CHAPTER 7

Three Simple Rules

INDIANAPOLIS, like Charlotte, is a successful city with insecurity issues. Locals sometimes refer to it as "IndiaNoPlace." But it is an *exceptional* place. Squarely in the Rust Belt, it has not emptied out like deindustrialized Detroit, Cleveland, Buffalo, and St. Louis, or even endured managed decline like Pittsburgh or Cincinnati. Since 1950, its population has roughly doubled (though a good portion of this growth resulted from consolidation with some inner-ring suburbs, about which more will be said later). All the other cities named have lost at least 40 percent of their residents in that time.

The contrast to Detroit is especially interesting. In the early years of the auto industry's development, each city was home to many carmakers contending for market leadership. For a time, those in Indianapolis—which included premium brands such as Stutz, Duesenberg, Cord, and Marmon—seemed to have a fighter's chance. In 1909, construction of the Indianapolis Motor Speedway reflected Hoosier optimism. When local products bested the competition on the track, eager consumers surely would beat a path to the victors' showrooms.

But Detroit held insurmountable advantages. It was blessed with important natural capital in the form of proximity to key raw materials and waterways that could be used to move them cheaply. As its firms grew they benefited also from agglomeration and scale economies that enhanced their competitive advantages. A Model T or Chevy might never outrace a Bearcat or impress onlookers like a "Duesy," but they were more affordable and reliable. Those virtues won market share if not trophies, and clinched Detroit's status as *the* Motor City: it boomed to twice Indianapolis's size by 1910 and was four times bigger by 1930. The Great Depression's onset made life difficult for all manufacturers, of course, but the Indy firms' focus on luxury models was especially problematic. By 1937, all the city's major automakers were out of business (though some suppliers and assembly plants for Detroit-based firms remained).

In the decades since, Indianapolis has proved that losing one key driver of an urban economy need not halt forward progress. Generations of civic leaders have worked hard to diversify the city's job base and manage its key institutions effectively. Their philosophy was best summarized by William Hudnut, who served four terms as mayor from 1976 to 1992: "To become competitive, we . . . trained our sights inward and concentrated on internal management of local government, knowing that our first job was to run the store well."[1] Not all the city's initiatives have been resounding successes, and it has not been immune to the myriad problems prevalent elsewhere in the Rust Belt. But it has certainly coped with deindustrialization, suburbanization, and other urban headwinds of the post–World War II era far better than the city that won the battle for supremacy in the auto industry. Today, Indianapolis is 16 percent larger than Detroit, its residents enjoy a median household income 54 percent greater, and its homicide rate is one-third as high.

The example of Indianapolis, then, offers some guidance for cities trying to restart their stalled economic engines. Of course, a good portion of the city's success is attributable to simple avoidance of policy blunders common elsewhere. It has not, for example, much tried to play the role of "Robin Hood" by aggressively pursuing redistributive programs that ratchet up tax rates and repel residents and investment to neighboring locales. And it has benefited from tax and labor climates more protective of property rights than is typical of other Northeast and North Central states.

But Indianapolis has also benefited from creative and courageous initiatives of its own. In particular, its political leaders have maintained a favorable climate for growth and investment not by relying heavily on special tax inducements or development subsidies (though these have not been unknown) but rather by focusing on economic fundamentals. They understood how three key forces at work in most markets—competitive conduct, scale economies in production, and price signals—could be harnessed to improve the operation of the government sector. As we'll see, each of these forces works better when certain key property rights are defined optimally. In this chapter we'll examine how this was done in Indianapolis, and then highlight a couple of broader applications.

