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PRIVATIZATION OF THE FEDERAL GOVERNMENT

HEARINGS

BEFORE THE

SUBCOMMITTEE ON
MONETARY AND FISCAL POLICY

OF THE

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CONGRESS OF THE UNITED STATES

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PRIVATIZATION OF THE FEDERAL GOVERNMENT

TUESDAY, MAY 1, 1984

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY AND FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:15 p.m., in room SD-562, Dirksen Senate Office Building, Hon. Steven D. Symms (chairman of the subcommittee) presiding.

Present: Senators Symms and Specter.

Also present: Steve H. Hanke and Edward Abrahams, professional staff members.

OPENING STATEMENT OF SENATOR SYMMS, CHAIRMAN

Senator SYMMS. The Joint Economic Committee's Subcommittee on Monetary and Fiscal Policy will now convene.

This is the first of a series of hearings on privatization before the Joint Economic Committee's Subcommittee on Monetary and Fiscal Policy.

Privatization is the transfer of ownership of assets and, consequently, the responsibility for supplying goods and services from the public sector to the private sector of the economy.

Over the years we have gradually but steadily transferred the responsibility for financing, supplying, and managing a staggering number of services from the private sector to the state. That transfer has a name. It is called collectivization. Our creeping collectivization has, as is always the case, hampered our economy and prevented most of our citizens from attaining higher standards of living.

Members of special interest groups, many whom have high incomes and wealth, have become the spokesmen for even more state ownership, management, and control. They are often also the beneficiaries of collectivization.

Angry about this state of affairs, the majority of our citizens has cast a blanket of blame on politicians for being supportive or neutral toward the tide of creeping collectivization and its consequent waste.

The Grace Commission, a privately financed group appointed by the President, has performed a great service for this Nation by documenting the waste and inefficiency in the public sector; the Commission has identified the symptoms of our disease.

The Commission has offered two types of treatment of the wastefulness that accompanies collectivization. One is for the state to copy the management techniques that are employed in the private sector. But political and bureaucratic incentives are not the same as those in the private sector. This is why public sector reforms that have attempted to imitate private enterprise have not and cannot eliminate the problem. To eradicate the symptoms we must eradicate their cause: Public ownership of the means of production is inefficient; and state ownership is inefficient, impoverishing, and consequently unfair.

We should release the state and its bureaucrats from duties they were never meant to perform and we should transfer these duties and responsibilities to the people so that they can be performed on a free and competitive basis.

This process is called privatization, and it represents the second type of remedy recommended by the Grace Commission. This remedy is the correct one and has great promise. This is why we are fortunate to have two central figures from the Grace Commission with us today.

It is my pleasure to introduce Mr. J. Peter Grace, Chairman of the President's Private Sector Survey on Cost Control, and Mr. J. P. Bolduc, Chief Operating Officer of the President's Private Sector Survey on Cost Control.

Mr. Grace, before we start with your testimony, I see that we have with us Senator Arlen Specter from the great State of Pennsylvania.

Senator Specter, we are delighted to have you here. Do you have any comments you would like to make?

Senator SPECTER. I came to hear Mr. Grace.

Senator SYMMS. Then we will go right ahead and hear our witness.

Mr. Grace, we welcome you here to the subcommittee.

We are going to hold a hearing here today and also a hearing tomorrow morning on this subject; and then we are going to hold field hearings. We will pursue this diligently. As far as I am concerned we are not going to allow the good work of the Grace Commission to fall in the dustbin of history, which happens so often when surveys show how to make this country of ours operate more efficiently and to allow for greater production and a better standard of living. So we are not going to allow your good work to die. We are glad to have you here and wish you would go right ahead with your testimony.

STATEMENT OF J. PETER GRACE, CHAIRMAN, THE PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL, AND CHAIRMAN AND CHIEF EXECUTIVE OFFICER, W.R. GRACE & CO., ACCOMPANIED BY J.P. BOLDUC, CHIEF OPERATING OFFICER, THE PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL, AND SENIOR VICE PRESIDENT, W.R. GRACE & CO., AND JOHN GISH AND DUNCAN BAILEY

Mr. GRACE. Mr. Chairman, we are very pleased to be here and to accept your invitation and to identify some of the major recommendations of our task forces related to the transfer of the Government's commercial activities to the private sector, or privatization.

My name is J. Peter Grace and I was the Chairman of the PPSS and I am still the chairman of W.R. Grace & Co. and the CEO.

With me is J.P. Bolduc, who was the Chief Operating Officer of the survey, and who is a senior vice president of W.R. Grace & Co. That is only because his former employer refused to keep paying, so we had to put him on the payroll, and I think you were there the last time we appeared before you and Senator Biden stood up and said be sure to keep that bum on your payroll; every company needs at least one wise guy. [Laughter.]

But anyway, that's how I will introduce J.P.

Senator SPECTER. Did Senator Biden say that the Senate had one wise guy?

Mr. GRACE. He said keep that guy on your payroll. He said every company needs at least one wise guy.

Senator SPECTER. Senator Biden was saying that to prove it. [Laughter.]

Mr. GRACE. Senator Biden also said that he had turned down the job of lifeguard on one of our passenger ships, so I referred to him from then on as a former lifeguard. But he didn't mind.

We will concentrate on a broader overview of PPSS and our findings and recommendations on contracting out, privatization, and in general the desirability of transferring Government activities to the private sector.

Let me provide a brief overview, if I might, of PPSS's formation, organization, and conclusions.

I don't know if you want me to go into that, Mr. Chairman, because that is what was written.

Senator SYMMS. Go right ahead.

Mr. GRACE. I will try and do it quickly.

President Reagan decided in February 1982 that it would be useful to have a study of the executive branch of the Government by members of the private sector, and he invited me to become chairman of this effort. He felt a survey patterned after the private sector study that he had instituted when he was Governor of California would be useful in identifying inefficiencies, overlap, and waste in the operations of the executive departments and agencies. The President is very concerned about the tremendous increase in the cost of operating the Federal Government, which has gone up almost sevenfold since 1964, from $119 to $854 billion for 1984, and of course the obligations are $1.2 trillion, which is even worse.

On June 30, 1982, the President's executive order was issued establishing the PPSS, and we started to organize the 161 executives who had been recruited from the private sector into cochairmen of 36 different task forces. Each task force was assigned to examine one or more of the departments or agencies in the Government or some functional area cutting across Government, such as procurement, such as procurement, asset management, personnel management, et cetera. In addition, we had 11 special reports prepared by the PPSS management office to examine areas of special interest.

In organizing this effort the private sector was requested by the President to finance the entire survey. Accordingly, we recruited more than 2,000 volunteers from the companies of the executive committee members and others, and we raised $3.4 million in cash from the private sector to pay for the central administrative expenses of the project. We created a special foundation to handle the financing of these administrative costs. In total, the private sector contributed $76 million to the survey in people, services, travel, equipment, materials, and supplies.

The 47 task force and management office reports consisted of 21,000 pages and 1.5 million pages of supporting documentation.

Senator SPECTER. Mr. Grace, may I interrupt you. We are going to have five bells ring in just about 4 minutes and I am going to have go then, and the chairman said I might interrupt you.

What is your very best idea? If you had to summarize the very best idea you have or a few ideas, how would you summarize them?

Mr. GRACE. The ideas are this, Senator. The culture here, the ethic is completely obsolete. The computers, the information systems. There are 17,500 computers. They are obsolete. The information is not available to show how many people are recipients of all the social programs. They didn't even know how many social programs existed. There are 963 all together. Our deficit is going to be $2 trillion a year in the year 2000, the debt will be $13 trillion, the interest is going to be $1.5 trillion a year. We are heading for a disaster.

Senator SPECTER. Your recommendation is to computerize in a way that we know precisely how much is paid to whom and for what?

Mr. GRACE. Computerize, Senator, in a way that we know how many Government employees are not paying on their $2.5 billion of student loans that have been defaulted. There are hundreds and hundreds of information gaps that persist in the Government. That's why the Defense Department is paying $91 for a 3-cent screw. They can't control the $41 billion in inventory they have. The whole Government has to be recognized.

Senator SPECTER. What would it cost us to close that information gap?

Mr. GRACE. You probably would lease the computers. I would say that it would add about $1 billion a year to get the thing organized and to organize the Government with a chief financial officer, a computer czar, the way big companies are organized to get their stuff under control. Maybe $1 billion.

What would you say?

Mr. BOLDUC. Senator, it is beyond just automation. The fundamental problem is the identification of management information upon which to make decisions. The Government doesn't identify the information it needs to make a capital investment decision, what it needs in order to make a decision concerning closing of an office or opening of an office. It doesn't even have basic information to measure personnel performance. They don't capture the right information, to make the right decision, at the right time. You've got to capture the right information before you can begin to automate anything.

Senator SPECTER. So you are talking about identification as to what is the right information.

Mr. BOLDUC. I'm talking about identification of what it takes to manage efficiently, and a good part of that is information flow.

Senator SPECTER. Where should that start?

Mr. BOLDUC. That should start at the Office of Management and Budget in identifying a primary, a secondary, and a tertiary level of information needs:

First, the first level of information requirements should be what the President and what the Office of Management and Budget needs to oversee and monitor Government operations clear across the board.

Second, the second level should exist at the Cabinet level in terms of a Cabinet officer, what he or she needs to manage his or her department.

Senator SPECTER. Has OMB been cooperative with you in implementing your recommendations?

Mr. BOLDUC. You are asking two questions. The first question: Have they been cooperative? Yes. Have they implemented our recommendations? Not in all cases.

Senator SPECTER. Have they implemented any?

Mr. BOLDUC. Yes.

Senator SPECTER. Have they implemented this basic one about trying to close the information gap?

Mr. GRACE. No.

Mr. BOLDUC. No.

Senator SPECTER. Why not? If you know.

Mr. BOLDUC. You'll have to ask them.

Mr. GRACE. You can guess why. The answer is that it downgrades the OMB and Mr. Stockman.

Senator SPECTER. What is wrong with that?

Mr. GRACE. There is nothing wrong. But he doesn't want it downgraded.

Senator SPECTER. But that is your No. 1 recommendation?

Mr. GRACE. The No. 1 recommendation beyond all is to get the information that you need, Senator, that people down here need to decide what is right and what is wrong. Today you don't have the information.

Senator SPECTER. What about the incentive side of this? Is there any incentive?

Mr. GRACE. If you've got the right information, and we know what the goals should be, then we can set up a very rational incentive system to correct this situation, and we can have it all corrected in 3 years.

Senator SPECTER. How would you do that? How would you get the right information?

Mr. GRACE. Set up the Federal Management System Office, Senator, with the free reign to get the information and set up the computers, we would just get in the computer system, lease them, get the information, get it on stream, and then gradually sort out the facts that we need, such as the W-2 forms, so everybody who gets anything, low interest loans or anything else, is identified, and then we go on from there and get the facts, and then you say all these things have to be corrected, let's incentivize the work force to do it. You could do it.

Senator SPECTER. Mr. Grace, what is the most important recommendation of your commission that has been carried out?

Mr. BOLDUC. The $4.7 billion in interest savings brought about through the implementation of cash management improvement procedures, bringing into play electronic funds transfer, letters of credit, and lock box operations.

Senator SPECTER. $4.7 billion a year?

Mr. BOLDUC. Out of the fiscal year 1985 budget.

Senator SPECTER. What is the second most important recommendation that has been implemented?

Mr. BOLDUC. The agreement to eliminate 40,000 mid- to senior-level management positions at the GS–11 through GS–15 level, called organizational fat.

Senator SPECTER. How much saving was that?

Mr. BOLDUC. $1.4 billion.

Senator SPECTER. What is the third biggest saving?

Mr. GRACE. Now you are getting down to penny pinching. [Laughter.]

Senator SPECTER. I'm just going to go as far as you run out of things you remember.

Mr. BOLDUC. You have $51 million brought about through the closure or reduction in size of 229 printing plants; you have $31 million brought about through the issuance of credit cards rather than cash for travel advances; you have $65 million in student loans that are delinquent to 41,000 active and retired Federal employees.

Senator SPECTER. Do you have a list there?

Mr. BOLDUC. Not here, but yes, we have a small list that we have put together. But you can't look only at what has been implemented administratively; you also have to take a look at what has been introduced, for example, in the Congress in terms of legislation with respect to $32 billion in delinquent loans, which we recommended an offset against IRS refunds, and that currently has been introduced in the Senate.

Senator SYMMS. J.P., I'm afraid we're going to have to recess for a vote. Before Senator Specter leaves, I want to focus on incentives for privatization. I was told—and I know it is one of the items you are going to bring out—that you discovered that the Federal Government owns 436,000 automobiles.

Mr. BOLDUC. 437,000.

Mr. GRACE. They trade them in at 9,000 miles.

Senator SYMMS. If they simply had that all in this computer system you are talking about and knew this, then maybe they could pay the going rate at Hertz and Avis or Budget and they would save a billion dollars a year. Is that correct?

Mr. BOLDUC. That's correct. The fundamental issue is that you have an Office of Management and Budget which is an Office of Budget, not an Office of Management and Budget. That's No. 1.

No. 2, you have one very critical component of management which is called personnel management, and that is not part of the Office of Management and Budget.

You have another critical part of management, which is the General Services Administration: Plants, facilities, real estate, and a whole series of other things; and telecommunications, office automation, and computers. Which is not part of the Office of Management and Budget. So you have an Office of Management and

Budget and you have given them one of the three legs to manage. You can't have those separated and have any effective control. We recommended a new office that would bring these under one group.

Senator SPECTER. Mr. Grace, one of the items of good information around the Senate, perhaps the only one, is telling us when we have to vote. So when those buzzers go off we usually respond.

I am pleased to have had a chance to hear a bit of it, Mr. Grace, and I will take your testimony with me.

Senator Symms at our Republican caucus today invited some of us to come over, and I want you to know that the absence of so many of our colleagues is due to the fact that they are very busy. But we have great admiration for the work that you have done and we thank you.

Senator SYMMS. I am going to take this with me and read it on the way over.

[A short recess was taken.]

Senator SYMMS. Mr. Grace, I started out with a great deal of enthusiasm trying to read your statement on the train over, but I was sidetracked in discussing the floor vote. So please go ahead. If you can give us the highlights, I think there are some points here that are very instructive for all Senators.

Mr. GRACE. Would you like me to go quickly through it?

Senator SYMMS. Why don't you go right on through it, and then we will get into some questions. I understand you need to leave here by 4 o'clock, and we will be able to accommodate you.

Mr. GRACE. I have to go up to Providence to speak at the request of Senator Chafee. That's why he gave us his sitting room there while we were waiting. They let us sit on his sofa.

Anyway, we had 47 task force and management reports, 20,000 pages, 1.5 million pages of supporting documentation, and we had 2,478 recommendations, all of them submitted to the President.

The areas of program waste and inefficiency and systems failures account for $312.2 billion, or almost three-quarters of the $424.4 billion total savings identified in those reports, as summarized in my prepared statement.

Program waste, 443 recommendations, $160.9 billion.

System failures, 1,152 recommendations, $151.3 billion, including the information gap and Government finances.

Personnel mismanagement, 422 recommendations, $90.9 billion; compensation and retirement plans.

Structural deficiencies, 211 recommendations, $12.7 billion; central financial and administrative management and management tenure in key positions.

Finally, 250 recommendations under other opportunities.

It totals $424.4 billion.

In reality, almost all of the waste and inefficiency that we found in the Federal Government can be traced to systems failures and restraints put on the management of the executive branch by the Congress. There is hardly anything basic in the management of Government operations that doesn't require congressional approval, be it closing obsolete facilities, buying new computers, the wage scale on Federal construction projects, or just about anything that might result in greater efficiency, including policy decisions in the Veterans' Administration affecting as few as only three employees.

The current and projected deficits are unacceptable to Congress, the administration, and to the American people. However, how those deficits are to be attacked has been the subject of much debate.

The available options are simple: Reduce costs; increase taxes; or combine the two one way or another, some combination.

The tax burden on the average American family is already at counterproductive levels, with the underground economy now at an estimated $500 billion, costing a little under $100 billion in lost Federal tax revenues per year.

The underground economy and the size of it is understandable when one considers that the median family income taxes have gone from $9 per year in 1948 to $2,218 per year in the latest year, or 246 times, while the gross income only went up 7.6 times in the same period; that is, taxes went up 32.4 times more than income.

The next chart shows the details of that number. And if you throw in Social Security, the number is $39 in 1948. That means $9 in taxes, $30 of Social Security, for a total of $39, which went to $3,833 in the latest year, a multiple of 98.3 times.

To balance the budget in 1983 would have required a 72.8-percent increase in the average tax rate of the median family income, from 9.2 to 15.9.

Why balance the budget on the back of the median income family? Why not tax the wealthy?

Now any meaningful increase in taxes from personal income would have to come from lower and middle income families, as 90 percent of all personal taxable income flow that is generated is generated below $35,000 of taxable income.

We have a chart in the prepared statement that shows how much of the total personal taxable income flow is captured at each bracket. At $15,000 it is 63.1; at $20,000 it is 74.9; at $25,000 it is 81.9; at $30,000 it is 87.2; and at $35,000 it is 90.4.

That leaves, Mr. Chairman, 9.6 percent of the total taxable income flow uncaptured at $35,000. At $75,000 only 2.9 percent remains, and it's $17 billion is all that is untaxed. The $17 billion is the remaining untaxed portion of all income of over $75,000. That would run the Government for 10 days if one took all of the income that everybody has over $75,000. That, of course, would run the Government for the 10 days that this went on. By a year later most of these people would be in the Caribbean, on a beach, or in the underground economy.

Taxing the rich makes more sense as a campaign slogan. And I understand from the newspaper that some of our candidates are getting loud clapping when they talk about taxing the rich. If they know these numbers, they are dishonest when they talk that way, and if they don't know these numbers, they are super stupid, because they are well known to most people.

That leaves reducing the cost of Government as our best bet to contain spiraling deficits, and that was the purpose of PPSS: Cost control.

The question then becomes where to cut the costs. On the problem in perspective, fiscal year 1962 was considered a good year. It was the first full year of the Kennedy administration. It was Camelot—peacetime, before guns and butter. Real GNP was up 5.8 percent in 1962; inflation was 1.8 percent; the prime rate was 4.5 percent; and the total Federal deficit was $7.1 billion, or 1.3 percent of the GNP.

In 1983 we had $195.4, up $7 billion in deficit, and if you add the off-budget stuff, it would be $207.8 billion, or 6.4 percent of GNP. And that does not include the unfunded liability of the different pension programs, which would produce a deficit of about $390 billion. And that, of course, would be 12 percent of GNP. If you add in the past service liability, the deficit was actually $394 billion, or over 12 percent of GNP.

In 1962 Federal revenues were 18.2 percent of GNP versus 18.6 percent for 1983. That's revenues. To get back to 1962 we'd have to cut taxes another $12.9 billion.

On the spending side, without counting past service liabilities that have not been booked, defense accounted for 9.4 percent of GNP in 1962—that's down from 10 percent in the Eisenhower years—versus 6 percent for 1983. So it is almost 60 percent higher than 6 percent. So that means Kennedy was spending about 60 percent greater share of the GNP on defense than President Reagan. We would have to add $109.8 billion to the 1983 defense budget to get up to the same percentage of GNP in 1983 as was accounted for in 1962.

In relative share of GNP, transfer payments have increased 2.3 times, from 5.6 percent in Camelot days in 1962 to 13 percent in 1983. We'd have to cut transfer payments by $238.9 billion to come out at the same percentage of GNP as we had in 1962.

The net effect of holding Government revenues and outlays to the same percentage of GNP in 1983 as in 1962 would be $164.7 billion reduction in the deficit. And that would keep the deficit down to about $20 billion.

I am not, of course, recommending that we turn the clock back to 1962, but this comparison does provide a useful perspective as to how we got into the mess we are in, and provides ideas as to how to solve the problem.

One might ask, as we have been asked, what experience businessmen have that qualifies any of them to examine the Federal Government.

The following is an array of similarities between the operations of the Government and business, with specific opportunities identified to improve operations.

I don't know whether it would be necesary to read this, Mr. Chairman. There are four pages of them. Would you like me to read just the headings?

Senator SYMMS. Just read a heading or two and then we will put them all in the record.

Mr. GRACE. Lending money: The Government has $764.6 billion of loans outstanding. It has four times the default rate as they do in the private sector.

When we got down here the debt hadn't even been aged. They didn't know when it was owed, whether it was overdue, not overdue. And that's 80 percent of a trillion dollars. When I tell people that in the field, Mr. Chairman, I try to let them know what a trillion is. Most people don't know what a trillion is. It's a thousand billions or a million millions. But in seconds it is 317 centuries. If you did that in seconds you would have to go 317 centuries or 31,700 years to get to a trillion.

So, 1 trillion seconds would take you 317 generations, 31,700 years. That's what a trillion is.

Senator SYMMS. Mr. Grace, my State is a rural State, an agricultural State. The Federal Home Administration there is a big operation. I have suggested to the gentleman who now runs it that perhaps we should pass a bill forbidding the lending of new money. They could gradually become a collection agency, and just collect all their outstanding loans.

If you go out there you'll see the young farmers—it is just tragic—who borrowed heavily during the last 2 years of the Carter administration. The Government wanted to attract a lot of young people to the farms. It was a noble idea; however, it was totally unrelated to the market. So they would lend money to young farmers to build a dairy who thought they could milk cows for a government subsidy. This created part of our surplus milk production from FHA loans. But a lot of them borrowed money they just could not pay back. Their debt services often exceeds their milk check.

Mr. GRACE. It's terrible.

Senator SYMMS. It's tragic. How would you address this problem?

Mr. GRACE. I think the only answer, Mr. Chairman, is that the farmland all over the country—I'm a farmer in three different States, and I'm afraid to say that the famland is greatly overvalued in every State—South Carolina, North Carolina, and Texas—where I farm. I don't know how the values can ever be sustained. You cannot buy good land in the Midwest for under $2,000 an acre; you cannot buy it in the Carolinas for under $800 an acre. I don't know what it goes for in Idaho, but I do know that the land in the United States is selling at about twice what it can be justified for in terms for the values that you can get off the farm.

Senator SYMMS. A lot of good farmers certainly agree with that; and they believe it is a detriment for their ability to farm.

In item 2 you mention timberland management and the comparison between private timber management vis-a-vis Government timber management. But on item 3, on grazing land management, you mention here that "Federal grazing programs collected $15 million in grazing fees while providing $41 million in services, recovering only 36.6 percent of costs."

I think a lot of the Federal grazers that I talked to out there would probably agree with you, although they might point out that what they pay in grazing fees is really about all it's worth. They will have to have 15 or 20 acres to support one cow, for example, or even 100 acres in some areas. Ultimately, isn't the only answer to some of these problems an arrangement allowing the private sector to allow these lands to be used publically?

Mr. GRACE. I think so, and then have a right to repossess when you need it, and limit what they can do with it.

Senator SYMMS. By making leases with performance clauses with respect to recreational values or ground rights?

Mr. GRACE. Something like that. But no matter how many acres you have to have to a cow, you certainly should recover more than 36.6 percent of your cost, Mr. Chairman.

Senator SYMMS. I agree with that. However, if you drive to those little towns in Idaho, the only place you will find new equipment and trucks in the whole town will be at the BLM office. You'll find a whole line of brand new trucks out there for the rangers to drive around. There are now 10 rangers, where there was just 1, 20 years ago. The bureaucracy continues to grow relentlessly.

Mr. GRACE. That's right. That's the trouble. And of course the President brought that up with me the first day I met him. He said I don't know what all these people and all these officers are doing in all these outlying areas, and they are just growing and growing and growing, and many times they are duplicated, particularly in the agricultural area. You have as many as 10 different offices of the Department of Agriculture in one area.

Isn't that right, J.P.?

Mr. BOLDUC. There are 15,000 field offices in the Department of Agriculture. There are 28 agencies in Agriculture, and nearly each one of the agencies has their own field offices. You have Federal Crop Insurance Corporation, Farmers Home Administration, Agricultural Stabilization and Conservation Service, the Food and Nutrition Service, Rural Electric Administration, Forest Service, Soil Conservation. And it goes on and on and on. You can get into many rural communities in which you will find 6, 7, 8, 9, 10, USDA offices in a local community rather than 1 office. That's not limited, incidentally, to Agriculture. You can go in Denver, CO and find over 20 personnel offices, Federal personnel offices.

Mr. GRACE. Instead of one place.

Senator SYMMS. And that's employment offices?

Mr. BOLDUC. Correct. Every Federal agency, Senator, has its own personnel operation. So if you are Agriculture in Denver, CO, you will have a personnel office for Agriculture.

Senator SYMMS. How much would it save us just to turn all of the employment business over to the private sector?

Mr. BOLDUC. We have never really calculated or estimated that.

Senator SYMMS. There are people that go into the business of trying to find jobs for people.

Mr. BOLDUC. That's a possibility, but I think before you turn it over you ought to first answer the question as to how much of it is necessary. I don't think you want to turn anything over to the private sector that is not necessary.

Senator SYMMS. That's what I mean. If you reduce and consolidate some of those Federal offices then the private sector might be able to provide the necessary information. The local Forest Service supervisor, for example, could call up the local private agency and simply ask for a few people to plant trees.

Mr. BOLDUC. There ought to be one place for prospective employees to go to do business. There ought not to be 25 to 30 different offices that an individual has to go to. Some of those operations could be placed in the private sector.

Mr. GRACE. These headhunters are falling all over each other and duplicating their own activities and constantly raiding good companies like our own, Mr. Chairman. So we would love to give them something else to do.

We also have hospital management where they operate 177,000 beds, and the VA spends $191,300 per bed versus $97,400 for Duke

University. By and large it's around double. But in nursing homes its quadruple—$16,000 in the private sector, $61,250 under VA.

AUTOMATED DATA PROCESSING

We've been over this many times. Over 17,000 computers, not interlinked, not talking to each other, not having the proper information interrelationship and, again, working on 332 incompatible accounting systems.

Inventory management, which is mismanagement, being mismanaged because of the computers, among other things, is $41 billion, and we could save by our suggestions, if they were adopted, $4.5 billion over 3 years.

ELECTRIC POWER

I know that's a very controversial point, but the taxpayers are paying to subsidize a much lower rate in the Northwest than exists throughout the rest of the United States.

BORROWING MONEY

There is $1.8 trillion that will be borrowed by the Federal Government by the end of fiscal 1985, and the Federal Government is going to be constantly taking a greater and greater share of the credit market, and something obviously has to be curbed or mortgage rates are going to be 16 percent again. They have already gone, Mr. Chairman, from 13½ to over 14, and they are moving up toward 15, and I think they will be at 15 within the next year or two.

R&D FUNDING

You've got over $40 billion. That was an obsolete figure, the $38.5 billion. It's now over $40 billion, $42 billion in the latest year. There are all kinds of demands made on the researchers. For instance, the Oak Ridge researchers consult 114 DOE offices for funding approval.

TRANSPORTATION OF PEOPLE

We have suggested that they have individual travel cards issued by the Government, that they use private sector travel agents and their expertise, and we would say that quite a bit of savings could be made if they would do that promptly. Already they have adopted the travel card idea that we gave them.

PAYROLL

Civilian payroll, $61.8 billion, and that compares to $1.09 trillion in the private sector. It costs the Army $4.20 to process a payroll check versus $1 in the private sector. A lot of that stuff ought to be eliminated by electronic data transfer anyway.

Senator SYMMS. Chairman Grace, I appreciate your points and I am going to pursue every one of these. What I would like to do, if I may, is summarize what we are talking about here. For example, it costs less to run a private payroll than it does a Government payroll, but we are not suggesting here today that we are not willing to pay for some of these costs. We must have an army, for example.

What I would like to do, if we could, is skim through, starting on page 25. I want to leave you enough time on page 25 so that we don't run out of time. I will have some questions.

There are areas where the Commission made recommendations on what the Government could do to be more efficient in its operations. And then there are several direct suggestions, some of which are very controversial in certain parts of the country. Please offer everything for the record.

Mr. GRACE. Mr. Chairman, we're at your service.

Senator SYMMS. We are on page 12 and page 13. We'll put all those in the record. Page 14, I would like to have that in the record. And 15.

I find these recommendations fascinating. Your questions about Federal vehicles are incredible, and I hope that the members of the press here will give them attention.

Consider pension funds, for example. It is fascinating to see how the private sector has a return of 14 percent and the Government sector's return is 7 percent. So it's no wonder pension funds cost the taxpayers a lot of money, because this fund is not managed well in the first place.

Mr. GRACE. That's right. It's everything you look at, Mr. Chairman, whether it be the 2.6 billion square feet of office space, which is the largest 10 cities in the United States, times 4; it's 14 times the expense per square foot as is the private sector. That's on page 14. That's just ridiculous.

Senator SYMMS. One little thing that I thought was fascinating is the Senate Hart Building, where my office is, right next door. The Government spent $140 million-some to build that building and there are not even facilities for the people that work in the building to shower if they want to jog down the Mall. I can't imagine the private sector spending $140 million on a building and not having either a cafeteria or facilities of any kind for the employees that work there. Only the Government could do that.

Mr. GRACE. Yes.

Mr. BOLDUC. Did they give you bathrooms?

Senator SYMMS. Yes; they did that. That was an afterthought. [Laughter.]

Mr. GRACE. Shall we jump to 25, Senator?

Senator SYMMS. Unless there are any points as you skim from page 15 and so forth, something that you think should be pointed out, I do have questions. I want to ask you about the privatization question.

Mr. GRACE. Well, we could start on the bottom of page 24, Mr. Chairman.

Turning to the area of this committee's immediate concern, our tasks forces developed recommendations which could save $37.1 billion over 3 years by optimizing by use of the private sector. And it's summarized on page 25:

Power marketing, $19.837 billion.

Commercial activities that can be contracted out.

Commissary operations privatized.

I spent the weekend in California where almost all new restaurants and retailing activities start. They are more imaginative, they are more daring or whatever. You are finding more and more of these warehouse-type activities where you roll a big cart or back your truck in and take it right off the platform—40 percent less than the rest of the retail business. So you've got lower prices in some of these warehouses already than you have got in the commissary. The private sector can do it.

You got contracting-out of selected Coast Guard services. As you know, they tow, in non-life-threatening situations, rich people's yachts all summer long off Long Island and Massachusetts; they sell maps at expensive gift shops that the Government provides; all kinds of charts at much too low a cost.

National space transportation system is a great opportunity for privatization.

THE FEDERAL VEHICLE FLEET MANAGEMENT

There are 435,000 cars, averging 9,000 miles per year. They don't even, by the way, bring them up to blue book value with a little maintenance, et cetera, a little painting where you can get better turn-in values, as all of our fleet operators do. They don't care. They turn them in for stupid values.

VA HOSPITAL AND NURSING HOME

Massive opportunities to be done efficiently, better, and at less cost.

Other privatization/contracting out issues are $1.5 billion.

Senator SYMMS. Mr. Grace, in each one of these cases that you cite here you're making the point that these same services can be delivered by the private sector at a lower cost.

Mr. GRACE. And the same quality if not better.

Senator SYMMS. With no breach of contract to any contract that the Government has signed, as with a veteran?

Mr. GRACE. Absolutely, Mr. Chairman. And tomorrow I understand our people are going to be testifying in detail on all of these different things.

Approximately 80 percent, or about $30 billion, of the above savings will require congressional action. The administration's authority; namely, commissary operations, will also be influenced by congressional action. We have heard enough noises already from the Hill on the commissary to make one feel that no administration would dare to make a move without congressional approval.

The details will be discussed tomorrow, et cetera.

Inefficient management tends to be rewarded with higher appropriations and more staff, which in turn upgrades their grade level, as you know.

Government businesses are insulated from competitive pressures and thus need not address fundamental changes.

Powerful constituencies exist within and outside the Government that can and do effectively lobby to prevent change.

We have seen in the commissary case that they are already attempting to widen the people that can qualify to be in the commissaries, like divorced wives, et cetera, et cetera, so they can get a bigger constituency before anybody can do anything about this. That's, of course, one way to go.

Two specific examples on the VA and the commissary:

Budget allocations are made to individual VA hospitals on the basis of the number of patient days each hospital records during the year. There is an incentive, therefore, to increase admissions and delay discharge until there is another patient to fill the vacated bed. Any hospital that fails to meet its target patient-day workload loses a portion of its budget appropriations, a reverse incentive, the burden of which must be borne by the taxpayer. It's usually the other way around where the more money you can save there is an incentive to do so. This was reverse incentive.

Once the Government decided to provide the military with less expensive food it chose to implement this service by establishing a complete retail grocery system. This duplication of private sector services is inefficient because there are no driving forces of marketplace competition. The Government, by directly producing the commissary service, creates a separate, uncompetitive market with no pressure to control costs.

We have noted that the commissary system continues and, in fact, grows because vested interests voice their opposition to privatization possibilities.

Senator SYMMS. On that point, Mr. Grace, could I ask you a question on that? As a U.S. Senator if I even suggest that we ought to take a look at the commissary system, all of the military people, the retired people, may believe that someone is trying to take something away from them; in other words, a breach of contract. Can you give me a suggestion on what we do about gaining public support to focus on privatization? Someone told me that the Pentagon runs the eighth largest grocery retail store in the world. Is that correct?

Mr. BOLDUC. I've heard the same statement. I don't know that for a fact, but I've heard the same statement myself. I would say it's pretty close.

Senator SYMMS. How do we go about this? I'm in politics. How do you sell this to the public? What do you suggest?

Mr. GRACE. In the first place, there ought to be a task force to bring up to date the price comparisons and to show what the benefit is to the military families, and then we ought to survey who is getting that and why they need it and where they are. I feel that if the facts were brought to the attention of the public that it cost about a billion dollars over 3 years to maintain this commissary system—and if you look at the number of families that have that, the half a million families—I think if it was just presented in proper context to the American public—it all takes time; it all takes some amount of money to get these stories over.

Senator SYMMS. In other words, if half a million families receive the benefits of the commissary system, it would be cheaper to give them a certain stipend.

Mr. GRACE. That's another way to do it. You could find out with a very scientific study. It wouldn't take that long. It's a question of numbers of people. We do it all the time in the retail business. We're price comparison shopping regularly. You have to do that to stay in the business. Get the price comparison shopping figures in

San Diego, San Francisco, Baltimore, Washington and one or two outlying areas and see what the price comparison is. You'll find the greater the outlying area, Mr. Chairman, the worse the comparison would be for our case, because the competition is not as great in the outlying areas. But if you come into San Diego, San Francisco, Baltimore, and Washington, you've got real tough competition in the retail business. You've got warehouse clubs. You could show the advantage if they shop properly on the outside. It's only so much. We'll give you that and close this damn thing down.

Mr. BOLDUC. I think, Mr. Chairman, that there are two things. No. 1, I think that people have got to quit talking and start acting. This has been going on for a number of years. There are all kinds of studies, and for every set of numbers you come up with the Department of Defense will produce different numbers. There is no such system as full costing in terms of what the true cost is, including overhead, pay, pension, fringe benefits, retirement, or producing products the military provides. That's the first point.

Mr. GRACE. Right now that billion dollar figure that we gave you is understated. This guy did not add back the pension costs of the employees. Right?

Mr. BOLDUC. Right.

Mr. GRACE. That's even understated.

Mr. BOLDUC. The second point is that I think it would behoove the whole process if a set of requirements were defined and those requirements were presented to the private sector and said, look, this is what we require in terms of inventory, in terms of product, in terms of quality. Submit your proposal in terms of what you will charge to produce these kinds of products for military personnel at the following locations. Then you're in a position to compare the cost here and do full costing on the other side, and you can begin to sit down and debate the merits of the case.

Mr. GRACE. It's a sacred cow, Mr. Chairman. They won't even go so far as to debate it because it's a sacred cow.

Senator SYMMS. Well, we will get back to this.

Just a little further in your prepared statement, you say the deck is stacked against contracting out because of the government's method of comparison, public versus the private provisions. Is this the A-76 circular?

Mr. BOLDUC. You'll get a great deal more on that from the gentleman that will testify tomorrow. But you can tell me what you want and I can devolve a methodology to prove your point. And that is exactly where they are coming from. Where they want to stay is to continue supporting and sustaining the existing system. So you develop a methodology that is going to yield the numbers that support your position. So when you select your sample of products you want to compare, you select those which present your strongest position and the private sector's weakest position, and you don't present them in a uniform, statistically valid point of view; you do it selectively. So there are flaws in the process by which they do comparative shopping.

Senator SYMMS. You began with a question that's very sensitive in my State. Let's shift from the Pentagon and the commissaries; let's go back to the Government lands in the Western States.

About a third of the land in this country is owned by the Federal Government. In my State, for example, 64 percent of all real estate is owned by the Federal Government. A lot of this is land—like the Sawtooth Mountains or the Salmon River—that is indisputably viewed as national treaures. These are areas where people can enjoy the wilderness if they happen to be wealthy enough or healthy enough to afford the time and the ability to walk where all access is virtually blocked off except by foot or horseback.

On the other parts of that land, where there are timber values and grazing values, if you try to raise the user fees on the grazing lands in the West to pay the cost of the Forest Service or the BLM—I can tell you right now that you can't raise the grazing fees high enough; no one will graze any livestock out there because it isn't worth paying what the fees would be.A lot of people say that's fine, don't graze out there and you'll have more feed for the deer and elk and so forth. But it really doesn't work out that way. What happens is you get a big fire out there if someone doesn't graze it.

How do we break this stranglehold? Do you have any recomendations? How do you go to a State like Idaho that has a news media that is very antiprivate property? You bring up the subject, and you immediately hear that all the farmers would be broke because they cannot afford to outbid the Rockefellers or Peter Grace or someone else who would come out there to buy the earth. That's how the media treats it. How do we focus some light on this subject and some intelligence? You can't raise the grazing fees on the Government land in the West enough to ever pay the cost of what it costs to manage the land the way the Government manages it.

Mr. GRACE. That is true in Idaho, Mr. Chairman. That's not true in certain other areas. As you know, real estate is a very local activity. You can know a lot about real estate in Brooklyn and when you go out to Long Island you don't know up from down. So what you are saying is true in Idaho, because it's dry, et cetera, in many parts of the country we're talking about. But these grazing fees in other areas that I am familiar with are not adequate and they should be higher. As a matter of fact, all kinds of people would love to locate their ranches next to Government grazing rights because that is considered a bonanza in a number of States, Mr. Chairman. Maybe not in Idaho.

Senator SYMMS. What I am getting is there is no incentive for the district ranger of the local ranger district of the Forest Service or the BLM to cut costs. If the ABC company owns it, there is an incentive to keep the grazing fees in line with the costs. There is no incentive out there.

Mr. GRACE. None.

Mr. BOLDUC. There is no incentive because that individual's performance is not being evaluated on the basis of incentive. If you worked for me, Senator, and I wanted to establish a bogey for you that says that you will manage those forests at the following costs and your performance will be evaluated accordingly and your pay raise at the end of the year will be determined on the basis of whether you managed within those budgetary constraints, there can be an incentive. But that's not the way it works. The way it works is that you have an almost automatic guarantee of salary increase at the end of the year without any specific, measurable, quantifiable levels of performance being measured.

Senator SYMMS. The politicians and bureaucrats don't answer to the profit and loss statement as the business person or the private sector does.

I'm sympathetic to the whole idea of privatization and I want to see something come of this. I am trying to get a handle on some directions that we can take and pick out the areas that might be the most successful.

Out of the recommendations of automobiles, or land—land is a very sensitive issue; it may not be the first one to tackle—renting cars instead of buying all these cars and so forth, hospital beds, commissaries, which ones that you have isolated and recommended would be the easiest ones to sell the idea to the public that the private sector could provide the services more efficiently?

Mr. GISH. Mr. Chairman, I think we should be donating the land to the State with a requirement that they continue it as grazing land. This would save the Government money inasmuch as a large portion of the subsidy that is provided is in the form of payment in lieu of taxes to the State. So if it is turned over to the State and you could avoid those payments you would still obtain a cost benefit to the Federal Government.

Senator SYMMS. And you could avoid the hiring of all the people who work out there.

Mr. GISH. Exactly.

Senator SYMMS. There is a project called the Sagebrush Rebellion that got off to a great start here in about 1979. Senator Hatch first introduced major legislation on land use. Congressman Santini from Nevada and myself introduced a bill in the House; and it raised a great controversy. Our attitude was to take some of the Federal Government lands and transfer it over to State governments. Then it would be the States' problem, and the politicians in those States would have a vested interest in privatizing those lands, or at least a vested interest in managing them better than we are managing them from the Federal level.

Would you recommend those kinds of things as a stepping stone?

Mr. GRACE. I would. I hadn't looked at that particular idea of Mr. Gish and Mr. Bailey. They did a lot of the leg work and the absolute individual deep down studies in these areas, Mr. Chairman, and I think their thought is very good.

Senator SYMMS. One thing that happened on the Sagebrush Rebellion, since you are talking about making Government run better, occurred when Cecil Andrus left as Secretary of Interior and Jim Watt came in. Within 6 months we stopped receiving all these complaints in my office about rangers running roughshod over the ranchers. There was a new attitude on the Western ranges of cooperation between the BLM district offices and the ranchers; and all of the sudden the Sagebrush Rebellion died. Now I don't notice the cost change that you're talking about, but the opposition to Federal management of the lands disappeared, evaporated because of the leadership Jim Watt gave the Interior Department. He might have gotten a lot of bad press in the Washington Post and in the Boise paper, too, but he didn't get it from the ranchers who graze on the Government lands.

Mr. GRACE. Well, he spent too much time in the West and not enough on the beach with the Beach Boys. [Laughter.]

Mr. BOLDUC. Senator I sense that your are fishing or trying to focus on something and I kind of get the feeling we're not being very helpful. Let me try a different tack. Maybe we can shed some light on it.

If I were attempting to answer the question what do I do about the issue of privatization, I think the one thing that ought to be done more than anything else is that there ought to be a strategy developed on the part of the Congress as to what it is you want to do with respect to privatization. Pick those targets of opportunity that either are the easiest to implement or that you can build a coalition on the other side that can provide counterpressures to bring about adoption. And you don't need to have 100 things, because even today there are more proven cases of privatization at State and local government than in our own Federal Government.

The Federal Government has very few success stories to talk about, and everytime they talk about privatization the skeptics say show me, it doesn't work.

The strategy ought to focus on those that can be done reasonably quickly. Motor vehicles is one that can be done under the administrative network of the Federal Government. I think the commissary issue with respect to the support you can get from food suppliers on the other side to provide countervailing pressures is a very strong possibility, particularly when you can demonstrate that the service is still there at the same cost, if not a better service.

Then I think once you have defined what it is you want to do with respect to a strategy you have to play some hard ball with the Office of Management and Budget which will require a structure on the executive side of Government that will give you the structure to implement the strategy. Right now there is no strategy and there is no structure, and until such time as you focus on those two key issues not very much is going to happen.

I don't think it's the kind of thing you pick on this one, grazing lands, and say let's do it.

Senator SYMMS. In your prepared statement, Mr. Grace, you point out that when you recommended the elimination of taxpayer subsidies to commissaries the following appeared in the August 15, 1983, issue of Exchange and Commissary News:

> It's time for this market to wake up and stop waiting for the House Armed Services Committee to constantly stop everything negative from becoming law. Our associations and key industry leaders must anticipate rather than react to head off moves to contract out or close the commissaries.

I'm excited-about what you have done at the Grace Commission. But the built-in momentum in Washington and throughout the Nation is for more Government; the momentum goes for more Government. And so I finally get to the point that, in frustration, I say, the only thing I can see to do is just pare away appropriations, hoping big Government will go away. But it hasn't worked that way. We never can get the votes.

Mr. BOLDUC. These folks are extremely well organized. They work hard at what they want. They communicate their concerns to elected officials, and the 86 million taxpayers who are paying $735 million a year in subsidies for military commissaries are not heard from. You also have a constituency of food suppliers out there that would be very much interested in supplying foods to the scale of what—the eighth largest food chain in the country, you said? I think they would be very interested in that. They have not been rallied and they have not been heard of very much.

Senator SYMMS. Did you do anything at all with respect to the school lunch program?

Mr. BOLDUC. We certainly did. In what respect?

Senator SYMMS. I have introduced a bill—I did it in the House and have done it over here in the Senate—to allow the USDA to send school districts so much money and tell the local school district dietitian to go buy the groceries for the school lunch program through local wholesalers. We have got the finest food distribution system in the world in the United States of America. Why have this Government program where you send out cans of peanut butter and pork chops? All the dietitians like this, because then they can structure a diet the kids will eat. But we can't get it through USDA, under a Republican administration.

Mr. BOLDUC. Why?

Senator SYMMS. Maybe we need Peter Grace running the Office of Budget. We can't get USDA to buy the idea. The Secretary of Agriculture has told me we are buried with surplus commodities, and he said he want to give away these surplus commodities and get rid of them. That is his final answer before the Budget Committee.

Mr. BOLDUC. Why don't you suggest to them that the way to get rid of those surplus commodities is to work out a contract with food suppliers across the country where, instead of giving food stamps, they can use food stamps in exchange for surplus commodities? In stead of being held in storage houses in Kansas City, these surplus commodities can then be made available to the American people.

Mr. GRACE. They talk on the one hand about the hunger and the people who have empty stomachs, suffering with hunger, and yet they won't give them the best way to solve hunger, which is healthy food. As you know, you can buy beer, caviar, you name it, Mr. Chairman, with food stamps. Food stamps should be limited to food that people need to sustain themselves and not to go to bed hungry. But they talk out of both sides of their mouth at the same time on that issue. They use the argument "going to bed hungry," but then they give food stamps in a way that does not limit it to preventing people from going to bed hungry.

Mr. BOLDUC. Senator, I addressed a group this morning. In the audience was the president of King Supers, which is a supermarket chain in Denver, CO, and he was telling me how he has proposed to the Department of Agriculture to take surplus commodities and make them available to poor and needy people in his chain of supermarkets, to get those surplus supplies out of the storage houses into his chain of supermarkets. He would do that pro bono for poor people to come in and say, "Here I'm authorized, I want that pound of cheese." And they wouldn't go along with that either.

So there is apparently a problem with respect to where the Department of Agriculture is coming from. I can't find anything wrong with the idea of taking surplus commodities and making them available in a commercial marketplace for needy people free of charge.

Mr. GRACE. And that would help the farmers, too, because then there will be less surplus. If we started to make good use of some of these surpluses this would not make the surpluses so burdensome.

Mr. BAILEY. One question that you come back to Secretary Block with is why do you have these surpluses in the first place. We're really using one wrong program to justify another wrong program, et cetera, et cetera.

Mr. GRACE. We all know why we have these surpluses.

Senator SYMMS. Of course, Secretary Block has inheritied the program. And then they decided they were going to pay the farmers back in the PIC Program with wheat instead of money, and it was just like clapping with one hand. Our production went down. It went up in Argentina, Brazil, Canada, and Australia, and we lost part of the market. We could take $25 billion and buy some of these markets to sell the wheat overseas. It would be cheaper than the way we do it.

I still get back to the point that we want to focus on the privatization question and the whole farm question is a classic example. I mentioned earlier the Farmers Home Administration. In our earlier statement you said something about hocus-pocus accounting. What were you referring to?

Mr. GRACE. The Government lends between $800 and $900 billion. They don't know how much is owned; they don't know how current it is; and they don't know much is delinquent or how it is subsidizing interest rates.

The Farmers Home Administration. If you ask someone in the Government, almost anyone in the Government, how much FmHA is spending, they will get it wrong. In just one program, the agricultural credit insurance fund, total obligations were $13.5 billion in 1984, but the outlays on the books were $1.5 billion, or a little more than one-tenth of the spending.

Do you want to know how the Government can spend 9.2 times their reported outlays? So did we. This intriguing bit of hocus-pocus was accomplished by the Government selling about $7 billion in agricultural credit insurance loans to itself, that is, to the off-budget Federal Financing Bank.

Senator SYMMS. I don't understand what you are talking about. Would you explain that to me again? The Farmers Home Administration is spending $13.5 billion?

Mr. GRACE. It shows up as $1.5 billion because they sold loans to the Federal Financing Bank, and they only report net loans, and once they have sold the loans to themselves, that reduced the new net loans they put out, because they never report on a gross basis. If corporations did that their executives would be put in jail. You have to report gross outlays. But they net it out through the Federal Financing Bank and then net it down, and the outlays are only one-ninth of what they really are. And that's selling it to itself.

Senator SYMMS. Did you want to comment on that?

Mr. GRACE. Mr. Gish is a super sleuth.

Mr. GISH. We found this very interesting, Mr. Chairman. This cuts across Government. You can go into almost any agency. You can go into Agriculture and Farmers Home Administration and you will find that the Government understates its total activity. In Farmers Home Administration, for example, they are issuing certificates of beneficial interest. What happens with these items is they will take a group of mortgages and they will say that these mortgages are represented by these certificates. They will sell them to the Federal Financing Bank. When you see the activity in a given agency what you are looking at is outlays. If they make $10 billion in loans and they sell $9 billion of those loans to the Federal Financing Bank, they're only reporting $1 billion in outlays to you. And this is what is happening in Farmers Home Administration. They are taking the money that they are receiving in repayments for their loans, netting it against the new loans, and only reporting the net spending to you. They are taking other amounts and moving it off budget by simply selling these loans to the Federal Financing Bank.

You can look in the Small Business Administration. They are doing exactly the same thing. They are making $1 billion in loans in one segment, maybe the Minority Business Administration, the MBA Program, selling off $900 million of it to the Federal Financing Bank, moving it off budget and telling you that they are spending $100 million.

Mr. GRACE. But in addition to that, Mr. Chairman—correct me if I'm wrong, John—when they report outlays it's always net outlays. Forget the Federal Financing Bank for 1 minute. As loans are paid in the normal course of events they reduce the amount of the loans they are making that year that they report. So actually they are collecting certain loans and making new fresh loans. What you want to hear is not only the new fresh loans that were made, not after deducting other loans that were paid back, and certainly not after deducting what was sold to an arm of the Government. Right?

Senator SYMMS. Correct. In other words, what they are doing is they are taking any money they get back from their loans, and they are putting that over to make more loans. And we appropriate more money to them, thinking that is all they have.

Mr. GRACE. That's all you think about is the new money. But they are rolling over a lot of new money. The thing is, it's new money to them, but not new money to you.

Senator SYMMS. When I was in Boise with the FmHA Director, I said all of your receipts from now on should come in and be paid back to the Treasury of the United States.

Mr. GRACE. That's right.

Senator SYMMS. Everytime somebody retires, you do not replace them. Gradually you will get it down to where there will be three guys left collecting the last loan.

Mr. GRACE. That's right.

Senator SYMMS. And let the private sector lend money from now on.

Mr. GRACE. Right.

Senator SYMMS. In the meantime, they will fill in the gap and the private market will take it.

Mr. GRACE. That's right. And they are supposed to graduate after they get along a little bit into the private market, but the differential in loan is 2.5 percent versus 11 or 12. So they never graduate. You and I never would have graduated if we had to pay nine times what we were previously paying. We'd stay in school forever. That's what they're doing.

Mr. BOLDUC. The real problem is when the loan is made. You're supposed to have a test-of-credit-elsewhere provision which requires that anybody getting a Farmers Home Administration loan must first demonstrate his or her inability to get commercial credit. Any banker who knows that the Government is going to stand behind the loan versus making a direct loan is simply going to sign a note that says "We do not wish to give you credit." You take those letters to Farmers Home Administration and they will make you a loan and guarantee it. Once you get into that cycle, then you get to the point that Mr. Grace is making with respect to graduation. It's a very, very vicious cycle.

The point that John made earlier—my concern with that is from an economic impact point of view—you are always reacting rather than being proactive and planning what is going to happen. You take a look at the end of the year as to how much money you fueled into the economy with respect to all those loans rather than plan them up front and account for them in terms of how much money will be provided to the economy. It's after the fact.

Senator SYMMS. You made a statement that the bureaucracy doesn't routinely consider privatization because it does not have to pay the carrying costs of the money. Why would they have such an incentive? I can't see any incentive for the bureaucracy to privatize anything under the current operation of the Federal Government.

Mr. GRACE. None at all. There is disincentive: Lower grading, less employees, less people under you, less power, et cetera. There is disincentive.

Senator SYMMS. Right in line with that—and I want to get to the Idaho National Guard versus the Air Force: I notice you testified about Air Force maintenance and so forth—the President established a Federal Property Review Board to review privatization options for real estate assets held by the Government. But to this date the reviewing organization has had no influence on the rate which surplus assets are privatized. How would you try to make that work?

Mr. BOLDUC. That, Senator, was an organization that was put together by Jerry Carmen at the General Services Administration. I don't think we're in a position to comment on that. We did not review that operation. That was put together while we conducted our study, and I don't think that I would venture to guess what may or may not have worked.

Senator SYMMS. How would you review it, though? What would you do? Let's forget about that. How would you go about that? How would you recommend that you get some of this surplus property converted and liquidated and out of the hands of the Government and reduce our debts? I think Senator Percy introduced a bill that talks to this issue. If he came from Idaho he wouldn't introduce the bill. He can do it because he comes from a State that is all privately owned. But if somebody introduced that bill in Idaho it would raise such a red flag out there that you couldn't even get out of your car.

Mr. BOLDUC. I think that is probably the reason why it's not working.

Senator SYMMS. Why?

Mr. BOLDUC. Because there are a lot of Idahos out there.

Senator SYMMS. I'm getting down here to the brass tacks of the whole Grace Commission. We've got a tremendous educational task for the humanitarian aspects that capitalism has to offer this country. All you have to do is pick up the newspaper, turn on the local nightly news and you are going to see an attack on capitalism. If you look at Newsweek, one week they will have "How Do We Stop the Right Wing Death Squads in El Salvador?" The next week the picture on Newsweek will be President Reagan embracing the Communist Chinese; and yet you couldn't kill as may people in Central America as the left wing death squads have killed in China. But you won't see that in the newspapers or on the front cover of Newsweek.

I am just trying to focus on this, because I want to see us make some headway here.

We want to let you out of here, Mr. Grace. I hear you have a speech to give tonight in Rhode Island.

Mr. GRACE. Senator Chafee asked me to.

Senator SYMMS. I don't want you to be late for my colleague's meeting.

Mr. GRACE. J.P. can stay, Mr. Chairman.

Senator SYMMS. J.P. can stay?

Mr. GRACE. Oh, yes.

Senator SYMMS. I just want to ask one question. You were talking about the provision of base support services for the Vance Air Force Base in Oklahoma, that DOD estimates a 22-percent savings by using private sector contractor. With respect to the Idaho Air National Guard, they have an Air Force photo recon squadron out there. The men and women of the Idaho Air National Guard take tremendous personal pride in the unit's airplanes. They offer that kind of leadership. They win every contest they get in; they can outfly and out-take pictures and do their mission better; in 72 hours, they can be anywhere in the world in a combat situation with this squadron. And I think it's really remarkable. But the maintenance people there have worked on the same airplane for 8½ years now. That's not true in a regular military squadron.

Did you make any recommendations on that? When you talk about private contracting, you're not talking about contracting out maintenance on aircraft.

Mr. GRACE. We are.

Mr. BOLDUC. I don't know why not. Why couldn't you?

Mr. GRACE. We are, Mr. Chairman.

Senator SYMMS. How do you do that and relate it with a combat situation?

Mr. BOLDUC. I think you could negotiate a long-term contract with those kinds of provisions in it, negotiate a long-term contract with continuity of employment.

Senator SYMMS. So those people would be the same people, work on the same airplane, and have an incentive.

Mr. BOLDUC. That happens to make sense, and that's where the payoff is. You negotiate that in the contract. You can even go so far as to identify the skills and the individual you want to maintain those aircraft.

Senator SYMMS. One of the critiques I run into all the time are people complaining to me about the 3-cent screw that cost the Federal Government $91. I hear this in every town meeting. How do you deal with that kind of an abuse?

Mr. GRACE. If you privatize it, the cost of the maintenance would be figured out on a sensible commercial basis, and no one will do that, No. 1, because how do you cure in the Government proper computer controls—that's all down in computers, Mr. Chairman—in terms of the inventory. There is $41 billion of inventory that is not properly controlled. Also, in the procurement process, all of the spare parts should be worked out in advance by the suppliers, no holdup to get back the overruns through the spare parts. That can all be controlled in the procurement process; lengthening of contract, working the whole thing out. What they did with United Technologies and GE the other day on those jet engines is taking the kind of purchasing recommendations we have made, including the spare parts, and that's how you get around that. Just good management, that's all.

Senator SYMMS. In other words, the bottom line is, if we are really going to be successful with the 424 billion dollars' worth of projected savings, we've got to turn to privatization as the real answer for public waste.

Mr. GRACE. Absolutely, and to somehow get management systems brought into the Government. What we really ought to do, Mr. Chairman, is to separate the foreign aid business, the foreign policy business, the weapons determinations, and some things, whether it be social programs, taking care of the poor, deciding how much food stamps—those are political knowhows. But there is so much in the Government that is exactly what business does. Let's separate the two functions and contract out every single thing that business would come down here and bid on and let the lowest bidder win it.

Senator SYMMS. Mr. Grace, you have been outstanding and have been very patient. We are going to continue to work on this. I want to thank you. I am going to ask you one question and let you go, and then I've got a couple of more for J.P. And we wish you a good, safe trip to Rhode Island. When you get to Rhode Island you'll find out it is 600,000 acres. So you can tell those people up there in Rhode Island—and I kid Senator Chafee about this—that my State is 52 million acres.

Mr. GRACE. And we have a 1,200,000-acre ranch in Australia, which is just twice Rhode Island's size.

Senator SYMMS. And some want to have big wilderness areas out in Idaho, locking up all the resources, while building a strategic task force to fight over the resources in the Persian Gulf region. This boggles my mind.

I had breakfast with Lewis Lehrman this morning, who is a friend of yours, a businessman from New York, and he mentioned to me that you favored the gold standard along with him. Do you think there is any way that we could privatize and break this monopoly the Government has to print money and help the future of the country by having honest money on a long-term basis where people could have expectations of investing for 20, 30, 40 years instead of always wanting a 30-day or 90-day Treasury bill?

Mr. GRACE. I have to answer that honestly, Mr. Chairman. Jack Kemp, who I admire greatly, is going the other way. As you know, he wants the term of the Federal Reserve Chairman to come on board with the President. He wants the Secretary of the Treasury on the Federal Reserve Board. I'm afraid that the day has passed when we can move as far as Lew Lehrman wants to in terms of that particular idea that you just mentioned.

Senator SYMMS. I will work on that with you. I'm not so sure that we can continue paying these exorbitant interest rates.

Mr. GRACE. I don't think we should, but there are other ways to avoid that. The first thing to do is to get the bloody spending down so that people think we are going to have this under control. This is all psychology: They are sure we are going back to inflation; they are sure we are going to be out of control; they don't know who is going to get elected in November; they know that if certain people get elected you're going to have wild spending sprees; and they are not willing to lend money in a period of uncertainty. That's the key issue.

Senator SYMMS. Thank you very much. We will let you go. Thank you, Mr. Grace. I appreciate your testimony very much.

Mr. GRACE. Thank you.

[The prepared statement of Mr. Grace follows:]

Prepared Statement of J. Peter Grace

Mr. Chairman, I am pleased to accept your invitation to address the work of the President's Private Sector Survey on Cost Control (PPSS) and to identify some of the major recommendations of our Task Forces related to the transfer of the Government's commercial activities to the private sector -- privatization.

My name is J. Peter Grace and I was the Chairman of the PPSS and I am Chairman and Chief Executive Officer of W.R. Grace & Co. With me is J.P. Bolduc, who was the Chief Operating Officer of the Survey, and who is a Senior Vice President of W.R. Grace & Co. In addition, tomorrow, the Co-Chairmen and Project Manager of our Privatization Task Force will be testifying before you, and so I'll concentrate on a broader overview of PPSS and our findings and recommendations on privatization, contracting-out, and, in general, the desirability of transferring Government activities to the private sector.

Prior to discussing privatization, let me provide a brief overview of PPSS's formation, organization, and conclusions.

