

The Privatization of Public Services

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"In public administration, there is no connection between revenue and expenditure ... there is no market price for achievements."

– [Ludwig von Mises](#)

Fifty years ago, Detroit was the fourth largest city in the United States, with a population of 1.7 million people, and at \$8,500 per year, one of the richest cities in terms of per capita income. It was 3.5 times the size of Indianapolis, the 26th largest city, whose income was almost identical on a per capita basis.^[1] Today Detroit and Indianapolis are the 11th and 12th largest cities, respectively, with Detroit's population cut in half from 50 years ago (and losing 3,000 people per year this decade), while Indianapolis has grown by 70% during the same time frame. Remarkably, Indianapolis now has a per capita income 50% *greater than* Detroit's.^[2]

How did this happen? One answer, according to the Mackinac Center for Public Policy, is that Detroit's city government is far larger, more regulation prone, and more bureaucratic than Indianapolis's city government: the ratio of residents to city employees, a key measure of city government productivity, is 50:1 in Detroit, one of the worst in the United States, but is 203:1 in Indianapolis, one of the best. More broadly, the central issue in political economy concerns the optimal delineation of the sphere of government activity versus that ascribed to markets, and in this essay we examine this question from the vantage point of municipalities.^[3]

What does economic theory say about the proper role of government, and how do proponents of larger government attempt to justify their argument? Writers from Aristotle to Locke to Adam Smith have inveighed against government intervention, and indeed, neoclassical economic

theory has affirmed the superiority of free markets as the institutional backdrop most conducive to the generation of wealth.

However, allies of big government rely on the modern theory that holds that government provision of goods and services is warranted in cases of *market failure* or *externalities* in production.^[4] Markets are said to fail in the event of natural monopoly (where average production costs decrease with increasing scale, and hence the most efficient industry structure is a single producer) or in the case of *public goods* such as national defense, where consumption of the good is nonexcludable and nonrivalrous (e.g., the consumption of national defense services, say, unlike the purchase of a home or an automobile, cannot preclude a "free rider" from enjoying the same services). Meanwhile, a popular example of a negative externality is factory pollution, where property rights are not clearly defined; in all these cases, traditional economic theory offers a *prima facie* rationale for government intervention or regulation.

The Austrian School of economics does not countenance the received theory in these instances: Ludwig von Mises pointed out, for example, that monopoly could only technically occur in an instance where a scarce resource was controlled by a single party (e.g., the DeBeers diamond holdings approach this), and thus most observed instances of monopoly were in fact generated by government sanction (e.g., public utilities).

Similarly, Austrians point out that public-goods provision as justified by the existence of free riders is often a case of poorly defined property rights.^[5] Nonetheless, as Tocqueville presciently warned, the activity of government at all levels of society has not been constrained, not even merely to the provision of public goods: the tendency has been for many indisputably competitive services to be provided by municipal, state, or federal governments, often in the name of redressing alleged social ills such as inequality. Via progressive (and progressively increasing) taxation, this has unduly burdened the public purse at all levels, and led to hardship, particularly in many "Rust Belt" cities.

In this essay we examine the linkage between taxation and the size of municipal government on the one hand, and economic vitality on the other, which is proxied by data involving population or per capita income changes. Via a case study of one Rust Belt city, Akron, Ohio, we review the recent history of how it has fared comparatively in terms of economic vitality.^[6] While the picture depicted is bleak and an all-too-predictable consequence of unrestrained growth in government, we then turn to a solution to Akron's problems — the *only viable solution* — based on privatization of city services and a lessening of the (tax) burden of government. This discussion is gleaned from well-run cities in the United States. We then conclude with observations about the meaning of these findings for the future of urban America.

AKRON, OHIO'S EXPERIENCE WITH GROWING GOVERNMENT AND SUBSEQUENT ECONOMIC HEALTH

Akron was once a proud industrial city, and home to the largest tire makers in the world. Aligned with manufacturers in nearby Pittsburgh, Cleveland, and Toledo, Akron supplied the automotive industry in Detroit, and was known as the world's "rubber capital."^[7] The city has been in a long-term secular decline, however, and city government is now dominated by the longest-

running mayor in the city's history — 20 years and six terms.^[8] A review of this period is in order, therefore, to assess economic growth in relation to the current administrative regime there. For this analysis, the US Census Bureau's [Statistical Abstract of the United States](#) and the [Mackinac Center](#) for Public Policy (a Michigan-based institute studying regional economies) are reliable data sources yielding the following observations:

