group argued that no city can compete globally without twenty-first century infrastructure, and that Chicago's is so antiquated and inadequate that it is without question one of the city's greatest challenges for maintaining and improving its global stature. Exploring ways to finance this expensive endeavor, however, was an idea raised by the Emerging Leaders Class of 2008. And this is exactly the kind of issue the program was meant to identify: bold challenges that city leaders will be dealing with ten, twenty, or thirty years from now.

The Chicago Council launched the Emerging Leaders Program in 2008 to engage Chicago's next generation of leaders who will help equip the city to compete and thrive in the global era. Our current leaders have brought Chicago success as it has transitioned out of the industrial era. Now, the Council is engaging individuals who are already dynamic leaders in their fields, but of whom even greater leadership is expected in the years to come. They have been identified by their mentors and selected by an independent committee as Chicago's leaders of tomorrow. Over the course of our two-year program, these Emerging Leaders examine a variety of global issues with local impact and then choose an issue on which to take a "deep dive." They have not come together as experts but rather as engaged citizens deeply concerned about Chicago's global future. Their shared commitment is what holds a group like this together, and allows each participant to bring a unique perspective to the table.

I am personally delighted that they chose such an unexpected and yet globally relevant topic to explore. This publication is not to be read as an expert document but rather as an informative and substantive piece from a concerned citizenry. Through extensive deliberations and an exchange that allowed them to learn more about themselves, their role in policymaking, and one another, they came to very thoughtful findings and recommendations that we expect other policymakers and ordinary citizens alike will find helpful.

All seventeen members of the Class of 2008 worked hours on this report and contributed to the final project. But I want to recognize the extra time and dedication provided by the self-created editorial board: Piyush Chaudhari, Zach Egan, Stephen Haggerty, Joshua Hale, S. Raja Krishnamoorthi, Sean Ryan, Roger Shores, and Charles Wheelan, the lead editor and writer of the final report. I also want to thank Tracey Scruggs-Yearwood who used her multimedia skills to create a supplemental short film on public-private partnerships.

The class was briefed by experts on privatization, and I would like to express the Council's gratitude to Armeane Choksi, adjunct professor of business and public policy at the Wharton School of the University of Pennsylvania; Rob Collins, managing director and head of infrastructure banking for the Americas at Greenhill and Co.; William Megginson, professor and Rainbolt Chair in Finance at the University of Oklahoma; Michael H. Moskow, vice chairman and senior fellow for the Global Economy at The Chicago Council on Global Affairs; Gene Saffold, chief financial officer of the City of Chicago; John Schmidt, partner at Mayer Brown, LLP; James M. Sweeney, president-business manager of Local 150 International Union of Operating Engineers; and Paula Wolff, senior executive at Chicago Metropolis 2020, for taking time to meet with this group, share their knowledge, and provide guidance.

I would also like to sincerely thank the members of the Emerging Leaders Selection Committee. This independent committee, cochaired by Council board members John F. Manley, president, Chicago City Capital Group, Inc., and Shirley Welsh Ryan, chairman, Pathways Awareness Foundation, dedicated many hours of their time to identify this diverse and exceptional group of leaders. The Committee's leadership and commitment to this program and to The Chicago Council is invaluable.

Chicago Council staff also worked closely with the group, helping to shape the agenda, providing resources, and keeping them on schedule. Thanks to Rachel Bronson, Juliana Kerr Viohl, Natasha Karpasov, Mia Luhtanen Arter, and intern Amit Damani. Catherine Hug and Ellen Hunt edited the final report and made major contributions.

And finally, enormous gratitude goes to the McCormick Foundation for funding the Emerging Leaders Program and to the Searle Funds at The Chicago Community Trust for their generous support for printing and disseminating this final document. These projects are a labor of love, but they require real resources, and we could not have developed this program without the contributions of such committed and ongoing supporters.

Marshall M. Bouton
President
The Chicago Council on Global Affairs
September 2010

Executive Summary

Chicago is leading the nation in the wave of privatizations. No other American city has been so aggressive in putting public resources into private hands. The transactions are worth hundreds of millions, or even billions of dollars, and have financial implications for current and future generations. Though the City and its advisors have arguably demonstrated financial savvy in structuring these transactions, they have occurred without meaningful public debate regarding how they serve the City's long-term goals, that is, how each privatization might constrain or advance the City's social, economic, or even environmental objectives.

The trend toward infrastructure privatization is happening not just in the United States, but globally. Public authorities in Europe and much of the developing world have been unwinding infrastructure assets for no less than three decades, with a quickening trend in recent years. Most major European airports, including those in London, Frankfurt, and Paris, are owned and operated by publicly traded corporations.

This report, authored by The Chicago Council on Global Affairs' Emerging Leaders Class of 2008, is an effort to better understand the benefits and risks of privatization, distill lessons learned from across the world, and to provide a template for future privatizations of public assets. The class chose to explore infrastructure privatization because:

- They agreed that in the global era, cities must invest in a first-class infrastructure to remain competitive.

- They recognized that federal, state, and city budgets are in dire straits, and many municipalities are considering privatizing assets as a new source of revenue, in many cases to fund objectives unrelated to infrastructure.

- They were concerned about the way the parking meter privatization was handled in Chicago, divided about whether other actual and proposed privatization deals were good for the city, and questioned to what extent privatization was in the public interest.

- They realized that privatization was relatively new to the United States, but had been employed globally for several decades and that some of the most relevant examples were outside the United States.

- They believed that other governments could draw from Chicago's past experiences, as well as those of other cities around the globe, and that The Chicago Council could serve as a useful platform for exploring these examples and developing recommendations.

- As they are all committed to Chicago and want the city to remain globally competitive, they want to ensure that infrastructure privatization deals in Chicago are pursued in ways that truly promote this goal

Privatization remains highly controversial among the public. Drawing from examples of five cities examined—Chicago, Hamburg, London, Sydney, and Bhiwandi, a textile center outside of Mumbai—the group found that both proponents and opponents of privatization deals are vehement in their arguments and often talk past each other, with each group focusing on only part of the issue. Any privatization deal has both financial and social implications. Only by addressing both considerations—and really thinking about the core functions of governance—will the public debate do justice to the fundamental question: When is infrastructure privatization in the public interest?

This report argues that a healthier, more productive conversation around privatization is needed. To date, the public debate has been polarized and has tended to focus on case-specific details of particular privatizations. Questions that *should* be asked include:

- How should we best approach this radical transformation of public responsibility?

- Why is this happening now?

- What are the alternatives?

- What is the appropriate role of government, and what can we learn from others as to the proper balance between the private and public sectors?

- What are the long-term economic and social implications of having an asset in private hands for ten, twenty, or even ninety years?

Benefits and Risks of Privatization

Privatization can be an effective tool to improve public services and improve the health of government finances. Or it can be a way to steal from the future, literally, by selling off future revenues for a quick injection of cash in the present. The wisdom, as always, lies in telling the difference.

Public authorities are increasingly turning to privatization for a number of reasons:

- Privatization can be an effective way to fund critical infrastructure needs.
- Privatization can provide a source of immediate revenue for strained public budgets.
- Private infrastructure funds are an attractive investment vehicle for certain investors, making infrastructure privatization appealing to potential bidders.
- Historically low interest rates enable private firms to make highly leveraged infrastructure investments.
- Because the private sector can often deliver greater efficiencies than government, privatization can result in better service at lower cost.
- Privatization can be a politically expedient solution to public problems.
- The alternatives to privatization—such as raising taxes, borrowing, or spending less—are unattractive.

Privatizing public assets has implications that stretch across generations and involve billions of dollars. The following are an inventory of potential pitfalls that ought to be considered in the context of any privatization decision.

- Privatization constrains future options.
- Privatization may have social implications, adversely affecting certain groups.

- Privatization deals typically generate huge cash windfalls in the present in exchange for revenue streams that would otherwise accrue to citizens in the future.

- Privatization may result in an undervalued deal.

- Private entities may fail to fulfill contractual obligations.

- A lack of public input in the privatization process can compromise the outcome and leave citizens deeply disaffected.

Key Findings

Based on the examples from the five cities examined along with the group's analysis of the benefits and risks of infrastructure privatization, the group sought to identify when and how privatization can be better accomplished, including the possibility that in some cases it should not be done at all. Some key findings include:

- Financial realities mean that the privatization of infrastructure will continue.

- An effective privatization policy would balance financial and equity considerations and give meaningful thought to what constitutes "the public interest."

- Privatization presents more policy options than merely selling existing assets.

- Privatization can make bad government worse, or good government better. It is not a cure for corruption, since corrupt politicians can use privatization to enrich themselves or cronies at the expense of the public.

- Privatization is neither good nor bad but an economic tool that can be used well or badly.

- Even a "good" privatization deal can end badly.

Recommendations

U.S. investment in infrastructure is lagging the rest of the world. Left unaddressed, this infrastructure investment gap will slow productivity, diminish our standard of living, and erode our global competitiveness. The yearlong study of the privatization of infrastructure has led the group to the following recommendations:

1. Establish a Blue Ribbon Commission to help develop a privatization policy for Chicago and Illinois. Specifically, the Commission should examine what kinds of assets are the best candidates for privatization; determine how the privatization process ought to be conducted; and develop the contours of transparent and effective public interest criteria.

2. Ask the right questions.

   - What are the potential benefits that private operation would bring *to this particular asset*?

   - How might privatization constrain future options?

   - What are the social implications of the privatization?

   - What are the alternatives?

   - How can taxpayers be assured that they are getting the best price for the deal?

   - How will the proceeds be used?

   - Is there adequate ongoing oversight?

   - Is there a process for comprehensive public input?

3. Promote a better public debate surrounding privatization issues and a fully transparent process for executing them, from start to finish. To that end, the report proposes that the elected legislative body with authority over public assets develop "privatization criteria" to evaluate privatizations. These criteria could include the following:

- A prescribed notification process if the executive is seriously considering a potential privatization.

- A checks and balances system by which the legislative body would approve the authority of the executive to conduct bidding and negotiate a particular privatization deal.

- A transparent bidding process and transparent criteria for selecting the bidder with whom the executive will conduct final negotiations.

- Publication of the final terms of the deal with a role for the legislative body to approve the final deal.

- Adequate notice-and-comment period between the time that the executive publishes the terms of the deal and a vote by the legislative body. Public hearing and debate should occur before the vote during this notice-and-comment period.

- Public access (preferably online) to all documents associated with bids and any papers associated with the executive's decision-making process, after a deal has been consummated.

- An independent assessment by the inspector general, or another appropriate independent body, to provide analysis of the deal under the privatization criteria, validate the financial numbers, ensure the deal's compliance with the law, and disclose all potential conflict issues.

Conclusion

Perhaps the most important result of past privatizations, and a key takeaway that Chicago leaders could benefit from, is the realization that if privatizations are to be successful, the public interest needs to be better accounted for in the process of striking a deal. There are important lessons to be learned from other states and countries in how to accomplish this.

Introduction

Chicago is selling off infrastructure, or more accurately, leasing it to private investors. Parking meters. Parking garages. The Chicago Skyway. Perhaps Midway Airport. Chicago is leading the nation in this wave of "privatizations." Over the past six years, Chicago has executed three major privatization deals and is considering more. No other American city has been so aggressive in putting public resources in private hands.

These transactions are worth hundreds of millions, or even billions, of dollars, and have financial implications for current and future generations. Chicago's three major privatization deals have generated nearly $3.6 billion in proceeds for the city. Though the City and its advisors have arguably demonstrated financial savvy in structuring these transactions, they have occurred without meaningful public debate regarding how they serve the City's long-term goals, that is, how each privatization might constrain or advance the City's social, economic, or even environmental objectives.

This report, authored by The Chicago Council on Global Affairs' Emerging Leaders Class of 2008, is an effort to better understand the benefits and risks of privatization, distill lessons learned from across the world, and to provide a template for future privatizations of public assets. The class chose to explore infrastructure privatization because:

- They agreed that in the global era, cities must invest in a first-class infrastructure to remain competitive.

- They recognized that federal, state, and city budgets are in dire straits, and many municipalities are considering privatizing assets as a new source of revenue, in many cases to fund objectives unrelated to infrastructure.

- They were concerned about the way the parking meter privatization was handled in Chicago, divided about whether other actual and proposed privatization deals were good for the city, and questioned to what extent privatization was in the public interest.

