

Research Report

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The Business of Government?

Competition Between Texas Governments & the Private Sector

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A study of the policy implications, and associated financial consequences, of Texas' governments competing with the private sector in commercial endeavors.



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The public is demanding a different direction for their government and the Texas Public Policy Foundation is providing the research that enables policy makers to chart that new course.

EXECUTIVE SUMMARY

Governments Compete in Commercial Markets. Governments in Texas compete with the private sector in a number of commercial markets. This study outlines the public policy implications of this competition and, through a review of Texas government budgets, attempts to quantify the financial consequences. Government is deemed to be competing with the private sector where:

Government competition in the private sector occurs if the subject activity is provided as a commercial service in any comparable location in the United States or the developed world.

Governments are Exiting the Competitive Market. For the most part, commercial activities in the United States are conducted by private companies, rather than government. Until recently, this was so to a greater extent than in other nations, in which large sectors of commercial activity had been pre-empted by government. By the 1980s, however, many foreign governments were engaged in returning commercial activities to the private sector and in expanding the role of the competitive market in the production of public services. In some fields, these governments have gone further than the United States in reducing government involvement in commercial markets.

Less Government Means Higher Incomes. There is a relationship between affluence and government interference in the commercial market among nations. Generally, greater affluence is associated with lesser levels of government involvement. At least partially because the United States tends to have less government interference in the market than other nations, it remains the world's most affluent country. And, the nation has produced better results for lower income households. A Swedish research report found that average African-American income in the United States exceeds overall average income in Sweden and that average low-income households in the United States have higher income than households in Sweden.

The Commercial Advantage: Economic Efficiency. The higher incomes that result in nations with less government intervention are principally the result of economic efficiency. The incentives of the commercial market encourage people to spend and invest more wisely. On the other hand, the incentives in government tend to be at odds with economic efficiency. Government managers often perceive their advancement opportunities as being related to larger budgets and larger staffs, which leads to higher than necessary cost structures. A major contributing factor in higher government costs are comparatively expensive employee compensation packages.

Markets Create Greater Affluence. Private production of commercial (non-subsidized) goods and services tends to lead to more favorable economic results, including a more affluent economy and higher incomes for low-income households. As a result, public policy should favor private production of commercial (non-subsidized) goods and services. Further, it is the commercial market, especially through the employment that it creates, that produces the taxes that government requires to perform its services. The

most favorable economic results can be expected where public policy precludes government from competing in commercial markets.

The Role of Government: Deciding. The essential role of government is policy making. This includes establishment of laws, establishment of regulations and the judicial, administrative and regulatory decisions necessary to enforce the laws and regulations. Beyond those functions, virtually anything that government does can be done by the competitive market, either under contract to government or commercially. However, U.S. governments compete against the private sector in some commercial activities and preempt competition by private companies in the provision of government services. This destroys economic growth, stifles entrepreneurial opportunity and is unnecessary.

Government Service Production Alternatives. A number of service production possibilities are available to government. Government can directly perform a public service. However, direct production is required only with respect to the inherent public function of deciding. Government may use the competitive market to produce a service or a support service through competitive contracting or franchising. Or government may purchase services directly from the competitive market.

Competition in Consumer Markets. Texas governments compete with the private sector or preclude competition in a number of consumer markets. Most of these government enterprises are either profitable or “break-even,” but are generally tax-exempt. As a result, these government enterprises are subsidized by taxpayers who must pay the tax revenues that would not be avoided if the enterprises were owned by the private sector. Moreover, government commercial enterprises tend to be exempt from regulations that are applied to their private sector competitors. Our survey of Texas governments found consumer market activity by government in a number of industries. In each, there would appear to be no significant public purpose to justify the government competition.

Telecom: The telecommunications industry has experienced some of the most significant recent intrusions by government. This has been limited in Texas by a provision of the Public Utilities Code that prohibits municipalities from providing telephone service. However, some Texas communities provide internet service and fiber optic cable leasing. The city of Dallas owns and operates a classical radio station.

Electricity: Most of the nation’s electric power is generated and distributed by commercial companies. In Texas, municipally owned electric utilities account for approximately \$3 billion in business annually, unnecessarily competing with the private sector.

Water and Wastewater: Texas governments spend more than \$3.5 billion annually competing in the water and wastewater business – which is a commercial business in many locations around the world.

Solid Waste (Garbage) Disposal: Solid waste disposal is a commercial business in many of the nation's communities. Yet, more than \$600 million is spent by Texas governments annually on solid waste disposal.

Other Businesses: Texas governments also compete or preclude competition in consumer markets in emergency medical service, natural gas, parking lots, and golf courses. Texas governments are also involved in airports, seaports and toll-roads, which are also commercial businesses in other countries.

Competition in Government Services. A strong supplier market has developed in a number of government service markets. Texas governments are involved in providing public transit, corrections and convention services, functions in which the commercial market provides a full range of government services. Similarly, Texas governments tend to rely on internal service provisions for many support services, precluding competition by firms that specialize in building maintenance and custodial services, vehicle fleet management, information technology, food services, school bus service, street maintenance, park maintenance and print shops.

The Cost of Government Competition. Based on the sample, it is estimated that annual commercial revenues in Texas are approximately \$5 billion, while government service market revenues are \$1.4 billion. Based upon this analysis and U.S. Census data, it is conservatively estimated that all Texas governments receive more than \$11 billion in revenues from consumer markets and spend \$8 billion annually on government services and support services for which there are well developed commercial markets. Thus, government competition in Texas accounts involves nearly \$20 billion, the equivalent of three percent of the Texas gross state product.

Policy Options. Texas could improve economic performance for its citizens by minimizing government competition with the private sector. This could be accomplished by (1) forbidding new entry by governments into competitive markets, (2) requiring reviews of the potential for exiting competitive markets, (3) removing favored tax-exempt and regulation-exempt status for government-owned commercial enterprises, and (4) implementing a process for converting government services and support services to competitive processes through "petitions of interest" from private companies.

