Privatizing Functions of State Government

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Introduction

Privatization of traditional governmental functions has been extensively discussed in the United States for more than two decades, and states have chosen a wide range of programs for privatization and selected a variety of implementation and oversight strategies. In this report we examine the potential for privatization, privatization pitfalls, and ways to optimize the success of privatization effects.

Privatization can be attractive for one of two different reasons. It may provide a revenue benefit when the contracting entity can provide the service at a lower cost than that experienced by the governing entity. Typically, lower costs arise from lower personnel costs or through the use of less expensive methods and technologies, including IT solutions. It may also be attractive because privatization may allow government to perform specific services more effectively or more efficiently than it could with its own employees. Typically, these situations occur when a private entity can be more flexible in the deployment of personnel and resources and when dealing with new technologies or processes.

Evidence from the literature

A review of academic literature on outsourcing suggests that:

- Contracting has an average cost savings of 8 to 14% with the highest savings in maintenance (30%), cleaning (30%), and garbage collection functions (19%). There are fewer studies of the cost effects for other functions, but studies of engineering, and parks and recreation functions also showed cost savings. On the other hand, studies of contracting out personnel, health, training, and transportation functions reveal cost increases. These studies suggest that savings are more likely where the work product is direct and easily measured and less likely in other situations. These estimates do not include costs incurred by an agency to contract and monitor outsourced services (Hedge 2000).
- In some cases, agencies are allowed to compete with each other and against private sector firms. Studies show that competitive bids involving public sector bidders produce larger cost savings than bids involving only private sector contractors. Public to public contracting was found to save 22% on average versus 14% for public to private contracts. Some studies also found that other mechanisms such as competition between agencies or between in-house teams resulted in average saving of 13% (Hedge 2000).
- Generally, performance monitoring is the "weakest link" in contracting out services.

Privatization in Missouri

There is no central source of information about all privatization activities in Missouri but privatization has occurred in a number of areas. The Council on Efficient Operations, chaired by Lieutenant Governor Roger Wilson, attempted to calculate the potential impact of privatization in the State.[2] In a 1996 report, the Council provided examples of savings in housekeeping ($44,000/yr), delivery services ($200,000/yr), invoice auditing ($800,000/yr) and state park concessions (16.6% return on sales). Recently, the Missouri General Assembly has been considering a more formalized approach to privatization. In 2003, it adopted Senate Concurrent Resolution (SCR) 13, which created the Subcommittee on Competition and Privatization and charged it with performing a competitiveness and privatization review. A 2003 report of the Oversight Division, Committee on Legislative Research for that committee summarizes some of the state's privatization initiatives. These include the following in broad categories:

- IT application development;
- Student loan processing;
- Building security;

- HIV case management;
- Prison medical and mental health services;
- Janitorial services;
- Printing;
- State employee cafeteria plan;
- Building design;
- Debt collection; and
- Mental health treatment and habilitation services.[3]

In addition to these piecemeal efforts undertaken by various departments, House Bill 1676 was introduced by Representatives Yates and Icet in 2004 to require state agencies to identify governmental activities that are not necessarily governmental functions, and to open those activities to competition.[4]

The Subcommittee on Competition and Privatization issued its final report in December 2004. That report notes several factors that cause government to grow, including the absence of a comprehensive oversight process, and recommends the creation of the Missouri Competition and Privatization Board. The Subcommittee recommended that the Board be empowered to require agencies to conduct a review and be provided sufficient funding to reimburse agencies for the cost of such reviews. Legislation to effect the Subcommittee's recommendations had not been introduced as of March, 2005.

<u>Privatization in other states</u>

A review of other states suggests substantial savings and improved efficiency are possible from privatization efforts, but higher costs and lower quality services may also occur (see appendix 1). Virginia estimated a savings of almost $14 million in 1997 from 20 projects, and since then they have identified substantial cost savings in a variety of policy areas. Similarly, Michigan has saved millions of dollars per year by contracting out prison health care and prisons for youthful offenders, and it sold its state accident fund to Blue Cross for $255 million. On the other hand, Kansas experienced higher costs after contracting out foster care and adoption services, and it experienced a shortage of qualified social workers as well as high staff turnover. Of even greater concern, Montana privatized its mental health system in 1997 but had to cancel the $40 million contract in 1999 due to substantial losses by the contracting company and its failure to pay claims to providers of services. Florida's $278 million outsourcing of its human resource system has been problematic, and the governor has proposed an Office of Procurement to help state agencies drive harder bargains.