- They realized that privatization was relatively new to the United States, but had been employed globally for several decades and that some of the most relevant examples were outside the United States.

- They believed that other governments could draw from Chicago's past experiences, as well as those of other cities around the globe, and that The Chicago Council could serve as a useful platform for exploring these examples and developing recommendations.

- As they are all committed to Chicago and want the city to remain globally competitive, they want to ensure that infrastructure privatization deals in Chicago are pursued in ways that truly promote this goal.

Why focus on infrastructure?

Modern economies rely on vast investments in physical infrastructure: Roads, bridges, port facilities, airport runways and terminals, power generation, water treatment plants, electric transmission lines, and railways all constitute elements of the robust infrastructure on which twentieth-century American prosperity was built. For example, the construction of the Interstate Highway System, which started in 1956, transformed American transportation and continues to yield huge economic dividends—and assorted costs. Modern infrastructure also includes hospitals, prisons, and other communal assets that serve the public interest.

Most of this infrastructure was initially part of the public domain, funded by taxpayers with the goal of increasing local and regional productivity, and with that, standards of living. America's infrastructure remains largely within the public domain, though that now appears almost certain to change. America's infrastructure is old, particularly in the industrial cities of the Northeast and Midwest. It is of deep concern that the cover of the Urban Land Institute's *Infrastructure 2010* report, whose subtitle is *Investment Imperative,* has a picture of Chicago on its cover. The report opens with a dire warning that "falling behind global competitors, the United States struggles to gain traction in planning and building the critical infrastructure investments that are necessary to ensure future economic growth and support a rapidly expanding population." One of the world's top ten global cities, Chicago will require serious capital investment if it is to continue to grow and thrive.[1] A 2007 report published by The Chicago Council on Global Affairs, *The Global Edge: An Agenda for Chicago's Future,* highlighted infrastruc-

1. See, for example, A.T. Kearney, The Chicago Council on Global Affairs, *Foreign Policy* 2010 Global Cities Index.

ture as a critical component of determining Chicago's global future. Privatization could play a helpful role in any solution to our city's long-term infrastructure challenge but, as is explored below, this is subject to serious caveats.

Why focus on privatization?

Public authorities are increasingly turning to privatization as a public policy tool for a confluence of reasons:

- A constrained capacity to build and maintain necessary infrastructure;
- Budget shortfalls at every level of government;
- An appetite among baby boomers for investments that offer an attractive inflation-hedged yield;
- Historically low borrowing costs, which promote deals that rely heavily upon debt; and
- A belief among economists and policymakers that private firms are better positioned than the government is to deliver efficient outcomes.

Each of these will be discussed in more detail in Chapter I. What is clear is that taken together, these factors have converged to produce an accelerating trend toward the privatization of infrastructure. U.S. cities and states are reconsidering their roles in infrastructure provision, often lured by the huge "windfall" cash flows that can be generated by asset sales or leases. The Royal Bank of Scotland estimates that about thirty-five privatization deals are now in the pipeline in the United States. According to the *Wall Street Journal,* those assets have a market value of about $45 billion—more than ten times the $4 billion or so in the pipeline two years ago.[2] Hundreds of more deals are being considered.

The trend toward infrastructure privatization is happening not just in the United States, but globally. In fact, although Chicago is outpacing many of its U.S. counterparts in experimenting with public-private partnerships, and Chicago city leaders rightly note that "the

2. Ianthe Jeanne Dugan,"Facing Budget Gaps, Cities Sell Parking, Airports, Zoo," *Wall Street Journal,* August 23, 2010.

City of Chicago has led the nation in pursuing and successfully closing innovative asset leases," Chicago and other U.S. cities are, in fact, relative latecomers to infrastructure privatization globally. According to the *2010 Infrastructure Report* mentioned above, while public-private-partnerships "have gained traction in Europe, Canada, and Australia, acceptance by U.S. state and local governments has been more problematic and spotty."[3] Public authorities in Europe and much of the developing world have been unwinding infrastructure assets for no less than three decades, with a quickening trend in recent years. Most major European airports, including those in London, Frankfurt, and Paris, are owned and operated by publicly traded corporations. Meanwhile, firms outside of the United States have led the way in devising the business models and financing structures that have made these privatization transactions possible.

Margaret Thatcher Led the Way on Privatizations in the United Kingdom

The privatization of the British Airports Authority ("BAA") in July 1987 occurred within a long and complex history of privatization in the United Kingdom. Begun by Thatcher's conservative Tory government in the early 1980's, privatization was the natural outgrowth of an ideological belief that emphasized the efficiencies and rationality of market forces. While there was no established policy framework at the time, the central goal of privatization was positioned by the British government as necessary to ensuring public sector efficiency. The successful transfer of a number of a significant government owned companies during the 1980's, most notably the £3.9 billion sale of British Telecom in 1984, seemed to validate privatization as a durable government policy initiative. Not only did employees and the general public often participate as share owners for financial gain, but revenue from privatization enabled successive Tory governments in the 1980s and the early 1990s to cut taxes—rendering privatizations more politically attractive over time. The Labour governments that followed Prime Ministers Margaret Thatcher and John Major have also endorsed privatization. Each has also developed more robust systems of soliciting private capital from across a wide spectrum of sectors and investment structures. Assets from hospitals and schools to individual London bus routes have been privatized. The U.K. has become one of the most advanced countries in integrating privatization into its public policy tool kit.

A Need for Scrutiny

If the United States is approaching a great privatization wave, as seems likely, then the public policy implications of the many kinds of deals that fall under the broad rubric of "privatization" deserve greater scrutiny. Perhaps because other countries are further down

3. Urban Land Institute, *Infrastructure 2010: Investment Imperative.*

the path than the United States, they are also further along in thinking through how best to protect the public interest while privatizing. A recent U.S. Government Accountability Office (GAO) report on infrastructure showed that:

> …governments in other countries, including Australia and the United Kingdom have developed systematic approaches to identifying and evaluating public interest before agreements are entered into, including the use of public interest criteria, as well as assessment tools, and require their use when considering private investments in public infrastructure. For example, a state government in Australia uses a public interest test to determine how the public interest would be affected in eight specific areas, including whether the views and rights of affected communities have been heard and protected and whether the process is sufficiently transparent. While similar tools have been used to some extent in the United States, their use has been more limited…. Using up-front public interest analysis tools can also assist public agencies in determining the expected benefits and costs of a project and an appropriate means to undergo the project.[4]

It is not clear that citizens, or even lawmakers, fully understand the nature of privatization transactions and their long-term implications.

To date, privatization in Chicago has been largely opportunistic, and there has been little strategic discussion about how privatization fits into the City's long-term strategic development (i.e., what should be privatized, when, and how). In October 2004, the City of Chicago awarded a ninety-nine-year lease to operate the Chicago Skyway, a 7.8-mile elevated toll road connecting Interstate 94 (Dan Ryan Expressway) to Interstate 90 (Indiana Toll Road). It was the first privatization of a major highway in the United States. In 2006, the city agreed to lease downtown parking garages to a private operator. As the *Chicago Tribune* reported, "In December of 2008, in what would prove to be an extremely controversial decision, the Chicago City Council approved a 75-year lease of the city's parking meter system reportedly without sufficient discussion of the proposal."[5] This

4. "Highway Public-Private Partnerships: More Rigorous Up-front Analysis Could Better Secure Potential Benefits and Protect the Public Interest," U.S. GAO Report, Washington, D.C., February 2008, pp. 8-9.

5. Dan Mihalopoulos and Hal Dardick, "Aldermen Approve Chicago Parking Meter Lease," *Chicago Tribune,* December 4, 2008.

activity led one *Wall Street Journal* op-ed contributor to derisively dub Chicago the "leader in municipal privatization efforts."[6] The effects of these decisions are wide reaching and hard to anticipate in their entirety. Even though the concession agreements spell out many contingencies, a more clearly defined process for evaluating and executing such deals is sorely needed, given the enormity of these deals. Chicago is not alone in its lack of clearly defined parameters for infrastructure privatization. Individual asset sales and leases elsewhere in the world are rarely evaluated in the context of a clearly articulated long-term plan that identifies social and economic objectives for current and future generations of a community. There is no meaningful federal policy with regard to privatization. There is no commonly shared privatization process at the state or local level. Instead, each state or city partially reinvents the wheel, deal by deal, place by place. "Not using formal public interest tests and tools," asserts the recent GAO report, "means that aspects of the public interest can potentially be overlooked."[7]

Indeed, one of the striking findings from this group's examination of privatization deals from around the world is that none of the political jurisdictions involved had an explicit strategy in place for determining which assets should be state owned and which should be privately operated. None had a standing process for promoting public discourse on the issue. None had a transparent policy for determining how privatization revenues should be put to use. In other words, the municipalities doing these deals, including Chicago, have no consistent framework for making governance decisions that can involve billions of dollars and affect multiple generations. Some cities have begun to develop frameworks since the completion of the privatizations examined by this group.

Privatization Cases Examined

- British Airport Authority in London, United Kingdom
- LBK Hospital Network in Hamburg, Germany
- Parking Meters, Parking Garages, and the Chicago Skyway in Chicago, United States
- Power Distribution Center in Bhiwandi, India
- Sydney Ferry System in Sydney, Australia

6. Thomas Frank, "The Real Chicago Way: A Privatization Scheme That's a Loser for Taxpayers," *The Wall Street Journal,* December 8, 2009.

7. "Highway Public-Private Partnerships," GAO Report, Washington, D.C., February 2008, pp. 56-57.

The Need for a More Informed Public Debate

While public officials may see privatization as a panacea for government ills, privatization remains highly controversial among the public. The *Chicago Reader* ran a front-page story in January 2010 on the rationale behind privatization, after acknowledging to its readers that "you've heard plenty in these pages about the hazards of privatization."[8] In a response to proposals to privatize the Sydney ferries, one group of concerned citizens produced a video that was released on YouTube identifying politicians that the group claimed fell from office because of their support for privatization deals.[9] In our analysis, we found that both proponents and opponents of privatization deals are vehement in their arguments and often talk past each other, with each group focusing on only part of the issue. Proponents of privatization tend to stress the financial gains of a deal and the potential operating efficiencies of the private sector. Opponents usually stress the social implications. In fact, any privatization deal has both financial and social implications. Only by addressing both considerations—and really thinking about the core functions of governance—will the public debate do justice to the fundamental question: When is infrastructure privatization in the public interest? So far, this debate is not happening.

A Skeptic Weighs In

In a December 17, 2009 *New York Review of Books* article on "What Is Living and What Is Dead in Social Democracy," Tony Judt argued that privatization is by its nature not in the public interest. He posits:

> If we deal uniquely or overwhelmingly with private agencies, then over time we dilute our relationship with a public sector for which we have no apparent use. It doesn't much matter whether the private sector does the same things better or worse, at higher or lower cost. In either event, we have diminished our allegiance to the state and lost something vital that we ought to share—and in many cases used to share—with our fellow citizens.

This report argues that a healthier more productive conversation around privatization is needed. To date, the public debate has been polarized and has tended to focus on case-specific details of particular privatizations. The questions that *have* been asked ("How much will it cost to park in front of my house?") have too often crowded out the questions that *should* be asked:

8. Mick Dumke, "The Case for Selling Off the City," *Chicago Reader,* January 14, 2010.

9. "Sydney Ferries Campaign," http://www.youtube.com/watch?v=A8I3cg4UX4U

- How should we best approach this radical transformation of public responsibility?
- Why is this happening now?
- What are the alternatives?
- What is the appropriate role of government, and what can we learn from others as to the proper balance between the private and public sectors?
- What are the long-term economic and social implications of having an asset in private hands for ten, twenty, or even ninety years?

Privatization can be an effective tool to improve public services and improve the health of government finances. Or it can be a way to steal from the future, literally, by selling off future revenues for a quick injection of cash in the present. The wisdom, as always, lies in telling the difference. What follows is a discussion of what this group believes the key public considerations should be surrounding infrastructure privatization decisions. The work is based on the examination of infrastructure privatization cases in Chicago, Sydney, London, Hamburg, and Bhiwandi, a textile-producing center on the outskirts of Mumbai. Chicago has much to teach on the subject of privatization; and, almost paradoxically, Chicago has much to learn. The goal of this document is to raise awareness of the issue in a way that promotes better public decisions in Chicago and to provide a framework for developing a more robust privatization process.