- The leading indicator of regional growth is population. While the US economy and population steadily advanced since 1987, Akron's population declined by 21,000 since then, to the current total of 209,000 residents. At the start of the current mayor's tenure, Akron was the 66th largest city in the United States; today it is the 92nd. From among the 100 largest cities in 1987, this is one of the most precipitous drops in the rankings, indicating an unusually poor growth environment relative to peer cities. Further, during 1990–2000, the latest decade for comparative data, of the 239 cities in the United States with population of at least 100,000 people, Akron ranked 212th in population growth, with a net loss of 6,108 residents. In contrast, other Midwest cities with demographics comparable to Akron fared far better: Cedar Rapids, Iowa (+11,904); Grand Rapids, Michigan (+8,127); Green Bay, Wisconsin (+5,616); and Rockford, Illinois (+6,173). All give lie to the notion that the decline that Akron experienced was "inevitable." Different policies and leadership produced different results elsewhere.
- Across 20 years, the current city government has pressed for numerous tax increases, implying Akron is underfunded. Yet according to the 2000 census, in measuring city government taxes per capita, Akron was 50th highest (of 239), at \$668 per resident. So, Akron's decline is not a story of an undertaxed city with an underfunded government. To the contrary, among the 239 largest cities in the United States, the majority of the lowest-taxed cities are in high-growth regions (e.g., Texas, Florida, inland California). This confirms empirical research in economics, which has repeatedly shown that high tax regimes act as a drag on employment and income growth.
- High taxation in turn can breed bureaucratic waste: as stated above, a key measure of "bureaucratic bloat" in municipal government is the ratio of city residents to full-time city employees. Again, Detroit (50:1) is a poorly managed city with a wasteful government; Indianapolis (203:1), conversely, is run efficiently, and even Los Angeles is 108:1. The ratio for Akron is 86:1, which is hardly a ringing endorsement of efficient city operations and judicious deployment of taxpayer funds.^[9] Akron's city employees also average \$74,700 in total compensation, or 2.3X the median household income (and 3.5X per capita income) of the city's population, a clear indication of patronage.
- Discussed below, one key "best practice" for cities battling bureaucratic waste is privatization or competition for municipal services. Indianapolis saved \$480 million in the 1990s via competitive bidding or privatizing 75 services which had previously been 100%-government owned and controlled, from golf courses to print shops to janitorial services. Similarly, Ed Rendell saved Philadelphia \$275 million with competition for 49 services. Yet this is one "best practice" that has never been tried in Akron.^[10]
- Akron is an aging city: of 239 cities in 2000, Akron ranked 45th in terms of percentage of population over age 65 (13.5%), and if corrected for retiree cities in the Sun Belt, Akron fares comparatively more poorly. This signifies a lack of entrepreneurial vibrancy borne of a poor record in attracting new businesses and is a dangerous indicator in terms of prospective economic growth.

- In terms of poverty and its most effective antidote, vibrancy of employment, Akron has long fared comparatively poorly; between 1999 and 2005, the percentage of residents in poverty increased from 17.5% to 20.1%, which was 45% higher than national figures. Conversely, Akron had the 47th highest unemployment rate (of 239) in the United States in 2000; examining metropolitan statistical areas (MSAs) shows little improvement, as Akron currently has the 117th highest unemployment rate (5.8%) of 369 MSAs.
- Employment begets income, which generates wealth and economic stability; the obverse of this is also true: prolonged periods of high relative unemployment generate decline. Among the top 100 cities in the United States, Akron has the 18th largest foreclosure rate; by contrast, Pittsburgh, Buffalo, and Syracuse are 80th, 83rd, and 92nd, respectively, indicating more resilient growth potential elsewhere in the Rust Belt.
- Lastly, Akron is best compared to the state of Ohio, which takes in four bigger cities and a few smaller ones (Dayton, Youngstown), all having similar demographics. These data, shown for the most recent year available since 2000, portray the relative performance of Akron's government at generating growth:

Comparative Statistics from the 2000 Census

Metric	Akron	Ohio
Population change, 1990–2000	-2.7%	4.7%
Population change, 2000–2003*	-2.2%	0.7%
High school grads	80.0%	83.0%
College grads	18.0%	21.1%
Home ownership %	59.4%	69.1%
Mean house value	\$76,500	\$103,700
Median household income	\$31,835	\$40,956
Per capita income	\$19,500	\$25,000
Per capita retail sales	\$8,023	\$9,181
Poverty rate, 1999	17.5%	10.6%

* Connotes relative decline continuing into 2000s for latest available comparative data; Akron population loss is now -3.2% from 2000 to 2007.

Source: US Census Bureau

In sum, Akron is seriously declining: since 1987, the US economy is 70% bigger in real terms, but Akron has *lost 21,000 people*. This period has been one of poor leadership, borne of an entrenched government, unfriendly to business and growing both absolutely and relative to other municipalities in size and scale of operation. However, economic decline is *not* inevitable, and Akron *can* achieve a strong turnaround, given its considerable assets. Its best — and only — hope, however, lies in replicating what has worked elsewhere, and involves cutting government and increasing the sphere of private sector activity.