Overall, the success of any effort to contract out services depends on several factors. First, does the state have a clear estimate of the costs incurred by the public agency in providing a service? Second, can it specify very clearly the services it is funding? Third, do the specified tasks require specialization of skills or tools that allow greater economies of scale so that one could produce more output from the same level of inputs (or greater efficiency)? Fourth, are there enough qualified competitors available to perform the service regardless of whether it is a public agency, private firm or nonprofit organization? Competition is the key to innovation and motivation to increase efficiency and reduce costs. Fifth, can valid performance measures be designed to reflect quality service and favorable policy outcomes? Finally, is the contracted service one that is relatively easy to monitor, in terms of cost, efficiency and service quality?

It can be difficult to assess these issues for every possible privatization effort, but Virginia's Commonwealth Competition Council offers a model for how to approach contracting out in a more systematic, coherent, and informed fashion. The Council offers a framework for analyzing costs, assessing benefits and risks, and ensuring that quality is not reduced. Their analysis (included in appendix 2) requires a detailed set of estimates on personnel costs, administrative costs, and operating costs for any government function considered for privatization, and they require an assessment of how contracting out could affect public safety, public welfare, public control and accountability. In addition to making the process more systematic, the Council tracks the effects of contracting out across state agencies and provides estimates of these impacts for both legislators and the public through regular newsletters and web page updates. Such procedures offer greater accountability of government to the people of the state.

In a review of state and local privatization efforts, the GAO suggested there are several lessons that policymakers should consider when considering privatization:.

- First, government needs to develop a statewide commission to promote privatization, identify appropriate opportunities, provide technical assistance, and develop policies and guidelines. This commission assumes the responsibility for establishing an analytical framework to determine costs, benefits and risks associated with contracting out, and a formal structure guiding the process for agencies is considered "highly desirable".

- Second, some legislative changes may be necessary in areas such as the state civil service to increase the likelihood of success, and a change in resources may be needed to encourage implementation of privatization. The enabling legislation, funding cuts, and specific goals are needed to send a clear signal to state employees that the effort is serious and not just another fad that will pass over if they wait it out.
- Third, comprehensive cost data on agency activities is crucial to success but difficult to obtain. A state's accounting system can be a major impediment to precise cost data, and it may be necessary to consider alternative cost analysis methods such as the ABC approach championed by Indianapolis or the federal government's A-76 program.
- Fourth, the state needs strategies to manage workforce transition in any privatization effort. State employees are often highly stressed by such efforts, and employee concerns can be one of the biggest roadblocks facing state privatization efforts. Workforce transition strategies will be more successful if they can 1) involve employees in the process from the start, 2) train employees for the private sector or contract management in the public sector, and 3) create a safety net for displaced workers. Allowing in-house competition for services or bids by employee groups may also empower front-line workers and encourage innovation while maintaining expertise. In one case in Florida, a public employee group won the bid for water and sewer services, and this group reduced employee costs from 64% to 46% of operating expenses by using fewer managers and more technology.
- Finally, privatization efforts demand careful preparation of contracts, thorough knowledge of performance measurement methods, and considerable monitoring activity. Because state employees may not have much experience in such activities or much expertise, training to improve these skills is essential. The move into a more competitive environment could lead to greater inefficiencies, waste, fraud or even abuse without skilled employees developing and monitoring contracts.

Conclusion

A number of states have attempted to systematically address these issues through a formal review of privatization proposals. These include the states of Arizona, Colorado, Florida, Georgia, Kansas, Kentucky, Maryland, Michigan, New Jersey, New York, Texas, Utah, Virginia, and Wisconsin. See Appendix 1 for more information about the programs in these states. States have engaged in privatization long enough for the value and pitfalls to be visible, as can be seen in Appendix 1. Privatization is most valuable when the need for flexibility is high, when the services to be rendered are readily quantifiable, and when states lack the required expertise. Privatization presents risks when the contracting agency does not assess the probable savings, when it focuses on cost savings without considering the impact on quality, when there are too few competitors, when the agency completely loses the ability to perform the work, and when contracting arrangements are not transparent. Transparency is particularly important because the potential for abuse is substantially greater in a contracting environment.