INTRODUCTION

Governments' Competition in Commercial Markets

Governments in Texas compete with the private sector in a number of commercial markets. This study outlines the public policy implications of this competition and attempts to quantify the financial consequences through a review of Texas government budgets. Government is deemed to be competing with the private sector where:

Government competition in the private sector occurs if the subject activity is provided as a commercial service in any comparable location in the United States or the developed world.

The United States: Free Market Example

The United States has long had the reputation as being the world's leading free market economy. This reputation was enhanced by U.S. policy especially during the first half of the 20th century as compared to Europe. In a number of countries, formerly commercial industries were nationalized (taken over by government). This included electric utilities, natural gas utilities, water, freight and passenger railroads, steel, trucking, airlines, mines, air traffic control, airports, seaports, inter-city buses, public transit, telephones, broadcasting, aircraft assembly, and other industries. The general philosophy behind these nationalizations was that governments would better manage what were considered to be critical industries, providing superior service and, by virtue of exemption from both the profit motive and the obligation to pay taxes, society would pay less for their output.

The Expansion of the Market

In both regards, the government ownership model was a failure, and early in the incumbency of Margaret Thatcher as prime minister of the United Kingdom, it had become clear that the nationalized industries were a significant drain on the economy. As a result, programs were undertaken to "privatize" government-owned commercial industries and to subject government services that required subsidies to competition. For the most part, competition in the production of government services meant seeking competitive bids (competitive contracting), with contracts awarded to commercial companies to operate under the supervision and specifications of government. Government-owned corporations have now been privatized in virtually all high-income nations, and competitive contracting has spread, though to a lesser extent.

Perhaps ironically, the United States, with its free market reputation, has been anything but a leader in this movement. The large New Deal power authorities (Tennessee Valley Authority and Bonneville Power Authority) remain government corporations. Airports remain in public ownership. Municipal water authorities can be found throughout the nation, along with municipal electric and natural gas utilities. In some respects, the United States has fallen behind, as other nations have expanded the role of the

competitive market into fields that were previously the exclusive province of government.

Affluence and the Market

Economic studies have often shown that societies in which people have greater economic freedom tend to have higher average incomes.¹ Generally, there is less affluence in societies in which government interferes more in the market, or in which government assumes roles that are filled by the competitive market. The extreme example is the former communist nations, in which the private sector was given little latitude in which to operate, and which managed to produce widespread poverty in nations that had formerly been comparatively affluent. To a lesser degree, the same dynamic occurred in western social democracies, where government often consumed one-half or more of the gross domestic product. The United States, which by most accounts has the freest markets in the world, remains by far the most affluent nation in personal income or gross domestic product per capita.²

Further, more recent research has shown that lower income citizens are generally better off where the market has a greater share. The Swedish Institute of Research recently reported that the average Swedish household had an average income below that of U.S. African-Americans, and that lower income Swedish households tended to have lower incomes than low-income American households.³ Swedish household incomes tend to be approximately the average for the European Union, which would indicate that lower income households in the United States earn at least as much as the *average* household in the European Union.

Why the Market Produces Greater Affluence

Economic efficiency is the core of the market's wealth producing capability.

- **Economic Efficiency:** Capital is put to more effective use in the competitive market. This is fundamentally because of the personal stake that investors, managers and owners have in the financial success of their enterprises. Entrepreneurs risk their own money with greater care than they would risk someone else's money, because losing their own money can seriously reduce their quality of life. Business executives have greater incentives to be careful with their firm's money than government officials, because greater fiscal accountability is associated with performance in the private sector. As a result, there is greater investment, entrepreneurialism and wealth creation.

¹ For example, see James Gwartney and Robert Lawson, *Economic Freedom of the World: 2002 Annual Report*, Fraser Institute (Vancouver, BC: 2002) and Gerald P. O'Driscoll, Jr., Kim R. Holmes and Mary Anastasia O'Grady, *2000 Index of Economic Freedom*, Heritage Foundation (Washington: 2002).

² Adjusted for purchasing power (purchasing power parity).

³ Fredrik Bergström and Robert Gidehag, *Tänk om Sverige varit en amerikansk delstat: En diskussion och analys av hushållsinkomster i Sverige och USA och betydelsen av ekonomisk tillväxt*, Handelns Utredningsinstitut (Stockholm: 2002).

- **Higher Government Costs:** Because decisions tend to be made in government outside of a competitive environment, there is a tendency for government costs to be higher than costs in the private sector. Government managers face a different set of incentives than in the private sector. Generally, their advancement depends on larger budgets and larger staffs, which is in direct opposition to economic efficiency and wealth creation. The resulting higher costs are evident in government services, such as public transit, solid waste disposal, waste-water treatment, custodial services and many others.⁴ This is despite the fact that, for the most part, government producers do not seek to earn a profit and are exempt from taxation. Much of the difference has to do with higher than market compensation of employees. While governments and public employee organizations often claim that their employees are underpaid relative to the market, government employee turnover rates tend to be much lower than that of the private sector, reflecting higher than market compensation. Studies have estimated government employee compensation per hour at up to one-third above that of comparable employees in the private sector.⁵

Policy Objective: Maximizing the Market

Greater economic freedom means greater opportunities for private, non-government investment and competition in the delivery of goods and services. Private production of commercial (non-subsidized) goods and services tends to lead to more favorable economic results, including a more affluent economy and higher incomes for low-income households. As a result, public policy should favor private production of commercial (non-subsidized) goods and services through the market rather than by government. Further, it is the commercial market, especially through the employment that it creates, that produces the taxes that government requires to perform its services. In short, government should be the direct provider of goods and services only if there is a compelling public purpose *and* if the goods or services are not produced by the commercial market. The most favorable economic results – maximum economic growth and maximum income distribution – can be expected where public policy precludes government from competing in commercial markets.

