

Carnegie Council Privatization Project

Moving Municipal Services Into the Marketplace



Stephen Goldsmith
Mayor, City of Indianapolis



No. 14

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November 20, 1992

Mayor Stephen Goldsmith

Let me tell you just for a second about Indianapolis; I think it is helpful to give you some background on our city. We are the twelfth largest city in the United States; our largest minority population is African American, which constitutes approximately 25 percent of our community; we have the typical urban problems of the other eleven cities, although ours are probably less acute; we have income disparities typical of large cities; and we have the continuing anxiety about whether the economic success of the city has been fairly distributed. So Indianapolis is a typical example of the larger cities, but its problems may be a little less severe. I am a Republican mayor who follows a Republican mayor and I have also advocated sweeping changes of city government. The process of infusing change when succeeding a mayor of your own political party is an intriguing dynamic in and of itself. The issue we are talking about today—competitiveness—I don't particularly view as partisan and, as I chart achievements by other cities, I find that the issue creates moving groups of consensus and coalitions that don't line up along political lines. Before launching into privatization, let me identify the changing contours in big city marketplaces across the country, which require cities to move forward in a more aggressive way to privatize. Some of these are subject to disagreement, but these are the types of things that motivated me to change city government in a relatively basic way.

First of all, in the last ten years, as Indianapolis tried to become a significant city, it viewed its economic development competition as Chicago, Cleveland, Detroit, St. Louis and other major Midwestern cities, and to some extent it tried to find businesses fleeing New York City. That concept continues, except increasingly our competition is our own suburbs. As businesses become interested in coming to Indianapolis, they look at where the lowest cost is to do business in the metropolitan community. Typically, it's not in an urban environment. We are now trying to acknowledge that our competition is ourselves and that the increased cost of living and working in an older part of the city needs to be reversed or wealth will flow out faster than we can keep up. Second, businesses have historically located in our

downtown area. Thirty years ago they had to locate downtown because they wanted to walk next door to buy their stocks or to trade information. Today we have more interstate highways than any city in the country, we probably have 50 percent of the faxes you have here in New York City and an equal number of modems, and people don't need to locate in high-cost urban areas. Third, the accelerating rate of urban family deterioration puts an enormous burden on the cost of city services. These are costs that are loaded disproportionately in older communities and that need to be somehow reversed through efficiencies. Fourth is the changing relationship between the federal government and the cities. As recently as eight or ten years ago, my predecessor had more money coming in than he had going out; now we don't really have very much money coming in.

The money has been replaced with mandates, and mandates translate into expenses, so we have an outflow. If you take out the revenue sharing and put in the mandates, the net change is about \$100 million a year. Finally, you have the environmental issues. What I'm trying to do is approach privatization not as a fire-sale

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for a city that is failing, but to approach competition as the fundamental aspect of change in order for a city that is successful to stay successful, despite the changing contexts in which cities find themselves. This distinguishes us from cities that have been forced to privatization to try to balance the budget. That is not our purpose. We already have a balanced budget; we are trying to move privatization in order to increase the efficiency and efficacy of service.

I was invited to talk about privatization, but let me start with a disclaimer: we do not have a privatization effort in Indianapolis. We have been very careful over and over again to say we do not have a privatization effort; instead we have the most comprehensive competition and competitiveness effort of any major city or maybe any governmental entity in the United States. The distinction is critical for a number of reasons: for labor reasons in my own area, and because private monopolies are only marginally more efficient than public monopolies. There is no great value in and of itself for privatization, as contrasted to the competitiveness process.

We have several different ways that we are approaching this; let me go through these structurally. First, we have a competitiveness council called the Service, Efficiency, and Lower Taxes for Indianapolis Commission—SELTIC. SELTIC is a council of ten of the most entrepreneurial business leaders in our community and 150 volunteers whose job is to go throughout government and identify transactions that can increase competition. We ask the commission to bring five or ten competitiveness opportunities to a public forum with a lot of attention, and generate widespread public observation of the process, because public participation is important for the process to be credible. This organization of business men and women and its volunteers have regular public hearings for transactional purposes. We told them at the beginning that we didn't want reports; we wanted transactions that could be debated in the public domain. So far they have identified about 150 governmental opportunities for competitiveness, a dozen or so of which have been implemented. SELTIC looks at every aspect of government; the opportunities for competitiveness are everywhere. They are in the print shop, they are in the mail room, they are in the car pool, they are in the people who own the buildings themselves; the more you step back, the more you begin to conclude that if government runs the judicial, equitable, and law enforcement components and everybody else was just a purchasing agent, you could probably run government more efficiently than you do now. Opportunities have been identified which include big asset transactions: the possibilities of selling our wastewater treatment plant; selling our city county building and selling our airport (which maybe we'll eventually consider but that's a bit farther down the line). There are also the little issues: the mail rooms, the postage meters, the microfilm division, the messenger services; these in some ways are really more fun to deal with because they create short-term successes which stimulate the rest of the process.