RULE 1: ELIMINATE MONOPOLY, CULTIVATE COMPETITION

When Stephen Goldsmith succeeded William Hudnut as mayor in 1992, Indianapolis was already poised to be a leader in the privatization of urban public services. Hudnut was a fan of management gurus such as Peter Drucker and W. Edwards Deming—he gave staffers books by the former and took cabinet officers and city-county councilors to seminars featuring the latter—and had worked hard to build an entrepreneurial culture in city agencies. His mantra was, "Do it better. Improve the delivery system. Become more efficient. Streamline and downsize. Do more with less. Privatize. Bring in competition. Break up the traditional government monopoly."[2]

This meant redrawing some turf boundaries: just because an activity had long been done by government workers did not mean they "owned" it. In his early efforts to implement Hudnut's philosophy, however, Goldsmith learned two important lessons. First, competition is the key that unlocks all else; privatization, by itself, need not "do it better." And it's possible to eliminate government monopoly without ending government employment.

Goldsmith's first attempt to do more with less involved the city's Department of Public Works (DPW), which spent a distressingly large portion of the revenue it collected in sewer charges just mailing out bills.[3] He approached the Indianapolis Water Company (IWC, the city's private water supplier), asked if they'd take on the billing duties, and was disappointed to learn that while they'd be happy to do so their price was only 5 percent below the DPW's cost. This produced an "aha!" moment: replacing a public monopoly with a private one won't get you very far.

So Goldsmith contacted every utility in central Indiana and asked for competitive bids for the sewer account. Newly motivated, IWC came back with a better offer: they would do the billing work for *30* percent less than the DPW—and also identify underbilled or delinquent sewer users, collect the missing revenue, and share the proceeds with the city. The resulting contract generated millions in budget savings.

A second key lesson came when Goldsmith put maintenance of some of the city's streets up for competitive bids. It seemed a logical step. Build-

ing such infrastructure is usually done by private contractors rather than city employees, so why not contract-out repairs to that capital? To Goldsmith's surprise, the city's unionized Department of Transportation (DoT) workers wanted to bid. And to his chagrin, they pointed out that they were competitively handicapped by political patronage: roughly one third of the staff in DoT's street repair division were highly paid "supervisors" who had been appointed, in part at least, because they were loyal supporters of Goldsmith's party.

To his credit, the mayor laid off or transferred half of those supervisors, provided the DoT workers with a consultant to help them prepare their bid, and then applauded when the city employees outbid their private competitors and won the concession with a price that promised 25 percent savings relative to prior costs. But they delivered more. As one worker put it, before bidding for the work, "we didn't give a hoot what anything cost," but once a competitive system was in place "we got efficient real quick."[4] In short order, the average productivity of work crews soared by two-thirds, from 3.1 to 5.2 lane miles serviced per day.

Such experiences led Goldsmith to argue that the word *privatization* should give way to *marketization*. It may be true that private firms are, on average, more efficient than public agencies in supplying goods and services, but what's true on average may not hold in any specific case. There's no reason to assume government workers can't compete when they are offered a chance to do so. The key to doing more with less is to create a market in which *everyone* has an incentive to act entrepreneurially and put their energy and creativity to work figuring out better ways to get things done.

Aside from the budget savings that can be obtained when workers start to "give a hoot" about cost and efficiency, encouraging pubic employees to compete alongside those in private firms can allay some voters' fears that contracting-out is a dark conspiracy against government workers and their unions. An open and inclusive bidding process will inform these voters (and their representatives) very directly about how expensive monopolies can be. If government agencies' bids are competitive, it's all to the good—or if voters see that their bids are millions more than the private alternatives, then public sympathy is much more likely to rest with the latter.

RULE 2: EXPLOIT ECONOMIES OF SCALE

Much discussion of Indianapolis's success in avoiding the decay and flight that has afflicted other Rust Belt cities focuses on its "Unigov" (for "unified government") system. On January 1, 1970, by act of the Indiana General Assembly and without any public referendum on the issue, the boundaries of the city of Indianapolis were made contiguous with those of Marion County. Overnight, the city's territory expanded five-fold (from 82 to 402 square miles), its population grew by 260,000 (to 740,000 residents), and its voter rolls expanded by 113,000 (to 406,000).