President Reagan decided in February 1982 that it would be useful to have a study of the Executive Branch of the Government by members of the private sector, and he invited me to become Chairman of this effort. He felt a survey patterned after the Private Sector Study he instituted when he was Governor of California would be useful in identifying inefficiencies, overlap, and waste in the operation of the executive departments and agencies. The President is very concerned about the tremendous increase in the cost of operating the Federal government, which has gone up almost sevenfold since 1964, from $119 billion to $854 billion for 1984. I share his concern.

On June 30, 1982, the President's Executive Order was issued establishing the PPSS, and we started to organize the 161 executives who had been recruited from the private sector into Co-Chairmen of 36 different Task Forces. Each Task Force was assigned to examine one or more of the departments or agencies in the Government or some functional area cutting across Government, such as procurement and asset management. In addition, 11 special reports were prepared by the PPSS Management Office to examine areas of special interest.

In organizing this effort, the private sector was requested by the President to finance the entire survey. Accordingly, we recruited more than 2,000 volunteers from the companies of the Executive Committee members and others, and we raised $3.4 million from the private sector to pay for the central administrative expenses of the project. We created a special Foundation to handle the financing of these administrative costs. In total, the private sector contributed $76 million to the survey in people, services and travel, equipment, materials, and supplies.

The 47 Task Force and Management Office Reports, consisting of over 20,000 pages of material, 1.5 million pages of supporting documentation, and including 2,478 recommendations, have all been submitted to the President.

The areas of Program Waste and Inefficiency, and Systems Failures account for $312.2 billion, or almost three-quarters of the $424.4 billion total savings identified in those reports, as summarized in the following.

(Chart on following page)

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PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL (PPSS)

RECOMMENDED SAVINGS
OVER A 3-YEAR PERIOD
$424.4 BILLION

	($ Billions)
Program Waste (443 Recommendations)	$ 160.9
- Subsidy Program Expenditures	
- Lending Programs and Debt Collection Activities	
System Failures (1,152 Recommendations)	151.3
- The Information Gap	
- Government Finances	
Personnel Mismanagement (422 Recommendations)	90.9
- Compensation	
- Retirement Plans	
Structural Deficiencies (211 Recommendations)	12.7
- Central Financial and Administrative Management	
- Management Tenure in Key Positions	
Other Opportunities (250 Recommendations)	8.6
Total 2,478 Recommendations	$ 424.4

In reality, almost all the waste and inefficiency we found in the Federal government can be traced to systems failures and restraints put on the management of the Executive Branch by the Congress. There is hardly anything basic in the management of Government operations that doesn't require Congressional approval, be it closing obsolete facilities, buying new computers, the wage scale on Federal construction projects, or just about anything that might result in greater efficiency, including policy decisions in the VA affecting as few as three employees.

The current and projected deficits are unacceptable to Congress, the Administration and the American people. However, how those deficits are to be attacked has been the subject of much debate.

The available options are simple:

- reduce costs,
- increase taxes, or
- some combination of the two.

The tax burden on the average American family is already at counterproductive levels, with the underground economy now at an estimated $500 billion, costing about $100 billion in lost Federal tax revenues per year.

The size of the underground economy is understandable when one considers that median family income taxes have increased from $9 in 1948 to $2,218 in 1983, or by 246 times, while gross income has increased just 7.6 times over the same period -- taxes up 32.4 times more than income.

(Chart Follows)

FEDERAL TAXES ON THE MEDIAN INCOME FAMILY

		(1)	(2)	(3)	(4)	(5)
				Average Income Tax Rates On Gross Income		
		Median Family Gross Income	Median Family Income Taxes	Actual	Required To Balance The Budget	Percent Required To Balance The Budget Above/(Below) Actual
(1)	1948	$ 3,187	$ 9	0.3%	0.1%	(66.7)%
(2)	1958	5,087	303	6.0	6.5	8.3
(3)	1970	10,216	902	8.8	9.1	3.4
(4)	1981	21,462	2,221	10.3	12.4	20.4
(5)	1983E	24,100	2,218	9.2	15.9	72.8
(6)	1983E As Multiple Of 1948	7.6X	246.4X	30.7X	159.0X	

Imagine:

- The median family's income is up 7.6 times,
- But its income taxes have risen 246.4 times,
- Including Social Security, the total Federal tax is up from $39 in 1948 to $3,833 in 1983, or by a multiple of 98.3 times.

Further, to balance the budget in 1983 would have required a 72.8% increase in the average tax rate of the median income family from 9.2% to 15.9%.

Why balance the budget on the back of the median income family? Why not tax the wealthy?

Any meaningful increase in taxes from personal income would have to come from lower and middle income families, as 90% of all personal taxable income is generated below the taxable income level of $35,000.

(Chart Follows)

CAN THE DEFICIT PROBLEM
BE SOLVED WITH INCREASED TAXES?
(1981)

	Taxable Income Bracket	(1) % of Taxable Income Through Each Bracket	(2) Number of Days Government Can Be Run If Government Takes All Remaining Income Above The Bracket As Tax
(1)	Up to $ 15,000	63.1%	206 Days
(2)	Up to 20,000	74.9	130
(3)	Up to 25,000	81.9	88
(4)	Up to 30,000	87.2	58
(5)	Up to 35,000	90.4	41
(6)	Up to 40,000	91.9	33
(7)	Up to 50,000	94.4	21
(8)	Up to 75,000	97.1	10
(9)	Up to 100,000	98.0	7
(10)	Up to 150,000	98.6	4

All taxable income not already taxed above $75,000 would run the Government only 10 days.

If the Government confiscated 100% of all taxable income beyond the $75,000 tax bracket not already taxed, the additional revenue would be sufficient to run the Government for only 10 days while destroying productive enterprise.

Taxing the rich makes more sense as a campaign slogan than as a serious approach to reducing budget deficits.

That leaves reducing the cost of Government as our best bet to contain spiraling deficits, and that was the purpose of PPSS -- cost control.

The question then becomes one of where to cut costs. For perspective on the problem, FY 1962 was generally considered to be a pretty good year for the United States. It was the first full year of the Kennedy Administration. It was Camelot -- peace time, before "guns and butter." Real GNP was up 5.8% in 1962, inflation was 1.8%, the prime rate was 4.5%, and the total Federal deficit amounted to $7.1 billion, or 1.3% of GNP. In comparison, 1983 brought us a record deficit of $195.4 billion, or $207.8 billion including both on- and off-budget spending, or 6.4% of GNP. If you add in the past service liability, the deficit reached $393.9 billion.

In 1962 Federal revenues were 18.2% of GNP versus 18.6% for 1983 -- to get back to 1962 we'd have to cut taxes another $12.9 billion.

On the spending side, without counting past service liabilities, defense accounted for 9.4% of GNP in 1962 versus 6.0% for 1983 -- we'd have to add $109.8 billion to 1983 defense spending to get up to the same percentage of GNP in 1983 as was accounted for in 1962.

Transfer payments have increased in relative share of GNP by 2.3 times, from 5.6% in 1962 to 13.0% in 1983 -- we'd have to cut transfer payments by $238.9 billion to be at the same percentage of GNP in 1983 as in 1962.

The net effect of holding Government revenues and outlays to the same percentage of GNP in 1983 as in 1962 would be a $164.7 billion reduction in the deficit.

I am not, of course, recommending that we turn the clock back to 1962, but this comparison does provide a useful perspective on how we got into the mess we are in and provides ideas on how to solve the problem.

One might ask, as we have been, what experience businessmen have that qualifies them to examine the Federal government. Following is an array of similarities between the operations of the Government and business, with specific opportunities identified to improve operations.

(Chart Follows)

WHY BUSINESS CAN ADVISE GOVERNMENT

	Function/ Item	Government	Private Sector	Federal Government Failures Relative to Private Sector
(1)	Lending Money	$764.6 Bil. loans outstanding	$1,500.0 Bil. loans outstanding	HUD makes only 3 attempts to collect loans versus 24 to 36 tries in the private sector; 41% delinquency rate on current Federal receivables.
(2)	Timberland Management	105 Million acres	347 Million acres	The U.S. Forest Service gav away $235 million of fire-wood in 1981, 24.5% of total commercial timber harvested.
(3)	Grazing Land Management	163 Million acres	587 Million acres	Federal grazing program collected $15 million in grazing fees while providing $41 million in services recovering only 36.6% of costs.
(4)	Hospital Management	177,000 beds	1,481,000 beds	VA hospital in the Bronx cost $191,300 per bed, about double the $97,400 per bed spent constructing the comparable Duke University Hospital.
(5)	Nursing Home Management	71,000 beds	1,029,000 beds	The VA spends $61,250 per bed to construct nursing homes -- almost 4X the $16,000 per bed cost of a major private sector nursing home operator.

WHY BUSINESS CAN ADVISE GOVERNMENT

	Function/ Item	Government	Private Sector	Federal Government Failures Relative to Private Sector
(6)	Automated Data Processing	250,000 ADP employees	2,000,000+ ADP employees	Half the Government's computers are so old that manufacturers no longer service them. Additional personnel expenses amount to $600 million annually.
(7)	Inventory Management	$41 Billion (over 99% in DOD)	$806 Billion	Private sector inventory replenishment techniques would save the Government $4.5 billion over three years.
(8)	Electric Power	244.0 Billion KWH	2,019.0 Billion KWH	Government subsidized power sold at one-third market rates, costs industrial users only 2.45¢ per kwh in the Northwest compared to 12.09¢ per kwh paid in San Diego for power generated by the private sector.
(9)	Borrowing Money	$1,381.9 Billion national debt	$420 Billion corporate bonds outstanding	Federal borrowing from the public of $135.0 billion in 1982 was 33.0% of the $408. billion raised in U.S. credit markets.
(10)	R&D Funding	$38.5 Billion	$36.1 Billion	Government R&D bureaucracy requires that Oak Ridge researchers consult 114 DOE offices for funding approval.

WHY BUSINESS CAN ADVISE GOVERNMENT

	Function/ Item	Government	Private Sector	Federal Government Failures Relative to Private Sector
(11)	Transportation of Persons	$5.2 Billion	$20.4 Billion (non-user operated transportation)	Since 1955 the Government has been prohibited from using private sector travel agents and benefiting from their expertise; a 1980 DOD plan for a professional travel service was rejected by Congress. The Government did not issue credit cards for travelers until we recommended it.
(12)	Payroll	$61.8 Billion civilian payroll	$1,090.0 Billion payroll	It costs the Army $4.20 to process a payroll check vs $1.00 average in the private sector.
(13)	Freight Handling	$5 Billion	$30 Billion	The Federal government does not negotiate volume discounts on its enormous freight charges.
(14)	Building Maintenance	2.6 Billion square feet	10+ Billion square feet	The General Services Administration employs 17X as many people and spends almost 14X as much on total management costs as a comparable private sector firm.

WHY BUSINESS CAN ADVISE GOVERNMENT

	Function/ Item	Government	Private Sector	Federal Government Failures Relative to Private Sector
(15)	Pension Benefits	$19.5 Billion Civil Service (CSRS)	$300 Billion	Pension benefits for the CSRS are 3 times those in the private sector.
(16)	Pension Fund Assets	$96.1 Billion Civil Service (CSRS)	$481.1 Billion	CSRS rate of return in 1980 was 7.4% compared to 14% and over for a majority of private sector plans.
(17)	Vehicles Managed	436,338 non-military	155,900,000 motor vehicles privately and commercially owned	Average utilization of Federal vehicles (excluding USPS) is 9,000 miles per year. However, effective utilization, per private rental firms, is considered to be 25,000 miles per year or 2.8 times Federal vehicle utilization. Failure to recondition vehicles prior to resale, as is common in the private sector, lowers the Government's resale revenues by $15.8 million over three years.
(18)	Procurement	$159 Billion	$2 Trillion	Lack of competition or control in Federal contracts results in the Pentagon paying $91 for a 3¢ screw, etc., etc.
(19)	Foreign Exchange	$10 Billion	$181 Billion	Hedging against foreign currency changes versus other industrial countries could save the Government $438 million over three years.

A continuing problem in the carrying out of PPSS savings recommendations has been erroneous reporting by the media.

Of particular note, the media grossly misinterpreted the findings of the CBO-GAO review of PPSS recommendations. That review, although very limited in scope, found $97.9 billion of PPSS savings possible over the 1985-1987 period. As the CBO-GAO stated, their analysis was limited in four ways:

First, they only examined 16%, or the 396 biggest dollar recommendations out of 2,478.

Second, they did not assign savings to the budget for 122, or 31%, of these 396 recommendations.

Third, the $97.9 billion does not include savings which will occur in later years.

Fourth, the $97.9 billion does not include savings which occurred in 1983 and 1984 or which are already in the 1985 budget.

Also, unlike PPSS, which presented savings for the three years following full implementation, CBO-GAO estimated savings for fiscal years 1985, 1986, and 1987.

The following puts this in perspective:

(Table on following page)

POTENTIAL SAVINGS PER CBO AND PPSS
($ Billions)

Savings per CBO for 1985-1987	$ 97.9
Recommendations Studied by CBO for Which They did not Include Savings for 1985-1987	87.7
Subtotal - Recommendations Studied by CBO, 1985-1987	$185.6
Recommendations Not Studied by CBO, 1985-1987	61.3
Subtotal, 1985-1987	$246.9
Recommendations for Later Years Implementation	130.9
Recommendations Already Put in Place	23.0
Additional Interest Using CBO Method, 1985-1987	37.1
Total Savings	$437.9*

* Compares with $424.4 billion savings in PPSS final report for the three years after full implementation.

Thus, starting with CBO's estimates for the recommendations which they analyzed and to which they assigned budget savings, PPSS savings would be in excess of the $424.4 billion as submitted to the President.

In net, with regard to numbers, CBO-GAO has covered only part of the waterfront. While the CBO-GAO conclusions validate 25% of the Commission's savings, they do not address the remaining 75%.

The media missed this last point entirely, or chose to ignore it, and reported that the CBO-GAO invalidated the remaining 75%.

We noted from the preface to the CBO-GAO analysis that "the report focuses on those recommendations that the Grace Commission estimated would have major budgetary savings." Thus, the CBO-GAO analysis does not cover three of the most important PPSS reports, Federal Financial Management, Federal Management Systems, and Information Gap, which provide recommendations that are fundamental to improving the efficiency and effectiveness of Government but for which no savings were claimed by PPSS.

For example, our Federal Financial Management and Federal Management Systems reports addressed fundamental deficiencies in the Government's budget accounting system. CBO-GAO stated in their review that our recommendations could not always be expressed in Federal budget accounting terms. The media, of course, reported this as -- CBO-GAO state PPSS savings claims are grossly inflated. The real story is that we found that the Federal budget accounting system could not be used to control a private sector company. A company trying to use the Federal system would go bankrupt. The U.S. Government, however, has unlimited borrowing power and the deficiencies in its accounting system - a true misnomer since there is a lack of accountability in the Federal system -- can be masked by ever-increasing debt to cover its ever-increasing deficits.

This is a major point -- the accounting system which formed the basis for the CBO-GAO analysis is of limited usefulness as a cost-controlling mechanism.

A logical first question in beginning any cost-control analysis is how much is being spent by line item of expense and what has been the trend in spending.

CBO-GAO would undoubtedly respond by referring to Federal outlays.

On- and Off-Budget outlays are estimated at $870 billion for 1984. However, this is not fully representative of Government spending since the Federal accounting system nets, i.e., offsets, spending by related revenues. Federal obligations, a more meaningful measure of gross Government spending, are $1,240 billion in 1984, or 42.5% greater than outlays.

Controlling costs by analyzing outlays is akin to a private sector company reviewing its gross profit while ignoring the component revenues and costs which give rise to its gross profit.

If we had reviewed the Government, made recommendations, and calculated savings based only on their potential for reductions in outlays and deficits, we would have short-changed the President who commissioned us to work "like tireless bloodhounds" -- the universe of Government spending would have been 42.5% greater than that which we would have reviewed.

Unfortunately, the Government has no published source which details total spending -- by office, by program, or by line item of expense.

When we found this appalling information gap, we spent the equivalent of ten man-years to study and analyze the budget Appendices to put together what every private sector executive has at his finger-tips -- an historical spending trend.

In addition, as I previously noted, the CBO-GAO review was exclusively concerned with potential savings over the 1985-1987 period. We did not want to fall into the trap of only recommending actions which would result in near-term savings.

A short-term perspective in both the Executive and Legislative branches is a major contributing factor to our current fiscal crisis.

For example, granting excessively liberal retirement benefits to Civil Service employees was a more politically palatable solution to the perceived problem of noncompetitive Federal salaries. Increasing salaries results in an immediate increase in outlays, while the costs of increased retirement benefits are largely in the future.

So today, we face a trillion dollar plus unfunded liability in the Civil Service and Military Retirement Systems which we will bequeath to our children and grandchildren -- largely as a result of our reliance on a Federal Accounting System which fails to meet many of the fundamental purposes of an accounting system, such as recognizing the total cost of your employees as they render service.

We are left with a situation where neither increasihg nor decreasing retirement benefits has much impact on near-term outlays and deficits, yet either move has very significant political repercussions.

The PPSS recommendations on Civil Service and Military retirement programs are indicative of the problems encountered in evaluating our recommendations within the context of the Federal Accounting System. If the Federal government kept its books as the private sector does, the PPSS savings attributed to retirement recommendations of $58.1 billion would be realized over the next three years since the expense to which those savings relate would, by law, be recognized in financial statements. Conversely, the impact on the Government's budget is described by CBO-GAO as "relatively modest" over the 1985-1987 period since outlays are not significantly reduced.

Of course, none of this showed up in the media -- only headlines noting that CBO-GAO found that PPSS had exaggerated possible savings.

This quality of reporting makes it very easy to continue the Government's business-as-usual practices of ignoring and covering up problems rather than fixing them.

The fundamental method by which the Government ignores problems is by the use of a Mickey Mouse accounting system which hides more than it shows, is understood by very few, provides virtually no management control, and would quickly lead any normal entity into Chapter 7 -- way beyond Chapter 11.

The Government is ignorant of its cash balances so it needlessly incurs large interest costs by borrowing unnecessarily. For example, funds given by the Federal government as grants and that are idle are invested in interest-bearing accounts by grantees while the Government "finances" their investment. Conversely, the Government lets cash seized from criminals sit idly in non-interest-bearing accounts.

The Government's lending practices are abysmal -- and they have between $800 and $900 billion in outstanding loans and guarantees. Despite the size of this activity, we found that the Government does not know how much it is owed; how much is current and how much is delinquent; how it is subsidizing interest rates; etc.

For example, with regard to the Farmers Home Administration, if you ask someone in Government -- almost anyone in

Government -- how much FmHA is spending, they will get it wrong. In just one program, the Agricultural Credit Insurance Fund, total obligations were $13.5 billion in 1984. Outlays per the books, however, are reported at only $1.5 billion, or a little more than one-tenth of actual spending.

Do you want to know how the Government can spend 9.2 times the amount of their reported outlays? So did we. This intriguing bit of hocus-pocus was accomplished by the Government selling about $7 billion in Agricultural Credit Insurance loans to itself -- i.e., to the off-budget Federal Financing Bank.

Other interesting accounting conventions, such as netting repayments against new loans, guarantee that it is unlikely anyone will ever figure out what is being dished out.

So, that's how we in PPSS used ten man-years -- figuring out what's being spent -- and that's why it is so galling to hear reported as a criticism of PPSS the fact that CBO-GAO could not relate some of our savings estimates to the Budget.

That Budget, and the accounting system underlying it, is a joke -- a bad joke on the taxpayers, who deserve better.

The second action, covering it up, requires two steps: First, you have to convince the media to focus on a symptom of the problem, the deficit, instead of the underlying problem, the runaway growth of Government. That makes the second step very easy. Argue that you solve the problem by raising taxes. Of course, once you see the problem in this light, you realize that raising taxes merely covers up the underlying problem because everyone is focusing on the deficit, and raising taxes masks the symptoms and allows the Government to continue growing.

And that's why we have 2,478 recommendations -- because we weren't going to ignore problems and we weren't going to let the Government's preposterous accounting practices continue to make those problems invisible.

Turning to the area of this Committee's immediate concern, PPSS Task Forces developed recommendations which could save $37.1 billion over three years by optimizing the use of the private sector, summarized as follows:

(Table Follows)

Privatization
Three-Year Savings by Major Issue

Issue	$ Billions
Privatization of Power Marketing Administrations	$19.837
Contracting Out of Commercial Activities	7.390
Privatization of Commissary Operations	2.447
Contracting Out of Selected Coast Guard Services	1.574
Privatization of the National Space Transportation System	1.523
Privatization of Federal Vehicle Fleet Management	1.460
Contracting Out of VA Hospital and Nursing Home Construction	1.342
Other Privatization/Contracting Out Issues	1.505
Total	$37.078

Approximately 80%, or $29.8 billion, of the above savings would require Congressional action. However, as I'll be discussing, even those individual items which we believe to be within the Administration's authority, e.g., commissary operations, are likely to be influenced by Congressional action.

The details of the above recommendations will be discussed tomorrow by the representatives of our Privatization Task Force. However, in general, we found that when the Government and private sector provided similar services, the Government's costs were higher since there were no incentives to operate efficiently, for example:

-- inefficient management tends to be rewarded with higher appropriations and more staff;

-- Government businesses are insulated from competitive pressures and thus need not address fundamental changes; and

-- powerful constituencies exist within and outside the Government that can and do effectively lobby to prevent change.

Two specific examples of the above incentives for inefficiency can be noted in VA hospitals and commissary operations.

-- Budget allocations are made to individual VA hospitals on the basis of the number of patient-days each hospital records during the year. This creates an incentive to increase admissions and delay discharge until there is another patient to fill the vacated bed. Any hospital that fails to meet its target patient-day work load loses a portion of its budget appropriations -- a reverse incentive, the burden of which must be borne by the taxpayer.

-- Once the Government decided to provide the military with the benefit of less expensive food, it chose to implement this service by establishing a complete retail grocery system. This duplication of private sector services is inefficient because there are no driving forces of marketplace competition. The Government, by directly producing the commissary service, creates a separate, uncompetitive market with no pressure to control costs.

It is interesting to note that the commissary system continues and, in fact, grows because vested interests voice their opposition to privatization while the vast majority of taxpayers, who are subsidizing the commissary system, remain silent.

For example, when PPSS recommended the elimination of taxpayer subsidies to commissaries, the following appeared in the August 15, 1983 issue of Exchange and Commissary News:

> It's time for this market to wake up and stop waiting for the House Armed Service Committee to constantly stop everything negative from becoming law. Our associations and key industry leaders must anticipate rather than react to head off moves to contract out or close the commissaries.

One strategy to maintain the status quo is the expansion of the number of potential beneficiaries of the commissary system. The more beneficiaries, the more pressure and votes that can be brought to bear to resist change.

Following the announcement of PPSS findings, three pieces of legislation were introduced, the effect of which would be to expand the number of users of the commissaries:

1. On June 13, 1983, an amendment was introduced to allow the use of commissary stores by all those persons who have left the military, are entitled to retired pay, but have not yet reached retirement age.

2. On July 13, a proposal to open commissaries to "former spouses" of military personnel was introduced.

3. The FY 1984 Defense Department Appropriations bill establishes a test program for the use of commissary stores by military reservists. This program, if fully implemented, could bring <u>950,000 new patrons</u> to the commissary system.

The military services build new commissaries from sales proceeds without having to seek construction money from Congress. No oversight has been exercised by Congress to prevent the emergence of new commissaries in metropolitan areas or the duplication of services. In the San Antonio (Texas) metropolitan area, for instance, where five commissaries can be found, two are on Lackland and Kelly Air Force Bases, which literally border one another.

Once new commissaries are constructed, the House Armed Services Committee has routinely raised commissary appropriations to provide these new stores with employees and inventories. The result has been to make commissary expansion self-perpetuating. With at least another 25 new commissary construction or renovation projects already underway, long-term and even higher levels of taxpayer support appear likely in the absence of corrective action.

The main problem is that the bureaucracy does not routinely consider privatization as an option when program objectives are debated, molded, and implemented -- there's no strategy and no agency responsible for pursuing privatization opportunities.

Similar in effect to privatization is contracting out. The Government performs an estimated 11,000 commercial activities, at a cost of about $20 billion a year. One in every four Federal employees, excluding Postal employees, is engaged in a commercial activity.

Last year, OMB estimated that simply adhering to existing policies on contracting out could save the Government $5 billion annually after a five-year implementation period.

Again, a case of no one being in charge -- no one being responsible for aggressive implementation of existing policies. In fact, the deck is stacked against contracting out with cost comparisons based on the Government's <u>theoretical</u> costs for its most efficient in-house operation. Add to that the fact that agencies do not recognize their full personnel costs -- most retirement costs are reflected in the OPM budget rather than agency budgets -- and private sector contractors must show a 10% cost advantage to those understated, theoretical costs, and it is little wonder that limited progress has been made on contracting out.

In just one example, the provision of base support services for the Vance Air Force Base at Enid, Oklahoma, DOD estimates a 22% cost savings as a result of using a private sector contractor. And service is better.

Using from 50% to 70% of the number of employees used at comparable airbases staffed by Federal workers, the contractor has maintained more aircraft on a mission-capable basis.

Still, aircraft maintenance is performed in-house at most airbases, at a higher cost, and not as well.

Until the privatization and contracting out effort is formalized with authority and responsibility established and supported by both the Executive and Legislative Branches, billions of taxpayers dollars will be needlessly expended each year.

As I noted earlier, you will hear more on the specifics of our proposals from the members of our Privatization Task Force who will be appearing tomorrow before this Committee.

I appreciate the time and attention this Committee has given to the review of PPSS recommendations. The interest shown by Congress gives us hope that the opportunities offered by PPSS will be fully explored and implemented.

Although PPSS is a commission established by Presidential Executive Order, 73 percent of its recommendations require the approval of Congress before they can be implemented. Congressional support for PPSS cost control efforts is, therefore, critical if the full savings impact is to be realized.

Over the course of the past several months, numerous hearings and briefings have been held at which PPSS representatives have discussed their findings and recommendations and responded to questions from members of Congress and their staffs. I and my associates have provided testimony to both the Senate and House Budget Committees, the Senate Finance Committee, the Senate Agriculture Committee, the Senate Committee on Environment and Public Works, and other committees as well. These sessions have in nearly all cases been marked by a willingness to give fair hearing to the recommendations and to consider how Congress might be involved in their implementation. Coming across clearly was a deep-seated concern with the burgeoning costs of Government and a consequent openness to initiatives that give promise of moderating the problem.

Before concluding, I would like to mention the system developed by the Executive Office of the President to review and implement PPSS recommendations. Each agency will evaluate each issue and recommendation, indicating whether the item can be implemented as recommended or whether it, in the judgement of the department, requires modification or has been identified for further study before implementation.

White House review groups have been established to consider department/agency responses. Cabinet members and agency heads as well as PPSS representatives have been invited to participate in all review groups considering matters affecting their departments/ agencies.

It is the responsibility of each agency evaluating individual issues and recommendations to present an implementation plan and schedule to the White House Office of Cabinet Affairs, so that progress can be monitored.

Agencies already have accepted and are implementing many of the PPSS recommendations. For example,

- o A series of PPSS cash management improvement recommendations are being carried out Government-wide, with estimated savings of $4.7 billion by FY 1985.

- o An aggressive Government-wide debt collection program which has been under way for nearly two years was reinforced by PPSS recommendations. Savings targets were established for FY 1983 through FY 1988, with projected total collections of over $20 billion.

- o The Administration has initiated action to reduce the number of employees in grades GS/GM 11-15 by 40,000, as recommended by PPSS. Total estimated savings through FY 1988 are $1.4 billion.

o A reduction of over 1,400 employees in the Department of Health and Human Services, as recommended by PPSS, is being made, with an estimated $172 million savings over three years.

I and my associates are ready to provide whatever assistance we can to the Executive and Legislative branches to further the understanding, acceptance and implementation of PPSS recommendations.

Senator SYMMS. J.P., in the prepared statement of Mr. Grace, your associate, I think you are very correct in saying that the Government and private business operate similar activities and that this qualifies businessmen to identify the problems of public provision of goods and services. But history has shown that businessmen are not particularly good at suggesting solutions for eliminating public sector waste, and I think the reason for that is quite simple—because most businessmen believe the public bureaucrats will use private sector management techniques if told to do so, and most businessmen believe that the public sector can imitate private enterprise if only the right people were instructing the bureaucrats as to what techniques should be used. But this is not possible precisely because the public sector is not privately owned. The public sector—whether a bureau, an agency, a quasi-public authority, a public enterprise, or an entire Socialist country—cannot perform at the standards of a freely competitive enterprise.

The late Ludwig von Mises, the former leader of the Austrian School of Economics, said that this statement was theoretically correct in his 1936 book "Socialism." We also know that this statement is true by observing history. Moreover, we know it's true by reviewing the findings of the Grace Commission. And my question is, If business operation is so desirable, why take such a tortuous route? Why not scrap government ownership and turn those public functions over to private enterprise?

Mr. BOLDUC. I think I would strongly agree and encourage that last statement you've made. I'm of the position, Senator, that when you start—for example, there are 500,000 positions in Government today that perform functions and activities that are commercial in nature, meaning that they are competing with the private sector. I go back to the point I made earlier about strategy. I think it would be a mistake to try to either focus on grazing lands or guaranteed loans in the Farmers Home Administration or commissaries and say we are going to go after those.

I think the process needs to be thought through in terms of what the Congress wants to will on the executive branch to get done in this connection, and it won't happen unless there is a framework and there is a structure and there is a constituency supporting that. And whether it is the 500,000 jobs we are talking about in those functions or activities, or whether it is commissaries, or whether it is the keypunch operator, my personal view is that you need to dissect the Government into component parts.

There is one part of the Government that deals with safety, defense, and social service programs, and those provide a national welfare and necessary services which may not always lend themselves to good business management practices. In subsidized loans, there are certain things you can do with respect to cost per delivery of service.

But setting that aside, then you have a whole host of functions and activities in the blue-collar side dealing with work performed by carpenters, electricians, painters, custodians, guard services, et cetera.

Moving away from that and focusing on white-collar workers, you have personnel management, real estate management, plant, facilities, payroll, billing, collection, payments—those are all functions that can be performed by the private sector.

A strategy along those lines, the packing of units.

You mentioned one earlier about hiring of people. Certainly that is a function that the private sector could perform, and you only pay the private sector once they deliver a person to fill a job.

The other one you mentioned earlier dealing with attrition rates in the Federal Government. There is roughly 10 percent turnover in the Federal Government. You've got 2.8 million civilian workers. That's 280,000 positions a year. If tomorrow morning they said we are not going to fill any one of those vacant positions, you know what would happen? Nothing. They wouldn't need to fill those positions and Government would go on.

Senator SYMMS. Sure.

Mr. BOLDUC. 280,000 positions fewer; probably 280,000 positions that are performing commercial-related practices and functions. Some of them unnecessarily.

Senator SYMMS. Some times the efforts, even though they are well intended, are negative to production. For example, if you go to Salmon, ID, the main Salmon River runs right by town. A few miles below or just on the low side of town the Lemhi River flows into the Salmon. On down the river about 15 or 20 miles is a place where Dump Creek runs into the Salmon River. This is public domain.

I know what my grandfather would do and the old pioneers, what they would have done. They had placer mined on Dump Creek years ago. That's how it got its name. It put a big alluvial fan into the Salmon River, creating kind of a dam in the river. This is unnatural.

So we have got this unnatural dam now in the Salmon River. It backs the river up, but it makes the water still for about 15 or 20 miles along the river. When the weather gets 25 below zero it starts freezing the river. So it freezes over, backs the water back up, floods the Lemhi and floods out the town. This last winter in the senior citizens home they were rushing 80-year-old people out doors, skidding them out on sleds and rafts and in freezing ice water. Ice water ran 2-feet deep right through the living rooms of the homes in Salmon; terrible tragedy and trauma to those people. The Federal Government's cost alone was $3 to $4 million.

I tried to get the Corps of Engineers to go down there and clear that river out down there so that it will break that unnatural dam. I know what people would have done 100 years ago. They would have said the hell with it. They wouldn't put up with it. But now we are so burdened with Government.

Up to this point we have been unable to make any headway to safeguard the lives of Salmon residents because of Government policy. There are 50 ducks that live up there now on a little place of about 50 acres. I can't believe it. It is the craziest thing I have ever heard of in my life.

I went clear up to the colonel and the general and everybody in the corps. They all agree that that is what should be done, but they can't do it because it's against the law.

Mr. BOLDUC. Change the law.

Senator SYMMS. Well, I would like to, but you can't change the law because all the environmentalists are out there saying you'll wash all that sand down the river and disrupt something else further down the river. But it's a classic example of the unaccountability of the Government sector when no one is responsible. Common sense could compensate for a big portion, and I think a lot of the Grace Commission report is a good application of common sense. There are a lot of Government services that could be performed a lot cheaper, more efficiently. But to a large degree I do not believe we can ever make the Government efficient without privatization.

Goldwater said in 1984, "I didn't come here to make Government efficient. I came here to abolish it." He didn't win the election, but he was correct in his assessment of what was happening in Washington.

We've asked an awful lot of you, the Congress has, and I hope some good comes of it. I notice on exhibit No. 1 of the Grace Commission's report on privatization you make approximately 100 privatization recommendations that you haven't been able to cover today, but were covered in the 47 task force reports. I think it would be very helpful if we could somehow gather those suggestions, if you could assist us in doing that, and if your staff could work with Steve Hanke, our senior adviser here on the JEC Committee, so we could put those 100 things together.

What I would like to do when we get through with this hearing on privatization is have a concise, condensed report that shows many suggestions detailing when, how, and where some of these functions could be performed privately.

Do you think it would be possible to do this?

Mr. BOLDUC. I don't think that's a problem at all. I would, however, strongly urge you to recognize the importance of the position that Congress can play in mandating certain initiatives to be undertaken by the executive branch of Government. It is not going to happen on the executive branch of Government without direction and without prodding, because the incentives are all on the down side. Therefore, if it is going to happen, it is going to happen with some legislative mandates. It may give them a menu and say here is how much we want to achieve in the way of a bottom line; it may be to focus specifically on hard data which is not now available; it may be on them to come back to the Senate with their strategy as to how to make it happen. But, Senator, today there is nobody in Government concerned about or responsible for contracting out or privatizing functions that ought to be in the private sector.

Senator SYMMS. Consider, for example, debt collections. I can't see any political down side to turning Federal debt collections over to private debt collectors.

Mr. BOLDUC. I think there is a political down side to the extent that a constituent who has been able to bluff off the Government for 10 years without paying and now is forced to pay is going to let you know about it. There are $32 billion of delinquent loans out there, and the average follow-up annually is 3 calls as opposed to 24 to 36 in the private sector. Certainly a private agency will charge you to do some of those follow-ups, and will charge on a percentage basis of what they collect. But the Government will be collecting money.

Senator SYMMS. Well, 50 percent of something is better than nothing.

Mr. BOLDUC. That is exactly the point. That, by the way, has been used quite successfully at the Department of Education on the Student Loan Program.

Senator SYMMS. Well, I have raised a lot of ruckus—I hope it has had some benefit—on that very question. I've always made the argument that if you just get the word out on the street that the debts will be collected, pretty soon people will pay it. One of the reasons some people do not pay back their education loans is they do not think anybody will ever collect it.

Mr. BOLDUC. There are several things that can be done in that area. The possibility of contracting out or privatizing debt collection is one. Another one which we have proposed, which is now being introduced in both the House and the Senate side, is to offset against any individual income tax refund the amount that is due under a delinquent loan which he or she has refused to pay. It's only good business practice. There is $32 billion out there.

Paul Volcker said that if you can take $50 billion out of the deficit you can reduce the prime rate by 1½ to 2 points. You know, if you could recover $15 to $18 billion of that $32 billion that is delinquent, you could possibly have an impact of 1 percentage point on the prime rate. And it's there. Nobody is going after it in an aggressive way.

Senator SYMMS. Thank you very much.

We will stand in recess until 10 a.m. tomorrow morning.

[Whereupon, at 4:20 p.m., the subcommittee recessed, to reconvene at 10 a.m., Wednesday, May 2, 1984.]

PRIVATIZATION OF THE FEDERAL GOVERNMENT

WEDNESDAY, MAY 2, 1984

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY AND FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, DC.

The subcommittee met, pursuant to recess, at 10:05 a.m., in room SD-562, Dirksen Senate Office Building, Hon. Steven D. Symms (chairman of the subcommittee) presiding.

Present: Senator Symms.

Also present: Steve H. Hanke and Edward Abrahams, professional staff members.

OPENING STATEMENT OF SENATOR SYMMS, CHAIRMAN

Senator SYMMS. The Subcommittee on Monetary and Fiscal Policy of the Joint Economic Committee will resume its second in a series of hearings on privatization of the Federal Government this morning.

These hearings, in my opinion, are important because they directly address a proven method of dealing with problems of eradicating public sector waste. As I mentioned yesterday, I do not believe that the wasteful practices that accompany the public provision of goods and services can be corrected by instructing civil servants to mimic their private sector counterparts. This approach has failed and will fail in the future because public ownership creates incentives that are quite different than those created by private ownership.

If we want to correct the problems that plague our overburdened public sector, we must address the real source of these problems and begin to privatize those public sector activities that can be provided with fewer resources by private enterprise.

Yesterday, Mr. Peter Grace, Chairman of the President's Private Sector Survey on Cost Control, and J.P. Bolduc, Chief Operating Officer of the President's Private Sector Survey on Cost Control, presented an overview of the findings and recommendations contained in the Grace Commission's report. Today, we will hear more detailed analyses from three gentlemen who were directly involved in the preparation of the Grace Commission's report on privatization: Keith S. Kendrick, assistant to the president of Chemed Corp.; Eben W. Pyne, retired senior vice president of Citibank; and Mr. David L. Yunich, retired vice chairman of R.H. Macy & Co., Inc.

Mr. Kendrick, did you want to testify first?

Mr. KENDRICK. I would like to suggest, if it's all right with you, Mr. Chairman, that we begin with Mr. Pyne for an opening statement and I will take us through the specifics of the numbers, and then we'll have a concluding wrap-up presentation by Mr. Yunich, if that's all right.

Senator SYMMS. That will be fine, and I appreciate that. Then we will proceed with a series of questions for the three of you as a panel.

Mr. KENDRICK. Very good.

Senator SYMMS. Go right ahead, Mr. Pyne. We welcome your testimony. We appreciated having you here yesterday, so you're very much up to speed on what we're trying to get at here. I think it might be worth mentioning that for those of us in the political arena, it's difficult for anyone in politics to fly much higher than their constituency. One of the things that happens as Government grows is that special interest groups form around these Government functions. We have to develop a coalition of people dedicated to the private sector if we will ever be successful. We need this coalition so Members of Congress and leaders in the political arena will eventually hear from groups interested in conducting these services that can replace the Government activities. And I hope that we can get to that in your testimony and later in the actual question-and-answer period.

Please go right ahead, Mr. Pyne.

STATEMENT OF EBEN W. PYNE, RETIRED SENIOR VICE PRESIDENT, CITIBANK

Mr. PYNE. Mr. Chairman, thank you for this opportunity to present this committee with the findings and recommendations of the Privatization Task Force of the President's Private Sector Survey on Cost Control. On many recent occasions I believe our analyses and recommendations have been misunderstood and improperly reported, so I am particularly pleased to have this session to discuss them in as much detail as time will allow.

My name is Eben W. Pyne, retired senior vice president, Citibank. In addition to private sector experience, I have served on the boards of several nonprofit hospitals and the Metropolitan Transit Authority. With me is Mr. David L. Yunich, retired vice chairman of R.H. Macy & Co., Inc. Mr. Yunich and I served as two of the Privatization Task Force's six cochairmen. Additionally, Mr. Keith S. Kendrick, assistant to the president, Chemed Corp., is here. Mr. Kendrick was active in the day-to-day operations of the task force. He is accompanied by Ms. Majorie T.J. Wong and Mr. Tracy Finn, both of Chemed Corp., and Kathy Barrne.

Mr. Yunich and I served as cochairmen of the Privatization Task Force, along with Mr. Paul F. Hellmuth, retired managing partner, Hale & Dorr, attorneys at law; Mr. Bruce J. Heim, vice president, F. Eberstadt & Co., Inc.; Mr. Edward L. Hutton, president and chief executive officer, Chemed Corp.; and Mr. Paul E. Manheim, advisory director, Lehman Bros. Kuhn Loeb, Inc. These four gentlemen are unable to attend today due to longstanding, prior commitments, but they are most aware of these proceedings and have requested that I express their appreciation for your thoughtful review of our proposals.

This morning I would like to explain briefly the organization of our effort, the general concept of privatization, and the need for a formalized structure and process to facilitate privatization on an ongoing basis. Mr. Kendrick will follow with a presentation of specific areas for privatization and Mr. Yunich will summarize the benefits of privatization. If this format is acceptable, Mr. Chairman, we would like to answer any questions you may have following Mr. Yunich's comments.

ORGANIZATION OF THE TASK FORCE

Our task force had a different origin than most. First, from the initial reviews of the original 35 PPSS task forces, it became evident that there were many products and services that did not need to be produced by the Government; therefore, our task force was created later in the review to study this area.

Additionally, as you may have noted in the introductions, four of our six cochairmen are retired; therefore, we did not have personal staffs to call upon to analyze these issues. Consequently, we had to undertake major fundraising and recruiting. In the end, we recruited 26 people from more than a dozen organizations who devoted 40 person months or more than 3 man-years to the study. If we had had more time, money, and people, we would have recommended additional areas for privatization. I know that I speak for all the cochairmen when I say that I wish we could have done even more.

At this time I would like to discuss the concept and implementation of privatization.

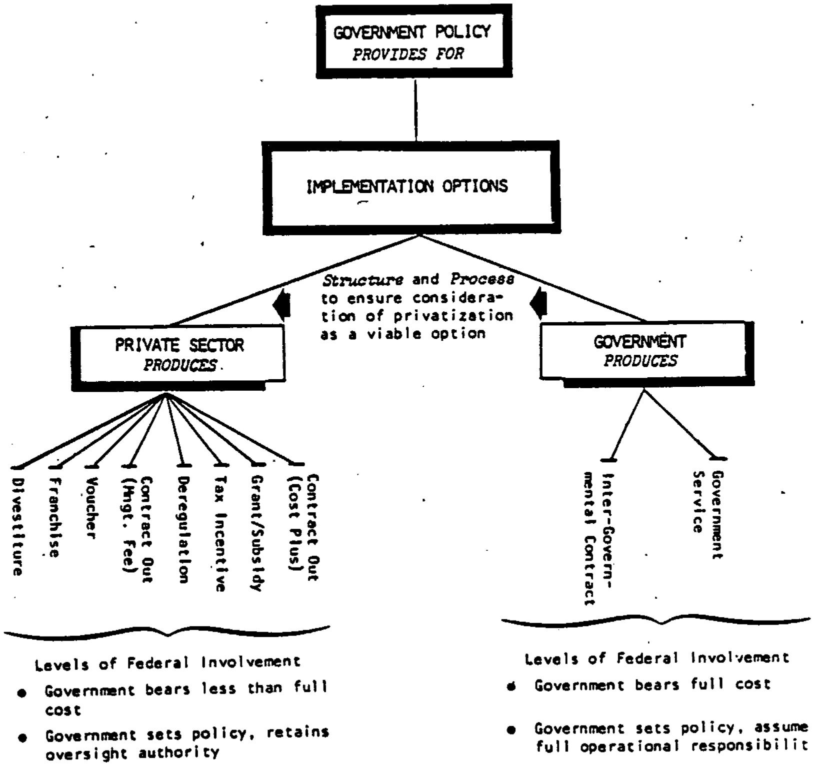
PRIVATIZATION—THE CONCEPT

Privatization, at the Federal level, means to turn over an activity, or part of an activity, currently performed by the Federal Government to a private sector entity. It is an option for implementing Government programs and policies, allowing the Government to provide services without producing them as shown in the following diagram.

[Diagram 1 referred to follows:]

Diagram 1

CONCEPTUAL FRAMEWORK FOR THE ROLE OF PRIVATIZATION IN THE FEDERAL GOVERNMENT



Mr. PYNE. As shown in this figure, privatization options range from contracting out on the one hand to complete divestiture on the other. Privatization does not lead to an abdication of Government responsibilities, but offers a more cost effective and efficient way for the Government to deploy its limited resources.

Local governments have found privatization to be successful as an alternative means for delivering services, while controlling cost. A 1982 survey of 1,780 cities and counties conducted by the International City Managers Association shows that 41 percent used private sector contracting for commercial solid waste collection, 34 percent for residential solid waste collection, 30 percent for tree trimming and planting, 78 percent for vehicle towing and storage, and 20 percent for motor vehicle fleet management. Local governments tend to experiment with alternative delivery approaches when the pressure from taxpayers to maintain or expand services combines with rising international production costs, squeezing already limited financial resources. Privatization examples abound.

Dozens of communities have contracted with private firms to operate municipal hospitals. Butte, MT for instance, estimates annual savings of $600,000.

Newark, NJ, is saving $200,000 per year by contracting out the collection of one-third of the city's refuse.

Scottsdale, AZ, contracts out all of its fire protection services for a $2 million annual savings.

Orange County, CA, has a private firm run its computer center at a $1.6 million annual savings.

In studying these success stories and analyzing possible Federal privatization areas, we discovered four common themes.

First, the service was initially produced by the Government because there was no other significant producer in the marketplace. Since that time, conditions have changed, yet there has been little incentive to develop a new production strategy as a response to a new environment. For example, when multipurpose dams were first built, the original projects were in rural or less-developed parts of the country that did not have investor-owned utilities to provide electricity. Military commissaries were established in the 1860's when the typical army post was a frontier post, miles from the nearest city.

The second theme is each service has become operationally inefficient.

Third, the Government has attracted many dedicated, competent people to run its operations, yet these managers are handicapped by a lack of sufficient authority to manage.

Finally, as Government has become increasingly complex, the businesses we recommend for privatization are not an integral portion of the parent organization, but instead are appendages, of less importance to the main function, receiving less than optimum attention and investment.

The Privatization Task Force recommends eight areas for privatization as shown in the following chart.

[Chart 1 referred to follows:]

Chart 1

Privatization Task Force Recommendations
($ Millions)

	(1) Recommendation Area	(2) Department or Agency	(3) Three-Year Cost Savings(S)/ Revenue(R)
(1)	Power Marketing Administration	Department of Energy	$ 3,535.0 (S) 16,301.5 (R)
(2)	National Space Transportation System	NASA	1,522.6 (S)
(3)	VA Hospitals/ Nursing Homes	Veterans Administration	1,436.5 (S)
(4)	Commissary Stores	Department of Defense	2,064.0 (S) 383.2 (R)
(5)	Metropolitan Washington Airports	Department of Transportation	113.0 (S) 341.5 (R)
(6)	Motor Vehicles	Various Departments	200.0 (R) 1,260.4 (S)
(7)	Coast Guard Services	Department of Transportation	1,259.4 (S)
(8)	ADP-Social Security	Social Security Administration	Not Quantified
			$28,417.1

Mr. PYNE. The first area we recommend is the power marketing administration with a cost savings of $19.8 billion. I might say that along with experience with that light company, I had firsthand experience in just how hard it is to keep electric lights down. I'm particularly concerned, Mr. Chairman, that our recommendations in this area of PMA's may be beat even before it's debated. I have been reading in the popular press about a deal that's been struck by the Department of Energy and the States of California, Nevada, and Utah, to guarantee those States, we will subsidize those States until the year 2017. I do not believe we can afford to simply strike a deal that involves billions of dollars when the national debt is growing by the minute.

The second area we recommend for privatization is the National Space Transportation System, with a savings of about $1.5 billion. VA hospitals and nursing homes, savings, $1.4 billion. Commissary stores, savings, $2.4 billion. I'd like to say that this must be PPSS's most misunderstood recommendation. This is not an antimilitary recommendation. In World War II, I volunteered to serve in the Army for 5 years and fought in the major campaigns in Italy.

Another recommendation, metropolitan Washington airports, total savings, $554 million. Motor vehicles next, $1.4 billion. Coast Guard services, $1.2 billion. And finally, ADP-Social Security, which has not been quantified. This brings up a total of $28.417 billion.

Mr. Kendrick will be discussing the details of these recommendations and savings later.

As you can see, privatization opportunities are not limited to one management area or department. In addition to the eight areas just discussed, the task force and the PPSS report to the President note 73 additional PPSS issue and recommendation areas with savings and revenue potential of $8.7 billion over 3 years. These additional areas include automated data processing, construction activities, Government loans and insurance, and credit bureaus and collection agencies. The total PPSS combined privatization and contracting out cost savings and revenue is $37.1 billion.

More important than action on these individual savings areas is a need for a structure, process, and strategy to facilitate an ongoing privatization program. To meet this need, we recommend (1) the establishment of a Privatization Office in the proposed Office of Federal Management within the Executive Office of the President, coupled with (2) an administrative and coordinating function in each department and agency.

This Privatization Office would be responsible for:

Pursuing the eight key recommendations of the Privatization Task Force, plus the additional 73 privatization opportunities previously identified; searching out and analyzing additional Government-produced products and services for privatization; aggressively pursuing privatization implementation options as new policies and programs are developed by asking—"Is it necessary to produce internally this new product or service?"; championing the privatization concept to Washington decisionmakers; and inviting, receiving, evaluating, and monitoring privatization proposals from interested private sector firms. Today, if a bright entrepreneur has a good idea, there is no one designated in the Federal Government to present it to.

This department must be creative, dynamic, innovative, and rewarded for challenging the status quo. And, most importantly, it needs congressioal support. In other words, the administration should seek, after Congress enacts law, that Government's long-standing policy of relying on the private sector for commercial services.

If anyone needs proof that we need a Privatization Office in OPM one needs only to review the track record of OMB circular A-76—the document which states: "The Government's business is not to be in business * * *. The policy of the U.S. Government is to rely on the private sector * * * to provide commercial goods and services." That document and its predecessors have existed since 1955, yet only a small portion of its potential has been realized.

CONCLUSION

In conclusion, to summarize, privatization is not a theory. It is providing in practice to be an effective cost control weapon in cities and towns across America. It is also enjoying popular support in Great Britain—British aerospace and cable and wireless have just converted back to the private sector—and Italy, where companies which were once private and were turned over to the Government are now being returned to the private sector.

Privatization increases the Government's efficiency by better utilizing scarce resources; enabling the Government to fulfill its responsibilities at a cost savings; putting the private sector to work for the American taxpayer; and encouraging real public ownership, that is, ownership by people, so that resources provide a tax base rather than a tax drain.

The opportunities for privatization at the Federal Government level are limited only by our commitment and creativity.

Once again, Mr. Chairman, thank you for this opportunity to participate in these hearings. As I noted earlier, my fellow cochairmen and I have been involved in PPSS for nearly 2 years and we do not intend to stop at just issuing a report. We are prepared to provide assistance in any way desired to further the understanding and implementation of every one of our recommendations.

Unless you wish to proceed differently, Mr. Chairman, Mr. Kendrick is prepared to present our recommendations in greater detail, followed by a short statement from Mr. Yunich.

Senator SYMMS. That would suit the chairman fine. I just want to thank you for a very excellent presentation. I wish all 100 Senators could have heard that presentation, Mr. Pyne, it was very excellent and I look forward to hearing from you now, Mr. Kendrick. Please go right ahead.

STATEMENT OF KEITH S. KENDRICK, ASSISTANT TO THE PRESIDENT, CHEMED CORP., CINCINNATI, OH

Mr. KENDRICK. Thank you, Mr. Chairman.

The slides that we are going to use this morning—we do have a chart packet available, Mr. Chairman, and I think Ms. Marjorie Wong and Ms. Tracy Finn would be happy to hand those out to members of the audience and to members of your staff in case anybody cannot see the projection screen very well this morning.

Senator SYMMS. OK.

Mr. KENDRICK. Once again, thank you very much for the invitation to allow us to be here this morning to make the presentation. My boss, Edward L. Hutton, served as a cochairman of the privatization task force and he is meeting with our board of directors this morning in a longstanding, previously arranged meeting.

The chart package has now been distributed and I'd like to run through each area that Mr. Pyne addressed. Specifically, I'll take the first four in a little more detail than the last four—power marketing administrations, motor vehicle fleet management, VA hospitals, and military commissary stores. I'd like to look at those in a little more detail than the last four.

I'd like to look at them in three stages—the specific recommendations, the analysis that led to those recommendations, and specific benefits that could be gained by implementing them.

Power marketing administration [PMA's], of which there are five, were established, as I'm sure you know, for the purpose of marketing hydropower for Federal multipurpose dams with the exception of those under the authority of the TVA. They are to sell that energy at wholesale prices consistent with sound business principles.

We have specifically recommended that the Federal Government should immediately begin to disengage from this commercial activity, that a Presidential advisory committee should be created to lead this divestiture process, and finally, during this period of disengagement, a user fee system should be established to be paid by electric power consumers. This is consistent with the recommendations of the Department of Energy Task Force of the President's Private Sector Survey.

The analysis that led us to those recommendations include several points. First, PMA's are not operated in a manner which is consistent with sound business principles. For example, not a single one of their financial statements which have been prepared now for about a dozen years, has ever received an unqualified statement from a private accounting firm. That's on its way to chapter XI on the private sector basis. One of the reasons that they fail to receive an unqualified statement is that they simply do not amortize the Federal investment. They work on pricing schedules that simply claim that in the 50th year they will pay back the specific investment and every year they push that 50th year further out.

PMA's have incurred a deficit of between $500 million and $1 billion each of the last 5 years. Although that pricing study is supposed to be calculated to cover all costs, they have actually run this deficit for the last 5 years.

Finally, there are alternatives; partnership arrangements, between the Federal Government, local governments, and private industry exist in a number of areas in the country.

The specific benefits that would be gained from the recommendations include the elimination of operating deficits, sound pricing to promote conservation, future expansion to be locally funded, local utilities and consumers can determine local market needs, and 3-year savings which total $19.8 billion.

We developed those cost savings numbers for four or five categories. First, we're making an assumption of the selling of assets at their current value of $25 billion over 5 years. Due to the way the PPSS counts dollars, we've just taken the first three-fifths, $5 billion a year, as income, plus reduction in annual investment, reduction of interest costs, and user fees on hydropower for a total savings of $19.8 billion over a 3-year period.

Something a little less exciting than falling water and dams is the automobile, and the Federal Government owns over 436,000 automobiles and we believe that's just a few too many. Specifically, we have recommended reduction in the size of the Federal vehicle fleet by 100,000 units, to bring the Federal fleet utilization closer to private sector standards. We wish to develop a fleet management information system [MIS] and we recommend that we improve utilization of the remaining fleet—336,000 automobiles.

The analysis that led us to that position is quite simple. The Government lacks accurate information on fleet costs. One of the areas that leads to that position, quite frankly, is they don't include the cost of capital. All the funds the Government has invested in those cars are not recognized. Those costs are real costs and the private sector does in fact have to recognize them. This is really a part of that information gap that you were discussing with Mr. Grace yesterday and it's quite a serious area in trying to do financial analyses to see how well you're doing.

The Government lacks accurate information on fleet utilization, really a second shot at the information gap. The way I like to think of it is, "When is a car not a car?" Answer: When it goes to the garage for the day to be repaired, the Federal Government drops the car out of the fleet count for the day and therefore they declare that it's no expense to the Government and not available. So you lower the denominator and it increases your utilization calculation for the day. It's just magical, misleading accounting.

The USDA has begun to close this information gap by implementing a fleet management information system, the improved MIS, as we've recommended.

Finally, privately owned vehicles are a very easy way to begin this privatization process. The privately owned vehicles cost the Government 20 cents a mile to operate versus 36 cents a mile for a Government-owned vehicle, using the Government numbers. We believe the cost actually is higher.

Quite frankly, the benefits of privatization are simple. We would have better fleet management, better fleet utilization, cost-effective fleet operation, and 3-year savings just by privatizing part of our fleet of $1.5 billion in the first 3 years of full implementation.

We developed those numbers quite simply by selling 100,000 cars conservatively at $2,000 a car. Interest savings, reduction of fleet operating costs, and finally, general management improvements through better MIS, POV's and private sector rental units. If we add back the cost of the MIS system, savings total $1.5 billion.

Senator SYMMS. Have you heard from any of the auto leasing companies?

Mr. KENDRICK. We did interview several, and they believe that in fact, yes, they could sign contracts to have vehicles available just as they negotiate rates with private sector companies. My corporation has a discount with several companies because we utilize their cars at a certain level a year. The Federal Government, in general, doesn't negotiate that type of contract and, yes, there is an interest in the private sector to provide that service.

Senator SYMMS. That would be very helpful if they would let it be known that they could provide that service at a lower cost for the Government. Then there would be a basis for a coalition to politically support such a service.

Mr. YUNICH. I'm sure that can be done, Senator. Mr. David Mahoney, who until recent months was the head of Avis, at the point in time when we were doing this study, indicated that there was no question but that he and other large fleet operators could do the Government a great service by leasing to them at a considerable cost benefit.

Senator SYMMS. Why did you not recommend privatizing the entire fleet? Is there some practical reason why they need some cars available?

Mr. KENDRICK. Sure. For example, many corporations do own a car for the chief executive office, for example, because they use it throughout the day for running him or her to and from meetings and they use it on a daily basis, every single day, with a lot of miles per day. Then it's economical for them to own it. But if you run that car 2 miles a day or 3 miles a day on average, it's not economically to own it. The entire Federal fleet averages only 9,000 miles a year versus 25,000 miles a year in the private sector.

The data that's available due to this information gap problem is so thin that it's very hard to crunch down and decide exactly where the magic line is at this time. That's why we're recommending improving MIS. In fact, we believe that our 100,000 is conservative by one-half. We believe we could cut another 100,000 out and still not affect the utilization.

Senator SYMMS. What you would like to do is to cut 100,000 cars out of the fleet to start with?

Mr. KENDRICK. And improve the MIS.

Senator SYMMS. Improve the MIS, and then if it works out well, cut another 100,000.

Mr. KENDRICK. That's right.

Senator SYMMS. And then, if it continues to work, you cut it down until you find out it's getting less efficient and then you buy some back.

Mr. KENDRICK. That's correct.

Senator SYMMS. It's the same principle that you have if you take over a company. You reduce personnel, until you reach the essential limits.

Mr. KENDRICK. Well, we hope that our analysis is better going in. We hope that we find the key person before we fire him.

Senator SYMMS. Once you finally get it bracketed, when you know you've overshot the mark, then you pull back a little bit.

Mr. KENDRICK. It's a standard business principle that it's often possible, if you're clever enough, to figure out and analyze what something is actually costing you, to find somebody to do it better for you. That's fundamentally what it is.

As an example, the city of Dallas just recently considered a new way of running their gasoline supply to their automobiles at night.

Their new business director who has been there a couple of years realized they did not know what the cost of running the private gasoline stations around town by each hour of the day. So when he did that cost study, he found that his actual cost to pump gas to police cars and fire equipment between midnight and 8 a.m. was twice as expensive as it was during the daytime. So he simply went to 7-11, a major convenience chain, which is open 24 hours a day, which has gasoline stations and they have a central billing form which is a fraction of what they are paying now. So he's kept his gasoline stations open during the day but he closes off at midnight for 8 hours and if a policeman needs to fill his car with gas, he pulls into 7-11 and 7-11 bills the city, and they're saving about 50 cents a gallon during those hours. They found they were running up to $1.60 a gallon between midnight and 8 a.m. when it is fully costed. So it's how you look at it and when you crunch the number and how clever you are at figuring out what it is, and that's what we're talking about.

If you would like to move ahead, to the Veterans' Administration [VA] Hospitals. When the Veterans' Administration moved into the hospital building business and setting up hospitals, they really didn't have a choice. This goes back to the first theme of privatization which Mr. Pyne addressed a moment ago. There were so many veterans in need of medical care following the world wars that the private hospital simply couldn't handle that influx of patients. So the VA had to build the facilities.

But in 1984, this situation is really quite different. We've recommended that the VA should phase out construction of hospitals and future construction could be handled by private sector hospital companies, of which now there are quite a few in this country.

