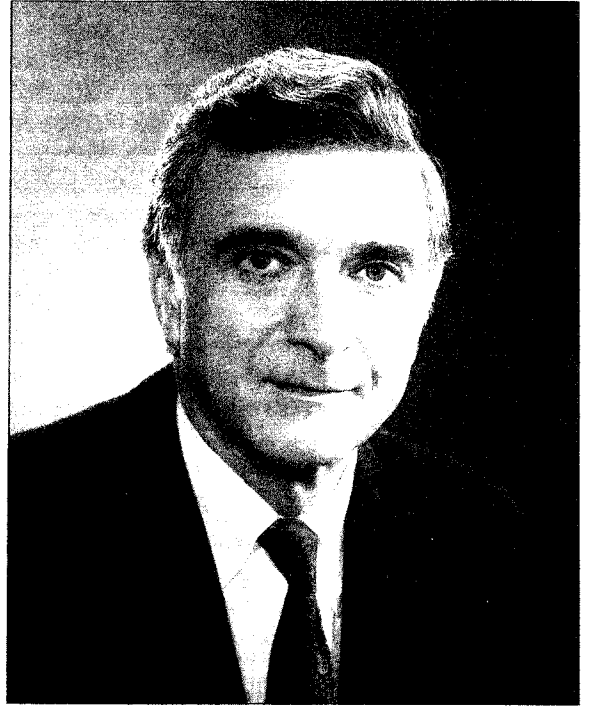


Carnegie Council Privatization Project

**Making New
York Work
Through
Privatization
and
Competition**



Frank G. Zarb
Chairman, Privatization Task Force, and
Vice Chairman, Primerica Corporation



No. 20

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Making New York Work Through Privatization and Competition

September 20, 1993

Frank G. Zarb

It is a pleasure to join the Carnegie Council today as it begins another series of programs focusing on the way privatization is being used by cities around this country and countries around the world as a tool for dramatically changing the way services are provided to citizens. I am speaking to you today as the chairman of the Privatization Task Force sponsored by the New York City Partnership and New York Chamber of Commerce.

This past June the Task Force released a report of its findings, entitled *Putting the Public First: Making New York Work Through Privatization and Competition*. That's a fancy name that says

it does everything for everybody including, especially, the taxpayer. But the fact is, what it said was very simple: The City is in a crisis, and one way to help solve aspects of the crisis is to join together the public sector and the private sector, Republicans

and Democrats, and labor and management. Otherwise it doesn't get fixed. Privatization is an interesting subject. It has a great deal to do with a change of public policy, and it also has to do with the management of any enterprise. It has an awful lot of interesting aspects to it and we shouldn't be discouraged over the fact that it's a long hard grind, because there are some institutional reasons why it is.

The Task Force recommended a number of specific changes in City services, and estimates conservatively that these changes could provide New York City \$16 billion in benefits over a ten-year period. Before I review the Task Force's recommendations for you, however, I would like to describe the context in which we undertook this effort.

I assume that most of the people here live or work in New York City. I do not have to tell you, then, that the past few years have been very difficult ones for the City. Within a four-year period we lost over 345,000 jobs, mostly in the private sector, and the effect on the tax base and government revenue growth has been fairly dramatic

and negative. At the same time, the trend in the cost of government has steadily increased. During this period, New York City has kept its fiscal house in order; the City's operating budget has remained balanced every year. But the City achieved this by a combination of tax increases, use of one-time revenue sources, and service cuts. The result is increased burdens on business and feelings of frustration among taxpayers at having to pay more for less.

Some people have suggested that there is nothing fundamentally wrong with the way New York works; that

when the economy recovers, services can be restored and the City can continue to do business as usual. I don't agree. There is a growing structural shortfall in the City's budget. The City's deficit is not a product of this

most recent recession. Although the recession cast New York's problems into bold relief, it did not create them. The City's gap in the growth between its revenues and costs predates both the recession and the current Administration. Furthermore, the recovery is a slow one, and one that is largely "jobless." To suggest that the recovery alone can close the gap is ridiculous.