⁴ E. S. Savas, *Privatization: The Key to Better Government*, Chatham House (Chatham, NJ: 1987).

⁵ Wendell Cox, *The Truth About Oklahoma State Employee Compensation*, Oklahoma Council of Public Affairs (Oklahoma City: 2000), Wendell Cox and Samuel A. Brunelli, *America's Protected Class: The Excess Value of Public Employee Compensation*, American Legislative Exchange Council (Washington: 1994).

GOVERNMENT IN THE MARKET

Governments involve themselves in four basic activities:

- Inherent public functions (public policy)
- Government services based upon a public purpose determination
- Services in support of inherent public functions or government services
- Commercial services

Inherent Public Functions (Public Policy): Inherent public activities are the very core of government functions, and are functions that cannot be legitimately performed by any other organization. The Citizen's League of the Twin Cities summarized this fundamental role of government as follows:

*The essential function of government is deciding. Government may later, itself, do what it has decided should be done. But equally it may not. Its basic intention is to see that what should be done is in fact done.*⁶

This implies a rather limited core of activities that are the exclusive province of government. Summarized, inherent government functions include establishment of policy (legislation), judicial determination (civil and criminal) and regulation. For example, the job of a legislator or judge must be performed by government directly. However, support services that support these functions can be provided legitimately by government itself or by the private sector under competitive specification by government.

But these core activities do not include support services, which *can* be provided by government, contractors or the market. Nor do they include government services that are provided to achieve a public purpose, such as providing prisons or public transit.

Government Services: Government provides services to consumers or clients, such as police protection, fire protection and welfare service based upon a determination that the public purpose requires it. Generally, the public purpose is demonstrated by a compelling need for a service that cannot be provided directly through the commercial market. Virtually all of these services can be produced directly by government, either by government contractors or by the commercial market. Some government services, such as police and fire, are almost always provided directly by government in the United States. However a wide range of other services are provided under competitive arrangements by the private sector. Further, government can provide its services through the commercial market, through user subsidies. An example is the federal food stamp program, which provides vouchers to qualifying households to supplement grocery purchases from commercial retailers.

Administrative and Support Services: In performing its activities, whether policy, government service activities or commercial activities, government requires

⁶ Citizens League of the Twin Cities, *Enlarging Our Capacity to Adapt*, Minneapolis, 1983.

administrative and support services. These services may be performed directly by government, by contractors or by the market. For example, a government may own and operate its own photocopy department, it may competitively contract the operation to a private company, or it might simply use commercial photocopy stores. Administrative activities are generally performed directly by government; however, some government services may have competitively contracted administration.

Commercial Activities: Commercial services are goods and services that the commercial market is able to provide to consumers without government subsidy. Most commercial services are performed by the commercial market in the United States, but there are notable exceptions. For example, government is a substantial producer of electric power in the United States and many municipalities own golf courses. It is a thesis of this study that commercial activities are not a legitimate province of government production in a society that seeks to achieve maximum economic growth and income distribution. A similar sense was conveyed by Texas Comptroller of Public Accounts Carole Strayhorn in suggesting a “Yellow Pages” test for government production:

Government should do no job if there is a business in the Yellow Pages that can do that job better and at a lower cost.⁷

Minimizing Government Economic Activity: Minimizing the role of government in production does not reduce the role of government with respect to public policy. Indeed, it can result in more effective achievement of public goals. For example, government provides food for low-income households through the food stamp program, which provides clients coupons with which they can make purchases at commercial stores. Whatever problems there may be with this program, it is surely more efficient and effective than would be the case if low-income households were served instead by government-owned and operated food stores. Similarly, government can obtain more services – more effectively – through competitive contracting of both the services used by consumers and those performed internally for governments themselves. Contractors that perform below standards can be dealt with or even terminated with significantly less difficulty than if serious problems arise with internal government departments or staff.

Production methods: Government may serve its public purpose functions in any of the following ways (Table 1, page 11):

- *Direct production:* Direct production occurs to the extent that a government function is performed by government employees or officials with authority to make public policy decisions (elected or appointed officials). Most government functions involve direct production. Nonetheless, it is only public policy determination – including judicial and regulatory decisions – that *must* be directly produced by government.
- *Contract production:* Contract production can apply to policy implementation, policy implementation administration or support of commercial activities. For

⁷ Texas Comptroller of Public Accounts, *Report of the e-Texas Commission*, December 2000.

example, a government may competitively contract its corrections function, which would involve policy implementation. On the other hand, a government could competitively contract administration of a corrections facility or a support service, such as food service. Finally, a government could competitively contract a commercial activity, such as solid waste disposal.

- *Commercial production:* The commercial market can also be used to accomplish government objectives. An example is the food stamp program, which uses commercial grocery stores to assist low-income households in obtaining food. Further, government uses the commercial market to support policy implementation by purchasing goods directly from the competitive market, such as office supplies, fuel and motor vehicles.

Table #1 Government Activities and Service Delivery Methods			
Activity	Production Method (Examples)		
	Government Internal	Government Contract	Commercial Market
Policy (Deciding)	<input checked="" type="checkbox"/> (Legislation Regulation Adjudication)	Not Applicable	Not Applicable
Policy Implementation (Government Services)	<input checked="" type="checkbox"/> (Transit)	<input checked="" type="checkbox"/> (Transit)	<input checked="" type="checkbox"/> (Food Stamps)
Government Services Support	<input checked="" type="checkbox"/> (Fleet Maintenance)	<input checked="" type="checkbox"/> (Fleet Maintenance)	<input checked="" type="checkbox"/> (Office Supplies)
Commercial Activity	<input checked="" type="checkbox"/> (Electricity)	<input checked="" type="checkbox"/> (Solid Waste)	<input checked="" type="checkbox"/> (Food Stamps)

Capability of the Market

As noted above, the private sector is capable of providing virtually all government functions, except for the determination of public policy (“deciding”). The mechanisms of competitive government service provision are, generally, forms of competitive contracting and government-user subsidies (vouchers) that are used by clients to purchase goods and services in the competitive market (Table 2, page 12).