Second, the VA should not construct additional nursing homes. And they are under legislative directive to build 5,000 additional homes over the next 5 years. Those additional people are not being taken care of in contracted nursing homes in the private sector for $44 a day, and when the Government runs it, it's $109 a day, and the VA has been instructed by the Congress to build more of those $109 a day rooms. We think that should stop.

The VA should test market the recommendations by taking three hospitals, giving a phase-in period, and see what happens. We think you will find great savings.

Subject VA facilities to a certificate of needs process that goes on in every other hospital in the United States.

The analysis that leads to those recommendations: VA hospital construction costs run anywhere from 30 percent to 69 percent higher than comparable private sector facilities.

Second, contributing to this cost is the VA Construction Office staff, which totals 800 people. One private sector hospital firm which built the same dollar amount of facilities over the last 5 years runs that same function with 50 people.

Third, the VA costs per episode of acute inpatient care is 70 percent and 48 percent higher than comparable private sector medical and surgical care. VA medical supply inventory levels run about 45 to 60 days, and that is up to 50 percent longer—25 to 50 percent higher than average private sector levels. VA purchases 42 percent of its supplies at the local level versus the private sector standard of 75 percent to 85 percent of their supplies through national contracts. The private sector estimates that those national contracts save them 20 percent.

And the VA, once again, has an information gap in their planning system which I will speak about in just a moment.

Specifically, benefits of privatization—and this is one of those fundamental things—is that we have higher quality of medical care for our veterans such as construction improvements. For less money we could get the needed hospitals in place and we could get them faster. Those 800 people in the construction office contribute to the fact that it takes the VA 7 years to build a hospital from the planning to opening the doors. The private sector is now doing that in 2 years.

Operating efficiencies—we can improve information levels. Planning advancements to be sure we have the right facilities at the right place when they are needed. Government would avoid overbuilding and overpaying for the facilities and we would generate, conservatively, $1.3 billion in cost savings.

Let me make that point on construction improvements. The VA facilities are becoming so obsolete now, even the VA estimates they need $33 billion over the next 4 or 5 years to bring their facilities up to snuff. This year, they are only going to get $1 billion in the budget for construction. So you see that the money just isn't there for them to keep up to standard.

We have broken out these dollars by recommendations—privatizing private beds, privatizing contructing and operating nursing home beds, private sector contract management of the hospital facilities, and the sharing of facilities and equipment and the certificate of need process, of $1.4 billion over the 3 years of full implementation.

Military commissaries, an issue you and Mr. Grace went around on quite a bit yesterday. The military commissary system was established as early as the 1820's. It was intended for the purpose of providing grocery products to servicemen who were in remote locations. There were not too many supermarket stores west of the Mississippi in the 1820's. That's a little different today.

We think the Secretary of Defense should require immediate comprehensive Bureau of Labor statistics market basket surveys of all commissary stores and that the commissary stores should be privatized via a competitive bidding process using this background from the survey results.

The analysis that led us to those conclusions include: The commissary system is a highly fragmented, decentralized, and has duplicative management. Yesterday, you referred to the fact that they operated the eighth largest grocery system in the country. That's correct on a bottom line number, but in fact they are running four separate grocery systems which are obviously all much smaller. So we're not running one big efficient grocery system; we're running four smaller systems, all with their own CED's.

Senator SYMMS. That's because of the four services you mean?

Mr. KENDRICK. That's correct, yes. For example, the Army and the Air Force years ago consolidated their exchanges and we haven't even begun that process of consolidating the management system of the commissary system.

Senator SYMMS. Do they cost out their personnel? Is that part of the cost of operating a commissary?

Mr. KENDRICK. The main portion of the appropriations this year, which will be about $597.2 million,[1] is personnel costs and the rental of facilities. The rest of the items—utilities and other items such as that—are supposed to come from the 5-percent surcharge charged on the grocery products. So most of the cost paid by the taxpayers are the labor in the commissary stores.

Senator SYMMS. In other words, if the commissary has a little residue money, then they build a new commissary with that money, not appropriated by Congress?

Mr. KENDRICK. That's correct.

Senator SYMMS. But the wages and salaries of the people who run the commissary are paid by the taxpayer?

Mr. KENDRICK. Right. In fact, they use excess surcharge funds for remodeling their facilities as they can so they are planning. But if they build a new store, then the procedure that's been used by Congress is: If you open a new store we will guarantee the employees for the store, so we up the appropriation and put more employees in the store. Congress does not review the location of those new construction sites on a regular basis because they are supposedly built with the surcharge money. Of course, they couldn't get the surcharge money if the taxpayers didn't pay the employees to open the doors and put the groceries on the shelves.

Senator SYMMS. Do you know of any commissaries that are being built that are not on military bases; built just for retired military personnel?

Mr. KENDRICK. I have not personally visited any facility in that classification, but in hearings before the House Armed Services Committee on March 27, there was an extended discussion of the El Segundo commissary which I believe is just outside San Diego, CA.

Senator SYMMS. No; it's in Los Angeles, I believe.

Mr. KENDRICK. OK.

Senator SYMMS. I believe that's right.

Mr. KENDRICK. We can certainly check that for the record.[2]

Senator SYMMS. I think that commissary is primarily for retired people. There are no active duty military people on this facility. I believe that's right because I was out there at that time. I believe it is El Segundo.

Mr. KENDRICK. That was the one that was discussed. I know that. I was at the hearing.

Senator SYMMS. I was in that area and I paid a visit to several grocery store operators. They claimed the Pentagon had built a new grocery store. And that's the first time that anybody from the private sector has ever started to form any kind of an interest group that might be in favor of trying to win business in my 12 years in the Congress. Nobody has ever talked about it from the retail point of view.

Mr. KENDRICK. I think the fact is that there is an extreme amount of private sector interest. The California Grocery Associa-

[1] The citation was incorrect by 3%.
[2] El Segundo is in Los Angeles, CA.

tion has been very vocal in wanting this matter cleared up, for one of the major reasons, that there are quite a few commissary stores in California and they are very concerned about El Segundo. The particular hearing I referred to, the president of the California Grocery Association was testifying and he brought up El Segundo and before the hearing was over it was fairly clear that it was not really an active military base designed for the commissary to serve active military personnel. It's really to service people living there, primarily retired people.

Their own studies show that roughly 60 percent of the commissary shoppers nationwide in 1982 were retired personnel. So it's really not helping the active duty enlisted man as a primary purpose. The majority of shoppers are actually retired people.

Let's go on with the analysis if we could for a moment.

Although they were intended for remote locations, 82 percent, according to the GAO, are within 10 miles of at least two supermarkets. Sixty-two percent in the 1981 triennial survey were justified solely because private sector prices were declared to be unreasonable.

The triennial survey savings are simply overstated. Commissary stores are not really comparable to supermarket stores. You can look at the hours of operation, the number of product lines in those stores. You can look at the price savings, it's more comparable to the prices available in the warehouse food industry. Commissary stores have simply not kept up with private sector standards.

One example, electronic scanning. I don't know if the supermarket you shop in has scanning yet, but quite a few do. It's a little scanning grid and you run it across an electronic eye; 95 percent of all warehouse food stores in America use electronic scanning. In the Army, out of 179 stores, they have it in 4. So they are just not keeping up. It's very difficult with a 5-percent surcharge. This system has its problems and we can improve it, we believe, by privatization.

Let's look at the specific benefits. We could maintain savings to consumers, offer greater product selection, extend the store hours. This isn't a minor issue. Commissary stores, on average, are open only 42 hours a week. Well, if you are a young person who is married and both members of the household work, a dual career couple, and you're working 40 or 42 hours a week, it's kind of hard to get to this benefit the taxpayer's funds provide for you. The average supermarket is open over 120 hours a week, a multiple of three. That's a real issue on how well this benefit is provided.

Finally, the private sector financing of inventories and store improvements simplify management requirements. We wouldn't have to have Congress reviewing it, as we did in the House Armed Services Committee. The specific question was to check into the glazed chicken "Lean Cuisine" [3] getting to a certain store. Well, we could worry about that problem with the private sector experts.

And the 3-year savings total $2.4 billion. We base that on eliminating the appropriations, possible rental income from private sector stores, the revenue acceleration based on selling off present

[3] Lean Cuisine is a trademark of Stouffers Foods.

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inventories, and interest reduction. A total of $2.4 billion savings over the first 3 years of implementation.

I think the next portion I'll move quickly through so we can get as quickly to the questions and answers as possible. Let's look at the National Space Transportation System [NSTS], which is composed of the space shuttle and the expendable launch vehicles [ELV's].

We recommend that the President and Congress develop and enact legislation to allow private sector participation in the NSTS, including purchase and operation of a fifth, and future, space shuttles, as well as ELV's.

The President and Congress should initiate Government/industry cooperative agreements offering incentives for investing in the space transportation system.

Specifically, our analysis revealed that the U.S. monopoly on space launch services has begun to erode as Europe and Japan have entered the market. The private sector has submitted two proposals for commercial participation. Finally, Government and industry experts agree a fifth shuttle is needed to meet demand. Additionally ELV's have increased in importance as a part of the NSTS.

Senator SYMMS. What's an ELV?

Mr. KENDRICK. Expendable launch vehicle. It's one time and that's it. It pops a satellite into orbit and there's nothing left.

Benefits of privatization: Ensures the viability of the National Space Transportation System; it would increase the space transportation capacity, avoid future Government investment, and provide a 3-year savings of $1.5 billion.

That's a fairly simple calculation the way we've done the dollar savings. A new space shuttle now costs about $2.3 billion and it takes about 5 years to build, so in average payments in our PPSS methodology we took the first 3 years of the payment and estimate $1.5 billion.

We looked at three specific Coast Guard services—short range navigational aids [SRAN], search and rescue [SAR], and commercial vessel safety [CVS]. This is the yacht owners' question that Mr. Grace was raising yesterday.

We specifically recommend that the Coast Guard should utilize the private sector towing industry for SAR operations. The Coast Guard should contract out its heavy-lift routine maintenance work for marine and inland buoy tending. The Coast Guard should continue to use private sector firms to provide vessel inspection and admeasurement.

Specifically, we found that 80 percent of the Coast Guard's assistance requests are nonthreatening—in other words, the yacht ran out of gas and would you please come give us a tow. The private sector can handle these calls—and that's not a typo—at one-twelfth the cost. That's correct. It's one-twelfth.

The private sector can perform maintenance on short-range navigational aids at a 24-percent cost savings.

The Coast Guard has utilized private sector firms for vessel inspection and measurement. We think that these CVS services could be completely privatized. In fact, we are quite certain of that.

The benefits of privatization is to return the Coast Guard to its national defense-related mission, cost-effective provision by the private sector of non-high-priority Coast Guard activities, and a 3-year savings of $1.3 billion. We developed those numbers for each of those three programs I just spoke about—the search and rescue at $651 million; the short-range aids to navigation at $477 million; and the commercial vessel safety at $130 million, for a total of almost $1.3 billion over the 3 years.

Senator SYMMS. Is there any way of doing that analysis that you could cost out or differentiate between the duplication of having, say, a Coast Guard cutter that is involved in stopping drugs coming into the country in Florida or somewhere and then turn around the next day and they make a high-priced stop to fill up somebody's cruiser with fuel who inadvertently ran out of fuel? How much of that happens?

Mr. KENDRICK. I don't believe we specifically did the costing on that, although we do have the numbers that show 80 percent of all calls to the Coast Guard are non-life-threatening.

Senator SYMMS. I can see that if I were representing the Coast Guard I'd turn around and say, yes. But we do this and this and this and these other things are incidental.

Mr. KENDRICK. And we are certainly not arguing that they shouldn't do those things. We are saying that they don't want to get into the business of charging a user charge because they don't want to get into the operation of having a business and handling money and figuring out costs. They would rather do, at least from our analysis, what they were intended to do, and we could certainly try to ask this question in more detail for the record, but I think the Coast Guard really doesn't want to put in a user charge system, the alternative to our recommendation. They don't want to set up the accounting system and the bookkeeping and all that. They would like to be involved in those defense-related and drug security issues and not have to worry with the business operations.

We think we could just say they don't do that any more and there are plenty of private sector firms that will go out and tow you in and charge you for it quite dearly.

Let's move on to the next issue, Metropolitan Washington airports, Dulles and National. Those two federally owned airports should be sold at fair market value to a self-sustaining and independent airport authority.

We found that the FAA's conflicting roles of supplier and regulator have resulted in a confusion of agency mission goals.

The existing ownership structure of the MWA prohibits not only a stable financial base, but also local involvement, adversely affecting long-term planning.

The FAA has concluded that the MWA could best be managed by a corporation.

Ownership and operation by a local authority could provide better service to the air traveler.

The benefits of privatization includes the return of the FAA to their primary mission of ensuring air safety and fostering civil aeronautics and air commerce; better service to the air traveler; and provision of long-range planning. The airport budget is on an annual basis, so if it takes 18 months to do something, it's hard to get funds to complete the project. Three-year savings is $454.5 million.

Finally, the ADP-Social Security issue. We did not claim cost savings in ADP-Social Security because we felt that the ADP task force and Social Security task force could look at those issues more clearly.

Specifically, the Social Security Administration should aggressively use private sector ADP resources to eliminate the current data processing backlog.

The plan originally, when HCFA broke off in 1977, was to let them handle their own ADP. SSA is still doing HCFA's ADP and it's become a real problem.

Let's look at the analysis. SSA processing of claims, benefits, and payroll is slow. Antiquated systems force the agency to sustain operations with manual processes. SSA's backlog approaches 5,000 computer hours per month. SSA simply does not have the resources to implement its currently planned systems modernization plan. They need to do more contracting out here. For example, HCFA which I was speaking of just a moment ago, 50 percent of all work done for the Health Care Financing Administration fails and requires a rerun. The systems are antiquated and obsolete. This is a great area where we have been able to demonstrate, I believe, that the private sector could really help the Government close that information gap and address that 50 percent of the 17,000 computers in the Federal Government that are obsolete and are no longer maintained by the original manufacturer.

Senator SYMMS. In other words, what you're suggesting is that you just lease out some of this to someone like ADP?

Mr. KENDRICK. Right. There are a number of corporations across the country that already handle SSA documentation for States across the country and they would have the capability. The take the risk of keeping the computer up to date, keeping up with the latest technology, and providing the materials on schedule. If they don't meet the contract, you fire them and get somebody else.

When the Government buys a computer, we're stuck with it. We've got it forever. So why do we invest in that if we could simply turn to a vendor to handle that service for us and make it easier for everyone?

Finally, in each of these eight areas we have really addressed the four benefits of privatization which are quite simple: Government initially produced the service because they didn't have an alternative. Now conditions have changed. We should update our operating assumptions.

The service has become operationally inefficient. If we tried to fix every inefficiency we believe that would take more time than simply going to the private sector and begin improving those operations today and do it for less money.

Many of our Government managers simply lack the authority to manage. The VA Administrator cannot put any change in place in his management structure if it affects more than 25 employees without going through the entire congressional hearing process on that change. Say he wants to change the type staffing in certain areas. That's a congressional decision. He can't make that based on what would be better for the VA people.

None of the services is really central to the mission of the Government and we already have an overly complex Government. It's tough to run a program with a $850 billion budget. Why don't we simplify it so we can understand it and put managers in charge?

So what we're really saying is we want to simplify management. Privatization would allow us to carry out these services as we are carrying them out today at less cost and more efficiently.

Thank you very much for your time in going through all this with us. If it would be all right, Mr. Chairman, we would like Mr. Yunich to give a brief summary statement, and then we would be glad to take your questions.

[The prepared statement of Mr. Kendrick follows:]

PREPARED STATEMENT OF KEITH S. KENDRICK

Mr. Chairman, thank you for this opportunity to present the findings and recommendations of the Privatization Task Force of the President's Private Sector Survey on Cost Control (PPSS).

My name is Keith S. Kendrick, Assistant to the President of Chemed Corporation, which is based in Cincinnati, Ohio. Our President and Chief Executive Officer, Mr. Edward L. Hutton, served as one of the Co-Chairmen of the Privatization Task Force. If it were not for a long-standing, prior commitment, he would be attending today.

At this time, I would like to review the recommendations of the Privatization Task Force and present several of the topic areas in detail. Following, Mr. Yunich has a brief summary statement.

The Privatization Task Force discussed eight major privatization issues as shown in the following chart.

(Chart on Following Page)

Privatization Task Force Recommendations
($ Millions)

	(1) Recommendation Area	(2) Three-Year Savings(S)/(Revenue(R)
(1)	Power Marketing Administration	$ 3,535.0 (S) 16,301.5 (R)
(2)	Motor Vehicle Fleet Management	1,260.4 (S) 200.0 (R)
(3)	VA Hospitals/Nursing Homes	1,436.5 (S)
(4)	Military Commissary Stores	2,064.0 (S) 383.2 (R)
(5)	National Space Transportation System	1,522.6 (S)
(6)	Coast Guard Services	1,259.4 (S)
(7)	Metropolitan Washington Airports	113.0 (S) 341.5 (R)
(8)	ADP-Social Security	Not Quantifiable
		$28,417.1

As shown in the previous chart, the Privatization issues are rather diverse. I would like to discuss each of the issues, the first four in more detail than the last four. The discussion is developed in three sections: (1) recommendation, (2) analysis, and (3) benefits of privatization.

Power Marketing Administrations

Five Power Marketing Administrations (PMA) exist to market the hydropower generated at all Federal multipurpose dams not under the Tennessee Valley Authority. PMAs essentially act as middlemen who sell, at wholesale prices, power that is "surplus" according to Federal requirements. The primary mission of PMAs is to market and transmit all surplus hydroelectric power and to market that power at the lowest possible rates consistent with sound business principles to recover the annual operating costs and repay the capital investment within 50 years.

Recommendation

Based on our analysis, the Task Force recommends that:

The Federal Government should begin immediately an orderly process of disengagement from participating in the commercial enterprise of electric power marketing over a five year period.

A Presidential advisory committee should be created to promote the sale of all electric generating and transmitting assets operated by the Corps of Engineers, Bureau of Reclamation, and the five PMAs.

During the period of disengagement, the Federal Government should establish a system of user fees to be paid by electric power consumers as fair market compensation for the consumption of the valuable national resources.

Any future hydroelectric power developments should be financed from non-Federal resources.

Analysis

The Task Force bases its recommendations on the following analysis:

1. Although the PMAs prepare consolidated financial statements on a cost accounting basis, none of these statements has ever warranted an unqualified opinion from independent auditors. The statements are not prepared in accordance with generally accepted accounting principles.

2. PMA prices are set based on "project repayment studies" which have allowed PMA operations to grow outside of the financial spirit of sound business principles. Generally speaking the PMAs have operated at a deficit every year since their inception. The Bonneville Power Authority unilaterally abandoned use of scheduled amortization of Federal investments--a sound business principle--in 1962. In fact, the PMAs have run a deficit of between $500 million and $1 billion each of the last five years.

3. An alternative to Federal Government ownership is a "partnership" between the Federal Government, local governments, and private industry--including investor-owned utilities. This concept has been successful in other regions of the country since the 1920s.

4. Investment and development decisions are slow at the Federal level. The State of Alaska has entered discussions with the Department of Energy on purchasing the assets of the Alaska Power Authority in order to speed the development of hydroelectric power in the state.

Benefits

Privatization of the PMAs would result in the following benefits:

- Elimination of current operating deficits through accurate pricing based on sound business principles.
- Sound pricing would promote conservation of valuable natural resources.
- Further expansion would not be subsidized or financed by the Federal Government; i.e., the U.S. taxpayers.

- The U.S. taxpayers as a whole would not be subsidizing 956 preference customers without regard to cost.
- Locally based utilities could decide what local markets need and can support.
- Three-year financial impact totals $19,836.5 million, as shown in the following chart:

Three-Year Summary of Savings
($ millions)

		(1) Year 1	(2) Year 2	(3) Year 3	(4) Total
(1)	Revenue Acceleration (Sales Proceeds)	$5,000.0	$5,000.0	$5,000.0	$15,000.0
(2)	Reduction in Annual Investment	-0-	110.0	220.0	330.0
(3)	Reduction of Interest Costs	500.0	1,050.0	1,655.0	3,205.0
(4)	User Fees on Hydropower	393.2	432.5	475.8	1,301.5
(5)	Total	$5,893.2	$6,592.5	$7,350.8	$19,836.5

Motor Vehicle Fleet Management

The Federal fleet of 436,000 vehicles is composed mainly of light trucks (63%) and sedans (22%). The two largest fleets are operated by the Department of Defense (138,000) and the United States Postal Service (118,000). The General Services Administration controls about 90,000 vehicles that comprise the Interagency Motor Pool System.

Recommendations

The overall size of the Federal fleet should be immediately reduced by 100,000 vehicles from 436,338 to 336,338. This would still leave over 100,000 vehicles in the Federal fleet above the number required based on the number of vehicle-years utilized.

By Presidential directive, OMB should immediately initiate programs to develop a fleet management information system (MIS) in all departments and agencies.

Federal fleet managers should immediately develop plans and delegate responsibility where necessary to improve the operation of the remaining 336,338 vehicles by utilizing consultants to set up MIS, or contracting out the entire MIS operation, and utilizing private sector leased vehicles and privately owned vehicles wherever cost effective.

Analysis

The Task Force formulated these recommendations based on the following analysis:

1. Effective management of the Federal vehicle fleet is constrained by the lack of accurate data on fleet costs and fleet utilization.

   - The Government does not have accurate information on fleet costs. The cost of capital is never considered in the fleet-cost calculation. In part due to the fact that they exclude cost of capital, two Federal agencies misleadingly report that their light trucks operate at an average cost of 17-18 cents per mile compared with a national rent-a-truck company which estimates its costs to be 42 cents per mile.

- The Government estimates that Federal vehicles travel less than 9,000 miles per year which is considerably below what private rental firms estimate to be the effective average utilization for mixed-fleet vehicles of 25,000 miles. The Government's 9,000 mile estimate is generally overstated.

2. The United States Department of Agriculture (USDA) has begun to implement a computerized fleet MIS called Motor Vehicle Information System (MOVIS) designed to provide a solid core of information on the USDA's vehicle fleet. This MOVIS could be adapted to develop a core MIS system for the Federal fleet.

3. Federal employees are often allowed and encouraged to use privately owned vehicles (POVs) to fulfill their transportation needs. The 1983 Government-wide reimbursement rate for a POV is 20 cents per mile as compared with estimated costs of 36 cents per mile for Government-owned vehicles.

Benefits

Privatization of the Federal motor vehicle fleet as recommended would result in the following benefits:

- Better fleet management.
- Better fleet utilization.
- Cost-effective fleet operation.
- Total savings of $1,460.4 million over three years is shown in the following table.

(Table Follows)

Three Years Summary of Savings
($ millions)

		(1) Year 1	(2) Year 2	(3) Year 3	(4) Total
(1)	Sell 100,000 units of the fleet	$200.0	$ 0.0	$ 0.0	$ 200.0
(2)	Interest savings on above sale	20.0	22.0	24.2	66.2
(3)	Reduction of fleet operating costs	240.0	264.0	290.4	794.4
(4)	Other management improvements, including MIS, POVs and private sector rental units	60.0	132.0	217.8	409.8
(5)	Cost of MIS	(10.0)	-	-	(10.0)
(6)	Totals	$510.0	$418.0	$532.4	$1,460.4

VA Hospitals/Nursing Homes

The VA hospital system was established in 1921 to care for the medical needs of veterans with service-connected disabilities because alternative health care facilities were not available. The World Wars placed a tremendous burden on the private hospital system that could not be met without substantial Federal involvement.

The situation in 1984 is vastly different. Veterans have improved access to a wide array of services and non-federal facilities.

Recommendations

The Privatization Task Force recommends the following based on our review:

> The VA should phase out construction of hospitals. VA should contract with hospital companies to construct facilities according to performance specifications.
>
> VA should not construct any nursing homes not already under contract. Instead, VA should convert under-utilized acute care beds to nursing beds and contract out for any additional demand.
>
> VA should contract for hospital management services at three hospitals, under a performance contract, on a trial basis.
>
> Subject VA facilities to the same certificate of need process required of all other health care facilities.

Analysis

The Task Force makes these recommendations based on the following analysis:

1. Many facilities are obsolete, and replacement construction cost for VA facilities ranges from 30% to 69% higher than private sector hospitals of the same or similar size.

   The VA's average cost for nursing home construction is nearly four times that of a major private sector firm.

2. The VA Construction office staff totals 800 versus 50 in a comparable private sector firm. Consequently, it takes the VA seven years to plan and complete a hospital as compared with two years in the private sector.

3. The VA cost per episode of acute inpatient care is 70% and 48% higher for an average episode of medical and surgical care, respectively, than community hospitals affiliated with medical schools. In a comprehensive services comparison of long-term and short-term treatment, VA costs averaged 15.5% higher than comparable community hospital costs.

4. The current budgetary system rewards VA hospitals for increasing admissions and extending the length of stay in contrast to the trend of shortening length of stay in private sector hospitals.

5. VA medical supply inventories are higher than comparable private sector levels.

6. VA purchases 42% of its supplies at the local level in contrast with the private sector practice of purchasing 75% to 85% through national contracts at a 20% savings.

7. VA does not have an adequate management information system to support its planning functions. For example, the current forecasting system is based on historical extrapolation and an assumption of no major technological changes.

Benefits

The benefits to be gained from our recommendations to privatize VA hospitals include:

- o Higher quality medical care for veterans.
  - Improved construction efficiency. Building facilities in less time at less cost allows quicker replacement of obsolete facilities.
  - Improved operating efficiency. Medical experts concur that excessive stays and improper type of care (assignment of a nursing patient to an acute care bed) is not in the best interest of patients.
  - Improved planning capability. Use of Diagnosis-Related Groups based resource allocation and certificate of need process would help to assure proper care for veterans in the years to come.
- o Government would avoid overbuilding and overpaying for medical care.
- o Savings over three years would reach $1,436.5 million, as detailed in the following table.

(Table Follows)

Three-Year Summary of Savings
($ millions)

		(1)	(2)	(3)	(4)
		Year 1	Year 2	Year 3	3-year Savings
(1)	Privatizing Hospital Beds	$167.6	$181.6	$204.0	$ 553.2
	Privatizing Nursing Home Beds:				
(2)	Construction	94.8	104.3	114.7	313.8
(3)	Operating	17.0	26.0	35.0	78.0
(4)	Private-Sector Contract Management	28.8	31.7	34.8	95.3
(5)	Sharing of facilities/ equipment	58.0	127.6	210.6	396.2
		$366.2	$471.2	$599.1	$1,436.5

Military Commissaries

Commissary stores are provided on military bases in the United States and overseas to military and retired military personnel. These stores, which generally resemble retail grocery outlets, were established in the 1800s to provide food items to military personnel stationed in remote locations. Today they exist in such remote locations as San Francisco (five stores), San Diego (4), San Antonio (5), and Washington, D.C. (6).

Recommendation

The Task Force, based on its analysis of the commissary system, recommends the following:

> The Secretary of Defense should require immediate comprehensive Bureau of Labor Statistics (BLS) market basket surveys of all commissary stores to establish real savings levels. Comparisons should be to comparable warehouse food stores.
>
> Commissary stores should be privatized via a competitive bidding process using the results of the BLS surveys to analyze bids.

Analysis

The Task Force developed these recommendations from the following analysis:

1. The commissary system is highly fragmented and decentralized, and has duplicative management. DoD operates four separate grocery systems.
2. Although originally intended to serve personnel in remote locations, in 1982, 62% of the stores were justified because commercial prices were declared to be "unreasonable." Another 15% were justified because commercial stores in such places as Oakland, California, and Louisville, Kentucky, were declared to have "inadequate" product selection.

3. The Triennial Survey to verify "savings" to military shoppers overstates the savings. The survey is biased in its methodology, the products surveyed, and the savings calculation. The savings are not the 25% claimed, but rather 15% less than private sector supermarket prices. Pricing in commissaries and wholesale food warehouses are generally comparable.

4. Commissaries are not comparable to supermarkets as claimed; rather they are similar to wholesale food warehouse stores. The Task Force reaches this conclusion based on product mix, limited products offered, limited store hours, and savings provided as compared with supermarkets.

5. Commissaries have not kept up with industry standards in the areas of hours of operation, inventory turns, products offered, and technological advancements such as electronic scanning.

6. Indirect costs of the system are estimated to be 42.4% of appropriated funds or $170.5 million for FY1983.

Benefits

Privatization of commissary stores would:

- maintain the savings to customers;
- offer greater product selection;
- extend store hours, enhancing convenience;
- allow the private sector to finance the inventories;
- allow the private sector to provide needed store improvements;
- simplify the management requirements for DoD; and
- save taxpayers $2.4 billion over three years.

A summary of the savings estimate follows:

(Table Follows)

Three-Year Summary of Savings
($ millions)

		(1) Year 1	(2) Year 2	(3) Year 3	(4) Three-Year Total
(1)	Savings (net of implementation costs) (a)	$597.2	$656.9	$722.6	$1,976.7
(2)	Possible rent income	36.0	39.6	43.6	119.2
(3)	Revenue Acceleration (Sales Proceeds)	264.0	0.0	0.0	264.0
(4)	Interest Reduction	26.4	29.0	31.9	87.3
(5)	Totals	$923.6	$725.5	$798.1	$2,447.2

(a) Appropriated Funds, Indirect Costs, Inventory Carrying Costs less Implementation Costs.

National Space Transportation System

The National Space Transportation System (NSTS) provides space launching services through expendable (one-time) launching vehicles (ELVs) and a fleet of four space shuttles. The NSTS is operated by the National Aeronautics and Space Administration (NASA).

Recommendations

The President and Congress should develop and enact legislation to allow private sector participation in the NSTS. This should include a provision for the private sector to purchase and operate a fifth space shuttle, and future shuttles, as well as the ELV systems.

The U.S. Government should initiate government/industry cooperative agreements offering incentives with private sector firms investing in space transportation systems.

Analysis

The Task Force developed these recommendations based on the following analysis:

1. The U.S., in the past 25 years, has maintained a virtual monopoly on space launch services. Recently, Europe and Japan, aided by cooperative government/industry arrangements, have developed space launch activities. The U.S. is now encountering growing foreign commercial competition in space transportation services.

2. Private sector proposals for space transportation systems, including two proposals for a commercially operated fifth space shuttle, have been submitted to NASA. The private sector wants to invest in and to produce space transportation services.

3. Government and industry experts agree that a need exists for additional shuttles, as the currently funded four-shuttle fleet will not be able to meet the commercial demand through the 1980s. A fifth space shuttle is needed solely for the private sector.

Moreover, ELVs, which were to be phased out by the Federal Government, have been determined to be an important component of the NSTS, offering services complementary to the shuttle.

4. It is inevitable that, at some point in the future, the Federal Government must make the long-term commitment of ensuring the viability of the shuttle program and ELV systems. Under current arrangements Federal funding would then have to be provided for a fifth shuttle, as well as future additional shuttles, and for the ELV systems. However, such future government funding would not have to be provided if the private sector is allowed to invest in NSTS.

Benefits

Privatization of the National Space Transportation System would result in the following benefits:

- Ensured viability of the NSTS.
- Increase in space transportation capacity.
- Avoidance of future Government funding for a fifth shuttle, as well as future additional shuttles, and for the ELV systems.
- Assuming a fifth shuttle is procured at an estimated cost of $2.3 billion, approximately $460 million in annual cost avoidances could be realized over the five-year procurement period, or $1,522.6 million over three years.

Three Year Summary of Savings
($ millions)

	(1) Year 1	(2) Year 2	(3) Year 3	(4) Total
Cost Avoidances	$460.0	$506.0	$556.6	$1,522.6

Coast Guard Services

The Coast Guard's mission has grown beyond the original intent of national defense. The Task Force investigated the transfer to the private sector of Coast Guard services in the areas of search and rescue (SAR) (non-life-threatening), short-range aids to navigation (SRAN), and commercial vessel safety (CVS).

Recommendations

The Coast Guard should utilize the private sector towing industry in its SAR operations, specifically the non-life-threatening incidents.

In its SRAN program, the Coast Guard should contract out its heavy-lift routine maintenance work for marine and inland buoy tending, before committing to major capital expenditures to upgrade buoy tenders, and should contract out its program for quick response to navigational aid failures.

The Coast Guard should continue to use the private sector to provide CVS services of vessel inspection and admeasurement, and should investigate the feasibility of expanding privatization to other CVS services.

Analysis

The Task Force based its recommendations for selected Coast Guard Services on the following analysis:

1. The Coast Guard's SAR program from 1970 to 1979 experienced a 55% growth to 70,000 calls for assistance per year, yet a majority of calls (80% at two Coast Guard stations) are for non-emergency, non-life-threatening situations. The private sector towing industry, which is extensive and sufficiently equipped to handle a large number of non-life-threatening SAR functions, can perform the same function as the Coast Guard, at a cost which is one-twelfth of the Coast Guard rate.

2. The Coast Guard's offshore SRAN program underutilizes its offshore buoy tenders (10-16% utilization range) and owns aging equipment (30-year average life for offshore buoy tenders). Studies have supported that private sector operators are significantly more cost-effective than the Coast Guard (more than 40% cost savings) in heavy-lift routine maintenance work. A private sector pilot program proposal for maintenance of short-range aids estimated 24% cost savings and a three times greater utilization rate compared with the Coast Guard.

3. The Coast Guard has begun to use private sector firms to provide selected CVS services such as vessel inspection and admeasurement. These CVS services could be completely privatized.

Benefits

Privatization of selected Coast Guard Services would result in the following benefits:

- o Return of Coast Guard to its national defense-related missions.
- o Cost effective provision by the private sector of non-high-priority Coast Guard activities.
- o Three-year total savings of $1,259.4 million as detailed in the savings summary chart below:

(Table Follows)

Three Year Summary of Savings
($ million)

		(1) Year 1	(2) Year 2	(3) Year 3	(4) Total
(1)	SAR	$196.7	$216.4	$238.0	$ 651.1
(2)	SRAN	144.3	158.7	174.6	477.6
(3)	CVS Inspection & Admeasurement	39.5	43.4	47.8	130.7
(4)	Totals	$380.5	$418.5	$460.4	$1,259.4

Metropolitan Washington Airports

The Metropolitan Washington Airports (MWA) are the Washington National Airport and Dulles International Airport, which are the only two commercial airports in the U.S. owned and operated by the Federal Government.

Recommendations

> The authority of metropolitan Washington's two Federally-owned airports should be sold to a self-sustaining and independent airport authority (such as those in New York and New Jersey) consisting of government representatives from the Commonwealth of Virginia, the District of Columbia, and the State of Maryland (if Maryland so desires). The airports should be offered to the newly created authority at the fair market value as determined by an independent appraisal.

Analysis

The recommendations related to the MWA were developed from the following analysis:

1. The divestiture of Federal Government ownership has been studied at one time or another by five Administrations, the Office of Management and Budget, Department of Transportation, and the Federal Aviation Administration (FAA). This highlights the conflict between the FAA's role of owner-operator of the MWA and provider of airport services and its larger, Federal role of ensuring air safety and efficiency and fostering civil aeronautics and air commerce. The FAA's conflicting roles of supplier and regulator have resulted in a confusion of agency mission goals.

2. Under the present MWA structure, funds for capital improvements, large and small, must go through the Federal budgetary process and be authorized and appropriated annually. Also, unlike other major U.S. airports, local community involvement in the management of the MWA is severely limited due to Federal ownership. The existing ownership structure of the MWA, which prohibits not only a stable financial base, but also local involvement, adversely affects long-term planning for development of the airports for the benefit of the community.

3. A FAA study concluded that the MWA (and the Baltimore-Washington International Airport)could best be managed by a corporation which included aviation and community interests on the Board of Directors. It also found that joint operation of the airports would substantially increase their ability to finance future improvements and would lead to a better balance of operations among the airports. Ownership and operation of the MWA by a local authority could provide better service to the air traveler.

Benefits

Privatization of the MWA would produce the following benefits:

- Return of FAA to its primary goal of ensuring air safety and efficiency and fostering civil aeronautics and air commerce.
- Provision of better service to the air traveler.
- Provision of long-range planning and a stable financial base.
- Three-year savings of $454.5 million as detailed in the summary chart below:

Three Year Summary of Savings
($ millions)

	(1)	(2)	(3)	(4)
	Year 1	Year 2	Year 3	Total
(1) Revenue Acceleration (Sales Proceeds)	$341.5	$ 0.0	$ 0.0	$341.5
(2) Interest Reduction	34.1	37.6	41.3	113.0
(3) Totals	$375.6	$ 37.6	$ 41.3	$454.5

ADP-Social Security

During the 1960s, the Federal Government was the acknowledged leader in using state-of-the-art computer hardware and software. From the mid-1960s, however, the Government fell farther and farther behind the private sector. Today, approximately 50% of the Government's 17,000 computers are so old that they are no longer supported by the manufacturer and must be maintained by specially trained Federal personnel. One of the areas which best exemplifies the degree of ADP problems in the processing of information and claims is the Social Security Administration.

Recommendation

Based on our analysis the Task Force recommends the following:

> The Social Security Administration (SSA) should aggressively use private sector ADP resources to eliminate the current data processing backlog and decrease the error rates in such critical areas as benefits payments.
>
> The SSA should continue to use private sector experts to aid in the further planning and implementation of the department's Systems Modernization Plan (SMP).
>
> The SSA should transfer the Health Care Financing Administration's (HCFA) data processing responsibility to the Department of Health and Human Services (HHS).

Analysis

The recommendations of the Task Force were developed from the following analysis:

1. Despite automated support, many of the SSA systems which process claims, benefits, and payroll are slow, error-plagued, and excessively costly.

2. Antiquated systems now in place force agencies to sustain their operations with manual processes and defer action on many critical projects.

3. The SSA's existing equipment and manpower levels are physically unable to meet many of their most basic responsibilities. The Department's gross workload, including known backlogs, approaches 5,000 computer hours per month. The maximum capacity of SSA's computers is only 3,000 hours, and the SSA's staff can only support 2,000 hours of computer operations per month.

4. SSA does not have the resources to implement effectively its SMP program in a timely manner. SMP is an ambitious, complex plan. Diverse ADP needs have to not only be met but also integrated. SSA currently uses outside consultants to establish direction, provide technical expertise, and supplement SSA staff resources.

- SSA currently handles the bulk of HCFA's data processing even though HCFA was separated from SSA in 1977. HCFA is now under the authority of HHS, but approximately 85% of its telecommunications volume is still being performed by outmoded and highly inefficient SSA systems. Ironically, this service is not even working well, as approximately 50 percent of all HCFA work performed by the SSA data center fails and requires a rerun.

Benefits

Our recommendations in this area would result in the following benefits:

- SSA benefits from improved, more cost-effective administrative procedures. The department will have better information, more quickly, and at lower cost. Payments and costs can be better controlled.

- Beneficiaries of SSA programs will enjoy faster, more accurate service.

- Taxpayers benefit from a more efficiently, less expensively run operation. Although the Privatization Task Force did not quantify savings from its recommendations on this issue, other Task Forces which concentrated on ADP have calculated significant savings from similar recommendations.

Summary

In these eight examples, the four common themes of privatization are present:

1. The Government initially produced the service because no other significant source existed to produce it.

   Today the situation is different. Government can provide the service without having to produce it internally.

2. The services have become operationally inefficient as compared with private sector standards.

3. Government managers are hampered in their efforts to improve the operations because they lack the authority to manage.

4. None of the services is central to the mission of the Government; therefore, they do not receive the attention and investment needed to best serve the recipients of the service.

In the final analysis, privatization of these services would simplify the overall management of Government and save time, talent, and limited financial resources. This more efficient utilization of resources would leave the Government in a more flexible position to meet the needs of a changing environment.

Thank you for this opportunity to present to you the Privatization Task Force Report.

Unless you wish to proceed differently, Mr. Chairman, Mr. Yunich has a short summary statement which we would like to follow by answering any questions you may elect to raise.

Senator SYMMS. Thank you very much for an excellent presentation, Mr. Kendrick. That was just outstanding and I second what I said earlier I'm only sorry that we don't have more Members of Congress here, because your presentations thus far have made the point that I've said over and over again, that if the Government would just take care of the things that the Constitution calls for it to take care of, maybe we could do a better job with those functions. The way it is, we sometimes tend to not concentrate with as much attention as should be given to the defense of this country, to the foreign policy of the country from a national perspective because we're bogged down with operations that Government should not have to concern itself with. Like you say, it would certainly simplify the problems that Members of Congress have. The Congress is, more and more every year, losing people who are reaching their prime ability. They often leave out of frustration because they are called on to focus on a different subject every 30 seconds for a 12-hour day. What happens around here is that we tend to know a lot of things about nothing and little about any one particular issue.

You certainly made a good presentation, and make a lot of sense.

Mr. KENDRICK. Thank you, Mr. Chairman.

Senator SYMMS. Mr. Yunich, we will hear from you and then I have some questions.

STATEMENT OF DAVID L. YUNICH, RETIRED VICE CHAIRMAN, R.H. MACY & CO., INC.

Mr. YUNICH. Thank you, Mr. Chairman.

I, too, am very appreciative of this opportunity to discuss the matters of the privatization task force with your committee and I just want to take a few minutes to zero in on one of the most controversial aspects of our report which happens to be my primary area of expertise.

My name is David Yunich. I am retired vice chairman of R.H. Macy & Co. and PPSS is not my first exposure to government activity. Before PPSS, in a pro bono public capacity, I served as chairman of the Metropolitan Transit Authority of the State of New York for 3 years, trying to infuse into that authority some of the very type of business principles that we are talking about today, and the frustrations to which you refer, Mr. Chairman, I can well understand.

In my years in retailing and government service, I have seen few concepts that hold as great a potential for cost control as privatization. One of the reasons I say this is because it's not an academic theory. It is a proven and productive cost-effective control method for cities and towns across the country, not to mention Great Britain where dramatic headway is being made with privatization today.

It's not an anti-Government program. Privatization should be viewed as a way for optimizing and utilizing the limited resources. Privatization is even used in the private sector. For example, at W.R. Grace, where I'm a director, we have over 82,000 employees who must eat lunch every day in plants around the country. And while the Grace Co. is in the restaurant business itself, they are not in the business of feeding a large number of people in a very short period of time on a very limited budget. So they contract out the cafeterias to other companies and that is in the best interest of Grace because those other companies know that business far better.

Several of the companies I'm involved with as a director require a great deal of printing, such as promotional material, company procedure manuals, and annual reports and so forth. But they don't go into printing business to satisfy those needs; they contract with the private sector specialist to fill that requirement.

These examples of privatization in the corporate sector are equivalent to privatization opportunities in the Federal Government. Successful businesses understand what they can do best and what others can do better. Invariably, they contract out functions or services to specialists who can do them better, and for less money. Government should do the same thing.

This point leads me to what I believe is one of the most misunderstood PPSS issues—the commissaries. With a potential saving to the taxpayer of $2.4 billion, without any sacrifice by the user. I feel qualified to speak on this issue because I spent 38 years with R.H. Macy & Co. running a multibillion dollar chain of department stores across this country with a record that has commanded pretty widespread interest by the investment community because we must have been doing something right.

So let me address some of the points that have been misrepresented in recent public discussions and other hearings.

It's been claimed that the PPSS's recommendations would destroy consistent nationwide pricing in the commissaries. We found no evidence of consistent pricing in the military commissary network. In fact, we found some commissaries were able to take advantage of a local deal that was not available throughout the system because they, in effect, were not buying nationally the way an efficient organization would be doing by making national contracts.

A privatization network of commissaries would more likely negotiate for entire groups, certainly on a regional basis, if not nationally.

In connection with consistent pricing, what is never mentioned but is of equal importance, is the inconsistent quality standards of the commissary stores. Fort Belvoir in Virginia has a new store but it equates to private sector standards of the 1970's. Cameron Station, just a few miles north, is just an old warehouse. In recent testimony, Brig. Gen. James S. Hayes reported that it will take 30 years at the present rate of construction to bring existing stores up to current standards without consideration of new or changing requirements. In the private sector one sees facelifts on hundreds of stores in a single year under one management in order to keep pace with a competitive environment. As a retailer, I am concerned that the commissary system might collapse of its own weight. As a taxpayer, I am concerned that I will have to pay even more for it.

It was claimed that wholesale food warehouse stores which currently are springing up all over this Nation in the private sector and which were suggested a long, long time ago, do not have representative assortments for our military shoppers. Warehouse food store, as typified by the Cub store in Chicago as just one example, has 7,000 to 9,000 SKU's or product lines, in more layman's language, versus only 6,000 in the commissaries. The selection is almost 50 percent more in that type of store.

It was claimed that our task force wants to take supermarkets away from military personnel and replace them with warehouse stores. The fact is that military personnel really do not have supermarkets by private sector standards. They have minimarket stores. Commissaries have very limited hours with limited products. Moreover, a majority of the Army commissary stores are over 25 years old. Privatized operations could address those problems and move very, very quickly.

It has been claimed that we want to give all 238 commissaries to 1 of the big private sector food chain. I should point out, Mr. Chairman, that this aspect of the PPSS received more public response than all the public response put together with respect to what we were proposing for military commissary privatization. Well, nothing could be further from the truth. It's not the intention of PPSS to give all the 238 commissaries to 1 big private sector food chain. Our plan would be to put each of the stores or groups of stores up for competitive bids. The point is that we want to establish a competitive marketplace for the commissaries so that our military personnel can reap the benefits from competition.

The DOD has claimed that it would cost the Federal Government $350 million more to compensate employees for the loss of commissary stores than it costs to operate the stores. When we looked into that we could find no evidence from the U.S. Department of Agriculture to support the basis for that calculation. Using USDA statistics, we found a savings of $66 million per annum by closing the stores and adjusting military pay.

The indisputable facts are that privatization of commissary stores, given the same rent opportunity and the opportunity to manage the cash flow would maintain the savings benefits to present users where there is 5-percent surcharge over and above the cost of the personnel, over and above the cost of the rent and so forth. Well, warehouse stores in America today are paying rent, paying employees, and paying advertising, and other things like pensions and so forth, and they are able to operate with an 8-percent surcharge or markup as it's more commonly known. So there's no doubt in my mind that the prices could be more advantageous and the selection could be far greater and there would be quality control.

If you were to walk into a commissary, Mr. Chairman, and look at the perishable goods, the baked goods, and the produce, you would see, as the wives of the military get turned away because they are selling day-old baked goods which no self-respecting supermarket could get away with; they are selling produce that is not fresh. They never have to mark down the produce. They just send it back to the warehouse and then it becomes a cost of some other department—the Defense Department. I mean, just to mention some of the kinds of things—I won't say abuses—but that's what the system provides for.

Given the same opportunity to the private sector, they would finance the inventories, they would make the needed store improvements for the commissaries to reach the private sector quality standards, and they would reduce the cost of operating the commissaries by $2.4 billion over 3 years.

Grocery retailing in the private sector is one of the most dynamic industries in our economy and it is the largest retailing segment, and I see no reason why our recommendation shouldn't be given the highest priority in order to harness that power for the benefit of the military. Our military deserves better than they are getting.

Finally, as my colleagues, Mr. Pyne and Mr. Kendrick, have stated earlier, we urge that a Privatization Office in the proposed Office of Federal Management be established. A Privatization Office as such could study new ideas which are emerging every day and need to be researched. Just recently I read about a new company called the World Mail Center, which is a private sector post office that a young entrepreneur has established in four locations across the country. His new company is already making money and providing better service, so he must be doing something right. I'm sure he will have competitors very soon as well.

Senator SYMMS. Or he will have lawyers from the Postal Service say he's breaking the antitrust laws somehow, and they do it in reverse. They go after private businessmen for monopolies and they go after people who try to compete with the monopoly Government has. They use the same lawyers out of the Antitrust Division in the Justice Department.

Mr. YUNICH. I see. Notwithstanding the merits of what he's trying to do?

Senator SYMMS. That's right. I'm not being critical only of the Justice Department.

Mr. YUNICH. Well, in his case, he does rent office space, pays the utilities, compensates the employees, calculates the mailing costs, and allows the U.S. Postal Service to make a profit on the stamps without incurring the normal overhead expenses of running a post office.

Senator SYMMS. How does he do that now? He actually stamps his mail?

Mr. YUNICH. I don't know whether he actually stamps his mail.

Mr. KENDRICK. What he does in this case in fact is that he sort of has a supermarket for postal services and he purchases the stamps—well, actually, the U.S. Postal Service provides him with the stamps and he reimburses them with the income he takes in. He represents the express mail. He represents Federal Express, UPS—there's a whole variety—so the consumer can come in and say, "Here's a package and I want it to go the cheapest way." He has a computer that will calculate the cheapest way to get it there in a reasonable period of time. Or if you want it to go fastest, he'll find the fastest. He will find out who has the next pickup and he gets it out and he initially was charging a small fee to consumers who used kit to find that service, to stop one place whereas before they had to go to all these different locations.

But instead, he generated such volume in his first few stores that even the Postal Service, along with Federal Express and Emory Worldwide and others said: "We'll pay you a small fee for representing us and we won't have to put an office in this location and pay for it ourselves. We'll pay for every piece you put through here." That's how he's doing it.

Senator SYMMS. That's outstanding.

Mr. KENDRICK. And he has cleared it with the Justice Department, by the way.

Senator SYMMS. Well, I can see that if he's doing it that way that he's not challenging the first class statute.

Mr. KENDRICK. Right, and he's not delivering the mail. He sells stamps so they don't have to sit there—say, USPS, for instance, to put the stamp across the desk and take the money. He's doing that function. He bags it and sorts it and the USPC picks it up.

Senator SYMMS. That's fascinating.

Mr. YUNICH. And it's also stimulated the express mail service of the U.S. Postal Service. I mean, in effect, Federal Express and other people such as United Parcel Service have gotten in to this business and private users are finding that to be a far more effective way to send things that used to be sent by the mail. At least that stimulated some response by the U.S. Postal Service for their express mail service. Again, the point is the element of competition.

Just to conclude, privatization is not a one-time effort. It is not intended to do away with needed services. To reach its fullest potential, there should be an ongoing review process just as businesses in the private sector review their costs and strategies every year, always looking for a better way to provide needed functions and services.

Mr. Chairman, we are appreciative of this opportunity and to hope this will begin a long association with your committee. As Mr. Pyne said, we have invested much time and effort and generally hope that our recommendations to establish privatization as a standard option for Government policy implementation will be given serious consideration. We certainly intend to do everything we can to further it.

[The prepared statement of Mr. Yunich follows:]

Prepared Statement of David L. Yunich

Mr. Chairman, I am most appreciative of this opportunity to discuss the Privatization Task Force Report of the President's Private Sector Survey on Cost Control (PPSS).

My name is David L. Yunich, Retired Vice Chairman of R. H. Macy and Company, Inc. PPSS is not my first involvement in government activities. Before PPSS, I served as Chairman of the Metropolitan Transit Authority in New York for 3 years.

In my years in retailing and government service, I have seen few concepts that hold as great a potential for cost control as privatization. One of the reasons I say this is because it is not an academic theory. It is a proven and productive cost-control weapon for cities and towns across the country, not to mention Great Britain where dramatic headway is being made with privatization.

Privatization is not an anti-government program; rather it is a program for optimizing the utilization of limited resources. Privatization is used by just about every successful company I know. For example,

- At W. R. Grace, where I am a director, we have over 82,000 employees who must eat lunch every day. Although we are in the restaurant business, we are not in the business of feeding a large number of people in a very short period of time on a very limited budget. We contract out our cafeterias to a company that <u>is</u> in that business and knows it well.

- Several of the businesses I have been involved with require a great deal of printing such as publicity documents, company procedure manuals, and annual reports. But we are not in the printing business, so we contract with a private sector specialist.

These examples of "privatization" at the corporate level are the same thing as privatization in the Federal Government. Successful businesses understand what their business mission is and what they do best. What they do not do best, they contract out or privatize to specialists who can do it best, and for less money. Government should do the same.

This point leads me to what I believe to be one of the most misunderstood PPSS issues--commissaries. I can speak on this issue because I have been involved in the retailing industry for a number of years. Let me address the initial points which have been misrepresented in recent public discussions.

1. It was claimed that our recommendations would destroy consistent nation-wide pricing in the commissaries. We found no evidence of consistent pricing. In fact, we found local commissaries taking advantage of local deal prices and privatized commissaries would do the same.

   In connection with consistent pricing, what is never mentioned, but is of equal importance, is the inconsistent quality standards of the commissary stores. Ft. Belvoir, Virginia has a new store which is equal to private sector standards of the 1970s. Cameron Station, just a few miles north, is an old warehouse. In recent testimony, Brigadier General James S. Hayes reported that it will take 30 years at the present rate of construction to bring existing stores up to current standards without consideration of new or changing requirements. In the private sector we do a face lift on hundreds of stores in a single year. As a retailer, I am concerned that the commissary system might collapse of its own weight. As a taxpayer, I am concerned that I will have to pay for it.

2. It was claimed that wholesale food warehouse stores do not have representative assortments for our military shoppers. Warehouse food stores, as typified by Cub in Chicago, have 7,000 to 9,000 product lines versus only 6,000 in commissaries.

3. It was claimed that our Task Force wants to take supermarkets away from military personnel and replace it with warehouse stores. The fact is that military personnel do not have supermarkets by private sector standards. They have mini-market stores. Commissaries operate limited hours with limited products. Moreover, a majority of the Army commissary stores are over 25 years old. Privatized operations could address these problems.

4. It has been claimed that we want to give all 238 commissaries to one of the big private sector food chains. Nothing could be further from the truth. Our plan is to put each of the stores up for competitive bids. We want to establish a competitive marketplace for the commissaries so that our military personnel can reap the benefits of competition.

5. DoD has claimed that it would cost the Federal Government $350.0 million more to compensate employees for the loss of commissary stores than it costs to operate the stores. We can find no evidence from the U.S. Department of Agriculture (USDA) to support the basis for the calculation. Using USDA statistics, we found a savings of $66.0 million per annum by closing the stores and adjusting military pay.

The indisputable facts are that privatization of commissary stores, given the same rent and the opportunity to manage the cash flow, would:

- maintain the savings benefits to present users;
- offer greater product selection;
- extend store hours, enhancing convenience;
- allow the private sector to finance the inventories and the needed store improvements for commissaries to reach private sector quality standards; and
- reduce the cost of operating commissaries to the American taxpayers by $2.4 billion over three years.

Grocery retailing in the private sector is one of the most dynamic industries in our economy and it is the largest retailing segment. I know that the pressure of a competitive marketplace would improve the commissary system. Our military deserves better than they are getting. Our recommendation should be given the highest priority.

The Need for a Structure and a Process

There are literally dozens of other privatization opportunities such as commissaries. As my colleague Mr. Pyne stated earlier, we must have a Privatization Office in the proposed Office of Federal Management to study the new ideas which are emerging every day. Just recently I read about a new company called the World Mail Center which is a private post office that a young entrepreneur has established in four locations across the country. His new company is making money and I am sure he will soon have competitors. This new business opens an entirely new option for the replacement and/or expansion of existing U.S. Post Offices. His firm rents the office space, pays the utilities, compensates the employees, calculates the mailing costs, and allows the United States Postal Service to make a profit on the stamps without incurring the normal overhead expenses. It is an exciting new privatization option, but our Task Force is no longer in existence to champion this idea. So you see, we need a small office in the Federal Government to analyze and promote continually these new options if the country is going to receive the greatest benefits for its tax dollars.

To conclude, privatization is not a one-time effort. To reach its fullest potential, it must be an ongoing review process just as businesses review their budgets and strategies every year, always looking for a better way.

Privatization Benefits

In the final analysis, privatization provides a competitive marketplace to promote operational efficiency and it allows Government to:

- better utilize its scarce resources;
- fulfill its responsibilities at a cost savings;
- concentrate Government talents on its areas of strength;
- encourage real public ownership; and
- allow managers the freedom to manage, to reap the benefits of success, and carry the responsibility of failure.

Mr. Chairman, we are appreciative of this opportunity to begin what we hope will be a long association with this Committee. Having invested the time and effort, we genuinely hope that our recommendation to establish privatization as a standard implementation option of Government policy will be given serious consideration. We intend to keep striving for implementation of every one of our recommendations.

We would be most pleased to answer your questions at this time.

Senator SYMMS. I want to thank the three of you for excellent presentations here this morning and thank your colleagues who are not here who worked on the task force on privatization for an absolutely outstanding job.

I have a series of questions I want to pursue and to wrap up the first two hearings we've had, but first I think we will take a 5-minute recess and then reconvene at 11:20.

[A short recess was taken]

Senator SYMMS. The committee will resume its hearing and I would say again that I certainly appreciate the time and effort that you gentlemen have put into this.

I might just say that in addition to some of the things you mentioned this morning, I notice that you made some other recommendations. One was to replace 7,000 post offices with alternative services, including contractor operated post offices, and to increase contract stations for post offices.

The reason I noted that—and I think this is one of the problems we have with this work is the challenge of educating the public on this matter. In January of 1973, when I was sworn into the House, I dropped in my first bill that day, which was to repeal the first class statute that the U.S. Postal Service enjoys. It has taken almost 12 years for me to get back to where I can have a good relationship with the postal workers in my state because, automatically, some people fear that somehow someone is trying to take away their job or destroy present services, which really isn't the case. It's just a principle of freedom.

We even had a little sticker we used to stick on the mail that said, "Have a private post office and raise the postal workers salaries," but that still didn't carry too much weight.

Your commissary presentation was outstanding. My administrative assistant told me during the recess—he's a former Marine and still active duty Reservist Marine Officer—that what you say about commissaries in this area is certainly true. He's been to many of them when he was originally stationed in Washington when he was on active duty, and there is nothing that's such a great benefit to the military personnel because they can go to any of the stores like Basics or Giants and have the same opportunities and even better—and better managed stores. So I think that's an excellent presentation and it may be a good place for some of these examples like this to be made.

But I think one of the things that we need from the Commission and from your privatization task force from the Grace Commission is to be sure that somehow you can get the message out to the right people in the military so that you don't have an automatic rejection out of hand. You don't get much support from the establishment media on anything that is supportive of private enterprise and private ownership because there has been a built-in bias in the United States, over the years, of our educational system being a Government monopoly. And I think that the Government monopoly in education certainly has contributed to an antiprivate property mentality in the country. The newspapers in my State, for example, give the post office a bad time where they compete with the post office rather unfairly. You'll notice that most journalists in newspaper will automatically disparage about "junk mail." A newspaperman selling newspapers and selling newspaper advertisements and inserts is in competition for his advertisement. And it just so happens that the U.S. Postal Service makes a profit on what the newspapers call junk mail. It's not junk mail. As a matter of fact, in many cases it's very informative mail for consumers. It's a good way for businesses to reach a constituency that they want to provide services for. It's very informational for the people who receive this mail. Yet, in the news media, because they compete with the newspapers, they will always hammer the post office on this. I suppose you've run into this, but you will find that you won't get a lot of support from the media. We have to go out and do a sales job.

So I would urge if you have business associates who own news outlets and news agencies that we need to do an educational job in this country to the journalists of the country so there's not such an antiprivate property bias on the part of the news media in general.

I personally believe, thanks in large part to the election of President Reagan, this is changing. Because there is a free press and there is competition and with offset duplication printing methods and more ways to reach more people the news media will have to compete; yet their constituents also grow in confidence paying no attention to what the local paper says if that paper is always out of step with Main Street America.

In the 1980 election, it was always amazing to me how, if you had just watched just the American news media and lived out of the country, you might never have had any idea that Ronald Reagan was going to be elected President. If you went anywhere outside of this 10-mile square area of Washington, DC, it was very obvious that he was going to win by a landslide.

But it's just interesting to see that kind of perspective. Now it's starting to change and there is some competition, but I think we have to reach people from an educational standpoint to get these ideas out where they will do some good.

For example, you recommend that the Government establish an office of Federal management to develop procedures that will identify and facilitate privatization. I think that's an excellent idea. I would hope that Mr. Grace would be able to get to the President on that and I would certainly offer my assistance to get that done. But I would like to point out that we had something like this for the review and sale of surplus assets and it really didn't work out very well for a lot of reasons. Maybe it was the first try and a lot of things don't always go on the first try, but I don't think that the groundwork was laid first.