Such consolidation of the urban core with its surrounding suburbs is commonly advocated by those with a redistributionist bent. The idea is that central cities are far poorer than the suburbs to which well-off residents have fled, and annexation of these areas will provide a city government with the broad, deep tax base it can use to better tend to the needs of its "left behind" populations. Of course, those affluent suburbanites generally dislike being treated like cows to be milked; when they have any say in the matter, city-suburb mergers meet with vigorous political opposition. Though much admired in progressive circles, such mergers don't often happen.

That Indianapolis pulled it off reflects the fact that all and sundry understood that Unigov was definitely *not* motivated by any sort of redistributive plan. If one assumes (fairly or unfairly) that Republicans are less inclined than Democrats to engage in progressive transfers of income or wealth, it's noteworthy that the Unigov law was passed and implemented while the mayor, governor, and clear majorities in the state Senate, House of Representatives, and city and county councils were Republican. In fact, Democrats denounced the plan as "Unigrab," arguing that consolidation would dilute the political influence of the city's poorer residents—and thus *forestall* redistributive efforts.

Whether that was, indeed, an unspoken motivation for the program is unclear. What its advocates did say was that they saw consolidation as an efficiency measure. In Hudnut's words, it was "precipitated by reformist zeal for better services at lower cost."[5] Unigov's advocates saw considerable waste resulting from "fractionated" government agencies, and pointed to the area's five different transportation authorities and sixteen

independent special-purpose municipal corporations operating over various jurisdictions. Ultimately, Unigov centralized management of many (but by no means all) local government services, creating six departments (Public Safety, Public Works, Metropolitan Development, Parks and Recreation, Transportation, and Administration) under a mayor elected countywide. For various reasons—primarily to overcome opposition to Unigov based on the perception that it would reduce local control in undesirable ways—the county courts, school districts, several of the municipal corporations, and a few neighboring towns were excluded from the governance structure of the new consolidated city.

How might delivering public services with fewer, larger agencies cut costs? The basic principle at work—scale economies in production—was identified as far back as 1776 by Adam Smith in *The Wealth of Nations*. In Smith's famous description of a pin factory, output soared when workers became specialized and the necessary tasks were divided among them. Government agencies are clearly not much like factories, but some of the same principles apply. When, for example, workers in a small enterprise are required to move among distinct tasks and perform various roles, their attention may be divided and their proficiency may fall. They might become "jacks of all trades and masters of none." Greater division of labor might also reduce capital costs. If, for example, workers in separate jurisdictions must both answer phone calls and enter data on computers (and assuming that these tasks do not overlap), the amount of each type of equipment needed might be cut significantly by setting up one phone bank and one data center, each staffed by specialists. In addition to such "technological" economies, larger enterprises can often benefit from "pecuniary" economies. Buying supplies in greater bulk, for example, may qualify the purchaser for volume discounts.

But how could the advocates of Unigov know that such savings would actually be realized? They couldn't. And it's important to note that enterprises can experience *dis*economies of scale. Perhaps, for example, excessive specialization and division of labor so bores workers that they become inattentive and less efficient. But there was actually very little risk that consolidating many municipal agencies into fewer, larger ones would ultimately increase the total cost of government services. If available scale

economies are exhausted, there's simply no reason to expand further and experience diseconomies, for the agency can default to prior (optimal) configurations of its operations, effectively locking in constant returns to scale.

In any case, Unigov delivered the goods. One independent review identified almost $6 million (in today's dollars) in budget savings in just the first year of implementation due to elimination of duplicative positions, bulk purchasing, and streamlined contracting. Broadening and diversifying the city's tax base also contributed to an improved bond rating and reduced borrowing costs. Within a few years, Indianapolis began to consistently rank among the top handful of the fifty largest U.S. cities in measures of fiscal strength, financial management, and staffing efficiency.