We are trying to create a marketplace for municipal services. I don't know if it's a word or not, but we think in terms of "marketization." Everywhere that we can create a true market, we are trying to do so, both internally and externally with respect to government.

Let me digress a little: Indianapolis' bond rating is a AAA. When I took office last year, we had, by any standard, even a New York standard, the fanciest, four-color, slickest certified financials you have ever seen. The color quality was great, probably even better than the Comptroller's Office of New York, but I had not a single idea how much any activity in government cost. I knew our budget, and that we took in more money than we spent, but I had no idea what anything cost. As we began to compete services, the fact that the Department of Transportation had a four-color certi-

fied financial showing a cash surplus was not a very good benchmark to figure out how much it costs to fill a pothole. This process of activity-based costing has to come in front of the competitiveness process because we can't even get our own folks into a bid mentality until we know how much it costs to provide a service. This is a more difficult issue than I originally anticipated and we are working through it transaction by transaction.

I got into this silly conversation with my top staff yesterday: we've created a separate office of competitiveness and those folks come in as purists and create havoc among the rest of the staff. So the privatization guy comes in and says, "We're going to compete out copying services. There is no reason for us to be doing our own copying. I come from a private law firm, where somebody picked up my copy and had it back in 30 minutes." And the lady who runs public housing says, "But our copy services don't cost us anything." So then we had this horrible argument about what it really costs and where the money is and so on. We have to work through this and that's what we are trying to do. The process is interesting because you find wasted capital as well as opportunities. We were horrified when we started calculating how much it cost to pick up a bag of trash, and found garbage trucks that were out of service because they were being repaired for six months. All we were told was that the cost of running the truck was X dollars, and nobody had ever thought about it before because there was a budget for the garage, there was a budget for the trucks, there was a budget for the gas, and there was a budget for the drivers. Those components didn't come together until we forced people to begin bidding. Now we have bids for franchises for hauling. Let me go back to the DOT—Department of Transportation—anecdote for a second: we forced through the process of figuring out how much it cost to fill a pothole, and then we

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decided to bid it. In the group of people involved in pothole repair there are 32 supervisors for 94 truck drivers. This was not a good ratio by most standards. So we announced we're going to open it up to bid. The drivers' union made the relatively legitimate point that if we wanted them to participate in the process, we had to free them up of all of the unnecessary overhead which we had loaded into their budget. That is not an inappropriate comment, so we removed



Attending a private meeting with Mayor Goldsmith are, left to right: Kevin Leitao, LeBoeuf, Lamb, Leiby & MacRae; Bret Schundler, Mayor of Jersey City; and Peter Ewers, Commonwealth Bank of Australia.

18 of the 32 supervisors and then we set out a bid to private contractors. Then the AFSCME (Association of Federal, State, County and Municipal Employees) workers got together—this may be the most remarkable success of my early career—and said, “We don’t need eight guys on two trucks. If you take this gadget off of truck 2 and put it on truck 1, we can put five guys on truck 1. We don’t need the second truck, or the other three people, and if you allow us to do that, we’ll bid.” They bid and they won. That’s just one victory out of many, but the point is that if you create a market opportunity and you have some good will, you can win.