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Appendix 1
Privatization Efforts in the States

Several states have statewide efficiency review programs in operation, including the following:
Arizona, Colorado, Florida, Georgia, Kansas, Kentucky, Maryland, Michigan, New Jersey, New York, Tennessee, Texas, Utah, Virginia, and Wisconsin**.** The summary of actions in the states below includes all of these states.

Arizona Governor's Efficiency Review (ER)
http://www.governor.state.az.us/er/Reports.htm

In 2003, Governor Janet Napolitano established the Efficiency Review Program with the goal to improve the performance and efficiency of the government. The ER is charged with determining practical and sensible ways to improve customer service, reduce cost and eliminate duplication.

- The Efficiency Review Program came up with 7,500 suggestions to save taxpayer dollars. Governor Napolitano said the new programs have potential for savings as large as $213.8 million over five years (Arizona Daily Star, December 23, 2003).

Colorado Commission on Privatization of Personal Services,
http://www.colorado.gov/dpa/dfp/

The Commission on Privatization of Personal Services is located within the Division of Finance and Procurement (DFP), which provides leadership, oversight, and guidance to state agencies and institutions of higher education for continuous improvement in the management of the State of Colorado's financial affairs, public procurement, construction and real property.

- Colorado contracted with the Nashville-based Corrections Corp. of America (CCA) to run its *prisons*. In 2004, there was a prisoner riot in a CCA facility**.** However**,** CCA contends that nothing is wrong with its prison operations and that the prison is adequately staffed; "problems are simply bound to come up from time to time." **(**AP, 7/22/2004).
- Sen. Ron Teck, R-Grand Junction, proposed a constitutional amendment that would completely privatize *higher education* in Colorado because he believes that lawmakers should face up to the fiscal crisis looming in higher education's future now, instead of waiting until the state runs out of money to pay for it in 2007 or 2008, as expected. The move was highly contested by University of Colorado President Elizabeth Hoffman, who said such a move would force state universities, including CU, to double or even triple what they charge for tuition overnight (Daily Camera, 2/12/2004).
- The Colorado Legislature passed SB 04-189, the College Opportunity Fund, which created a first-in-the-nation funding mechanism for *higher education*. The fund distributes public money directly to students through stipends or vouchers rather than the state giving a block of money for tuition subsidies to colleges and universities. The vouchers take effect in Fall 2005. Students only receive the money if they apply for it. (Daily Camera, 2/7/2005).

Florida Office of Program Analysis and Government Accountability
http://www.oppaga.state.fl.us/

The Florida Office of Program Policy Analysis and Government Accountability (OPPAGA) is a special staff unit of the Legislature created by state law under the oversight of the Joint Legislative Auditing Committee. It examines agencies and programs to improve services and cut costs, including privatization efforts, when directed by state law, the presiding officers, or the Joint Legislative Auditing Committee.

- After six years of privatizing activity, the legislature is looking at ways to impose more accountability in contracting (Tallahassee Democrat 1/24/2005).
- Governor Bush proposes the creation of an Office of Procurement to help agencies bargain with contractors. Legislators plan to introduce a bill that sets quality standards for contracting by the Department of Children and Families (Tallahassee Democrat 1/24/2005).
- State auditors question contracting problems in a personnel contract and a technology contract worth a total of $476 M and seven top administrators in the Department of Children and Families have been fired or resigned in the last six months over alleged contract irregularities (St. Petersburg Times, January 2, 2005).
- Gov. Jeb Bush canceled $176 million in technology contracts after discovering a former official may have improperly communicated with a vendor, prompting an ongoing criminal investigation (St. Petersburg Times, 2/19/2005).
- Gov. Bush announced his most ambitious privatization proposal: shifting the nearly $15-billion *Medicaid* program to private insurers (St. Petersburg Times, 2/19/2005).