For example, in my State, two of my colleagues who I have the greatest respect and admiration for, both finally came out in opposition to some of the sale proposals of the Government lands in my State. These are two of the most prolimited Government people in the entire Congress.

So how do you propose, if we set this up, that we get privatization off to a good start without having it shot down before it gets started? Who can assist the President in this effort? How do you perceive this thing working without being shot out of the water before it even gets started?

Do any one of you want to comment on that?

Mr. PYNE. Well, I think the first step would be to consult with the President personally, and I would recommend that Mr. Grace do that with this very recommendation in mind and, if possible, get the administration——

Senator SYMMS. I would recommend that he take one of you two with him when he goes because two can always have a better chance of arguing something.

Mr. PYNE. Well, I would agree with that. Maybe the three of us could go.

Senator SYMMS. You need to send about 30. If you go down to the White House, they always have an army of people around to be sure that nobody rocks the boat too much.

Mr. YUNICH. Well, unlike the effort in the sale of public assets, what we're really proposing is just having a small office, in effect, that would be doing the kind of thing that we were doing in this privatization task force, of identifying the opportunities, and the way it would work—it would still be necessary to do all the things that you have said, Mr. Chairman, with respect to educating the constituency. Mr. Grace is spending countless hours of his time now going everywhere. I was with him this past weekend out on the coast where he made several speeches and he met with several groups talking about what was going on.

But in the case of a military commissary, one of the best ways to prove our case to the military would be to at least provide an opportunity——

Senator SYMMS. Pilot projects?

Mr. YUNICH. Take three commissaries or six commissaries as a pilot kind of an operation and the proof of the pudding will be in the eating, and I would be willing to stake my reputation on the fact that the pilot operation would be embraced by the users.

Senator SYMMS. Let's just say, for example, in my State, we only have one major military installation, Mountain Home Air Force Base, and it's about 10 or 12 miles from Mountain Home where there are supermakets—Safeway, Albertson's, Smith's food chain—I think there may be about three major ones besides the 7-11 type stores. If we would take the same building that the military commissary has now and give it to or lease it to——

Mr. YUNICH. Albertson's.

Senator SYMMS. Lease it to Albertson's, for example, and have them pay the same rent that the military commissary has been paying, what you're saying is that the pricing level would be less, the hours of—the Albertson's store that's nearer to where I live in Idaho is open 24 hours a day. I don't know what the hours are on the base out there. The way to do it would be to try it for few years and then see what the response of the military personnel was.

Mr. YUNICH. Give Albertson's the same benefit that the commissary has with respect to the rent, with respect to the cash flow.

Senator SYMMS. If it's statistically proven that there would be a higher pricing for the goods and services, they make a slight food allowance for those people in the test area to be sure, if you wanted to remove all the opposition, until once it's shown—I'm confident, like you are, that it will turn out that they would prefer, given the choice, to shop in a modern supermarket with a good produce counter and a good meat counter.

Mr. YUNICH. Not only that, but Albertson would come in with a far better selection.

Senator SYMMS. That's what I mean.

Mr. YUNICH. And they would get into other categories that have every-day needs like health and beauty aids. That's the modern name for drugs. I mean, proprietary type drugs.

Senator SYMMS. Right.

Mr. YUNICH. And then there are some other impulse items and so forth that would be made available because these all have been proven to have great consumer preference and acceptance. But that would be the way to do it.

Senator SYMMS. And you'd say with respect to the Veterans' Administration that you would recommend trying the same approach? In other words, you're not saying let's do away with veterans' hospitals and do away with the services, but let's go to someplace that's not—in my State, for example, we have a veterans' hospital in Boise that's probably one of the best run veterans' hospitals in the country because of the location, the environment that it's in, and it is a very well-run hospital—but there are some places where I have seen some of the stories about veterans' hospitals where, as a Member of Congress, I personally feel like the U.S. Government is not living up to the contract that was made with the soldier over what kind of treatment he would get medically as a qualified veteran. Those would be places where I would think we could take a few pilot cases into some of the hospitals and lease them out to, say, Hospital Corp. of America, for example. What do you do about the Veterans' Administration employee?

Mr. KENDRICK. In the case of most of the hospital management corporations—Hospital Corp. of America being one—when they take over a municipal hospital, which they've done several dozen times over the last 5 or 10 years, what they do in almost every case is they guarantee to that local municipal government that everyone who has a job the day the contract is signed will have a job the day HCA comes in. They keep the same staff. They put in new top management in the hospital but they retrain and refocus those people to what they think would be the most efficient way.

Senator SYMMS. Everyone keeps his job when HCA takes over a community hospital?

Mr. KENDRICK. That's exactly right.

Senator SYMMS. Feasibly, the commissaries and the VA proposals should have a lot of support from the taxpayers and maybe from the constituents of the VA hospital. The opposition will come from the VA itself. So you're saying that the VA employees would be either hired by HCA or given a year's severence pay from VA or transferred to another VA hospital?

Mr. YUNICH. Well, I'm sure that it would not be the intent to put anybody out of a job.

Senator SYMMS. Some postal workers in Idaho think I'd put them all out of a job. If you went out and asked them on the street about Symms, they'd say, "Oh, he's the guy who wants to close the post offices and I'll lose my job." This is not my intention.

Mr. YUNICH. I'll give you an example. In my own company, R.H. Macy, for years in our New York division, we maintained one of the largest delivery fleets that existed in the department store industry. We came to the conclusion that it was better to have this service provided by United Parcel, after we had done it for years and years and years. Every one of our drivers, every one of our dockmen, were taken over by United Parcel. That was part of the agreement.

I'm sure that the hospital corporations work the same way. But the fact of the matter is that the drivers when they were being managed by United Parcel were doing far more productive and effective work than when Macy's was managing those drivers, and the same is true with the hospital workers. There are countless examples of that kind of situation.

We would be foolhardy in the political arena to come up with recommendations that were going to immediately result in people being put out of work.

What we are trying to espouse is the fact that we can improve the benefits of the end user through privatization which in effect means doing it better, doing it more efficiently, utilizing every current method of management that there is in existence, because the private sector places a great premium on management efficiency. That's the only way that you can exist.

In the Government sector, there's no penalty for failure. If you strike out, there's big daddy there with an increased appropriation to bail you out. There's no penalty for failure.

Senator SYMMS. Well, you and Mr. Pyne were both on the Metro Transit Authority in New York City and were there any privatization proposals that were brought forward there while you were on it?

Mr. YUNICH. Yes.

Senator SYMMS. Were you on it at the same time?

Mr. PYNE. We were on it at the same time. I was there a little longer. The Metropolitan Transportation Authority, in effect, was a quasi-public kind of an authority. I mean, we were all political appointees, but we were in the authority permitted to run this as close to business principles as we could.

Mr. YUNICH. The Federal Government turned the Stewart Air Force Base up near West Point over to the MTA and in effect we privatized the Stewart Air Force airport, running it by the MTA, relieving the Government of the expense, and we turned it around when we had it as compared to when the Government had it, and worked out a tremendous operation with the U.S. Department of Agriculture.

Senator SYMMS. So what were some of the worst things that happened when you were on the Metropolitan Transit Authority board? Were there some failures?

Mr. PYNE. Well, the only real failure was we could never get the rates up to support the operation of the system and that, of course, caused all kinds of problems. We didn't have sufficient funds and we had the political problems of trying to increase the rates, particularly when it came to increase the subway rates in New York City, that was never a particularly attractive point for the mayor to follow. So there were times when it was obvious that the fare box did not support the operation of the system, but the mayor, because he was running for political office, would see to in any number of ways that the fare would not be raised except at a time that was convenient for him.

Mr. YUNICH. While I was chairman, we reduced the expenses of MTA which covered subways, commuter railways, bridges, tunnels, some of the airports, by $300 million. But then we'd bump into the very things that you bump into on a national scale but that was on a much more narrow sphere.

For example, we were running buses around the clock and I produced evidence of the fact that we could not afford to pay a bus driver $28,000 plus peripheral benefits equal to about 70 percent of his pay—it's not a bad pay for a bus driver—these were abuses that had been built in over the years. And that bus driver drove a bus route out in Queens somewhere and he carried one passenger in 8 hours. So the suggestion that maybe we ought to eliminate that bus run immediately caused all of the council members from that part of the city from that borough to descend on the mayor and the mayor then said, "You will run that busline." And there were countless examples of unnecessary service.

Senator SYMMS. In other words, if they could privatize the whole transportation system, then you, as chief executive officer who had line item veto that President Reagan doesn't have, would say, "We are going to cut that busline out that runs from midnight until 4 a.m."

Mr. YUNICH. You can be certain of that. There's just no way in the private sector world that you would do something like that. There are many food operations that run 24 hours a day that aren't profitable, but they do serve a need in a particular community and, as a result of being unprofitable during the nighttime hours, apparently they build up a bigger customer following for their peak hours. The private sector is not totally irresponsible when it comes to service.

Senator SYMMS. There's no question about that. The reason Albertson's is open 24 hours a day in some of their stores is to compete with Circle K and 7-11, so that they make it more difficult for more of those kind of convenience stores to come in. There's no question about it. So they have a motive for it which is commendable.

Mr. YUNICH. Exactly. Take the subway system in Washington, Senator. I think it would have been cheaper to buy everybody a car than build the subway system here.

Senator SYMMS. I had breakfast with an economist from George Mason University a couple weeks ago and when he got there and sat down he said—I was buying his breakfast—and he said, "Not only thanks for the breakfast, but thanks for the ride down here." He came down on the subway at a cost of $4 to the taxpayers and he paid about $1. So I guess that makes the point.

Mr. YUNICH. It certainly does. I happened to be chairman in New York and I was head of APTA, the American Public Transportation Association, at the time when this was being built, and I was in utter shock.

Senator SYMMS. What would happen if Mayor Koch, for example, seriously took the proposal to sell the subway system in New York City and he says, "Look, I'm mayor and I don't want to have to put up with this any longer." What do you think would happen?

Mr. YUNICH. Well, the first thing that would happen would be nothing. The subway system is really an agency of the State of New York, so if Koch proposed it, the State would be against it automatically.

Senator SYMMS. Do you think it could be done politically?

Mr. YUNICH. To sell the subway system?

Senator SYMMS. Yes.

Mr. YUNICH. If it were sold at a price of what it's really worth and not what it's carried on the books by the State of New York—you know, there are over 700 miles of tunnels, well over 25,000 miles of track involved in various states of deterioration, but if all of that could be set aside and a private company were given the opportunity somewhat similar to the way Conrail has worked its way out of its problems—but if it were to be sold on the basis of an exorbitant amount of capital required just to acquire the tunnels and tracks the way it is, the subway stations in the condition that they are——

Senator SYMMS. How much does it cost every year to operate the transit system up there in terms of an operating subsidy just in New York City?

Mr. YUNICH. In terms of an operating subsidy?

Senator SYMMS. Over and above what the people are paying for tickets for it.

Mr. YUNICH. I would say at this point in time it's probably in the area of around $1,250 million or $1,300 million in subsidy.

Senator SYMMS. So if a company would go in and buy it or portions of it but put it up for auction and buy it without any union contracts so they could start over clean, in other words, they could go in and provide the services without all the operating subsidies and manage it efficiently you think, and provide the same or better services? Or is that possible?

Mr. YUNICH. It's possible.

Senator SYMMS. What do you think, Mr. Pyne?

Mr. PYNE. Well, I think it's possible, providing you can get a fair rate for the service provided. As you probably recall, the subways were originally operated by the private sector, but because they got locked in with rates which didn't meet the operating budget they eventually were forced to sell the subways to the public sector, which in those days was the New York Transit Authority. And the whole theory of setting up the MTA umbrella as such was because what Governor Rockefeller in those days wanted to do was to use the profits from the Tri-Borough Bridge to offset the deficits of the subway because politically you could only charge a decent rate for the subway. If you charged too high a rate, that meant that the person in the lower income level wouldn't be able to afford to go to his job.

So to answer your question specifically, I would think that if a company could take over the subway system and receive a fair rate for the service provided, there would be interest in the private sector, if that was politically possible; and I don't think it is, realistically.

Mr. YUNICH. But politically, some of the things that we did—for example, New York City is the only city in the world where you have subsurface and surface transportation that's absolutely duplicative around the clock. In order to prove that people would pay more, even though politically keeping the fare down was a very, very major issue, several private line bus routes were established from the outer regions of the five boroughs. In other words, there's an express bus route from several areas in the Bronx, from several areas in Brooklyn, from Staten Island. And it's an express bus route along the same route that you can travel on for 90 cents, but there you pay as much as $4, and you have people stand in line to pay the $4. But MTA is not permitted by itself to operate that way. We were permitted to arrange for a private operator to operate that way.

Senator SYMMS. Well, I ask those questions because one of the questions I wanted to ask, which I'm going to ask, is about the privatizing of the electric generation and transmission assets owned and operated by the Federal Government.

The problem you had on MTA is the same problem that I would have if I made a proposal to do that. I will just say that one day we had a meeting of the Northwest delegation—this was when the late Senator Jackson was the senior member of that delegation and he called us all together to talk about the problem of WPPSS, the public power system in Washington State, which has got contracts that overlap into some of the other Northwestern States. And they were talking about all the different alternatives and how we were going to get this funded and so on. I asked the question, "It just sounds to me like it's broke. How much would it be worth if we just put one of those plants up for sale and sold it for a penny on the dollar to Washington Power or Idaho Power and maybe they'd go ahead and finish it and start generating electricity and get on with it, and admit that this thing had been an unmitigated disaster." I thought some of my colleagues were dismayed. I just asked the question. I didn't really make a recommendation to do that. I just posed it as a question. And I think that's what we're up against.

How do you propose to sell the public power generating systems in view of the fact—like some of the rural electric co-ops that are in Idaho, for example, they are required by the law that set up the co-ops that if some guy comes in and wants electricity—where the private shareholder-owned utility would not go deliver the electricity there because they'd say, "No, we won't deliver that because it's not economically feasible and you're off here in the south 40. Unless you pay for bringing a line in, we won't set it up for you." Where the REA is required by law that they actually have to go put the poles in and string a line into somebody's place that's back on the south 40, for example. And it may be a high cost where they would never get their money back out of the investment on the lines.

How do we outline and develop an effective coalition that could promote the idea, which—having had private power, you wouldn't have the bankrupt WPPSS system out there because the private engineers and entrepreneurs and shareholders would not have made decisions to start building four plants at enormous billions of dollars of cost and sold bonds like they did and now they've got three or four dead horses out there unless somebody finishes some of them. It looks to me like the horse is already out of the barn and somebody better start selling electricity.

Mr. YUNICH. Well, how did Congress, in its infinite wisdom, break up AT&T? Because you're going to have that same problem with telephone service in these remote areas on the south 40 and so forth when AT&T used to bring in telephone lines that couldn't possibly——

Senator SYMMS. I think it was actually the Justice Department that broke up AT&T. However, I'm not defending Congress. I agree with you. I've always had the theory, if it ain't broke don't fix it. But I read an article yesterday where it said our telephone service is going to start going downhill because we have public utility commissions that set the rates politically so that there's going to be a gradual starvation of capital and advancement and it will slip and slip and slip.

I know the President in one of his magnificent speeches used to cite the example of the post office versus AT&T and how it cost $28 to make a long distance call from Bangor, MA to San Francisco, CA in 1932, or something, for a 3-minute call, and it only cost a penny to mail a letter. And by 1980, it was up to where you could make a phone call for 70 cents or something for 3 minutes and the letter costs 20 cents and it took the letter longer to get there than it had in 1932. So I think you have a point.

Mr. KENDRICK. I think if we're going to make headway on the energy issues, it's going to be the same way we're going to make headway on the VA hospitals and commissary stores, and it's going to be winning one fight at a time. It's going to be looking, for example, right now the Hoover Dam situation, which is the next dam up for contract renegotiation. We're going to have to take them one location at a time and not take all the Bonneville Power Administration or all of the Western Power Authority. Take one dam at a time and sell off the power-generating facilities and if you want to continue guaranteeing those low rates for a period of time, or phase them in, it would be cheaper to at least pay the subsidy rather than taking all the taxpayers' money and shipping all that money to Washington, chewing up 28 percent of all the employees of the Department of Energy to manage PMA's, and shipping that money back out and subsidize them that way.

If we could have a phased-out subsidy over a period of 5 or 10 years, at least in the long term we will have made progress. Those rates would slowly come up and you could do it carefully one at a time and demonstrate that as the private operator takes over those power generating facilities they can do it more efficiently—one at a time, one step at a time, and I think you would begin to make that kind of progress.

As it stands now, we are about to give up the battle on Hoover until the year 2017. I will be 60 years old before we review this tall structure again. So there goes my taxes for my lifetime.

Senator SYMMS. That's the point that's got me bothered about how you get it done. And I don't want to leave that point and I want to get back to it, but on AT&T, I think what I would recommend—and it shocks people to hear somebody who's in the Senate say this—but the only way that I can see that you can solve the problem as a Member of Congress and for the consumers' benefit with respect to AT&T is, I think the Congress would have been well advised along in the late 1930's or at least at the end of World

War II if they had just abolished the Antitrust Division of the Justice Department and said that we no longer are going to consider antitrust as a proper role of the Government because there's enough competition out there to take care of this. All the stories you hear about the trust busters at the turn of the century was a different environment and a different economy. It wasn't a worldwide economy. It was more of a national economy here, and I really frankly think that the Justice Department—if they would all go home and never come to work—it would be the cheapest thing that would ever happen for the American consumers, just to get rid of them. They do nothing beneficial for the consumers or competition in this country, in my opinion.

Mr. YUNICH. I couldn't agree with you more.

Senator SYMMS. Now that's not a widely held view in the Congress.

Mr. YUNICH. I wanted to applaud, but I didn't think it was proper.

Senator SYMMS. So Congress is responsible for that end with respect to the telephone company situation. But the same people in Congress who attack the oil companies for trying to have mergers will turn around and attack the Justice Department for breaking up AT&T. So it seems like an inconsistent situation to me. I think there's enough competition out there, if you have no grants of special privilege given by the Government, competition will take care of it.

Mr. KENDRICK. I think what we really have to do—I won't get into the antitrust department of the Justice Department position because I'm not an attorney, but——

Senator SYMMS. Well, I'll go back to the dams. I just wanted to make that point.

Mr. KENDRICK. Of course, if you have attorneys on staff, they have to do something, so they show up.

Senator SYMMS. They could go fishing.

Mr. KENDRICK. Well, that would be fine under these recommendations, but I think it's the same story over and over and over in terms of an implementation strategy. I think all of us on the task force would have liked to have seen—"It's a great recommendation, we've got the numbers, we've got the facts, and tomorrow morning let's make the move." When you have a company that's in trouble, you send out your top people and you stay on top of it and you kick it and fight it until you solve the problem, and you don't sit around and wait for Armageddon to take place.

Look at commissaries. Between 1978 and 1982, on an average annualized basis, the number of stores for that period declined by 1 percent.

Senator SYMMS. Declined by 1 percent?

Mr. KENDRICK. The number of stores dropped by 1 percent. The number of employees declined about 1 percent over that period on an average annualized basis. Sales have increased right at the inflation rate. But the appropriated funds have been growing at a real rate of about 4 percent. So it's costing more and more to run it to provide basically the same thing. It's growing faster than inflation. If a business would start seeing those trends going the opposite directions, we would realize we wouldn't be doing our jobs much longer if we didn't get control of our operation.

So I think what we're really saying is to give us one store, take the Pepsi challenge, so to speak, and compare and see what it is you want to do. Go ahead and see how it happens and what works. That's the only way you're going to prove the case for certain. It's the same thing with PMA's. Work with one dam and we're going to have to give it a shot. It's much cheaper financially for the Federal Government to go in and subsidize the people getting the power from Hoover, for example, over a 10-year phaseout than it is to subsidize them and try to run the facility. So I think all of us would take a subsidy if we could take that in the interim and put that management back at the local level so the local people can respond to the needs of the community.

Senator SYMMS. I think your idea of having a special office to start pushing privatization ideas is a good idea. I have one more question I want to get asked.

From what you said here this morning, it appears to me, as someone who's gone through this gauntlet, and have had a hard time trying to explain it—and I said some of the things I said about the news media not in condemnation of any particular news journalists, but we have just a vacuum of appreciation of the humanitarian aspects of a free market and capitalism. People are taught from the time they're little kids about the greedy capitalists out there trying to exploit everybody. There was a game I saw the other day in the stores where the consumers always lose and the capitalist wins. Well, that's just totally an untrue situation, but yet those kind of myths are allowed to perpetuate.

Now it's improved a lot in the last 3 or 4 years and maybe we will see an evolution in a more positive way toward a more profreedom position, but the commissaries and the veterans' hospitals, if it was handled right to show that it would give better delivery to the end user, as you pointed out, Mr. Yunich; if you could make that case out and if you could make that case out in the public on the front end of it, that might be a place that it could be done easier than with respect to like the MTA or the Bonneville Power Administration.

The Congress passed a resolution here last year that said they can't even study raising their rates. That's what you are making reference to.

Mr. KENDRICK. What does exist as Government policy basically for using the private sector, any time you start to go into the area to do the study—certainly in the military this has been the case for the last 3 years, the rumor goes out that somebody may follow OMB policy and conduct the study to find out just what the numbers are, what the story is, and somebody sticks a rider on a bill late at night up here and then we're forbidden to even do the financial study to find out the facts.

Basically, I think that's the most appalling thing because we could find out it would be cheaper for the private sector to do it and still not choose to do it, but at least let's play with all the facts rather than stopping before we know the story.

Senator SYMMS. I wanted to examine these ideas about National Airport and Dulles Airport. You're recommending that we lease those out to a long-term franchise on a competitive basis; is that the recommendation?

Mr. KENDRICK. In the airport area we're actually talking about a local quasi-public operation where a local group representing Virginia, Maryland, and the District of Columbia would have a board that would have members appointed both from the political process and on a private sector basis, very much the way the transit authority handles it.

Senator SYMMS. Well, the operation of National Airport, is that a money-losing proposition?

Mr. KENDRICK. National turns a slight profit. Dulles is a losing operation. Back in 1981, to stimulate traffic, the FAA stopped all landing fees at Dulles to increase usage, and it did increase utilization. So when they give you the numbers on those airports, they combine them and you get a break-even position.

Senator SYMMS. You also make the point about safety. Do you think if that was operated by somebody besides the Government that maybe the safety inspections would limit the number of flights that come in and out of National? The way it is, when they have a vote on it, there are more Congressmen from east of the Mississippi who can ride on airplanes conveniently out of National than they can from Dulles, so they just vote to not limit the flights.

Mr. YUNICH. There are three major airports in New York, Mr. Chairman, Kennedy, La Guardia, and Newark, operated by the New York-New Jersey Port Authority, and they are all operating in the black. They have as heavy, if not heavier, schedules of planes leaving and coming in as compared with National, and I think it would behoove your assistants to have a look at the profitability of those airports and the fact that those airports are able to sustain themselves.

Just in the press yesterday there was quite a story about the New York-New Jersey Port Authority becoming this tremendous power base because they also operate—MTA operated the tunnels within the City of New York and within the State of New York, and the New Jersey Port Authority operated the bridges and tunnels between the two States. But they have operated in a quasi-public fashion and without cost to the taxpayer and have managed to keep improving these airports and providing all the services, including all the safety, and this is what is, in effect, being proposed for study with respect to Dulles and National. And I dare say, that when one looks at the terminal in National Airport, having just returned from Tokyo and other cities in the Far East with Peter Grace, there's absolutely no comparison. When one looks at the terminal in Atlanta and one looks at the terminals in New York City or in Chicago or in San Francisco or Los Angeles—and this is our national capital. It's a travesty to see the terminal here and these others that I've cited are all operated by the kind of authority that we're proposing.

Mr. KENDRICK. I think an additional point that I'd like to make is that if we turned it over to the smaller authority in the area, taking it off the Federal books, we wouldn't have 535 members of the board of directors and we could get it down to 20 members of the board of directors who could make decisions on where the airport needs to be in 10 or 15 years in terms of safety, length of run-ways, radar and the terminal building, and set those plans out and go after the bonds or whatever they need to issue the bond program and raise the money and make those improvements.

As it is now, the annual appropriation process is considered a hot point and it's very difficult to make long-term plans for National or any other facility. And we could get a better, faster decision process which would guarantee that National could catch up. It also means that we could let that board find out exactly what the landing fee ought to be there. Fore example, at La Guardia in 1981, the landing fee for 1,000 pounds was $1.85. For National, we're running it at 43 cents. So they are not even making their top revenue because of their 535 directors who are all in a difficult position. So let's let people who know how to run airports do it and let the gentlemen who understand the political process run the decision process at the Capitol. That's what America is about.

Senator SYMMS. I think there's a better chance to do that now that Highway 66 is completed because it is very easy to get to Dulles now from the Capitol; and it wasn't so when all those votes took place. The inconvenience for Members of Congress was probably the primary reason why the airport has been controlled like this. Congressmen want to be sure that they can get in and out conveniently to all these points where flights from National go. Some of us go further West and it isn't quite as much concern because we can fly out to Salt Lake or Denver and those flights normally run out of Dulles anyway.

You've been very patient, all of you, and I have one last question I want to close with, and that is the question that will come up as a result of this discussion—and I'm sure I will be asked about it—with respect to commissaries, with respect to veterans' hospitals, contracting out. We didn't get into the space question which you talked about in your testimony. But one of the political problems we run into is that when private procurement takes place. Take for example the story normally in the news media attacking the Pentagon; so the Pentagon by nature gets more criticism than some other agency. But be that as it may, it is just a fact that there are political points to be gained in attacking the military-industrial complex.

But how do you deal with the alleged abuses for contracting out? For example, you always hear about the $12 wrench that costs 50 cents or the $91 screw that they bought that they really should cost 20 cents. How are we going to control alleged abused in contracting out? Is there a mechanism that would be built into this other than just the market system? How are you going to do this without having immediately, on the first try, have some kind of abuse take place and then all the efforts just get shot down?

Mr. KENDRICK. Well, one of the important aspects to understand on many of those cases that, to the Defense Department's credit, it was their audits that found the $19 wrench and so forth.

Senator SYMMS. Right. That's what I've said many times over. Some Secretary of Defense some day is going to get credit for some of the things that he is doing.

Mr. KENDRICK. I think it's very harsh on Secretary Weinberger to be taking the heat for an abuse that he uncovered and reported and is trying to fix. But in many of those cases you will find once again that we've got an information gap problem. The reason I harp on that more then some of the others is because I chaired that report and I'd like to push that too, and it really impacts on privatization and is really linked to it.

Many of those hammers, screws, and wrenches were in situations that to get the program, to get the appropriation in place, to keep the cost down, we didn't buy the technical rights on the data on exactly what is the size of the screw or what is the size of the hammer. We didn't pay a small fee for them to make that decision and release that information to the Government. Consequently, we start building a particular jet engine under an exclusive contract—we've started to change that now with dual sourcing—but a single contract for one engine but we don't get the technical data for later—year replacement. So they are the only ones that even have the specifications. We don't even have the proper information to go out in the marketplace and say, "Does Handy Dan have this screw so we could buy them?" We don't know. We blind ourselves going in.

Senator SYMMS. So the Government created a monopoly for the supplier of the aircraft in the first place.

Mr. KENDRICK. That's right.

Senator SYMMS. So through the process of the Government procurement system, they gave a monopoly to, say, McDonnell Douglas to supply for phantoms.

Mr. KENDRICK. That's correct.

Senator SYMMS. And they didn't leave the door open so that they might buy those parts from Sears Roebuck or something?

Mr. KENDRICK. That's correct. Under our view of privatization, we would foster a competitive marketplace. You would have every store and it might be hundreds of different companies that would go into the 238 commissary stores. The last thing we are interested in in the privatization issue is creating any kind of false monopoly because when you do that you get the $91 screws.

Senator SYMMS. I always thought it's kind of a fascinating story but a true story that when Maj. George S. Patton was a young tank battalion commander in France in the First World War, he couldn't get the parts for the tanks through the Army procurement system. Since he was a man of substantial wealth, he bought the parts privately through Montgomery Ward and Sears Roebuck—because tanks were less complicated than, and they said that he would never disclose publicly how much money he spent of his personal fortune to buy parts for the first American tank battalion that was used in France.

I thought that was a fascinating story. Patton, in his view of the Education Age where officers often times outfitted their own units, he thought that was perfectly fine. He did what he could afford, since he could, and he never would disclose to the press how much money he spent buying parts for those tanks. He just bought them from the market.

I don't know whether that's possible today or whether we could do more off-the-shelf purchasing for the military, but I sometimes wonder if we don't have overly restructive specifications. That's where a lot of this comes from, from the military specifications that are so technical.

Mr. KENDRICK. You have a combination. For example, the specification for Worchestershire sauce is 17 pages long.

Senator SYMMS. The military specs for Worchestershire sauce——

Mr. KENDRICK. They are 17 pages long.

Senator SYMMS. You've got to be kidding. And we actually have a military spec for Worchestershire sauce?

Mr. KENDRICK. Yes. We do for toothpicks, too. We don't buy them off the shelf.

So that really makes a complicated procurement process. So you have that problem operating along with setting up a monopoly or not having information on what it is you really want to procure in the outyears, and you hit yourself coming and going.

Mr. YUNICH. Just managing the inventories, there are no MIS systems. In a typical department store, there are 400,000 SKU, stockkeeping units, and toothpicks would be one of them. Through the use of modern merchandise information systems, they can tell how many toothpicks are on hand in each one of their stores and they can tell who the alternate suppliers are and what the costs are and, most importantly, what the turnover rate is. I think if you would examine some of the storerooms you would find an 85-year supply on some items and yet they have a 17-page specification for what has to be in that product.

Mr. KENDRICK. I think in looking at this issue that it's important to note that we are looking at this issue that it's important to note that we are looking at, for example, the screws or the wrenches, they give you a price to sell and give them a monopoly and it's very hard not to take everything you can get.

But in privatization what you're looking at is giving, say, a commissary store operator an opportunity to make a profit and he can make that profit only if he can get people to come to his store, and that's by being very competitive on the pricing, the hours, and the product lines. So he knows his contract will be up for renewal and it must be rebid and if he doesn't look for the hardest, toughest way to run that store and make it the most tightly run operation he can, somebody is going to beat him. And that's what privatization is going to do for us in putting the competitive marketplace together.

That's also not to say that any one of us denies the fact that we will have problems if we have privatization programs. It's not going to be the easiest thing that we've ever tried to undertake. The eight issues we talked about, the $28.4 billion, that's not even counting the fact that we just counted the first 3 years, and when we talk about the outyear benefits we're talking about $40 billion over 5 years time. It's worth going to the trouble if we could save that money.

Senator SYMMS. And there isn't any of these eight suggestions that you're making, saving $28 billion, that would in any way pass on any special tax privileges to the people who would take them over either?

Mr. KENDRICK. That's correct.

Senator SYMMS. There's not tax benefits involved in any of those eight items?

Mr. KENDRICK. In the NSTS issue, we have made a recommendation to enter into certain R&D areas it might be a way of getting that done more quickly to offer certain tax benefits, but the core issues, no, special tax benefits.

Senator SYMMS. That's something we need to make very clear here for our record.

Well, I thank you very much. We may have other questions. We will send them over to J.P. Bolduc and maybe they could forward them on. We thank you so much for your interest and your efforts and the contribution that you've made. I only hope the Congress will follow through on some of these recommendations and give the country an opportunity to maybe reverse these problems. Perhaps if the Pentagon didn't have to be concerned with running four major grocery chains, for example, then they could concentrate more on some commonsense applications—and not dwell on the 17-page specification for Worchestershire sauce. They could concentrate just on the general procurement procedure, and we might be able to do more and apply some management abilities. What worries me—I always come back to this conclusion—the only way you can ever cure these things as long as you leave the Government bureaucracy in place is reduce expenditures. But when we talk about national security, there becomes a tradeoff at some point where we have to spend enough money to be sure that we still have the airplanes that will fly and the ships that will defend the sea lanes of the world and operational equipment for the military units, sometimes at a great expense. And I have to admit that I'd like to spend less money at it, but I don't want to end up in second place with respect to the Soviets because the way we're heading with our budget being massively consumed by entitlement spending programs, we will end up—if we keep going at the rate we've been going for the last 15 years of reducing defense expenditures so we can have more money for social services—we'll be a giant welfare state in the world that's run by the Soviet Union in very short order. The President has reversed that trend somewhat, but I think his efforts are certainly under fire because of the big deficits, and I think you have offered a real contribution here and I thank you for it.

The subcommittee stands in recess.

[Whereupon, at 12:20 p.m., the subcommittee recessed, to reconvene at 9 a.m., Wednesday, May 30, 1984.]

PRIVATIZATION OF THE FEDERAL GOVERNMENT

WEDNESDAY, MAY 30, 1984

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY AND FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, DC.

The subcommittee met, pursuant to recess, at 9 a.m., in the Gold Room, Idaho State Capitol, Boise, ID, Hon. Steven D. Symms (chairman of the subcommittee) presiding.

Present: Senator Symms.

Also present: Steve H. Hanke, professional staff member.

OPENING STATEMENT OF SENATOR SYMMS, CHAIRMAN

Senator SYMMS. The Subcommittee on Monetary and Fiscal Policy will now convene. The subject of our hearing today is the Privatization of the Federal Government.

This is the third hearing we've had in a series of hearings on privatization before the Subcommittee on Monetary and Fiscal Policy.

The first two hearings were held in Washington, DC, on May 1 and May 2, 1984. They focused on the Grace Commission's report on privatization. Witnesses at those hearings included Mr. J. Peter Grace, Chairman of the President's Private Sector Survey on Cost Control, PPSS; and J.P. Bolduc, chief operating officer of the PPSS. And three members of the PPSS task force on privatization: Mr. David Y. Yunich, retired vice chairman of R.H. Macy & Co.; Keith S. Kendrick, assistant to the president of Chemed Corp.; and Eben Pyne, retired senior vice president of Citibank.

These three witnesses concluded that there is a massive waste in the Federal Government. In fact, the PPSS found that it will amount to about $425 billion over the next 3 years. The privatization of Government assets and services offers a new, innovative and proven method of controlling waste. And that the taxpayers of the United States, who are fed up with Government waste, increased Government spending and regulations, and ultimately increased taxes, should not focus their ire on public employees. Instead, taxpayers should be focusing on the source of our problems, and that's the system of Government ownership. It is Government ownership that is the source of the problems.

If we wish to put the consumers back in the driver's seat of our economy, we must begin to privatize public assets and service functions and depoliticize our economy.

Given the importance of privatization, I am pleased to be able to hold these hearings in Idaho to further explore this new concept which is already beginning to work so well at the State and local level.

Today we are particularly pleased that we have one of Idaho's most distinguished native sons, Mr. William Agee, with us. He will address the privatization issues contained in the Grace Commission, of which he was a member. He performed an analysis of all of the Government computer systems for the PPSS, and we'll have many questions with respect to that and other facets of the Grace Commission.

In addition, we have one of Idaho's most well-respected citizens, the retiring chairman of CH2M Hill, Mr. Earl Reynolds. We have Mr. R.M. Davidson from Pasadena, CA, the Parsons Corp., who has had a great deal of experience in the privatization of public facilities, such as water control, pollution control, and other cleanup activities. We have Mr. Richard Christensen from the investment banking industry in Salt Lake City with us. These gentleman will discuss the concept of privatization and how it is being applied to the field of constructing and operating the so-called public infrastructure.

I might just make a note to say that one of the classic examples that came out of the Grace Commission—Mr. Agee, we know you have to return to New York this afternoon. We welcome having you here. It was interesting to note that the Grace Commission report, which is worth $76 million in services contributed by 1,200 participants, made more than 2,500 recommendations of places where the Federal Government could save money and reduce waste. We could save up to about $424 billion, with the total recommendations. It was a voluminous report. The fear that I have as a member of the Senate is that the report will end up in the dust bin of some Government warehouse and be put aside and nothing will ever come of it. We need a concerted effort to keep alive all of the good work that was done by the Grace Commission.

They printed up a summary of the Grace Commission report, which sells for $48.50 at the Government Printing Office. Now, if you'd rather have a less expensive version, the MacMillan publishers reprinted it at $9.95. So I think that's a good example of ways we could save money for taxpayers, by allowing such firms as MacMillan to do more of the Government printing. In the long run it would be less expense for the taxpayers.

Bill, we welcome you here to your hometown of Boise. We know you've come a long way to get here. We thank you very much for being here to bring this report of a very important commission to the people here in Idaho. You bring us fresh hope that the Congress and the administration will straighten out the Federal budget and the deficit without just raising taxes. So please go right ahead.

STATEMENT OF WILLIAM J. AGEE, CHAIRMAN, SEMPER ENTERPRISES, INC., OSTERVILLE, MA

Mr. AGEE. Thank you, Mr. Chairman. I am very pleased to accept your invitation to address the work of the Grace Commission and to identify the potential for major, if not massive, savings from the transfer of some of the Government activities to the private sector. We call this privatization. I very much applaud your effort in this regard.

My name is William Agee and I was cochairman, along with Joseph Alibrandi, chief executive officer of the Whittaker Corp. in California, and Donald Procknow, president of Western Electric Co. in New Jersey. We were the cochair for the task force on automated data processing and office automation for the Federal Government. Presently I am chairman of Semper Enterprises, located in Osterville, MA, and I was formerly the chairman and chief executive officer for the Bendix Corp.

Prior to discussing privatization, and more specifically the automated data processing area, I'd like to just take a couple of minutes, if I could, for a quick review on what was the Grace Commission, what was it all about and what were some of the findings.

As many of you may know, in February 1982 President Reagan decided that it would be useful to have a study of the executive branch of the Government by members of the private sector. He invited, as the chairman indicated, J. Peter Grace to head this effort, hence the name the Grace Commission.

The President, as well as many citizens in this country, are very concerned about the tremendous increase in the costs of operating the Federal Government, which has gone up almost sevenfold since 1964, from a modest $119 billion to $854 billion for 1984. I'm sure many of us in this room share that concern.

Well, on June 30, 1982, the President's Executive order was issued and the PPSS was formed. There were 161 executives who had been recruited from the private sector and they worked as cochair for 36 different task forces. Each task force was assigned to examine one or more of the agencies or departments of the Government or some functional area which cuts across all sectors of Government, such as procurement and asset management, and yes, computers and communications. In addition, 11 special reports were prepared by the Grace Commission management office to examine areas of special interest.

In organizing this effort, the private sector was requested to finance the entire survey. Accordingly, more than 2,000 volunteers, 36 of whom were associated with the Bendix Corp., and other companies of the executive committee members, and $3.4 million were raised by these people. A special foundation was set up to handle the financing, and we were underway. In total, the private sector, in terms of money, time, travel expenses, contributed $76 million to this effort, all privately funded.

The 47 task forces and management office reports consists of, as you might expect, 20,000 pages of material, 1.5 million pages of supporting documentation, and they included 2,478 very specific recommendations that were all submitted to the President.

The areas of program waste and inefficiency, and most importantly, systems failures account for $312 billion, or almost three-quarters of the $424 billion total savings identified in those reports, as summarized on the following page, which I'll touch on in a moment.

But the thing that's most interesting for me to note and to underline is that the joint review by two congressional areas or executive areas, namely, the General Accounting Office and the Congressional Budget Office, looked at all of these recommendations and after only reviewing 11 percent of these specific recommendations concluded that the 3-year savings for those programs that they looked at would only be—these were their words, would only be $98 billion over a 3-year period of time. This, again, as I underlined, they only looked at 11 percent of the recommendations that were carefully put together.

Well, ladies and gentleman, what more can I say to you than when we have a budget deficit in this country of $200 billion, we are constantly talking about how much should our taxes be increased, or how much should our defense spending be cut, or how can we get away from this insidious problem? You have a group of private citizens who gave their time and effort to come up with a program that they honestly feel will generate over $400 billion in savings in 3 years. The math is pretty simple. That works out to be about $130 billion a year. The Congressional Budget Office looks at it and the GAO looks at it and they say, "No, we think you're wrong," but they only looked at 11 percent of our recommendations, and they say you're only going to save $90 billion. You divide that by three, that's $30 billion a year. And yet, we have thousands of rooms around this country where people don't even know what the Grace Commission was, and they don't have any idea what the recommendations were, let alone the magnitude of these.

So if we did nothing else today in other rooms like this around the country to raise the American's consciousness level to this problem that has been fought about for years by the citizens of this country, and have now been documented by objective, disinterested people from the private sector to show that we can save, by Congress budget office admission, at least $30 billion, and by our recommendations, over $100 billion a year, and people don't talk more about the Grace Commission and what's being done to implement this change and that change and the other kinds of changes as opposed to talking about let's just raise taxes, we do have a serious problem in this country. We have a check and a balance by the citizens who put it forward. We have the Congress who looked at it and said, "Yes, we think it's going to be at least $90 billion," only looking at part of it, so I suggest to you to look closely at this. This is a meaningful document. This is a meaningful study, and if we would only implement part of it, it would go an important way of closing the budget deficit that we all agree, Democrats, Republicans, and Independents alike, is the underlying most insidious problem facing this country.

Now, to be specific, what I'd like to do just for a few minutes is to talk about the findings of the automated data processing and office automation task force which, as I mentioned, I cochaired. At present, there is no function of the Federal Government, administrative, scientific or military, that is not dependent on the smooth functioning of computer hardware and software. We have in our Federal Government over 17,000 computers and a work force of more than 250,000 people. Federal systems operations dwarf those of even the largest private sector companies imaginable. The Federal inventory lists over 6,000 general purpose or administrative systems and almost 11,500 special purpose systems.

From the massive transaction-processing activities in agencies like our friends at the IRS and the Social Security Administration to the military command and control systems, the Government absolutely depends on automated data processing systems, and they commit large amounts of resources to acquiring, and more for operating these systems. About 41 percent of the Federal data processing budget is allocated to personnel resources. By comparison, in the private sector only 36 percent of the private sector budget in this area is allocated to personnel. The private sector also spends less of its data processing dollars on software, only 10 percent. The Government is spending almost 19 percent, and more on hardware. The Government is spending 31 percent, while in private industry we spend 21 percent, and I'll explain why in a moment.

Although the differences in resource allocation may be due to differing data processing aids among the various departments, Agriculture, Commerce, the White House, whatever, it very much indicates the inefficiencies of the ADP function of the Federal Government. This possibility, I would say strong probability, strongly supports the rationale of all of our task force's efforts. Despite the fact that ADP pervades the functioning of all aspects of the Government, the estimate—and this is an estimate, it wasn't documented by them of the ADP expenditure—is only $12 billion, about 1.6 percent of the total Federal budget, but the ADP clearly has the potential of saving far in excess of these annual expenditures.

Why do I say that? This great country of ours has 332 incompatible accounting systems—332 incompatible accounting systems. They have 319 incompatible payroll systems. When I say incompatible, if you'd spend a little time in financial areas or are a CPA and have done work like this, and some of you in this room are, you know what a nightmare incompatibility is.

It costs the Army $4.10 for every payroll check processed. In the Bendix Corp. it cost us $0.60 per check. We have a few people in the Army, and if you multiply biweekly three times $3.50, that's a lot of money just on that little item. But there's more.

Our data processing systems throughout the Government, with the possible exception in certain areas in the Federal defense area, are obsolete. They are not one generation behind, they're two generations behind. We have identified in our task force, and I say this conservatively, because we wanted to have credibility and we wanted to be able to defend each and every number, we believe that if our recommendations just in the automated data processing area were implemented that we would realize $29 billion in savings over a 3-year period of time. As that $30 billion almost is made up of $11.1 billion identified in the Government-wide opportunities for savings, and $18.4 billion identified by other task forces and reported in individual task force reports on opportunities for specific agency changes. We've netted out that $18.4 billion so it wouldn't be double counted. But if you put under the heading of automated data processing, what could we say and what could we enhance this country's bottom line, less taxes, more income to the Government, you're looking at $30 billion just in the area of computers.

What's the proof on that? Well, of those 17,000 computers I talked about a minute ago, over half of those computers are so obsolete that they are not serviced by the manufacturers any longer.

We are running payroll checks, social security checks on computers that went out of style, fashion, and were economically nonviable 15 years ago. It takes 3 years to buy a new piece of hardware in the computer area for an agency that doesn't know how to get through the Government labyrinth. Any of you who follow the computer business know that hardware is obsolete sometime between 6 and 18 months, which means by the time the request gets the approval, that manufacturer has already gone on to the next generation of equipment. So the manufacturers kind of like this because the Government ends up buying their obsolete inventory at prices that were retail a few months before.

Well, you know, when you get unhappy and you see this waste take place—and these are only specifics, you don't have time to listen to all of them this morning—you say what can you do about it, because it is a problem, it is real, it is documented. I have no axe to grind, except that I want this country to run better, and I know these numbers are right in just this little area. You can blame it on lots of things, but let's talk about some specific ways that perhaps we can help with the solution.

It would obviously be easy to conclude that bureaucratic reform aimed at making the bureaucratic—all those bureaucrats there behave like business people, that would be the way to do it. Some would even suggest that the replacement of bureaucrats with business people would solve the problem and eliminate all this waste and all this inefficiency and everything that we've been talking about.

However, unfortunately, in the political and practical world that we live in, it's not practical to do all of that, nor would it be fair and equitable to those people in Government who have devoted a good bit of their lives in this area. So the problem is only partially those people, those people who are in the public bureaus and agencies. The point is that the system of public ownership is the principal source of the problem that we're talking about.

The key to understanding much of this waste and inefficiency that was uncovered by the Grace Commission is to understand the fundamental difference between private and public sectors. I want to look just for a moment at the difference, what drives a profit-seeking enterprises.

A private firm's ultimate objective, whether you run a television station, an automotive company, a newspaper or a hot dog stand, those people are driven by a profit. Consumers determine what is of value, so a private firm must answer to the consumer. If a firm produces products that are not wanted at the going market prices, they either don't make a profit or they don't make a profit and go out of business. In addition to producing what consumers want, private firms must also produce their products in a cost effective way, since if they don't, if they don't operate cost effectively, they're not going to compete and they also will go out of business and not make a profit.

So the real bosses who we are accountable to are the consumers. So with the profits as an objective, entrepreneurs are going to attempt to produce what the consumers want at the price they're going to pay. Moreover, if business people fail to provide the most efficient production practices, they're going to be replaced by others. That's pretty fundamental stuff.

That's clearly not the case with public agencies and bureaus. They don't have profits and losses. In short, they don't have a bottom line. In short, they are basically unaccountable to anyone.

A business person is judged by whether he or she has generated a profit or loss. This profit and loss calculus is unavailable when resources are publicly owned. Rather than being judged by profits and losses, a public sector bureaucrat is judged by whether he or she has followed the rules. Without having to answer to profits and losses, the civil servant is close to being ignorant of whether suitable means have been used to produce whatever is being produced by the public sector. Without private ownership, the objective of pursuing profits and the profit and loss calculus, the civil servant is operating like a person who is forced to spend his life virtually blindfolded. So therefore, if it's efficiency that we desire, we must rely on private ownership to a greater degree in the profit and loss system.

The implications of this, of course, are rather profound. If we want to eliminate waste and inefficiency in many of these areas that we identified and documented by the Grace Commission in a practical and in a humane manner, we should consider privatization and begin to turn Government functions, not all of them, by any means, but many of them, over to private enterprise. It is time that we unburden the State and return those activities to the private sector.

I have a couple of specifics, and later today the chairman and others should be talking about other areas of privatization where this has worked, and let me just give you a few examples. There's some cities and towns in this country where this exact process has worked and worked very effectively. In certain countries in Europe, whether it be Great Britain or Italy, certain areas of these are working well. In France there are certain areas where government has taken over functions and then turned them back to private enterprise and they're running better, most cost effective, and a lost less costs for the consumers.

I could spend more time on it, but what I'd like to do is talk just a moment about the privatization of certain areas of the computer area, where might we begin, where might we just try a couple of experiments so we don't go there all the way. Let's start to look at the Social Security area as an example. In the Social Security area, which I've already identified as being one of the most obsolete, in the dark ages in terms of the way they send our Social Security checks, their backlog right now would scare most people. Let me give you a few statistics.

Right now their gross workload is 5,000 control processing units, and any of you who like computer buzzwords, that's called CPU's. They have 5,000 of those per month. However, the maximum capacity of their computers, their outdated computers, is 3,000 CPU's per month. Their current staffing levels are sufficient to support 2,000 hours per month, based on a 40-hour workweek. So they're going 7 days a week, 24 hours a day, three shifts just to keep up. If you saw how they had to patch together their software and how close some months they come to not hitting the mails on time for the Social Security checks, you would say that something needs to be done here.

Well, let's try something. Let's take and have a competitive market situation where private firms who do remain technologically up-to-date are given an opportunity to take this overload and privately contract out the overload of the Social Security Department. It's a problem that they have. Let's send it out, subcontract it out, and then let's see how efficient private enterprise can be. It's not taking it all away, it's a transition. My suspicion is that if we were to do this, we would see drastic savings, efficiencies, and all of the things we've talked about, but let's try that there.

Another area where experimentation, not going all the way, but at least letting people know that this isn't just some idealistic theory, would be to take the inventory control systems in the Defense Department, which is another area I'm quite familiar with. The DOD reported total repairable and consumable inventories of about $40 billion in September of 1981, and we have every reason to believe it's substantially more than that today. Those inventories are stored in 30 different places around the distribution depots around the world. The DOD has long recognized the need for better inventory control systems—I'd say an inventory control system, and they say better, and that's okay—the use of automated reporting and processing techniques used in the private sector, the DOD is unable or unwilling to implement a modern approach to inventory management.

Here again, I believe that the public employees and the DOD don't have that profit and loss incentive that exists, and that's a large reason why the inventories are not managed in a businesslike manner. We hear a lot these days about a 5- or 10-cent bolt that's costing the Government $9 or $90, and other things have been publicized, but we don't hear enough about how that 40, 50, or 60 billion of inventory that isn't being managed, how much the excess is, how much the obsolete is, and what the carrying costs on that are.

Just for instance, let's suppose that 20 or 25 percent of that inventory doesn't need to be on hand. It can be at the manufacturer's level. That's a modest, you know, 10, 15 billion, and at 12, 15 percent interest, that adds up to just about a modest billion and a half dollars that's being lost all because we don't have a good inventory control system.

Well, consequently, and I'll sum this up quickly, private firms have all their lives and all their lives in the future been pushed very much in the pursuit of profits and the pursuit of excellence and the pursuit of efficiency. They manage their inventories effectively. If we can save just on that experiment $150 million as a modest number over a billion, we can show again how private enterprise, not taking over Government, but helping Government become more efficient, could again solve part of our deficit problem.

Well, armed with this Grace Commission and this little peek under the tent today of the area that I had the good fortune to spend some time with, I hope the public will be more aware of the massive and abusive wastes in Government that absolutely can be documented beyond a shadow of a doubt, and a plan that's not disruptive, is transitional, but not disruptive, to move this area to more efficiency. The public has to realize that the system of public ownership and bureaucratic management is to blame. If we wish to rid ourselves of part and hopefully someday all of this waste, we should go to one of the sources, and we should eliminate, where practical, those areas of public ownership where we can very practically and very humanely introduce private enterprise to show the way.

By doing this, we're going to put the consumers back in the driver's seat, and we're going to put the profit and loss discipline back into our economy. Most importantly, we're going to put this country back on the path of becoming more efficient, more effective, and less burdened by the terrible budget that is an albatross around all of our necks.

Mr. Chairman, I've appreciated the opportunity to be with you today to testify before your joint economic subcommittee. I very much applaud your efforts and your colleagues' efforts. I was very proud to be part of this, and I hope very much that your efforts are successful, because in my judgment privatization is a proven way to solve the problems that accompany public ownership. The only way to ensure that privatization will be the policy adopted is to educate the public, and it will take time, and gain their trust and support for privatization. No policy, however well-founded and logical, can succeed without public support, and I believe that your efforts and the efforts of others will help to generate this support. I thank you very much.

[The prepared statement of Mr. Agee follows:]

PREPARED STATEMENT OF WILLIAM J. AGEE

Mr. Chairman, I am pleased to accept your invitation to address the work of the President's Private Sector Survey on Cost Control (PPSS) and to identify the potential for major savings from the transfer of some of the Government's activities to the private sector -- privatization.

My name is William Agee and I was Co-chairman -- along with Joseph Alibrandi, President and Chief Executive Officer of the Whittaker Corporation and Donald Procknow, President of Western Electric Co., Inc. -- of the PPSS Task Force on Automated Data Processing/Office Automation (ADP/OA). Presently, I am Chairman of Semper Enterprises, Inc. and was formerly the Chairman of the Bendix Corporation.

Prior to discussing privatization, let me provide a brief overview of PPSS's formation, organization, and conclusions, as well as the conclusions of the Automated Data Processing/Office Automation Task Force.

<u>Review of the PPSS</u>

President Reagan decided in February 1982 that it would be useful to have a study of the Executive Branch of the Government by members of the private sector, and he invited J. Peter Grace, Chairman and Chief Executive Officer of W. R. Grace and Co., to Chair the PPSS. The President felt a survey would be useful in identifying inefficiencies, overlap, and waste in the operation of the executive departments and agencies. The President is very concerned about the tremendous increase in the cost of operating the Federal government, which has gone up almost sevenfold since 1964, from $119 billion to $854 billion for 1984. I share his concern.

On June 30, 1982, the President's Executive Order was issued establishing the PPSS, and work began to organize the 161 executives who had been recruited from the private sector into Co-Chairmen of 36 different Task Forces. Each Task Force was assigned to examine one or more of the departments or agencies in the Government or some functional area cutting across Government, such as procurement and asset management. In addition, 11 special reports were prepared by the PPSS Management Office to examine areas of special interest.

In organizing this effort, the private sector was requested by the President to finance the entire survey. Accordingly, more than 2,000 volunteers from the companies of the Executive Committee members and others, and $3.4 million were raised from the private sector to pay for the central administrative expenses of the project. A special Foundation was created to handle the financing of these administrative costs. In total, the private sector contributed $76 million to the survey in people, services and travel, equipment, materials and supplies.

The 47 Task Force and Management Office Reports, consisting of over 20,000 pages of material, 1.5 million pages of supporting documentation, and including 2,478 recommendations, have all been submitted to the President.

The areas of Program Waste and Inefficiency, and Systems Failures account for $312.2 billion, or almost three-quarters of the $424.4 billion total savings identified in those reports, as summarized in the following.

(Chart on following page)

PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL (PPSS)

RECOMMENDED SAVINGS
OVER A 3-YEAR PERIOD
$424.4 BILLION

	($ Billions)
Program Waste (443 Recommendations)	$ 160.9
- Subsidy Program Expenditures	
- Lending Programs and Debt Collection Activities	
System Failures (1,152 Recommendations)	151.3
- The Information Gap	
- Government Finances	
Personnel Mismanagement (422 Recommendations)	90.9
- Compensation	
- Retirement Plans	
Structural Deficiencies (211 Recommendations)	12.7
- Central Financial and Administrative Management	
- Management Tenure in Key Positions	
Other Opportunities (250 Recommendations)	8.6
Total 2,478 Recommendations	$ 424.4

Review of the PPSS's
Automated Data Processing/Office Automation Task Force Report

Now, allow me to briefly review the findings of the PPSS's Automated Data Processing/Office Automation Task Force, which I co-chaired with Messrs. Alibrandi and Procknow.

At present, there is no function of Federal Government -- administrative, scientific, or military -- that is not dependent on the smooth functioning of computer hardware and software. With over 17,000 computers and a workforce of more than 250,000, Federal systems operations dwarf those of even the largest private sector users. The Federal inventory lists over 6,000 general purpose or administrative systems and almost 11,500 special purpose systems.

From the massive transaction-processing activities in agencies like the Internal Revenue Service and the Social Security Administration to military command and control systems, the Government depends on automated data processing (ADP) systems and commits large amounts of resources to acquiring and operating these systems. About 41 percent of the Federal data processing budget is allocated to personnel resources. By comparison only 36 percent of the private sector budget is allocated to personnel. The private sector also spends less of its data processing dollars on softward (10 percent) than the Federal Government (18.8 percent) and more on hardware -- 31 percent versus 20.8 percent for the Federal Government. Although the differences in resource allocation may be due to differing data processing needs, it could also indicate inefficiencies in the ADP function of the Federal Government. This possibility strongly supports the rationale for this Task Force's efforts. Despite the fact that ADP pervades the functioning of almost all aspects of the Government, the estimate of Federal ADP expenditures is only $12 billion, about 1.6 percent of the total Federal budget, but ADP has the potential for savings far in excess of these annual expenditures.

It was the task of the Automated Data Processing/Office Automation (ADP/OA) Task Force to identify opportunities for cost savings, cost avoidance, and operational improvement across Government. As a functional, crosscutting task force, the ADP Task Force focused on six areas: ADP management, ADP acquisition, general systems resources, teleprocessing, office automation, and personnel. To identify potential cost savings on both an agency-specific and a functional basis, the Task Force operated as a matrix organization. Task Force members were assigned to one of five functional area subcommittees. In addition, Task Force members were assigned to act as liaison to various PPSS agency task forces in order to make use of their ADP-relevant information.

The Task Force identified over $29.5 billion in potential net cost savings and revenue enhancement over the first three years. The $29.5 billion in savings and revenue enhancements is composed of:

- $11.1 billion identified by this Task Force in Government-wide opportunities for savings, and
- $18.4 billion identified by other PPSS task forces and reported in individual task force reports on opportunities for specific agency savings and revenue enhancements. These opportunities are selectively repeated in this report to heighten an awareness of the significant potential available across Government and to place the ADP/OA opportunities in perspective. This $18.4 billion in opportunities were netted out in the President's Report to avoid double counting.

It should be noted that these savings are substantially in excess of total current data processing cost. (This is because much of the savings will accrue from substitution of data processing functions for more expensive manual operations, producing cost savings, revenue enhancement, and improved efficiency.)

Reflections on PPSS

The PPSS clearly revealed and carefully documented the fact that, when measured by traditional private sector standards, waste and inefficiency occur in virtually every Federal program. This is not too surprising. After all, any ordinary citizen who compares the operation of a public bureau or agency with a private firm operating in a free enterprise, profit and loss system would, too, discover that bureaucratic management is wasteful, inefficient, slow, rolled up in red tape and hopelessly out-dated.

It is easy to conclude that there should be bureaucratic reform aimed at making the bureaucrats behave like businessmen. Some would even suggest that the replacement of bureaucrats with businessmen would solve the problem and eliminate the waste, inefficiency and so forth.

However, these suggestions are not sensible and are, in fact, unfair. The problem is not with those who man the public bureaus and agencies. The point is that it is the system of public ownership, not the bureaucrats, that ~~are~~ is the source of the problems that the PPSS documented. Actually, the bureaucrats are just as much the victims of public ownership as anyone else.

The key to understanding the waste and inefficiency that was uncovered by the PPSS is to understand the fundamental difference between government and profit-seeking private enterprise.

Let's look for a moment at what drives a profit-seeking enterprise. A private firm's ultimate objective is to make a profit. This means that the private firm must produce what consumers desire. Consumers determine what is of value, so a private firm must answer to consumers. If a firm produces products that are not wanted at the going market prices, then the firm cannot make a profit and it is doomed. In addition to producing what consumers want, private firms must produce these items in a cost-effective way, since firms that do not operate in a cost-effective manner will be unable to compete and will, therefore, be unable to make a profit.

So, the real bosses in private markets are the consumers. With profits as an objective, entrepreneurs will attempt to produce what consumers want. If consumers do not purchase the goods offered, businessmen cannot recover their costs and will then lose money. Moreover, if the businessmen fail to apply the most efficient production practices, they will ultimately be replaced by others willing to do so. In short, under a system of private, competitive markets, those who fail to produce, at the lowest possible cost, what consumers want will be unable to make a profit and remain in business. So, profits and losses are the means by which consumers keep a tight reign on business activities.

This is not the case with public agencies and bureaus. They do not have to answer to profits and losses. In short, they do not have to face the "bottom line".