I, like the Partnership and Chamber and many others, have come to believe that New York City suffers from a persistent imbalance in its finances that must be corrected if this city is to revive and prosper. I also believe that quick fixes and one-time revenue plugs are nearly exhausted. City Council Speaker Peter Vallone agrees. He described the budget enacted for the current fiscal year as a "dinosaur"—the last of its kind.

There is no one solution to New York's problems. The Task Force was careful to avoid treating privatization or anything else as a panacea. It is going to take a lot of different actions in combination to put New York on the right track. Among the actions necessary for achieving

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structural balance is finding ways to streamline City government. This is where promoting privatization, and, specifically, competition between the public and private sectors, can play a dramatic role in providing New Yorkers better services at more affordable prices. The Task Force has uncovered considerable room for improvements in efficiency and quality in New York; other studies have uncovered similar opportunities. One study, for example, found that, when compared to the average number of employees used in large American cities to deliver some basic municipal services, New York City uses 38 percent more people. We shouldn't draw too much from this statistic, but it reinforces the gut feeling that the more than \$31 billion New York City government will spend this year will not produce a corresponding level of service.

The City must boost its return on investment. One way to achieve greater efficiencies is through reengineering City operations. In recent years most of us in the business world have become familiar with this concept as we have reacted to a difficult economy. We have, over time, reevaluated almost everything we do. It is a necessity in the private sector to continually improve and to stay competitive as well as to ensure proper returns.

Reengineering any complex process is always a time-consuming endeavor; doing it in government seems even



Ronald K. Shelp, president and CEO, The New York City Partnership, introduces Mr. Zarb.

nized the way they worked to improve their chances of winning the competition. They reformed themselves to be more competitive.

This is the kind of thing that ought to be happening more often in New York—using competition to promote efficiency and innovation. In our report, we are careful not to call for wholesale substituting of the private sector for the public sector. There is no magic formula in the private sector which ensures better performance. In many cases the public sector will provide better services at a better price than a private sector equivalent. We all recognize also that creating private sector monopolies is

no solution. We propose competition with winners selected purely on the basis of quality and price, regardless of private or public sector status.

Let me give you another example, and lead into a review of some of the specific findings of the Task

“The City’s long-term budget gap is estimated to be around two billion dollars on an annual basis. In identifying a few areas of operations, we have identified realistic ways to help close the gap. Privatization has been proven again and again around the world. It is not the total answer but it is recognized as a step in the right direction.”

Force. One of the areas we looked at was solid waste management—what we used to call garbage collection and disposal. The City’s Department of Sanitation spends almost \$600 million annually to collect garbage and materials for recycling, clean the streets, deliver recyclables for processing and marketing, and dispose of the garbage. In many respects the Department of Sanitation is one of the best run City agencies. Its garbage collection and disposal services are generally reliable and of high quality, and agency employees have performed admirably in such emergencies as last December’s Noreaster—where they helped sandbag seawalls—or last March’s blizzard, where they put plows on the garbage trucks and cleared the streets. Agency employees have been able to patent innovative garbage truck designs and have won awards for their truck repair service. The agency used to be a model of City efficiency as well, but that is

more difficult. So many existing practices seem to be enshrined in laws, regulations, labor contracts or work rules. The process of change becomes painstakingly slow, and a sense of real progress is hard to achieve. A willingness to open government services to competition from the private sector can tremendously accelerate this process. Let me illustrate what I mean.

During this past year, the City’s Parks Department structured a competition between some of its own work force and private contractors to see who could cut down and remove dead trees at a lower cost. At the end of this experiment the Parks Department concluded that its own employees had done the job at a much lower cost. If we put aside the issues of similar work assignments and fully loaded departmental expenses and focus on the process, we discover that the Parks Department tree-cutting crews decided to waive some of their work rules and reorga-