- Under state law, *for-profit private prisons* are supposed to produce at least a 7 percent cost savings over similar state prisons run by the state. While there has been report after report showing that this threshold has not been met and private prisons might cost more than their public counterparts, the state continues to fund them. Because there is a cap on the amount of cost that the contracted company must absorb**,** last fiscal year, the taxpayers of Florida paid more than $1.8 million in medical costs for private prisons because there is a medical cap on their inmates (St. Petersburg Times, 12/16/2004).
- Florida contracts with Kids Central to administer the state's *foster care and related services* for abused, neglected and abandoned children and their families. Kids Central has an $83.9 million competitively bid contract, which went into effect in March 2004 and runs through June 2007. It is not contingent on the number of children receiving foster care or protective services, meaning more cases does not mean more money to handle them. The increase in cases has made it difficult for Kids Central to meet its goals, which include reducing the turnover among case managers, the amount of time children spend in foster care before either being reunited with parents or adopted, and the caseloads of staff members. (St. Petersburg Times 11/29/2004).
- The Florida Department of Juvenile Justice discovered that *state maintenance workers* were far cheaper than the private alternative (Tampa Tribune, 5/4/2002).
- National surveys found that Florida has the most efficient government in the country, with the lowest payroll cost per taxpayer a year in the nation and with the third smallest state government based on population (Tampa Tribune, 5/4/2002).
- The Department of Agriculture and Consumer Services privatized its *payroll system* run by private company Convergys of Cincinnati and experienced a number of problems including: some employees were told their insurance had been canceled when they were reassigned or promoted; department staffers trying to resolve problems spent two hours on the phone with Convergys' service center; and overtime and other additional pay for employees wasn't being processed appropriately (St. Petersburg Times 11/11/2004).

Georgia Department of Audits and Accounts
http://audits.georgia.gov/01/home/

The Department of Audits and Accounts exists to provide decision-makers with credible management information to promote improvements in accountability and stewardship in state and local government. This department monitors agency contracts for consulting, outsourcing and any interagency contracts that fall under consulting and outsourcing.

- In an effort to control spending by Medicaid patients, the state has put *Medicaid* up for bid to private health insurers. Governor Perdue argues that cost savings under the HMO program will come from having patients seek primary care in doctors' offices, not in emergency rooms, which are much more expensive (Atlanta Journal-Constitution, 1/6/2005).
- The state attempted to privatize the *Atlanta Airport* in order to fund the city's massive sewer and water project (Atlanta Journal-Constitution, 11/19/2003).
- Georgia and the Herschend Family Entertainment Company developes a public/private partnership at *Stone Mountain Park*. The arrangement has increased state revenue. In sum, "Herschend pays the state more than the state ever made on the park, Herschend pays for all the upgrades, the upgrades have to be approved by the state and the customer experience is enhanced." (Atlanta Journal-Constitution, 6/10/2003).

Kansas. Kansas Legislative Division of Post Audit
http://www.kslegislature.org/postaudit/about.shtml

The Legislative Division of Post Audit is the audit agency of Kansas government. The programs and activities of state government now cost about $9 billion a year. The Division of Post Audit provides the needed information for legislators to evaluate the work of governmental agencies. The Division prepares reports on agency performance, compliance and control, and financial compliance.

- Kansas privatized *family preservation, foster care and adoption* services in 1996 -- "the only state to have outsourced child welfare on a large scale" (Governing Magazine July 2000).
- Kansas privatization of *child welfare services* was a "no-holds barred effort to build a public-private social services system using managed-care principles" (Governing Magazine July 2000).
- When Kansas privatized *child welfare services*, many of the state social workers did not transfer to the private sector along with their cases, causing a shortage of qualified social workers. The system then had to turn to less experienced social workers right out of college, and "inevitably, the quality of work done with families

dropped" (Governing Magazine July 2000).