RULE 3: AVOID LYING PRICES

Clearly, marketization and consolidation enabled Indianapolis's political leaders to run their store better. To understand the entrepreneurial culture that prevails among city officials, however, we should not overlook how the products on the store's shelves are *priced*. It's common for many of the services provided by government to be bundled together and a single price charged for all, in the form of each constituent's total tax bill. Whether it is a historical accident, politically expedient, or the result of brilliant economic thinking, however, Indianapolis goes very far in the opposite direction.

For example, the city-county features one of the most complicated and detailed property tax systems in the United States, with sixty-three different tax areas. Within each, a property owner's total bill might include several special levies to fund a variety of services and programs. It seems confusing but is, in fact, a good thing: an array of honest prices that help consumers of government services know what they're paying for and how much. By *un*bundling its package of products and putting price tags on them, local officials and their constituents communicate more effectively about what's valued and what's not. Consumers armed with better information about the cost and quality of government services might see better options elsewhere in the store (or across the street) and move along, so sellers have strong incentives to offer value. The "zeal for better services at lower cost" that animates many of Indianapolis's elected representatives might be a by-product of the way these services are priced.

In any market, prices always serve two crucial functions: they send signals to buyers and sellers about how each should behave, and they allocate (or "ration") the good in question. And prices discharge these responsibilities better or worse depending on how honest they are—which is to say, depending on how closely they correspond to the true, real costs of producing goods and delivering value to consumers.

As one example of the consequences of dishonest or *lying* prices,[6] consider events in the gasoline market in New York in the aftermath of Superstorm Sandy. Given widespread power outages, many stations couldn't operate, so Governor Andrew Cuomo—either naively thinking that this would alleviate shortages quickly or cynically betting that there was political gain in giving something away—announced that people could claim up to ten gallons of "free" gas at several government-supplied fueling locations. Chaos ensued. Large crowds queued up, and National Guard troops were needed to keep order. And it soon became clear that the available supply wasn't being allocated efficiently or fairly. At a zero price, folks who attached relatively *low* value to gasoline had an incentive to queue up for it, and many got in line ahead of those with more urgent demands—such as first responders and drivers of emergency vehicles. Different sites attempted different ways of rationing more effectively, some banning distribution to "civilians," but to little avail. The program was quickly canceled.

But state officials still could not abide "price gouging." They threatened to prosecute sellers who raised prices above pre-Sandy levels and imposed an odd-even rationing scheme (allowing those with license plates ending in an odd number to purchase gas one day, those with even numbers the next). Still, queues were lengthy, since at the artificially low price level, buyers (or at least those who had time on their hands) had little reason to economize on their use of the scarce and valuable good; hoarding flourished. And with their prices fixed, suppliers had little incentive to transport added supplies to the market (at added cost) from other areas. In effect, by telling buyers and sellers that the gas available in the affected area was still cheap, officials were lying. As with most lies, the consequences were harmful—here, an unnecessary shortage of an important good, misallocation of the supplies that were available, and additional inconvenience and misery for people who had already suffered far more than their share.[7]

When it comes to government services, lying prices are commonplace—just less so in Indianapolis. In one recent report on property taxes, for example, the Marion County treasurer reported that across the aforementioned 63 political jurisdictions and districts, residents might face as many as 60 applicable levies, yielding a 3,780-cell matrix of possible tax rates, depending on where the taxpayer chose to live. And property taxes are just one of several prices of government that one might consider in making this choice; user fees for specific services also vary widely.

To illustrate one virtue of such a well-defined price system, consider the levy for Indianapolis's Flood Control Special Taxing District. Plainly, the possibility of flood damage is not randomly or uniformly distributed. Riverfront property faces high risk, while tracts on high ground face low or zero risk. If you were to bundle the total costs of flood control together with the costs of all other services provided by the local government and then divide these costs among all taxpayers with a single, lump-sum tax bill, you would have lying prices. The apparent cost of building in the flood plain would seem lower, and that of locating out of harm's way higher, than the true costs. You'd see too much development in risky areas and too little on high ground. Over time, as the subsidized flood plain became more populous, you'd also see the expenditures required to avoid floods or cope with their damage rise to non-optimal levels. It would be much better to signal to those considering living in the flood plain that such a location decision carries an extra cost. Then and only then could you be confident that those who choose riverfront property value it as much or more than the costs of mitigating the risk of flooding.