Looking to Chicago for Ideas to Save Cleveland

In March 2010, The Reason Foundation partnered with comedian Drew Carey on a cable television series about saving Cleveland, "the mistake by the lake." Cleveland, one of America's ten largest cities in 1950, is not even in the top 30 according to the 2000 Census. The series put forward a set of recommendations to drive a Cleveland renaissance, and focused extensively on lessons learned from Chicago. A policy brief that accompanied the third episode, entitled "Privatize It," outlines ten privatization deals that Cleveland could pursue. The brief focuses on Chicago's efforts to privatize Midway Airport, highlights the success of London's airports, and recommends that Cleveland tap legal and financial advisors to pursue its own airport privatization. Leasing the city's garages, parking meters, and the waste collection services were also on the list of possible sources of new revenue. The episode concluded by citing a report that argues that privatization can save taxpayers 10 to 25 percent on average, while providing more efficient and responsive governments, and could be the right answer for Cleveland.

Chapter I: The Arguments for Privatization

What is privatization?

Privatization is a somewhat amorphous term that can refer to several different kinds of public-private partnerships:

1. **The contracting out to private firms of services traditionally performed by the public sector, such as trash collection or management of municipal golf courses.** The government entity does not give up ownership or control of the relevant asset (e.g. the golf course); it merely hires a private firm to perform specified services.

2. **The sale or long-term lease of an existing public asset, whereby a private entity undertakes to operate and maintain the asset for a predetermined length of time in exchange for some or all of the revenues generated by that asset over the same period.** The rights and obligations of the private entity, including pricing, are usually governed by detailed contracts with the relevant public authorities. (The contract between the City of Chicago and the consortium that leased the Chicago Skyway is 107 pages long and includes an additional lengthy and detailed operating manual with stipulations and standards ranging from the maximum toll—7.9 percent per year maximum increase through 2017—to the maximum time allowed for clearing "road kill.") At the end of a long-term lease, the asset reverts back to public control. Chicago will regain full control of the Skyway in 2104.

3. **The use of private capital to build and operate new public infrastructure in exchange for the right to collect the revenues associated with the new asset.** For example, a government can use its unique power of eminent domain in order to acquire the land and/or rights of way to build a new highway or transit line. A private partner can then provide the capital needed for the project in exchange for the right to operate the asset for a predetermined length of time and realize the relevant revenues (e.g. tolls or fares). After the period of time specified in the contract, the asset is transferred to public ownership and operation. Such arrangements, what are often referred to as "greenfield" projects, can be less controversial because they avoid the debate over whether government is "selling the family jewels."

The Illiana Tollway – A Greenfield Privatization

In June 2010, Illinois Governor Patrick Quinn and Indiana Governor Mitchell Daniels signed the Public Private Agreements for the Illiana Expressway Act, committing both states to work together on a new expressway. The Illiana Expressway will connect Interstate 65 in Lake County with Interstate 55 south of Joliet, alleviating the largest bottleneck in the country for interstate travel. The public-private partnership allows the states to contract with private companies that will pay to build and operate the expressway. The expected $1 billion in expenses will be funded by 60 percent private sector monies and 40 percent public sector monies shared between the two states. Although the expressway is expected to reduce the number of trucks on local roads and cut travel times by a third or more, there is opposition from voters concerned that privatization will raise toll fares. James Sweeney, President-Business Manager of Local 150 of the International Union of Operating Engineers, who backed this project, emphasizes that unlike other privatization deals where the state is selling off public assets to private companies, this is an opportunity to develop a new asset that the state does not currently have, invest in much-needed infrastructure, and create much-needed jobs.

The emphasis of this report is on category two, concessions and the selling of rights to operate existing assets, since that has been the character of several recent and prominent Chicago privatization deals. However, one of the report's key findings is that greenfield privatizations should receive greater attention. Given the dearth of U.S. infrastructure investments, and the fiscal crisis plaguing state and local governments, these kinds of deals represent a public finance tool that can be used to build necessary infrastructure without further stretching public spending or borrowing.

Why is this happening now?

As outlined in the introduction, public authorities are increasingly turning to privatization as a public policy tool for a number of reasons, including a constrained capacity to build and maintain necessary infrastructure; budget challenges; a belief in the efficiency of the private sector; and a lack of viable alternatives. These drivers occur in a context of a demand for investments that both generate cash and protect against inflation, among buyers eager to take advantage of historically very low borrowing costs. Each of these is briefly examined below.

Figure 1 - Privatizations Occur for Different Reasons and Achieve a Variety of Goals	
	Examples
Increasing Operating Efficiency	**Hamburg hospital** • Private sector takeover of a loss-making hospital network • Achieve sustainability through operating efficiency
Increase Investment Capital	**Bhiwandi Circle, India — major textile hub** • 10-year lease deal with private entity to invest in reliability, lower losses and increase access to power • Expand/upgrade infrastructure
Reduce the Role of the State in the Economy	**British Airport Authority** • Thatcher government's belief in relative efficiency of the private sector • Privatization now viewed as key financial lever by political parties and public
Generate New Sources of Revenue	**Chicago Skyway** • $1.8 billion used to pay down debt, improve city bond rating, address budget gaps, and invest in long-term reserve (later used to help with 2008-2010 budget gap) • 42% debt, 33% operating expenses, 25% long-term reserve **Chicago parking meters** • 88% of proceeds, $1.2 billion, used to address 2009 and 2010 budget gaps and operating expenses • 12% remaining in a long-term reserve at end of 2010

1. Privatization can be an effective way to fund critical infrastructure needs

In the global era, cities around the world are building and enhancing their social and physical infrastructures to become or remain competitive. They are also facing the daunting challenge of how to pay for the upgrades. The United States is facing a particularly dire challenge. Infrastructure is the backbone of a modern economy, yet as a proportion of gross domestic product (GDP), the United States currently invests half as much in infrastructure as Europe does, and a quarter as much as China.

It is hard to imagine a more vivid picture of underinvestment in essential infrastructure than the 2007 bridge collapse in Minnesota, in which an eight-lane bridge across the Mississippi River crumbled into the water during rush hour, killing thirteen people and injuring scores more. For well over a decade, the American Society of Civil Engineers (ASCE) has given U.S. infrastructure very poor grades in its *Report Card for America's Infrastructure* across a range of catego-

Bhiwandi, India, Privatizes Power Distribution Center

Developing countries need major investments in basic infrastructure to promote economic development, but they also lack sufficient access to capital. Public officials are frequently tapping into domestic and foreign pools of capital to fund projects. For example, the power distribution center in Bhiwandi, a major textile hub outside of Mumbai, India was suffering from poor performance while under state control from 1978 to 2006. Since power-looms are energy intensive, city leaders were under significant pressure to provide reliable power and to address the frequent blackouts that were occurring for up to 12–14 hours a day. To address the situation, the public sector company, Maharashtra State Electricity Distribution Company Limited (MSEDCL), signed a ten-year agreement with the private company Torrent Power to distribute power to 160,000 consumers in the Bhiwandi circle. In less than two years, the center's operating performance demonstrated vast improvements and transmission and distribution losses declined from 49 percent to 22 percent. Since India faces considerable obstacles to reach its power needs more broadly, and the estimated cost to overcome them is roughly $1.5 trillion, the Bhiwandi success has led MSEDCL to consider setting up such franchises in other Indian cities where commercial losses are even greater than in Bhiwandi.

ries.[10] In 2009 the ASCE reported that the United States would need $2.2 trillion in investment just to maintain its existing stock of roads and bridges—not to mention new investments in transit, energy, communications, and other infrastructure that are necessary to make our lives better in the twenty-first century.

While the United States invests an average of 2.4 percent of GDP every year in infrastructure, Europe and China invest 5 percent and 9 percent, respectively.[11] Governments in the United States—local, state, and federal—are in no position to close this gap. Public finances in many jurisdictions (e.g. California and Illinois) were in poor shape before the financial crisis; now they are worse. Governments at every level are making cuts. Taxpayers are refusing to pay more, and often voting to pay less. Privatization can be a politically expedient tool for funding infrastructure improvements.

It is also important to recognize that privatization revenues can finance investments in infrastructure and human capital that make future generations more productive. For example, if revenues from an asset are used to improve the quality of, or the access to, education (particularly for disadvantaged citizens), the economic benefits could be quite significant. Chicago used part of the revenue from the

10. *2009 Report Card for America's Infrastructure,* American Society of Civil Engineers, March 25, 2009, Reston, VA.

11. "The Cracks Are Showing," *The Economist,* June 26, 2006.

Skyway deal to pay down city debt, which helped attract additional capital to the city. This is hardly stealing from the future, though the social benefits of this kind of spending are extremely hard to quantify. Similarly, privatization can unlock capital for investments in infrastructure that promote growth, ease congestion, improve the environment, or otherwise enhance the lives of future generations.

2. Privatization can provide a source of immediate revenue for strained public budgets.

Policymakers are increasingly turning to privatization as a way to deal with strained public finances. The demographic trends in most industrialized societies—and in some industrializing societies such as in China—will impose huge additional costs on the public sector in coming decades. Citizens around the world are generally living longer (spending much longer stretches in retirement) and, especially in industrialized countries, having fewer children. While this is a healthy trend in many ways, it also puts new stresses on the traditional mechanisms for funding old-age benefits, since the ratio of retirees receiving public benefits to workers paying for those benefits is growing steadily. In Japan, for example, the proportion of the population over age 65 will increase from roughly 20 percent in 2005 to 29 percent in 2020.[12] This trend has been mitigated to some extent in the United States by a relatively high rate of immigration.[13] Still, Medicare and Social Security benefits for U.S. retirees are projected to grow in coming decades at a far greater rate than the revenue streams that were designed to pay for them, leaving policymakers with an undesirable but inevitable choice between cutting benefits and raising taxes. In any case, aging societies—including America's large baby boom cohort, which has now reached retirement age—will create a more or less permanent fiscal crunch around the globe.

The present financial crisis exacerbates the structural challenge within aging societies. Like the federal government, states and municipalities are reeling from increased financial claims just as their tax revenues are at cyclical lows. Privatization offers a large source of immediate revenue to help meet these budget challenges.

12. Zoe Matthews and Andrew Channon, "Will there be enough people to care? Notes on workforce implications of demographic change 2005–2050," World Health Organization: Geneva, March 2006.

13. Jogadeesh Gokhale and Kent Smetters, "Fiscal and Generational Imbalances: New Budget Measures for New Budget Priorities," Federal Reserve Bank of Cleveland, Policy Discussion Paper, March 2002.

Lawyer Discusses Opportunities and Risks Associated with Privatization
In September 2009, John Schmidt, a partner at Mayer Brown, LLP, who has worked on many public-private partnership deals including the Chicago Skyway Toll Bridge, the Indiana Toll Road, and the proposed Midway Airport deal, briefed the Emerging Leaders. He emphasized that "privatization presents an enormous opportunity for public entities to capture value that can be recovered from existing revenue-generating assets, or build new revenue-generating assets to capture the future value and use it to pay the costs of building that new asset." Yet, he was uneasy about privatizations being driven by a budgetary crisis. "It becomes dangerous if that becomes the driving force," he argued, "and in the long term, it is dangerous politically because it will be perceived as something that you do only when you are desperate." He highlighted California's Public-Private Partnerships statute as an example of the seriousness that local governments are giving to the issue.

3. Private infrastructure funds are an attractive investment vehicle for certain investors, making infrastructure privatization appealing to potential bidders.

It may strike some as a curious fact that a once little-known Australian bank is among the largest players in infrastructure privatization globally. Indeed, Macquarie Bank was a key member of the consortium that acquired the Chicago Skyway and, soon thereafter, the Indiana Toll Road. Macquarie also manages an infrastructure investment fund that holds, among other assets, Thermal Chicago, the world's largest district cooling system, which supplies steam and chilled water to approximately 100 buildings in downtown Chicago for cooling and heating under a long-term contract.