One unrelated aspect of this story is that, as I said earlier, I’m Republican and I follow a Republican. We had a patronage city where mid-level supervisors tended to be the party of the mayor and the workers who were there for long periods were generally of the opposite party. In the last election AFSCME opposed me and the managerial staff supported me because they had been hired under Republican administrations. Once I got elected, I laid off eighteen of the thirty-two people who endorsed me and I kept every one of the people who opposed me. My political party thinks I’m absolutely irrational. That’s a prime example of what I mean when I say that

the coalitions shift on these issues. So, the first aspect of competitiveness is broad-based public attention and the second aspect is activity-based costing. The third is that just to do something more efficiently when it shouldn’t be done in the first place is not the goal of a well-managed government. There should be some ability to evaluate whether government is ultimately adding value. This process is performance-based accounting. Figuring out how to measure outputs is equally confusing. Yesterday I had an argument with Mitch Roob, the director of the Indianapolis Department of Transportation, who is really a zealot for competition and comes from a private business background. I was complaining to everybody about how we were only measuring inputs and

said that from that point on I wanted everybody to measure output. I told Mitch that I wanted to know exactly how many chuckholes the Department of Transportation was filling per hour. He said, “I thought you were interested in output performance measurements.” I said, “I am” and he said, “Well, you ought to be measuring how smooth the pavement is and you shouldn’t care whether we are fixing cracks or repairing potholes. How do you know that we are not repairing potholes so badly that we have to go back and do it again the second day?” That’s a very good point, and it shows that we need a process of getting to accurate measurements of performance. This will probably be the most difficult thing we will confront. It also has to be done simultaneously with large privatization contracts, so that you have something to measure in terms of quality at the end of the process.

These things work out in interesting ways. I have a lot of little anecdotes, but I’ll just give a couple to emphasize my point that the little victories are relatively easy. In our microfilming department we found we had X millions of dollars and that the people who sat in dungeons and micro-filmed pieces of paper all day, under awful working conditions, were relatively low-paid individuals. We put that up for bid and discovered that despite the low pay of individuals who are banished into this area of government, the private marketplace could, on a per image basis, reduce our cost by 60 percent. We bid that out and it has worked nicely.

Here’s another example: we have a sewer utility and a water utility. The water utility is private; the sewer utility is public. Each sends out bills to the same customer, so we asked the water utility if it would take over the service; we thought that would be privatization. The water utility agreed

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and gave us a price that was 5 percent less than our cost. We said, “That’s not going to work,” so we called all the rest of the utilities in the central Indiana area—the electric utility, the gas utility, the water utility—and asked them to bid on the cost of sending out these bills. The price dropped by 70 percent.

Just moving from a public monopoly to a private monopoly without building in competition is not going to be successful.

Here’s another story: the city makes street signs and it seemed obvious to me that there had to be a signmaker out there who could make them more efficiently than we do. We cost accounted and bid it out—and our folks won. We

still have an effort to move this service out of government because that's not the best place for it to be, so now we're in the process of trying to do our own internal LBO with the sign shop employees—help capitalize them, help provide

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the consulting services, and then kick them out the door and keep the business for X years. As they move out we could free them up from a lot of other restraints; they've already shown that they are cost competitive.

The problem with the competitiveness process is that government itself is so inefficient that the operating units tend to be indirectly penalized by the rest of us. Government is a very control-oriented, autocratic, top heavy organization; the purchasing people, the personnel people, the central garage people, and the central information people all impose costs on front-line units of government that are trying to compete. We are trying to liberate our own units of government either to go outside for support services or to compete without our restrictions.

Let me just footnote a few additional issues that aren't directly related to competition but which affect the market place. We are trying to create “marketization,” so I think it's important for a city that wants to be competitive not to just look at how to compete services but how to empower the markets themselves. You have to look at the regulatory obstacles you put on your marketplace, and you have to look at the tax obstacles you put on your marketplace. As long as we have a welfare system that doesn't allow the marketplace to work, we are sending conflicting messages. We are desperately trying to change the economics of welfare in order to give folks who are poor more authority to spend their own money; and we are trying to create markets for folks regardless of their wealth. But a government, even a local government, that says it wants to be competitive, that it wants to have markets, and then says to folks who are poor, “But you're not smart enough to spend your own money; you have to have a rent check, you have to have a food stamp check, you have to have a counseling check. We don't trust you with just money,” is sending out conflicting messages. We're trying to use a theory of markets and empowerment across the board to send out consistent messages.