- Private *foster-care* providers found their costs far exceeding what they had expected, because regardless of whether the agency had run through its budget for a child, the decision to continue services in the case was up to a judge (Governing Magazine July 2000).
- Kansas faced several problems with its privatized child welfare services, such as the hiring of unqualified social work staff, confusion over responsibilities, high turnover and the shifting of kids from caseworker to caseworker (AP 4/1/99).
- Twice between 1997 and 1999, Kansas lawmakers had to deal with money emergencies in privatized child welfare services, appropriating $45 million extra (almost one-third of the existing state foster care budget) because private agencies "were unwilling to scrimp on the services they were under contract to supply" and "insisted on adequate resources" (AP 4/1/99).
- Lutheran Social Services, which held an adoption services contract with Kansas from October 1996 until July 2000, announced it was near bankruptcy and could not fully pay its subcontractors the estimated $2 million it owed them (Topeka Capital-Journal 8/17/00).
- Real costs of child welfare services have become apparent since privatization: In 1995, before privatization, the state spent $58 million on foster care and adoption combined. For 2001, the state approved $83.5 million for foster care and another $22.5 million for adoption services. This makes it difficult to determine whether improvements are due to increased funding or to privatization (Governing Magazine July 2000).
- Since privatization, the number of child protective services workers investigating cases of *suspected abuse and neglect* increased by 30%, and family preservation services are now available 24-7, as opposed to 8 am to 5 pm in many counties before privatization (Topeka Capital-Journal 8/10/01).
- Before privatization, *foster parents* received $10.12 a day to care for children, many of them with severe problems. In 2001, foster families received $18 to $20 a day and up to $70 a day for those with specialized needs (Topeka Capital-Journal 8/10/01).
- In the first four years of privatization in Kansas, *adoptions* increased by 78% and the percentage of adoptions that failed was 2.4%, compared to 12% nationally (Topeka Capital-Journal 8/10/01).
- The percent of children in need of care who are placed in family foster homes instead of group homes or institutions increased from 67% to 85% (Topeka Capital-Journal 8/10/01).
- Challenges of privatization include a new layer of administrative overhead between policymakers and those responsible for delivering the services, making accountability more problematic (Nancy Snyder, Wichita State University, 2/24/2004).

Kentucky State Agency Service Contract Administration Program Review and Investigations Committee
http://lrc.ky.gov/Statcomm/Progrev/homepage.htm

The Program Review and Investigations Committee is a 16-member bipartisan legislative committee. According to KRS Chapter 6, the Committee has the power to review the operations of state agencies and programs, to determine whether funds are being spent for the purposes for that they were appropriated, to evaluate the efficiency of program operations and to evaluate the impact of state government reorganizations.

- Kentucky signed a contract with a private company, Aramark Correctional Services, to provide food *services at state prisons*, which is expected to save more than $5 million per year (AP 11/12/2004).
- In 1998, the state paid $25.8 million to an estimated 1,800 *foster families* and $67.2 million to 45 private agencies to treat about 3,500 disturbed or disabled children (AP 3/29/99).
- In 1999, the state considered expanding privatization of *child welfare* to include not only the treatment of troubled children (for which it already contracts with private agencies), but also the operation of foster care and adoption programs and services (AP 3/29/99).

Maryland Commission to Study the Structure and Efficiency of State Government Department of Budget and Managemnt
http://www.dbm.maryland.gov/portal/

The Commission to Study the Structure and Efficiency of State Government is located within the Maryland Department of Budget and Management, which helps the Governor, State agencies, and their employees provide effective, efficient, and fiscally sound government to the citizens of Maryland.

- In 2004, the state's *mental health* agency considered privatizing services to fix its structural budget deficit (The Daily Record, 2/17/2004).
- The Maryland State Senate approved a bill to establish a panel to study relinquishing state control of *BWI*

Airport to an autonomous airport authority. The bill, SB 745, would establish a 14-member panel to study the merits of privatization, or "entering lease arrangements to make the airport more viable and efficient." The House Environmental Matters Committee however, gave the bill an unfavorable report (The Maryland Gazette, 3/20/2004).
- In 2003, the Maryland State Health Secretary recommended the closure of Crownsville Hospital Center and the privatization of Walter P. Carter Center, two of Maryland's *mental health facilities* in order to save as much as $15 million a year (The Daily Record, 10/9/2003).
- House Bill 1459 prohibited the Mental Hygiene Administration from: "closing, downsizing, consolidating, or selling the Crownsville Hospital Center on or before June 1, 2006, unless specified requirements are met; requiring the Administration to conduct or commission a study regarding the Crownsville Hospital Center; and requiring the study to make a determination about specified issues." (HB 1459, 2004).
- The Maryland legislature will consider a bill in 2005 that extends the authority of the state's juvenile justice monitoring program to include services provided by private contractors as well as state run facilities (Washington Post 2/1/2005).

Michigan General Government Appropriation Act
http://www.michigan.gov/dmb/

The General Government Appropriation Act of 2000 requires state departments to submit project plans to the legislature prior to beginning any effort to privatize and to evaluate the privatization effort and report to the legislature within 30 months. Reports are submitted to the subcommittees of the Senate and House standing committees on appropriations and the Senate and House fiscal agencies for approval.

