

Carnegie Council \ DRT International Privatization Project

Privatization: Opportunities for New York



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Thank you very much. The book you have at your places outlines privatization for New York. It could be privatization for New Jersey; it could be privatization for Austria; it could be privatization for Mexico. Throughout the world people are realizing that government cannot do everything. Today in Eastern Europe privatization is the key word on changing from communism to capitalism. At the same time, the *Wall Street Journal*, writing a couple of years ago, asserts: "One nation is still standing on the platform watching the global privatization train depart: the United States." What is amazing is that this country, which was the teacher of the world on what private individuals can do, has become the student. Throughout the world, you see what happens with privatization. In Margaret Thatcher's Britain, for example. And even France, a country with a Socialist president, has started a major privatization transformation. You see it in Hungary, Czechoslovakia, and the former Soviet Union. The question is: If it works there, why can't it work here?

When I started working on privatization a few years ago during that very interesting time that I ran for mayor, it was very obvious that New York City and New York State were about to go under because government had over-extended itself. Yesterday evening we met with Governor Cuomo and I expected to find a person who would say to me, "We don't want to know about this." But he said something totally different. He said: "Privatization can work here. Show me some people, show me some buyers, show me the possibilities. I'm open to it because we have no choice". It's a nonpartisan issue, because until now we were offered only two choices: raising taxes or cutting services. Now we know there is a third choice: privatization.

The chart shows the enormous potential of privatization: a \$10.5 billion dollar saving which almost balances the budget. Let me go through some of the areas on the chart.

The first one, which is probably the largest, is a \$4.7 billion savings in education. What does that mean? First of all, to educate a student in a Catholic school costs approximately \$1,800; to educate a student in a New York public school costs \$8,000. Something is drastically wrong. New York State spends the second most money in the country per student and gives him a second-rate education. What's happening? First of all, of every dollar we put into education in New York City high schools, only 32¢ actually gets to the classroom; the other 68¢ is spent on bureaucracy. What is happening, basically, is that the bureaucracy

is taking over the entire education system. We talk about putting more money into education, but very little of that money actually reaches the classroom. There are two possibilities: we either say let's give up or let's try an alternative that has worked in other places. The key thing that has worked is choice and a voucher system. What that means is that every

student is given a voucher, let's say for \$2,000, and the parents can determine which school their child will go to. This has been experimented with in District 4 in Manhattan, in a limited way. In District 4 there were 50-odd public schools and parents were allowed to choose any school they wanted for their children. So parents went from school to school to see which was the best school for their children. One public school specialized in math, another in athletics, a third in English, a fourth in something else, and so on. As a result, District 4 went from being one of the worst

Privatization Savings for New York

Category	Annual Savings	Sale of Assets
• Education	\$4,700 Million	
• Competitive Bidding	3,030 Million	
• Medicaid	1,200 Million	
• Housing	800 Million	
• Buses	310 Million	
• Solid Waste Management	230 Million	
• Off-Track Betting (New York City)	30 Million	\$ 40 Million
• Airports	220 Million	2,230 Million
• Thruway		1,000 Million
Total	\$10.52 Billion	\$3.27 Billion

districts in the school system to being a competitive district because parents were picking the schools best for their children. It's a question of competition. If we instituted choice—the voucher system—in the United States, and particularly here in New York, we would save billions of

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dollars because we would reduce the education bureaucracy, and we would instill competition. That is what privatization is all about; getting away from monopolies and moving toward competition.

The voucher system has been tried, for example, in Vermont since 1894. It is working in Minnesota and an experiment was started six months ago in Milwaukee, where parents are given a choice. A student can go to a public school or a private school. If students go to private schools, their parents have to pay extra money, but they have that choice. Parents can send their child where they want to go; you cut out billions of dollars of bureaucracy; you have introduced competition; and you have better schools.

The second item on the chart is competitive bidding, which is very simple: every public service in New York State has to be competitively bid. Private firms should be allowed to compete against public agencies. Most public employee unions fear this, so they have union agreements stating, “You can't contract competitively for services,” but these agreements are running out. In England, for example, it is mandatory that many conventional public services be competitively bid. If we instituted competitive bidding, we would get the lowest price. There would be great pressure put on the unions and government to compete. Even if only 20 percent of services are subjected to public-versus-private competition and contracting, the saving would be in the neighborhood of \$3 billion.