CASE STUDY OF PRIVATE SECTOR SOLUTIONS: INDIANAPOLIS

Indianapolis in the 1990s provides a lodestar as a model. In the early 1990s the city and local economy were still restructuring from an earlier stagnation in which, as in Akron, durable manufacturing jobs had been lost; the population of Indianapolis was 15,000 less than in 1970. While the city had begun to diversify into services such as health care in the 1980s, only the government sector had grown materially (Indianapolis is the state capital). Further, property tax and county income tax rates had exploded, and were up 25% and 350%, respectively, during the 1980s.[\[11\]](#)

Mayor Stephen Goldsmith took office in 1992, committed to a turnaround based on privatization of city services, and creating a climate more conducive to entrepreneurship. During his eight-year tenure as mayor, the city's population increased by nearly 50,000 residents, induced by a more business-friendly environment and its corollary, smaller government. The Indianapolis turnaround was engendered via a three-part program:

(1) ***Creation of the "SELTIC" ("Service, Efficiency, and Lower Taxes for Indianapolis Commission")*** — SELTIC was composed of nine private-sector volunteers, primarily leaders in the business community, who in turn chaired subcommittees with more volunteers with various needed functional expertise or skills. SELTIC's mandate was to study *every* activity of city government, from wastewater treatment to business licensing. The goal: make every city service higher quality, less expensive, and business friendly — or eliminate it altogether. Best practices were gleaned from other municipalities or the private sector, and benchmarking was done for competitor cities and suburbs. SELTIC reported to Mayor Goldsmith, and became an outreach vehicle for new business recruitment.

This commission was the driver of the ensuing miracle in Indianapolis, and has been copied all over the United States. Under Goldsmith, Indianapolis cut its budget and accrued savings of \$480 million in eight years (based on straight-line projections dating to the early 1980s); cut its employee workforce from 4,650 to 3,400 (improving its efficiency ratio of residents to employees to one of the best in the nation, well over 200:1); cut property taxes four times; held its income tax steady after ten years of increases; and saw its municipal debt upgraded to AAA.[\[12\]](#) Finally, unemployment declined from 5.2% to 2.3% during Goldsmith's eight-year tenure, beating the national averages absolutely and relatively. As a result of this impressive performance, over 3,500 mayors, governors, and councilmen came to Indianapolis to learn how it was done in the late 1990s.

A long literature in Austrian economics details how and why governmental bureaucracies fail in the real world; in brief, there are problems with incentives, and failures to exploit knowledge that can solve problems in society.[\[13\]](#) Further, absent private property, there is no entrepreneurship — what Israel Kirzner refers to as the *driving force* of the market economy — and thus poor coordination and use of resources. The SELTIC commission provided empirical validation to this thesis, and was an essential part of the revivification of the city of Indianapolis.

(2) ***Commitment to excellence via privatization*** — In business or government, monopoly can be inimical to economic growth. Monopolists retard quality and customer service, increase costs,

and impede innovation, and America's best-run municipalities now choose private competition over monopoly wherever able. This was the secret to the Indianapolis boom, which other cities have now replicated, and it is Akron's best hope for its future.

How does it work? Indianapolis's SELTIC started with a "yellow-pages test": dozens of city services, from janitorial to print shop to sewer billing to golf course management, were analyzed to see if private-sector vendors offered the service in the yellow-pages. If so, a competitive bidding occurred for contracts to provide the service. This is outsourcing with a twist, however, because if the private vendor won the bid, it absorbed the city's AFSCME (American Federation of State, County, and Municipal Employees) unionized workers. In fact, during Goldsmith's 8-year tenure, *not one city employee became unemployed; the employer merely changed*, with Indianapolis insisting that comparable pay and benefits be initially maintained. And in unique arrangements, AFSCME sometimes continued to represent the workers under now-private ownership. Eventually, 75 services were put to competition: sometimes the city employees won the contract; sometimes a private firm won; but in all cases, huge savings and efficiencies emerged. *This* is how Indianapolis cut 43% (1,200 workers) of its non-public safety workforce, and shaved \$480 million from its budget in 8 years.[\[14\]](#) And happily, the public sector union, AFSCME, generally applauded Indianapolis's public-private partnership excellence, especially when workers received incentive bonuses allowed by new ownership and governance.