- Taxpayers spent as much as $7,000 more per mile for a private company to maintain 20 miles of *interstate highway* near Lansing (Detroit News 8/11/00).
- The state is making $1.6 million less on *liquor sales* under partially privatized distribution system than under an old agency-run system (Detroit News 8/11/00).
- In 1994, Michigan sold its *state accident fund* (which handles *workers compensation claims*) to Blue Cross for $255 million (largest privatization of a public agency in US history), and the fund is doing "excellent" (Detroit News 8/11/00).
- Outcome of privatization efforts is difficult to measure because there has been little systematic follow-up (Detroit News 8/11/00).
- Savings from privately owned *prison* for youthful offenders is at least $3.6 million a year, but has a higher rate of violent incidents than other maximum security facilities (Detroit News 8/11/00).
- About $650,000 in liquor disappeared when the state turned *liquor distribution* over to private companies and about 370 state workers lost their jobs (AP 4/9/99).
- DOT is unable to determine if using *private paving contractor* is saving money—no useful comparison data. DOT has a $1 million contract with one firm and a $2 million contract with another for road maintenance (AP 5/24/99).
- Medicaid in Michigan is being underfunded by an estimated $400 million, in part because of cuts that were made when services were bid to *managed care* companies. In addition, Medicaid payments are often late – sometimes up to two years late (AP 2/6/00).
- Department of Corrections signed a contract with CMS in 1998, and in 1999 signed a four-year $178.6 million extension contract to provide *health care* to 45,000 *prison inmates* in Michigan at $70.57 for each inmate per month. UAW brought lawsuit against the state because of this privatization (AP 5/25/00).
- Estimated $17.6 million savings in 1998 from privatized *prison health care*, but these savings are questioned. Overall, prisoner health care cost $114.4 million in 1998 or about $2,539 per prisoner (AP 5/25/00).
- Lawmakers are discussing privatization of *mental health* care. Services are currently overseen by Community Mental Health offices, but if the state finds that CMHs are not meeting requirements, bids for services will be accepted from private providers (Detroit Free Press 2/25/02).
- Lack of benchmarks and monitoring make it almost impossible to determine the impact of privatization on cost and quality of service (Mackinac Center for Public Policy, April 15, 2002).
- Privatized *child protective services* performed at least as well as state provided services (Svetlana Yampolskaya, *Evaluation Review*, Vol. 28 (2), April 2004).
- A number of Michigan school districts are privatizing services once provided by employees, such as *custodial services*, as a response to rising costs and state budget constraints (AP, 8/23/2004).
- In Michigan, if the state decides that an agency does not meet its requirements, bids will be accepted from private providers to provide *mental health care*. In 2002, the state announced that the troubled Detroit-

Wayne County Community Mental Health board did not meet the state's qualifications to provide services to its clients, putting it up for bid to private operators (Detroit Free Press, 5/5/2002).

- Michigan contracted with Waste Management Inc. of Houston in a cost-cutting effort to end inconsistent *trash pickup* and pay less workdays for city employees (Detroit Free Press, 2/19/2001).

New Jersey New Jersey Advisory Commission on Privatization
http://www.state.nj.us

The New Jersey Advisory Commission on Privatization was created in 1994 through Executive Order #17. It was established to conduct a review of existing feasibility studies and actual experiences of governments that have initiated privatization efforts; evaluate the advantages and disadvantages associated with privatization; conduct a feasibility study of New Jersey State government; and propose appropriate and beneficial methods of implementing privatization in this State.

- The Port Authority of New York and New Jersey chose not to convert the *federal security screening* staffers at the airports it operates to privately employed workers, even though they were allowed seek permission from the Transportation Security Administration to make such a switch (AP, 11/18/2004).
- The Division of Youth and Family Services contracted with a private sector social work firm, Social Work P.R.N., to help overburdened state employees reduce the backlog of thousands of *child welfare cases*. Social Work P.R.N. was awarded a $738,000 one-year contract (The Record, 6/9/2004).
- According to a report released by the State Treasurer in 2003, New Jersey needed to hire private Wall Street firms in order to diversify its $62.3 billion portfolio as part of a drastic retooling of the state's *investment operation* (The Record, 9/19/2001).
- Gov. Codey has looked at the idea of *leasing or selling the New Jersey Turnpike* and two other toll roads to help close its budget gap (Times Union, 1/26/2005).