Table 2 Hierarchy of Government and Other Activities: Capability of the Competitive Market		
Type of Activity	Activity	Competitive Service Delivery Options
Government	Public Policy (Deciding)	Government
	Government Services	Competitive Contracting & Vouchers
	Support Services	Competitive Contracting & Vouchers
Commercial		Market

Methodology

This report analyzes a sample of government budgets within the state of Texas. The sample includes the state of Texas, the University of Texas, 13 municipalities, 11 counties and nine school districts. The budget sample includes all cities and counties with more than 500,000 residents (Table 3, page 13). The analysis uses the following definition of commercial activity as a standard:

Government competition in the private sector occurs if the subject activity is provided as a commercial service in any comparable location in the United States or the developed world.

Because of the great variation in budget organization and information, it was often not possible to determine whether or not a particular service was provided by a government, or if it was, whether or not the service was competitively contracted to the private sector. With respect to some services, the U.S. Census Bureau reports state level spending for local governments, which is also used in this analysis.

Table 3 Government Budgets Analyzed		
State	Texas	
	University of Texas at Austin	
County	Collin	
	Bexar	
	Dallas	
	El Paso	
	Harris	
	Hidalgo	
	Potter	
	Tarrant	
	Tom Green	
	Travis	
City	Amarillo	
	Arlington	
	Big Spring	
	Corpus Christi	
	El Paso	
	Dallas	
	Denton	
	Fort Worth	
	Laredo	
	Longview	
	Lubbock	
	Round Rock	
	San Angelo	
	School Districts	Amarillo ISD
		Austin ISD
Brownsville ISD		
Dallas ISD		
Grand Prairie ISD		
Houston ISD		
Northside ISD		
Pasadena ISD		
San Angelo ISD		
Wichita Falls ISD		

COMPETITION IN CONSUMER MARKETS

Governments are providers of a number of commercial goods and services to consumers, and there is some evidence that the commercial role of governments is increasing, especially in the telecommunications industry.

For the purposes of this report, government competition in consumer markets refers to government production of a good or service that can be provided by the competitive market to consumers without government subsidy.⁸ This includes instances in which government precludes competition by the private sector, such as in markets served by municipal electric utilities. Most economic activity in the United States falls into this category, and in most such industries there has been, historically, little or no government competition with the private sector. For example, governments have generally not been engaged in commercial retailing, manufacturing, food production, or most services. This is despite the absence of broad constitutional or legislative prohibitions against such activity.

Generally government commercial services are operated either on a “break-even” or profitable basis, but an unprofitable (subsidized) operation is not at all unusual. For example, government-owned golf courses and water systems sometimes require subsidy, and formerly nationalized industries (such as telephones and steel) were subsidized in the United Kingdom and elsewhere before they were sold to the private sector.

Beyond the negative economic implications of government commercial activity, additional factors make government competition against the private sector in commercial markets questionable.

1. Government commercial enterprises are generally exempt from some or all taxation. While some government commercial enterprises pay a dividend to their government owners in lieu of taxes, they often pay little or no taxes to other levels of government. For example, a private utility will generally pay taxes to the municipality, county, state, and federal government. A government owned utility generally pays taxes to no government, and if there is an “in-lieu” payment, it is to the owning government only. Other taxpayers must make up for the tax revenue that would be paid if the organization were privately owned. Thus, even profitable government enterprises are subsidized through tax exemption.
2. Government commercial enterprises in regulated industries are generally regulated principally by their government owners. This means that there is little or no external government regulation of the sort that is applied to regulated industries. This factor is becoming less important as formerly monopoly utility markets are being deregulated.

⁸ There is a public purpose to the provision of some commercial goods and services, such as food and housing. User subsidies provide government the opportunity to provide these services to low income households through the commercial market. Examples are food stamps and housing vouchers.

Nonetheless, governments, including Texas governments, engage in the provision of consumer services that are routinely provided by the commercial market.

There is a long history of government commercial service provision in utilities. Virtually every level of government in the United States – federal, state and local – is involved in providing utility services to consumers. Examples include electric power, natural gas, water and wastewater. Nonetheless, most of the nation’s electric power and natural gas service is provided by commercial firms, often under government franchises. The U.S. pattern is similar to that of other high-income nations, except that telephone service was, until recently, largely provided by governments in western Europe and Japan. Most of these overseas government telephone utilities, together with some electric, natural gas and water utilities, have now been sold to the private sector. Generally, where government provides consumer utility services it does not simply compete with the private sector, it precludes competition by the private sector.

In recent years there have been a number of initiatives by government to enter the telecommunications business, such as through internet service, fiber optic networks, and cable television services.

A number of other commercial goods and services are offered to individual and commercial consumers by governments around the nation, such as solid waste (garbage) disposal, municipal golf courses, hospitals, health clubs, ambulance (emergency medical) service, and charter bus service.

Results by Function

The review of Texas budgets and related documents is summarized by industry below.

Telecom: The telecommunications industry is largely a commercial market. Virtually all telecommunications products – such as telephone service, cable television, internet service, and high speed data networks – are provided, without subsidy, by the competitive market. In some nations, telephone service was provided by government monopolies; but for the most part, government telephone companies have been sold to the private sector.