In short, Indianapolis's unique and complex system of multiple tax districts with varying rates and user fees performs the signaling and rationing functions of a good price system much more effectively than is common in the market for government services. It is far from perfect, of course, but it does make residential location decisions there much like a trip to a store, where shoppers can compare hundreds of products and choose the combination of quality and price that best suits them. And that, in turn, puts local officials into a far more competitive frame of mind than is common among political leaders elsewhere in the Rust Belt.

TAKING IT TO THE STREETS

Avoiding the damaging effects of lying prices often faces two formidable obstacles: "fractionated" local government (in Mayor Hudnut's expressive phrase) and a deep-seated feeling among elected officials that voters can't handle the truth.

Consider the enormous waste of time and gasoline—to say nothing of the toll on Mother Earth—resulting from our commitment to "free"-ways. In Los Angeles, for example, congestion delays increase average commute times by *36 percent*—adding a full hour and forty-eight minutes to a normal five-hour weekly commuting schedule.[8] In a year, that's ninety hours wasted creeping, beeping, and polluting. One would think Angelenos (and New Yorkers, San Franciscans, and other residents of cities with similar congestion) would very much want to solve this problem. And they do: ask them how to make their commuting lives better, and most will loudly demand that more roads be built.

Except—there's no evidence that this actually works—or works for long. An unfortunate fact of commuting life, first noted by Anthony Downs as he observed the results of years of frantic freeway construction, is known as Downs's Law: on commuter routes, peak-hour traffic rises to meet capacity.[9] In short, we respond to the availability of extra space on the road by filling it up. The reason: *lying prices*. And in this case, those lies induce us to take actions that are costly not just to us, but others.

At five in the morning, for example, your route to work is a public good—that is, non-depletable, in that your use of it doesn't really diminish the amount available to me as we both cruise along at the speed limit. If, however, you start your drive to work at eight-thirty, you might be the straw that breaks the freeway's back. Traffic flowed nicely until your arrival, but now the road is over its optimum capacity and everyone slows down as a result. You're unhappy because you might be late; you're paying a cost of your decision to commute at the peak of rush hour. But everyone else also pays, which economists refer to as a "congestion externality" because you imposed a cost on those "external" to your action. Of course, you're free to argue that everybody else is imposing the external cost on you, since any of them could have slept in, thereby eliminating the cost

for all. In fact, economists are careful to say that all externalities are reciprocal in nature, so fixing blame is pointless; the goal is to solve the externality problem. And charging a price (in money rather than in time wasted) can do exactly that.

Making the freeway "free" only makes sense at off-peak hours or whenever demand is below the road's capacity to carry traffic at optimum speeds. The problem is the rest of the day, when a zero price sends bad signals to potential users, inviting everyone who attaches even a trivial value to using the road to give it a shot. That's a prescription for gridlock. One recent survey totaled up the typical delays nationwide and concluded that Americans waste $121 billion annually in congestion-related fuel and time costs.[10] There's no free lunch, and pretending there is can be a horribly expensive, inefficient, and even inequitable way to ration a valuable good.

The solution is to (a) coax those who *least* value the road at peak times *not* to use it, thus reserving space for those who value it most, and (b) make those high-valuing users pay for the privilege. Tolls do both. The prospect of avoiding a toll might get more commuters onto buses, induce more carpooling, or give employers incentive to adopt flex-time so their workers can commute during off-peak (and off-price) periods. Absent reliable signals about the value of scarce freeway space and honest prices for it, no one has much incentive to change habits that lead to chronic congestion.