If you're really successful, these will become linked, because there is a great opportunity here. The most populist things are competition and privatization. The antithesis of populism is when government taxes its citizens, takes money out of their pockets, and says it knows how to spend their money better than they do. If government provides them competitive opportunities to consume services, and they can keep more of their money, then that is populism. Secondly,

we need to connect our competitiveness process to business opportunities for minorities and women. Take the example of a middle class suburban parks worker. We tax somebody in a poor neighborhood, we accumulate their limited wealth,

and then we hire somebody in another neighborhood (the parks worker) to go back into the first neighborhood and do an inefficient service. It's not fair. It's not equitable.

We can make privatization a competition that is the most populist, the most equitable, and the fairest way to

approach city services. We're trying to reach out to people who live in communities that have not had their fair share of services or wealth and say, “Do *you* want the contract to maintain your small park? Do *you* want the contract to take care of your alleys? What other services are we now doing that *you* would like to bid on?” Then we're going to provide them the services to help them structure the bids so that they can participate as well. There is a wide range of competitiveness opportunities available for 501(c)(3)s and others who wish to deliver community-based services. The signals have to be clear.

The last point is that the federal government is really in our way. Let me give just two examples. We have the worst mass transit system, I think, in the country. We have the highest cost and we have the lowest ridership per capita; nothing works. It seemed to me that the greatest thing I could do, as a committed mayor, was to blow it up and create a series of minority franchises, so that people would



John Fund, The Wall Street Journal, speaking with Mayor Goldsmith.

have the opportunity to participate. But I can't do it. Why can't I do it? The federal government and the Congress say the only way to compete out bus routes is if the bus drivers union agrees. They might agree to competition if there were some legal authority to do it, but to go up to them and say, “By the way, do you mind if we compete out your routes?” is very difficult, no matter how persuasive you might be. We did, nonetheless, get them to agree to compete out the routes for the disabled. The disabled population in my city

hates the bus company because they have awful stories about callousness on the part of the drivers. So we bid out the bus service, increased the number of rides for the disabled by 300 percent with the same dollars spent, and now we have a legal challenge because the union will not continue to consent to competition since it didn't win.

Those obstacles are everywhere. I'm a Jack Kemp fan in terms of philosophy, but trying to get privatization through HUD is Kafkaesque. It absolutely is. The second month I was in office, I walked through a public housing community, absolutely convinced and committed to providing better services. I walked into elderly public housing and visited some of the residents' apartments, and they were awful. They're half the size of this room. They were not painted, and they hadn't been taken care of, and I don't mean by the people who live there, I mean by us; those of us who provide the services. We made some phone calls and we found there was some HUD money to rehab these places, so I went back the next day and said that within 90 days every apartment in the building, all 16 floors, are going to be painted. I gave them my word on it. So, I have the money and I give them my word. These apartments could be painted in three hours' time; it didn't seem to me a very difficult mathematical equation. Then I find out I can't hire private painters. So we talk that through and I say, "Ok, if I pay Davis Bacon prevailing wage can I hire private painters?" And they say, "Yes." I go to the building trades union, which is not the city union, and say, "These people are living in situations they shouldn't be allowed to live in. What rate would you charge us to come

in and paint these at the wage rate in this community?" We negotiated a rate; it had a lot of apprentice rates and so the rate came down, and we said, "Ok, let's go forward." They said, "No, no, no, no, you don't understand. If you use HUD dollars, the Department of Labor in Washington determines the painting rate in Indianapolis, Indiana. And by the way, the painting rate for the first three floors can be residential but we have a rule that if it's over four stories tall, it's commercial painting rate. That increases the painting rate \$10 per hour."

You know what the moral of the story is, of course: the top ten floors are still unpainted and these people think I broke my word. I've got the money in the bank, but I can't get these apartments painted. All I had to do was bid it out and I would have had swarms of private painting companies who are used to doing efficient work competing to come in and turn the apartments around. The result of the story is that if we focus public policy arguments, we will win these battles. I have people living in poverty who can't get jobs because I can't compete out mass transit services. I have elderly people living in poverty, and I'm not even allowed to compete out the painting of their apartments. Every one of these anti-competitive restrictions, whether they be city or state or federal, forces some group to live in a condition that they would not otherwise live in. We will slowly get this done, and the big projects such as wastewater treatment and others will be more controversial, but if we're consistent and thematic and the public understands that this is a populist expression, then eventually we will be successful. ■

Questions and Answers

Q Competition can come from outside government services as well as from inside. Indianapolis has a remarkable program. The Golden Rule Insurance Company and Eli Lilly have banded together to finance 600 scholarships for low income students to attend private schools in the Indianapolis area. My question is, has this had any effect on the existing public school system? Has this competitive entrant changed their behavior; changed the way they do business?