Macquarie was an early mover in infrastructure investment funds in part because of a 1992 Australian pension reform. Anticipating an increase in pension liabilities that would strain the public budget, Australia created a compulsory retirement scheme involving private investments. By 2006 Australians had more money in managed funds per capita than any other developed country.[14] This, in turn, drove a creative search for places to invest pension assets, including infrastructure. Fortunately for Macquarie, the Australian government was privatizing toll roads at the same time, which allowed Macquarie to package toll roads into a bond-like investment vehicle. The long-term, stable cash flow of infrastructure (e.g., tolls for ninety-nine years) offers the predictability of a bond with the added advantage

14. "Australia 'Tops' in Managed Funds," *The Sydney Morning Herald,* January 23, 2006.

that tolls (as well as airport landing fees, port fees, etc.) generally rise with inflation, giving investors a natural hedge against inflation.

Many banks around the world have since launched similar infrastructure funds to help meet the investment requirements of aging baby boomers. Financial investors have been attracted to infrastructure-related investments by the premiums they often yield over corporate and public bonds.

4. Historically low interest rates enable private firms to make highly leveraged infrastructure investments.

Debt is cheap. While historically low bond yields make it difficult for pensioners to fund their retirement, the flip side is that borrowing costs are low, making leveraged investments in infrastructure by private firms attractive. The stable, predictable cash flow generated by infrastructure assets can generally support highly leveraged transactions. For example, the consortium in which Macquarie participated to buy the Chicago Skyway offered the City of Chicago almost 80 percent more than the next highest bidder and several times what the city believed the asset might be worth. Macquarie funds have paid similarly large premiums over what other public investors were willing to pay for infrastructure assets elsewhere in the world. These bids are largely due to Macquarie's aggressive view of how much debt these infrastructure assets can support.

5. Because the private sector can often deliver greater efficiencies than government, privatization can result in better service at lower cost.

The present wave of privatizations can also be viewed in the context of the broader liberalization programs ushered in with Margaret Thatcher in the 1980s and to a lesser degree by Ronald Reagan in the United States. Thatcher's privatization of large state-owned corporations such as British Gas was driven by her conviction that "the imperfections of State intervention in the economic field are likely to be not merely equal to, but greater than, the imperfections of the market." Poorly run private businesses must fix themselves or perish; state-run enterprises face no such constraint.[15] Today, the United Kingdom is arguably the most market-oriented of all states when it comes to infrastructure, having sold everything from the rights to

15. "The New Conservatism (Lecture to the Bow Group)," Margaret Thatcher Foundation, August 4, 1980.

operate individual London bus lines to on-site management of concessions in hospitals and elementary schools.

Reagan similarly made privatization a theme of his presidency, describing the 1987 divestment of Conrail, a large freight railroad, for $1.575 billion as "the flagship of privatization and the first of what we hope will be many government functions returned to their rightful place in the private sector."[16] While his two terms in office did see the privatization of many services through government contracting, intentions to privatize government corporations and assets gained little traction despite the creation of the high-profile Commission on Privatization.[17]

Today, much empirical evidence supports the claim that private companies are generally more efficient operators than government entities.[18] The reasons for this are various and include management incentives tied to performance, a better capacity to fund capital investments, greater operating leverage, the introduction of proprietary technology, and the de-politicization of pricing and other operational decisions (e.g., raising tolls or cutting money-losing routes).

Germany Privatizes Hospitals to Increase Cost Effectiveness

Germany's health sector is privatizing rapidly. Between 1991 and 2004, public hospitals fell from 46 percent to 36 percent as a share of total hospitals, while private, for-profit hospitals grew to almost 26 percent from nearly 15 percent with nonprofits making up the balance. Privatizations happen for many reasons, but in the case of the LBK Hamburg hospitals—a ten-facility public hospital system in Germany—the facilities were struggling financially for years and were a major drain on the city's finances. Ongoing operating losses and expanding infrastructure investment requirements at the hospitals, coupled with major public employee pension obligations, drove the Hamburg government to consider privatization in a nearly non-cash deal structured to protect the city from further losses. In 2004, despite significant and sustained political opposition, particularly by union members, the City of Hamburg sold a 49.9 percent stake in the hospitals to Asklepios, Germany's largest for-profit hospital company, with the expectation that a private firm could increase cost effectiveness while simultaneously improving the quality of health care. Microsoft later examined one of Asklepios' major IT investments in the hospital system, and recognized LBK Hamburg as an international leader in implementing a cutting-edge IT platform.

16. Ronald Reagan, "Remarks at a White House Ceremony Marking the Sale of the Consolidated Rail Corporation," April 3, 1987.

17. Joel Brinkley, "Reagan Appoints Privatization Unit," *New York Times,* September 4, 1987.

18. William Megginson, "Privatization in the Developed World," Briefing to report authors, November 13, 2009.

Broadly speaking, the public appears to have more general confidence in the efficiency of the private sector than was the case several decades ago, when the fear of private monopolies outweighed concerns about public inefficiency. However, the backlash in Chicago against the poorly executed parking meter privatization has almost certainly jaded local opinion against infrastructure privatization, at least in the short run. There is also a heightened skepticism and distrust of Wall Street, as reflected by a May 2009 Pew Research Center study showing that 67 percent of the public surveyed say that “Wall Street only cares about making money for itself.” There would thus likely be skepticism of many of the financial players that would be involved in any future privatization deal as well.

6. Privatization can be a politically expedient solution to public problems.

Another advantage of the private sector, unrelated to efficiency or expertise, is that its executives do not have to run for re-election, although they do have to respond to shareholders. Private operators can do things that politicians are unwilling or unable to do, such as raise tolls or parking fees. This actually can work to the public’s advantage, because the price of a privatization deal reflects these additional revenues that will be recovered by the private operators. John Schmidt made this point with regard to the Chicago parking meter deal. He explained to the *Chicago Reader,* “I don’t think there’s any city that has consistently been able to price its street parking at a market level, which is a point that environmentalists have made for years, advocating not only higher parking rates but higher parking taxes. I think it’s the phenomenon where the incremental benefit of raising parking meter rates in any single year is going to be relatively slight but the political reaction to it is going to be significant. It’s not necessarily that everyone’s going to complain, but enough will that a politician is going to resist it.”[19]

7. The alternatives to privatization are unattractive.

Privatization decisions do not take place in a vacuum, which is a policy reality often lost in the public discourse. The long-term lease of public assets has the potential to generate enormous public revenues. That point is obvious. The less obvious reality is that in the

19. Mick Dumke, “The Case for Selling Off the City,” *Chicago Reader,* January 14, 2010.

absence of those revenues—if a privatization deal is not done—a government must implicitly choose a different course. At bottom, this is just math. Without the large influx of cash provided by a privatization agreement, a public entity has four choices:

- *Raise taxes.* If the goal is to finance some level of spending, then whatever revenue does not come from privatization must come from somewhere else. One likely source of "somewhere else" is higher taxes, which is both politically unpopular and can have adverse economic consequences in the long run.

- *Borrow.* Most governments have the capacity to issue bonds, which provide an opportunity to make investments in the present (or to pay current bills) and then spread payments over a longer term such as 30 years—even longer in some cases. Privatization revenues are another source of revenues to make such investments (or to pay current bills) and can replace or supplement public borrowing. It should be noted that privatization and public borrowing, which are seemingly dissimilar tools, have broadly similar intergenerational effects. Both privatizing a public asset and issuing public debt provide a benefit in the present that must be paid for in the future. In the case of debt, future taxpayers must repay the bonds, with interest. In the case of privatization, future taxpayers must forego the revenue stream that has been sold (e.g., future toll revenues). Both public tools involve spending in the present at the expense of the future; of course, both can be justified if the current spending leaves future generations better off.

- *Spend less.* Privatization effectively packages a future stream of income (e.g., tolls or parking meter revenues) into a large dollop of public income in the present. This revenue can be used to cover deficits, invest in new infrastructure, expand social services, or do anything else that governments typically do. If a government does not earn privatization revenues and is unwilling or unable to raise taxes or borrow, then this spending cannot happen. As a result, the government will have to cut deeper to balance a budget, invest less in infrastructure, or spend less on social services, and so on.

- *Manage assets more efficiently, either to stanch the financial bleeding or to improve profits.* This may involve politically unattractive decisions that improve revenues (such as raising tolls) or that reduce costs (such as demanding labor concessions from public employees).

Chapter II: Risks of Privatization

Privatization is an extraordinarily powerful governance tool. As with any other tool, it can be used be used incorrectly, in the wrong circumstances, or with malevolent intentions. Privatizing public assets has implications that stretch across generations and involve billions of dollars. The following is an inventory of potential pitfalls that ought to be considered in the context of any privatization decision.

1. Privatization constrains future options.

By definition, privatization places a public asset in private control for some period of time, if not indefinitely.

A privatization contract can be written to demand all kinds of performance measures—but only those that can be anticipated at the time the contract is written. A lot can change in twenty or fifty or ninety-nine years; the public has little control over a private entity that is adhering to a contract that is valid but nonetheless outdated because it no longer reflects what the public desires or expects.[20] In contrast, an elected government controlling a public asset is always accountable to voters. If those citizens decide that they want something different with respect to an asset (because of changes in technology, lifestyle, demographics, or anything else), then the government is unhindered in its ability to cater to those evolving preferences.

2. Privatization may have social implications, adversely affecting certain groups.

The primary benefit of privatization lies in the efficiencies of the private sector. Profit-seeking firms have a powerful incentive to increase revenues and reduce costs. This incentive, usually a good thing, can turn out to have adverse social consequences when certain kinds of public assets are put in private hands.

First, a private operator may cut costs by taking actions that harm a vulnerable segment of society, such as low-income citizens. For example, an efficient operator will cut money-losing services

20. Supporters maintain that privatization inoculates the government from certain long-term risk by shifting the assets' risks from government to the private sector. Since the city is paid in advance, and nobody knows the actual future value of the infrastructure, the risk (and of course any potential upside) is absorbed by the private sector.

(e.g. bus routes to certain neighborhoods) and purge customers who aren't profitable. The subsequent reduction in service may cut off workers from their jobs or eliminate some basic service for the most needy.

Second, private operators may act in ways that create costs that spill over into the public sector. Take the example of a privatized toll road whose operator has leeway in setting use fees. It is understood that levying tolls on highways will alter driver behavior and road usage. Transportation research has shown that, in the face of rising toll costs, drivers' route selection is highly elastic, meaning that many will modify their choice of routes when confronted by relatively small increases in fees.[21] Some motorists will detour onto public roads that do not charge tolls. As drivers opt to reroute their travel, congestion levels on other roadways will increase, leading to rising costs for other drivers in the form of longer commute times and higher public costs for road maintenance and repair.

Third, making a good asset more popular, and thereby increasing revenues, may not always be in society's best interest. Consider the case of a lottery privatization. A private operator can improve the "efficiency" of the lottery by making it more popular. Revenues will go up. However, low-income citizens buy a disproportionate share of lottery tickets, so that a more popular lottery will essentially transfer income away from some of society's neediest citizens, leaving any resulting social problems for the public sector to fix.[22]

Finally, a private operator may maximize profits by limiting competition, which was the case with the British Airport Authority, which had a disincentive to invest in expanding capacity, thereby boosting profits at the expense of airport congestion (a cost borne by weary travelers). In fact, BAA invested heavily in airport retail, creating at least the appearance of a misaligned incentive, since stranded travelers have more time to shop.

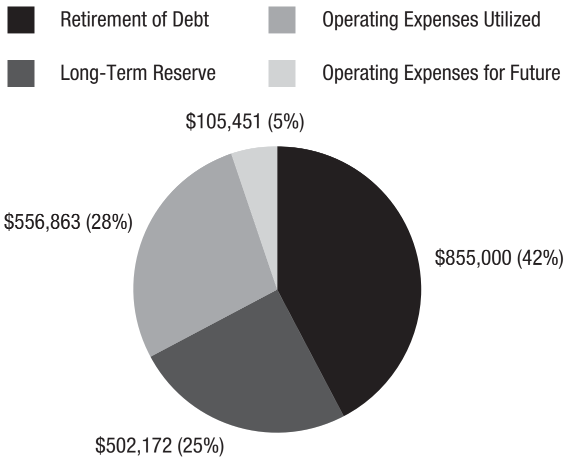
3. Stealing from the future?

Privatization deals typically generate huge cash windfalls in the present in exchange for revenue streams that would otherwise accrue to citizens in the future. From a public interest standpoint, we must be

21. Peter Swan and Michael Belzer, "Empirical Evidence of Toll Road Traffic Diversion and Implications for Highway Infrastructure Privatization," January 14, 2008.