The lowered burden of government unleashed the private sector of the Indianapolis economy across the board: per capita income was up by a fourth at decade's end, and employment growth averaged 1.4% every year during the 1990s. Many cities have copied this formula now for the same reasons: Green Bay, for example, privatized its transit system, with cost savings of 7% annually and improved service quality. Managed competition was instituted in Phoenix and Charlotte for waste collection, Buffalo for recycling, and Dallas for vehicle fleet maintenance. Ditto for Los Angeles golf courses, Riverside County's libraries, and facilities maintenance in Cincinnati. Virtually every municipal service is easily amenable to competition (if not outright privatization), with impressive results in better quality and efficiency, lower costs, lower taxes, and improving job-creation environments.[\[15\]](#)

From the foregoing, it is clear that Akron needs to seek efficiencies and cost improvements in order to lower city spending. Why? Because *taxes must be lowered for Akron to revive*. Only 20% of US cities have more onerous tax structures than Akron, and there is a significant correlation between low taxes and job growth. For example, since 1990 Akron has lost 14,000 people, and Green Bay has gained 7,000 with similar demographics; Green Bay's per capita tax burden is *less than half of Akron's*. And, Green Bay's per capita income is now 25% higher, while its resident/city-employee ratio, again a key measure of municipal government productivity, is 27% better than Akron's.

Similarly, in 1999, Goldsmith's last year, Indianapolis had a budget of \$545 million (in 2007 dollars), and employed 3,400 (down 1,200 from eight years earlier); Akron's 2007 budget is almost as big at \$490 million, with only 2,400 employees. Worse, Indianapolis had a population then of 780,000 — nearly *four times that of today's Akron*. Clearly, Akron city government is inefficient and the primary reason for the long-term downdraft in growth, and needs a SELTIC in the manner of Indianapolis.

(3) **Transparency** — Private-sector innovation brings *tools* to generate efficiency, quality, and integrity: activity-based costing, performance measurement, audits, and explicit contract requirements were all part of Indianapolis' success. This enforces a culture of excellence in contrast to, say, Akron's city managers, *none* of whom — even in the year 2008 and "post-Enron era" — have written job descriptions against which performance can be judged, according to the city of Akron's finance director.

As an example, the website for the city of Akron contains the 2007 annual budget in a document of 27 pages; it is impossible to glean details from this summary.^[16] Mayor Jim Schmitt of Green Bay, whose website, by contrast, contains a detailed 192-page city budget audited by a third party, summed up what such a culture breeds. Schmitt, who moved his economic development team next to his office and spends over half his time in business recruitment, said that "entrepreneurs know what they're doing; the best thing we can do is get out of their way." Their creative ideas and systems, he said, help both private and public sectors become better. Indeed, football wasn't the only winner in Green Bay this fall: WS Packaging Group, a \$380 million-in-revenues manufacturer of labels, coupons, and packaging, has just committed to move to the city, and population is up by over 1,000 in Schmitt's 4-year tenure.^[17]

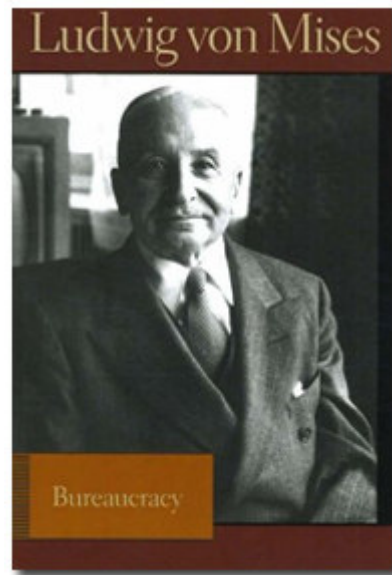
Indianapolis, and more recently cities like Green Bay, offer a blueprint for the renaissance of Akron:

1. a SELTIC-like commission driving change,
2. demanding a culture of excellence dominated by privatization and competitive bidding, and
3. transparent reporting and openness.

It is a formula by which Akron's union workers *and* businesses can win, and it confirms a fundamental verity propounded by Austrian economists with respect to the ironclad nexus between limited government and economic growth.

SUMMARY

Municipal governments that grow raise the tax burden on their residents, and this in turn acts as a drag on both the future tax base and economic growth of the area. The decline of Akron, Ohio is a clear example of this, and the resurgence strategy of Indianapolis in the 1990s is the *only* path to a reversal of fortune in this case. Indeed, a long-term view of this is instructive, as per Detroit and Indianapolis discussed at the outset. While both are Midwestern cities with a heavy industrial base, they are at opposite ends of the spectrum in terms of size and scope of municipal government: the size of government for each city is in inverse proportion to their levels of per capita income. Indianapolis continues to grow, while Detroit's population is declining on a *weekly* basis now.



[\\$18](#)

"It is in the very *nature* of government management that it will be inefficient, and prone to corruption."