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Let me give you another example, and lead into a review of some of the specific findings of the Task Force. One of the areas we looked at was solid waste management—what we used to call garbage collection and disposal. The City’s Department of Sanitation spends almost \$600 million annually to collect garbage and materials for recycling, clean the streets, deliver recyclables for processing and marketing, and dispose of the garbage. In many respects the Department of Sanitation is one of the best run City agencies. Its garbage collection and disposal services are generally reliable and of high quality, and agency employees have performed admirably in such emergencies as last December’s Noreaster—where they helped sandbag seawalls—or last March’s blizzard, where they put plows on the garbage trucks and cleared the streets. Agency employees have been able to patent innovative garbage truck designs and have won awards for their truck repair service. The agency used to be a model of City efficiency as well, but that is

no longer the case. About ten years ago, garbage collection shifted from a three-man to a two-man truck operation; an enormous gain in efficiency. To achieve this, the City agreed to share some of the savings with collection workers and to fix both the number of truck shifts and length of each truck route. I am a full believer in gainsharing, but to fix routes and shifts in an environment as dynamic as New York City is a mistake. Over the last ten years there have been many shifts in population among neighborhoods in the City. More importantly, environmental concerns have led to State and City recycling laws which have radically transformed the way garbage is collected and handled. In the face of all these changes, the routes designed more than ten years ago no longer make sense. The Sanitation Department, though, is forced to stick with these outdated routes. At the same time, the agency has had to field a new fleet of recycling trucks; a tremendous added expense to the City exacerbated by the Sanitation Department's inability to make adjustments in the basic collection system.

Budget constraints demanded that something give. In this case, it was street cleaning services. Cuts in street cleaning operations have been very deep, and the streets are obviously dirtier as a result. Dirty streets send a very loud message to the public—they are an important indicator of quality of life, and New York really cannot afford to let cleaning services slide.

Based on experiences elsewhere in the United States, the Task Force estimated that the Sanitation Department could save \$78 million a year in collection costs alone by contracting out. We are urging the City to test this proposition by running a pilot program in a few of the collec-

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tion districts which would open the right to collect garbage to competition between Sanitation Department collection crews and private contractors. We would be neither surprised nor disturbed if Sanitation Department crews were able to produce the winning bid, but we would expect that such a bid would be below current costs. Savings could be used to restore sorely needed street cleaning services. The big winner would be the public, which would get more and better services, at a competitive price.

This same approach could be used to provide better bus service in New York, for estimated savings at \$300 million a year. Over the past thirty years bus ridership



Left to right, Frank Zarb; Alan Stoga, Kissinger Associates; and Ray Price, The Economics Club of New York.

has been cut in half while costs per passenger mile have tripled. This terrible trend is continuing because we have a system which has been slow to respond to changes in its market and to embrace new technology and management practices. Other cities in this country and around the world have realized major savings by bringing private bus companies into the process, and, aside from the obvious benefit of reducing costs, service has improved as well.

I would like to mention one other recommendation which has proved very controversial, namely our call to authorize electronic tolling on all bridges to Manhattan and to provide private businesses the opportunity to lease, or even buy, these bridges. We project that tolling these bridges would produce \$790 million a year in revenue, a substantial portion of which could be returned to the City.

User fees are a way to properly allocate infrastructure costs and are an established part of privatization theory. The current situation in New York exemplifies the distortions that can result when user fees are not properly allocated. Some bridges and tunnels are tolled and are well-maintained. The free bridges, as anyone who has ever tried to cross the 59th Street bridge at any time of the day has discovered, are in terrible condition, and completely congested. Drivers seeking to avoid tolls pack bridges which have neither the access nor the capacity. Aside from the obvious safety considerations, the congestion and traffic diversions add to the City's air and noise pollution, and create unnecessary gridlock. There are also questions of fairness involved: If we have decided to charge a fee to enter or exit Manhattan, why should some drivers be exempted? And why should anyone be exempted from contributing directly to the upkeep of the bridges they use?

