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Testimony of
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Before the
New York State Commission on State Asset Maximization

New York City
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Distinguished members of the Commission, my name is James A. Parrott and I am the Chief Economist and Deputy Director of the Fiscal Policy Institute. In previous positions I was the Chief Economist in the economic development area for the City of New York in the early 1990s, and for five years I worked in the State Comptroller's office that monitors the New York City budget. I am a member of Governor Paterson's Council of Economic Advisors and was a member of Governor-elect Spitzer's Economic Development Transition Committee. Thank you for the opportunity to present our views at this hearing.

As the Governor has emphasized, New York State is facing enormous fiscal challenges, including how to adequately and fairly fund essential infrastructure improvements and expansions. We applaud the Governor for seeking, through the Ravitch Commission, new revenue sources to put financing for the operating and capital needs of the Metropolitan Transportation Authority on a sound footing for the next ten years.[1] And with this Commission examining the role of public-private partnerships, it is appropriate for the State to re-think long-established ways of doing things and explore whether there are new models that may better serve the State and its taxpayers in maximizing the value and use of state assets and resources.

We would like to share several concerns with the Commission.

Our general concern is that any proposal for "public-private partnership" needs to explicitly and carefully address three critical questions:

(1) **What is the source and magnitude of savings compared to a project being carried out exclusively by state government?**
My sense is that reported "savings" usually stem from one of two sources: either labor cost savings or savings due to the ability of a private owner or investor to take depreciation of capital assets as an offset to a portion of taxable income.

[1] FPI presented testimony before the Ravitch Commission at its September 15 hearing in New York City, http://www.fiscalpolicy.org/ParrottTestimony_RavitchCommission_September2008.pdf.

Labor "savings" that involve the reduction of wages or fringe benefits are "penny-wise and pound-foolish" and are harmful to responsible labor standards. The intense economic polarization that exists in New York and around our nation is fueled, in part, by such actions and that is a trend that we should seek to reverse, not contribute to. Depreciation tax benefits are effectively a subsidy paid by the revenue side of the government ledger and a comprehensive accounting framework should acknowledge that.

(2) **What discretion and authority is the State relinquishing in establishing a public-private partnership?**
It seems to be a matter of the abdication of government authority to shift responsibility for decisions involving the public's use of public or formerly public assets—for example, decisions involving toll rates—to a private, for-profit corporation answerable only to its shareholders and not to taxpayers and citizens. Non-compete clauses in certain deals seem particularly ill-advised in unduly tying government's hands.

(3) **What quantifiable efficiencies are gained under a public-private partnership that are not attainable for a project carried out directly by state government or by a state-created authority?**
Government officials have a responsibility to be as efficient as possible and there should be ways for such efficiencies to be identified and implemented short of entering into a long-term public-private partnership arrangement.

In reviewing the record of public-private partnerships,[2] we are skeptical that there are benefits to taxpayers beyond what is achievable through efficient government operation. And it is hard to imagine how elected officials, provided with careful answers to these three questions, could, in good faith, enter into a long-term public-private partnership arrangement. If the lure is a substantial up-front payment made by the private partner that is rooted in the long-term leveraging of a revenue stream such as tolls, a public authority could just as easily borrow based on that revenue stream and generate that substantial up-front payment. More over, tax-exempt public sector borrowing would almost certainly be less costly than private borrowing.

We also question the potential benefits that might result from allowing public projects to be built on a "Design/Build" basis. Design/Build involves a single contract for both the design of a project and its construction. Governments, including New York State, typically contract out public works construction. But design work on public works projects in New York is often done by state engineers, or overseen by state engineers.

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[2] See, e.g., the cases discussed by FPI Executive Director Frank J. Mauro in *A New York Perspective on Public-Private Partnerships* presented in March 2006 at a conference sponsored by the New York State Department of Transportation, http://www.fiscalpolicy.org/MauroPresentation_PublicPrivatePartnerships_March2006.pdf. See also, Public Employees Federation, Public-Private Highways: Careening Toward Failure Nationwide, available at www.pef.org, under "privatization/fact sheets".