A busines~~sman~~ Person is judged by whether he has generated a profit or loss. This profit and loss calculus is unavailable, when resources are publicly-owned. Rather than being judged by profits and losses, a public sector bureaucrat is judged by whether he or she has followed the rules. Without having to answer to profits and losses, the civil servant is ignorant of whether suitable means have been used to produce whatever is being produced by the public sector. Without private ownership, the objective of pursuing profits and the profit loss calculus, the civil servant is operating like a Person ~~man~~ who is forced to spend his life blindfolded.

If it is efficiency that we desire, we must rely on private ownership and the profit and loss system.

Now, the implications of these reflections are rather profound. If we want to eliminate the waste and inefficiency documented by the PPSS, we must not advocate replacing the present civil servants with new ones from the business community. Moreover, we must not recommend that the civil servants mimic private sector employees. No. If the results of our private sector operations are so desirable, we must not follow such recommendations. Rather, we should consider privatization and begin to turn government functions over to private enterprise. It is time that we unburden the State and relieve it from conducting activities that it was never meant to perform.

The Privatization Option

The privatization option did not go unnoticed by the PPSS. A Privatization Task Force was formed, and directed by the following distinguished Co-Chairmen: Mr. Eben Pyne, Retired Senior Vice President of Citibank; Mr. David L. Yunich, Retired Vice Chairman of R. H. Macy and Company; Mr. Paul F. Hellmuth, Retired Managing Partner, Hale and Dorr, Attorneys at Law; Mr. Bruce J. Heim, Vice President, F. Eberstadt and Co., Inc.; Mr. Edward L. Hutton, President and Chief Executive Officer, Chemed Corporation; and Mr. Paul E. Manheim, Advisory Direotor, Lehman Brothers Kuhn Loeb, Inc.

The Privatization Task Force found that privatization is not just a new empty word. Privatization is proving in practice to be an effective cost control weapon in cities and towns across America. It is also enjoying popular support in Great Britain (Brith Aerospace and Cable and Wireless) and Italy (IRI and ENI) where companies, which were once private and were turned over to the Government, are now being returned to the private sector.

Specifically, the Privatization Task Force recommended eight areas for privatization. These are summarized in the following table.

(Table on Following Page)

Privatization Task Force Recommendations
($ Millions)

	(1) Recommendation Area	(2) Three-Year Savings(S)/(Revenue(R)
(1)	Power Marketing Administration	$ 3,535.0 (S) 16,301.5 (R)
(2)	Motor Vehicle Fleet Management	1,260.4 (S) 200.0 (R)
(3)	VA Hospitals/Nursing Homes	1,436.5 (S)
(4)	Military Commissary Stores	2,064.0 (S) 383.2 (R)
(5)	National Space Transportation System	1,522.6 (S)
(6)	Coast Guard Services	1,259.4 (S)
(7)	Metropolitan Washington Airports	113.0 (S) 341.5 (R)
(8)	ADP-Social Security	Not Quantifiable
		$28,417.1

As you can see, privatization opportunities are not limited to one management area or department. In addition to the eight areas just discussed, the Task Force and the PPSS Report to the President note 73 additional privatization ~~PPSS~~ issues and recommendation areas with savings and revenue potential of $8.7 billion over three years. These additional areas include automated data processing, construction activities, government loans and insurance, and credit bureaus and collection agencies. The total PPSS combined privatization and contracting out cost savings and revenue is $37.1 billion.

More important than action on these individual savings areas is a need for a structure, process, and strategy to facilitate an ongoing privatization program. To meet this need, we recommend (1) the establishment of a Privatization Office in the proposed Office of Federal Management (OFM) coupled with (2) an administrative and coordinating function in each department and agency. This Privatization office would be responsible for:

- pursuing the 8 key recommendations of the Privatization Task Force, plus the additional 73 privatization opportunities previously identified;
- searching out and analyzing additional Government-produced products and services for privatization;
- aggressively pursuing privatization implementation options as new policies and programs are developed

by asked -- "Is it necessary to produce internally this new product or service?";

- championing the privatization concept to Washington decision makers; and
- inviting, receiving, evaluating, and monitoring privatization proposals from interested private sector firms. Today, if a bright entrepreneur has a good idea, there's no one designated in the Federal Government to present it to.

This department must be creative, dynamic, innovative, and rewarded for challenging the status quo. And, most importantly, it needs Congressional support.

Privatization and ADP

One of the areas that the proposed Privatization Office ~~of Federal Management~~ should look into is the area of privatizing or contracting out for ADP services. As you will recall, Mr. Chairman, ADP is the functional area of the PPSS that I personally was most involved with. I will now turn to a brief discussion of the need and potential for privatizing ADP.

Today, approximately 50% of the government's 17,000 computers are so old that they are no longer supported by the manufacturer. Consquently, they must be maintained by specially trained government personnel. Although this leads to great waste and inefficiency, it is, from the bureaucrat's point of view, desirable. Remember, that public employees are not judged by a profit and loss statement. Rather than having their Salaries ~~his salary~~ tied, either directly or indirectly, to profits -- bureaucrats in management positions have their salaries tied, in part, to the number of personnel that they supervise and the total budget that is under their purview. ~~preview~~. This, of course, puts in place incentives that "push" bureaucrats to prefer out-dated ADP systems that must be maintained by large staffs of government employees, instead of private manufacturers.

One of the areas which best exemplifies the degree of ADP problems in the Federal Government is Social Security Administration's (SSA) processing of information and claims. This area was singled out by the PPSS's Privatization Task Force as a prime candidate for contracting out.

The SSA's ADP is obsolete and unable to meet many of its most basic responsibilities. The SSA's gross work load, including known backlogs, approaches 5,000 control processing unit (CPU) hours per month. However, the maximum capacity of SSA's computers is 3,000 CPU hours per month, and current staffing levels are sufficient to support 2,000 hours per month, based on 40-hour work weeks. So, the SSA is currently operating three shifts per day, seven days per week, and this is not enough to keep pace. In addition, it is not cost-effective. Clearly, the SSA's ADP system is completely inadequate to process required information in a reasonable timeframe.

Competitive markets require that private firms remain technologically current and use their personnel effectively. Therefore, the SSA should attempt to solve its ADP system problems by contracting out or privatizing these functions. Given the existing overload on the SSA's system, this could be done by simply contracting out for the current overload and any new increments in the SSA's work load. By performing this privatization experiment, we would be able to observe the efficiency of the private contractors relative to the SSA. If the private sector proves, as we believe it will, to be more cost-effective, then the SSA should begin to phase-out its existing ADP operations.

Another area where experimentation with contracting out of ADP services would save money is in inventory control for the Department of Defense. The DOD reported total repairable and consumable inventories of about $40 billion as of September 1, 1981, excluding fuel and substance items. These inventories are stored in some 30 distribution depots. Although DOD has long recognized the need for better inventory control through the use of automated reporting and processing techniques used in the private sector, the DOD is unable or unwilling to implement a modern approach to inventory management.

Here again, I believe that the public employees at the DOD just do not have the profit and loss incentives that exist in the private sector, and this explains why inventories are not managed in a business-like manner. Public employees hoard inventories, not because they are stupid, but because they do not have to pay capital carrying charges on the inventories they hold. This is not the case for private firms that must pay capital carrying charges on the inventories they hold.

Consequently, private firms ~~they~~ are "pushed", in their pursuit of profits, to manage their inventories efficiently. It is the pursuit of profits that explains why private firms rapidly adopt innovative ADP inventory control systems.

The PPSS estimated that a one-time savings of $1 billion and a concommitant savings in annual carrying costs of about $150 million would be realized if DOD inventories were monitored and controlled by a private ADP system.

By starting a pilot privatization project for DOD inventory control, we would be able to learn more about its potential at DOD. In addition, we would be able to determine whether there were wider possible applications for contracting out for ADP inventory control systems within other parts of the government.

Concluding Observations

Armed with the PPSS, the public should be able to more clearly recognize that there is massive waste in the government. I only hope that our citizens do not blame the bureaucrats for this state of affairs. The public must realize that the system of public ownership and bureaucratic management is to blame, not the public employees who work for the system. If we wish to rid ourselves of the waste uncovered by the PPSS, then we should go to its source and eliminate public ownership.

By doing this, we will put the consumers back in the driver's seat and put profit and loss descipline back into our economy.

Mr. Chairman, I have appreciated the opportunity to testify before the Joint Economic Committee's Subcommittee on Monetary and Fiscal Policy. I applaud your efforts to explore the privatization concept. I hope that your efforts are successful because privatization is the only proven way to solve the problems that accompany public ownership. The only way to insure that privatization will be the policy adopted is to educate the public and gain their trust and support for privatization. No policy, however well founded and logical, can succeed without public support, and I believe that your efforts at the Joint Economic Committee will generate this support.

Senator SYMMS. Thank you very much for an outstanding statement, which I appreciate very much.

In your prepared statement you made some specific recommendations. One of the recommendations that was made in Washington concerned the Federal automobile fleet. We have 435,000 such Federal automobiles, driven an average of about 9,000 miles a year. If they rented these cars at the going commercial rate, it would be a billion dollars a year cheaper than owning them. I know that might not be practical in every case, where you have a district ranger who needs a truck 50 miles in the forest. I would not recommend disposing of all of them.

Let me list the recommendations the privatization task force recommended: power marketing administration, motor vehicle fleet management, VA hospitals and nursing homes, military commissary stores, the space system, Coast Guard services, the National and Dulles Airports. Here in Boise I think we're very fortunate to have a very well-run Veterans' Administration Hospital—especially in comparison to what I see in other parts of the country. But if you start talking about privatizing the Veterans' Hospital, we hear concern about taking something away from the veterans.

How do we get the message across that we are not trying to cut benefits? Consider the example of the commissaries. When I made a statement about the commissaries, I didn't say that I was for or against privatizing the commissaries. I only stated that the military commissaries are operated on an average of 42 hours a week, whereas the Albertson's store that I occasionally shop at in Boise is open 24 hours a day for the convenience of the consumers. The average supermarket has 9,000 units for sale, choices that the person can make when they go into a store. The best commissaries have 6,000.

How do we go about bringing this matter up without having it defeated right off the bat? For example, I got a letter recently talking about how some fear that Senator Symms is trying to take something away from the military families. In fact, with an experimental privatization of some of the commissaries, you would probably find that military families would prefer it. How do we do that?

Mr. AGEE. Well, you do it delicately and diligently. It's natural when you're talking about some change with regard to services that you've just mentioned, and there are many more, that people will all of a sudden feel that they will get less or they will be eliminated. That's why I think you must take some test cases and some experiments. You don't do it across-the-board every place. You take some of the worst examples, some of the proven worst cases where the disparity between what's being done in Boise, which is very good in the VA area, and as I recall there are several in the East that are being done very poorly, not only in terms of service, but costs, and you get an agreement that you will have a test case at that one place. You will say for 1 year we will try it—or a 2-year period, so you have at least enough time so that you have a phase-in period of time. Then you have a disinterested group of people who review and come back and recommend. It seems to me that that's one of the things the Grace Commission or a successive area can do to take where it was alleged that there would be savings and inefficiencies and better service, that we go back and do some audits, and not audits by the people who are in the Congress or people who happen to be the private enterprise serving them, but a disinterested group of citizens who have their mission to say is the thesis right, can we privatize in these areas, will service go up, will costs go down, will these theories be proven, and you have hearings to say this is what we have to show.

You will always, anytime you have change, whether it's to take the car away from the person whose always had a car, and if you say go lease it from Hertz, or whether it's the VA Hospital or whatever example you want to use, the person who's benefiting by that today feels that change will be worse by definition. What we have to do is gradually show that change can in some cases be betterment, not only financial betterment, but in terms of more efficient, more caring, more understanding type of service, like the VA Hosptial.

So it's gradualism in some cases where human lives and human care is involved. But like in Social Security that I mentioned, some processing in IRS, cash management in this country where we have about $90 billion that's basically unaccountable. It's just kind of floating around the system today. When you look at the cash management system, we don't have a central cash management system in this country like major companies have, where they know where every dollar is at all times. Just running that can be very efficient, where that's not going to affect anybody, whether they be a veteran or somebody on welfare, whatever. Take those areas and do them. But be careful in those areas where human lives, human jobs are affected, do it transition, do it carefully and have a third party come in and support it, or disprove the point.

Senator SYMMS. Well, thank you. On the point of cash management, is it customary for the Federal Government to pay upfront money for a contract? If they had some kind of research and development contract, they pay the money upfront so the Federal Government never accumulates the interest like private companies would?

Mr. AGEE. That is a case of negotiation. In some cases the Federal Government will advance against order because the contractors are saying we want cash against orders. This happens every day in private business. You go in and obviously if you can get your customer to pay you before you deliver the goods, that's all to your betterment. What's happened up until now is that there's become practices in the defense business and others where people say we want an advance against this. Some cases where it's far out R&D, very speculative activity, there can be some justification for that. But when there's a single contractor producing a product that the Government is going to produce for an extended period of time, I would like to see the Government get quite hard-nosed and say fine, send us the bill. We'll be happy to pay in 30 days or 60 days, just like you pay people who supply you, instead of paying money upfront. There's billions right there.

Now, what I'm talking about, that obviously is going to affect private enterprise, and they're going to have to find a way to do that, but that will cut down the cash outflow for the Federal Government. So be better procurers. They're not as hard-nosed at procuring as they should be, by any means, because they have these 331 different systems that don't communicate with one another. They don't run the Government as a business. The sooner they run it as a business, they'll run their cash flow better, they'll be purchasing better, and they'll be saving the taxpayers billions of dollars.

Senator SYMMS. Well, I certainly appreciate your outstanding contribution to this hearing. I can attest to you, Bill Agee, that I'm one Member of the Senate that's not going to let the work that you and others did on the Grace Commission just fall to the wayside. I do think that your point about privatization is one that should not go unheeded, because in terms of cleaning up the water in this country and the air, pollution control, toxic waste dumps, and so forth, it just appears that the fastest, most efficient use of the moneys from the private sector, from the citizens of this country, would be to hire these jobs out to private enterprise. They could do them efficiently, and it certainly would be a good test of how we could start running some payrolls.

I know there's a company called ADP. In fact, we now have a member of the Senate, Mr. Lautenberg from New Jersey, who is a former chairman of that corporation. Their entire business is running payrolls for businesses in the country. The size of the average company that they run payrolls for is about 70 people. I was interested in your comment that it cost the Bendix Corp. 60 cents to run a paycheck and $4 for the Army.

Mr. AGEE. $4.10.

Senator SYMMS. $4.10. So like you say, that's $3.50 more for each check. It might not be practical in every foreign destination to process checks privately. It is probably practical in some places to do so.

What you'd recommend is to take a test area, say, on private commissaries, and then see how the military families like it.

Mr. AGEE. Or a VA Hospital or some of these other areas.

Senator SYMMS. I want to ask you one other question, and then I'll let you go. With respect to accounting costs, there's been a great controversy over whether or not the Federal Government should lease certain items. And from my examination of the commissaries, they really don't charge an accounting cost to the commissary system for the cost of the building, like any other company in the retail grocery business.

Is leasing a more practical way for those of us in the Congress to keep an accounting? There's no capital cost. Explain that to me.

Mr. AGEE. No, no. Let me tell you that's one of the other areas where we're so out of control that it's frightening. We don't even know what the total debt is in this country because there's a lot of off-the-balance-sheet debt, including leases, including other commitments that take our over trillion dollar deficit way up there, to say nothing of unfunded pension costs. But what's happened when bureaucracies have a difficult time getting procurements through, purchases through, they've resorted to leasing.

Leasing is, by definition, more expensive for those people because there's a financing cost built in. Not only are they circumventing the procurement procedure under some of the leases, they're ending up costing themselves more money. They will justify it because they'll say that you can drop the lease after a year or whatever, and that's less than if you sell it. But those leasing companies are in it to make a profit, and they make more profit by leasing over time. You'll find that most leased equipment that the Government goes after, they keep it for the full life anyway, so that asset has cost them more money. Maybe they wouldn't have procured it in the first place if we would have more rigorous rules against leasing.

So off-the-balance-sheet financing, which we have way too much of, whether it be in the REA and the Small Business Administration and some of these other areas where there's billions at risk and billions that we bail them out of, we must do away with that. We can't be schizophrenic. If we're going to pay for everything, as we've done up to now, let's pay for everything, but let's be up front about it and eliminate the expensive leases. It will make you stronger and better in procurement.

Senator SYMMS. How about the depreciating value? I can't ever find out how the Federal Government accounts for its capital costs in depreciation.

Mr. AGEE. They can't, either, and that's one of the problems. What we need to do, what I'd rather see, rather than going leasing, what we should do is refine our accounting principles and practices and also to set up uniform accounting principles and practices throughout the Government.

When you have 332 incompatible accounting systems and you have varying accounting principles, you have chaos. Nobody knows what's going on, and that's part of the problem. If we would mandate more stringent, more uniform accounting practices and accounting systems, we would start to come closer to getting control on how we're running our financial managment. But unless and until we have that, everybody gets confused by the numbers because there are no common numbers, and that's the place you must begin, and then you can start to compare.

Everybody will say their business is different. I happen to be involved in a company where we had 170 different businesses and everybody running their business said they were different. We had one accounting system and it was compatible with everybody else's. We knew exactly where we were, what we were doing and how we depreciated. That's another area you can push on and it will save billions because you will then make the people in Government more accountable. They're not accountable today because of the public sector, and they're further not accountable today because there isn't an accounting system that makes them accountable. Sorry you got me off on that topic.

Senator SYMMS. That's good. Do you have an idea on how that could be implemented? Can the Secretary of the Treasury do this?

Mr. AGEE. No, sir. What I'd do, and one of the suggestions that wasn't in the Grace Commission, is I suggested that we develop a financial czar for a period of time with a self-destruct time of something like 2 years. This financial czar becomes the chief financial officer of the United States. I know we have the OMB and we've got the Treasury, and they're always fighting, and we've got the people, whoever they are, running the Federal Reserve and the people running the Council on Economic Advisers, then the people in the White House, then the Congressional Budget and everything else. You've got all of these fiefdoms around. If we had one central area that was the chief financial officer who was given the mandate to bring order, uniformity, and accountability, and then he disappears so he's not going to build himself a big network there, but come in to say this is what we want to have happen, you'd see a lot of fighting, you'd see a lot of resistance to it, but at least they'd come in with a recommendation that if you want yourself to be accountable and you want uniformity, here it is for you. You can do a Grace Commission type of activity, but it would be a self-destruct one so we wouldn't end up duplicating what happens in OMB and what happens in these other places. You have power too far spread and removed. There is no accountability. The President, unfortunately, has so many different people that he can't look—he has to look to their varying interests. He needs a chief financial officer for a period of time.

Senator SYMMS. The OMB and the CBO are jealous of the Commission, in my opinion.

Mr. AGEE. Sure, sure. The treasury department of Bendix and the controller's department were jealous of one another when I ran both of them as chief financial officer. I had to resolve their differences and recommend to the chief executive that this is the way we would go for accounting policy or treasury policy or whatever. The President of the United States has enough to do with foreign policy and all the other deals that he has to worry about, he can't be the chief financial officer. He doesn't have one. He needs one for a period of time.

You start there. The privatization, in all respects, is the right path and that will soilve part of the problem. But the most fundamental and the bigger problem is the accounting system, is the overall accountability within those items that still stay in the public sector. So you need to do both.

Senator SYMMS. Thank you very much for an outstanding contribution to our hearing.

Mr. AGEE. You bet. Thank you.

Senator SYMMS. I appreciate it. I should have asked if Mr. Hanke had any questions. I didn't introduce Mr. Hanke. He formerly was on the White House Council of Economic Advisers and now works for the Joint Economic Committee part time and for the Manhattan Institute part time and Johns Hopkins University full time.

The way modern education works, the more successful people are, the less they teach. I never have quite figured it out yet.

Mr. HANKE. I keep telling you, Senator, I'm in a private institution. We have flexibility.

Senator SYMMS. OK. Who's the next witness?

I should ask if either Mr. Davidson or Mr. Christensen have airplanes to catch. We'll now hear from Mr. Earl Reynolds, the retired chairman of the board of CH2M Hill. Earl, if you'd please come forward and make yourself known. We appreciate very much your helping us with this. I know that Earl Reynolds has had a great deal of experience in the business of cleaning up the water in this country, and I think this is one place where a lot could be done a lot faster. We all have an interest in cleaning up the water. Probably more could be done faster in the private sector than any other area, and I think that maybe some of these things are already happening. So we look foward to hearing from you, and you have the floor.

STATEMENT OF EARL C. REYNOLDS, JR., SENIOR CONSULTANT AND RETIRED CHAIRMAN OF THE BOARD, CH2M HILL, BOISE, ID

Mr. REYNOLDS. Thank you, Mr. Chairman. I appreciate very much this opportunity to share my viewpoints with you. I have a prepared statement that I think is considerably more lengthy than the time would be appropriate to àllow.

Senator SYMMS. Your entire prepared statement will be part of the record.

Mr. REYNOLDS. I understand that.

Senator SYMMS. As well as appendix A, which is the statement by Richard D. Harza, Harza Engineering Co., will be part of the record, which you've got with you.

Mr. REYNOLDS. Very well. It will be my proposal, if agreeable to you, to highlight the statement, underline some of the things I think are particularly important, probably stress the viewpoint where I'm coming from, since it differs quite substantially from Mr. Agee's, his having undertaken a very major part of the Grace Commission.

As I have been introduced, I am a senior consultant with the firm of CH2M Hill and retired chairman of the board. CH2M Hill is a major national engineering organization. In a recent edition of an Engineering News Record, which is a trade journal of the engineering and construction arena, our firm was listed as the seventh largest design organization in the United States.

Approximately 75 percent of the work of CH2M Hill is involved in serving our clients who are in the public sector. They are local, State, and Federal Governments. A major portion of this work involves the design, construction management, operation and maintenance of water, waste water, solid wastes, hazardous wastes, and electric power projects. I will speak with respect to privatization principally to these areas in which we are now heavily involved in the public sector.

The interest of CH2M Hill in privatization is twofold. First, as I've already mentioned, 75 percent of our clients are in the public sector, providing services to the public, such as water supply, waste disposal, solid waste management, electric power production, and so forth. Increasingly, our clients in this area have had difficulties in financing projects that they need to undertake to properly serve the public.

We see that privatization has many opportunities to provide opportunities for financing public works that would relieve overloaded public agencies from high and increasing budgets.

Second, CH2M Hill as a potential contractor to Federal, State, and local governments, has a very distinct interest in privatization, since we believe we have something to offer to the public that could be provided more efficiently, perhaps more quickly than could be provided by public agencies. Particularly in areas where public agencies are small, they do not have available to them the professional and technical management staff which will allow them to undertake a very complex project.

I might spend just a moment on a definition of privatization, since I think perhaps all of us this morning might be using slightly different definitions. My definition for privatization is a very broad one. I would say that privatization includes all occasions in which a private entity or individual performs a service that is frequently or more often accomplished by a unit of government. Under this broad definition, privatization could include just the simple leasing of equipment to a local unit of government to make it unnecessary for them to secure public financing to buy that equipment. It could also include a simple contract under which a private entity might operate and maintain a rather complex facility that is required to serve the public, such as a water treatment plant or waste water treatment plant, to which you have referred.

At the other end of the spectrum of privatization, we can see almost total control of a given service by a private entity where the private entity would actually arrange for the development of the project, arrange the financing, provide the design, undertake the construction, and when it is completed, actually provide the operation and maintenance of this facility so that the involvement of the public sector would be very minimal.

I would point out that as I'm speaking to privatization, more specifically for local units of government, this is really not a new concept. As people here in the city of Boise are well aware, their water service for domestic water has been for many years very successfully provided by the Boise Water Corp., which is the local private entity, and that the local unit of government has no responsibility or no need for financing and operating water facilities in this city.

Mr. Agee outlined very effectively the critical need of the Federal Government to reduce expenditures, reduce deficits. Perhaps not so much attention has been paid to the fact that local units of government are in very similar situations. I think in general, as far as deficits are concerned, local units of government generally are doing a much better job than the Federal Government. Part of this is because in the State of Idaho it's unconstitutional to actually run up a deficit. The budget has to be balanced each fiscal year. The same provisions in many cases extend to local units of government, special purpose districts, cities, counties, and so forth.

Nevertheless, the needs are critical as the Federal Government is moving to reduce its expentitures in recognition of the fact that there's no way that the Federal Government and the U.S. taxpayer can meet all of the needs, all of the requests that are placed before the Congress. Many grant and loan programs that have existed in the past whereby the Federal Government did make available to local units of government moneys to construct certain facilities, such as wastewater treatment plants, solid and hazardous waste treatment facilities and so forth. The Federal Government is now finding it necessary to curtail these grant programs, which is going to throw a much larger burden on the local units of government. This is an area where, if privatization can be encouraged, the need for the local unit of government to incur additional indebtedness or higher operating budgets could be avoided.

In my prepared statement I have outlined some of the specific examples—advantages of privatization. I think Mr. Agee has already spoken to some of those. Some others that I might mention: Obviously, privatization avoids the need for public financing. Hopefully it will utilize the efficiencies of the private sector, and we're finding in our experience that there are many instances where the privatization can provide a more experienced management and professional input than could be provided by a local unit of government acting on its own.

As an example of this, one of our subsidiaries, Operations & Maintenance International, is involved in the operation and maintenance of wastewater treatment plants. We currently have, I think, something in excess of 18 contracts where we are providing full responsibility for the operation and maintenance of these wastewater treatment plants without owning them. We're just operating and maintaining them. But we are able to have on our staff experts in chemistry, water biology, and wastewater treatment, that a local unit of government couldn't possibly afford and couldn't justify. Those skills are necessary to keep those facilities operating correctly. By spreading this professional management staff over a whole number of facilities, as we're able to do, we can bring a distinctly higher quality of skills to those operators than would be otherwise possible.

I think the private sector could certainly move more quickly. They aren't handicapped by the checks and balances that are apparently necessary at all levels of government. Financing could be arranged quickly. Construction could move as quickly as efficient construction will permit, without costly delays that may be required to attain approval from grant authorities of the Federal Government, and so forth.

Some of our clients see advantages in privatization in the fact that they can transfer the responsibility to someone else. For example, we just recently entered into a contract with the city of Fayetteville, AR, where we have total responsibility for the operation and maintenance of their wastewater treatment plant, and we have the obligation to guarantee that the effluent quality from this wastewater treatment plant will actually meet the State and Federal standards for discharge.

Senator SYMMS. Did you run the billing, also, or did they do that?

Mr. REYNOLDS. No, they did not run the billing in that. We bill the city.

Senator SYMMS. And they bill the customers?

Mr. REYNOLDS. The customers, correct. But the question of customer billing is still a distinct possibility.

Senator SYMMS. But you do have the people that actually supervise the operation of the waste plant and the facility?

Mr. REYNOLDS. Totally.

Senator SYMMS. The city doesn't have to worry about it, then?

Mr. REYNOLDS. No.

Senator SYMMS. Well, who is liable for the stream standard? Are you?

Mr. REYNOLDS. We are, OMI.

Senator SYMMS. You by contract are guaranteeing that you will meet the State of Arkansas and the Federal EPA water standard qualities?

Mr. REYNOLDS. The quality of water. They felt that we had the expertise available and our willingness to make this guarantee was one of the principal reasons that caused them to contract with us.

Senator SYMMS. Earl, when CH2M Hill goes into a contract like that, are you bonded, or do you buy insurance for liability in case something happens and you get a spill?

Mr. REYNOLDS. Yes, we do carry insurance.

Senator SYMMS. Once the city signs a contract with you, their obligation is that they are———

Mr. REYNOLDS. They transfer their full obligation to us.

Senator SYMMS. And they would hold you liable if anything happened?

Mr. REYNOLDS. That's correct.

Senator SYMMS. Where they were held liable? Well, here in Boise we have a problem. Something that I've been working on is the pretreatment of the Hewlett Packard effluent where they have that it's better than the categorical standards that EPA has demanded, and they're saying that they have to have pretreatment as well as postreatment, which is double. Who runs the waste facility here? In the city of Boise?

Mr. REYNOLDS. City of Boise.

Senator SYMMS. It's not private like the water system?

Mr. REYNOLDS. No. the water system is private. The sewer system is not.

Senator SYMMS. Let's take, for example, hypothetically that if CH2M Hill entered into a contract with both the city of Boise and Hewlett Packard, I wonder if we could solve that problem that way? I've been having a hard time getting Mr. Ruckleshaus to see the virtue of my amendment, which will be coming up on the floor of the Senate. I think we have the votes to carry it, but it seems so patently common sense that you shouldn't treat the water twice, that as long as it meets the standards or is better, that that's enough.

Mr. REYNOLDS. There are some instances, and I'm not familiar enough with the technical problems involved here, I do know that they exist, sometimes it is necessary to provide pretreatment of specific types of industrial waste so that the waste in the industrial waste won't adversely affect the operation of the major——

Senator SYMMS. Obviously, these 18 cities that you do this for—did you mention 18?

Mr. REYNOLDS. Yes.

Senator SYMMS. Fayetteville the recent one?

Mr. REYNOLDS. Yes.

Senator SYMMS. They must think they're doing it in a least-costlier way to their taxpayers than the way they've been doing it?

Mr. REYNOLDS. I think it's difficult to determine the cost issue, Senator Symms, because very many times we aren't providing apples in one case and apples in the other. For example, a number of the places that we've come into, been asked to come into, are those in which the operator, the public agencies are already in trouble. They aren't meeting their discharge standards. They don't know quite how to get there. So in that case we've come up with an upgraded operation and probably have more qualified people on our staff, may even have some higher costs, at least for a period of time, till we get that thing straightened around.

Senator SYMMS. You once mentioned the book "America in Ruins," about the infrastructure when proposition 13 passed in California, people were saying "no," they didn't want to spend more money on capital improvements. But the city of Los Angeles—I thought it was kind of interesting—has 6,000 miles of pipe, I think that's in the sewer, and it costs——

Mr. REYNOLDS. That's correct.

Senator SYMMS [continuing]. $3 billion to build it. If you're optimistic, it has a 100-year useful life. That means you need to be rehabilitating 60 miles of pipe for $40 million a year, but yet, the city of Los Angeles is only spending $3 million a year.

Are you saying that you think it might be possible for a company with your capability, coupled with a construction company, to take over the management of the waste facility from a place like Los Angeles and do it, and include in the charge enough money to keep replacing 60 miles of pipe a year; is that what you're——

Mr. REYNOLDS. I think that could be done, and certainly the Boise Water Corp., which is a regulated utility, still has the responsibility of keeping the system maintained. If the depreciation rates, which are—that's another subject, and I won't address that. In an inflationary period, which we have seen and apparently will be facing us for some period of time, the standard depreciation of capital item just will not provide the funds that are necessary to replace it when it does require replacing. Additional financing would be necessary.

Senator SYMMS. It just seems to me like it would be a so much better way for the cities in many cases to operate, would be just to hire somebody to operate it and then hold them accountable for it. The mayor wouldn't have to worry about all of the people that work for the waste disposal plant. He'd let you worry about it and he'd just look at your records. I would think it would simplify things.

Mr. REYNOLDS. I think, Senator Symms, that on that point that I believe the record of local government is probably a little bit better than that of the Federal Government, because it's smaller, it's more visible, the——

Senator SYMMS. Well, I'll tell you one thing, if it isn't any better than the Federal Government, we're sure in trouble, locally.

Mr. REYNOLDS. But I think the record really speaks for itself. Nationwide, privately owned water utilities are not unusual. Privately owned wastewater facilities are not so common, but they are increasing, and I will get to this a little bit later. If the environment is made sufficiently attractive from the tax standpoint and other Federal legislation, I am certain that this privatization effort will emerge as a very logical transition.

I might speak to those questions. I am convinced that privatization has some definite advantages. I think these advantages are sufficiently valuable that the Senate and the Congress should make every effort they can to make this concept more attractive so that it can be utilized. There are currently, however, several measures making their way through the Congress which may severely inhibit application of privatization unless they are modified.

As you are undoubtedly aware, H.R. 4170, the 1984 tax/deficit reduction bill, will soon be considered by a conference committee. If highly restrictive language in the House version of the tax bill becomes law, it will be impossible to utilize privatization for sewage treatment and drinking water facilities. Provisions included in the Senate version of the tax bill contain language which is certainly much better, though there is some question even there that drinking water facilities might be covered.

I have outlined in the written statement some specific recommendations that we have in regard to this tax legislation. First, we would hope that you particularly, Senator Symms, as a member of the Finance Committee, could utilize your position to encourage the conferees to support the following provisions. These provisions are to include the special service contract rule for solid waste, wastewater and energy recovery facilities; to retain exceptions for wastewater and solid waste facilities from accelerated cost recovery systems restrictions where industrial development revenue bonds are used; provide exceptions for wastewater and solid waste from arbitrage restrictions where industrial development revenue bonds are used; and, very importantly, do not impose dollar limits on the amount of industrial development revenue bonds that may be issued to finance municipal drinking water, wastewater and solid waste/energy facilities. Such facilities are public purpose projects vital to public health and environmental quality.

With respect to this last point, the Senate version of the tax bill places no limit on the amount of industrial revenue bonds that can be issued. The House version, however, includes a provision placing a cap on the total amount of IDB's the State may issue on a per capita basis. I would hope that the Senate conferees would insist that either the House cap provision be dropped or that IDB's for waste and wastewater treatment be exempt from any such cap that is included in the final version.

There is one other item of legislation in the Congress that I think will certainly demand the attention of the Senate and the House. There are, as you're undoubtedly familiar, two measures in the Senate dealing with an omnibus public works bill—omnibus water projects bill, S. 1739 and H.R. 3678. The exact magnitude of this bill is not yet known. It's our opinion that it will probably take the form of an authorization that will exceed $10 billion. So lots of Federal tax dollars are under consideration in this legislation.

We note that rather than encourage the concept of privatization in this legislation, there is some language in those two bills, and particularly the Senate bill, that is really very threatening as far as a firm like CH2M Hill is concerned. As presently drafted, these bills would tend to expand the role of the Federal Government at the expense of the private sector, rather than favoring the private sector to entering into areas now untaken by the Federal Government.

As an example, S. 1739 would permit the U.S. Army Corps of Engineers to continue their broad involvement in the engineering aspects of these water project developments. It would further add responsibilities in the field of domestic water supply, which has traditionally been accomplished totally by the private sector or by units of local government. This is a piece of direct competition in the field that has not been entered heretofore by the Corps of Engineers.

In particular, the program authorized under title VIII of S. 1739 pertain to municipal water facilities which have long been the responsibility of local units of government or the private sector with only incidental infusion of Federal funds. Should this bill become law, in our opinion the Corps of Engineers will certainly use its authority to add additional permanent employees to meet what would be claimed as their additional responsibilities.

Senator SYMMS. I'm glad you brought that up. That's very important. It's not too late I think to head some of that off, and I'm glad to have you bring that to my attention.

Mr. REYNOLDS. We think you certainly could be helpful there. It is obviously a growing trend.

Senator SYMMS. This is another example, Earl, of what goes on in Washington. It is difficult for a Senator or Congressman to keep track of all legislation. People like yourself in the private sector know more about what's in the bill that affects your particular interests than the people in the Congress know, and we're the ones voting on it. This is the thing that scares me so much about what goes on in Washington.

Mr. REYNOLDS. But I would certainly hope support could be generated for it. I think there are certainly other Senators that once they are alerted to what the conditions are will be certainly willing to support it. To be candid, I think part of the problem that we didn't get the language that we would like to have seen in the committee version is that, as you well know, the Federal Government is both friend and foe. When the State is interested in a project that would be of material benefit to that State, I'm certain the Senator representing that State is going to be reluctant to incur the wrath of the Corps of Engineers. We have to draw the line and see what is prudent and fair.

Senator SYMMS. That's why I always say if you can get a Congress to meet somewhere away from where the Federal establishment was, they wouldn't be lobbied so much by the agencies. If we could meet in tents out in the middle of the Wyoming desert, we probably could perform more business faster.

Mr. REYNOLDS. I'd like to expand on that Corps of Engineer role a little. The Corps of Engineers claims to have a goal of contracting out 25 percent of their civil works. Civil works, as contrasted with defense works. They include such things as water resource projects, as we've been talking about. They claim to have a goal to contract our 25 percent of this.

Data available to me from the American Consulting Engineers Council says that what they actually do contract out is about 11 to 13 percent. So we really have—already we have a strong competition from the Corps, and with this language in S. 1739 we really allow the camel's nose under the tent without any limitations at all, and we think they certainly should be provided.

We have provided wording of a specific amendment, which we hope that you would be able to offer on the floor, Senator Symms, if you support this. That amendment would be the Secretary shall procure—that's the Secretary of the Army—shall procure by contract not less than 50 percent of architectural and engineering services required for technical assistance, reconnaissance surveys, feasibility reports, design, and construction of water resource projects. With respect to the programs authorized in title VIII—that's drinking water—100 percent of such services described above shall be contracted out.

Now, I think that's a practical amendment. That's probably the best that we can do under the circumstances. Personally, I don't really see that the Corps of Engineers has any role in development of drinking water systems, since they have not historically in the past. I am not quite certain why they have to be at this point, but as a practical matter, maybe this is the best we can accomplish.

Senator SYMMS. They've got their hands full just working on floods, in my opinion. I spent yesterday in Salmon, and they got a job down there that they have to go down and get done before they worry about drinking water. They have to take the plug out of the Salmon River at Dump Creek so they can keep the town from flooding again this winter. That's just a good example. They don't need to get off into some other area. It will just confuse them more on the things that they're supposed to do.

Mr. REYNOLDS. I certainly couldn't agree more. I'm in a little touchy position, as I recognize that the Senator might very well be when he's considering projects that might be beneficial and needed in his State.

Senator SYMMS. I looked at your amendment. I appreciate your bringing it to my attention.

Mr. REYNOLDS. I'm in somewhat the same position. The Corps of Engineers is also a client of ours, as well.

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Senator SYMMS. I understand that, but you see I have no problem with the people working with the corps, and some of those Army officers are outstanding people that I work with and I have the highest regard for them. But as the late Ben Rogee used to say, if the Federal Government would just do the things they were supposed to do and keep its nose out of the things it shouldn't worry about, it could then do the things it was supposed to do well. There are floods all over this country that have been and actually are considered to be a responsibility in some of that area of the Corps of Engineers auspices that started clear back when General Washington set up West Point, and it's been going on a long time. We still have flood problems in States like Idaho and other places in the country, and that's where they should concentrate their energies domestically, in my opinion.

Mr. REYNOLDS. Certainly those are welcome opinions, Senator Symms.

I do very sincerely appreciate the opportunity to appear before you and present this testimony to you.

Senator SYMMS. Well, I thank you very much.

Mr. Hanke, do you have any questions? I've been asking mine, kind of as we go along.

Mr. HANKE. Mr. Reynolds, let me just ask: If you can go back to page 6 and maybe explain just a little bit in layman's language what this special service contract rule change, why that's needed.

Mr. REYNOLDS. I really would have to defer to our tax people. I'm not familiar in detail with just what that refers to. I think some of the other——

Senator SYMMS. Could we submit that question to you and have your tax people answer that for us and we can put it in our record. I'd like to have that from you.

Mr. REYNOLDS. The last thing I claim to be is a tax and financial expert.

Senator SYMMS. We may have other witnesses that will speak to it, also.

Mr. REYNOLDS. I suspect from the brief conversation we had before, we might very well find that out.

[The prepared statement of Mr. Reynolds, together with a joint statement of Mr. Harza and Ms. Cornell, follows:]

Prepared Statement of Earl C. Reynolds, Jr.

INTRODUCTION

Mr. Chairman, thank you for this opportunity to present this committee with my viewpoints on Privatization--An Alternative for Financing Public Services.

My name is Earl C. Reynolds, Jr. Senior Consultant and Retired Chairman of the Board of CH2M HILL a major national diversified engineering organization. CH2M HILL was listed in 1984 as the seventh largest design organization in the United States by Engineering News Record, a national trade magazine serving the engineering and construction industry.

Approximately 75 percent of the work at CH2M HILL and its subsidiaries is involved in serving public clients, including federal, state, and local government agencies. A major portion of this work involves the design, construction management, operation, and maintenance of water, wastewater, solid wastes and electric power projects.

CH2M HILL's interest in privatization is two-fold. First, as a consultant and advisor to many clients who are units of governments, privatization offers, in many instances, an attractive means of financing vital public works projects. Secondly, as a large engineering organization, CH2M HILL is a potential participant in performing services as a contractor to federal, state, and local government.

DEFINITIONS

The term "privatization" as utilized in my testimony this morning will include all instances in which a private entity or individual perform a service that is frequently or most commonly provided by a public agency. Under this broad definition, privatization can include the simple leasing of needed equipment to a municipality or the contract operation and maintenance of a publicly owned wastewater treatment plant by a private entity. It can also include more complex arrangements in which the private entity would assume total responsibility for the development, financing, design, construction, operation, and maintenance of a facility to provide needed service to a public agency.

Under this definition, privatization is not new. Citizens of Boise, Idaho, for example, have long been provided with municipal water supply by a private entity: the Boise Water Corporation. Federal and state governments have long made use of contract services provided from the private sector. The term "privatization" has emerged only recently, apparently in response to new and increased pressures to relieve the financial obligations of government agencies in meeting needs that exceed available budgets.

THE CURRENT PUBLIC WORKS ENVIRONMENT

The decades of the 70's and 80's have seen increasing frustration in the financing of necessary public services by all units of government in the United States. The inability to raise sufficient funds to even maintain, much less replace and expand, an aging intrastructure has been caused by many events and continues to cause grave concern throughout the nation.

Susan Walter and Pat Choate, in their book, America In Ruins, point out the critical need of addressing the problem of maintaining America's intrastructure. To cite a single example, the City of Los Angeles sewer system comprises some 6,000 miles of pipe with a replacement value of perhaps $3 billion. If an optimistic one-hundred year useful life is expected, the need exists to rehabilitate or replace over 60 miles of pipe at a cost of perhaps $30 million per year. Yet the City of Los Angeles is able to spend only about $3 million per year to maintain its system. Concurrently, huge additional capital improvement outlays are urgently needed for sewage treatment plants, water supply, treatment and distribution facilities, and a host of other needs. Funds available from conventional municipal financing and current federal loan or grant programs are simply insufficient.

Imposed upon these increasing needs of local units of government, a significant tax payer revolt has spread from California across much of the nation. Howard Jarvis and his California Proposition 13 didn't cause a problem single-handedly, but this movement accurately reflected the mood of the tax paying electorate. Increasingly, the voters have been saying, NO, to capital improvement. Along with voting down bond measures, rate payers have been increasingly unwilling to accept new or increased service charges. This evident public mood, developing in an environment of concern over the course of interest rates and future inflation, has made intrastructure development and maintenance an extremely difficult and challenging task.

Problems of public works development and maintenance are not restricted to state and local government. Congress, and this Committee in particular, must be acutely aware of the critical needs to reduce the federal deficit, which will undoubtedly involve sharp cut-backs in expenditures which somehow must be made to provide vital services needed by the public.

Something more is needed, and I believe public agencies are considering privatization as a concept which may provide some of the answers to the current issues.

ADVANTAGES OF PRIVATIZATION

Regarding financial issues, it is my opinion that the potential advantages offered to units of local government by privatization are quite clear. They include the following:

- An alternative source of financing may be possible.
- Governmental units can potentially shift "front-end" costs to someone else: the private sector.
- The need for the governmental agency to successfully pass a bond issue, obtain an appropriation, or provide revenue experience may be avoided.
- The limited debt financing capabilities of local and perhaps even state government is preserved and can be utilized for other purposes.
- Overall cost to the rate payer for a specific service may be less.

The above factors can certainly represent significant advantages, and with the possible exception of the last mentioned, I believe these advantages are recognized by units of local government. Other advantages which may by offered by privatization to governmental agencies are as follows:

- Time delays associated with waiting for grants, approval of federal and state agencies, meeting legal requirements for financing etc., may be avoided.
- Privatization may reduce the time required for construction. Time saved in construction, particularly during a period of inflation, generally reflects substantial cost savings.
- Private operation may offer savings in operating costs by spreading administrative, management and professional/technical costs among multiple facilities and by obtaining bulk purchase discounts.
- Since the private sector can frequently move more rapidly and with less need for time-consuming financial arrangements, facilities can be provided with less reserve capacity than may be the case under public ownership. Under private ownership, expansion of capacity can be provided more easily, and hence, more frequently. Capacity provided, therefore, can be more closely matched to capacity required.

There are other advantages to privatization that may not involve direct financial considerations. Units of government for example, may frequently find it to their advantage to pass the responsibility for operating a complex facility to a private organization that is able to maintain a staff of highly trained professionals and technicians not available to the unit of local government. In other instances, the local government may wish to transfer the responsibility for operating a sensitive facility to the private sector. For example, our subsidiary, Operation Management International, has recently contracted with the City of Fayetteville, Arkansas, to operate and maintain a 10 million gallon per day advanced wastewater treatment plant. Under terms of the contract, OMI is responsible to the City of Fayetteville to guarantee that the effluent from the wastewater treatment plant meets the state imposed discharge requirements.

In other instances, local government may perceive a benefit in eliminating difficult political considerations by transferring responsibility for providing services to the public to the private sector. For example, privatization may give the opportunity for a private entity to assume the responsibility for negotiating union contracts with specialty crafts involved in the operation and maintenance of a complicated facility providing water, wastewater, power, or solid waste disposal services to a unit of local government.

CH2M HILL EXPERIENCE WITH PRIVATIZATION

As previously stated, a major interest of CH2M HILL in privatization is to be able to offer to our clients in state and local government alternatives for the financing, construction, operation, and maintenance of public facilities which may be an advantage to the client. Our experience in this area has been most favorable in the areas of energy, solid waste to energy, water, and wastewater management.

In the energy area, CH2M HILL is involved in at least 20 small hydroelectric projects ranging in size from 100 kilowatts to 20 megawatts. Our experience suggests that these projects are today being developed on a more rapid schedule and at a lower cost than that which could have been obtained through conventional financing and management procedures that public agencies are normally required to follow.

CH2M HILL is also involved in development of the world's biggest solar power plant, a 17.5 megawatt facility near Brawley, California. The team in this instance, includes the San Diego Gas and Electric Company owner; Guy S. Atkinson Company, general contractor; Luz Israel, manufacturer of the solar collectors, CH2M HILL, engineers and a number of others firms. CH2M HILL is involved in the design of the facility.

CH2M HILL's subsidiary, Operations Management International, currently has contracts to operate and maintain 18 wastewater treatment plants from Maui, Hawaii, to Fayetteville, Arkansas, as previously described.

In the municipal water supply field, CH2M HILL (in association with the Kansas City firm of Black and Veatch) has recently been selected to provide design and construction engineering services to the City of Austin, Texas, for a $275 million water supply project including major water treatment facilities, reservoir intakes, and a 30-mile tunnel conduit to transport the finished water to the city. Although the City of Austin has not made a final decision, privatization is one of the alternatives for financing the facility which is to be investigated as a part of our services.

Another example of a successful water project involves a $50 million facility for Orlando, Florida. This water resource facility involves a contract by Signal Company for the building and ownership of the facility designed by another consulting firm engaged by the municipal utility. CH2M HILL's subsidiary, OMI, is to provide operation and maintenance services for the completed facility at a cost of over $2 million per year in current value dollars.

FEDERAL ACTIONS REQUIRED TO ENHANCE PRIVATIZATION

I have tried to outline briefly in the foregoing some of the principle advantages of privatization. In my opinion, these advantages are sufficiently attractive to justify taking steps to make this form of providing services to the public more readily availiable.

There are currently, however, several measures moving through the Congress which may severely inhibit application of privatization unless they are modified.

Units of local government in the United States are faced with major problems in the financing of domestic water supply facilities and wastewater treatment facilities required to meet the requirements of the federal Clean Water Act and the Safe Drinking Water Act. In the case of the Clean Water Act, EPA estimates construction needs of $120 billion to solve all of our wastewater needs by the year 2000. In Idaho alone, the unmet need amounts to $323 million. In addition, $60 billion is required nationwide to meet drinking water needs. An effective financing mechanism that can assist local units of government in meeting these requirements is the use of private financing, ownership and operation (privatization) of the needed public works.

As you are aware, HR 4170, the 1984 tax/deficit reduction bill will soon be considered by a Conference Committee. If highly restrictive language in the House version of the tax bill becomes law, it will become impossible to utilize privatization for sewage treatment and drinking water facilities. Provisions included in the Senate version (Dole-Long Amendment No. 2902) of the tax bill contain language which would allow communities to use this means of financing.

As a member of the Finance Committee, Senator Symms, you are in a position to encourage the conferees to support the following provisions that:

- o Include special service contract rule for solid waste, waste water and energy recovery facilities (Section 22-New Section 168)(k)(3)
- o Retain exceptions for wastewater and solid waste facilities from accelerated cost recovery systems (ACRS) restrictions where industrial development revenue bonds (IDBS) are used (Section 715).
- o Provide exceptions for wastewater and solid waste from arbitrage restrictions where IDBS are used (Section 717).
- o Do not impose dollar limits on the amount of IDBS that may be issued to finance municipal drinking water, wastewater and solid waste/energy facilities. Such facilities are public-purpose projects vital to public health and environmental quality.

With regard to the last point, the Senate version of the tax bill places no limit on the amount of IDBs that may be issued. The House version, however, includes a provision placing a cap on the total amount of IDBs a state may issue on a per capita basis. I would hope that the Senate conferees insist either that the House cap provision be dropped or that IDBs for water and wastewater treatment be exempted from any such cap that is included in the final version.

There is another area that must be continually addressed by the Congress if the resources of the private sector are to be fully utilized in the development and re-development of the public works intrastructure of our nation. This issue is the tendency to shift responsibilities to the federal government which should be left to local government or the private sector. For example, the provisions of the omnibus water bills now moving through the Congress, S1739 and H.B. 3678. These bills will authorize $10 billion or more in federal funds for water resource projects. As presently drafted, these bills would tend to expand the role of the federal government at the expense of the private sector. S1739 would permit the U.S. Army Corps of Engineers to continue their broad involvement in the engineering aspects of water project development. It will further add responsibilities in the field of domestic water supply, which have traditionally been accomplished totally by the private sector and/or units of local government.

The programs authorized under Title VIII of S1739 pertain to municipal water facilities which have long been the responsibility of local units of government with only incidental infusion of federal funds and with design and construction being accomplished essentially totally in the private sector or by local government.

Should this bill become law, the Corps will certainly use its authority to add additional permanent employees to meet what will be claimed as its new municipal water authority responsibilities, for this agency currently has no expertise in this area. The Corps will not only take over a traditional private sector A/E market, it will now also compete with us for personnel as it did in the wastewater construction grants program some years ago.

I have attached as Appendix A, testimony of Richard D. Harza of Harza Engineering Company and Holly A. Cornell of CH2M HILL, which was presented last year before the Senate Subcommittee on Water Resources of the Committee on Environment and Public Works regarding cost sharing and urban water supply. This testimony describes in detail how the private sector and local government can perform all elements of a major water resource development projects at a cost substantially less, and in a fraction of the time that would be required if the traditional process involved in federal funding of water projects were followed.

The Corps of Engineers claims to have a goal to contract out 25 percent of their civil works (water resource development projects) to private sector A/E firms. Data available to me from the American Consulting Engineers Council, suggests that the actual amount contracted out is but 11-13 percent of the total architect/engineers (A/E) services. Even without the new programs and projects to be authorized in S1739, this is a costly duplication of the private sector's capabilities.

In order to assure minimum acceptable level of A/E participation in current civil works projects and to preserve our traditional drinking water supply markets, I would hope, Senator Symms, that you, as a member of the Public Works Committee, would offer the following amendment to S1739 when it is considered on the Senate floor:

> "The Secretary shall procure by contract not less than 50 percentum of architectural and engineering services required for technical assistance, reconnaissance surveys, feasibility reports, design and construction of water resource projects. With respect to the programs authorized in Title VIII, 100 percentum of such services described above shall be contracted out."

SUMMARY

In summary, it is my strong opinion that privatization has a strong and important place in meeting the need to construct, redevelop, maintain and operate facilities necessary to offer vital services to the citizens of the United States. Continued vigilance and action by the Congress is required, however, to assure that the resources of the private sector can indeed be brought to bear in meeting these public needs. I sincerely appreciate your interest in this subject and the opportunity you have given me to present my views on this subject.

BOP277/008

TESTIMONY OF

RICHARD D. HARZA

HARZA ENGINEERING COMPANY

CHICAGO, ILLINOIS

AND

HOLLY A. CORNELL

CH2M HILL ENGINEERS

CORVALLIS, OREGON

BEFORE THE

SUBCOMMITTEE ON WATER RESOURCES

OF THE

COMMITTEE ON ENVIRONMENT AND PUBLIC WORKS

UNITED STATES SENATE

REGARDING

COST-SHARING AND URBAN WATER SUPPLY

S. 1031, THE WATER RESOURCES POLICY ACT OF 1983

Washington, D.C.

June 28, 1983

Statement Of Richard D. Harza

Mr. Chairman, members of the Subcommittee on Water Resources. My name is Richard D. Harza, Chairman and President of Harza Engineering, Chicago, Illinois. With me are Holly Cornell of CH2M Hill Engineers, Corvallis, Oregon, and Laurence D. Bory, Deputy Director of Governmental Affairs for ACEC. We are pleased to have this opportunity this morning to address cost-sharing as it relates to urban water supply. The American Consulting Engineers Council (ACEC) endorses S. 1031, the Water Resources Policy Act of 1983, and urges amendments to it to require federal agencies to rely more on the private sector, in the development of water resources projects.

We will make a brief general statement about federal water projects policy and then specifically describe a major urban water supply project totally funded by local sources to show that 100 percent cost-sharing can and does work.

ACEC is an association of 3,800 private engineering firms employing more than 120,000 engineers, scientists and technicians. More than 25 percent of our member firms are civil engineering firms that perform planning, design and construction management services for water resources projects. Dams and reservoirs, locks, hydropower generating facilities, stormwater basins and drainage systems, irrigation systems, ports, harbors and marinas, water and wastewater treatment and supply systems, groundwater recharge projects and aquifer monitoring and control systems are designed and built with the technical expertise of consulting engineers.

ACEC and its members have observed four trends in recent years that threaten the future development and maintenance of our water infrastructure:

1. An increasing reliance and dependence upon federal funding for water projects of all kinds;
2. An increasing demand for uniform national standards or criteria for design of water projects which would inhibit tailoring projects to local conditions and applying innovative design criteria;
3. An increase in the time and money needed to construct water projects due to the bureaucratic delay that accompanies federal involvement; and
4. A neglect of rehabilitation, maintenance and upgrading of existing water resources facilities because federal funding focuses on new construction. The deteriorated condition of the nation's water infrastructure is in part a result of the political attraction of new construction starts.

Water projects funded through the Corps of Engineers, the Bureau of Reclamation, the Tennessee Valley Authority and the independent power commissions have an abysmal record of delay and inflated project costs. A recent General Accounting Office (GAO) report suggested that the Corps of Engineers could achieve greater savings through increased use of value engineering. The average federally funded water resources project does not receive construction funding from Congress until more than 20 years after preliminary feasibility studies are authorized. Each year agencies must ask Congress again for funding of ongoing projects, making the financing of water resources projects essentially a political process. Need, technical feasibility and cost-effectiveness, not politics, should be the primary determinants in selection of projects for funding, as the ACEC supported 1982 revisions to the Department of the Interior's Water Criteria and Guidelines stated.

ACEC's members believe local funding through cost-sharing can alleviate many of the problems outlined above.

Specifically, the cost-sharing concept incorporated in S. 1031 would reduce project costs and accelerate completion by:

- Acceleration of feasibility studies

Local funding of feasibility studies can cut as much as five to seven years off the current 20-year-plus average. Many projects languish for years while the Corps establishes its own internal priorities. Early completion of preliminary studies by private engineers would permit projects to be acclerated toward design approval, and eliminate non-cost-effective technical solutions from consideration. This can save 20 to 30 percent of final construction cost in inflation alone.

- Advanced purchase or options on land acquisition

Many federally funded projects struggle through the funding process only to be further delayed because necessary land acquisition, rights-of-way or condemnations have not commenced. Beginning of the land acquisition process after completion of the feasibility studies may save 25 percent in land inflation and forestall speculative purchase in anticipation of federal funding.

- Advanced commitments of local financing

Establishing a source of local financing in advance of construction approval can also save time and money. Creation of an industrial development authority and preparation of a private investment package (often called "privatization") plan in advance can significantly reduce costs and stimulate local interest and business support for the project. Advance local financing also encourages ancillary taxable investment directly resulting from the project. This may save an additional ten percent.

Local financing of design using local private sector engineers and local participation in construction, such as advance purchase of equipment, are other examples of cost-sharing strategies. It has been conservatively estimated that cost-sharing could reduce project completion times by more than half and total project costs by more than 60 percent in inflation-related savings alone.

Local funding can be accomplished through user fees that reflect the value of the water service. The federal government can create incentives for beneficiaries of funded systems to repay the local share and the operation, maintenance, capital replacement and rehabilitation costs. This will not only reduce the demand for federal funds and the pressure on the federal deficit, but spread the availability and incentive of federal funds further.

The Reagan Administration has consistently asserted that federally funded projects that have an identifiable group of local beneficiaries should be required to share costs if they are "enterprise" derived -- that is, if fees are generated from the federal facility or service. ACEC supports this position. Most water projects primarily benefit local, not national users but such national interests as economic development, energy generation, improved navigation and water quality improvement are generally also served by water resources projects. The funding ratio between federal and local sources should, ideally, reflect the proportionate local and national benefit.

Is cost-sharing practical, can it be the basis for significant water project development? ACEC believes it not only can, but does, and offers an example of a project that was financed through local "enterprise" funding without any federal participation and, consequently, at substantially less cost and far less time.

In the late 1960s the Bureau of Reclamation did some preliminary studies for a major water supply and flood control project on the South Platte River in Colorado. The project contemplated a high and low dam to capture snow melt and provide municipal as well as agricultural water for Denver and the surrounding area. It would also complement an existing flood control reservoir.

It became clear that federal funding for the project was going to be a long-term proposition. The Denver Water Board decided that the Foothills portion of the project was too important to rely on the distant future chance of federal funds. Since this was critical for a reliable source of water for municipal and industrial purposes for the city and its expected rapid growth, the Water Board decided to undertake the project itself.

After additional analyses for location cost and engineering features it was decided to design and build a system with three major components: (1) a dam and impoundment on the South Platte River, (2) a water supply tunnel to take water from the dam to the (3) treatment plant which would eventually double the total water available to the city.

The Denver Board of Water Commissioners selected three private sector engineering firms each with specific experience and skills to plan and design each project component:

- Harza Engineering Company, Chicago, Illinois, my own firm, was selected to design the dam. We decided a double curvature thin-arch concrete dam was the most appropriate cost-effective and efficient technology. The Strontia Springs Dam, by its unique design, uses less than half the concrete of a traditional dam. Its location provides an assured water supply for Denver fed by gravity to virtually eliminate pumping. Hydroelectric generation can be added later. The design was developed using up-do-date computer models which permitted testing a wide variety of alternatives to combine safety, cost-effectiveness and ease of construction. Design and construction were completed in seven years, and our estimates were less than one percent different from the $36.4 million construction cost.

- DMJM/Phillips, Reister, Haley, Inc., Denver, Colorado, were chosen to design the water supply tunnel. This three-mile-long, 10.5-foot-diameter, concrete-lined tunnel connects the intake tower behind the dam with the treatment plant. Design and construction required nine years and cost $22 million dollars, $2 million under design estimates.
- CH2M Hill, Corvallis, Oregon, designed the treatment plant. The plant is fully automated and computer controlled and provides water of quality which exceeds EPA drinking water standards. One hundred twenty-five million gallons per day are treated which increases the total treated water capacity of the city by 25 percent. The design contemplates three additions to the plant capacity, one of which is now being designed. This addition also of 125 mgd will increase the city's capacity to 750 mgd. Ultimately, the plant will double the treated water capacity.