A number of jurisdictions around the nation entered or attempted to enter various segments of the telecommunications industry. A 2001 report by the Progress and Freedom Foundation found that 232 municipalities were competing in telecommunications services, most through municipally owned utilities. There were 109 municipal utilities providing cable television service, 61 were internet service providers, and 58 leased fiber optic infrastructure to the private sector. In addition, a smaller number of government-owned utilities provided high-speed data service and telephone service.⁹ These intrusions into the commercial market have led to legislative prohibitions in some states. Montana, for example, does not permit its local governments to provide internet

⁹ Jeffrey A. Eisenach, PhD., *Does Government Belong in the Telecom Business*, Progress and Freedom Foundation (Washington: 2001).

service. And, Texas law was amended in 1995 to prohibit municipalities from engaging in competition with telephone services.¹⁰

Nonetheless, the city of Abilene subsequently undertook efforts to enter the telephone exchange business and sought a ruling from the Federal Communications Commission (FCC) to the extent that the Texas prohibition was pre-empted by federal law. The FCC ruled against the city of Abilene, and this ruling was upheld by the federal court.

However, Texas governments are providers of other telecommunications services, according to the Progress and Freedom Foundation.¹¹

- Internet services are provided by municipal utilities in Floresville, Lubbock and Schulenburg.
- Fiber optic leasing is provided by College Station, Garland, the Lower Colorado River Authority, Lubbock and Schulenburg.

However, no Texas municipalities were reported to be engaged in the provision of cable television services.

Radio and television in the United States are nearly 100 percent privately owned and operated. One of the few exceptions, however, is found in Texas. The city of Dallas operates a classical radio station with an annual budget of \$4 million.

The government telecommunication assets noted above could be sold to the private sector as a part of a program to remove government from competition with the private sector.

Water and Wastewater: Both water and wastewater services are provided, at a profit, by the private sector. Private companies supply much of the water to consumers in the United States. Moreover, the World Bank has cited private wastewater treatment as having great potential, especially in developing nations.¹² In addition, both water and wastewater systems are provided under contract to governments by private companies in many U.S. communities. In recent years, major conversions to competitive contracting have occurred in Indianapolis, Buffalo and Milwaukee.

All of the Texas municipalities in the budget sample provide water and wastewater (sewer) service, with annual expenditures of more than \$1.7 billion. The five largest cities, Houston, Dallas, San Antonio, Austin and Fort Worth all have water and wastewater expenditures of \$200 million or more (Table 4, page 17). These services are principally provided directly by the local governments. The U.S. Census Bureau estimates that in 1999, local government water and wastewater utilities in Texas spent nearly \$3.5 billion.

¹⁰ Texas Utility Code Chapter 54 Section 202.

¹¹ Eisenach.

¹² <http://www.worldbank.org/watsan/>.

There would appear to be substantial opportunities to remove government from competition in the water and wastewater markets. Systems could be sold to the private sector, or operations could be competitively contracted or franchised. These strategies could be helpful to communities facing large requirements for capital investment to comply with environmental regulations.

Solid Waste (Garbage) Disposal: Garbage collection is a profitable commercial business that operates in many U.S. locations. In some municipalities, garbage collectors operate competitively, and without a franchise, competing for customers who pay the companies directly for their services. In other communities, garbage collectors are franchised by municipalities and operate commercially.

Nearly all of the sampled local governments provide solid waste disposal service, with annual expenditures of more than \$330 million (Table 5). The U.S. Census Bureau indicates that nearly \$650 million was spent on solid waste disposal by Texas governments in 1999.

There is no need for government to compete in solid waste disposal. Government competition could be ended by (1) selling assets to commercial operators or (2) competitively contracting with commercial companies to provide service.

Electricity: Most of the nation's consumers purchase electric power from private electric companies. However, there is a strong government presence in this commercial industry, with a large percentage of power produced and sold by federal government agencies (such as the Tennessee Valley Authority) and municipal power companies.

Among the sampled municipalities, three are producers of electric power:

- San Antonio has annual revenues of approximately \$1.2 billion
- Austin has annual revenues of more than \$800 million

City	Expenditures (In Millions)
Arlington	\$76
Austin	\$282
Big Spring	\$8
Corpus Christi	\$57
Dallas	\$369
Denton	\$51
El Paso	\$79
Fort Worth	\$211
Houston	\$277
Laredo	\$14
Longview	\$22
Lubbock	\$44
Round Rock	\$22
San Antonio	\$200
Temple	\$15
Total	\$1,727

City	Expenditures (In Millions)
Arlington	\$5
Austin	\$41
Big Spring	\$1
Corpus Christi	\$13
Dallas	\$50
Denton	\$12
El Paso	\$26
Fort Worth	\$24
Houston	\$63
Laredo	\$19
Longview	\$13
Lubbock	\$16
San Antonio	\$47
Temple	\$2
Total	\$332

- Lubbock has annual revenues of approximately \$100 million

The electric utilities make contributions to municipal budgets in the form of dividends or payments “in-lieu” of property taxes. However, the existence of municipal electric (or other) utilities can result in a tax loss for some local jurisdictions. Generally, municipal utilities are exempt from property taxation, so that county governments and school districts are denied revenue that they would have received if the utility were privately owned. This can be a considerable amount, since private utilities often have the largest tax bills in local communities.

Overall, the U.S. Census Bureau estimated that government owned electric utilities spent approximately \$2.9 billion in Texas in 1999.

Texas is in the process of deregulating electricity. However, the municipal electric utilities, unlike their private counterparts, are able to deny consumers a choice of electric providers by failing to “opt in” to the new system. This represents a continuation of public policy that precludes competition in a commercial market by the private sector.

Government competition with the private sector could be ended by selling municipal electric companies to the private sector. Selling could provide owning communities with a sizable infusion of income to improve infrastructure, provide a cash dividend to residents, or for other needs.