The third area is Medicaid, with a \$1.2 billion savings. Here is an interesting fact: California has 1.3 million people more on Medicaid than we do in New York, but it spends \$5.3 billion less on Medicaid. Why? In California there is a great deal more competition, a great deal more outpatient service, and a great deal more effective management in the whole administration system. By having competitive

contracting with private health maintenance organizations (HMOs) on a per-capita basis instead of fee-for-service, we could save another \$1.2 billion annually.

The next area is housing. Today New York City's government is the largest landlord in the country. Turning City-owned housing back to private individuals at auction—no matter at what price—would put it back on the tax rolls. Also, in the case of rent control and rent stabilization, New York has learned brilliantly from the Soviet Union how to create a housing shortage. Rent control was started after World War II, to help returning GI's find a place to live. It was meant as a temporary measure; not intended to continue for the next 40 or 50 years. The Commission is not

advocating removing all rent control or rent stabilization, but we are saying that if you decontrol apartments that are rented to high-income tenants; high-rent apartments; and other controlled dwelling units, the extra taxes that would be generated and the savings on bureaucracy would amount to something on the order of \$800 million.

Next, buses. The bus systems in more and more cities today feature competition between private and public providers. A similar arrangement could save New Yorkers somewhere in the neighborhood of \$310 million annually. In Colorado, for example, the state legislature required Denver to contract out 20 percent of its bus operations. The result: audited savings of 27.5 percent and 31 percent, respectively, in the first two years.

Another interesting case is found in England: the National Bus Company was divided into sixty bus companies and sold to their employees. The experiment with



Ronald Lauder discusses the Commission's report at a Privatization Project breakfast.

privatization has been so successful it is now going to be extended to London.

Solid waste management is another prime target for privatization. Let me tell you an interesting story about Phoenix, Arizona. In 1979 Phoenix was almost in as bad shape as New York with respect to refuse collection. The City introduced competitive bidding district by district and soon, lo and behold, private firms won out over the City agency. Then, spurred by this competition and fearful of being driven out of business altogether, the City agency reformed its practices, improved its productivity, was able to compete, and little by little over several years it won back every district. The difference is that the cost was cut by a third because competition forced the City agency to be more efficient. Phoenix now follows this practice of public versus private competition in eleven different municipal services.

Now let us take a look at Off-Track Betting. Something extraordinary is about to happen: OTB next year will lose money in New York City. If you told that to any bookie, he would look at you as though you were crazy. There are honest business people right now who want to buy OTB and run it as a legitimate business. We could not only sell it for \$40 million, but we could save \$30 million a year.

Next, airports. Many of you know that I have proposed selling Kennedy and LaGuardia airports. For those of you who do not know, the land on which Kennedy and LaGuardia airports are built is owned by New York City and leased to the Port Authority. The Port Authority pays New York a very small amount of money each year. These two airports are worth somewhere in the neighborhood of \$3 billion to \$3.5 billion dollars and one of the things that

Two things happen when you privatize an airport: first, you have a one-time windfall (in the case of New York City and JFK and LaGuardia, that would be about \$2.2 billion), and secondly, you put the airport back on the public tax rolls and money comes in. You also gain more efficiency because the airports would be competing between one another. I would not sell Kennedy and LaGuardia to the

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same group, but to two opposing groups who would compete to provide better services. Now there is no incentive to provide better services because the airports are not competing, they have a monopoly.

Last, but not least, I put the Thruway down on the chart. The Thruway is a very interesting possible sale, and there are people who would like to buy it. A sale would earn the state possibly \$1 billion.

If you add up all these areas, you arrive at a \$10.52 billion annual savings, and one-time revenue from the sale of assets of \$3.27 billion. These are conservative estimates. It may take years and it may not be achieved completely, but there are real alternatives.

Right now we have major problems in New York and throughout the country. Privatization is a very effective tool for tackling many of these problems. Some people are very afraid of it, however. First of all, many politicians are scared of the public-employee unions and are afraid that the first thing unions will say is, “We’ll lose jobs”. In some cases that may be true but not in general. For example, in England, when the airports were privatized, more jobs were created, and the same thing happened in the Port of Buffalo. So the potential is there for creating more jobs through privatization, not less. And contracting out is generally handled by

attrition, not layoffs. Another fear is that when an area or an agency is privatized, the person or politician who heads the agency will lose power, but it will create a healthier and better economy for all concerned.