New York New York State Advisory Commission on Privatization and the New York State research Council on Privatization
http://www.gorr.state.ny.us/gorr/EO8.htm

The Advisory Commission and Research Council on Privatization was created in 1995 through Executive Order No. 8 by Governor George Pataki. The Commission and Council review existing feasibility studies regarding privatization and any reports relating to privatization efforts and experiences of national, state and local governments; analyze existing legal, regulatory and contractual impediments to privatization and evaluate the advantages and disadvantages associated with the various modes of privatization and conduct feasibility studies.

- In January 2005, New York State began looking at ways to privatize some *major roads, bridges or other transportation assets* to help pay for much-needed improvements and overall maintenance (Times Union, 1/25/2005).
- Legislation *banning the privatization of prisons* in New York City was approved in 2002 (Daily News, 11/26/2003).
- Because of county budget cuts, Niagara County's *AIDS case management program* was privatized in 2003, through a contract with AIDS Community Services of Western New York, a Buffalo-based not-for-profit agency (Buffalo News 1/18/2003).
- A report by the Manhattan Institute in 2002 found that New York State could save at least $340 million a year by contracting the *city's blue buses* out to private companies (NY Sun, 11/20/2002).

Tennessee Comptroller of the Treasury
http://www.comptroller.state.tn.us/

The most important duty of the Comptroller of the Treasury is to audit state and local government entities and their participation in the general financial and administrative management of state government, such as agency privatization efforts.

- In 1994, Tennessee created a $4.4 billion "semi-privatized" program, TennCare, to replace Medicaid in Tennessee with a *managed care* format that "would curb the outrageous annual growth in costs and to expand health coverage to previously uninsured Tennesseans." The state contracted with private companies to oversee health care of enrollees (AP 2/4/00).
- Since its inception in 1994, TennCare has experienced numerous problems and cost overruns. TennCare consumes roughly one in three dollars in the state budget (Tennessee.gov, Office of the Governor, 1/12/2005).
- In 2005, Governor Bredesen, in response to budget shortfalls decided to shift back to the traditional Medicaid. The new plan "preserves full coverage for all 612,000 children on the program and maintains a

reasonable level of benefits for 396,000 adults who are eligible for Medicaid." 323,000 adults, however, will be removed from the program because they are not eligible for Medicaid. The new changes to TennCare could generate at least $575 million in cost savings for the State. Gov. Bredesen argues that even with the reductions in adult benefits and enrollment, Tennessee still provides more "extensive healthcare coverage than nearly 40 other states." (Tennessee.gov, Office of the Governor, 1/12/2005).

- The Shelby County Commission considered privatized its *local prison* in order to cut operating costs, over in January 2005, the Commission deferred action (The Commercial Appeal, 1/11/2005).
- Marion County commissioners chose to privatize its *ambulance service* and awarded a contract to Grandview Medical Center. The county bid out the ambulance service to save money and improve pay and benefits to ambulance workers. Grandview Medical Center was contracted to operate the ambulance services for a maximum county subsidy of $180,000 a year (Chattanooga Times Free Press, 4/30/2003).
- Marion County contracted with Tennessee-American Water Co. to privatize its publicly owned *water system*. The contract will improve water quality, expand service and promote development in the rural areas of Sequatchie and Marion counties (Chattanooga Times Free Press, 3/10/2003).
- The Tennessee Department of Correction privatizes its *health care services for inmates* to a Missouri company, Correctional Medical Services, which is expected to save the state approximately $12 million over five years (AP, 6/15/2001).
- Maximus Corp., a private contractor that collects *child support* payments in two Tennessee counties, could not renew the contract with the state because DHS officials said state collection workers could do the job cheaper. Maximus had asked for $4.2 million, but the state only allows a contract amount of $2.4 million (The Commercial Appeal 8/17/00).
- In August 2000, DHS cancelled its contract with Cherokee Children and Family Services, a private agency that brokered *child-care services* in Shelby County, because of allegations of corruption. A federal grand jury is investigating the agency's operations. DHS will resume the duties of all the child-care brokers in the state (The Commercial Appeal 8/27/00).
- Tennessee turned over six *state park* facilities to new government and private managers, which is expected to save the Tennessee Department of Environment and Conservation an estimated $500,000 a year (The Commercial Appeal 9/1/00).
- A 2001 bill proposed that *retail operations in state parks*, such as inns, golf courses, restaurants, gift shops and marinas, be removed from state management and placed in a private corporation. The plan was estimated to save $10 million by 2005 by reducing purchasing costs and personnel (Knoxville News-Sentinel 4/22/01).
- On July 1, 2001, the Department of Corrections turned over most *inmate health care* services to a private company. The contract, worth about $23 million a year, is expected to save about $12 million over five years. 25 state employees were affected by the contract, and 15 of them have been placed in other positions (The Commercial Appeal 6/16/01).