Design/build, on the other hand, entails the privatization, or contracting out, of the design function as well, and, given considerable evidence, that seems questionable.

The Fiscal Policy Institute Executive Director, Frank J. Mauro, has examined the state's experience in recent years in contracting out the design of state transportation projects.[3] The FPI report, drawing from audits conducted by the State Comptroller and a study prepared by KPMG for the state Department of Transportation, concluded that, in the transportation area, the State could save hundreds of millions of dollars by reducing its reliance on outside engineering services for design, supervision and inspection, and instead utilize the state's own engineering professionals. In the early 1990s, State Comptroller Edward V. Regan, in issuing an audit of the use of consulting engineers, stated: "The State Department of Transportation could save millions of dollars by reducing its reliance on outside engineering services for design, supervision and inspection, and instead increasing its own engineering staff."

The way the state now contracts out transportation engineering work limits competition with the result that taxpayers do not get the benefit of reduced costs nor does the state get higher quality work. At a minimum, there should be a cost-benefit analysis comparing the relative merits of performing design work in-house versus having it done by a private firm before any projects are contracted out. Contracting out design and other state professional services such as information technology, costs the state as much as 50-75 percent more than if the work were done in-house by state government employees.

It is also critical in any state-funded construction work that prevailing wage requirements be maintained. Considerable economics research shows that prevailing wage in construction means more cost-effective construction, and more skilled and better-paid workers.[4]

Considering the charge to this Commission to explore how to "maximize the value and use of state assets", it seems to me that the State should re-assess how it provides economic development subsidies, particularly in cases where the State provides cash subsidies and tax breaks to private companies to foster high technology development. In the pending deal with a newly formed business called Advanced Technology Investment Company, a company based in the Cayman Islands that is co-owned by Advanced Micro Devices and an investment firm owned by the government of the United Arab Emirates, the state is providing $1.2 billion in bond proceeds and tax breaks. The $650 million in cash the State is slated to provide from bond proceeds will be used to build a chip fab facility and for research and development expenses. Given this scale of public investment, the State is clearly taking considerable risk and is acting as an investor. In exchange, taxpayers should receive an ownership stake in the joint venture.

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[3] Frank J. Mauro, Fiscal Policy Institute. *Privatization without Competition Equals Huge Losses: How the New York State government Wastes Hundreds of Millions of Dollars without Increasing Service Quality*, June 2005, http://www.fiscalpolicy.org/professional~services~savings~report.pdf

[4] Fiscal Policy Institute, *The Economic Development Benefits of Prevailing Wage*, May 2006, http://www.fiscalpolicy.org/FPI%20Prevailing%20Wage%20Brief%20May%2006.pdf. See also, Letter to the Editor, James A, Parrott, Long Island Business News, February 29, 2008. http://www.fiscalpolicy.org/ParrottLetter_LIBN_truecostofprevailingwage.pdf.

New York State has had a successful equity investment program for smaller high tech investments since the early 1980s. Originally called the Corporation for Innovation Development (CID) and now operating as the Small Business Technology Investment Fund (SBTIF), this fund makes early-stage equity and debt investments in technology-based companies in New York State. As of late 2005, it had $40 million invested and its investments over time had created 2,500 jobs, with an average salary of $60,000. The fund achieved evergreen status in 1995, with all of its expenses paid out of its own funds since 1990.[5]

Thank you for the opportunity to present our views to this Commission.

[5] Olson, Deborah G., "Fair Exchange: Providing Citizens With Equity Managed By A Community Trust, In Return for Government Subsidies or Tax Breaks to Businesses," *Cornell Journal of Law and Public Policy*, Spring 2006 Vol. 15, No. 2, page 334, http://organizations.lawschool.cornell.edu/cjlpp/large/pastissues/articles/15/Olson.pdf