A We have a health insurance company that has decided it's going to force competition upon the school system despite their will to the contrary, and so they've offered scholarships. The result of the scholarships has been that these students have essentially left the public school system. It is beginning to make the school system understand it is competing for students. I don't think before that the schools—although they were in fact competing and losing—realized it; now the competition is more expressive. Before, schools' only competition was for people who had money and who picked up and moved out of the district to exercise their choice. Now, poor folks can exercise a choice and they are doing it with great enthusiasm. I went to a picnic with these kids and

they and their parents are really upbeat about the fact that they've been able to make their own choice. My pessimistic comment is that there are so many restrictions on the way the school does business that it has to understand it can't compete under its current environment. When it reaches that conclusion, then it will be successful. Our most difficult school system clearly is in the area with the worst property tax base. It has the highest number of administrators per teacher and all the rest of the indicia that go with it. It really has to completely change the way it does business. So yes, it's the first step of a thousand, but at least it's a step. I talked with Lilly about possibly quadrupling the options—right now, we've got a little bit of scholarship and a big public budget. If the numbers came more into parity, it might force the schools into competition in a serious way. We've talked about over-funding it as an intentional policy decision.

Q You mentioned privatizing the wastewater treatment services in Indianapolis. Where does that stand now? Is it a privatization of services or a direct asset sale and if it's being held up, what's causing the holdup?

A I think we have the largest wastewater treatment plant in the country currently in the process of considering privatization. We've worked very closely with the EPA and hope next week to announce that we're a pilot site because we're trying this differently. We are trying to work with the EPA so that when we reach the end of the line they don't keep us from doing it. I have directed a group of folks not just to figure out how to produce money out of the plant, but instead to develop a long-term plan for the most efficient way to operate it over the next ten or twenty years. We have a fairly modern and sophisticated plant. There are some public financing issues of extraordinary complexity. Early next year we will come to a conclusion. The wastewater treatment plant probably is the best pilot question because privatization obviously means a hundred different things; we have a continuum from outright sale to having the city continue to own and manage it. My guess is that we're going to come out somewhere in between these two options. Last year President Bush issued an executive order that Indianapolis lobbied for considerably, telling federal agencies that they can sell assets and that localities only have to pay them back the depreciated value of the dollar. Immediately following the president's order I received at least three letters from high-ranking people in various departments, saying, "I know what he said but he didn't really mean that. Here is what he really meant." The Parks Department sent us one, EPA sent us one. I've tried to convince the EPA that it shouldn't really care how much money we make or how much money we pay them. What the EPA should care about is whether the money we take out of the plant is reinvested in the mission for which the money was originally granted. Indianapolis has a \$400 million combined sewer overflow problem. If we can refinance the wastewater treatment plant, and can put all the money into cleaning up water for separating combined sewers, then everybody ought to say, "Congratulations, thanks so much." The wastewater treatment plant also raises very nice issues about whether you should use tax dollars or user fees. If government really wants to be market driven, then the more it moves to user fees, the better off it is. This creates a small problem for residential homeowners, because user fees are not deductible from federal taxes but property taxes are, so this creates a 28-30 percent penalty. If we can figure out a way around that, we can move to user fees and the market would drive consumption, which is what the EPA should want for solid waste or sewers.

Q You said that you have a council on competitiveness whose mission is to identify competitive opportunities. You also said that you thought it was necessary for some sort of public debate to make this work. Could you talk a little about how you get from the council's identification of competitive opportunities to the public debate?



Privatization Project private meeting for Mayor Goldsmith. To the mayor's left is Eduardo Franck, president, Techint, S.A.