The amazing thing is if you go to different countries

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Governor Cuomo said was, “You find me a buyer and I’ll sell it.” We may have a buyer already: the British Airport Authority. It privatized Heathrow Airport in England a few years ago at a price of \$2.5 billion, and today it is said to be worth over \$4 billion, and run very efficiently.

throughout the world, privatization is what they are talking about, but it is rare to find that kind of talk here in New York. Many times when I speak to people, they say, "You're right, but what do we do?" We need legislation, we need to find buyers, we need to explain to the people who run the City, and who run the State that it is a real alternative. It is promising that Governor Cuomo read the Commission's report, he knew what was in it, and he was

very interested. It is also interesting that in New York City—which has even worse problems than New York State, if that's possible—Mayor Dinkins and his people have not shown much interest in meeting with me or other people on privatization. This is, I believe, one of the key issues in the 1990s and it is something that we, the United States, should take the lead in. ■

Questions and Answers

Q I think your comparison of Catholic schools to the public school system is somewhat unfair because in Catholic schools you don't have labor unions and you have volunteer teachers who are not paid to teach in the Catholic educational system. How do you account for that?

A As we have all been reading in the newspapers and elsewhere, the supply of nuns has diminished rather significantly; so that does away with the myth of an unpaid teaching staff. And 80-90% are unionized—they belong to different unions—but they are professional teachers, not religious individuals. The comparison is legitimate, because the Catholic school system in New York City educates Muslims and Baptists as well; more than half of their students are not Catholic and come from the poorest neighborhoods in our City. But the Catholic schools are successfully educating these students, whereas the public school system is not. One of the questions Governor Cuomo asked us yesterday was, "How about students who are disruptive?" The answer is that Catholic schools have taken disruptive students, put them in school, and have been very successful with them. They have taken students who have not been able to be in any public school and have taught them and taught them very well. The Catholic school system is working. There are two major differences between parochial and public schools: one is the question of bureaucracy and the second is the question of competitiveness. Catholic schools know they have to compete to get the students, so they do, while public schools are just sitting back.

Q You suggested that District 4's choice trial program has been successful. Before moving into privatization and destroying public education, why don't we consider expanding the District 4 program? Clean the house that we have before destroying it.

A I went to public high school, and I believe very strongly in public education. But I believe we have to introduce competition. If we have the option of choice within a district as a way of having public schools compete, I'm all for that. I also believe that if parents want—or have

an opportunity—to send their child to another school but do not have the money, they should have the right to use some type of voucher. I believe in public education, but I also believe in good education. Right now, the children who are going to public schools are not necessarily getting a first-class education.

Q What are the limits to the philosophy of privatization?

A The limits are simply wherever private institutions, private individuals, and private companies can do things better, faster and cheaper. For example, there's a great deal of controversy in the idea of private companies building and running prisons, even though it turns out that a private firm can build and run a prison at a much lower cost than the government can. People get nervous when they talk about a private prison, but it has worked very effectively. There is no end, then, to where you can look; it is just a question of what makes sense.

Q One of my customers is a European family and we've been looking to purchase a large site for a conference center. We are presently engaged in talks concerning the old Bennett College in Millbrook and are also interested in purchasing Stewart Air Force Base. Large landowners near Stewart are telling local resi-



Ronald Lauder (left) with president, The Honorable Angier Biddle Duke.

Photos by Larry Lettera.



Rick Dowden (left), president and CEO, Volvo North American Corp., and Ronald Lauder.

dents that they will be inundated with thousands of blue-collar workers and their property values will decrease. We need help getting people to support privatization.

A When I spoke about airports I mentioned Kennedy and LaGuardia, but I was also talking about Stewart. It has fantastic viability. I believe that if Stewart is privatized, not only would it be a very good venture for whoever privatized it, but it could become a hub that would open up that whole area of New York that is not now serviced. The budget cuts that that area is currently considering would not be necessary because the extra revenues that would come in would more than meet its needs.

Q **In Philadelphia, where I live, the unions have an extraordinary amount of money that they are putting into an advertising campaign against the new mayor because of his privatizing efforts. It would seem to me that the aim of education about privatization has got to be toward the unions who, I believe, are getting a raw deal because they are getting misinformation.**