The plant has several innovative design features which save significant operating costs:

- A 3,000 kw hydroelectric turbine installed in the headworks (the point at which the water supply tunnel enters into the treatment plant) driven by the raw water flow generates all the electricity needed to operate the plant with surplus sold to a local electric utility. Estimated annual savings $400,000.
- Because the plant was located several hundred feet above the city power to pump finished water is reduced 38 percent an estimated annual saving of $1.1 million.
- The plant can be run by only two operators. Automation of processes and computer run instrumentation assures maximum efficiency of chemical and energy utilization and reduces unnecessary labor costs. Management data gathering and analysis such as inventory control, maintenance schedules, permit compliance statistics are also built into the system.

The plant was completed for $50 million consistent with design estimates and was delayed only by a four-month construction strike. Finished water was available to the system in June, 1983, as projected in the schedule.

Finding a comparable federally funded project would be very difficult. But based on conservative averages we estimate that this project which cost over $108 million and took approximately ten years to design and construct would not even have been approved for design had the city chosen to await federal funding. Using a very conservative 20-year planning-to-construction cycle and an inflation rate of six percent (half the average construction inflation rate over the last ten years) the project would not have been completed until 1996 and would likely cost more than $228 million. This does not include increased costs due to federal requirements such as Davis-Bacon and other social and environmental regulation.

We suggest, therefore, that the following principles be added to the water resources legislation to accomplish the important national objectives we all desire in water development:

1. Greater reliance on the private sector, especially for engineering and other technical services, such as value engineering;
2. Encouragement of innovative and creative designs that increase cost-effectiveness; and
3. Greater flexibility in national standards in response to local conditions or professional judgment.

These changes are in the public interest because private consulting engineers and construction contractors have unparalleled experience in designing and building water projects for both public agency and private industrial clients, such as power companies. Their record for cost-effectiveness, innovation and on-time, under-budget completion cannot be matched. Local governments and private beneficiaries which will be paying between 30 and 100 percent of the cost under the cost-sharing proposal should have the benefit of private sector engineering skill and know-how.

The realization of the federal-local partnership envisioned by the proposed legislation will be aided immeasurably by the participation of the private sector. The Corps of Engineers and the private sector have worked together to build water resources projects throughout the United States and across the globe. It was not so long ago that our water projects were the envy of and model for the world. Inflation, delay and excessive federal spending have eroded some of that leadership. But renewed and reformed federal cost-sharing policy can make local governments and states partners in that leadership position, not dependents in a federal water welfare program.

We appreciate the opportunity to present our views on this legislation.

Senator SYMMS. OK. Thank you very much, Earl. We appreciate it.

The subcommittee will stand in recess for about 5 minutes and give our reporter a chance to stretch and the chairman a chance to stretch, and then we'll come back to our last two witnesses.

[A brief recess was taken.]

Senator SYMMS. The subcommittee will resume the hearings, and we are delighted to have as our next witness, Mr. Robert M. Davidson, senior vice president of the Parsons Corp., to testify.

Mr. Davidson, please go right ahead.

STATEMENT OF ROBERT M. DAVIDSON, SENIOR VICE PRESIDENT, THE PARSONS CORP., PASADENA, CA

Mr. DAVIDSON. Senator Symms, I'm very pleased to be here to testify before your subcommittee.

My name is Bob Davidson. I'm a senior vice president with the Parsons Corp. of Pasadena, CA. Parsons is one of the world's largest engineering construction companies. We have a strong record in the development of energy projects and natural resources and an equally strong record of building infrastructure facilities, both in the United States and in some 40 countries around the globe. We have designed and built some of the largest airports in the world, worked on virtually every subway system in America, and designed water and wastewater systems from Chicago to Cairo.

In this committee's initial report on America's infrastructure, it was stated that we must develop new financing mechanisms if many of the aging and inadequate infrastructure facilities in this country are to be replaced.

Your assessment is correct. The needs are enormous. The Congressional Budget Office estimates that annual capital outlays for infrastructure needs by all levels of government must increase in constant dollars from $36 billion in 1983 to $53 billion in 1990.

But we are going in the opposite direction. State and local infrastructure expenditures have declined from $35.9 billion in 1968 to $21.1 billion in 1982. Federal grants and direct expenditures are also declining.

In this day of tax revolts and Federal deficits, it will be very difficult to increase Government spending for capital outlays. Several innovative solutions have been suggested, including State and Federal infrastructure banks and bond funds. These ideas need to be explored. I appear before you today as an advocate of another financing mechanism, one that substitutes private credit for public debt and competition for bureaucracy. It is the privatization of public purpose infrastructure.

Just what is privatization? In the first place, it is a new idea only in its application. For decades, many cities have contracted out to have a variety of services performed by companies in the private sector. Rubbish collection, groundskeeping, maintenance services, engineering, and a wide variety of construction services are often performed for municipalities on a contractual basis. In recent years a number of projects in which solid waste is turned into energy have been developed by the private sector.

Privatization is already proving its value in several cities around the country. I am proud to say that in Chandler, AZ, Parsons is playing a pioneering role in the process. Chandler has become the first American city to opt for the private financing of a new wastewater treatment plant. Auburn, AL, is following suit with plans for two new wastewater treatment plants that will be privately funded. In both cases Parsons is the private sector company involved, putting us in the position of being well qualified to discuss this innovative financing technique.

Many of you are no doubt familiar with the growing private industry of treating solid waste by burning it to create energy. My discussion today is focused on the treatment of water and wastewater.

The Environmental Protection Agency has estimated that approximately 6,500 American communities will have to build new wastewater treatment plants by the end of the century because their existing plants no longer meet their needs, either in terms of capacity or in terms of EPA clean water standards. The cost of building these new, upgraded facilities will exceed $100 billion. Reports vary on just how much of this money will be available from the Federal Government. Certain budgetary pressures will lead to a reduction of Federal grants. As a result, more and more communities are looking at privatization as a possible solution to their problems.

By one estimate, discussions are now underway to privatize something approaching 5 billion dollars' worth of these facilities. We believe the figure could go much higher, pending a favorable outcome of legislation now being considered by Congress. My company is receiving inquiries about privatization on a weekly basis from cities and Government agencies that have searched in vain for a cost-effective method of upgrading wastewater treatment programs.

Also, many municipalities are in drastic need of new potable water treatment plants. Estimates are that somewhere between $6.3 billion and $9.1 billion per year must be spent on such plants between now and the year 2000, with actual expenditures to date falling considerably short of that figure. Again, many cities have expressed the desire to have the option to finance these facilities through privatization.

What is the basis for the cities' interest in privatization? First and foremost are financial considerations. With Federal grants drying up and many cities near or at the legal limit of their bonded indebtedness, the prospects of raising tens of millions of dollars for a new plant are not bright. Since many cities are already facing crises in such areas as education, police and fire protection, the funds that are available are going to meet these more highly visible needs. Wastewater treatment and other infrastructure projects, being less visible, are placed at the bottom of the priority list, and they stay there for years. The city of Auburn, AL, for instance, has spent 12 years looking for an economical way of financing a new wastewater treatment plant.

Economy is another reason why cities are turning to privatization. Chandler, AZ's financial adviser, Boettcher & Co., has estimated Chandler will save about $1.1 million per year through the privatization of its new wastewater treatment plant.

The city's residents will also save. Chandler officials say they will have to hike user fees from their current level of $3.50 per month to $7.30 per month this summer and to $8.85 by July 1985. Had they been forced to finance their new wastewater treatment plant themselves, they estimate user fees would have skyrocketed to $18.50 during the same period.

In Auburn, where the average family currently pays $6.72 per month in user fees, costs will climb to $10.85 per month to finance their new facility under privatization; but, had they been forced to use a more conventional form of financing, Auburn officials believe their fees would have increased to at least $13.30 per month.

But there are other key factors in keeping costs down, which privatization allows, through the development of turnkey projects. Normally, facilities such as water and wastewater treatment plants are designed by one firm, built by another, and then operated by city employees. While this may appear on the surface to be a good system of checks and balances, what it has really meant is that the engineers have frequently designed such plants without enough thought to the constructability of the design. It looks good on paper, but can it be built that way? Frequently, the answer is no. The American Clean Water Association says its research shows that a steady stream of change orders has in the past driven up the cost of constructing these new plants. Nor have these plants been designed with efficiency of operations and maintenance in mind. Operations and maintenance costs can be reduced if the plant designers take O & M problems into consideration when the plant is still on the drawing board.

While these factors can contribute to cost savings that are passed along to cities, I must point out that the private sector can and will pass on even greater savings, including tax savings, if given the opportunity to develop such projects.

The resolution of two tax issues currently before Congress will determine whether cities will be given the option to finance their wastewater and water treatment facilities through privatization.

The first issue relates to the availability of investment tax credits and accelerated depreciation to the private parties who finance and own these facilities. A current House of Representatives proposal, H.R. 4170, designed principally to place restrictions on leasing to municipalities, is so broadly and poorly drafted that it would threaten to remove these tax benefits for owners of water and wastewater treatment plants who provide a treatment service to a municipality. Such highly restrictive legislation is antimunicipal and antiprivatization.

Under its provision, a company wishing to finance and own facilities for the manufacturer of some drug paraphernalia or pornographic materials would receive an unimpaired right to investment tax credits and accelerated depreciation. If the same company wished to finance and own facilities to clean a city's water, these tax benefits would be denied. Our cities and our people will not long tolerate legislators with those values.

The second threat relates to companion legislation which would limit the use of industrial development bonds for the private financing of these infrastructure facilities. If tax exempt bonds are to be limited, it should be done sensibly. And many limitations should go to the use of bonds, not to the issue of private versus public issuers or ownership. Certainly, it is just as much in the public interest to encourage private companies to use their own credit to construct public purpose infrastrucutre as it is to encourage debt-ridden cities to incur still more debt.

Reducing Federal deficits and closing tax loopholes are laudable goals. The tax provisions I have just outlined, however, cannot be shown to raise a single dollar, and if adopted, will no doubt kill any possibility for the future privatization of water and wastewater facilities.

The EPA has mandated an end to the dumping of untreated or undertreated sewage by 1988. Municipalities have been told that a lack of Federal funds to pay for upgraded plants won't be considered an acceptable excuse for noncompliance. EPA officials have been quoted as saying they mean business as far as enforcement goes with communities that fail to develop secondary and advanced treatment systems liable for fines. In some cases, EPA-fostered lawsuits are expected.

Without recourse to privatization, many communities will find themselves with their backs against the wall. With State limits on their bonded indebtedness and on property taxes, many cities can only hope once again for what has all too often been the last refuge of municipal governments, the Federal bailout.

If Federal funds are not available, cities will be forced to turn to so-called creative financing, which brings with it a variety of pitfalls and risks to municipal credit ratings. Privatization is a better solution. With privatization, the private sector company involved assumes substantially all the financial risks of such a project.

Some critics have contended that municipalities leave themselves open to numerous risks once they begin doing business with private sector companies. That is contrary to our experience. We have found city officials and their professional advisors fully capable of choosing among competing privatization proposals and contracting sensibly for these services. Indeed, given a choice, they would prefer to avoid the redtape of Government grants.

In summary, there is no question that thousands of communities around the Nation are making some very hard choices if they are to maintain the basic level of services the public has come to expect. At the same time, the Federal Government is getting tougher in its enforcement of environmental protection regulations, while warning that the Federal well into which cities have been dipping for years is beginning to run dry.

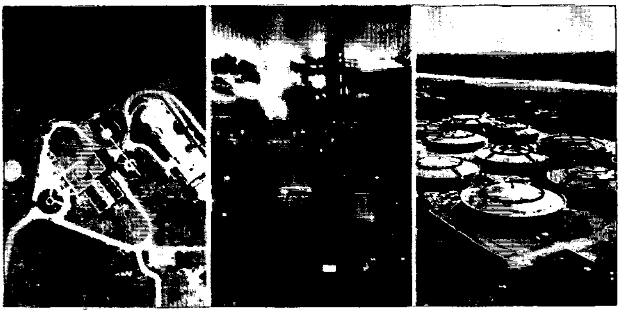
Cities and other local governments are in desperate need of new infrastructure facilities they simply don't have the money to pay for. Privatization is a logical alternative to meet these needs. Privatization has been endorsed by many States and cities. Several States, such as Utah and Alabama, have adopted legislation to encourage privatization.

In my own State of California, Governor Deukmejian's infrastructure review task force has recommended the privatization of wastewater treatment and other facilities as a means of meeting California's critical needs. The enthusiasm and support of State and local governments has been demonstrated. The interest and ability of private industry has also been demonstrated. What is needed is a cooperative attitude on the part of the Federal Government.

Thank you for the opportunity to address this subcommittee. If you have any questions, I would be pleased to answer them.

[The following articles were attached to Mr. Davidson's statement:]

Privatization of Public Facilities



The Parsons Corporation

PRIVATIZATION:

The wave of the future for U.S. cities

American cities, faced with the need to expand or rebuild many public works and infrastructure projects, are discovering a new financial option in their efforts to meet those needs.

The concept is called privatization, a unique blend of government and private enterprise.

Privatization offers local government a practical method of providing an essential public service without placing an increased financial burden on taxpayers. Under the privatization concept, private enterprise not only designs and builds, but also owns and operates an infrastructure or public works project. Through the use of industrial revenue bonds, private industry also provides complete financing, a method that allows the community to deliver a requisite service without raising taxes, increasing user fees or impairing its own bond rating.

A pioneer in the development of the privatization concept, The Parsons Corporation is one of the world's largest international engineering and construction organizations. Parsons operating companies each year design and/or construct facilities for government and industry worth approximately $2.6 billion.

Under the privatization concept, Parsons or one of its subsidiaries, such as the prominent environmental engineering firm Engineering-Science, Inc., provides design and construction management services, as well as operations and maintenance and complete project financing.

Parsons' services in the area of privatization are being made available to a wide range of municipal facilities, among them water and wastewater treatment plants, conventional and cogeneration power plants, and transportation systems.

The Parsons Corporation

Chandler Privatizes Wastewater Facility

By Robert M. Davidson, Senior Vice President, The Parsons Corp.

Like many Sun Belt cities, Chandler, Arizona, has undergone dramatic growth. Founded in 1912 as an agricultural community 35 miles southeast of Phoenix, Chandler underwent a population explosion in the 1970s because of an influx of goods-producing industries ranging from electronic calculators to mobile homes. The city's population grew from almost 14,000 in 1970 to nearly 30,000 in 1980 and has since risen to more than 45,000.

As is the case in other cities, growth has strained Chandler's ability to provide municipal services, including wastewater treatment. Chandler, however, has taken a step to solve its problems, by becoming the first municipality in the nation to opt for the privatization of a new wastewater treatment plant.

An extended aeration, activated sludge facility capable of processing up to five million gallons of wastewater per day will be built on a 40-acre plot in Chandler, and the entire facility will be privately financed as well as privately owned and operated. Chandler will pay a monthly service fee to have its wastewater treated and will retain ownership of the end product. The new plant will be a reclamation facility with the treated water sold to local agricultural interests for irrigation purposes and later to developers for recreational and industrial use.

Chandler's decision to turn to the private sector for help in providing needed municipal services began in 1979 when the city commenced an extensive program of planning for future growth. With the population swelling by an estimated 1,000 people per month, Chandler officials recognized that needs would overburden the city's ability to deliver municipal services unless careful planning was undertaken. According to City Manager Hal Schilling, privatization was one of the alternatives under early consideration.

"We are a city with no reservations on the issue of the private ownership of public services," says Schilling. "As long as the service offered is equal to or better than that which could be provided by a public agency, and as long as the cost is right, we will go to the private sector."

That philosophy had already led Chandler to contract with private enterprise for refuse and garbage collection, as well as some public groundskeeping and civil engineering review services. But the development of a new wastewater treatment facility differed from those projects, due to the required heavy capital outlay.

Among the people providing financial advice to the city was Boettcher & Company, a Denver-based investment banking firm. Steve Butterfield, a municipal finance specialist in the firm's Phoenix office, recommended a privately financed program.

"Privatization was a much-discussed, but yet untried, method of financing treatment plants," says Butterfield. "But the more we looked into it, the more sense it seemed to make."

Boettcher identified numerous advantages for Chandler in privatization. Privatization would free the city from having to raise user fees, and left Chandler's bond capacity unimpaired, thus permitting conventional bonds as an option for financing other needed services.

Privatization would also save Chandler both time and money in bidding the job, and Boettcher convinced the city that a new wastewater treatment facility could be built and operated by private enterprise for less money than Chandler could build and operate the plant itself. Boettcher's plan, accepted by the city council, called for raising approximately $23 million through industrial development revenue bonds to be issued by the Industrial Development Authority of the city of Chandler.

The next step was to find a company with the expertise to build and operate the plant and the willingness to take the financial risks. The Parsons Corporation, an engineering/construction organization headquartered in Pasadena, California, was selected for the project.

In order to take advantage of incentives that would make industrial development bonds attractive to potential investors, the funding phase of the project needed quick institution. Worried by a possible loss of federal tax dollars through the sale of tax-free industrial revenue bonds, some members of Congress have threatened legislation that would make the issuance of such bonds more difficult. Since Arizona has no laws prohibiting the private ownership of public facilities, it was important to close the project in 1983, before the effective date of any adverse legislation.

The funding plan Parsons offered included two alternative proposals to the industrial revenue bond concept Chandler was using. The first was the use of the financial strength of the corporation to back the issuance of the bonds. The second was the use of a variable or floating rate rather than a fixed rate to pay bond holders.

The two Parsons' proposals were accepted by Chandler officials. Three weeks after Parsons was selected, a comprehensive service agreement was completed. Chandler's Industrial Development Authority subsequently issued nearly $23 million in floating rate industrial development bonds secured by an irrevocable letter of credit from the Bank of America and backed by Parsons.

The agreement included review of the initial wastewater treatment plant design by Parsons' subsidiary, Engineering-Science. This option allowed Parsons to assume design responsiblity for certain aspects of the plant. Construction and plant operations and maintenance will be the responsibility of a new subsidiary, Parsons Municipal Services, Inc.

The decision to privatize a needed public facility has allowed Chandler to provide its residents with a public service without a significant increase in user fees or a general tax increase. The use of floating rate industrial development bonds will save the city an estimated $1.1 million per year in the cost of financing the wastewater treatment project.

Schilling sees privatization as a possibility for other public works projects in Chandler. "We need to get more and more private investment in our communities, but you can't if you don't have the infrastructure to support new facilities," he says. "Since you won't have the federal government to defray as many of the expenses in the years to come, this kind of financing of public facilities is the future." □

James Flanigan

Parsons Shows Ingenuity Can Work Wonders

Whatever happened to Yankee ingenuity? You get the feeling sometimes that the whole country is like an old house going to ruin because the handyman has gone away. The bridges and roads are in need of repair; traffic is snarled but there are no trains; electric power plants—planned at a different time for different needs—are too expensive to open, too costly to cancel. There never seems to be enough money to do what needs to be done. What's happened to Yankee ingenuity?

It's alive and well and recently showed its face in Chandler, Ariz., a growing town of 45,000 that is 25 miles southwest of Phoenix. Chandler needed a new waste water treatment plant but was hard pressed for the money to pay for it. The city asked prospective contractors to be prepared to put up 20% of the cost of the plant if they wanted to be considered for the job of building it. But in came Parsons Corp., the Pasadena-based engineering and construction company, and offered not only to finance the entire $23-million plant but to own and operate it, selling the water treatment service to Chandler for the next two dozen years, after which the town will have the option of buying the plant or continuing to pay for Parsons' service, but at a lower rate.

Profitable Company

Is Parsons an angel of municipal mercy? Not at all. It is a highly profitable engineering company with an $8.5-billion backlog of work, and earnings last year of $46 million on $800 million in revenues—the third largest, after Bechtel and Fluor, of the big U.S. engineering firms. Parsons makes its money, whether designing and building a new industrial city in Saudi Arabia or retrofitting a refinery in Louisiana, by billing the time and output of its engineers. And good money it is, roughly 26% on investment last year.

It will make a comparable return on its investment in the water treatment plant for Chandler, yet the community will pay less for the service than if it had financed the project itself with tax-free municipal bonds. How is that? First of all, Parsons has put up $23 million to back industrial revenue bonds that will be issued by Chandler, but not charged to the town's debt total because Parsons is bearing the risk. Also, because Parsons is a private company, it can take the risk of floating interest rates on the bonds—currently it is paying less than 6%—while a political entity using public funds could not. Then, too, Parsons will benefit from tax credits—the investment tax credit (about 10%) and accelerated depreciation—that will shelter its other corporate income. The result: Chandler gets a low service charge for water treatment, and Parsons gets work for its engineers and a good profit.

Parsons is bidding on a similar project in Auburn, Ala., and looking also to build, own and operate steam and electricity co-generation facilities for chemical companies near Houston (Parsons would sell process steam to petrochemical producers, and sell the electricity to Houston Lighting & Power).

Loaded With Spare Cash

Note: Parsons is loaded with spare cash, and it is a relatively slow time for engineering projects worldwide. Other companies might think of diversification at such a time. But Parsons, more sensibly, is developing a variation on its main business, playing from its strength. "We are not uncomfortable designing and building these plants," observes Chairman William Leonhard, a former Air Force general. "It's a way to make an honest buck."

"It's a concept whose time has come," declares Harvey Goldman, a partner in the accounting firm of Arthur Young & Co. The Young firm pioneered the idea of privatizing public works two years ago when cutbacks in federal funding for water treatment left localities in difficulty. Now it is consulting with Utah, on four projects in Salt Lake City, with New Jersey, on a $40-million facility in Bayonne, and with 22 other states on ways in which private industry and local government can work together.

Is this a healthy trend? Of course it is. The skills of private industry are being directed to the public purpose, and tax credits, for once, are being used to foster useful and necessary work. Think about that the next time some after-dinner speaker or political candidate gives off a belch of hot air about the implacable conflict between business and government. With a little ingenuity they can work together for the good of all.

Los Angeles Times

Sunday, March 11, 1984

BusinessWeek

'PRIVATE' PUBLIC WORKS

CHANDLER MAYOR BROOKS AND BUILDER DAVIDSON: SAVING MILLIONS IN SEWAGE BILLS

Although raw sewage has been running down their streets, distraught city fathers in the tiny Southern California town of Norco could not afford to build a new sewage-treatment plant. As a result, they faced the unpopular prospect of turning away new residents and businesses. But this year, Norco finally hopes to break ground on a sewage plant—thanks to a financing technique called "privatization." By enlisting a profit-making company to build, own, and operate basic facilities, Norco and other financially pinched cities may get municipal services sooner and save up to 60% at the same time.

Under privatization, a facility—such as a wastewater or sewage-treatment plant—is financed with tax-exempt industrial development bonds (IDBs). The IDBs are issued by the municipality or county, but they are an obligation of the private company that owns and operates the plant and is responsible for paying the bondholders. The company's cost of borrowing through an IDB is virtually always lower than it would be without the tax-exempt status. Once the facility is up and running, the owner takes the tax benefits that normally go along with a private project, including investment tax credits and depreciation—benefits that are not usable by a municipality.

The tax advantages that the corporation captures help produce a huge saving for the city. But it is precisely these tax benefits that have raised hackles in Congress, which is currently in a frenzy of loophole-plugging to shrink the budget deficits (page 29). Faced with a storm of protest by governors, bond underwriters, and pollution-control companies, the lawmakers are unlikely to simply outlaw IDBs, but even their alternative proposals would jeopardize many privatization projects. For instance, they would like to limit each state's IDB issuance to $150-per-person, a cap that would leave cities fighting for their annual share.

RUNAWAY ENTITLEMENTS. Congress also wants to put a $40 million limit on the number of IDBs per company and shrink tax benefits by tightening depreciation rules. Says Dan Rostenkowski (D-Ill.), chairman of the House Ways & Means Committee: "We recognize that volume limitations are very controversial, but they are the only effective way to control what has become the equivalent of a runaway entitlements program."

Robert M. Davidson, senior vice-president of Parsons Corp., says if such proposals become law, "it will severely damage, if not end, the privatization projects." Parsons, a Pasadena (Calif.) engineering firm, hopes that at the least certain key community services will be exempted from any legislation. The company expects the profitable activity to become a major business thrust.

The Environmental Protection Agency estimates that some $118 billion worth of work needs to be done by the end of this century in sewage treatment alone. Parsons' Davidson sees at least as much construction needed in water treatment. "There simply is not enough money in the federal Treasury to support those needs," says Jack E. Ravan, the EPA's assistant administrator for water. Other candidates for privatization are hydroelectric generation stations, toxic-waste projects, transit systems, office complexes, parking garages, and health and educational facilities.

PRIVATIZATION OR BUST. One of the most established applications of privatization is the refuse-to-energy projects that Signal Cos., a La Jolla (Calif.) conglomerate, has pioneered for nearly a decade. Now, as more towns bump ceilings on their bond-issuing capacity and find federal grants drying up, the technique is gaining wider notice. Some city officials, such as Norco's Ronald E. Cano, see a partnership with a private company as their only option. "We were really up against a wall, and conventional financing was too expensive for us," Cano says. A Boston engineering firm, Metcalf & Eddy Inc., will finance, design, manage the contruction, own, and run Norco's new sewage-treatment plant.

Investment bankers and consultants say that dozens of other cities—including Auburn, Ala.; Trenton, N. J.; Salt Lake City; and Orlando—are considering projects using privatization. For the rapidly growing Phoenix suburb of Chandler, privatization was "the only practical alternative" for building a new sewage-treatment plant, says Barry H. Webber, the town's director of management services. "We either had to do this or stop growing."

Utilizing a $22.9 million IDB, Parsons Corp. will build the town's sewage plant at a cost to Chandler equal to an interest rate of about 7.2%. The company will provide a wastewater treatment service, but the water will still be owned and controlled by the town. Parsons will have no direct contact with the public. Chandler will pay Parsons its fee while it will continue to bill its residential and other sewage customers.

Most cities, of course, have not privatized such facilities, often financing them with revenue bonds backed by fees the city collects from users of its sewage and water systems. That alternative, however, is not always feasible. Says Chandler's Webber: "We couldn't hope to go to the Street and sell a 23-year revenue bond issue at 7.2%."

HARD SELLS. Webber figures Chandler is saving $1.1 million a year during the contract's 25 years, and the savings will be passed on to users. Instead of sewage bills jumping from $3.50 per month to $18.50, they will rise to only $7.30 this summer and to $8.85 in July, 1985. Although he says structuring the deal was difficult, Webber is considering privatization for a water treatment facility, too. Jerry Brooks, the mayor of Chandler, concedes that there was resistance to the technique at first, "but once the people and council members understood it, they were wholeheartedly behind it."

ENR *Editorials*

Privatization is no scam

The flood of private investors champing at the bit to get in on the wastewater privatization bonanza automatically signals alarms in Washington and town-council chambers. The tax-shelter potential is immense. And that sounds like big money can be made by private investors providing public services—exactly the opposite of what well-intentioned promoters of the privatization concept want to convey.

Wall Street is spending time and money to convince Congress to retain the generous tax benefits available for private investors in municipal wastewater treatment plants. But they are putting the cart before the horse. Nearly everyone contacted for this week's article on privatization in the wastewater business noted that they have investors lined up but no place to put all the money (see p. 24). Municipal officials are curious, but few are taking the bait.

One estimate of the privatization potential in the wastewater business is that it will rival the federally subsidized market created by the Environmental Protection Agency construction grants program. Without the municipalities on board, however, it won't amount to a hill of beans. What's needed—and what the American Clean Water Association (ACWA) is trying to put together—is an educational campaign directed at municipal officials and the public showing that privatization is not a scam but a logical way to finance, design, build and operate new systems or expansions.

Larry J. Silverman, executive director of the 200-member organization formed in 1979 to meld environmental and wastewater business interests, is leading the educational effort from his office in Washington, D.C.

Few are better qualified to convince the tennis shoe contingent of the good results that can be had by unleashing the Wall Street wolves. Silverman is a lawyer, a graduate of Ralph Nader's lobbying school and a convert—after the 1977 amendments to the Clean Water Act—to the proposition that businessmen and environmentalists work best together as a team promoting clean water. He has credibility and experience in Washington and in town councils.

ACWA seeks to become the clearinghouse for information on privatization. The dedication and experience is there. What it lacks is a war chest.

Reprinted from ENGINEERING NEWS RECORD, January 19, 1984

ENR
Feature

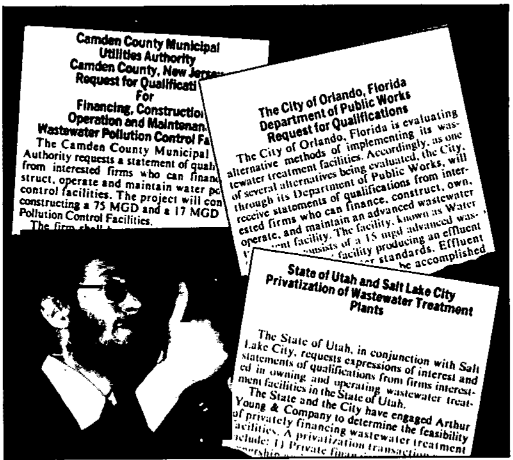
Private cash in public pipes

First wastewater privatization pact signed, more on the way

The concept of private ownership, operation and responsibility for municipal services in the U.S. is catching on in the sewerage business as cash-strapped towns are lured into the complex privatization arena by promises of prompt completion of needed projects and reliable service at affordable prices. The first such deal in the wastewater field has been signed with a fast-growing electronics hub south of Phoenix. And towns in California, Pennsylvania, Mississippi and New Jersey may be close behind.

"There is about $5 billion worth of projects I'm aware of where people are actively working on some kind of wastewater privatization program," says Harvey J. Goldman, a partner at management consultant Arthur Young & Co., New York City. Goldman, one of the earliest and most enthusiastic promoters of the idea, says he has privatization studies under way for two dozen clients—including New York City—and for treatment plants and pipe projects ranging from $3 million to $750 million.

French and West German engineering and wastewater equipment firms, with long experience owning and operating treatment plants at home, are looking to sell their experience here. They are joined in the search for willing municipal partners by nearly every major U.S. environmental engineering firm plus a handful of contractors and equipment suppliers.



Environmentalist Silverman is key lobbyist promoting private responsibility for clean water.

Those that have successfully tapped the treatment plant operation and maintenance business have an advantage because they have earned the trust of municipalities. But the market is large. About 5,000 towns and cities need to expand treatment capacity or build new sewerage systems, according to the Environmental Protection Agency. For a lot of them, private equity is the cheapest source of cash for getting projects stalled in EPA's construction grants pipeline moving toward construction.

For investors, "The tax credits involved in municipal sewage treatment projects are far better than for real estate or most other tax shelters. The multiples are so great, there's no better place to put your money," says Robert G. West, chief financial officer for The InterWest Group, Inc., a San Ramon, Calif., residential developer and prospector in the wastewater privatization market.

Pathfinder. The Parsons Corp., Pasadena, Calif., has grabbed the first slice of the pie as the sole financier of a 5-mgd advanced wastewater treatment plant for Chandler, Ariz. And the big constructor is hungry for more. After being selected in Chandler's second solicitation, "we sat down with the city, negotiated the contract and sold the bonds in less than a month," says Jacques R. Allewaert, manager of corporate accounting for Parsons. "We want to be in this business and we're going to promote it heavily."

Parsons, ranked fifth on ENR's Top 400 contractors' list last year with $4.3 billion in new 1982 contracts, is financing the project with $22.9 million in industrial revenue bonds issued as tax-free, floating-rate securities sold to institutional investors by E.F. Hutton & Co., Inc., New York City, and by Chandler's financial adviser, Boettcher & Co., Denver. The 25-year bonds, backed by a letter of credit from the Bank of America, initially carried an interest rate of 6%. The rate on the "lower-floaters" changes monthly but has averaged 6.3% since the bonds were introduced in September, 1981.

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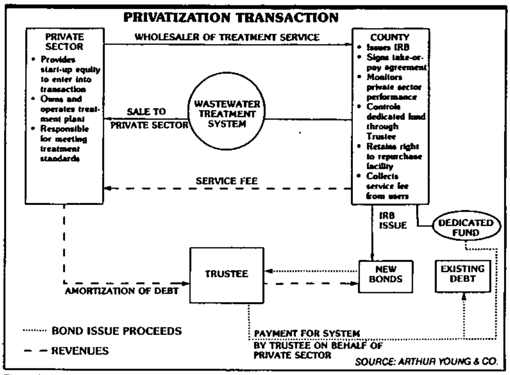
Parsons will provide engineering and construction management on the project while a new subsidiary, Parsons Municipal Services, Inc., will be responsible for plant operations and for effluent quality under a contract that, because of state procurement regulations, must be renewed annually. Another Parsons subsidiary, Engineering-Science Cos., Arcadia, Calif., will do design reviews and construction inspection. The plant is scheduled to begin delivering treated sewage to the municipality for agricultural use by the end of 1985. Eventually, the effluent will be sold to developers of a 5-sq-mile new town near Chandler.



Financing packages involve complex divisons of responsibility to protect all partners.

Chandler, 25 miles southeast of Phoenix, currently averages a new housing start every 34 minutes to support a flood of electronics and computer industry professionals. The population is expected to grow from 45,000 to 100,000 by 1990 and to 300,000 by the turn of the century. "We can't afford to sit around and wrench our hands. We had to do something to accommodate growth or begin shutting things down," says Harold L. Schilling, city manager.

The wave of the future. Chandler is not unfamiliar with public-private partnerships. It has contracted out its garbage collection, parks maintenance and engineering plan checking to private firms and expects to award a contract similar to the wastewater project for its potable water treatment system sometime next month. "This is the wave of the future for U.S. cities," says Schilling.

Not the immediate future. Despite cutbacks in EPA grants and the private tax advantages shared with municipal partners, only a handful of towns are seriously considering the leap into private ownership of wastewater plants. Part of the reason is the uncertainty over federal legislation on the use of tax-free industrial development bonds for municipal projects and other tax advantages given to private investors in such projects. "If you want to make video games, OMB and Treasury will give you all kinds of tax credits. But if you want to make clean water, they want to take those credits away," says Larry J. Silverman, founder and executive director of the American Clean Water Association, a Washington, D.C., environmental business group leading the privatization lobbying push there.

The other side is that most municipal officials and their constituents don't trust fast-talking MBAs in pinstripe suits. "People think they're getting ripped off and unions are very suspicious," says Silverman. Over the long run, that caution is healthy, he believes: "If one or two municipalities get screwed early in the game, this whole privatization thing will go the way of the Zeppelin."

Clean water. An environmental hardliner, Silverman sees the entry of private business—and especially engineering firms—into the municipal wastewater market as the surest route to affordable clean water. "It's a lot easier to get serious about enforcement with a private company than it is with a municipality," he observes. And secondly, "In the EPA grants marketplace, the profits are made in change orders—$100 million in New York State alone. In the privatization marketplace, it wouldn't be that way. They would be turnkey projects, putting the bankers, engineers and contractors on the line."

Most engineers are not opposed to designing cost-effective sewage treatment plants—or to making money. "We can make a living owning and operating treatment plants," says William K. Davis, vice president of BCM Eastern, Inc., a subsidiary of Betz Converse Murdoch, Inc., Plymouth Meeting, Pa.

Davis is waiting for the Pennsylvania Public Utilities Commission to decide how much it would get involved in the regulation of a proposed wastewater privatization pact between BCM and a semirural community south of Philadelphia. He has lined up support from the governor on down for a $10-million project to install sewers and wastewater treatment for 3,500 people in the town using a limited partnership and tax-free bonds to finance the project.

The plan is to start construction in July and complete work in six months. "But when the PUC starts monkeying around with the numbers, that throws a lot of grey into the financial plan" upon which the whole show is based, he says. And investors don't like grey. "You've got to be able to see costs clearly all the way to the end," Davis says.

Municipalities want the same assurances. Norco, Calif., expects to issue a letter of intent to Metcalf & Eddy, Inc., Boston, and its partners for a $33-million privatization project to expand sewage treatment for the fast-growing city 50 miles south of Los Angeles. But, says Ronald E. Cano, deputy city manager, "We've got to have very firm assurances that the privatization package presented is the lowest-cost alternative in terms of users fees to our residents." ■

City blazes new trail for sewer plant

By Tom Herrmann
Staff writer

Caught between a need to keep pace with the city's rapid growth and a limited source of funding, Chandler officials are turning to a unique arrangement to build the South Chandler sewage treatment plant.

If negotiations with a California firm can be completed in the next 10 days, Chandler will become the first city in the nation to let private industry build and operate such a plant.

Under the arrangement, called "privatization," Parsons Corp. of Pasadena, Calif., would build the $28 million plant and treat the city's sewage for the next 23 years. The result is expected to be substantial savings for the firm and for Chandler, said Steve Butterfield, a representative of Boettcher and Co., which is overseeing the project.

"It's the best of both worlds," said Butterfield, who also has said the city could save nearly $1 million a year by letting Parsons own and operate the plant.

Under the plan, Parsons would issue $28 million in tax-free bonds, which the city would repay at a 7.15 percent interest rate, about four points below the current market rate of interest. The Chandler Industrial Development Authority last week gave preliminary approval of the industrial revenue bonds for the project.

Final approval from the IDA and the Chandler City Council is expected to come Dec. 28, if negotiations are completed by then.

No other cities have tried privatization on sewage plants because the concept is a new and difficult one for city leaders to grasp, Butterfield said.

"Until recent years it just hasn't been widely known," he said. "There haven't been seminars to explain it.

"What makes it difficult is that the city has to embrace the concept of giving up ownership of something that traditionally has been theirs," he said. "It's a philosophical decision: What do you give up? And you also have to decide whether to give up operating the plant.

"These people (city officials) have gone to school and been taught that these are services cities provide. It's difficult for them to give that up. That was the original point of negativism on the council, they didn't want to give it up. It's a big step."

Chandler already has a contract with a private firm, SCA Services, to collect garbage. That experience may have been enough to convince city officials to give privatization a chance, Butterfield said.

"I think through the garbage thing they came to realize that private management may be able to do a better job with some things. That's a big reason they've decided to go ahead with privatization."

The city's potential advantages of working with private industry go far beyond the estimated $950,000 a year cash savings, Butterfield said.

"Chandler has grown by leaps and bounds, as you know, but that's not always good for a city because you have bonding (debt) limits," he said. "You can run out of bonding capacity in a hurry.

"Chandler has been very innovative in using improvement districts for streets and using Municipal Property Corporation bonds for downtown. They're using all their financial options quite creatively, but they're still getting near the limits."

By letting Parsons issue the bonds for the sewage plant, the city doesn't push itself closer to those state-imposed limits, he said. That, in turn, keeps the city from having to decide whether to use its bonds for the plant or, for example, for downtown redevelopment, he said.

"It's not their (the city's) debt. It allows them to meet their other obligations because it doesn't go toward any of their bond limits. As far as the city's concerned, it's a real beauty."

Chandler officials originally thought of using a grant from the federal Environmental Protection Agency to pay for the plant. But reductions in federal spending under the Reagan administration have left Chandler well down the list of cities that will receive federal funding.

Those federal cuts may cause a lot of cities to follow Chandler's lead, Butterfield said.

"The EPA historically has given out tremendous amounts of money for sewer plants, but there has been a freeze under this administration," he said.

"More than anything else, this (privatization) is going to be the thing of the future, with funds drying up and the bond market getting tighter and tighter. That's an added reason why this is just starting to take place. There has been money up until recent years; now it's starting to dry up."

There also are advantages for the firm, he said. Parsons will realize a "substantial" savings by being allowed to issue the tax-exempt bonds.

"Parsons is doing it for a tax credit. They're in a 50 percent tax bracket. What better way to put their money to use?

"They get a tax credit, accelerated depreciation (on investments in the plant and equipment) and their capital is being used in something they do. They're not investing in stocks and bonds or something someone else may know better than they do."

The company also will be able to use the plant as an advertisement for projects with other cities, he said.

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December 18, 1983

Senator SYMMS. Yes, I do have a question. I thank you very much for a very good statement.

The question I'm trying to get at is, we are told if the county or State or city allows private enterprise to have a big tax credit and a nice tax advantage to invest in this that ultimately they end up with a big bill when they're going to have to buy again, that the taxpayers will pay for it twice.

Just walk me through an example of, let's say, if the city of Boise or Salt Lake City, or wherever you my have such a facility, Auburn, AL. If it's going to be privatized, who puts the money up, and how is the financial package managed? Does Merrill Lynch sell these items to Prudential-Bache, or do individual people? What kind of a tax advantage does an investor get? What kind of a return on the investment is it? Ultimately, at the end of the course, what's the city have?

Mr. DAVIDSON. OK, that's a bundle of questions.

Senator SYMMS. Walk me through an example, we have a lot of misinformation on it. I think that's part of what happened to the House Ways and Means Committee, that they have staff people tell them one thing and the Members didn't know exactly what was going on, and so they probably voted for something without really knowing how it worked.

Mr. DAVIDSON. Let me give you a few base lines before I try to walk through a hypothetical example.

Senator SYMMS. I might just give you one comment that you made that you said the public—I made a note of it here. You said that our cities and our people will not long tolerate legislators with those values. I don't know why you'd say that because they've been doing it for the last 50 years. How'd we end up with an $850 billion Federal Budget?

The Grace Commission is probably one of the most fortunate things that's happened in President Reagan's administration, that he's got that done. But the national news media will spend more time on the Jesse Jackson campaign than they will on the Grace Commission. They won't hardly come to the meeting. When Peter Grace himself testified, it was hard to get the news media to cover it.

Mr. DAVIDSON. Senator, let me give you two base lines that you can keep in the back of your mind before I go through perhaps a hypothetical example of how one of these is financed and what the various benefits are.

Recall that in my remarks I quoted officials of the city of Chandler, AZ, indicating that on a $22.9 million, about a $23 million facility, they were saving $1.1 million a year. Now, they and their financial advisors——

Senator SYMMS. This is Chandler, AZ?

Mr. DAVIDSON. Chandler, AZ.

Senator SYMMS. How big a city is that?

Mr. DAVIDSON. The city has a population of about 45,000 right now.

Senator SYMMS. OK.

Mr. DAVIDSON. Now, that facility is going to be their second facility. They already have one. On a $23 million facility they will save $1.1 million per year for 24 years. Now, that's their calculation, not mine. But just keep that in the back of your mind, that the cities do perceive savings.

Senator SYMMS. Yes.

Mr. DAVIDSON. Second, keep in your mind how we have financed these programs for many years. In this great country of ours we have cash and we have debt. Those are the only forms of financing that we have. To date, these facilities have been financed with Federal cash in the form of EPA grants, direct grants, and municipal debt. In each case they create debt. The Federal cash creates Federal debt, and the municipal debt, of course, is municipal debt.

What we are talking about here is a substitution of private cash and private debt for public cash and public debt. That alone, even if there wasn't one cost savings, one penny of cost savings, that alone is a laudable goal, I believe.

Now, in the past these plants have been built with 75 percent EPA grant funds. Now, I understand that they may lower that to 55 or 65 percent. But in either case, well over half the facility is direct Federal expenditures coming right off and adding to the Federal deficit.

Financial advisors tell me that in a wastewater treatment privatization program, the present value of all the tax benefits, including ITC and ACR's depreciation. You take all those over the years—and remember, depreciation is just a deferral of taxes, not an elimination of taxes—but you take those at present value. It is approximately a 20 percent number, 20 percent of value of the plant. So initially, the Federal component of expense, in this case, less taxes paid, although I want to get to that in a minute, 20 percent versus a 55 and 75 percent direct grant. So the minimum Federal savings is in the order of 45 to 50 percent. The conventional way versus privatization. So that when people talk about the costs to the Government of these tax credits, they are not doing an apples-to-apples comparison, because the conventional way to do it is for the Government to write a check for 55 to 75 percent of the plant. We're not asking for that money.

Now, the way that we financed Chandler and the way we would propose to finance Auburn and the other projects that we would undertake, and many of our competitors—this is a very competitive business—is that we would issue industrial development bonds, which are currently allowed under the law, on the private company's credit. The city of Chandler is not responsible to repay 1 penny of those industrial development bonds. Those industrial development bonds are backed by Parsons Corp., further backed by, in this case, the Bank of America. So the bondholders have not only the credit of Parsons, but the credit of the entire Bank of America, to make sure they get their bonds repaid. But not the city of Chandler. So we don't impair their bonded capacity or their credit rating.

They are free, then, to use their credit availability, their bond capacity, to ensure other services and infrastructure that is not convenient or appropriate to privatize. We then charge the city of Chandler a service fee, which in this case, has two components to it, what we call the base service fee and an O&M service fee.

Now, I believe that we are going to be more efficient for the reasons that our previous folks who have testified had given. But for the purposes of comparison, let's assume that our O&M expenses and the municipal O&M expenses are equal, that we bring no private cost savings in that area. As I say, I believe that we will. But if you look at the base service fee which represents in a sense the cost of having that facility there and available to treat the wastewater for many years, that service fee is substantially less than what the municipality would have to pay merely for debt service if they were to finance it themselves. Our fee is less than just the interest they would pay, and I'm not talking about the amortization of the principal, I'm talking about merely the interest on the principal. Even if they weren't amortizing any of that debt, just paying principal every year, our service fee is less.

Now, it is true that the tax law requires that at the end of the service period, if the city wishes to acquire the facility, and I say if, because the more these cities think about it, the less they want to own these facilities, but if they desire to acquire at the end of the service period or, indeed, any time, the tax law does require them to pay fair-market value.

Senator SYMMS. That's where the argument comes from in some of the Senate staffers on the Finance Committee that you have to buy it twice.

Mr. DAVIDSON. Yes, but they're wrong, because when you realize that the city is paying a service fee that's less than interest. Remember, if you were the bank and you loaned them the money and they were paying you interest only, they'd have to pay the principal off some day. But they're paying us less than interest cost alone. So they're making a tremendous savings every year. Those savings, if abrogated, are far more than are sufficient to pay off the cost of the facility at the end of the service period.

Senator SYMMS. Now, does the law require that you sell it to them or just offer it to them?

Mr. DAVIDSON. No, the law does not require a sale, but the law requires that if there be a sale or if the city has an option to purchase, that it be done at a fair-market value. Now, nobody yet knows what the fair-market value of a 25-year-old sewage treatment plant is going to be. However, with the number of them being privatized, we believe that that is an ascertainable figure 20 years downstream. We don't believe that figure is going to be anywhere near what the cost of a new facility is, given the fact that the facility has aged and technology has advanced.

Senator SYMMS. One thing about it, the person that owns it doesn't have a whole wide range of choices of people to sell it to.

Mr. DAVIDSON. Exactly.

Senator SYMMS. Only the city is going to have much use for it.

Mr. DAVIDSON. Exactly. In the case of Chandler, we offered to give them an option to purchase, if they wish, in year 24, or to continue with a service fee that's renegotiated at a substantially lower rate. We will be offering the same in the city of Auburn.

Senator SYMMS. What's your investor get, then?

Mr. DAVIDSON. Well, in the case of Chandler, the investor is the Parsons Corp. We have no syndication of equity or no people interested in investing.

Senator SYMMS. So in other words, you buy a sewage treatment facility and build it?

Mr. DAVIDSON. Yes.

Senator SYMMS. You own it?

Mr. DAVIDSON. Yes.

Senator SYMMS. $24 million. What's the return on the investment, then, or is that confidential information?

Mr. DAVIDSON. Well, I'm not sure yet. Since we know how much that's going to cost us, we can calculate that.

Senator SYMMS. You can buy treasury bills and get 10 percent. Can you get that much out of a sewage treatment plant?

Mr. DAVIDSON. We certaintly hope so. We're in the business of making a profit. As Mr. Agee said, we have that discipline on us.

But even with a return which is average or equivalent return for the remainder of our business, we can offer the city very substantial savings, and it comes about because we're—we can design and build them more efficiently. It comes about through the use of some tax savings, admittedly, and it comes about through the efficiency of operations. It also comes about because we can build them so much quicker. When you go through the Federal grant program, they have many stages, and at the end, sometimes not even at the end of each stage, all the paperwork has to go back to the EPA's regional headquarters in Washington and reviews have to be done and people scratch their heads and make changes in amendments and red-line drawings and this and that and other things, and the fact of the matter is, the plants take years and years to build.

In the city of Chandler, we have designed what we want to build. We know what their needs are, and that plant is going to be on line in less than 2 years. If it were and EPA program, it many take 4 or 5 years for that plant to be on line. You know that time is money, and we can save a tremendous amount of money for ourselves and the city by just going about getting the job done.

I don't know, Senator, if I fully responded to your question because it is a complicated situation.

Senator SYMMS. Well, I think you have. I'm going to use the record to help me with some of my—do you have a question, Mr. Hanke?

Mr. HANKE. I was just wanting to know, you mentioned you're going to put this thing on line in 2 years in chandler, and it takes maybe 8 years on average with the EPA, or something like that.

Mr. DAVIDSON. It certainly takes more. I don't know if 8 is correct.

Mr. HANKE. Let's say we agree that 8 is a reasonable number, because that's the one I've used on occasion myself.

Now, coming back to the Clean Water Act, those deadlines are 1988——

Mr. DAVIDSON. July 1, 1988.

Mr. HANKE [continuing]. We're now in 1984, so what you're saying in short is that it's impossible to achieve the goals of the Clean Water Act unless you privatize; right?

Mr. DAVIDSON. Well, I think for a large number of cities that's the case. Of course, we have a very difficult situation with one level of Government, the EPA, attempting to do their job and to enforce standards against another level of government, that is, municipalities, when neither of them have really the financial wherewithal to get the job done. We believe that this country can privatize a vast majority of new facilities required in the areas of drinking water and wastewater treatment and get the job done by the deadline period, it it starts now and if the conferees in the House and the Senate, who are now meeting, takes sensible measures in resolving their differences between the——

Senator SYMMS. In other words, you support what Mr. Reynolds said?

Mr. DAVIDSON. Absolutely. Your asked him the question of the service contracts.

Mr. HANKE. On those four points maybe, Mr. Davidson, if you'd get back to Mr. Reynolds' prepared statement, he's got four points there. Oh, you don't have the prepared statement, sorry.

Point 1 was the service contract. Can you tell us what that issue is all about so the Senator has a better feeling for it?

Mr. DAVIDSON. Yes. As you probably know, the bills which are in conference now from the House and the Senate have provisions in them to remove certain tax benefits from investors if they lease property to tax-exempt organizations. The purpose of that bill, as we understand it, was to prohibit the so-called abuse of municipalities and cities leasing back existing facilities to investor groups and sharing in the tax benefits that accrue. The concern in Congress was that the entire infrastructure of the country would be leased out and that the Federal Government would lose billions of dollars of tax revenues. These concerns may be well founded. I think there are people who would question that. Nonetheless, that was the purpose of the legislation.

So antileasing rules were written, but it was discovered by those who were writing them that there are three things you can do with property: You can own it and sell it, you can lease it, or you can provide a service with it. So they needed to draw some distinctions between leasing and providing a service with property. Therefore, they developed a service contract or service agreement exemption from the leasing prohibitions. However, in doing that, their language made almost everything a lease, and it's almost impossible to have a service contract, even if in fact you have a service contract.

The only exemption in the House was to solid waste to energy, where you take solid garbage or whatever, burn it and create energy. The Senate realized that there were other infrastructure needs that could be met through legitimate service contracts, no leases, and I'm going to get to the difference between those two shortly. They provided exemptions not only for solid waste to energy, but for cogeneration, alternate energy, and waste-water treatment.

We believe the language means drinking water as well as waste water. We see no logical reason to exclude drinking water, and we have asked some Senators to perhaps clarify that this language really means drinking water and waste water. But nonetheless, we now stand with the position that the Senate provisions much more sensibly address the question of service contract of this needed infrastructure than does the House provisions.

Let me get to the difference between a service contract and a lease, although there are many technical definitions in the legislation. The principal definition, the principal distinction in my mind is that of an active versus a passive investment. If one is leasing back city hall there really is—the owner really has no operating responsibility for that facility. He doesn't possess it for control. He takes no risk of loss. It is a pure financial transaction. That is not the case in the solid-waste/waste-water privatization programs. My company, for example, in the city of Chandler will operate that facility. We will control that facility. We will maintain it, fix it if something goes wrong, and we bear the risk of loss if the facility does not operate properly. That is not the case with these financial transactions where city halls, or Navy ships, or libraries are being sold and leased back. Those are fundamental distinctions. We are in the business of providing a waste-water-treatment service. We are not merely leasing property.

If the Senate can persuade the House that drinking water and waste-water treatment should be given proper recognition in the service contract language, it will go a long way toward at least opening the door, not to force cities to privatize, but to giving them an option to privatize their water and drinking water and waste-water facilities.

The other provisions which our former speaker identified relate principally to the House restrictions on industrial-development bonds. We have a situation in this country where municipalities under law are allowed to issue tax-free bonds to finance their operations. That has been the case for many years. Even under the House legislation, which is somewhat restricted, that, of course, will continue. The restrictions are being put on what's known as private activity industrial-development bonds. These are tax-exempt bonds, a portion of the proceeds of which go to a private company rather than to a public entity.

It is our view that if restrictions need to be placed on the potential abuses of industrial-development bonds, so be it. However, we believe those restrictions should be sensibly adopted and that the restrictions should not automatically and doctrinally be developed because of private or public ownership. Rather, the restrictions should go to the use that development bonds are being placed to. For example, in the area of water and waste-water treatment, we believe as my statement records, that it is just as much in the public interest to have a private company receive the benefit of the industrial development bonds and pass that through to the city, but put it on its own credit rating, its own debt, rather than to do the same thing and have the city increase its debt. It's just as much of a public-purpose use, and we would like to see the restrictions in the industrial-development-bond area. If there are to be caps, or limits, or restrictions, that those restrictions be properly prescribed and defined by the use of the bonds, not by the 1945 fair-deal notion of private verses public ownership.

If the public is benefiting, that should be the test. There are a number of restrictions that the House has come up with in the area of industrial-development bonds. Some of them relate to the amount and timing of depreciation. Some of them relate to the question of arbitrage restrictions and, of course, the major restriction in the House is the per capita limit on the use of industrial-development bonds.

Senator SYMMS. What do the arbitrage restrictions deal with?

Mr. DAVIDSON. Senator, I am not—I really can't answer that in detail. I would be happy to provide an answer to that, at a later date.

Senator SYMMS. That would be fine.

Mr. DAVIDSON. But my people tell me that it's something that will affect our programs adversely if adopted without regard to the public-purpose test. As I mentioned, the biggest restriction is in this per capita restriction the House has of $150 per capita to issue these bonds in any State.

Now, there are a number of States that are up to that limit immediately and wouldn't be able to issue any industrial development bonds, regardless of how noble the purpose. Again, we think if there are to be caps that waste-water treatment, drinking water treatment, and the other public-purpose uses shoud be exempted from those caps. It doesn't harm the cities or the taxpayers in those cities if private companies are willing to take the credit for these projects.

I hope that has answered your question.

Senator SYMMS. That is very good. Thank you.

Does the Parsons Corp. ever get involved in any bridges?

I mean, we're not talking about bridges here, we're talking about water facilities, but I also chair the Surface Transportation Committee. I can't tell you how many billion dollars worth of worn out bridges we have in America, but it's just astronomical. The old joke in the old days was they sold the Brooklyn Bridge, but it's become profitable. Now that people are actually considering selling these bridges, and letting people rebuild them, and charge a toll to drive over them.

Mr. DAVIDSON. Let me tell you what our experience has been in that area. The Parsons Corp. does have a subsidiary called Deleuw Cather Co., which has been in business 80 years in the area of designing and managing the construction of bridges and rehabilitating bridges. So we can attest to the need in the United States of rehabilitating principally old bridges. Again, the needs are very large and your infrastructure task force has outlined those needs.

In the area of privatization, however, we have to look at what facilities can best be privatized, which ones are truly ones which bear ownership, operation, risk of loss, continuing maintenance and those sorts of things; and from the private sector's viewpoint, which one can we pass the most benefits along to the cities? We believe that the areas of soild waste to energy, congeneration, where cities have big steam needs because of office buildings, hospitals, universities and the like, they can generate that steam, and with the same fuel, with no extra fuel, generate electricity and sell it to a public utility very efficiently. Water and wastewater treatment facilities, these are in a sense process facilities which are the most amenable to privatization.

A bridge is really more of a passive type investment of which I spoke of, and I believe your Congress would call that a lease, and I think we would lose our tax benefits and, of course, could not than pay——

Senator SYMMS. It's kind of interesting, the way it works out when the Government runs it. Up in Connecticut you remember the tragic accident last year when the bridge collapsed and five or six people were tragically killed. When that bridge had already failed Federal specifications and the State had been told it was unsafe, but the State of Connecticut was bleeding money off the people who paid tolls for years to drive on that section of the road where the bridge was and using the money in the general fund to run the State of Connecticut's welfare projects and other State programs—and not taking the money that people were paying to drive on the road to repair the bridge. So what happened was the Federal Government gave them $40 million to fix it out of the Federal Trust Fund that we all paid money into, over my objection. But the point is, it's badly circumvented. The people who make the argument against tax loopholes on the operation of water companies, all they have to do is look and see how governments do it and then privatization would look pretty attractive.

Mr. DAVIDSON. Well, Senator, I made that point in my remarks that there are many public needs that are much more visible than infrastructure, and the tendency of Government is to do exactly what you just described, and that is to shift moneys to those services which are more likely to come on TV, or more likely to be the subject of debate at a city council meeting, and to shift money away from infrastructure. But infrastructure is certainly one of our national treasures and we need to preserve it.

Senator SYMMS. Well, the politicians in Connecticut were buying votes from special-interest groups with the money that was being spent on the infrastructure. It is just that simple.

Mr. DAVIDSON. Now, in the area of bridges and roads and metro systems, the Government has, as you know, recently adopted a 5-cent gasoline tax which is going into a fund for the repair of these facilities. I don't know whether this is the sole answer, but I believe that we are now seeing more resources channeled toward the repair of that kind of transportation infrastructure. So in that area the funds are tending to increase through the use of this tax revenue.

And in the area of water and wastewater treatment, the funds are decreasing at the Federal level, and it seems to me that we have here a very good match of private willingness to put their expertise and credit on the line and a public restriction on the amount of resources they can provide.

Senator SYMMS. Thank you very much. I think Mr. Hanke has one question.

Mr. HANKE. Yes. I just wanted to clarify something that you spoke of earlier, and that was the present value of the tax benefits for these plants, and you mentioned that the present value was roughly 20 percent.

Mr. DAVIDSON. That's the maximum that it would be. Let me go through that just a second.

Mr. HANKE. My question is: Does that include ITC and the accelerated cost——

Mr. DAVIDSON. Yes. The ITC, as you know, is a 10 percent ITC. However, these facilities are not subject to total ITC. In other words, all of the facility does not bear investment tax credit. It has been our experience that between 70 and 80 percent of the facility qualifies for investment tax credit. So on the average that might be a 7½-percent cost out of the 20.

Now, on the depreciation side, we have a certain portion of the plant that may qualify for relatively short-term depreciation, 5 or 7 years perhaps in the new legislation, and the remainder for 15 or 20 years. Now, you can use various costs of money, but when you bring those back to present dollars, it is my belief that even under the most pessimistic assumptions you will find that the costs to the Federal Government is about 20 percent.

Now, let me remind you that when the Treasury people go about assessing the costs of these tax bills, they are not being realistic. An assumption is made that whenever a company receives a tax benefit for a particular activity, such as wastewater privatization, that they would not have made an alternate or optional investment to receive any back-tax benefits. That certainly is not reality. If Parsons doesn't get its tax benefits in wastewater treatment, it's going to get them someplace else.

Now, I told you, although we're not in this business and we never intend to be, we can easily go in the business of drug paraphernalia or pornographic literature and those facilities would get all sorts of tax benefits. Now, where is the logic? Tell me where the logic is that we can get tax benefits for that activity and not to clean a city's water? There is no logic.

Mr. HANKE. Well, there isn't even any logic in these committees because on the Finance Committee they are looking with blinders at the tax bill and they say well, if we allow these private wastewater facilities, we're going to have—they don't make this calculation because they don't even know how to do it, but you'd have a tax benefit of present value at 20 percent of the total, OK. Let's assume they knew how to make it and they could. Now, that's one committee. Now, you go over to the next committee, Environment and Public Works, and what are they doing? They're giving a 55-percent grant——

Mr DAVIDSON. Minimum.