A We picked eight to ten of our most successful entrepreneurs, as contrasted to our largest business CEOs, and then we recruited 100 volunteers—the best investment bankers, the best lawyers, and the best accountants that we could find—and we essentially turned them loose on every agency of government. The SELTIC commission also has a staff; so the staff, the volunteers, and this group of commissioners meet regularly with a notice to the press and the public. We invite neighborhood groups and labor groups and the media. The commissioners will report, for example, that over the next two months they are going to be evaluating whether the city should privatize the wastewater treatment plant, and then the volunteers submit information or they lobby. At the end of the evaluation, one of the chairpersons presents to the rest of the group his or her conclusion: that yes, this should be privatized or not; yes, this should be competed out or not; and the decision on whether to proceed is made publicly. Two things are accomplished. One is that it serves as a lightning rod to flush out where the legitimate vested interests are, and second, it gives me time to evaluate legislative support. The process brings competition out in the open. The one thing I want to avoid at all costs is having the public think that a few business owners are making extraordinary profits by picking off our city assets. This open process serves that purpose pretty successfully.

Q This may sound chauvinistic, but I think New York City still holds the record for the worst and the most inefficient transportation service. One way to get around the problem is what San Diego has done, which is simply to set its rate of bus contracting at less than the rate of attrition, so there have been zero layoffs. I don't know if you've had an opportunity to apply it in Indianapolis yet.

A You can't get there through attrition. In ten months, I've gone from 5500 employees to 4500 employees. (We're the same size as Washington, D.C., which has

A 60,000 city employees, so you get some range of scale.) I've increasingly come to the conclusion that I have to draw walls to force people to think differently. To the extent that city managers perceive an availability of more tax dollars they will make a case for more tax dollars; to the extent that city managers perceive that they will only reduce staff through attrition they operate with a different mind-set toward competitiveness. My concern is that the salaries for bus drivers are so extraordinarily out of place with the market—triple and quadruple—that those guys will drive forever.

Q Supposing you were a Democrat, and you felt that you needed the support of the municipal unions. You sit down and you lay out your agenda to them and they laugh, and say, "Are you kidding? Where are you coming from?" How would you sell this to a powerful municipal union organization?

A Let me say that every one of my city services is unionized. Most of them are AFSCME (Association of Federal, State, County, and Municipal Employees). The most important thing we did was honestly and fairly let the transportation union compete for one of the first contracts, which they won. They perceived the system to be fair and not anti-union. Second, the attrition issue on the union side helps substantially, and we're trying to figure out how to combine early retirement programs with competitiveness programs to create an opportunity there. Third, we are in the middle of contract negotiations now and we are tying salary increases to productivity and tying productivity to competitiveness so they can choose to keep their wages high, in which case they will go out of business, or they can be competitive and pick up business. So far they have agreed. Eventually, though, you do reach a stone wall. The nastiest event we had to date concerned our golf courses which have AFSCME groundskeepers. They are going out of business because they can't manage the golf courses as competitively as private providers. We tried to say to them, "All right, we'll put you at the top of the list to transfer to another labor union where we are not privatizing," but it didn't work. So my response to your question is that you can work it down to a point, but you have to be

prepared at the final point to say, "I'm sorry. We've got to compete this. We cannot afford these extraordinarily high salary levels." Sometimes that doesn't work, but I'm convinced that if we can't get the message through to the unions, eventually we won't have enough money to pay for the services in the first place. I know I'm a little wishful, but at least we're dealing in good faith with them and I'm really happy that in current labor negotiations, after they've seen they can lose some contracts and they can win some contracts, they might agree to certain productivity/competitiveness opportunities.

Q The first example of firing workers that you used was 32 supervisors that went down to 18. Can you give us a big picture of what happened to the 14 and how fast that happened to them?

A Yes. I laid them off quickly. I sent shock waves through the community and the rest of city government. It was an unpleasant event. I actually knew some of those folks from years of political battles, and we tried to arrange out-placement services, but most of them were not particularly successful at getting placed. The fact of the matter is there were a bunch of people without jobs three weeks later, which was unfortunate. Period. You do, however, need to draw some sharp lines that send messages to everyone else that this is a serious process, this is not a typical municipal bookkeeping game where you claim a victory and move everybody around and keep your budget the same. We can't afford to do business like that. By the way, this was a very important message to the union. In fact, my parks union is irate because their boss has not laid off the right number of supervisors and they think that they are being intentionally priced out of opportunity. While this episode had a very negative effect with some groups, it had a very positive effect with the front-line workers who saw that I was willing to take the political risk to make the system fair. And because of that, frankly, I've received an equal degree of support from Democrats and Republicans. These decisions haven't yet translated to partisan distinctions on the privatization agenda. ■

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