The problem, of course, is that people in general don't like the idea of paying for something that is customarily free. Never mind that Americans are, in fact, paying that aforementioned $121 billion. We apparently think we can make that go away, in defiance of Downs's Law, by lobbying for more lanes to be built. In the meantime, we seem to like the *illusion* of a zero price, because every time anyone proposes greater reliance on tollways and congestion pricing, the response is overwhelmingly negative.

Eventually, though, some enterprising U.S. city is going to try what the clever Swedes did to overcome resistance to using tolls to alleviate Stockholm's chronic traffic problems. In 2000, a parliamentary commission recommended treating the city's congestion in the usual way: more roadbuilding. But the cost—roughly half of the national government's capital budget for the next decade—was so high that other approaches, including always-unpopular tolls, made their way into the public debate. As a con-

dition of joining a ruling coalition, Sweden's Green Party won a promise that the government would simply *try* congestion charges in Stockholm.

This blunted the opposition to charging for that which is commonly free. Even some enemies of tolls were looking forward to the trial period to demonstrate how unfair and inefficient it would be to price road capacity; it was called "the most expensive way ever devised to commit political suicide."[11] Nevertheless, an intrepid group of transit experts and government officials designed a system that charged varying amounts to those traveling in and out of Stockholm from 6:30 A.M. to 6:30 P.M. on weekdays. There were no toll booths to slow travelers down, however: transponders in cars were linked to bank accounts and charges collected automatically, as is done in the United States with systems like the EZ Pass along some East Coast interstates.

The trial began on January 3, 2006, and the results were immediate and visible to the naked eye. The next morning's headline in a leading Stockholm newspaper said it succinctly: "Every fourth car disappeared." Accompanying before-and-after photos showed a clogged arterial highway pre-toll and the same spot flowing freely under the new pricing system. This was not a fluke. Over the six-month study period, monthly reductions in the numbers of vehicles passing the toll cordons averaged 21 to 30 percent. The average time wasted in traffic jams fell one-third in the morning and one-half in the evening peak hours. Exhaust emissions fell 10 to 15 percent. Road safety improved. Equity effects were generally favorable, since much of the toll burden was shouldered by employed, affluent drivers and lower-income commuters benefited from expanded public transit capacity funded by the tolls.

But these were outcomes that economists had long predicted. What was surprising was how *public opinion* swung from negative to positive as the pricing system's favorable effects became apparent. A few weeks into the trial, the Swedish prime minister announced he'd changed his mind about tolls and now supported them. About 35 percent of respondents in subsequent polls said they'd done the same. That was—barely—enough: once the trial was concluded and the evidence processed, Stockholm residents voted 53-47 in favor of continuing the congestion charges; in August 2007, the system was reinstituted and made permanent.

Clearly, then, honest prices can be extremely effective in allocating scarce resources such as road capacity. People well understand the signals that such prices transmit and are quite capable of modifying their behavior in wholesome ways in response. What's more, as they do so they ultimately appreciate how congestion pricing can yield personal benefits. That so many Swedish commuters changed their minds indicates they realized that the value of time saved under the toll system repaid them for the requisite monetary outlays or other inconveniences. Surveys showed that a lot of the car trips that disappeared during rush hours were discretionary shopping trips or other leisure activities that were easy to reschedule or do without.

In addition, congestion pricing can yield financial benefits for localities. Tolls convert the time and fuel wasted via "rationing by waiting" into revenue streams; they monetize the efficiency gains that result from traffic jams avoided. Though the startup costs of installing toll equipment can be substantial, over time this investment can generate surpluses that can be used for other needed public goods, especially complementary transit infrastructure. In New York, for example, the Metropolitan Transit Authority was merged (in 1968) with the Triborough Bridge and Tunnel Authority so that surplus toll revenue could be invested in subway repairs and improvements, helping rescue that system from physical and fiscal decline.[12] Still, however, the city is not pricing away congestion externalities the way it ought: not all its bridges and tunnels are priced at all, or in both directions, so opportunistic truckers and commuters often plot circuitous "free" routes through clogged surface streets to save cash, instead spending their and others' time, gas, and air quality.