Mr. HANKE [continuing]. Minimum up front to a new wastewater treatment plant, and yet, the Tax Committee is driving all of this legislation saying we're going to have huge budget exposure by giving these tax benefits for private plants, whereas you're saving probably 35 to 55 percent immediately by privatizing.

Mr. DAVIDSON. We are decreasing the Federal deficit through the privatization of wastewater treatment plants. Now, let me tell you something else——

Senator SYMMS. I tell you something else, the members of the Tax Committee, they think all the money belongs to the Government and anything that they let the people keep they call it tax expenditure. It's a new definition.

Mr. DAVIDSON. Let me tell you something else that's happening here. In the city of Chandler, Parsons & Chandler, without going to the Federal Government, made a deal. By the way, we had a lot of competition and we were selected. We made a deal. We made a local deal using private credit, private equity to build a wastewater treatment plant.

In the other system, what happens? The Federal Government doesn't need certain things. They put certain requirements on cities and then the State establishes priority lists. So the local community has to have people that understand the EPA rules and the

State rules. The State has to have people that understand the EPA rules. Applications are made for funds. Those applications go to the State. Then the applications go to the Federal Government, and what we have is thousands and thousands of bureaucrats all functioning on a system that's trying to distribute funds to municipalities. Who accounts for all of those expenditures? How many wastewater treatment plants can be built with all the money we've spent on buildings and bureaucrats just to administer this system?

Mr. HANKE. Those are in the 312 incompatible accounting system.

Senator SYMMS. Right. Thank you very much. I appreciate it.

Now I'd like to hear our last witness, and I want him to know that he's certainly not our least witness. He will get every bit as much attention as the other witnesses.

Mr. Richard Christensen is from Prudential-Bache in Salt Lake City, who is going to tell us about some of his personal experiences involved in privatization. We look forward to hearing your statement. Your entire statement will be made part of our record, and please go right ahead.

STATEMENT OF RICHARD CHRISTENSEN, FIRST VICE PRESIDENT, PRUDENTIAL-BACHE SECURITIES, INC., SALT LAKE CITY, UT

Mr. CHRISTENSEN. Senator Symms and Mr. Hanke, it's a pleasure to be with you. I'm pleased to be able to participate in this event, which I think has some far-reaching beneficial consequences to the management of governmental services and entities across the country.

I've spent 25 years involved in the financing of infrastructure types of improvements for local entities throughout the intermountain West.

The subject of privatization has sparked the interest and fired the imagination of many across the country. The public sector, both Federal and local, being under particularly onerous economic constraints at this time, has viewed the concept either as a method of obtaining alternative financing for necessary public projects or an avenue for deleting certain services from the ever-increasing roster of public services provided by various government entities at all levels.

The private side, in characteristic fashion, has formulated visions of new markets and new services to be provided, new revenue streams to be generated, profits to be earned, and dollars to be tax-sheltered.

At the Federal level there seems to be dual thrusts for going private. First, the philosophical position of a desire for less governmental involvement in people's lives, which has been articulated today. Second, the intense pressures to reduce spending, increase revenues, and generate capital for budget balancing and debt reduction purposes, which has also been articulated.

These forces lead to the exploration of concepts such as the sale of Federal lands, Government-owned hydroelectric projects and other public assets, and the contracting for services, rather than the acquisition of the service rendering capital assets.

Previously discussed, also, was the next paragraph concerning the Navy ship transaction. I would just like to say in conclusion to that, that some solidification of the understanding of the net impact on the Federal Treasury resulting from this type of transaction is needed. It does not always follow that the two concepts of more private sector business and lower costs are necessarily compatible.

At the local level government entities are engaged in the exploration of alternative financing methods for the complete roster of public services. Historically, public type functions and services have been variously in and out of the public jurisdiction.

Hospitals and facilities for rendering health care have had an assortment of owners, including to a large extent, municipal governmental units, as well as churches, fraternal organizations, and doctors groups. The trend in recent years, for the most part, has been out of these modes of ownership and into either nonprofit public corporations or for-profit investor-owned corporations.

In bygone years across the country, the majority of the culinary water systems were privately owned, and because of lack of proper maintenance and economic incentive over the years, have generally gravitated into public ownership, with the supplying of domestic water now being handled in the majority by the public sector.

In the electric power business, the trend has been from public utilities to investor-owned utilities, and back again. I see no clear indication as to the direction of that process at the moment, nor any compelling economic or other reasons why there should be much shift, though as rates continue to increase there will undoubtedly continue to be a goodly portion of unrest.

The air transportation business in the United States has gravitated to a wholesome mix of private and public, with airlines themselves being private companies, but airports and related functions being primarily in the public province. You made a comment about the Washington airport, Senator, which bears there.

Waste water treatment has nearly always been a franchise of the public sector, whereas the provision of natural gas and other fuel sources has been, for the most part, the domain of the private sector. There are, of course, certain exceptions in all of these cases.

There seems to be no overwhelming economic mandate for vital and basic services to be provided exclusively by either the public or the private sector. I do not regard privatization as the solution to all of the tough economic decisions faced by Government and corporate leaders today. It does, however, appear to be an important concept holding great promise for many projects and, therefore, worthy——

Senator SYMMS. If I can just interrupt you for a second for a question. You made a comment about the airports, and it's very interesting that the public tells me all the time that they want to have a safe regulation of air traffic and air safety so that when they go get on an airliner and fly somewhere they feel safe. Yet, the CAB and FAA, which regulate and operate National Airport in Washington, DC, for a long time have said there's too many flights in and out of there. It's a very congested air space and it's a high-risk probability that they don't view it as safe. They're supposed to be the people regulating it. Every time it comes up to send some of the flights out to Dulles Airport, which is near Washington, the Congress has a vote on the floor and votes to make them put the flights back at National because it's more convenient for the Congressmen flying out of town.

Then the same people turn around and try to tell the people out here in the West how to run their business and meet the standards. Yet, it goes on every day right almost in the shadow of the Capital, and it's incredible to me that nobody ever focuses on those kinds of issues.

Mr. CHRISTENSEN. It's a real anomaly, and I think what you have is the inability of regulators to cut through the real demands of the free market which require or insist that these planes land at that particular airport or in those locations.

Senator SYMMS. It's such a mess at National Airport. Last Friday afternoon I left there on a Friday afternoon flight and I almost missed the flight because of the traffic jam just trying to get in and out from the terminal because it's so overloaded with people. They can't handle the whole thing. It's just an unbelievable mess operated under the so-called guise of Government safety regulation; but they can't do anything about it. I don't blame the people who work at the FAA and the CAB for that, because they have the Congress telling them what they have to do.

Mr. CHRISTENSEN. I think there's a case where rather than listening to pressure groups, the Congress and the Senate just have to make some hard decisions.

Senator SYMMS. Well, the Congress—a guy lives in Columbus, OH, he's out working the floor because if he goes to Dulles it takes him longer to get to the airport almost than it does to fly to Columbus. You can run over to National in just a few minutes. So from a convenience standpoint, they'll go around and lobby and get votes to keep more flights at National because all of the flights east of the Mississippi come out of National. Most of us who come further west a lot of times will go on to Dulles and fly to Salt Lake or Denver. It's just really interesting. They've got enough votes that they can overturn a ruling the CAB makes, or Mrs. Dole might make a ruling from the Department of Transportation and Congress overturns it.

Mr. CHRISTENSEN. It's an interesting system, Senator.

Senator SYMMS. It's a good reason to privatize it.

Mr. CHRISTENSEN. If privatization as a tool can be developed and refined, and it is being so accomplished, it can then take its place as a valid competitor for the honor of being the vehicles by which great and vital public service is rendered.

Our responsibility is to develop the option, to make it available, to make it competitive and, therefore, to give variety and choice to public officials in infrastructure financing, making it possible for them to more effectively render sound economic decisions in today's difficult environment.

In developing the conceptual option, let me outline what I see as the major areas of concern as I work with local public officials. Then I've set forth, and I don't need to read all of these, the problems, and most of these have been discussed.

Bob talked about economic incentives. As I deal with these local officials, the problem that I see there is the fundamental public policy question of the continued economic incentive in these projects and, therefore, attention and interest on the part of the private investors and operators.

Pricing and competitive pressures, this gets us into the public service commission type regulatory organization that may or may not be desired or necessary by public officials in these privatization deals. Bob has discussed in answer to your question, Senator, the question of residual values. That still does remain a bit of a problem in the minds of local officials who seem to have some inclination toward a desire to ultimately own the public facilities again.

The regulatory climate that we face now and utility operations and the unrest that seems to be widespread across the country. Are we going to put a roadblock in the way of the privatization process by injecting into these projects regulatory systems that then chill the interest in the private sector in being involved? And then the question of control.

These are the major concerns I see when local political subdivisions consider the subject of privatization of local public services. Any help we can all collectively give to the removal of these impediments, real or presumed, will be helpful in moving the process forward.

Let us now switch to a specific Federal power project which is in the process of going private and with which I have had some interesting experience. First, a little background.

The Central Utah project is a participating project of the Colorado River storage project and was authorized by Congress in 1956. It is a multipurpose water resource project to bring critically needed water to the west slope of the Wasatch Mountains along Utah's Wasatch Front. The water will be brought westward via a transbasin diversion from the south slope of the Utah Mountains in northwestern Utah. The project consists of six units, the largest of which is the Bonneville unit which delivers water from the Unitah Basin to the Diamond Fork River system and thence to the Bonneville Basin.

The Diamond Fork power system is an integral part of the Bonneville Unit and will be the power generation portion of the project utilizing approximately 200,000 acre feet of water each year for power generation purposes. The project consists of three small conventional hydro plants and one large underground pumped storage powerplant. The flowthrough plants will have a combined installed capacity of about 42 megawatts, and the pump storage plant will have a maximum capacity of 1,140 megawatts and will consist of four units of 285 megawatts each. The costs of the water delivery works and those portions of the project attributable to other than power generation and transmission will be federally funded.

It is the intention of the administration, the Commissioner of Reclamation and the regional director of the Upper Colorado region of the Bureau of the Reclamation unitedly and in concert with their staffs and others to finance the total project costs allocable to power generation and transmission with non-Federal funds.

This is not technically privatization in the strictest sense because not only are investor-owned or private utilities invited to participate, but also other non-Federal public utilities, such as REA's municipal power systems, agencies and consortiums of public power and other preference power customers are all invited to be project participants.

It is anticipated that the non-federally financed portion of the project costs will be about $1.5 billion, excluding interest during construction, reserve funds, working capital, and other costs associated with the project and its financing.

A crucial question at the moment and at this stage of the project's progress is whether or not the project is economical in the real world of power generation and marketing. In order to attract non-Federal funding for this project, or to privatize it, the project output of energy must be competitively priced in stiff competition with all other baseload and peaking resources in the Western Area Power Administration's marketing area, or for that matter, any available resource with the capability of being wheeled to the market.

There is included as a part of my presentation a copy of the summary report on Diamond Fork, which may be of interest to you and has been prepared by Reclamation, Western, and non-Federal people.

This document was mailed to nearly all public and private power entities in the Western States with a request that it be reviewed and a determination made as to any interest in participating in the project. Participation in this case means the willingness to enter into the necessary contractual agreements to assure the sale of project capacity and energy, the supply of pump-back energy and the implementation of necessary contractual security arrangements for purposes of the financing.

The financing of the project is at this time in rough concept only, and for purposes of the study we have assumed that it can be accomplished on a tax-exempt basis, with 50 percent of construction costs funded initially with long-term bonds in the traditional revenue sense, and 50 percent with tax-exempt, commercial paper. The short-term commercial paper would be refinanced with long-term bonds after the completion of construction and the last of the units is on line, about 1993.

Joint project costs which have already been expended or are under contract, are assumed to be repaid to the Government over a 50-year period at the 3.22 percent Federal rate for reclamation projects.

The basic privatization game plan for Diamond Fork power system assumes that on completion of a successful market test for the sale of the project output there will be assembled a roster of participants who stand willing to make the necessary contractual commitments to assure the market for the power and implement the financing. For the preference customers it is anticipated that there could be a joint action agency formed which would transact business and implement the financing for and on behalf of its members.

Since the probability exists that preference customers from several States may participate, there may be needed some kind of interstate compact to join together the several interests of multiplicity of public power entities. The Tennessee Valley Authority is an example of such a compact.

On the other hand, there may need to be created several joint action agencies to represent the divergent interests and legal framework from which the participants would respond. In the event of multiple agencies, there would then be necessary some form of joining agreement, compact or agency, or perhaps separate financings for separate interests.

In the event of participation by the private power companies, the 25-percent rule would apply. If the participant mix is such that 25 percent or more of the output over the life of the power is taken by private interests, tax exemption is not available. In such an event the financing might take the form of tax exempt financing for the preference customers as above and a package of taxable debt or debt and equity in combination to finance the private side of the transaction, and it could be built on a condominium basis with preference customers and their fanancing, nonpreference customers and their separate financing.

There are many unanswered questions regarding the project, and let me hit several of them. First of all, the question of a preference. The political underpinnings of this concept are under heavy attack and will likely continue the polarized controversy between the public and private power interests. Though on solid legal footing at the moment, the consensus of opinion has the preference question being addressed by the Congress. Non-Federal funding of power projects could be significantly impeded prior to the resolution of this question. That's an important matter to be addressed at the Federal level.

TRANSMISSION

This is nearly always a controversial subject, depending on who controls the transmission lines. Because of limited capacity in existing lines and corridors and environmental difficulties in building new lines, transmission capabilities are extremely limited, particularly in Utah and the Southwest. With limited transmission ability, power cannot flow from generator to market with the fluidity the country needs to most efficiently use our resources. This is not a question the Federal Government can address completely, but an environment of healthful cooperation could assist greatly.

Three, the ownership. Does the United States have to own a resource and asset such as the Diamond Fork power system, or can the participants in taking a project like this private hold title? If ownership is by non-Federal interests, does that change the status of the FERC licensing exemption and the environmental permitting? Both of these are particularly strong and attractive aspects in this project.

MARKETING

Does the existing Federal power market structure, WAPA in the case of Diamond Fork, have to assume the responsibility for marketing project power, or can Intermountain Consumers Power Association, Intermountain Power Agency, Southern California Public Power Association, or some other entity already existing or created for that or other purposes market the project output and supply pump-back energy?

Number five, the cost allocation. What is the project cost allocation formula, and is there any intent on the part of the Bureau or the administration to have the power interests in a project of this nature subsidize other aspects of the project, such as M&I water, recreation, agriculture, flood control, and et cetera? It is unlikely the private capital markets are going to be willing to finance any subsidy. It is also unlikely that any subsidy will permit a project to be competitively feasible. It is also a sure bet that private investors will want to look behind all the numbers and assumptions used in the cost estimates and allocation of those costs between project functions.

Stand alone or blended rates. Should the project output pricing stand alone for financing and marketing purposes, or should the project be regarded as another Federal resource and be blended with other Colorado River storage project rates or even blended over a wider base? Obviously, the answer to the preference questions will weigh heavily on this and so will the point in time when any Federal power projects are privately funded.

Whether or not Diamond Fork is privatized depends more on the competitive price of the project output, and less on whether the actual machinery for non-Federal financing will work. I believe we can make it work for a good project, but not without cooperation at every level.

In the power business market factors change. Today we have a glut of cheap power. Five years ago almost anything that produced a megawatt could be sold. Such is the case in the commercial world and from which factors and Federal enterprises have been insulated. Nevertheless, a project such as Diamond Fork, if well-conceived, properly designed and competitively priced, can be privatized. The earlier in the life of the project those responsible for setting such a course can get together and in concert as a Federal/non-Federal team determine the course necessary to privatize, the greater the chance of success in so doing.

[The prepared statement of Mr. Christensen, together with additional material, follows:]

Prepared Statement of Richard Christensen

The subject of privatization has sparked the interest and fired the imagination of many across the country. The public sector, both federal and local, being under particularly onerous economic constraints at this time, has viewed the concept either as a method of obtaining alternative financing for necessary public projects or an avenue for deleting certain services from the ever increasing roster of public services provided by various governmental entities at all levels.

The private side, in characteristic fashion, has formulated visions of new markets and new services to be provided, new revenue streams to be generated, profits to be earned and dollars to be tax-sheltered.

At the federal level there seems to be dual thrusts for going private.

A. The philosophical position of a desire for less governmental involvement in people's lives and

B. The intense pressures to reduce spending, increase revenues and generate capital for budget balancing and debt reduction.

These forces lead to the exploration of concepts such as the sale of Federal lands, government owned hydro-electric projects and other public assets, and the contracting for services rather than the acquisition of the service rendering capital assets.

A recent business magazine article pointed out a private sector transaction for purposes of the Navy's acquisition of thirteen cargo ships to supply the Indian Ocean fleet. Congress cut them from the budget. The Navy then contracted for "transportation services" and entered into contracts that permit private interests to build or convert the ships using bank loans for the construction to be paid off with equity investments upon completion of construction. The investors then are the recipients of investment tax credits, accelerated depreciation and interest expense deductions. Though controversial, this transaction illustrates the nature of and potential for privatizing Federal level transactions. Some solidification of the understanding of the net impact on the Federal treasury resulting from this type of transaction is needed. It does not always follow that the two concepts of more private sector business and lower costs are necessarily compatible.

At the local level governmental entities are engaged in the exploration of alternative financing methods for the complete roster of public services. Historically public type functions and services have been variously in and out of the public jurisdiction.

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Hospitals and facilities for rendering health care have had an assortment of owners including to a large extent municipal governmental units as well as churches, fraternal organizations and doctors groups. The trend in recent years, for the most part, has been out of these modes of ownership and into either non-profit public corporations or for profit investor owned corporations.

In bygone years across the country the majority of the culinary water systems were privately owned and, because of lack of proper maintenance and economic incentive over the years, have generally gravitated into public ownership, with the supplying of domestic water now being handled in the majority by the public sector.

In the electric power business, the trend has been from public utilities to investor owned utilities--and back again. I see no clear indication as to the direction of that process at the moment nor any compelling economic or other reasons why there should be much shift, though as rates continue to increase there will indoubtedly continue a goodly portion of unrest.

The air transporation business in the U.S. has gravitated to a wholesome mix of private and public with airlines themselves being private companies, but airports and related functions being primarily in the public province.

Wastewater treatment has nearly always been a franchise of the public sector, whereas the provision of natural gas and other fuel sources has been, for the most part, the domain of the private sector. There are, of course, certain exceptions in all of these cases.

There seems to be no overwhelming economic mandate for vital and basic services to be provided exclusively by either the public or private sector. I do not regard "privatization" as the solution to some of the tough economic decisions faced by government and corporate leaders today. It does, however, appear to be an important concept holding great promise for many projects and therefore worthy of the attention of your sub-committee and all other governmental leaders, both Federal and local, interested in and concerned with the efficient furnishing of basic services.

Government officials, corporate executives, the finance community, lawyers, engineers and other disciplines all need to focus sufficient attention on the subject to assure its development and perfection and use in acquiring the capital assets necessary to supply these essential services.

If privatization as a tool can be developed and refined, it can then take its place as a valid competitor for the honor of being a vehicle by which great and vital public service is rendered.

Our responsibility is to develop the option, to make it available, to make it competitive and, therefore, to give variety and choice to public officials in infrastructure financing, making it possible for them to more effectively render sound economic decisions in today's difficult environment.

In developing the conceptual option, let me outline what I see as the major areas of concern as I work with local public officials.

I. Economic Incentives. Under the current statutes the economic benefits in privatization come largely in the form of tax shelters and are in a major way available up front to the investors, probably over the first eight years or earlier. The combination of investment tax credits, accelerated depreciation and interest expense deductions may return up to half the initial project cost to investors in the first three or four years. The fundamental public policy questions then concerns the continuing economic incentive and therefore attention and interest on the part of the private investors and their operators.

The financing and their cash flows can usually be structured to provide the returns as desired, but there does exist a dichotomy between the investors interest in the greatest and quickest return of and on his money, and the public's interest in consistent and long term attention to the project.

II. Pricing and Competitive Pressures. Since most of these public services, if switched to the private sector, would probably still not be subjected to the competitive pressures created by a multiplicity of suppliers, we would then, in most cases, still be supplied by a single private enterprise, leaving him in the monopolistic posture. It was in the course of overcoming this difficulty that the formation of public utility or service commissions occurred. Would the same kinds of regulatory body be necessary if privatization were to be accomplished in other areas of public service? If so, would the existence of those regulatory bodies then serve to defeat the concept of privatization because of their control of rates of return and the dilution of economic incentive?

III. Residual Values. Current tax laws preclude the fixing of the residual value of a facility at the end of a financing period. This leaves a significant void in the financing formula and the placement of values for good decision making on both the private and public side and is particularly difficult if change of ownership might be desired by the public entity at a certain point in time. Most local public bodies with which I have dealt have been inclined toward the eventual return of the assets and ownership of the project to public hands. This would indicate more a posture of privatization being a financing matter than a fundamental switch in the method of doing public business.

IV. Regulatory Climate. Does the current public unrest in the face of increasing rates for public services such as electric power, natural gas, telephone and communication services, health care and etc., and the propensity at the political level to accomodate the public in these matters ultimately interfere with the thrust toward public trust in the private sector, and a setting in which private enterprise can feel confortable with their ability to set rates to cover contractual obligations and rate of return expectations?

V. Control. The major concern I work with centers around the perception of giving up control of the ownership and operation of a public works by a board elected or appointed to exercise control and management and endowed with a strong sense of the fiduciary responsibility connected with the same.

These are the major areas of concern I see when local political subdivisions consider the subject of privatization of local public services.

Any help we can all collectively give to the removal of these impediments, real or presumed, will be helpful in moving the process forward.

Let us now switch to a specific federal power project which is in the process of "going private" and with which I have had some interesting experience. First a little background.

The Central Utah Project is a participating project of the Colorado River Storage Project and was authorized by Congress on April 22, 1956. It is a multi-purpose water resource project to bring critically needed water to the west slope of the Wasatch Mountains along Utah's Wasatch Front. The water will be brought westward via a transbasin diversion from the south slope of the Uintah mountains in northestern Utah. The Project consists of six units, the largest of which is the Bonneville Unit which delivers water from the Uintah Basin to the Diamond Fork River System and thence to the Bonneville Basin. About 120,000 acre feet of municipal and industrial water will be made available along with about 165,000 acre feet of agricultural water. This should bring 27,000 acres of new farm land into production and provide supplemental water for about 216,000 acres.

The Diamond Fork Power System is an integral part of the Bonneville Unit and will be the power generation portion of the project utilizing approximately 200,000 acre feet of water each year for power generation purposes. This power system is designed to utilize an elevation difference of approximately 2,600 feet as the water descends down the Diamond Fork River System.

The power generation portion of the project consists of three small conventional hydroplants and one large underground pumped storage powerplant. The flow thru plants will have a combined installed capacity of about 42 M.W. and the pump storage plant will have a maximum capacity of 1140 M.W. and will consist of four units of 285 M.W. each. The costs of the water delivery works and those portions of the project attributable to other than power generation and transmission will be federally funded.

It is the intention of the Administration, the Commissioner of Reclamation and the Regional Director of the Upper Colorado Region of the Bureau of Reclamation unitedly and in concert with their staffs and others to finance the total project costs allocable to power generation and transmission with non-federal funds.

This is not technically "privatization" in the strictest sense because not only are investor owned or private utilities invited to participate but also other non-federal public utilities such as R.E.A.'s, municipal power systems, agencies and consortiums of public power and other preference power customers are invited to be project participants.

It is anticipated that the non-federally financed portion of the project costs will be about $1.5 billion excluding interest during construction, reserve funds, working capital and other costs associated with the project and its financing.

The crucial question at the moment and at this stage of the project's progress is whether or not the project is economical in the real world of power generation and marketing.

In order to attract non-federal funding for this project, or to privatize it, the project output of energy must be competetively priced in stiff competition with all other base load and peaking resources in the Western Area Power Administration's marketing area, or for that matter any available resource with the capability of being wheeled to the market.

There is included as a part of my presentation a copy of a summary statement prepared on the Diamond Fork Power System as a joint effort of Reclamation, Western and non-federal people as listed in the appendix at the back of that report.

This document was mailed to nearly all public and private power entities in the western states with a request that it be reviewed and a determination made as to any interest in participating in the project. Participation in this case means the willingness to enter into the necessary contractual agreements to assure the sale of project capacity and energy, the supply of pump back energy and the implemention of necessary contractual security arrangements for purposes of the financing.

The financing of the project is at this time in rough concept only, and for purposes of the study we have assumed it can be accomplished on a tax-exempt basis, with 50% of construction costs funded unitially witn long term bonds in the traditional revenue sense and 50% with tax-exempt commercial paper. The short term commercial paper would be refinanced with long-term bonds after the completion of construction and the last of the units is on line, about 1993.

Joint project costs which have already been expended or are under contract are assumed to be repaid to the government over a 50 year period at the 3.22% federal rate for reclamation projects.

The basic privatization game plan for Diamond Fork Power System assumes that upon completion of a successful market test for the sale of the project output there will be assembled a roster of "participants" who stand willing to make the necessary contractual commitments to assure the market for the power and implement the financing. For the preference customers it is anticipated there could be a joint action agency formed which would transact business and implement the financing "for and on behalf of" its members.

Since the probability exists that preference customers from several states may participate there may be needed some kind of an interstate compact that could join together the several interests of a multiplicity of public power entities. The Tennessee Valley Authority is an example of such a compact.

On the other hand, there may need to be created several joint action agencies to represent the divergent interests and legal framework from which the participants would be spawned. In the event of multiple agencies, there would then be necessary some form of joining agreement, compact or agency or perhaps separate financings for separate interests.

In the event of participation by the private power companies, the 25% rule would apply. If the participant mix is such that 25% or more of the output over the life of the Power System is taken by private interests, tax exemption is not available. In such an event the financing might take the form of tax exempt financing for the preference customers as above and a package of taxable debt or debt and equity in combination to finance the private side of the transaction with the project possibly being built on a condominium basis.

A detailed finance plan cannot be formulated at this time because of the uncertainty of the mix of participants, their locations, the delivery points necessary for transmission and the attendant cost implications of changes in the basic model assumptions. The subject has been sufficiently studied by competent legal and financial counsel such as makes the finance team optimistic about structuring a non-federal financing upon the project's survival of the critical competitive market test.

There are however, at this early stage many unanswered questions as this project is privatized and as the eyes of many across the federal spectrum are upon it. Following are some areas that will require definitive resolution before the Diamond Fork Power System or other federal power projects like it can be privatized

I. Preference. The political underpinnings of this concept are under heavy attack and will likely continue the polarized controversity between the public and private power interests. Though on solid legal footing at the moment, the concensus of opinion has the preference question being addressed by the Congress. Non-federal funding of power projects could be significantly impeded prior to the resolution of this questions.

II. Transmission. This is nearly always a controversial subject depending on who controls the transmission lines. Because of limited capacity in existing lines and corridors and environmental difficulties in building new lines, transmissions capabilities are extremely limited, particularly in Utah and the Southwest. With limited transmission ability, power cannot flow from generator to market with the fluidity the country needs to most efficiently use our resources. This is not a question the Federal government can address completely, but an environment of helpful cooperation could assist greatly.

III. Ownership. Does the United States have to own a resource and asset such as the Diamond Fork Power System or can the participants in taking a project like this private hold title? If ownership is by non-federal interests, does that change the status of the FERC license exemption and the environmental permitting. These aspects of this particular project are extremely attractive.

IV. Marketing. Does the existing Federal Power Market structure (Western Area Power Admininstration in the case of Diamond Fork) have to assume the responsibility for marketing project power or can Intermountain Comsumers Power Association, Intermountian Power Agency, Southern California Public Power Association, or some other entity already existing or created for that or other purposes market the project output and supply pumpback energy.

V. Cost Allocation. What is the Project cost allocation formula and is there any intent on the part of the Bureau or the Administration to have the power interests in a a project of this nature subsidize other aspects of the project such as M&I water, Recreation, agriculture, flood control and etc? It is unlikely the private capital markets are going to be willing to finance any subsidy. It is also unlikely that any subsidy will permit a project to be competitively feasible. It is also a sure bet that private investors will want to look behind all the numbers and assumptions used in the cost estimates and allocation of those costs bewteen project functions.

VI. Stand Alone or Blended Rates. Should the projects output pricing stand alone for financing and marketing purposes, or should the project be regarded as another Federal resource and be blended with other Colorado River storage project rates or even blended over a wider base? Obviously the answer to the preference questions will weigh heavily on this and so will the point in time when any federal power projects are privately funded.

Whether or not Diamond Fork is privatized depends more on the competitive price of the project output, and less on whether the actual machinery for non federal financing will work. I believe we can make it work for a good project, but not without cooperation at every level.

In the power business market factors change. Today we have a glut of cheap power. Five years ago almost anything that produced a megawatt could be sold. such is the case in the commercial world and from which factors some federal enterprises have been insulated for good reasons. Nevertheless a project such as Diamond Fork, if well conceived, properly designed and competitively priced can be privatized. The earlier in the life of the project those responsible for setting course can get together and in concert as a federal/non federal team determine the course necessary to privatize, the greater the chance of success in so doing.

DIAMOND FORK POWER SYSTEM

BUREAU OF RECLAMATION
UPPER COLORADO REGION
WESTERN AREA POWER ADMINISTRATION
SALT LAKE CITY AREA

MAY 1984

INDEX

TECHNICAL DATA

WHAT IS THE CENTRAL UTAH PROJECT?

The Central Utah Project (CUP) is a major multiple-purpose water resource project that will provide critically needed water supplies to Central Utah. Construction of the CUP as a participating project of the Colorado River Storage Project was authorized by the Act of April 22, 1956, (70 Stat. 105). The CUP consists of six units that can be constructed and operated independently. Five of the units - the Uintah, Vernal, Jensen, Upalco, and Ute Indian Units - are developments in the Uinta Basin of the Upper Colorado River Basin. The sixth and largest - Bonneville Unit - diverts water from the Uinta Basin and delivers it through the Diamond Fork System to the Bonneville and Sevier River Basins.

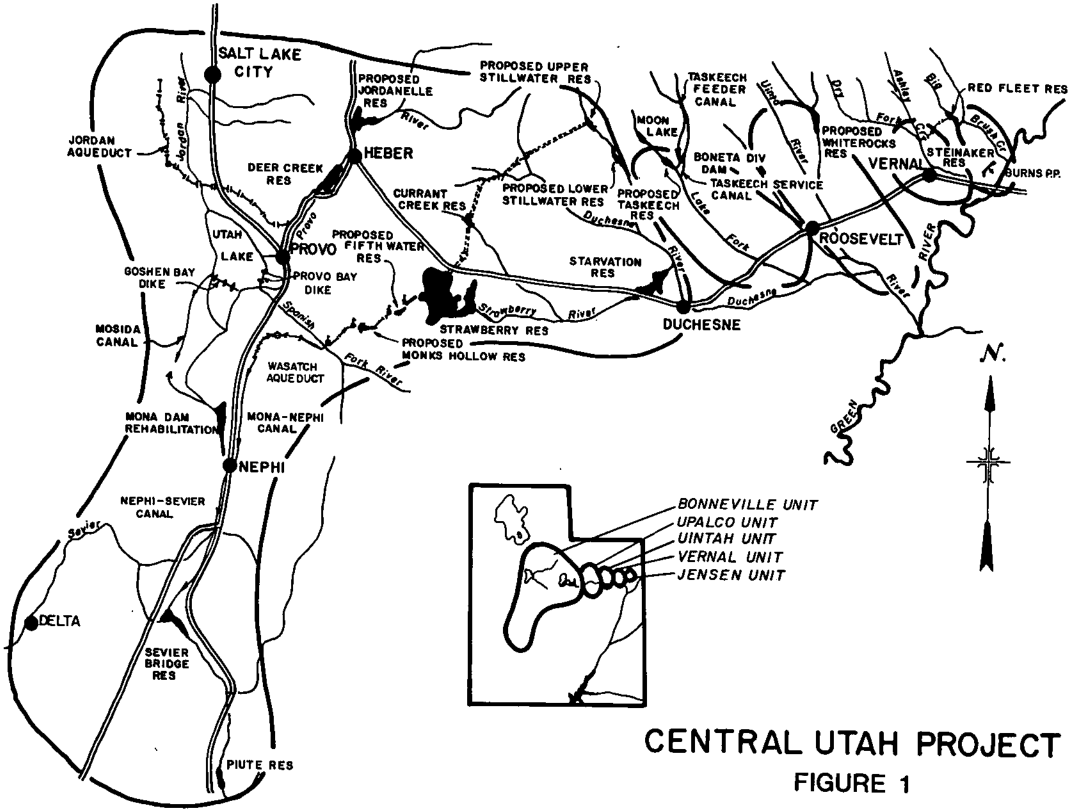
The Bonneville Unit, under construction since 1966, was divided into six systems according to location and function for convenience in planning and coordination. These systems are the Starvation Complex (essentially completed), Strawberry Aqueduct and Collection System (under construction), Diamond Fork Power System, Irrigation and Drainage System, Municipal and Industrial System (under construction), and the Bureau of Indian Affairs Developments (partially completed). The Bonneville Unit plan is shown in Figure 1. The unit will include: 10 new reservoirs; the enlargement of an existing reservoir, more than 140 miles of aqueducts, tunnels, and canals; five powerplants; 8 primary pumping plants; and about 200 miles of pipe drains. Water will be made available to meet present and future economic, industrial, municipal, agricultural, and recreation needs in Utah by providing about 121,100 acre-feet of M&I water; about 166,250 acre-feet of irrigation water for 27,340 acres of new farmland and 216,250 acres of existing farmland now short of water; and a minimum of 6,500 acre-feet for stream fisheries.

HOW DOES THE DIAMOND FORK POWER SYSTEM FIT?

The Diamond Fork Power System is an integral part of the Central Utah Project's Bonneville Unit and will serve as the conduit through which an average of approximately 200,000 acre-feet of water will be delivered from the Uinta Basin to the Bonneville Basin each year. The Diamond Fork Power System shown in Figure 2 is designed to utilize an elevation difference of approximately 2,600 feet to generate hydroelectric power as the water is transported through the Wasatch Mountain Range.

Power Generation

The proposed plan consists of a series of tunnels, reservoirs, pipelines, and powerplants, including three small conventional hydroplants and one large underground pumped storage powerplant. Figure 3 is an artist's conception of the large pumped storage powerplant. The three small conventional powerplants will have a combined installed capacity of 42.4 MW. The pumped storage powerplant will have a maximum capacity of 1,140 MW at maximum head, (4 units at 285 MW each), which, when added with the conventional hydro, gives a total installed capacity of 1182.4 MW. Of this amount, approximately 20.9 MW is needed for the Bonneville Unit Project pumping and will be Federally financed. Table 1 lists the major project features and their respective sizes and and capacities.



CENTRAL UTAH PROJECT
FIGURE 1

DIAMOND FORK POWER SYSTEM

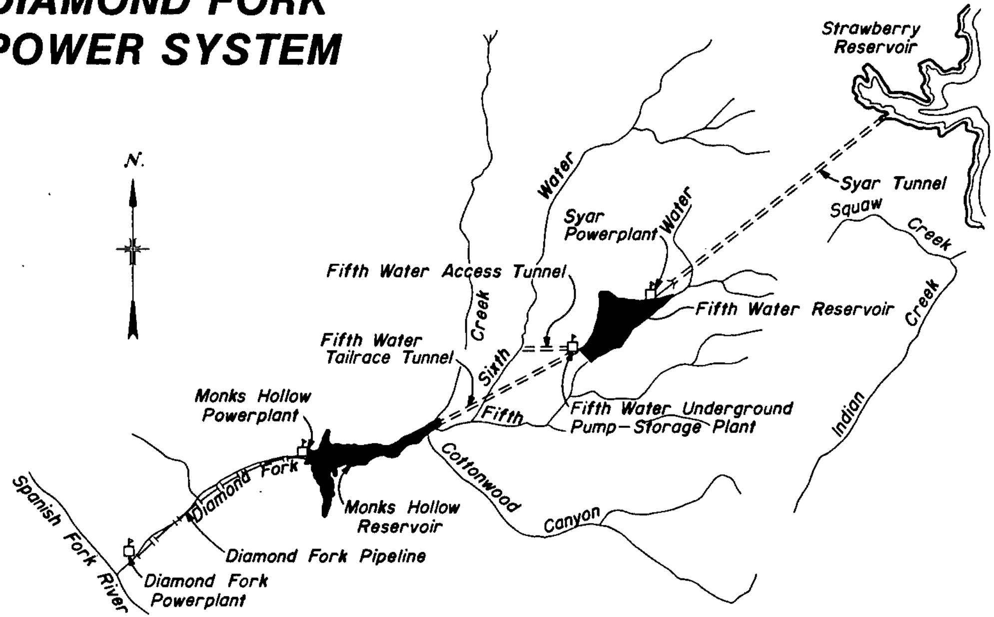


FIGURE 2

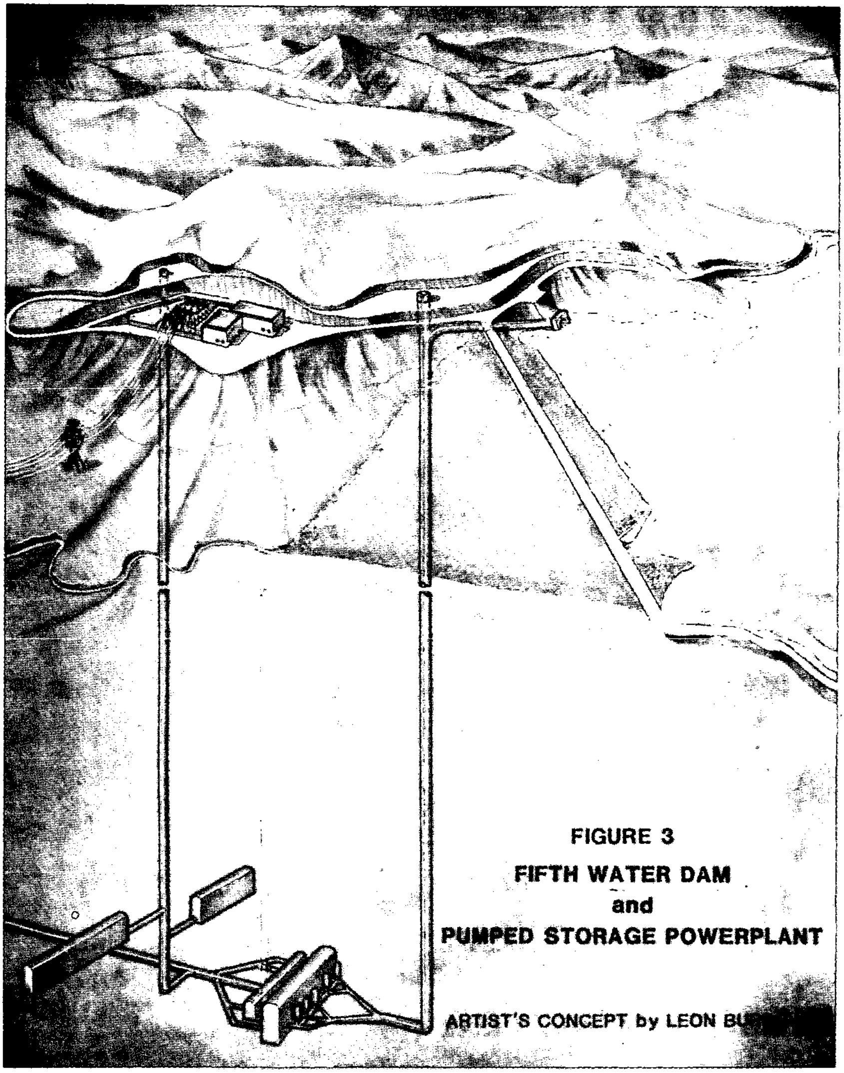


FIGURE 3
FIFTH WATER DAM
and
PUMPED STORAGE POWERPLANT

ARTIST'S CONCEPT by LEON BU

Table 1
Summary Data for Diamond Fork

Power System Facilities

Syar Tunnel, Penstock, and Powerplant	
Syar Tunnel	
Length (miles)	5.3
Diameter (feet)	10.5
Capacity (cfs)	800
Syar Penstock	
Length (feet)	1,130
Diameter (feet)	7
Capacity (cfs)	800
Syar Powerplant	
Capacity (MW)	26.0
Fifth Water Dam and Reservoir	
Dam	
Height (feet)	309
Material volume (cubic yards)	5,000,000
Reservoir capacity (acre-feet)	49,700
Surface area at normal water surface elevation, 7,100 feet (acres)	530
Fifth Water Pumped Storage Powerplant, Penstock, and Discharge Tunnels	
Fifth Water Pumped Storage Powerplant	
Capacity at maximum head (MW)	1,140
Capacity at minimum head (MW)	1,040
Fifth Water Headrace Tunnel and Shaft	
Length (feet)	2,400
Diameter (feet)	21.5 - 28.5
Capacity (cfs)	10,008
Fifth Water Discharge Tunnel	
Length (feet)	15,400
Diameter (feet)	28.5
Monks Hollow Dam and Reservoir	
Dam	
Height (feet)	250
Material volume (cubic yards)	150,000
Reservoir capacity (acre-feet)	32,790
Surface area at normal water surface elevation, 5,550 feet (acres)	360
Monks Hollow Powerplant	
Capacity (MW)	9.6
Diamond Fork Pipeline	
Length (miles)	6.9
Diameter (feet)	9.0
Capacity (cfs)	450
Diamond Fork Powerplant	
Capacity (MW)	6.8

Total Installed Capacity = 1,182.4 MW

Product Delivery

For this proposal, several basic assumptions have been made to define the transmission system necessary to carry power generated by Diamond Fork. The system would also be capable of delivering pumping energy for operation of the Fifth Water Pumped Storage Powerplant.

Equivalent or designated Federal Points of Delivery (FPOD's) would be established as a result of detailed transmission system analysis and other transmission considerations which ultimately depend on project participants.

Loads were assumed to be as follows;

- 440 MW to preference customers in the Northern Division of the CRSP marketing area delivered over the CRSP transmission system.

- 100 MW delivered at Flaming Gorge Switchyard.

- 200 MW delivered at Sheep Creek Substation.

- 400 MW delivered to entities in Arizona, California, and Nevada.

Additional transmission required for this assumed load distribution is shown schematically in Figure 4. The new transmission includes:

1. 46 kV and 345 kV transmission lines between the Fifth Water Switchyard and the powerplants and switchyard facilities to terminate these lines.

2. A 345 kV transmission line between Sheep Creek and Bonanza Substations with terminating facilities.

3. A 345 kV transmission line from Sheep Creek Substation to Sigurd Substation, thence to Glen _anyon Switchyard, thence to the Navajo Switchyard, along with substation facilities to terminate these lines.

4. A 345 kV transmission line between Sheep Creek Substation and Springville Substation, along with substation facilities to terminate this line.

5. A 46 kV transmission line from the Diamond Fork Switchyard to tie into an existing 46 kV transmission line.

Delivery of power beyond equivalent or designated FPOD's will be addressed and would define Western's and Reclamation's responsibilities in the delivery of electric service. As a general practice, all costs, including losses for delivery of service beyond the specified contract FPOD's would be the responsibility of the participant. However, alternatives could be considered to provide for third-party wheeling or assistance in the construction of required transmission facilities. Arrangements will also be considered in which participants provide their own pumping energy or where it is provided for in their behalf by other sources.

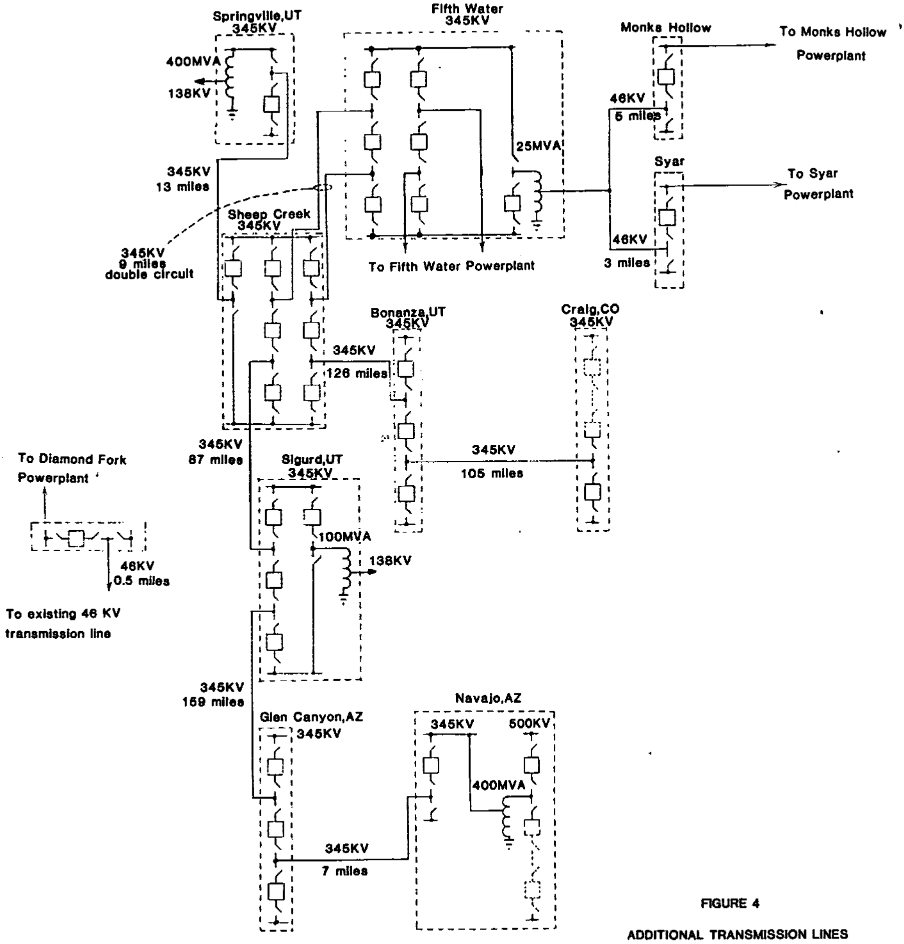


FIGURE 4

ADDITIONAL TRANSMISSION LINES
WHICH MAY BE REQUIRED

HOW WILL DIAMOND FORK OPERATE?

Water releases through the Diamond Fork Power System will be made according to downstream agricultural, municipal, and industrial demands. These downstream water uses will have priority over power generation. However, operation of the Fifth Water Pumped Storage Powerplant is not constrained by downstream water demands. The average annual flow-through energy of 403 GWH produced by the project was determined by using operation studies based on the 1921-1973 hydrologic period.

Table 2 summarizes the monthly energy produced at the powerplants based on average hydrologic conditions. The pumped storage energy production figures shown in the table are based on an assumed annual plant capacity factor of 16 percent. This average annual plant capacity factor was used in planning reports and represents Reclamation's estimate of the long-term average operating conditions throughout the life of the project. However, the Fifth Water Pumped Storage Powerplant has a theoretical capability of operating on a weekly cycle at a 34 percent plant capacity factor. The actual operation of the plant will be according to the needs of the power users. The pumpback energy requirements shown in Table 2 are based on a turnaround efficiency of 75 percent.

The Fifth Water Pumped Storage Powerplant has been designed to operate on a weekly cycle. The plant will have the capability of generating at capacity for 12 hours each weekday, with pumpback energy being supplied on weeknights and weekends. Fifth Water Reservoir contains enough capacity to store the equivalent of approximately 31,500 MWH of energy. During an emergency, this capacity could be used to operate Fifth Water Pumped Storage at maximum output for up to 29 hours.

Three operating cases have been analyzed in order to illustrate the relationship of energy generated by Fifth Water Pumped Storage Powerplant and the amounts of pumpback energy required. Each operating case was evaluated using typical summer and winter releases from Strawberry Reservoir. The July operations shown assume an average flow through component of 690 cfs. The January operation was based on an average flow through component of 128 cfs. Capacities and energy shown for each case are for the Fifth Water Pumped Storage Powerplant only and do not include the capacity and energy generated at Syar, Monks Hollow and Diamond Fork Powerplants.

Under Case 1, the plant would be operated to meet 850 MW peaks of 4-hour duration each weekday. The remaining plant capacity was assumed to be set aside for reserves. Figures 5 and 6 show the assumed operation patterns for a week in July and January, respectively. The amount of energy generated during the summer and winter weeks was 17,000 MWH. The primary difference between the summer and winter operation was the amount of pumpback energy required. The winter operation required approximately 19,600 MWH of pumpback energy, whereas the summer operation required only slightly more than 6,000 MWH of pumpback energy. This difference is due to the larger releases from Strawberry Reservoir flowing through the system during the summer months to meet downstream water needs. Figure 7 shows how the static head would fluctuate during January operation in Case 1.

Case 2 operation assumed that 850 MW peaks of 8-hour duration would be met each weekday. Figures 8 and 9 show the assumed operation patterns terns for summer and winter operation under Case 2. The January static head fluctuation for this case is shown in Figure 10.

Case 3 represents maximum operation of Fifth Water Pumped Storage Powerplant. Under this case, the plant would generate at maximum capacity for 12 hours each weekday. Figures 11 and 12 show the approximate summer and winter operating patterns for Case 3 and Figure 13 shows the corresponding January static head fluctuations.

Conventional turbines can operate through a fairly large range of flows and loads (40 to 100 percent of rated capacity) without detrimental problems. High head, reversible pump-turbines are not capable of operating at very low flows. Sustained operation below 60 or 70 percent of rated capacity may be accompanied by severe vibration and unstable power output. In the pumping mode, the units must operate at full capacity.

The costs for Fifth Water Pumped Storage Powerplant presented in this document are based on four equal-sized units of 285 MW each. This configuration was used to obtain plant uniformity, construction economy, and minimum maintenance costs. However, this configuration would also limit the minimum sustained plant output to loads of 170 to 200 MW or greater. Other configurations could be used that would provide greater operational flexibility. One such configuration studied by Reclamaiton included three 285 MW units and two 125 MW units. Such a configuration would increase the initial construction costs by approximately $25 million. With the given head at the site, the smallest pump-generating unit that could be practically manufactured is 125 MW. The final unit sizing will be based on the operational needs of the project participants.

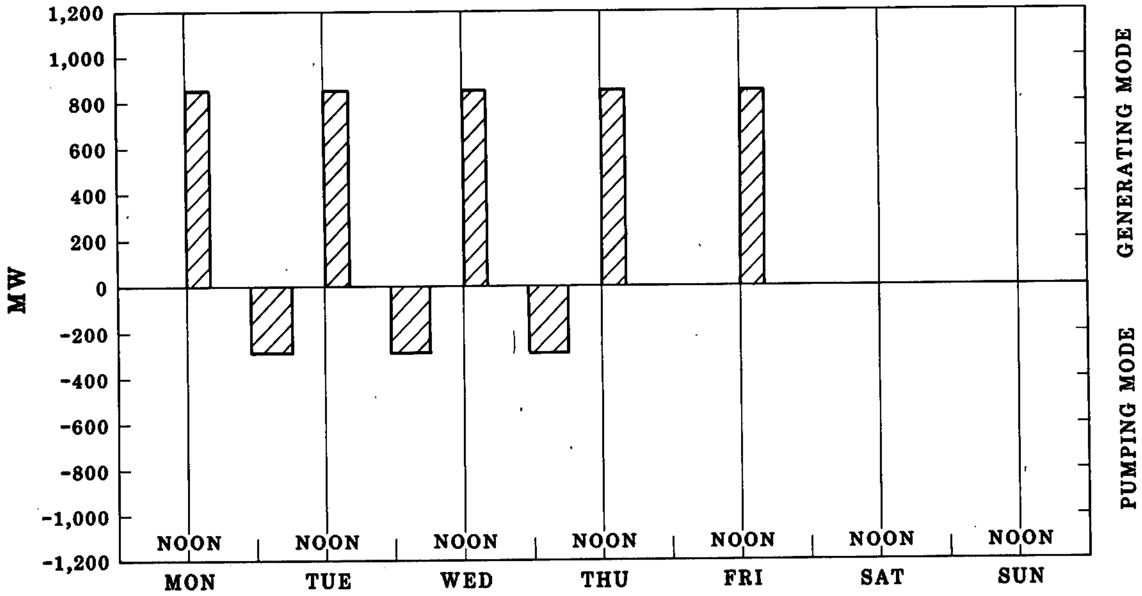
Table 3 contains a summary of average monthly releases from Monks Hollow Reservoir that would be required to meet downstream water demands. Figure 14 illustrates the probability of various annual release levels. As mentioned previously, water releases will be made according to downstream water demands. During dry years, large quantities of water will be released from Strawberry Reservoir through the Diamond Fork Power System. During wet years, lesser amounts of water will be released.

Monks Hollow and Diamond Fork Powerplants will operate according to downstream water demands, whereas operation of the Syar and Fifth Water Powerplants will be more flexible, since flows can be reregulated in Fifth Water or Monks Hollow Reservoir.

Table 2
Diamond Fork Power System
Approximate Energy Generation
Average Water Year
Average Pumped Storage Operation (16% PF)

Plant Name	Installed Capacity MW	Energy Generation (MW-HRS) October	November	December	January	February	March	April	May	June	July	August	September	Yearly Total
Syar	26	3887	2761	3008	3205	2761	2761	3348	9743	12684	15831	10794	6074	76857
Fifth Water	1140	14508	65489	209060	286136	88863	33248	11083	37581	247548	286136	244827	95311	1619790
Flow Through		14364	9595	9594	11992	9594	9594	10777	37255	47007	48650	40342	18254	267018
Pump Storage		144	55894	199466	274144	79269	23654	306	326	200541	237486	204485	77057	1352772
Monks Hollow	9.6	1435	1605	1605	1585	1529	1737	4190	4455	5134	6964	5116	4285	39640
Diamond Fork	6.8	719	0	0	53	0	0	346	1864	4181	4181	4873	3063	19280
Total Generation	1182.4	20549	69855	213673	290979	93153	37746	18967	53643	269547	313112	265610	108733	1755567
Irrigation Pumping Requirements	20.9	1749	1890	1935	1902	1800	1912	2262	3051	4636	6618	3372	2017	33144
Available Energy	1161.5 1/	18800	67965	211738	289077	91353	35834	16705	50592	264911	306494	262238	106716	1722423
Pumpback Energy		192	74525	265955	365525	105692	31539	408	435	267388	316648	272647	102743	1803696

1/ Represents the maximum installed capacity at plant minus irrigation pumping requirements.