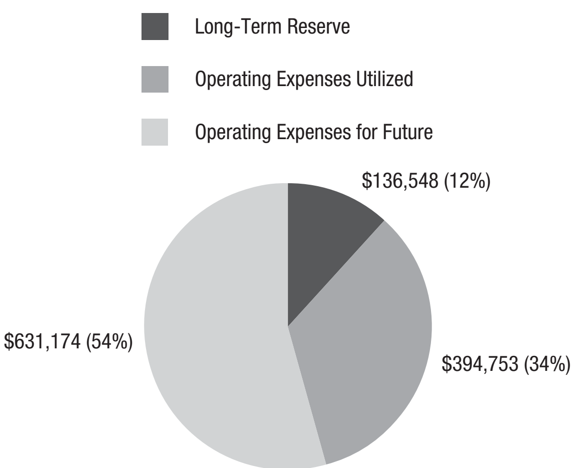
22. Depending on how the deal is structured, popularity can also be a net gain for everyone. For example, government can accrue greater revenues once capital gains are taxed.

Figure 2 - Skyway Use of Proceeds Through 12/31/2009



Proceeds include interest earned. Source: City of Chicago asset lease agreement reserve fund balances.

Figure 3 - Parking Meters Use of Proceeds



Source: Civic Federation; City of Chicago FY2010 Proposed Budget: Analysis and Recommendations; November 18, 2009.

concerned with how any privatization proceeds are used, particularly since public budget pressures appear to be the catalyst for the sale or lease of assets in the United States (though not necessarily elsewhere in the world).

For example, the City of Chicago was paid $1.8 billion for the Skyway toll bridge south of the city; in exchange, a private firm will collect the toll revenue for the next three generations. The City used 42 percent of the proceeds to pay down debt and thereby increase the city's credit rating, which had immediate positive economic benefits, and invested 25 percent in a long-term reserve. This rainy day fund was helpful when the devastating economic crisis of 2008–2009 (a true rainy day) hit full force. However, nearly 33 percent went to bolster the operating budget, which closed an immediate budget gap, but did not lead to structural readjustment.

In the case of the parking meters, for example, the City had intended to allocate the new monies to a long-term reserve and funds devoted to budget relief, human infrastructure, and budget stabilization. When the financial crisis hit full force, these plans were set aside and the new revenue allowed the City to pull forward $200 million into the 2009 budget. One city official points out that if the City had not had access to the privatization monies, then the City would have been forced to make painful choices that could have included significantly raising property, fuel, and sales taxes and cutting the budgets of vital services such as those of the fire and police departments. Such measures would have compounded the pain of other cuts instituted to address the worst economic crisis since the Great Depression. Still, at the end of the day, unless the budget is restructured and long-term investments are made, financing deficits with one-time gains only pushes the problem onto future leaders. As it stands, 88 percent of the proceeds will be spent on immediate budget needs—such as salaries—by the end of 2010, with only 12 percent remaining in a long-term reserve. According to Fitch Ratings in August 2010, Chicago's bond rating has been downgraded to AA from AA+, which could raise borrowing costs, partly due to Chicago's accelerated use of reserves to balance operations.

Future generations can benefit if privatization revenues are invested in things that will increase future productivity and prosperity, such as human capital and infrastructure. Or future generations can be robbed if the cash inflows—often a large lump sum—are squandered or used to pay current expenses. In that case, current citizens are paying their own bills by tapping into a revenue stream—tolls, landing fees, and parking meters for instance—that could have

Shortened Contracts Can Minimize Controversies over Valuation

Bloomberg News released a report in August 2010 stating that Chicago drivers will pay the Morgan Stanley-led partnership managing the city's parking meters at least $11.6 billion to park at city meters over the next seventy-five years, ten times what the City of Chicago received when it leased the system of 36,000 meters to investors in 2008 for $1.15 billion. According to the *Chicago News Cooperative,* the 218 percent rate hike introduced since the parking privatization barely reduced meter use, resulting in better-than-expected profits for the investors. Some experts argue that governments should negotiate shorter-term leases so that they are better able to revisit the agreement when the value of a deal proves higher than anticipated. One of only five alderman among fifty who voted against the lease, Alderman Scott Waguespack of the 32nd Ward, is concerned that "the next couple of generations will pay the price" of undervaluing the deal since the contract does not expire until 2084.

been used to pay bills in the future. This is essentially a transfer of wealth from future citizens to current citizens.

From a political economy standpoint, it is worth pointing out the obvious, which is that current citizens can vote and future citizens, depending on the time frame, often cannot. If one takes a long view of social welfare, a privatization deal that passes political muster today may still not be in the public interest because the people who stand to lose aren't around to be heard and counted.

4. Privatization may result in an undervalued deal.

Citizens must receive the fair market value for any public assets put in private hands. Again, this is separable from deciding whether or not a particular asset is a good candidate for privatization. A good deal demands the right price; anything less than that is simply a transfer of wealth from taxpayers to the private firm or firms involved. And again, basic political economy matters: Elected officials have an incentive to accept a "bad deal" if control over the cash inflows strengthens their own political position. Machiavellian motivations aside, public servants may also simply lack the technical and financial skills to get a fair price for taxpayers.

In the case of Chicago's ninety-nine-year parking meter lease, there was considerable debate after the deal was consummated over whether the deal was valued appropriately. Core assumptions on the future parking meter rates, demand for meters, and deal terms created a public debate on the accuracy of the valuation. Prior to the announcement, little public debate and discussion had occurred. Operational issues during the rollout created additional public and media scrutiny of the deal.

One relatively obvious point is that shortening the duration of a privatization deal can minimize mistakes over valuation (or any other errors, for that matter. It can also decrease the gains accrued from the deal). For example, the Bhiwandi power distribution agreement with Torrent Power was structured as a ten-year lease. The shorter term contract helped to create less debate over the deal valuation and more public focus on service (availability of power) and the impact on union jobs.

5. Private entities may fail to fulfill contractual obligations.

A privatization contract is only as good as its monitoring and enforcement. Privatization is built upon "contractible quality," meaning that the contract explicitly specifies what is expected of the private operator in terms of quality and service levels, among other issues. Contracts do not enforce themselves. Government must devote resources to overseeing privatization contracts and must have a strategy in place in case a private firm does not or cannot fulfill its contractual obligations.

In the case of the Chicago Skyway, a private firm that was awarded the concession to operate a rest area has run into solvency issues and can no longer fulfill its obligations. Yet motorists still need a safe place to stop on the Skyway—something that government is expected, once again, to provide. This ongoing oversight role is a critical part of a privatization agreement and needs to be given sufficient budget and staff support: The costs of monitoring must be considered in any costs-benefit calculus, not just the headline proceeds.

6. A Lack of Public Input

A lack of public input—real or perceived—at any point in the privatization process can compromise the outcome and leave citizens deeply disaffected. In theory, any government is designed to represent the voice of its citizens; in practice, privatization may demand public input above and beyond the normal processes of government at every step in the process. Even a "good" privatization deal in a financial sense will generate public consternation and distrust if there is a lingering belief that it did not reflect the public will.

Process matters. Every step of a privatization deal must be perceived as fair, transparent, and inclusive. The ends will not justify the means, since there is no obvious metric for quantifying the success of a privatization agreement (unlike the private sector, in which a good return on investment can redeem even the sloppiest deal). If anything, a poor public process can poison a deal that makes sense in every other respect.

Mitigating the Risks of Privatization

If privatization were a prescription drug, its risks would be the warnings on the side of the bottle. There is nothing about the warnings that suggests one should abstain from taking the medicine. Yet, the more powerful the medicine, the more important it is to consider side effects and improper usage. Each of these potential concerns suggests ways in which privatization can be used to advance the public interest. We can mitigate the risks and adverse effects by selecting the right kinds of assets; by writing good contracts and then monitoring them; by demanding the right price; and, perhaps most important, by developing a good process for doing all of this.

Chapter III: Developing Criteria

As noted, the public discussion of privatization, like the deals themselves, has been episodic and there is no strategic framework to help the public and their representatives responsibly assess a deal. Both critics and proponents often talk past each other. For example, the benefits of privatization can be overblown. While it is an article of faith among proponents that public resources must necessarily be more efficient in private hands, this is simply not the case. One lesson from the privatization of British airports is that a private operator will resist calls to expand capacity (keeping landing fees high), which punishes consumers with higher fares and more air traffic congestion.

The criticism of privatization can be wrong-headed, too. It is often asserted that private operators care about profits, not social justice or equity, so disadvantaged groups must necessarily suffer whenever a public resource is placed in private hands. After all, a private operator would never offer reduced prices to low-income customers, or continue unprofitable routes in disadvantaged neighborhoods. But this assertion is wrong. A private firm will offer reduced fares for low-income riders if the terms of the privatization contract require it—although the cost of that subsidy will be reflected in the price of the deal. Consider the 2010 *Bloomberg* article, “Corrections Corp. Shows Crime Pays With Private Jails,” that evaluated prison privatizations and showed that government can build into the contract that prisoners be offered General Education Development classes, earn wages for working in the facility, or be provided with adequate health care. If the privately operated prison were found mistreating its prisoners, it risked losing out in the contract renewal process or failing to attract business in other locations. Any privatization deal is a contract, and that contract can be used to ensure or protect any clearly-defined social objective that political leaders feel is necessary.

Similarly, the risks associated with turning over a public asset to private hands can be mitigated by shortening the duration of the lease. There is clearly less uncertainty in a ten-year lease than with a ninety-nine-year lease. Critics should also ask, if not privatization, then what? The alternative is often higher taxes or less investment in public infrastructure.

Infrastructure Privatization Criteria

Based on the examples from the five cities examined, along with the group's analysis of the benefits and risks of infrastructure privatization, this report puts forward the following criteria for evaluating privatization proposals. The bottom line is that every municipality should be asking whether privatization is in the public's best interest, and how to make it so. Our work suggests that such a broad question can only be answered for any given proposal by asking a series of more explicit questions:

1. What are the potential benefits that private operation would bring to this particular asset?

What are the specific gains from privatization? Does the private sector bring management efficiency or expertise to the asset, where public management has been inadequate? Does the asset require capital expenditure that the government cannot readily fund? Is there an economy of scale that emanates from having a private operator manage multiple facilities, such as a continuous multi-state stretch of highway? In short, what can the private sector do better with this asset than the public sector, and what evidence is there to support that belief?

2. How might privatization constrain future options?

As technology or demographics change over the years, what contractual mechanism is in place to help ensure, to the greatest extent possible, that the contract remains flexible enough to account for such change? How difficult is it to anticipate changed circumstances with respect to the particular asset? Can the contract be drafted to anticipate this uncertainty and protect important policy goals? How will the operator of the asset be regulated, and what will this cost? How can behavior of a private operator be changed if the public is unsatisfied with the performance of the asset many years after the deal has been done?

3. What are the social implications of the privatization?

What are the social implications of more efficient or less costly service? Will certain groups be adversely affected? A privatization contract can protect against these kinds of outcomes. However, any social objective not consistent with maximizing profits must be identified in advance and contracted for explicitly. To the extent that these services lower the profits from the asset for a private provider, they will lower the price paid to the government for the lease or purchase of the asset. Will the privatization cause a spillover effect on the public sector and what is the cost to address any spillover problem?

4. What are the alternatives?

What is the public impact if an asset is not privatized? Will there be less infrastructure, because only the private sector has the necessary capital to make a new investment? Will taxes be higher? Privatization in a particular case may have drawbacks; the alternatives could easily be worse. The real question is: If not privatization, then what? And how do those two scenarios compare?

5. How can taxpayers be assured that they are getting the best price for the deal?

Has the municipality considered all options and price offers for selling an asset to avoid selling it too cheaply? Have elected officials avoided accepting incentives that strengthen their own political positions? Has a fair price been negotiated for taxpayers? Does the deal include a reassessment of revenues and agreements in the short-term allowing for more negotiation on the value and services?

6. How will the proceeds be used?

Has the government given up all control over the asset, which may constrain its future options? Are future generations of citizens robbed of the revenue stream that would have been generated by the public asset—tolls, landing fees, parking meters, etc? Does it make sense to divest from physical infrastructure in order to reinvest in social infrastructure, and how should the latter be defined? Should the proceeds from long-term infrastructure assets be used to meet short-term budget deficits, rather than raising taxes or curtailing spending? How can the process remain transparent and can the government publish how the revenues were used?