Monetizing the value of scarce curb space is another possible source of funding for urban public goods. Drivers often cruise crowded city streets in search of "free parking" (yet another lying price). In some congested neighborhoods, 30 percent of the traffic consists of drivers searching vainly for underpriced curbside spots rather than paying a fee sufficient to ration this scarce good more effectively.[13] So far, San Francisco, Los Angeles, and New York have been the leaders in experimenting with metering technology aimed at better equating the demand for and supply of parking on public streets, installing sensors to measure space availability in problematic areas and providing smartphone payment apps and electronic signage with

rate and availability information. As with tolls, the unpopularity of such pricing systems tends to diminish over time as consumers see its benefits.

LEVELING THE LEARNING FIELD

Ninety percent of American children attend public elementary and secondary schools. But these schools get very low grades from consumers. A recent Gallup poll found that only 37 percent of respondents rate public schools "excellent" or "good," versus 78 percent for independent private schools, 69 percent for church-related schools, and 60 percent for charter schools.[14] How do the public schools maintain their near-monopoly status in many communities? Another lying price, of course. Send your child to his or her assigned public school, disappointing though it may be, and it's "free." Go private and you're on the hook for tuition, while your taxes pay to educate others' kids.

It's been known for a long time that the public schools are underperforming—probably since a 1975 *Newsweek* cover story titled "Why Johnny Can't Write," but certainly since a 1983 presidential commission shocked parents with a scathing report titled *A Nation at Risk*. So lots of money has been thrown at the problem, more than doubling inflation-adjusted per-pupil spending on public education since 1975. Nevertheless, teens' scores on the National Assessment of Educational Progress have remained stubbornly flat, and a 2012 report from Harvard's Program on Education Policy and Governance ranked the U.S. twenty-fifth of forty-nine countries regarding student achievement.

Marketization would therefore seem to have enormous potential to enhance performance in this vital sector. This is especially true in some large cities, where greater population density, mass transit infrastructure, and a rich endowment of established church-related schools increase the chances that students could access competitive institutions. The best evidence is clear: in education as in much else, monopoly is the enemy of quality and cost effectiveness, while competition is their ally.

Even when private alternatives are largely absent, competition *between* public systems has beneficial effects on educational performance. Many public systems are huge and dominate an enormous area: New York's covers the five boroughs and enrolls over a million students, L.A. Unified

serves almost seven hundred thousand, and the entire state of Hawaii is a single school district. But some metropolitan areas—Indianapolis and Boston are good examples—contain many independent school districts within a short distance of each other. In such areas, families can vote with their feet and locate in the districts that offer the best value. In turn, those districts and their political leaders have a stronger incentive to safeguard school quality. In 2000, Caroline Hoxby compared public school performance in areas with lots of interdistrict choice to that in areas with essentially none.[15] She found that eighth grade reading scores in competitive areas were 3.8 national percentile points higher, tenth grade math scores 3.1 points higher, and twelfth grade reading scores 5.8 points higher than those in noncompetitive districts. What's more, the competitive districts got these superior results while spending 7.6 percent *less* (per pupil) than the no-choice districts. And public schools in areas blessed (for historical reasons) with a large market for private schooling show similar gains in test scores. When they fear losing business to rivals, the public schools can, indeed, do more with less.

Milwaukee was a trail-blazer in using vouchers to help its poorest students escape underperforming public schools. Starting in 1990, families with incomes below 175 percent of the poverty line could apply for vouchers to be used toward tuition at accredited private schools. Generally, the voucher amount was less than two-thirds of the public system's per-pupil spending. The district lost half of the voucher amount every time a qualifying student left for the private sector, so it had a reasonable incentive to get better—especially when the city's self-imposed cap on participation was raised to 15 percent of district enrollment. And, indeed, the threat of voucher-related loss of enrollments led to improvement in *all* the potentially affected public schools, but the stronger the degree of competition was (measured here by the fraction of eligible families in a district), the greater was the gain in students' test scores.