Natural Gas: Natural gas is overwhelmingly produced and distributed in the commercial market in the United States. Nonetheless, the budget sample revealed that one city, Corpus Christi, has a natural gas utility, which spends more than \$40 million annually. Overall, the U.S. Census Bureau estimated that government-owned natural gas utilities spent more than \$190 million in Texas during 1999. Natural gas utilities, like electric utilities, could be sold to the private sector.

Emergency Medical (Ambulance) Service: Commercial ambulance services operate in many communities in the nation. In addition, many communities provide emergency medical service, either directly or through competitive contract. The budget sample indicates that some Texas municipalities provide this commercial service.

- San Antonio spends \$37 million
- Dallas spends \$37 million
- Austin spends \$19 million
- Laredo, Denton and Big Spring all spend between \$1 million and \$3 million

The U.S. Census Bureau does not report statewide government spending on emergency medical services.

The most feasible strategies for ending government competition in emergency medical services would be either to divest operations to commercial companies or to competitively contract for the service.

Parking Lots: Parking lots are commercially operated by the private sector throughout the nation. Yet one city in the budget sample, San Antonio, operates parking lots. Annual expenditures are approximately \$10 million. San Antonio appears to account for nearly all of the state public parking lot expenditure, which was estimated at \$13 million in 1999 by the U.S. Census Bureau.

Golf Courses: Golf courses are a commercial activity, with approximately 30 percent of the nation's golf courses privately owned and operated. In addition, a number of governments competitively contract or franchise operation of golf courses.

There are a number of municipal and county owned golf courses in Texas. According to the sample of budgets, public spending on golf courses is as follows:

- \$7 million in San Antonio
- \$6 million in Fort Worth
- \$3 million in Houston
- \$3 million in Dallas
- \$1 million in El Paso County
- \$250,000 in Big Spring

Some municipal golf courses in Houston are operated under contract by the private sector.

Golf course competition by government could be eliminated by sale to the private sector, by competitive contracting or by franchising (leasing).

Airports: Unlike many nations in the high-income world, major airports are not owned and operated by the private sector in the United States. Airports have been sold to the private sector in the United Kingdom, Canada, Australia and elsewhere. Sale prices can be considerable. In 2002, Kingsford Smith International Airport in Sydney was sold for approximately U.S. \$3 billion.¹³ Kingsford Smith has an annual volume similar to that of Dallas-Fort Worth International Airport and doubles that of George W. Bush Intercontinental Airport in Houston.

The principal barrier to sale (privatization) of airports in the United States is federal law, which does not permit privately owned airports to receive the federally collected ticket tax revenues that, along with landing fees, pay for airport construction and operation. Nonetheless, Indianapolis has competitively contracted much of its airport operation, both saving money and providing a more attractive environment to passengers.

Among the sampled governments:

- Houston airport expenditures were \$255 million

¹³ <http://www.sydneyairportmedia.com/upload/sydneyairportsale.html>.

- Austin airport expenditures were \$93 million
- San Antonio airport expenditures were \$73 million

According to the U.S. Census Bureau, public expenditure on airports in Texas was nearly \$900 million in 1999.

While sale of airports offers substantial benefits, federal law would need to be revised to make it possible.¹⁴ On the other hand, government competition with the private sector in airports could be reduced by competitively contracting airport operations.

Ports: As in the case of airports, seaports around the world have been privatized in recent years. However, in the United States and in Texas, seaports remain publicly owned. According to the U.S. Census Bureau, public expenditure on ports in Texas was more than \$200 million in 1999.

Government competition in ports could be eliminated by selling port authorities to the private sector.

Toll Roads: Toll roads are a private commercial activity in some high-income nations. Currently, for example, the French toll road system is being sold to the private sector. Further, Governor Perry has proposed building a new network of transportation corridors that would be operated by the private sector.

The Federal Highway Administration reported that toll road expenditures in Texas were more than \$300 million in 2000.¹⁵

Governor Perry's new corridor plan anticipates using the private sector to develop new toll facilities across the state. This program could significantly open the roadway provision market to competition by the private sector, which has largely been precluded from participation in the past.

Summary of Commercial Government Competition

The data indicates that approximately \$5 billion in commercial activity is conducted by the sampled Texas governments annually (Table 6, page 21). Nearly all of this activity was engaged in by municipalities. The budget information from the other types of governments surveyed – counties, school districts, special districts, the university and the state – indicated comparatively little commercial activity.

¹⁴ An amendment to federal law permitted a limited number of pilot privatization projects. For example, Stewart International Airport in Newburgh, New York (New York metropolitan area) has been leased to a private airport operator.

¹⁵ Federal Highway Administration, *Highway Statistics 2000*.

City	Expenditures (In Millions)
Arlington	\$80
Austin	\$1,320
Big Spring	\$10
Corpus Christi	\$120
Dallas	\$450
Denton	\$60
El Paso	\$140
Fort Worth	\$250
Harris County	\$140
Houston	\$630
Laredo	\$40
Longview	\$40
Lubbock	\$160
Round Rock	\$20
San Antonio	\$1,560
Temple	\$20
Total	\$5,030

GOVERNMENT SERVICE COMPETITION PRE-EMPTION

As was noted above, while governments determine the services that they provide, it is not necessary that they be the direct producer. The private sector is theoretically capable of providing virtually any public service, subject to government specifications and oversight. In a number of government services, there are well developed commercial markets that provide government services and support services.

The principal mechanism of competition is competitive contracting, which is also called “public-private competition” or “outsourcing,” or “franchising.” Under competitive contracting, government specifies the service that it requires and seeks competitive bids. The contract is generally awarded to the lowest responsive and responsible bidder for a specific time period (such as five years), after which time the service is rebid. Government agencies are allowed to compete for the service as well, though precautions need to be taken to ensure fair cost comparison and bid evaluation.