Some have suggested that raising \$790 million a year

in bridge tolls is just another tax, and has little to do with privatization. I disagree. Tolls are the revenue source needed to provide the foundation for a business. No business can exist without revenues. Tolls create the incentive to attract bridge operators who will maintain facilities efficiently, make the best use of new technologies such as electronic toll collection—and provide for the best flow of traffic. Bridge tolls, therefore, not only straighten out the existing distortions among accesses to Manhattan, but also make it possible to engage the private sector. To toll and privatize the bridges kills many birds with one stone. First and foremost it ensures that our bridges are restored to safe and usable conditions. It improves access and introduces new technologies. And it removes a burden from city government and replaces it with a revenue source that could be dedicated to repairing City streets and other smaller bridges.

There are many more specific recommendations in our report, which, I assure you, is quite detailed.

These are just a couple of the more important ones in terms of their impact. The City's long-term budget gap is estimated to be around two billion dollars on an annual basis. In identifying a few areas of operations, we have identified realistic ways to help close the gap. Privatization has been proven again and again around the world. It is not the total answer, but it is recognized as a step in the right direction. Why then is it that New York City has not responded more aggressively to the call?

First of all, there is a great tradition in New York City of government involvement in the delivery of services. For instance, the City operates twelve municipal hospitals. The next nearest city in the United States has two. Furthermore, as recent headlines about the Parking Violations Bureau demonstrate, there is a real fear of privatizing City operations. Corruption always seems to be the end result.

The public should not tolerate corruption in either government employees or private contractors. We should always attempt to learn from incidents of corruption, but let us make sure we are learning the right lessons. It is my belief that there is a weakness in the system that promotes these scandals, but it has nothing to do with the integrity of New Yorkers, it has to do with the system through which they must operate. It is an area that the Task Force studied at length. If privatization is to work in New York City, the procurement of services must be efficient and easy to understand.

The Parking Violations Bureau controversy only confirms our Task Force's findings about New York City's procurement and contract management process. It is a system of extraordinary—actually unbelievable—red tape based on fear: fear of making mistakes, and fear of becoming involved with a corrupt vendor or otherwise giving the appearance of impropriety. Each new scandal

tends to add further layers of control. But the result has been no marked improvement in the ability to prevent or detect corruption. On the contrary, City agencies and vendors struggle with a system which is so complex that almost nobody, in or out of government, understands it. This is a system that invites people with the best of intentions to take shortcuts to get a job done.

The present system has successfully discouraged many reputable companies from even bidding to do business in New York. The hassle factor here is judged to be just too high and the process too costly. This system is also a major obstacle to New York City's efforts to create

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opportunities for minority- and women-owned enterprises and community-based nonprofits trying to do business with the City. If large companies have trouble cutting through the red tape, imagine what it is like for a small business or nonprofit organization.

Our report details the problems of this system at length, and emphasizes simplification of the process and professional training of procurement personnel as the solution. It doesn't sound as exciting as leasing or selling Manhattan bridges, but it is just as important. If New York City is going to expand its partnership with the private sector, then it needs a fair and user-friendly process to expand and manage these partnerships.

I have talked for some length and I want to be sure to leave time for questions, so let me conclude with some remarks about public employees. Wherever privatization is discussed, public employees are initially fearful and resist such changes. That has certainly been the case in New York, where employee organizations are very strong. What needs to be understood is that for public-private competition to work, employee cooperation is an absolute necessity. We are not seeking to “break” the public work force, we seek only to improve efficiencies through the introduction of competition. That means we must address the very real fears and concerns of public employees in a constructive way. We cannot protect public employees from change, for change is needed. But we should be able to show them that dedication, the ability to deliver excellence, and an efficient product are the secrets to long-term job security—not inflexible work rules and ironclad contracts.

First and foremost we need to emphasize that we are promoting competition between the public and private sectors; not a knee-jerk presumption that the private sector is superior. On the contrary, the public sector has a

vast experience base to draw from and its personnel is every bit as capable. In other competition-based models around the country the public sector has often outperformed the private sector competitors. In those instances

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where private companies win the competition, it is possible to cushion the blow for public employees by such measures as requiring contractors to give displaced city employees preference in hiring, so long as they are qualified. Gainsharing arrangements should also be considered. One particular concern which has been raised is that contractors might not be as aggressive as the City of

New York has been in hiring minorities or City residents. We are sensitive to this concern, as were officials in Philadelphia where similar actions have been undertaken. There, similar fears proved to be unfounded, and contractors largely matched the City’s record in hiring. We must work continuously to break through employee fears and explode the myths about privatization which create such fears.