A In the case of Philadelphia, the new mayor there believes very strongly in privatization. We've already sent him some materials. Again, it's a question of getting the message out. The major problem we have here in New York State, and it happens probably throughout the country, is that we have no political spokesman. Yes, the Governor might mention it in a speech or the Mayor will mention it or for that matter in many cases the President or the Vice President of the United States will mention it, but we have no strong advocate who says, "It has to be done, here are the possibilities, this is what it will take, these are the steps, this is the type of legislation needed." We've been working here in New York to figure out how we can implement the legislation. It's difficult to get someone in the Assem-

bly or in the Senate to sponsor a privatization bill because the minute they do it they are afraid that all the unions will come down on them. And they're right. They see what is happening in Philadelphia; they see what happens in other places; they see the television ads saying stop the tax cuts in education; and the unions will fight this every inch of the way and until recently no politician wanted to stand up to them. It was similar in England. Even though Margaret Thatcher talked about privatization in her campaign, it wasn't until after she was elected that she took it to the people. She was extraordinarily successful, but she was one of the few courageous ones who did that. But now the political calculus is changing in the United States, and elected officials are advocating and implementing privatization.

Q **Have you met with union leaders and some of the other private interest group leaders and what kind of reaction do they have? Is there anything positive to build upon, either with them or independently?**

A Remember that I am a private individual. Although I was appointed by the State Senate to look into privatization, I'm still a private individual. When I meet with union leaders or when I meet with any group, I'm meeting with them as a private individual, not necessarily as someone who can take action. In general I have not yet met with the various key unions, although I expect to meet with them in the future. Right now meeting with me and trying to decide how they can deal with privatization is very difficult for them. They are afraid it will only be a lose/lose situation for them because even if jobs move from one union to another union, one union must necessarily lose jobs. The other point is that when they meet they don't have a very defensible argument, so what do they gain by meeting?

Q **One thing concerns me in these discussions when you talk about the savings that can be realized in Catholic versus public schools. Isn't the bottom line that a parochial or private school can tell Johnny or Jane to leave, if there is a discipline problem? They can remove a student and return him to the public school system. And the private schools, I believe, are not responsible for special education; they are not responsible for mainstreaming handicapped students, which is a very expensive component, and I think that we would agree that we want all of our students to be educated. So I think there is a tendency to distort the numbers. \$1,800 in a parochial school versus \$8,000 for public schools does not bring into account those factors.**

A First, let me clarify: the savings figure of \$4.7 billion is not based on the \$6,200 difference between \$1,800

per pupil in parochial schools and \$8,000 per pupil in public schools; it's based only on about \$1,800 savings per pupil. In other words, the Catholic school cost was more than tripled in order to account for the differences that you spoke about.

Second, I'm not talking about cutting out the special schools, I'm saying get rid of the bureaucracy; that's where the major expense is. The total budget for the school system in New York is something like \$19 billion. I'm suggesting that it can be cut by \$4.7 billion, which still leaves more than \$14 billion for public education. And of course problem students or handicapped students should be taken care of.

“Basically, New York City and New York State are not functioning well. Privatization offers a better way, because it takes advantage of competition and market forces. Implementing these much needed changes is the challenge of the 1990s.”

Q I wonder if subways have ever been successfully privatized elsewhere.

A There is a great deal that can be done in privatizing the subway systems, starting from one extreme—which is merely using contractors to repair and maintain subway cars and to clean subway stations—to the other extreme of having a private company purchase and run the subway system.

In Tokyo, the cleaning of subway stations is contracted out by competitive bidding and they're doing a very good job. Even in New York City, when the subway cars were overhauled recently, some were done by private firms. There are private firms in the New York area which repair subway cars and they were able to do the work for about 20-25% less, and with a higher quality of work. The Transit Authority doesn't like these comparisons, however, and is not acting on them.

Q I heard that at the last Transit Authority fare increase the New York City express buses raised their fares, but Liberty Lines did not because they were

making a large enough profit. They were, however, forced to increase their fares as well, because they were undercutting the New York City buses and they were told if they didn't they would lose the right to run the bus lines. Isn't there something you can do legally to stop the City from putting a private enterprise out of business because it is underbidding the City?

A The Commission report gives an example of people who have started private van services in different areas but the City is trying to put them out of business. The City and the State do not want competition. They do everything they can to prevent it because when they compete they're likely to lose. Liberty Lines is an example. This is an area that's going to be extremely controversial. Even though Governor Cuomo said to me "Find me a buyer and I'll sell you Kennedy and LaGuardia," or "Find me some people who can do these things and I'll be glad to do it," many politicians want to keep the status quo no matter what happens to the City, no matter what happens to the State. I believe this is the major problem that we face here in the 1990s. Basically New York City and New York State are not functioning well. Privatization offers a better way, because it takes advantage of competition and market forces. Implementing these much needed changes is the challenge of the 1990s. ■

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