7. Is there adequate ongoing oversight?

How will the private entity be monitored and contract terms enforced? What provisions, including penalties, are built into the contract to ensure expected service levels? What will happen if the firm fails to live up to the terms of the agreement? Is there sufficient transparency on the use of the proceeds and protections against fraud? Is there sufficient budget and staff support for regulatory and contractual oversight?

8. Is there a process for comprehensive public input?

Is there a clear public strategy for choosing which assets are candidates for privatization? Is there a process for soliciting multiple bids and determining a fair price? Is there a voice in these decisions for all affected parties? Is it clear how the revenues from any privatization deal will be used? Is every stage in this process fully transparent?

Chapter IV: Findings and Recommendations

Do It Right, or Not at All

Notwithstanding the complexities of privatization outlined above, most public entities pursue these transactions without any established process or policy framework. For example, Chicago policymakers seem to understand the criteria that make assets eligible for privatization, but no transparent policy framework exists to address the broader issue of when and how privatization promotes the public good. Instead, transactions are analyzed on an *ad hoc* basis; the proceeds from privatization deals—literally billions of dollars—are committed by the city as dictated by the politics of the day. Long-term assets are being divested based on short-term goals. This process can almost certainly be improved.

This group has sought to identify when and how privatization can be done better, including the possibility that in some cases it should not be done at all. Our work is based on the study of a limited number of privatization deals in Chicago and elsewhere in the world. The conclusions are necessarily provisional; there is doubtless much that we have missed. Nonetheless, we are hopeful that there is benefit in creating a framework for thinking about privatization as an increasingly important tool for promoting the public good, rather than as a narrow and arcane aspect of law or public finance, which is how it is often perceived. We need to understand the full implications of putting public assets in private hands because we are likely to see many more such deals in the coming decades. The quality of the overall debate must be elevated sharply; it is difficult, if not impossible, to make consistently good public decisions without a more sophisticated process for considering this complex issue.

Findings

1. Financial realities mean that the privatization of infrastructure will continue.

The recent acceleration globally in infrastructure privatization is the outcome of a confluence of factors, many of which are long-term in nature. These include demographics, the need to replace postwar infrastructure, and changing attitudes towards the private sector. To the extent that the present financial crisis introduces urgency and even desperation to public finances, it hastens the move towards privatization. Many municipalities simply do not have the funds to maintain aging infrastructure, let alone expand it to meet the increasing demands of cities. With falling tax revenues and stable or increasing demand for government services, cities are increasingly cash-strapped.

Moreover, even if we have seen the worst of the global downturn, the pressure on city finances is likely to grow more acute before it eases, since city fiscal conditions typically lag economic conditions by two years. This is a function of the fact that residential property taxes, which constituted 32 percent of municipal general fund revenue in 2009, move with property values, which themselves lag general economic activity. The National League of Cities estimates that the low point for city fiscal conditions will occur in 2011.[23]

In this context, many cities besides Chicago have identified infrastructure assets that might be divested to meet budget deficits or reduce debt. The debt-burdened state capital of Harrisburg, Pennsylvania, for example, recently retained a consultant to analyze its options. The recommendation: double the property tax, sell city-owned garages and museums, or even a park, and increase water and sewerage rates.[24] Mayoral candidates in Toronto have identified a diversity of assets including campgrounds and a downtown heating and cooling system that could be sold to shore up city finances.[25] Los Angeles, Indianapolis, Las Vegas, and Pittsburgh have or are now waiting for offers from the private sector on long-term parking concessions.[26]

Cities have a limited number of policy responses to budget deficits: They can increase taxes, reduce services, borrow more money, or sell city assets. The first two options are politically unattractive to elected officials; mounting public debt and skittish bond markets will increasingly preclude the third. The financial reality of cities and states virtually ensures that we will see many more of these transactions.

---

23. Christopher Hoene, "City Budget Shortfalls and Responses: Projections for 2010-2010," *Research Brief on America's Cities.* National League of Cities, December 2009.

24. "A Burning Issue: Pennsylvania's State Capital Is on the Brink of Bankruptcy," *The Economist,* March 18, 2010.

25. Toby Sanger and Jim Stanford, "Selling Off our Public Assets Makes No Sense for Toronto." *Toronto Star,* April 6, 2010.

26. Gregory Seay, "City May Sell Off Parking: Hartford Eyes One-Time Payment as Budget Fix," *Hartford Business Journal,* March 15, 2010.

2. An effective privatization policy would balance financial and equity considerations and give meaningful thought to what constitutes "the public interest."

A key to assessing whether a privatization deal is in the public interest is assessing who bears the costs of the deal and to whom the benefits accrue. In an early guide to privatization decisions published by the Brookings Institution, Jose Gomez-Ibanez and John Meyer caution that attempts to realize efficiency gains through infrastructure asset privatization might lead to an inequitable distribution of costs and benefits among members of society. They write:

> Privatization creates winners and losers and thus [raises] considerations of equity. Indeed, the debates over cost savings and efficiency often fail to distinguish between savings that are net efficiency gains and those that represent transfers from one segment of society to another.[27]

As a result, there is a risk that broader social costs associated with a privatization decision could be neglected when assessing the terms of an agreement. In cases where public assets are sold or placed under a long-term lease, fiscally responsible governments should take steps to ensure that privatization minimizes unintentional fiscal and economic effects. These steps include:

- Conducting impact assessments to determine whether consumer behavior might be influenced by changes in asset ownership, leading to negative spillover effects.

- Ensuring that the service quality is maintained.

- Estimating the monitoring and oversight costs incurred by government agencies responsible for post-privatization compliance and factoring these costs into the benefit-cost formulas for assessing potential privatization deals.

- Shortening the contract period for infrastructure-asset leases, thereby allowing competitors the opportunity to bid for future contracts while also guarding against the danger that the initial contract undervalues the privatized asset.

27. J. A. Gomez-Ibanez, and J.R. Meyer (1993) *Going Private: The International Experience with Transportation Privatization,* Brookings Institution Press, p. 5.

- Conducting studies of other U.S. states like Oregon and Texas or countries like Australia and the United Kingdom, which have developed mechanisms for including a public interest criteria when assessing the costs and benefits of a particular privatization deal.

3. Privatization presents more policy options than merely selling existing assets.

Privatization comes in two "flavors," both of which involve creating a public-private partnership in order to tap capital and expertise from the private sector for public purposes. This report has focused on the kinds of deals done recently in Chicago, in which an existing revenue-producing asset (e.g. the Skyway and its tolls) is sold or leased to private investors. However, it is crucial to recognize that privatization deals can also be used to build new infrastructure. In these cases, government uses its unique power of eminent domain to provide property or right of way for a new infrastructure investment; a private partner offers some or all of the capital for the construction of the new asset in exchange for the right to operate it and earn the relevant revenues for a predetermined amount of time.

These "greenfield" privatization deals mentioned in Chapter I allow for the construction of new infrastructure in an environment in which governments are struggling to find capital. At the same time, these deals are substantively and politically different from selling public assets. They avoid some of the most contentious policy issues related to divesting existing assets because there are no "family jewels" being turned over to private hands, nor is there a large dollop of money falling into the hands of politicians. Similarly, the politics of this kind of privatization have the potential to be dramatically different because these projects are creating new infrastructure, and therefore new jobs, rather than putting existing jobs at risk as a form of private sector cost savings.

Given the inexorable trend toward privatization that we have identified, we recommend exploring these kinds of "greenfield" projects and strongly believe those engaged in the public debate should focus attention on this aspect of infrastructure privatization.

4. Privatization can make bad government worse, or good government better. It is not a cure for corruption, since corrupt politicians can use privatization to enrich themselves or their cronies at the expense of the public.

Because privatization is such a powerful tool, it amplifies the power of whichever entity wields it. Under normal circumstances, an inept or corrupt government can squander all the resources at its disposal. Privatization enables a bad government to squander future resources as well. Privatization can:

- make corruption worse because the huge sums involved invite kickbacks or sweetheart deals;
- magnify political myopia because the benefits are heavily front-loaded relative to the costs; and
- paper over unsustainable fiscal deficits because the revenues can be used to pay current operating costs—for a while.

Conversely, privatization can enhance the ability of a "good" government to plan and invest for the future. It provides a source of capital that can be used to make a city's infrastructure and people more productive, and therefore more prosperous, in the long run. However, it requires strong political leadership and rigorous, ongoing civic engagement to make sure that hundreds of millions or even billions of dollars of one-time revenues are put to use in ways that promote the public interest. (Of course, that process must begin with a sophisticated discussion of what exactly constitutes "the public interest.")

There is a dangerous misperception that privatization is a substitute for bad governance, or a cure for corruption. In fact, privatization is a tool best reserved for those government institutions in which we have the most confidence.

5. Privatization is neither good nor bad but an economic tool that can be used well or badly.

This report concludes that privatization is a tool that can be valuable for policymakers; it can also be abused or executed poorly. A meaningful comparison can be made to a major medical procedure, such as open-heart surgery. It's not a good or bad thing in general; rather, it is right or wrong for a given patient—and a shoddy job of it is never a good thing. The U.S. Government Accountability Office came to a similar conclusion in its 2008 report on public-private partnerships in transportation infrastructure, in which it concluded that:

> Highway public-private partnerships show promise as a viable alternative, where appropriate, to help meet growing and costly transportation demands. The public sector can acquire new infrastructure or extract value from existing infrastructure while potentially sharing with the private sector the risks associated with designing, constructing, operating, and maintaining public infrastructure. However, highway public-private partnerships are not a panacea for meeting all transportation system demands, nor are they without potentially substantial costs and risks to the public—both financial and nonfinancial—and trade-offs must be made. While private investors can make billions of dollars available for critical infrastructure, these funds are largely a new source of borrowed funds, repaid by road users over what potentially could be a period of several generations. There is no "free" money in highway public-private partnerships.

While answering the question of whether a given privatization deal is good for the public interest with "It depends" may not be satisfactory, it is an important advancement to the current debate. It suggests that the focus should not be on whether the idea of privatization is good or bad, but rather whether the deal is a good one financially, whether the right protections have been written into the contract, and how the "use of proceeds" are structured.

6. Even a "good" privatization deal can end badly.

Discussions of privatization, including this report, rightfully focus on the three key aspects of a privatization agreement: ensuring that there are efficiency gains to be generated by putting the asset in private hands; pricing the deal fairly; and guarding against any unforeseen or unacceptable social costs. But even when those three criteria are met, the public interest can still be compromised, for two reasons.

First, the private firm or firms acquiring the asset can renege on their obligations under the agreement, due to bankruptcy or some other contingency. Any reasonable contract will protect against the adverse financial consequences of such a development. (Presumably the asset reverts to public control and can perhaps be sold again.) But the public is not necessarily protected against service interruption. Our group was briefed on the state of the Illinois Tollway Oases, which were, until recently, operated by a private firm under contract with the Illinois State Tollway Highway Authority. When that firm declared bankruptcy, the Oases were closed—leaving motorists without basic amenities. This could be a socially disastrous situation if a private firm were unable to honor its agreement to operate a major transit line, a hospital, or some other form of crucial public infrastructure.

Second, grandstanding politicians may be tempted to roll back privatization agreements, at enormous taxpayer expense. One of the important benefits of privatization is that an asset is often more valuable in private hands because private operators are willing to make politically unpopular decisions that improve revenues, such as raising tolls or hiking parking meter fees. But that benefit can boomerang if opportunistic politicians make higher fees or tolls a populist election issue and promise to roll back a privatization deal. For example, one could easily imagine a Chicago mayoral candidate running against the parking meter deal and vowing to get the city out of it. Of course, a contract is a contract, meaning that the government would pay a steep price for this change of heart, making citizens worse off in two respects: 1) they would be stuck with the price of the broken contract; and 2) the asset in question would be "underpriced" for the foreseeable future.