Governments are using the private sector more in the delivery of their services. One study found that, over the past five years, the use of competition in government services had

increased in 60 percent of governments.¹⁶ This use of competitive processes follows the model increasingly used in the private sector in which companies outsource many of their activities.

Texas government pre-empts commercial competition in government services with respect to a number of functions in which there are well-developed commercial markets. The use of competitive contracting could permit commercial operators to compete for these services.

Government Services

The surveyed governments were found to be engaging in three principle government service activities for which a strong competitive supplier market has emerged: corrections, convention center management and public transit.

Corrections: Private corrections operations have been expanding both in the United States and overseas. It has been estimated that average cost-savings are in the range of 10 percent to 20 percent.¹⁷ Among the local governments in the budget sample, approximately \$190 million was budgeted for corrections in 2001-2002. At the state level, \$2.0 billion was budgeted for corrections in the same year. Overall, the U.S. Census Bureau reports that Texas state and local governments spent more than \$3.7 billion on corrections in 1999.

Convention Services: There is a well developed market of firms that manage convention centers around the nation. A number of Texas municipalities studied provide convention services, especially through convention centers. Approximately \$80 million was identified in convention center spending, most of it through direct provision.

Public Transit: Throughout the high-income world, public transit systems have been converted to competitive contracting over the past two decades. National conversions have taken place in the United Kingdom, Denmark, Sweden, Finland and New Zealand, while major systems have been competitively contracted in France, Germany, South Africa and Australia. The European Union is finalizing regulations that will require most transit systems in Europe to be competitively contracted.

In the United States and Texas, however, most public transit service is directly provided by government. The sample budgets indicated a spending level of \$60 million for 2001-2002. According to information in the 2000 Federal Transit Administration National Transit Database, less than 15 percent of Texas transit service is competitively contracted. Annual operating expenditures were approximately \$750 million.

¹⁶ Reason Public Policy Foundation Privatization Center (<http://www.privatization.org>).

¹⁷ Charles Thomas, Ph.D., "Comparing the Cost and Performance of Public and Private Prisons in Arizona: An Overview of the Study and Its Conclusions," August 1997, <http://www.crim.ufl.edu/pcp/>.

Support Services

Government provides various services to support its operations, virtually all of which are provided by the private sector through competitive contracting in many jurisdictions around the country. The following functions were identified in the analysis of budgets.

Building Maintenance and Custodial Services: Virtually all governments, state, municipal, county, school districts and special districts must pay to maintain and clean buildings. Among the sampled governments, more than \$120 million was identified in building maintenance and custodial services expenditures. The statewide figure is likely to be much higher, because many budgets, including the state and the University of Texas at Austin, are not presented in a fashion that identifies the function. Some of the sampled governments already use competitive contracting for building maintenance, including Lubbock and San Antonio.

Information Services: The surveyed governments budgeted at least \$200 million for information services (data processing), the majority of which was to be directly provided. Currently, it is estimated that more than 30 percent of governments obtain their information technology services through competitive contracting.¹⁸

Food Services: More than \$120 million in directly provided food service spending was identified in the budget sample. Most of this was in school districts. For example, the Dallas Independent School District budgeted more than \$65 million for food service. School districts alone spend more than \$1.4 billion for food services in 1999, according to the U.S. Census Bureau. It is likely that the total amount is considerably higher, with food services at correctional facilities and universities representing the most significant expenditures.

There is a well developed market of contract food suppliers that are precluded from this market by non-competitive public provision. The Houston Independent School District has competitively contracted its food services, with cost savings and better quality resulting from these contracts, according to the Comptroller of Public Accounts.¹⁹

School Bus Service: Every school day, Texas school districts provide nearly 2.75 million trips to and from school for students.²⁰ This is approximately 2 million more riders than use all of the transit bus and rail services in the state.²¹ In the process, school districts in the state spend more than \$850 million annually. It appears that the overwhelming majority of school bus services are directly provided by school districts, rather than through competitive contracting. Among the sample of agencies, school bus services were provided internally by the Amarillo, Austin, Brownsville, Grand Prairie, Houston,

¹⁸ <http://www.privatization.org>.

¹⁹ *Report of the e-Texas Commission*.

²⁰ Calculated from information in *School Bus Fleet 2000 Fact Book*.

²¹ Estimated from *National Transit Database 2000* data, assuming that passenger trips equal 0.8 of total trips to exclude transfer (transfer factor is taken from the United States Department of Transportation Nationwide Personal Transportation Survey, 1995).

Northside (San Antonio) and Pasadena Independent School Districts. The Dallas Independent School District was notable for competitively contracting all of its nearly \$20 million in school bus service. There was no indication in the other school district budgets that competitive contracting is being used.

Nationally, the competitive school bus industry is strong, operating nearly one-third of the nation's school transportation for public school districts alone.²² Based upon this ratio, it is estimated that daily one-way trips by private school bus companies exceed more than 14 million, a number that approximates the same number of riders as are carried on all transit bus and light rail systems in the nation. School bus contracting companies serve the majority of public school districts in Connecticut, Minnesota, New York, Pennsylvania and Wisconsin.

Fleet Management: Vehicle fleet management is one of the most highly developed support service markets. Savings of up to 40 percent have been reported, and the number of governments using competitive fleet management is increasing.²³ Over \$125 million in budgeted expense was identified in the sample of jurisdictions for largely direct operations. Again, it is likely that the level of spending throughout the state is much higher than the sample estimate because many budgets, including the state and the University of Texas at Austin, do not specifically identify this function.

Street Maintenance: Municipalities in the sample budgeted more than \$175 million for street maintenance, much of it provided through direct operation. In addition to this potential savings, the Comptroller of Public Accounts has noted that more state highway maintenance could be provided by the private sector as well.