Charter school legislation has been somewhat easier to obtain in the political marketplace than vouchers, and the results have been similarly encouraging. Arizona and Michigan have been early leaders in these efforts. Hoxby has found that in the former, fourth grade reading and math scores improved by 1.4 national percentile points per year in schools that

faced competition from charters. In the latter, the improvements were even greater: 2.4 added percentile points in fourth grade reading and 2.5 points in math. That can add up. For example, if impoverished and largely minority Detroit (whose public schools now face some competition from charters) can continue such relative gains, it would close its students' achievement gap with affluent Gross Pointe in less than a generation.

Of course, monopolies never yield their dominant positions without a fight, and the political opposition to competition in this market from teachers' unions, bureaucrats, and ed-school academics has been well-funded and no-holds-barred.

Cyberspace is full of agenda-driven "studies" defending the education status quo (while advocating ever-more-lavish funding), denunciations of marketization as "elitist" and contrary to our democratic ideals, and vitriolic assaults on "profiteers" exploiting our children while lining their own pockets.

All of this is more than a bit ironic, since the monopolists are themselves defending some very lucrative turf: they control streams of tax dollars that fund generous compensation schemes and retirement benefits, set work rules that make life on the job more pleasant, and define curricula that require students to conform to their tastes about what should be learned and how. It would be naive to suppose that they will easily give all this up just to enhance student learning or lighten the burden on taxpayers.

Nevertheless, the campaign to loosen these groups' stranglehold on the education market—waged variously by reformist politicians, philanthropists, and entrepreneurial educators tired of the failures of prevailing approaches—has made significant progress. Vouchers, which can reduce or eliminate the public schools' price advantage and are thus of greatest value to poor parents, now exist in seventeen states. In 2002, the Supreme Court's ruling in *Zelman v. Simmons-Harris* removed a legal impediment to the growth of such programs by establishing that the federal constitution does not bar parents from applying vouchers to religiously affiliated schools. In a few states with constitutions that are more restrictive on this score, education tax credits are helping close the public-private price gap. And forty-one states and the District of Columbia now allow charter schools, though some of these publicly funded but semi-autonomous insti-

tutions are so constrained in their management, staffing, and curriculum decisions that they are virtually indistinguishable from the public schools with which they are nominally competing for students.

The question is how to bring marketization to locales where the opposition is most deeply entrenched. One answer might be to employ the same strategy used by former Indy mayor Goldsmith to bring greater efficiency to street maintenance: simply put the work up for competitive bids, allowing unionized public employees a fair chance to keep their jobs if they can deliver better results.[16] Where it is politically infeasible to create competition *within* the market—by empowering parents with vouchers they may spend at any of several private schools vying for their business, for example—it may be possible to realize gains via competition *for* the market.

In a nutshell, public officials could identify the most dysfunctional schools in their district, engage parents in setting improved standards for student performance and other school characteristics, and specify an amount to be paid to the eventual contractor. Bidders would then compete not by offering lower prices but better quality. This strategy, while it foregoes some potential cost savings associated with marketization, blunts criticism that students in targeted schools would be shortchanged by "greedy education entrepreneurs," and that marketization is mere union-busting. As a practical matter, the education monopolists do not actually *own* the schools they operate—they just behave as if they do, and absent market pressure can mismanage them without much consequence. Even if this contracting approach is just applied to a few schools within a much larger district, such an apparently minor rearrangement of property rights might encourage all others to raise their game.

There are, in sum, many steps great and small that city governments might take to perform their traditional functions more efficiently. Unfortunately, however, it's often less fun to "mind the store" and give customers better quality, service, and prices than to attempt to remodel it entirely, a topic to which we must turn in the next two chapters.