Recommendations

U.S. investment in infrastructure is lagging behind the rest of the world. This infrastructure investment gap will slow productivity, diminish our standard of living, and erode our global competitiveness if left unaddressed. Our yearlong study of the privatization of infrastructure has led us to the following recommendations:

1. **Establish a Blue Ribbon Commission to help develop a privatization policy for Chicago and Illinois. Specifically, the Commission should examine what kinds of assets are the best candidates for privatization; determine how that process ought to be conducted; and develop the contours of transparent and effective public interest criteria.**

Details matter when it comes to privatization. Some assets are perfect candidates for privatization; others are not. Even a perfect asset for privatization becomes a bad deal if the price or public protections are not right. And even a good privatization deal at the right price with adequate social protections can be contrary to the public interest if the revenues are used unwisely. What's the best way to use the proceeds from a sale? How can the proceeds do the most good?

Accordingly, the mayor of Chicago, the governor of Illinois, and/or prominent Chicago civic groups should appoint a diverse panel of experts to examine the kinds of issues raised by this report and provide substantive input to guide policy going forward. The commission should be made up of academics, legal experts, experts in public finance, organized labor, and representatives of public interest groups that can speak to the relevant equity issues.

The exact composition of the commission matters less than its balance between substantive expertise and political relevance. The commission must have the requisite substantive expertise to make recommendations that speak to the complexity of the privatization issue. The group collectively must also have sufficient political acumen that the policy guidance is relevant and realistic. It should neither be a political rubber stamp for sitting lawmakers nor an academic exercise that gathers dust.

This report has made clear that privatization is a fabulously complex issue that affects numerous stakeholders, often across multiple future generations. The Blue Ribbon Commission can address many of the key needs and policy deficits we have identified: the need for a consistent intellectual framework for evaluating when privatization makes sense and when it does not; a policy that incorporates the lessons learned from abroad, including the development of an objective criteria for identifying and incorporating broad public interest concerns in the final deliberations; a process for generating a better public discussion around these issues; safeguards for transparency; and guidelines for using privatization revenues. In short, the commission can begin to transform privatization in Chicago and elsewhere from a set of seemingly disparate "deals" to a coherent policy. Chicago could contribute, again, to advancing the privatization debate.

2. Ask the right questions.

To develop an effective way to evaluate and discuss any deal, local leaders must ask the right questions. Chapter III outlined a set of key questions such as:

- What are the potential benefits that private operation would bring *to this particular asset*?

- How might privatization constrain future options?
- What are the social implications of the privatization?
- What are the alternatives?
- How can taxpayers increase the likelihood that they are getting the best price for the deal?
- How will the proceeds be used?
- Is there adequate ongoing oversight?
- Is there a process for comprehensive public input?

3. **Promote a better public debate surrounding privatization issues and a fully transparent process for executing them, from start to finish.**

As illustrated by past privatization deals (e.g., Skyway, parking garages, parking meters) and proposed privatization deals, citizens want greater openness in the process by which public assets are potentially privatized. They want a greater say as to whether an asset should be privatized; which, if any, public assets are privatized; and they want greater transparency about the terms under which the assets will be operated once privatized.

Greater transparency and a fully informed debate will benefit all parties: They will protect the public from dubious decision-making regarding important public assets and help public officials earn the trust of their constituents, whose buy-in is crucial for the political success of public-private partnerships in the long-run. Indeed, today, in some quarters, "privatization" is a four-letter word given the way in which certain privatizations have been carried out. This state of affairs is unfortunate, since in a world of limited resources, the public and private sectors should work together wherever feasible.

To that end, the report proposes that the elected legislative body with authority over public assets (city council, state assembly, Congress, etc.) develop "privatization criteria" to evaluate privatizations. These criteria could include the following:

- A prescribed notification process if the executive is seriously considering a potential privatization.

- A checks and balances system by which the legislative body would approve the authority of the executive to conduct bidding and negotiate a particular privatization deal.

- A transparent bidding process, and transparent criteria for selecting the bidder with whom the executive will conduct final negotiations.

- Publication of the final terms of the deal with a role for the legislative body to approve the final deal.

- Adequate notice-and-comment period between the time that the executive publishes the terms of the deal and a vote by the legislative body. Public hearing and debate should occur before the vote during this notice-and-comment period.

- Public access (preferably online) to all documents associated with bids and any papers associated with the executive's decision-making process, after a deal has been consummated.

- An independent assessment by the inspector general, or another appropriate independent body, to provide analysis of the deal under the privatization criteria, validate the financial numbers, ensure the deal's compliance with the law, and disclose all potential conflict issues (for instance, campaign contributions by any of the concessionaires or advisors to executive or legislative issues).

Conclusion

Chicago and the Richard M. Daley Administration have been helpful in getting these issues on the agenda (although more could be done to create a strategic framework to help the public better understand and assess the deals in terms of determining when and how privatization of city assets should proceed). Since entering a long-term agreement to lease the Chicago Skyway, Chicago has taken a leadership role in the United States in its pursuit of privatizing public infrastructure. Both for the deals Chicago has done—parking garages, metered parking operations, and the Skyway—and those it has or is considering, such as Midway Airport and water, the city is defining the realm of possibilities for privatization. However, we are concerned about the way in which the city presents possible targets for privatization to the public. For example, the idea for privatizing water was suggested casually by a high-ranking city official as an aside at a press conference.

Chicago has proven adept at closing privatization deals. The speed at which these deals move from introduction to finalization is considerable, especially given the various levels of decision-making in the process, including the need to win over the support of a majority of the city's 50 aldermen. While we recognize the need to avoid "bureaucratic gridlock," we would recommend that the city, or perhaps the Blue Ribbon Commission we recommend above, present a list detailing possible targets for privatization and their rationale so that the public has ample time to study both the challenges and opportunities.

Perhaps the most important result of past privatizations, and a key takeaway that Chicago leaders could benefit from, is the realization that if privatizations are to be successful, the public interest needs to be better accounted for in the process of striking a deal. There are important lessons to be learned from other states and countries in how to do this.

The crisis in state and city budgets means that privatization will continue to provide an attractive financing mechanism to raise cash and attend to the city's severe infrastructure challenges. Now is the time to determine how it can be used to its fullest advantage. Today, we have the opportunity to answer "Yes" to the question, "Is the privatization of infrastructure in the public interest?" But to do so, we must ask the right questions and develop the right public policy responses. It is our hope that this report takes us at least part of the way in doing so. Future generations are depending on us to get this answer right.

Emerging Leaders Class of 2008

Olga Camargo
Senior Vice President
Mesirow Financial
Olga joined Mesirow Financial in 2004. She is in charge of identifying, developing, and building the company's business with new millennium markets, including Hispanic and women business owners. She is a member of the Economic Club of Chicago, a board member of the Instituto del Progreso Latino, a board member of Chicago United, and was designated by Chicago Latino Network as the Latina Professional of the Year in 2007. She earned her BS in Marketing and her MA in English from the University of Illinois at Chicago.

Piyush Chaudhari
Executive Vice President
Aon Consulting
Piyush joined Aon Consulting in 2006 after having worked at IBM, Motorola, and McKinsey and Company. He has been awarded two U.S. patents in the area of microelectronics. He earned his BS and MS in mechanical engineering from the University of Illinois at Chicago and his MBA from the Kellogg School of Management at Northwestern University.

Zach Egan
Director of International Research and Fund Manager
Columbia Wanger Asset Management, LP
Zach joined Columbia Wanger Asset Management in 1999. He was a Robert Bosch Foundation Fellow in Germany in 1998-99 and is a trustee of the Lycée Français de Chicago. He earned his BA in philosophy from Middlebury College and his AM in political science from the University of Chicago.

Stephen Haggerty
Global Head of Real Estate and Development
Hyatt Hotels Corporation
Stephen joined Hyatt in 2007 after thirteen years with Marriott International. He is responsible for global development activity for all of Hyatt's lodging brands, owned real estate, and related asset management activities. Steve has extensive international experience, having held positions in Europe and the Asia/Pacific region. He earned his BA from Cornell University.

Joshua Hale
Executive Director
Big Shoulders Fund
In 2005, Josh became the executive director of Big Shoulders, which provides scholarships and programmatic support for ninety-three inner-city Catholic schools and more than 25,000 children. Previously, he worked at Cristo Rey Jesuit High School, as management consultant with The Hale Group, Ltd., and as a volunteer school teacher with the Jesuit Volunteer Corps in the Marshall Islands. He earned his BA in communications from Marquette University.

Minoo Javanmardian
Vice President
Booz and Company
Minoo is focused on developing corporate and business strategies and strategy-based-transformation in the healthcare industry including payers (health plans) and providers (e.g. hospitals and clinics). Born in Iran, she completed undergraduate studies in chemical engineering at the University of Tehran, received an MS in chemical engineering from the University of Manchester in Britain, a PhD in chemical/biochemical engineering from the University of Michigan, and an MBA from the University of Chicago.

S. Raja Krishnamoorthi
President
Sivananthan Laboratories
Raja recently joined Sivananthan Laboratories, a company focused on basic scientific research and development. In 2010, he ran for Illinois State Comptroller, losing by 1% in the 2010 Democratic Primary. Prior to this, he was Deputy Treasurer for Illinois, making him the highest ranking South Asian to have served in Illinois government. Before that, he was a partner at Kirkland & Ellis, a Special Assistant Attorney General in the Illinois Attorney General's office, and a member of the Board of the Illinois Housing Development Authority. Raja earned his BSE in Mechanical Engineering from Princeton University and his JD from Harvard Law School.

Kate Maehr
Executive Director
Greater Chicago Food Depository
In 2006, after ten years with the Food Depository, Kate was selected to lead the nation's premier food bank. She has been recognized by

Crain's "Who's Who" in 2006 and 2007, Crain's "40 Under 40" in 2004, and participated in Leadership Greater Chicago in 2005. She earned her BA in English and art history from Macalester College and her MA in public administration from the University of Wisconsin, Madison.

Lisa McClung
Executive Vice President
Lismore International
Prior to joining Lismore International in 2009, Lisa had worked at W.M. Wrigley Jr. Company since 2000. She has over fifteen years of global marketing and product development experience. She has lived in Africa and Europe. In Chicago, Lisa is a member of several boards, including the Board of Trustees of the Chicago Architecture Foundation, the Women's Board of the Field Museum, and Ravinia Associates. She earned her BA from Smith College and her MBA from the Kellogg School of Management at Northwestern University. She was also a visiting scholar at Harvard College.

Sean Ryan
Partner
A.T. Kearney
Sean has over ten years of consulting experience with U.S. and European clients. He specializes in growth related issues in consumer products and health care and leads the North America practice area. He has published articles on Europe, the global economy, and finance. He earned his BA in history from Boston College, his MA in international relations from The Johns Hopkins University (SAIS), and his MBA from the University of Chicago.

Tracey Scruggs-Yearwood
Vice President of Multimedia
Chicago Urban League
Tracey is an Emmy Award-winning producer. She is the executive producer of the Chicago Urban League's television series, *nextTV.* She joined the League in 2007 after having previously worked with the Illinois Department of Human Services and CNN. She produced segments for the Oprah Winfrey Show and was an Ethel Payne Fellow in South Africa in 1998. She has studied in Italy and earned her BS in communications from Northwestern University.

J. Jordan Shields
Associate Director
Navigant Consulting, Inc.
Jordan joined Navigant Consulting in 2006 and has healthcare consulting experience with Ernst & Young and Arthur Andersen. He studied in Chile and volunteered in Ecuador as a school teacher and for the government. He earned his BA with honors in economics and Spanish from Bowdoin College and his MBA from the Kellogg School of Management at Northwestern University, where he was named Top Student in Health Industry Management.

Roger Shores
Group President
Illinois Tool Works
Roger has been with ITW since 1992 and has more than ten years of experience in managing global businesses. He is a current member of the board of directors of the Chicago Youth Centers. He earned his BS in mechanical engineering from the University of Massachusetts.

Juliet Sorensen
Assistant Clinical Professor, Northwestern Law School
Senior Lecturer, Kellogg School of Management
Juliet recently joined the faculties of Northwestern Law School and the Kellogg School of Management, where she is an assistant clinical professor teaching and researching in the areas of international criminal law and human rights. Prior to this, she was an Assistant U.S. Attorney from 2003-2010 focusing on fraud and public corruption, and a litigation associate and a judicial clerk in Boston. She was also a maternal and child health volunteer with the U.S. Peace Corps in Morocco and volunteered in Colombia as a trial advocacy instructor. She received her BA in politics from Princeton University and her JD from Columbia University School of Law.