FIFTH WATER PUMPED STORAGE POWERPLANT
WEEKLY OPERATION PATTERN
CASE 1 - JULY

ASSUMPTIONS:

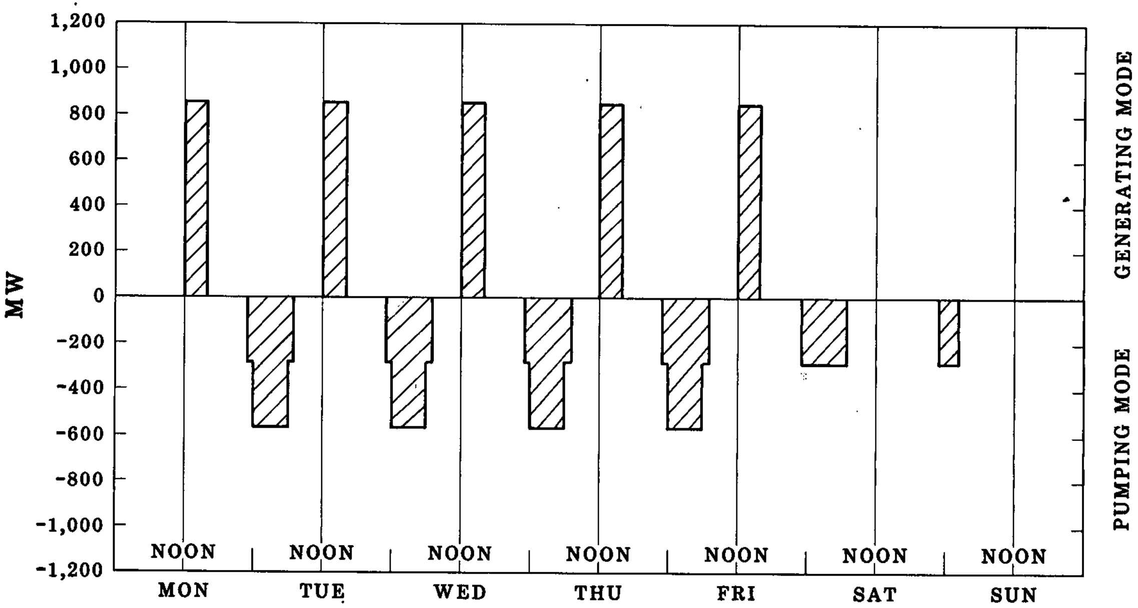
WEEKDAY PEAKS = 4 HRS. at 850 MW

AVERAGE FLOW THROUGH = 690 CFS

ENERGY GENERATED =17,000 MWH

PUMPBACK ENERGY = 6,045 MWH

FIGURE 5



FIFTH WATER PUMPED STORAGE POWERPLANT
WEEKLY OPERATION PATTERN
CASE 1 - JANUARY

ASSUMPTIONS:

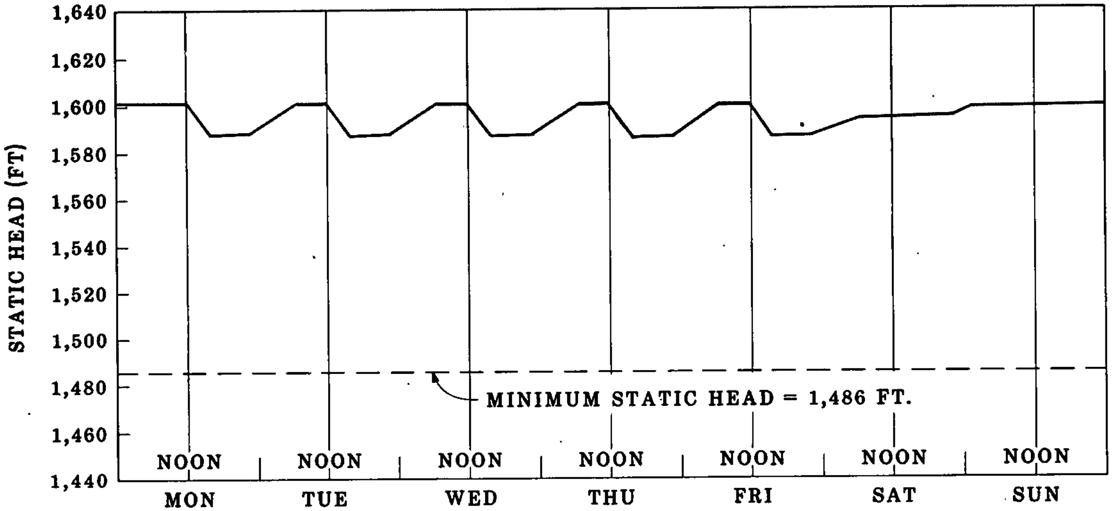
WEEKDAY PEAKS = 4 HRS. at 850 MW

AVERAGE FLOW THROUGH = 128 CFS

ENERGY GENERATED = 17,000 MWH

PUMPBACK ENERGY = 19,601 MWH

FIGURE 6



FIFTH WATER PUMPED STORAGE POWERPLANT
WEEKLY STATIC HEAD FLUCTUATION
CASE 1 - JANUARY

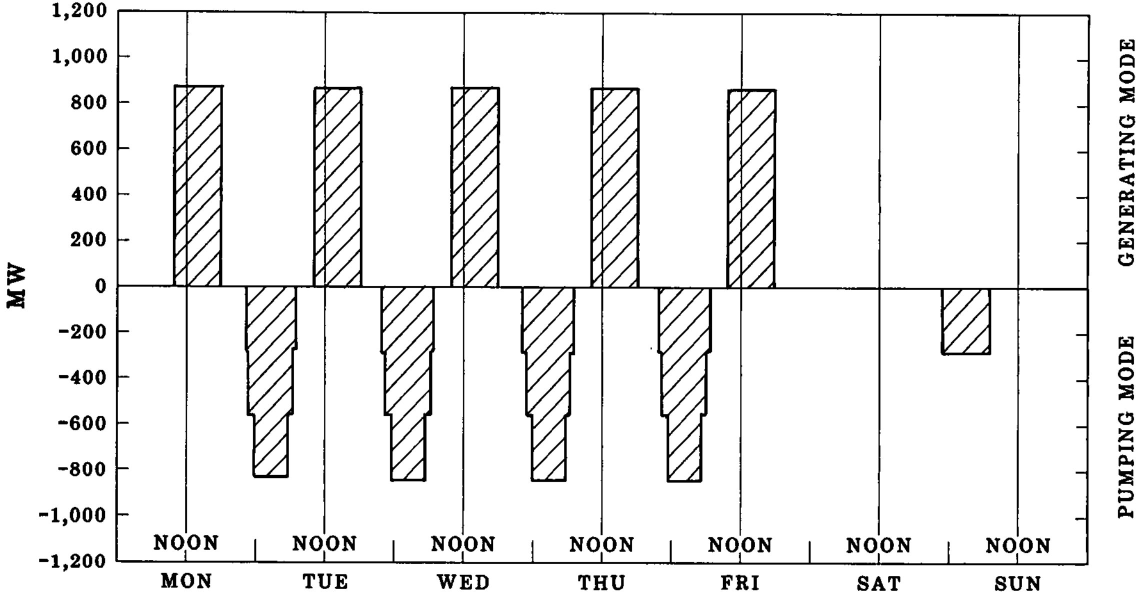
ASSUMPTIONS:

WEEKDAY PEAKS = 4 HRS. at 850 MW

AVERAGE FLOW THROUGH = 128 CFS

FIGURE 7

38-507 O - 85 - 16

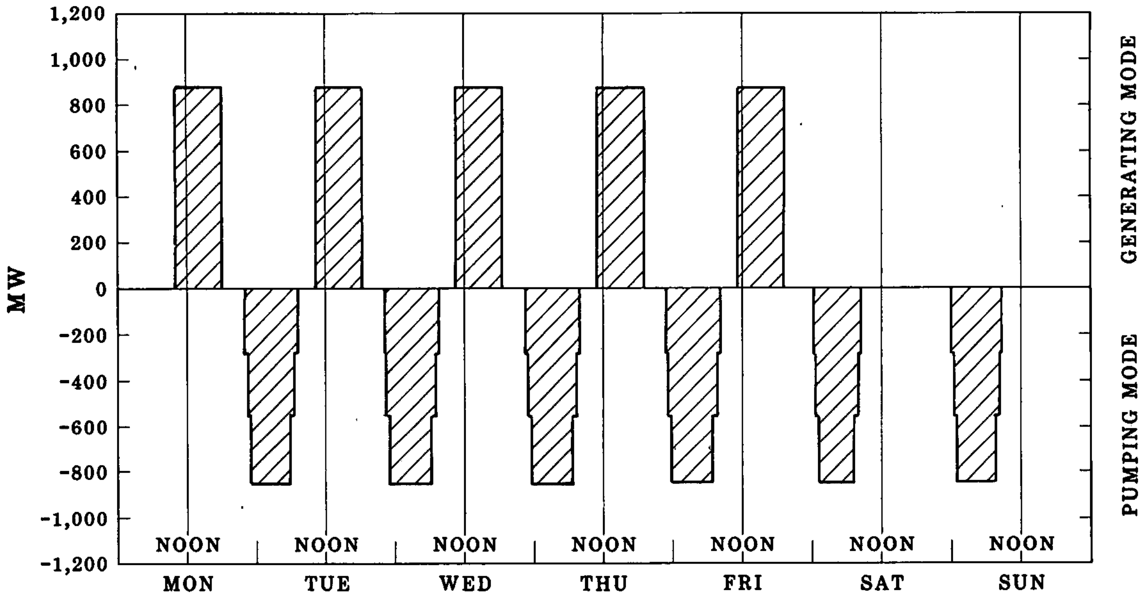


FIFTH WATER PUMPED STORAGE POWERPLANT
WEEKLY OPERATION PATTERN
CASE 2 - JULY

ASSUMPTIONS:

WEEKDAY PEAKS = 8 HRS. at 850 MW **ENERGY GENERATED = 34,000 MWH**
AVERAGE FLOW THROUGH = 690 CFS **PUMPBACK ENERGY = 27,159 MWH**

FIGURE 8

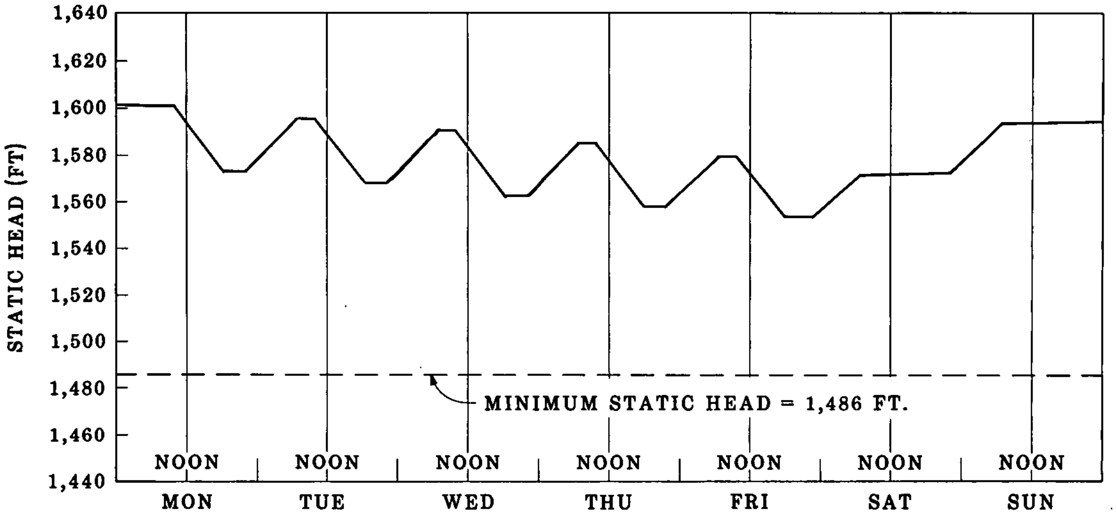


FIFTH WATER PUMPED STORAGE POWERPLANT
WEEKLY OPERATION PATTERN
CASE 2 - JANUARY

ASSUMPTIONS:

WEEKDAY PEAKS = 8 HRS. at 850 MW | **ENERGY GENERATED = 34,000 MWH**
AVERAGE FLOW THROUGH = 128 CFS | **PUMPBACK ENERGY = 40,495 MWH**

FIGURE 9



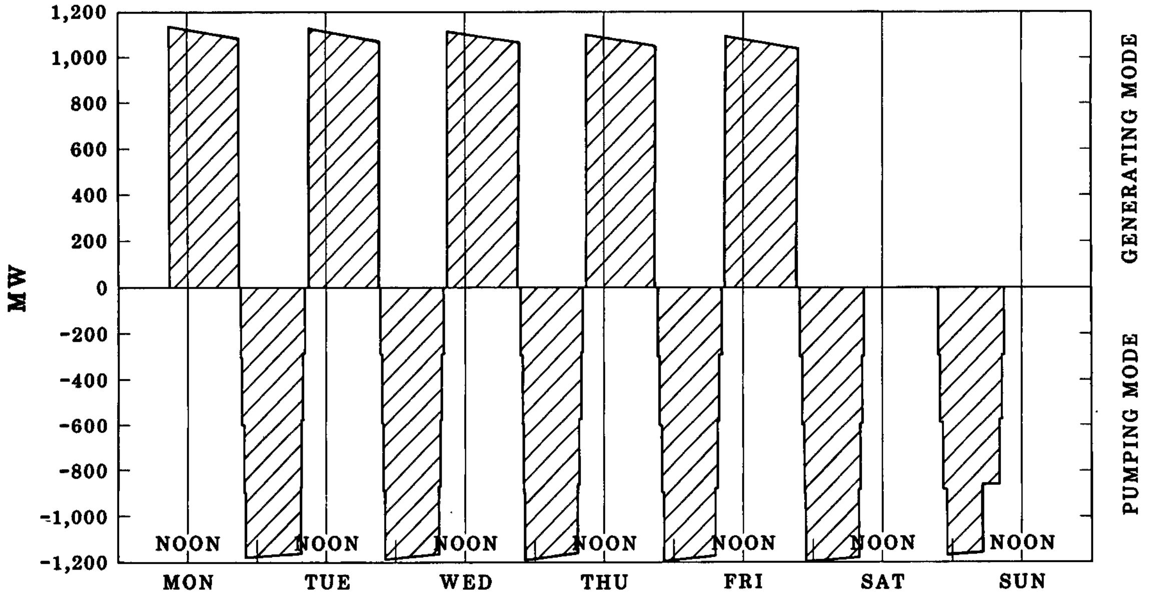
FIFTH WATER PUMPED STORAGE POWERPLANT
WEEKLY STATIC HEAD FLUCTUATION
CASE 2 - JANUARY

ASSUMPTIONS:

WEEKDAY PEAKS = 8 HRS. at 850 MW

AVERAGE FLOW THROUGH = 128 CFS

FIGURE 10



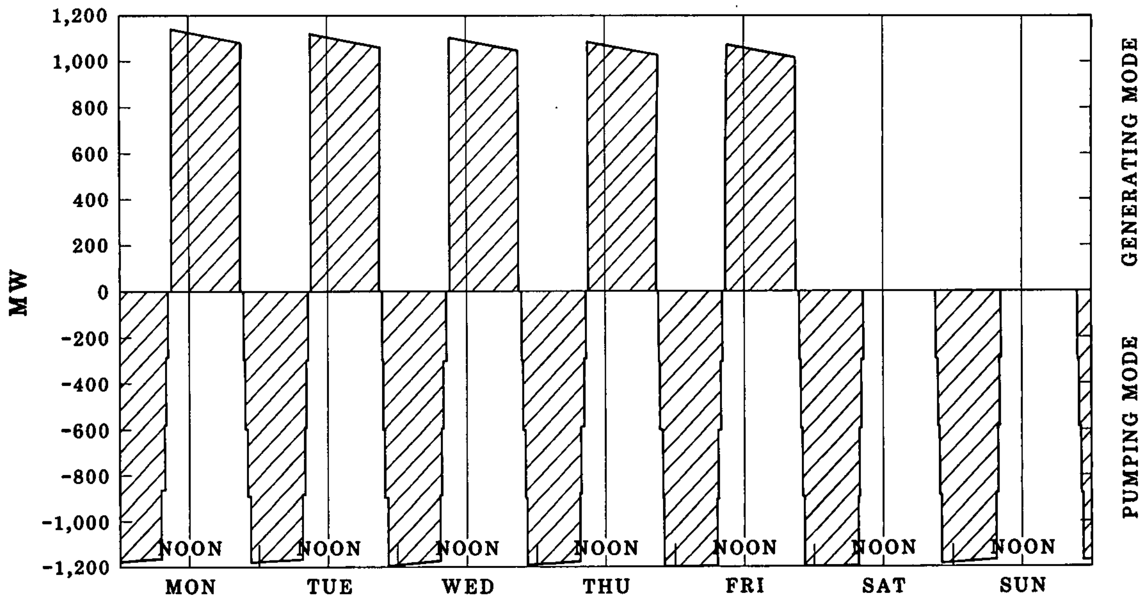
FIFTH WATER PUMPED STORAGE POWERPLANT
WEEKLY OPERATION PATTERN
CASE 3 - JULY

ASSUMPTIONS:

WEEKDAY PEAKS =12 HRS. at MAX. OUTPUT **ENERGY GENERATED = 65,477 MWH**

AVERAGE FLOW THROUGH = 690 CFS **PUMPBACK ENERGY = 69,167 MWH**

FIGURE 11



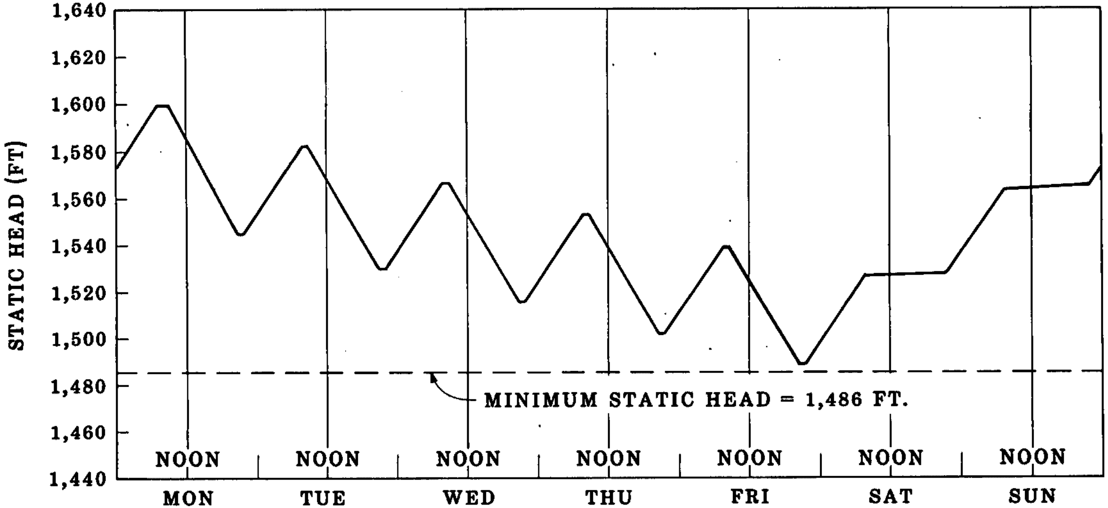
FIFTH WATER PUMPED STORAGE POWERPLANT
WEEKLY OPERATION PATTERN
CASE 3 - JANUARY

ASSUMPTIONS:

WEEKDAY PEAKS =12 HRS. at MAX. OUTPUT **ENERGY GENERATED = 64,605 MWH**

AVERAGE FLOW THROUGH = 128 CFS **PUMPBACK ENERGY = 81,302 MWH**

FIGURE 12



FIFTH WATER PUMPED STORAGE POWERPLANT
WEEKLY STATIC HEAD FLUCTUATION
CASE 3 - JANUARY

ASSUMPTIONS:

WEEKDAY PEAKS = 12 HRS. at MAX. OUTPUT

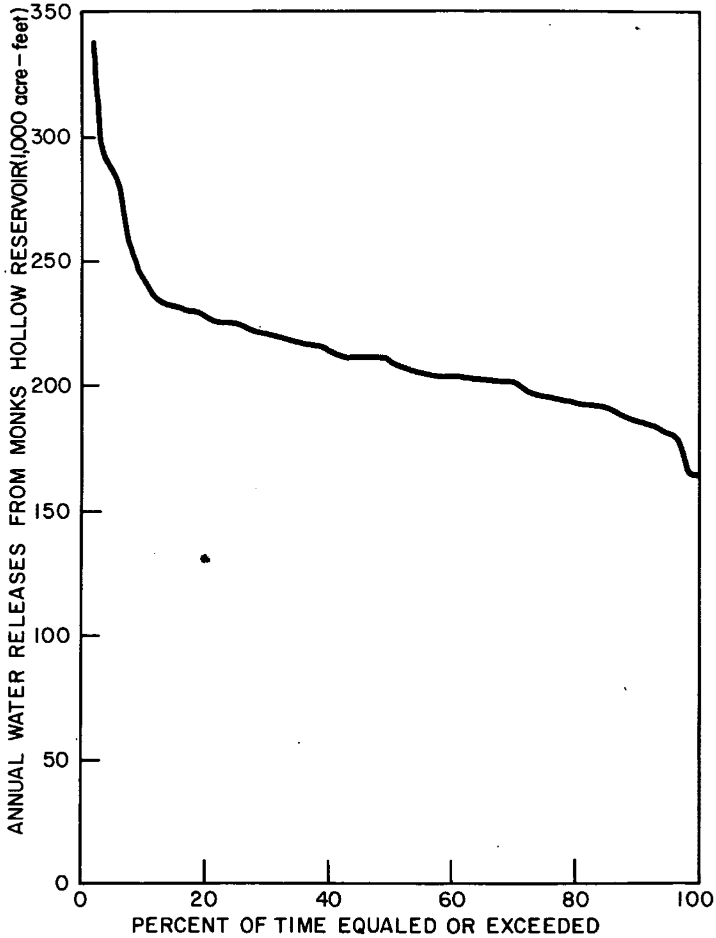
AVERAGE FLOW THROUGH = 128 CFS

FIGURE 13

Table 3

Monthly Water Releases From
Monks Hollow Reservoir
Average Water Year
(Based on 1921-1973 Hydrologic data)

Month	Release (1,000 a.f.)
October	14.0
November	9.4
December	8.7
January	8.6
February	8.0
March	8.8
April	11.8
May	18.9
June	31.3
July	42.5
August	30.9
September	20.8
Total	213.7



ANNUAL WATER RELEASES FROM MONKS HOLLOW RESERVOIR (based on 1921-1973 hydrologic data)

FIGURE 14

SCHEDULES & REGULATORY CONSIDERATIONS

NEED FOR WATER DELIVERIES

Current water demand projections for the Wasatch Front indicate a need to have joint use water conveyance facilities in place to deliver Bonneville Unit water from Strawberry Reservoir by 1992, and no later than 1996. The Diamond Fork Power System must be constructed now since water deliveries honoring existing contracts must be made within this timeframe and construction of the systems must be concurrent.

Project Status

Feasibility designs have been completed for all of the major features of the Diamond Fork Power System. Geologic and other design data investigations for final design of the project facilities are currently underway.

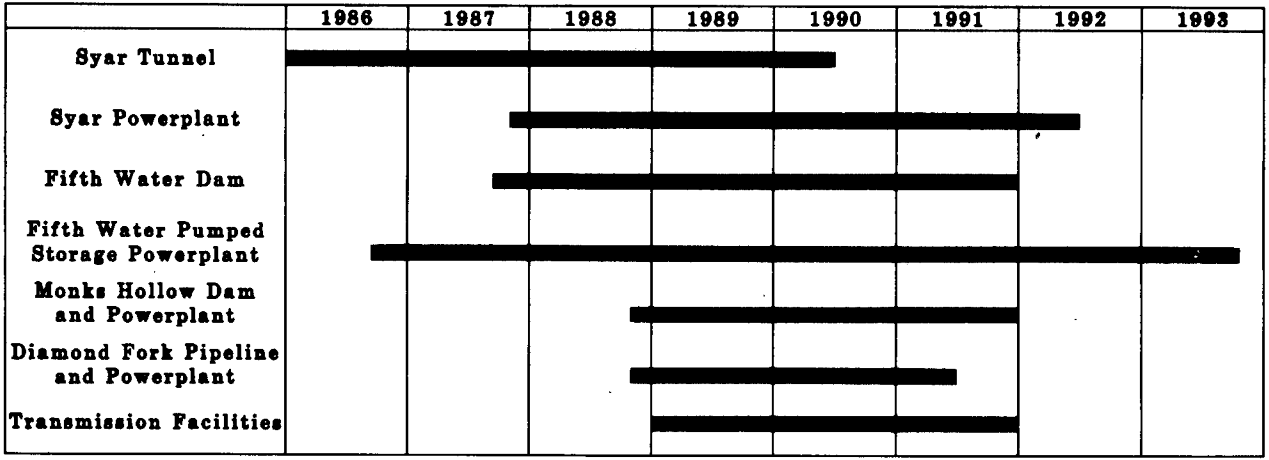
A draft environmental statement for the Diamond Fork Power System facilities was published in June 1983 and attendant public hearings were held. The final environmental statement will most likely be filed with the EPA during the summer of 1984. Environmental studies are currently underway on the additional grid transmission facilities that will be required to distribute Diamond Fork power. No endangered species have been identified within the project area.

Reclamation expects to obtain an exemption to section 404 of the Clean Water Act which will eliminate the need for dredge and fill permits. We anticipate that FERC license will not be required since the project authorization by Congress included development of power as a project purpose of the Central Utah Project.

An access road into the Fifth Water Pumped Storage Powerplant site is currently under construction and scheduled for completion in the summer of 1984. This road will provide construction access for an exploratory shaft into the underground powerplant cavern area. Specifications for the exploratory shaft, which will provide data to move to final design are currently being prepared.

Design and Construction Schedule

The design and construction schedule shown in Figure 15 for the Diamond Fork Power System has been prepared with a target plant-on-line date of 1992. This schedule shows construction of the major facilities beginning in 1986 and completion of construction in 1993. If necessary, the schedule could be adjusted to delay the power-on-line date until 1996; however, initial water delivery is scheduled for 1992.



DIAMOND FORK POWER SYSTEM

CONSTRUCTION SCHEDULE

FIGURE 15

MARKETING & MANAGEMENT

POWER MARKETING CONSIDERATIONS

Development of power marketing criteria for the proposed Diamond Fork System output will be based upon provisions of applicable Acts of Congress. The market area for resources from the Diamond Fork Power System will be determined as a direct result of expressions of interest in the project. First priority will be given based on preference under the law and participation in non-Federal financing.

The marketable classes of service available from the Diamond Fork Power System would be identified as either long-term or short-term resources and could include the marketing of such services as interchange, emergency assistance, or maintenance services.

Determination of the marketable firm capacity would require adjustments to the maximum available capacity to account for operating reserves, possible adjustments based on variation in hydrological conditions and contractual water release schedules, and reductions to account for priority use loads such as irrigation pumping.

Determination of the marketable firm energy would require similar adjustments to the maximum available energy generation to account for losses from transmission, both delivered and received (pumpback energy), and priority use energy requirements. Firm obligations from participants to supply pumpback energy would be required and defined in the resource characteristics. Possible purchases by Western or others at the cost of the customer could be considered as an option to each customer providing pumpback energy.

PROJECT MANAGEMENT/OWNERSHIP.

Management

The organization for project management during design and construction and for operation and maintenance are viewed as open. Both Reclamation and Western recognize the need for flexibility to accommodate non-Federal financing and ownership requirements in this project.

Reclamation is moving toward final design data gathering and is planning to prepare specification designs consistent with the construction schedule in this proposal. Reclamation is also willing to provide construction management services or let those services be provided for as will best accommodate the configuration of participants and financing requirements.

This flexibility is also reflected in Reclamation's position during operation and maintenance, assuming required water deliveries are made by the operating entity.

Power scheduling, billing, and dispatching of the Diamond Fork resource could be the responsibility of Western subject to the requirements of participants. Maintenance of the transmission system may be negotiable. Integration of this additional resource with the established operational procedures for CRSP and other projects would require careful consideration of all elements of power generation, transmission, and accounting.

Ownership

Reclamation law generally requires that title to project works remain with the United States. However, in light of the possible financing requirements, this matter is being reviewed. We believe that the ultimate financing structures for this project depend upon the mix of financing participants; each of their needs with respect to ownership will vary with their taxable status. We are very willing to work with project participants to find mutually agreeable ownership arrangements.

PRODUCT COSTS & FINANCING REQUIREMENTS

PROJECT CONSTRUCTION COST ESTIMATE

Project Construction Cost Estimate

It is estimated that the non-Federally financed portion of the total construction costs for generation and transmission facilities will be 1.2 billion (January 1983 prices). This estimate is exclusive of interest during construction, reserve funds, working capital, and cost to particular participants such as taxes, regulatory expenses, and contingency and financing expenses. This estimate includes engineering overhead and miscellaneous costs. These baseline numbers may be helpful to you in calculating what the energy and capacity might cost under your specific financing preferences.

Table 4 summarizes the January 1983 construction estimate. The separable costs shown in the table represent the construction costs of facilities whose sole purpose is power generation. The transmission costs include the construction costs of additional transmission lines, switch-yards, and substations needed to deliver Diamond Fork Power to the assumed points of delivery. The joint costs are the power systems share of the costs of facilities that serve more than one of the Bonneville Unit Project's purposes. It is anticipated that Reclamation will offer long-term financing (40 years) for sunk joint costs at 3.222 percent interest.

Table 4
Diamond Fork Power Project
January 1983 Construction Cost Estimate
Estimated Construction Costs 1/
(000's)

Separable costs	$ 738,000
Transmission costs	247,000
Joint costs to be built (non-Federally financed)	235,000
Total costs to be non-Federally financed	$1,220,000
Sunk joints costs (Federally financed at 3.222 percent)	260,000
Total project costs	$1,480,000

1/ Excludes interest during construction, reserve funds, working capital, owner's contingency, and financing expenses. The Federal share of costs for Bonneville Unit pumping requirements has also been excluded.

The construction cost estimates in Table 4 are based upon the following major assumptions, each of which we believe realistic:

1. The project will be constructed according to the existing schedule. To the extent delays occur on completion dates of project features, those delays may result in increased project costs.

2. Construction labor supply will be adequate to provide skilled and unskilled tradesmen necessasry to construct the facilities. There will be no strikes or significant shortages or delays in receipt of materials or equipment.

3. All necessary permits, licenses and approvals will be obtained on a timely basis.

Advances would be required based upon a schedule of estimated expenditures. Reclamation will seek budget contract authority which essentially permits an agency to write its own appropriation within limits set in the legislation, for normal appropriated funds as well as revolving funds. Project financing participants would be guaranteed that the Federal Government is committed to funding its portion of the project on a timely basis. In turn, project participants must be bound to maintain their level of funding as advances come due or payment for sunk joint costs come due.

Financing Alternatives

Financing Diamond Fork costs may be accomplished individually by participants or by an agency or multiple agencies set up for that purpose dependent upon the participant mix. For illustration purposes, we have structured a representative tax-exempt bond financing program.1/

Methodology

This analysis is based upon the estimated costs for generation and transmission facilities. These costs would be expended through 1993 and the final unit is anticipated to be on line on October 1, 1993. This non-Federal funding is assumed to be on a tax-exempt basis, with 50 percent or construction costs funded initially with long-term bonds and 50 percent with tax-exempt commercial paper (T.E.C.P.) with the T.E.C.P. being refinanced with long-term bonds shortly after the project is on line. The joint costs which have already been incurred are assumed to be repaid to the Government over 40 years at an interest rate of 3.222 percent through a repayment contract arrangement.

Assumptions

General

The inflation rate is assumed to be 5 percent annually over the construction period. Long-term bonds and commercial paper are issued 1 year ahead of scheduled construction expenditures as shown in Table 5.

1/ The non-Federal financing adjunct committee of investment bankers and bond counsel which is composed of Mr. Dick Christensen, Prudential Bache Securities; Burrows Smith Division, Mr. Fenn Putman; Salomon Brothers, Inc., Mr. Don Larson; Smith Barney, Harris Upham, and Company; and Mr. Bob Ferdon of Mudge, Rose, Guthrie, Alexander, and Ferdon developed this bond financing example in concert with the Reclamation and Western.

Table 5
Long-term Bond and
Tax Exempt Commercial Paper (TECP) Issues
(000's)

Issue Date	To fund construction for	Long-term bonds	TECP
1/1/86	1985-1987	$ 349,080	$ 144,803
1/1/87	1988	270,755	134,625
1/1/88	1989	418,505	233,430
1/1/89	1990	390,190	247,965
1/1/90	1991	271,665	199,600
1/1/91	1992	79,965	83,185
1994		$1,223,940 1/	0
Totals		$3,004,100	($1,043,635)

1/ The TECP is refinanced in 1994, at the completion of construction with long-term bonds. This figure compares with the total of TECP but also includes debt service reserve fund and allowance for bond discount.

Issue Sizing

The average coupon rate for the tax exempt bonds is assumed to be 11 percent and for tax-exempt commercial paper is 6 percent. Interest during construction is assumed to capitalize to October 1, 1993. The construction fund is assumed to be drawn down quarterly. Financing expenses are assumed to be 2.5 percent of the bonds and .125 percent per year on the amount of tax exampt commercial paper outstanding.

Given these assumptions, a total of $3,004,100,000 in bonds issued in annual incremental series over the construction period would be issued to cover the costs of the generation and transmission facilities. In current dollars, this total in bond issues amounts to $1,844,256,000.

The total of $1,844,256,000 in bond issues and $322,000,000 of sunk joint costs (including interest during construction) amounts to $2,166.256,000. Based upon an installed capacity of 1182.4 MW, the estimated price per installed kW for generation and transmission facilities is $1832.

Table 6, Column 8 sets forth the total costs payable annually from electric rates. Using this information and the information in Table 2, mill rate could be derived. Repayment of the sunk joint costs at 3.222 percent over 40 years, a $14,435,000 annual payment is displayed in Column 7. As noted, these payments will continue beyond the year 2020. Column 2 displays the grand total of debt service which includes all principal and interest payment on the bonds, and includes the short-term construction debt (T.E.C.P.) to be rolled over into long-term bonds.

Power Rates

Alternatives for establishing either uniform or non-uniform power rates for all participants will be presented to assure recovery of all costs and expenses associated with generation and transmission services. Establishment of power rates would be contingent upon the individual participants status for non-Federal financing and recommended financing options.

The rate may be a separate service rate or may be an element of an integrated rate schedule with other resources such as the Colorado River Storage Project (CRSP).

Any mill rate estimate would vary according to revised cost and expense estimates and whether the Diamond Fork Resource is "blended" with CRSP.

Table 6
Diamond Fork Power System
Funding of Joint and Separable Costs
Preliminary Calculation of Total Payments To Be Made By Non-Federal Participants

Date	Grand total debt service	Capitalized interest	Balloon payment refinancings (TECP & Bonds)	Reserve fund income (post construction)	Debt service payable from electric rates	Reimbursement of joint costs previously incurred (@3.22%)	Total costs payable from electric rates
1	2	3	4	5	6	7	8
January 1, 1987	47,088,600	47,088,600			0	0	0
January 1, 1988	84,949,150	84,949,150			0	0	0
January 1, 1989	144,990,500	144,990,500			0	0	0
January 1, 1990	202,789,300	202,789,300			0	0	0
January 1, 1991	244,648,450	244,648,450			0	0	0
January 1, 1992	258,435,700	258,435,700			0	0	0
January 1, 1993	258,435,700	258,435,700			0	0	0
January 1, 1994	1,302,070,700	193,826,775 3/	1,043,635,000 3/	43,053,102	21,555,823	14,435,000	35,990,823
January 1, 1995	330,451,000			43,053,102	287,397,898	14,435,000	301,823,898
January 1, 1996	330,451,000			43,053,102	287,397,898	14,435,000	301,823,898
January 1, 1997	330,451,000			43,053,102	287,397,898	14,435,000	301,823,898
January 1, 1998	330,451,000			43,053,102	287,397,898	14,435,000	301,823,898
January 1, 1999	361,631,000			43,053,102	318,577,898	14,435,000	333,012,898
January 1, 2000	361,626,200			43,053,102	318,573,098	14,435,000	333,008,098
January 1, 2001	361,629,650			43,053,102	318,576,548	14,435,000	333,011,548
January 1, 2002	361,629,000			43,053,102	318,575,898	14,435,000	333,010,898
January 1, 2003	361,628,600			43,053,102	318,575,498	14,435,000	333,010,498
January 1, 2004	361,632,300			43,053,102	318,579,198	14,435,000	333,014,198
January 1, 2005	361,627,900			43,053,102	318,574,798	14,435,000	333,009,798
January 1, 2006	361,628,250			43,053,102	318,575,148	14,435,000	333,010,148
January 1, 2007	361,622,950			43,053,102	318,569,848	14,435,000	333,004,848
January 1, 2008	361,635,000			43,053,102	318,581,898	14,435,000	333,016,898
January 1, 2009	361,631,400			43,053,102	318,578,298	14,435,000	333,013,298
January 1, 2010	361,628,100			43,053,102	318,574,998	14,435,000	333,009,998
January 1, 2011	361,628,950			43,053,102	318,575,848	14,435,000	333,010,848
January 1, 2012	361,630,700			43,053,102	318,577,598	14,435,000	333,012,598
January 1, 2013	361,617,450			43,053,102	318,564,348	14,435,000	332,999,348
January 1, 2014	361,625,650			43,053,102	318,572,548	14,435,000	333,007,548
January 1, 2015	361,621,950			43,053,102	318,568,848	14,435,000	333,003,848
January 1, 2016	361,623,700			43,053,102	318,570,598	14,435,000	333,005,598
January 1, 2017	361,631,800			43,053,102	318,578,698	14,435,000	333,013,698
January 1, 2018	361,635,150			43,053,102	318,582,048	14,435,000	333,017,048
January 1, 2019	361,629,550			43,053,102	318,576,448	14,435,000	333,011,448
January 1, 2020	833,654,400		475,000,000 1/	434,444,943	-75,790,543	14,435,000	-61,355,543
TOTAL	12,293,061,750	1,435,164,175	1,518,635,000	1,553,825,595	7,785,436,980	389,745,000 2/	7,875,145,980

1/ Amount to be refinanced in year 2020.
2/ Total of 27 years' payment. Payment on sunk joint costs will continue beyond year 2020.
3/ Represents rollover of TECP into long-term bonds.

PROJECT MERITS

PROJECT MERITS

What Are the Advantages of Pumped Storage?

The primary economic benefit of pumped storage is the ability to convert low-cost energy available during off-peak hours to high value energy during period of peak demand. Pumped storage also has numerous other benefits which are also valuable to the electrical system. Some of these benefits are:

1. Large standby capacity available on short notice. Machines in a pumped storage plant can be operating at their most efficient point and still pick up or drop load very rapidly. During the pumping cycle, twice the rated capacity of the plant is available for use in emergency situations. The dropping of full pumping load makes capacity equal to the total plant capacity available immediately. This can be followed in a few minutes, if necessary, by the additional full generating capacity of the plant.

2. Spinning reserve is available to supply reserve requirement.

3. Load and frequency control. Turbine operations of a high head pump/turbine unit may be expected to be smooth from 75 percent to 100 percent at full load. In this range the generator can assist with system load and frequency control.

4. Synchronous condenser operation. Pump storage machines can be used for reactive compensation to the power system, thus providing system voltage control.

5. Improve system reliability, security, and availability. It has been demonstrated in other areas that introduction of pumped storage into the system can significantly improve these factors.

6. Delay investment in large, expensive baseload plants. Pumped storage can often show a large economic benefit to the system by deferring construction of nuclear and coal plants to a later period.

7. High availability rates. Pumped storage plants, when designed appropriately, can reach availalbility rates as high as 92 percent. This has great economic value, since a utility's reserve requirements are related to the availability of the generating components.

8. Greatly reduced staffing requirement. The staffing requirements of a typical pumped storage plant are approximately one-fifth that of steam plants.

9. Long life. The structures and waterways of pumped storage systems have extremely long lives, up to 100 years, while the mechanical and electrical components are replaced every 40 years or less.

10. Interruptible pumping (load management). During off-peak periods, less efficient, more flexible, older steam plants are often shut down, and the system load is carried by the efficient but inflexible baseload plants. Under these conditions a large interruptible load is of particular value to the system.

11. Enhancement of entire system generating efficiency. Pumped storage can reduce the usage of inefficient thermal plants. With pumped storage in place in a system, highly efficient baseload plants can operate at a higher load factor, thus improving the overall system efficiency. Pumped storage can further enhance and extend the life of steam plants by allowing them to operate at a fixed point. Thermal transients, which are the greatest cause for reduction in plant life, can be greatly reduced by using pumped storage.

12. Reduces the use of gas turbines and displaces high-cost, oil-fired units.

13. Helps with system maintenance scheduling. Pumped storage plants generally have large units which can fill in for other units in the system during scheduled maintenance.

Specific Advantages of the Diamond Fork Power System

The Fifth Water Pumped Storage Powerplant is not a pure pumped storage plant. An average volume of approximately 200,000 acre-feet of water will flow through the system each year as a result of the transbasin diversion. This flow through component is a renewable resource that will significantly reduce the amount of pumpback energy required to operate the pumped storage plant, especially during the summer months since about one-half of water deliveries for the Central Utah Project must be made during these months.

Comparison with other recently-constructed pumped storage systems indicates that the Fifth Water Plant will have excellent generation load following ability. The ratio of Tw, water starting time, to Tm, machine starting time, is indicative of good response when the ratio is less than 0.24. Likewise, a gate time constant, Tg, less than 25 also indicates good response. As shown in Table 7, the Fifth Water Pumped Storage Powerplant machinery is well below these criteria.

Table 7
Time Constant Comparisons for Various Pumped Storage Powerplants

Plant Name	Head (FT)	Tw/Tm	Tg
Mt. Elbert	400	0.339	80.3
Drakensburg	1,525	0.292	51.2
Bijina Basta	1,969	0.215	
Dinorwic	1,774	0.192	18.6
Helms	1,763	0.132	10.6
Fifth Water	1,475	0.08 to 0.11	12.3 to 18.3

A great deal of baseload generation capacity exists within the Intermountain area. Diamond Fork could help these highly efficient steam plants operate at a higher plant factor and thus improve the overall system efficiency. These plants may be an ideal source of pumping energy for operation of Fifth Water Pumped Storage Powerplant.

As mentioned previously, Reclamation anticipates that the Diamond Fork Power System Final Environmental Statement will be filed with the EPA during the summer of 1984. Work on the transmission facilities environmental statement is currently in progress. We do not foresee any delays in the project caused by waiting to obtain compliance with the National Environmental Policy Act.

The water supply for the Diamond Fork Power System is essentially developed. All of the major features of the Strawberry Aqueduct and Collection System are either completed or under construction with the exception of the 0.8-mile-long North Fork Siphon. Construction on that feature is scheduled to begin in 1984. On June 17, 1965, the State Engineer approved Reclamation's Application No. 36639 which appropriates up to 500,000 acre-feet of water from the Strawberry and Duchesne Rivers for storage in Starvation Reservoir and from sources along the Strawberry Aqueduct for storage in Strawberry Reservoir. This application has a priority date of November 19, 1964, (12:00 noon). No further approvals are required.

Construction of the Diamond Fork Power System would create approximately 22,230 jobs (person years) in direct and indirect employment during the construction period. Most of the money from construction workers' paychecks would be spent in Utah County, particularly in the cities of Provo and Orem, which would create a substantial economic stimulus that would help offset other negative social impacts to the area.

The Bureau of Reclamation has had over 80 years experience in developing engineering techniques which have enabled it to build some of the world's finest, most innovative water projects. Reclamation's enginering expertise has earned the agency a worldwide reputation for excellence in design, construction, operation and maintenance. Advanced designs using state-of-the-art engineering are a Reclamation tradition which are borne out in such structures as Hoover, Grand Coulee, and Morrow Point Dams. Reclamation engineers and construction managers are prepared to design and construct the Diamond Fork Power System.

Reclamation is proud of its record in the past; and feels that your organization would want no less than the best advice possible. Our structures and the service they give to the nation speak for themselves, as does the quality of the work we do. It is our sincere hope that you will take advantage of the services available to you through the Bureau of Reclamation.

APPENDIX

Contact Points for Further Information:

Diamond Fork Generating Facilities	Clifford I. Barrett Regional Director Upper Colorado Region Bureau of Reclamation P.O. Box 11568 Salt Lake City, Utah 84147	801-524-5592
	Kirt Carpenter Project Manager Utah Projects Office P.O. Box 1338 Provo. Utah 84603	801-379-1000
Transmission System and Power Marketing	A. M. Gabiola Area Manager Western Area Power Administration P.O. Box 11606 Salt Lake City, Utah 84147	801-524-5493
Financing Costs in this Proposal	Deborah M. Linke Chief, Repayments Staff Bureau of Reclamation P.O. Box 11568 Salt Lake City, Utah 84147 801-524-5435	Dick Christensen First Vice President Burrow-Smith Division Prudential Bache Securities 50 West Broadway No. 250 Salt Lake City, Utah 84101 801-355-6700
Technical Design and Operating Data	Jay W. Franson Chief, Planning Division Utah Projects Office P.O. Box 1338 Provo, Utah 84603 801-379-1155	Arlo Allen Regional Supervisor of Power Upper Colorado Region P.O. Box 11568 Salt Lake City, Utah 84147 801-524-5299

This proposal is a joint effort of the following Reclamation, Western, and non-Federal people.

	Organization
Arlo Allen	Bureau of Reclamation, UC Regional Office
Larry Anderson	Bureau of Reclamation, UC Regional Office
Glade Barney	Bureau of Reclamation, UC Regional Office
Clifford Barrett	Bureau of Reclamation, UC Regional Office
Kirt Carpenter	Bureau of Reclamation, Utah Projects Office, Provo
Dick Christensen	Prudential Bache Securities
Dick Cook	Bureau of Reclamation, Utah Projects Office
Donald Dean	Bureau of Reclamation, UC Regional Office
Bob Ferdon	Mudge, Rose, Guthrie, Alexander and Ferdon
Larry Ferris	Bureau of Reclamation, UC Regional Office
Jay Franson	Bureau of Reclamation, Utah Projects Office
Al Gabiola	Western Area Power Administration, Salt Lake City Area Office
Marv Hein	Bureau of Reclamation, UC Regional Office
Louise Jansen	Bureau of Reclamation, UC Regional Office
George Jones	Bureau of Reclamation, UC Regional Office
Vern Jorgenson	Western Area Power Administration, Salt Lake City Area Office
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Sam Loften	Western Area Power Administration, Salt Lake City Area Office
Jeffrey McCoy	Western Area Power Administration, Salt Lake City Area Office
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Richard Noble	Bureau of Reclamation, Utah Projects Office
Shari Pitkin	Bureau of Reclamation, UC Regional Office
Fenn Putnam	Salomon Brothers, Inc.
Ginger Reeve	Bureau of Reclamation, UC Regional Office
Ellen Shorthill	Bureau of Reclamation, UC Regional Office
Karen Thompson	Bureau of Reclamation, UC Regional Office

Senator SYMMS. Thank you very much for your statement. Earlier this morning when Mr. Agee testified, included in his testimony was a statement that came from the original Grace Commission recommendations on privatization that we also had received in Washington, DC. One of the recommendations they made was to privatize the Federal Power Marketing Administration, a 3-year savings was about $3.5 billion, and then the revenues would be about $16 billion. So it amounted to about $20 billion total.

Now, you've got a list here, when I looked at your May 1984 Bureau of Reclamation, Upper Colorado Region, Western Area Power Administration, Salt Lake City. Now, looking through that list of all the different people who are involved from Solomon Bros. to the Bureau of Reclamation, several offices, to Smith Barney, Harris Upham & Co, Prudential-Bache Securities, of course, which you're associated with, but a wide variety of things. What I'm trying to get at here, how much is this going to be like WPPSS over here in Washington State where they've got the mess?

Mr. CHRISTENSEN. Heaven forbid, Senator, not at all like WPPSS. Let me just give you a little background on this project.

This is a project that's been kicking around the area for some time. The difficulties in getting the whole thing federally funded have put off the construction of this project for these many years. The administration then has come down with this non-Federal funding concept, privatization concept. There's a lot of thrust in that direction, as we know. That led the Bureau to conduct some seminars on the subject of how things really are financed outside of the Federal umbrella in the private or other public world. I assisted the Bureau in putting together some video tapes and some presentations and so forth, and then advised them on the structuring of a team that could explore the possibility of privatizing this particular Federal power project.

I, as senior manager, chose some of the great finance and legal people on the subject of power across the country, being Solomon & Brothers and Smith Barney, the firm of Mudge, Rose as bond counsel. We have met and outlined some of the things that we think are necessary to be accomplished in order to finance this particular project with non-Federal dollars. The team you see, then, is basically four from the private side, being three investment banking firms and one law firm, and the balance being people from the Federal side—Bureau of Reclamation people, both local and Washington, as well as Western people.

Senator SYMMS. Would these people actually have equity in it and operate it, or would the Bureau operate it?

Mr. CHRISTENSEN. Well, those are all questions. Nothing has been solidified. The Bureau has finally expressed a willingness——

Senator SYMMS. How big is the investment we're talking about?

Mr. CHRISTENSEN. A billion-and-a-half dollars.

Senator SYMMS. A billion-and-a-half dollars and it would produce, did you say, 42 megawatts?

Mr. CHRISTENSEN. No, 1,182 megawatts.

Senator SYMMS. A big plant.

Mr. CHRISTENSEN. Very big.

Senator SYMMS. Plus, there would be irrigation and other benefits that would be derived from the operation?

Mr. CHRISTENSEN. Right. This is a major Federal water project of which a portion is power generation. So we're carving out the power generation portion of it, since that's where all the revenues are generated, pledge those revenues to the financing of the power generation portion.

Senator SYMMS. Well, I am—Mr. Hanke has a question.

Mr. HANKE. I'm curious. If you don't have private equity in it, I don't understand how you can conceive of it as a privatization project because all debt, whether it's offered by a private corporation or a governmental entity or a nonprofit entity, is held privately. Some private person has to finance that. So in that sense, everything is privatized. But I think what we're concerned with are the advantages of actual private ownership of the equities and private management of these things because that's in part where all the savings are. If you're just going to figure out another way to finance a Bureau of Reclamation project, what savings is that to anyone, except the fact that it will come on line earlier than if it had to go through the regular appropriation process?

Mr. CHRISTENSEN. OK. Doctor, I think there are two parts to the answer. First of all, I said this was not in the strictest sense a complete privatization. It may be only a partial privatization. It is, however, totally non-Federal, and I think that's part of the point. From the Federal Government's standpoint, if the Federal Government doesn't have to finance it under the policy of the Grace Commission, then it shouldn't make a lot of difference to them whether it's financed by a consortium of Utah Power & Light, Idaho Power & Light, Department of Water & Power at Los Angeles; and to the extent that someone like Water & Power of Los Angeles is involved, that in effect is not privatization. However, it is non-Federal funding.

To the extent that Utah Power & Light, Idaho Power & Light, and Arizona Public Service and those private corporations are involved, it is in fact privatization. And in those instances their participation, their portion, their percentage of the capacity would be financed in typical corporate finance fashion, which may consist of a combination debt and equity.

Mr. HANKE. OK. In these things you have financed, and that can either be public or private initiation, and then supply of the actual project of services, and that can be private or public, and I guess my question is: You are going to privatize the finance, take that option? Now, let's move to the supply side and what I'm asking is, is this going to be a Bureau project or not?

Mr. CHRISTENSEN. Well, and I'm saying that that question hasn't been answered yet. Those are the kinds of questions we can't answer until we line up this roster of participants.

But let's suppose the roster of participants is outlined here and then they collectively decided that then want to own it or have to own it for operational financing reasons and so forth, what I'm saying is, the Bureau has decided that that probably is acceptable to them. So I can conceive of this project being taken off the roster of Federal projects, become completely privately owned, managed, operated, financed, or some combination——

Senator SYMMS. The chance of getting a billion-and-a-half dollars appropriated out of Congress for the Central Utah project are getting more difficult every year.

Mr. CHRISTENSEN. That's very remote.

Senator SYMMS. It's very, very remote. In fact, if you look at the record, I don't think Congress has passed a Bureau of Reclamation project since 1974–75.

Mr. CHRISTENSEN. Other than study money and so forth.

Senator SYMMS. And we're almost getting to the same point with respect to highways.

Mr. CHRISTENSEN. That's correct.

Senator SYMMS. Because there's so much politics involved in the process that you can't get a highway project passed. You can't get a simple formula highway bill through the Congress now without Tip O'Neill or someone wanting to hang on a $2 billion project to it, which sinks the rest of the formula and dislocates what the highway program is supposed to be. That's very fascinating if you can get it built. I understand Mr. Hanke's question, but if you can actually build the project and make the power and there's a market for the power that will pay for the costs of it, it may be the only way to get it done.

Mr. CHRISTENSEN. And that's the course of this thrust. What we're saying is here's a Federal project that may or may not be any good, but for sure will not be federally financed.

Senator SYMMS. How do you feel——

Mr. CHRISTENSEN. But let's find out if it's any good. If it is, we can finance it privately.

Senator SYMMS. You know, up here at American Falls Reservoir the Bureau built that in 1928 and it was faulty. They had poor concrete in it. The aggregate became loose and it became unsafe so they had to rebuild the dam. Idaho Power Co. sold power to pay for a large portion of the project there, the rebuilding, and turned the dam back over to the Bureau.

You're talking about paying for this project with power generating and still have the Bureau operate the reclamation part of it?

Mr. CHRISTENSEN. Yes, the reclamation part of it.

Senator SYMMS. The irrigation part?

Mr. CHRISTENSEN. Yeah.

Senator SYMMS. You would have the power part——

Mr. CHRISTENSEN. Right.

Senator SYMMS [continuing]. And they would have the water, the fisheries, whoever would handle that?

Mr. CHRISTENSEN. That's correct.

Senator SYMMS. You would just try to do it on the power. How does your plan square with what Peter Grace is advocating with his commission that the Federal Power Marketing Agency should be sold or turned over? I don't know just exactly what all they're talking about, whether they're talking about the REA co-op, or whether they're talking about the Bonneville Power Association or what. He's talking about the BPA, I guess.

How do you feel about that?

Mr. CHRISTENSEN. The BPA and Western are just 2 of the 12 power marketing agencies across the country that are Federal.

Senator SYMMS. Barry Goldwater when he ran for President, he said they ought to sell the TVA. He was about half joking and half serious. They rode him out of town on a rail, practically.

Mr. CHRISTENSEN. That's what the Grace Commission is saying, the same thing. The difference between what they're saying and what we're trying to accomplish here is that this is not yet a power project that the Federal Government owns, but if it's to be built, let's not build it as a Federal project originally. Let's build it originally as a private project, which is the same thing as the Government selling——

Senator SYMMS. That's a good point. But do you feel like the attitude of the general public to accept this concept is any better today than it was 20 years ago when Goldwater was a candidate for President and he made comments about—somebody said how much do you want for the TVA, and he said, "Oh, I don't know, 50 cents." They just practically beat him out of the woodwork over it.

What do you think would happen today? Peter Grace says that too, but he's not running for office.

Mr. CHRISTENSEN. Senator, I think there's a conceptual difference that the public would have to address here. One is in the Grace Commission regarding existing power projects, the sale of public assets, and that has a little different connotation than the construction of power projects by the private sector. The sale of public assets goes back clear to—I think part of the Revolutionary War was financed with the sale of Federal lands.

Senator SYMMS. Yes.

Mr. CHRISTENSEN. And there's just a little bit of a different connotation there. I think really that the public would have no problem accepting the concept of building a power project with private enterprise dollars, which is a little different than selling Hoover Dam or Yellowstone Park.

Senator SYMMS. With the attitude of the local newspaper here in Boise and other large newspapers in the State, I think it's going to be a while before the sale of public lands, particularly Government-owned lands in the West, would ever get very far. Of course, we're not talking about that here today, and you're not talking about it, but I think it's very fascinating. I appreciate having that statement.

Do you have any more questions, Mr. Hanke?

Mr. HANKE. Let me just ask one here. In the past, particularly, what the Bureau has done has taken over in many cases private irrigation projects that turned out not to be feasible and couldn't be financed ultimately in the private sector. Now, what you're saying is that you're in fact going to take over a project that was conceived by the Bureau and privatize it——

Mr. CHRISTENSEN. That's correct.

Mr. HANKE [continuing]. In terms of the power generation part?

Senator SYMMS. Well, I think it kind of offers a good way, because like I say, the Central Arizona project consumes all the money that's been—if there's ever any chance of getting it appropriated through the Congress in the near future, it would take the whole thing for the next several years, and because of politics, we can't agree on allowing anybody else to get a project, so nothing is done. There's no more reclamation projects taking place in the

West. Of course, some people would argue that we have surpluses of agriculture, and we don't need any more reclamation projects. That's another question. But I think it is very interesting, and I really appreciate your testimony.

I don't think I have any more questions. I know it's about time to close. I notice we have State Senator Dave Little out here in the audience.

Dave, do you have any questions you wanted to ask or offer?

Mr. LITTLE. No. Privatization of Federal, we have the same thing in the State, and it's ridiculous. The State land, we sold some over there and the State endowment fund, it's receiving 48 times what they were taking in. You know how they shot down the privatization of Federal lands. To me, it was utterly ridiculous because the people forgot to look at the financial statement. It's a real serious thing.

This own building here, or the Capital Mall, we contracted out to private enterprise for the janitorial services, the custodial part. It saves the State a quarter of a million dollars. You know, so what? Nobody gets excited about it.

Senator SYMMS. It makes a lot of sense.

Mr. Andreason, do you have any questions?

Mr. ANDREASON. No, but I've learned quite a bit in listening to these gentlemen. I'm glad to have had the opportunity.

Senator SYMMS. We're glad to have you here. If there's no further comments, I want to thank again all of our witnesses who gave of their time and effort.

We do have a noted privateer here in Idaho in the audience. He is one member of the news media who is in favor of privatization, Mr. Ralph Smeed. Do you have any questions, Mr. Smeed, before we close the hearing off?

Mr. SMEED. Well, I'm just scared to death of these well-meaning private people who want to make the welfare state efficient. That scares me. The thing that really worries me, if there is anything to the idea of private ownership and if that is the major difference between our system and the Soviet Union's, and if it's private ownership, if that's what we're after, it scares me to death that the Government sees something here that needs to be done, so they're going to usurp that area and then they're going to lease it out to these gentlemen to run it. It worries me that the absence in their testimony that the problem here is collective ownership, and I don't have the answer to the water. For example, if it runs down the river, who does own it, or who's entitled to it? But we don't address the common ownership and we're making more communal ownership efficient, and that's what scares me.

But I'm glad that somebody here is trying to make a buck at this thing. A little competition may turn out all right, anyway.

Senator SYMMS. I think so. I thank you very much for a very good point that Ralph Smeed does make, that this is the one thing that bothered some of us in the Joint Economic Committee and in the Budget Committee where the Grace Commission people also testified and the Finance Committee, is the fact that many of the businessmen who are on the Grace Commission, want to just make the Government more efficient. The one part that shows some real potential would be to try to spin off, and I think Bill Agee touched on that very well this morning, that the people in the Government agencies don't have the advantage of the private companies to have the discipline of the market to guide their decisions.

The problem with the Grace Commission is that a lot of their colleagues thought they could apply what they did at the W.R. Grace & Co. to the department of whatever in Government. The way we have to do it is to follow your suggestions, and thin those things out and get it away from the Government. And that's what I'll never forget when I first got elected to the House. The late N.L. Terteling told me that what needs to be done with respect to Federal power marketing and the Northwest power problems that he foresaw was to have Congress pave the way and pass legislation which would allow for the sale of the entire BPA to the private utility companies.

Now, there were other problems in that when I looked into it. The REA's are required to deliver power, whether it's efficient or inefficient, to one person out here if they want to have electricity delivered, no matter what it costs. Now, if you go to Idaho Power or the Utah Power & Light, they make you pay to put the line in even if you're just going to buy a little bit of power. The REA's are not allowed to do that.

But he made the point that in the State of Washington, under the WPPSS thing that they were starting to build powerplants up there, this was in 1972, that eventually they'd end up in a great state of financial disarray, and he was absolutely right on target on that. I think if private investor-owned utilities were managing more of that we wouldn't have the mess in the Northwest we've got today. It looks to me like eventually what will have to happen is we've got to get those powerplants built, one way or another finished. They're 97 percent done. We've got to complete the last 3 percent and turn the switch on and start selling electricity or it will be about the biggest dead horse that's been bought in history.

Your idea fascinated me, Mr. Christensen, because maybe somehow they could get those WPPSS 1, 2, and 3 somehow privatized and put in a situation where they could at least start selling electricity. I guess there are some liabilities there with those bondholders that will have to be reckoned with sooner or later. But if it was Pacific Power & Light that had them, you know what would happen. They would flush them on down the drain and auction it off on the block next Tuesday morning and somebody else would take it over and finish building the plant and start selling electricity. Because the Government's involved in it, we're just paralyzed. It's costing the people out here enormously in terms of dollars that could be spent in production and true enterprise to increase the standard of life in the Northwest.

Any comments, Mr. Hanke?

Mr. HANKE. No.

Senator SYMMS. Yes, Mr. Christensen.

Mr. CHRISTENSEN. It's not only costing the people here in terms of power charges and contractual obligations, it has cost public power interests, anyone financing in the public markets, untold millions of dollars just because of the uncertainty and, therefore, the increased level of interest rates particularly for Joint Action Agency power projects.

Senator SYMMS. Thank you very much. We appreciate all of the witnesses. I have a 12:30 appointment, so the meeting is adjourned.

[Whereupon, at 12:15 p.m., the subcommittee adjourned, subject to the call of the Chair.]

[The following article was subsequently supplied for the record by Mr. Hanke:]

THE NEW YORK TIMES, THURSDAY, MARCH 29, 1984

Privately Providing Public Services

By Steve H. Hanke

David Suter

BALTIMORE — For the many municipalities facing grave fiscal problems, privatization may be the wave of the future. Wisely, New York City has latched on to the trend.

Item: Scottsdale, Ariz., saves $2 million a year by contracting for fire protection.

Item: One-third of the refuse in Newark, N.J., is privately collected, saving $200,000 a year.

Item: Dallas closed its municipal late-night gasoline depots; now police cars and some fire vehicles use gas pumps at 7-11 stores after midnight, saving $200,000 annually.

Item: A private firm operates the Orange County, Calif., computer center, at an annual saving of $1.6 million.

Item: Butte, Mont., contracted for the private operation of its municipal hospital; annual savings are $600,000.

Item: Newton, Mass., saves $500,000 a year through a contract with a firm that supplies the city with paramedical and ambulance service.

The innovative, cost-cutting transfer of public services to the private sector is increasingly being given attention as mayors and other municipal officials find traditional fiscal solutions more and more unattractive.

The national magnitude of the problem was demonstrated in a study, "Trends in the Fiscal Conditions of Cities: 1981-1983," prepared for the Joint Economic Committee of Congress by staff members and published last November. It found that 64 percent of the 299 cities sampled anticipated operating deficits last year.

The growing desirability of the solution was demonstrated by another survey. The International City Management Association in 1982 looked at 1,780 cities and counties and found that 59 different types of public services were being privately provided. Of the cities and counties reporting, 41 percent used private contractors for commercial solid-waste disposal, 34 percent for residential solid-waste collection, 30 percent for tree trimming and planting, 78 percent for vehicle towing and storage and 28 percent for vehicle fleet management. Moreover, since the survey was taken, the types of public services privatized has almost doubled and the frequency with which privatization is used has increased, according to my own studies.

What has set the privatization trend in motion?

To address their fiscal problems, municipalities customarily have cut back public services, raised more revenue, or both. But these standard options are disappearing. Reduction of services can create political problems for everyone involved. As for revenue-generating, citizens' revolts have made increases in local taxes fraught with political peril, too. In the face of high real interest rates, constitutional debt limitations, voter disapproval and the prospect of poorer bond ratings, municipalities have slowed down their borrowing. State and Federal grants-in-aid, an old source of municipal funds, have been reduced in recent years and show no prospect of being increased.

Cost savings are the key to privatization's success. With the private sector brought into play, services don't have to be reduced; rather, they are simply provided cheaper. The process works well because private enterprise usually can outperform public enterprise. Entrepreneurs' incentives are imposed by the competitive market, while politicians' and bureaucrats' incentives are imposed by political and bureaucratic processes. As a result, private enterprise is usually able to supply the same quantity and quality of service at about one-half the cost of public provision.

In addition to contracting out, cities are realizing the benefits of privatization by putting unused or underused real assets on the auction block. New York City, for example, sold the old United Nations School in midtown Manhattan for $12.3 million — a bid that was almost twice the original asking price. The city, in 1983, received $13.15 million for a parcel at William and Beaver Streets in Lower Manhattan — a local record for a single parcel of city-owned property — after a 10-minute bidding spree. Moreover, the city has made sure that some idle property has been put to productive, higher valued used: For example, the abandoned King Street School, in Greenwich Village, was sold to a private interest and then converted into apartments. Another benefit of such action, of course, is that once properties are privatized, they join the tax rolls.

Troubled municipalities and counties that have begun to privatize are putting their fiscal houses in order. More important, they are setting the stage for depoliticization of economic decisions, improved delivery of services, tax reductions — and for the consequent economic growth and social revival that they need.

Steve H. Hanke is professor of applied economics at The Johns Hopkins University, a senior fellow at the Manhattan Institute for Policy Research and a senior adviser to the Joint Economic Committee of Congress.