The Partnership and Chamber have their work cut out for them. Employee fears and resistance are still very strong and the recent contracting controversy in New York has only reinforced resistance and suspicion of greater reliance on the private sector. But to go back to my starting point, New York City is facing

some very daunting challenges and the City’s ability to find short-term fixes is dwindling. Consensus is emerging on the need for fundamental changes. I am convinced that the promise of a system which emphasizes public-private competition and public-private partnership in service delivery is so compelling that New York will have to embrace it. ■

Questions and Answers

Q I’ve read reports similar to yours over the years, and I hope that this time something’s going to change, but could you give us a scenario as to how it’s going to change, because the crisis that we talked about may not really be apparent to that many people.

A We should not expect anything in terms of major public policy change during an election year. However, the crisis of the city is deep enough so that either candidate is likely to consider major shifts after the election. It is up to people like you to push for necessary change. If the public is concerned enough, politicians will respond.

Q Please explain how you would get the unions to cooperate and realize the advantages to them. Could you give us one or two examples?

A The formula is simple—limit the downside effects on workers and unions and make sure the structure provides benefits to labor. I have worked on privatization projects where we have actually given the employees equity in a new private company. But what is most important is the ability to demonstrate that the entity will be healthy and ultimately be a

better employer in private form than it would be in public form.

Q If you could magically change the political climate here in New York regarding privatization, where would you start? What facilities, agencies, or infrastructure would you look to first for privatization?

A The first thing I would do is privatize the bridges. These bridges are now a burden and generate no revenue. In a privatization model, they will not only be better maintained, but they will also generate new revenues. I worked on a privatization of a bridge across the Bosphorus River in Turkey and it worked wonderfully.

Q In your discussions, did you include union leaders?

A No, we did not and we did not on purpose because we did not want to put them on the spot and if we had included them, they would have been on the spot. So what we did was consult with them before we issued the report and they weren’t happy with us. We also talked regularly with City officials and Deputy

Mayor Steisel came to everything he was invited to, so we tried to keep everyone informed. We didn't do anything in the closet, but, more importantly, we tried to be sensitive to the issues which would be important to the unions, and the next time around, I think I would even want to bring in a few union leaders to sit around the table, if they were willing to do it with an open mind.

The only thing that I felt about your report was that you were terribly polite. The procurement reforms that need to be put in place we've been trying very hard for four years at the Procurement Policy Board to describe and to push through. The thing that's frustrating to me is that we are not being better supported within government about these very crucial reforms. Privatization is not going to work unless you have skilled people in government who are allowed to use their discretion and who are provided some flexibility to cut out all of the bureaucracy that you just described.

Politicians and bureaucrats will rarely upset the *status quo* on their own. However, as I said before, crisis is fuel for reform and it is my view that some areas, such as procurement, will be forced to change by favorable public outrage.

What is it that can mobilize people to change?

Crisis. When we have to institute these changes in order to improve the running of the City so that we don't lose jobs, that we keep businesses in the City, and that we cut the cost of running government, and people come to truly believe that there is an



Gloria Gilbert Stoga, director, Privatization Project, speaking with Porifiro Ramirez of Arnold & Porter, at the cocktail reception for Frank Zarb.

answer to solving the crisis, they're going to do the bold things that they've been reluctant to do up to now.

But it's like a cancer that people don't know they have, and they won't find out about it until it's metastasized so far that it will be really too late. How can people be alerted to the dimensions of the crisis that we are in the middle of?

It's already too late. We have lost a lot of ground as a City, which we shouldn't have lost, and there is no magical answer except, after the election, the new mayor may decide it's time for a massive departure from the norm because it's what we need to do to get the job done, but only if people like you make sure they understand how serious you believe the crisis is.

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This is the twentieth in a series of briefings published by the Carnegie Council as part of the Carnegie Council Privatization Project.

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