Nik Theodore
Associate Professor
College of Urban Planning and Public Affairs, University of Illinois at Chicago
Nik teaches, writes, lectures, and consults on urban planning and labor markets in the United States and Britain. He was an Atlantic Fellow in Public Policy at Manchester University in England and was recognized by *Crain*'s "40 Under 40" in 2003. He earned his BA in urban studies and political science from Macalester College and his

MA in urban planning and PhD in public policy analysis from the University of Illinois at Chicago.

Charles Wheelan
Senior Lecturer
Harris School of Public Policy, University of Chicago
Charlie teaches at University of Chicago and Dartmouth College and is the author of *Naked Economics: Undressing the Dismal Science,* a monthly columnist on Yahoo! Finance, and a correspondent for WBEZ Radio. Previously, he worked for Chicago Metropolis 2020 and *The Economist.* He earned his BA from Dartmouth College, his MPA from Princeton University, and his PhD from the University of Chicago.

Reza Yassari
Director of Spinal Oncology and Assistant Professor of Neurosurgery
Montefiore Medical Center at Albert Einstein College of Medicine
Reza earned his MD from the University of Vienna and his MS from the University of Chicago, where he was also a fellow at the MacLean Center for Clinical Medical Ethics. He most recently was an instructor at Johns Hopkins Hospital, Department of Neurosurgery, in the Spine Division. He has published extensively in neurosciences and has been awarded numerous scholarships and awards in the United States and abroad. He works as a volunteer for the Virtue Foundation, where his main interest has been the development of sustainable educational and medical infrastructures in developing countries.

Resources

Aghor, Ashwin. "Torrent of Power Awaits Bhiwandi." *Daily News & Analysis India,* December 20, 2006.

American Society of Civil Engineers. "2009 Report Card for America's Infrastructure." Reston, Va.: American Society of Civil Engineers, 2009.

American Trucking Associations. "Highway Users Form Coalition to Oppose Privatization of Toll Roads Group Says Government Must Be Held Accountable for Financing." Press Release, February 9, 2007.

Brinkley, Joel. "Reagan Appoints Privatization Unit." *New York Times,* September 4, 1987.

Bullock, Nicole. "Recession Hits US Cities' Finances." *Financial Times,* September 1, 2009.

Choksi, Armeane. "Privatization in the Developing World." Briefing to report authors, December 11, 2009.

City of Chicago, Department of Finance. "Asset Lease Agreements."

City of Chicago, Department of Finance. "Comprehensive Annual Financial Report for the Year Ended December 31, 2008." Chicago: City of Chicago, 2009.

Civic Federation. "Alternative Service Delivery." Civic Federation Issue Brief. Chicago: Civic Federation, 2006.

Collins, Robert and John Schmidt. "Introduction to Privatization." Briefing to report authors, September 11, 2009.

Coloaco, C.A. "Powered by Privatisation." *Financial Express,* November 5, 2008.

D'Souza, Rohan S. "Impact of Privatisation of Lakes in Bangalore." Mumbai: Centre for Education and Documentation, 2007.

Dugan, Ianthe Jeanne. "Facing Budget Gaps, Cities Sell Parking, Airports, Zoo." *Wall Street Journal,* August 23, 2010.

Dumke, Mick. “The Case for Selling Off the City.” *Chicago Reader,* January 14, 2010.

Dutzik, Tony, Brian Imus, and Phineas Baxandall. “Privatization and the Public Interest: The Need for Transparency and Accountability in Chicago’s Public Asset Lease Deals.” Chicago: Illinois PIRG Education Fund, 2009.

Economic Times. “MSEDCL, Torrent to Supply Power to Bhiwandi.” December 22, 2006.

The Economist, “A Burning Issue: Pennsylvania’s State Capital Is on the Brink of Bankruptcy.” March 18, 2010.

The Economist, “The Cracks Are Showing.” June 26, 2006.

Enright, Dennis J. “The Chicago Skyway Sale: An Analytical Review.” NW Financial Group, May 2006.

Fernando, Valérie. “Disappearance and Privatisation of Lakes in Bangalore.” Charles Léopold Mayer Foundation for the Progress of Humankind, November 2008.

Financial Express. “Bhiwandi Suffers on Increased Load-Shedding.” February 13, 2007.

Financial Express. “Power Franchisee Model in Bhiwandi Soon.” June 5, 2006.

Fitch Ratings. “U.S. Toll Road Privatizations: Seeking the Right Balance.” New York: Fitch Ratings, 2006.

Foote, John H. “Understanding Contemporary Public Private Highway Transactions: The Future of Infrastructure Finance.” Testimony to the Highways, Transit and Pipelines Subcommittee of the U.S. House Transportation and Infrastructure Committee, May 24, 2006. Accessed via the Harvard Kennedy Law School.

Foreign Policy, “2010 Global Cities Index.” September/October 2010.

Frank, Thomas. “The Real Chicago Way: A Privatization Scheme That’s a Loser for Taxpayers.” *Wall Street Journal,* December 8, 2009.

Gabriel, Seth, and Jordan Head. "The Private Finance Initiative: An Innovative Procurement Tool for Today's Public Administrators." *Policy Perspectives* 13 (2006).

Gilroy, Leonard C., ed. "Annual Privatization Report 2009." Washington, D.C.: Reason Foundation, 2009.

Gokhale, Jagadeesh, and Kent Smetters. "Fiscal and Generational Imbalances: New Budget Measures for New Budget Priorities." Policy Discussion Papers. Cleveland: Research Department of the Federal Reserve Bank of Cleveland, 2003.

Gomez-Ibanez, Jose A., and John R. Meyer. *Going Private: The International Experience with Transportation Privatization.* Washington, D.C.: Brookings Institution Press, 1993.

Hoene, Christopher W. "City Budget Shortfalls and Responses: Projections for 2010-2010." *Research Brief on America's Cities.* Washington, D.C.: National League of Cities, December 2009.

Illinois Commission on Government Forecasting and Accountability. "Government Privatization: History, Examples, and Issues." Springfield, Ill.: State of Illinois, 2006.

Johnson, Craig L., Martin J. Luby, and Shokhrukh I. Kurbanov. "Toll Road Privatization Transactions: The Chicago Skyway and Indiana Toll Road." Bloomington: Indiana University, September 2007.

Judt, Tony. "What Is Living and What Is Dead in Social Democracy?" *New York Review of Books,* December 17, 2009.

Karandikar, Shrirang, and Ashok Ghatol. "Combating Overload in Distribution System to Control Power Loss and Increase Reliability." Paper presented at the First International Conference on Emerging Trends in Engineering and Technology, Nagpur, India, July 2008.

Lawson, Nigel, "Economy: New Conservatism (Lecture to the Bow Group)." August 4, 1980. Accessed via Margaret Thatcher Foundation.

Little, Richard G. "Beyond Privatization: Rethinking Private Sector Involvement in the Provision of Civil Infrastructure." Working Paper. Los Angeles: University of Southern California, 2010. Accessed via SSRN.

MacDonald, Alistair. "U.K. Considers Privatizations to Cut Its Debt." *Wall Street Journal,* October 14, 2009.

Matthews, Zoe, Andrew Channon, and Wim Van Lerberghe. "Will There Be Enough People to Care? Notes on Workforce Implications of Demographic Change 2005–2050." Geneva: World Health Organization, 2006.

Megginson, William. "Privatization in the Developed World." Briefing to report authors, November 13, 2009.

Mihalopoulos, Dan, and Hal Dardick. "Aldermen Approve Chicago Parking Meter Lease." *Chicago Tribune,* Clout St. blog, December 4, 2008.

Mihalopoulos, Dan and Mick Dumke. "Outrage Aside, Drivers Fuel High Parking Meter Profits." *Chicago News Cooperative,* July 29, 2010.

Mihalopoulos, Dan. "Firm with Parking Lease to Net $11.6 Billion: Report." *Chicago News Cooperative,* August 9, 2010.

Moskow, Michael, and Paula Wolff. Briefing to report authors, May 14, 2010.

Pew Research Center for People & the Press. "Trends in Political Values and Core Attitudes: 1987-2009." Washington, D.C.: Pew Research Center, 2009.

Preston, Darrell. "Morgan Stanley's $11 Billion Makes Chicago Taxpayers Cry." *Bloomberg,* August 8, 2010.

Reagan, Ronald. "Remarks at a White House Ceremony Marking the Sale of the Consolidated Rail Corporation." April 3, 1987.

Saffold, Gene. "Privatization Efforts in Chicago." Briefing to report authors, October 9, 2009.

Sanger, Toby, and Jim Stanford, **"**Selling Off our Public Assets Makes No Sense for Toronto." *Toronto Star,* April 6, 2010.

Schulman, Daniel, and James Ridgeway. "The Highwaymen: Why You Could Soon Be Paying Wall Street Investors, Australian Bankers, and Spanish Builders for the Privilege of Driving on American Roads." *Mother Jones.* January/February 2007.

Seay, Gregory. "City May Sell Off Parking: Hartford Eyes One-Time Payment as Budget Fix." *Hartford Business Journal,* March 15, 2010.

Seliga, Joseph. "An Overview of the Chicago Skyway Transaction." From a Powerpoint presentation at Northern Border Finance Conference, May 2007.

Singh Rawat, Virendra. "Torrent, Reliance Bid for Power Distribution in Agra." *Business Standard,* February 25, 2009.

Southern Illinoisan. "Chicago Privatizes Skyway Toll Road in $1.8 Billion Deal." October 17, 2004.

Steinhauer, Jennifer. "Arizona May Put State Prisons in Private Hands." *New York Times,* October 23, 2009.

Swan, Peter and Michael Belzer, "Empirical Evidence of Toll Road Traffic Diversion and Implications for Highway Infrastructure Privatization", January 14, 2008.

Sweeney, James. Briefing to report authors, April 9, 2010.

Sydney Morning Herald. "Australia 'Tops' in Managed Funds." January 23, 2006.

Tata Power Website. "Coming Full Circle – The Case for Privatization of Power Distribution." http://www.tatapower.com/whatsnew/pdf/coming-full-circle.pdf

Taub, Daniel. "Corrections Corp. Shows Crime Pays as States Turn Jails Private." *Bloomberg,* May 11, 2010.

Tembhekar, Chittaranjan. "Power Privatisation Puts Bhiwandi in New Light." *TNN,* June 24, 2009.

United States Government Accountability Office. "Highway Public-Private Partnerships: More Rigorous Up-front Analysis Could Better Secure Potential Benefits and Protect the Public Interest." Washington, D.C.: United States Government Accountability Office, 2008.

The Urban Land Institute and Ernst & Young. *Infrastructure 2010: Investment Imperative.* Washington, D.C.: The Urban Land Institute, 2010.

Varghese, Merin, and Radhika Miglani. "Privatization of Water in Karnataka: Special Focus on Bangalore." Centre for Civil Society Working Paper 190. New Delhi: Centre for Civil Society.

Warrick, Joby, and R. Jeffrey Smith. "CIA Hired Firm for Assassin Program." *Washington Post,* August 20, 2009.

Youtube. "Sydney Ferries Campaign." http://www.youtube.com/watch?v=A8I3cg4UX4U

Emerging Leaders Class of 2008

Olga Camargo
Mesirow Financial

Piyush Chaudhari
Aon Consulting

Zach Egan
Columbia Wanger Asset Management, L.P.

Stephen Haggerty
Hyatt Hotels Corporation

Joshua Hale
Big Shoulders Fund

Minoo Javanmardian
Booz and Company

S. Raja Krishnamoorthi
Sivananthan Laboratories

Kate Maehr
Greater Chicago Food Depository

Lisa McClung
Lismore International

Sean Ryan
A.T. Kearney

Tracey Scruggs-Yearwood
Chicago Urban League

J. Jordan Shields
Navigant Consulting, Inc.

Roger Shores
Illinois Tool Works

Juliet Sorensen
Northwestern Law School and Kellogg School of Management

Nik Theodore
College of Urban Planning and Public Affairs, University of Illinois at Chicago

Charles Wheelan
Harris School of Public Policy, University of Chicago

Reza Yassari
Montefiore Medical Center at Albert Einstein College of Medicine

THE CHICAGO COUNCIL
ON GLOBAL AFFAIRS

332 South Michigan Avenue
Suite 1100
Chicago, Illinois 60604
thechicagocouncil.org