Park Maintenance: Municipalities in the budget sample budgeted more than \$50 million for park maintenance, the overwhelming majority of which was provided directly. Private sector operators now maintain parks in approximately one-third of municipalities around the nation.²⁴

Print Shop: Some governments in the sample operate print shops, an activity that is widely available through the commercial market.

²² Calculated from information in *School Bus Fleet 2000 Fact Book*.

²³ <http://www.privatization.org>.

²⁴ <http://www.privatization.org>.

THE EXTENT OF GOVERNMENT COMPETITION

From the analysis of budget data and other sources available, it would appear that competition against the private sector by government is substantial in the state of Texas.

- Approximately \$5 billion is budgeted annually among the surveyed jurisdictions for commercial services that are offered to the public. These are services that the competitive market could provide virtually without subsidy. Electric and water utilities make up nearly \$4 billion of this amount. The overall statewide extent of this competition is considerable. It is estimated that Texas governments had gross revenues in commercial consumer markets of at least \$11 million in fiscal year 2001-2002.²⁵
- More than \$1.2 billion is budgeted annually by surveyed jurisdictions, without competition, for government services and support services that the private sector is prepared to provide (and is providing) in other jurisdictions. It is likely that the total amount, state-wide for the identified services, is at least \$8 billion.²⁶

Thus, overall it is estimated that governments in Texas either compete against the private sector or preclude competition with the private sector to the extent of nearly \$20 billion annually. This is equal to nearly 20 percent of total expenditures by all state and local government units in Texas. This is the equivalent of nearly three percent of the Texas gross state product.

Further, new commercial supplier markets are developing in other government services as well. There is a good example in Texas, which was one of the nation's most innovative competitive contracting proposals. In 1995, the state attempted to competitively contract eligibility determination for more than 50 health and human services functions, including welfare, food stamps and Medicaid. The competition was to involve a private company against the Texas Workforce Commission, which had joint-ventured with another private company. The competition was cancelled due to objections by the federal government. This case, however, illustrates the fact that the commercial market can be used to provide virtually any public service except for the inherent government activity of policy determination (deciding).

²⁵ The budget sample included municipalities with approximately one-third of the state population, counties with approximately one-half of the state population and school districts with approximately one-quarter of the state population. It was conservatively assumed that the budget sample accounted for one-half of budgeted expenses in the categories for which no statewide local government data was available.

²⁶ Assumes that the statewide figure is double the surveyed figure. Budgets at the state and the University of Texas-Austin do not delineate the cost of support services, such as custodial and fleet management. Based upon the ratio of payroll expense at the state level (including higher education), it was assumed that the potential for competitive contracting was 25 percent of the local level potential (municipal, county and school district). The estimate is adjusted upward to account for the full cost of services for which statewide data is available (corrections, school bus service, school food service and public transit service).

POLICY OPTIONS

As noted above, throughout the developed world substantial steps have been taken to remove government not only from commercial markets but also from the direct provision of public services and support services that can be provided by the competitive market. Various strategies have been undertaken:

- Utilities have been ordered sold to the private sector by legislative actions. This includes water, natural gas, airports, seaports, telecommunications holdings and other commercial undertakings.
- Governments have been required by legislation to competitively contract public services. In the United Kingdom, the Local Government Act of 1986 required all municipalities to competitively contract specific support services. Mandatory public transit competitive contracting legislation has been enacted in a number of countries, and for Denver's transit district, by the Colorado legislature. An Australian state required municipalities to convert percentage targets of their spending to competitive contracting over a period of time. New Zealand required governments to establish their commercial enterprises as "arms-length" enterprises, withdrew their tax exemptions and required them to operate under the same laws and regulations as the private sector.

The Texas economy could be strengthened by a deliberate program to remove government from competition with the private sector, and to expand entrepreneurial opportunities by subjecting more government and support services to competition. This could be accomplished by a program containing the following elements:

- **Prohibition of new competition in consumer markets.** The ban on municipal entry into telephone service (above) should be extended to all commercial activities. This could be accomplished by state legislation prohibiting the state, its constituent units and all local governments and districts created under state law from entering any commercial activity that is conducted by the private sector.
- **Review of consumer market activities.** The Comptroller of Public Accounts should undertake a review of all government commercial activities in the state to determine the potential and implications for privatization through sale or other appropriate mechanisms. Recommendations should be provided as appropriate.
- **Removal of favored status.** There would seem to be no reason why a government owned business should receive favored treatment relative to a private firm in the same industry. Where government continues to compete in commercial markets, it should be subject to the same regulatory and taxation regime as private competitors. There should be no tax exemption for government-owned commercial enterprises and they should be regulated by the same commissions and regulations as apply to private firms in the same field. State law should be enacted to accomplish this objective.

- **Petition of Interest for Government Services and Support Services.** There have been attempts to increase the use of competition in the production of both government services and support services. Progress, however, could be quicker. The Comptroller of Public Accounts reports that \$53 million in savings has been achieved through the efforts of the Council on Competitive Government (CCG), which was established to encourage competition in government. While this is a substantial amount, the potential appears to be significantly greater, estimated at \$8 billion annually at the state and local level by this report. There is a need to formalize a competition review process with respect to government services. This could be accomplished by a “petition of interest” process, which would allow private companies to initiate competition review processes. Under the petition of interest, which has been used by the Arizona Private Enterprise Review Board, a company can notify a government of its ability and interest in providing a particular government service or support service. The government would then undertake a review of the market, which would lead to a competitive process for the service. This would represent a substantial revision of the present procedures, which rely on government administrators to administer a competition expansion program that has the potential to reduce their budgets and staffing levels (and generally run counter to incentives in the public sector, as noted above). The petition of interest process would instead substitute the initiative of commercial suppliers in the market, who have every incentive to expand their business opportunities.



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