Texas Council on Competitive Government (CCG)
http://www.ccg.state.tx.us/index.html

The Council on Competitive Government is charged with identifying and determining services that government should privatize. The CCG explores how different institutional arrangements, such as managed competition, outsourcing, reengineering and public/private partnerships can create incentives for efficiency, improve customer service, enhance accountability, and save taxpayer dollars.

- In 1993, Texas gave the job of *providing health care* for prisoners to the UTMB at Galveston and Texas Tech University. A report was issued 10 years later claiming that privatization improved state prison conditions. Specifically, health care that meets national standards is available to almost every Texas inmate (AP, 7/28/2004).
- Montgomery County privatized about 300 beds in *a new jail expansion* for use by federal prisoners, in order to fill empty beds (Houston Chronicle, 6/17/2004).
- Montgomery County is negotiating to *privatize its jail* in an effort to save up to $3 million annually through operational savings and federal prisoner contracts." Under the contract with the GEO Group of Boca Raton, Fla., the private company would handle inmate population and contracts with the federal government to house federal prisoners in the facility (The Houston Chronicle, 2/10/2005).
- The Texas State Auditor's office found that the Health and Human Services Commission "has not established adequate systems and controls to monitor its *Medicaid and Children's Health Insurance Program managed care contracts*." The result being more than $13 million

in funds due to the state were not being collected (Corpus Christi Caller-Times, 7/24/2004).

- The Mansfield school district considered privatizing its *bus system* in hopes of saving some of the $ 4.5 million that the district has spent during the 2004 school year to bus 6,000 students to and from school (Fort Worth Star Telegram, 2/24/2004).

Utah Privatization Policy Board
http://www.utah.gov/main/index

The Privatization Policy Board was created by the General Assembly in 2003 to review whether certain services performed by existing state agencies could be privatized, to review particular requests for privatization of services and to assesss whether there is agency competition with the private sector.

- In 2004, the Salt Lake County's Oxbow Jail was overflowing with inmates, causing the state Department of Corrections to consider a *privatized facility for women*. The state solicited bids from private companies to build a 500-bed facility on state property. Utah chose to pursue privatization to avoid state financing of the building and to offer programming not currently available to women inmates (Salt Lake Tribune, 6/17/2004).
- After privatizing its *Convention and Visitors Bureau*, Utah County attracted more revenue (Deseret Morning News, 3/20/2004)

Virginia Commonwealth Competition Council
http://www.egovcompetition.com/home.htm

The Competition Council was created to examine and promote methods of providing a portion or all of select government-provided or government produced programs and services through the private sector through a competitive contracting program. Other responsibilities include the evaluation of public-private partnerships and to conduct cost-benefit analyses of privatization efforts.

- The Public-Private *Transportation* Act of 1995 – any "responsible public entity" may enter contracts with private firms; act allows for unsolicited proposals from companies (Richmond Times-Dispatch 9/5/95).
- A 1996 report by the House Appropriations Committee that questioned the savings of Governor Allen's attempts to cut government stated that the full-time state work force had shrunk to its lowest level in four years, but that remaining employees are on the job longer and work more overtime. For example, the amount paid for overtime was expected to be 14% higher in 1996 than in 1995, and contract services were expected to jump 19% from 1995 to 1996. Full-time employment decreased by 4,728 from 1995 to 1996 (Richmond Times-Dispatch 5/21/96).
- In 1997, privatized *child support enforcement* offices collected more money overall and more money for families that receive no aid from the state, but publicly run offices collected more effectively for families that receive benefits under the TANF program (Governing Magazine May 1998).
- For the first quarter of 1998, two private child support offices had collected $2.8 million and $3.8 million, while two state-operated offices had collected $3.3 million and $2.4 million (Governing Magazine May 1998)
- Publicly run child support offices increased the number of child support orders established by much more than the privately run offices. On the other hand, privatized child support offices cost $16,185 less to run than state operated ones in 1997 (Governing May 1998).
- Estimate net savings in 1997 from 20 privatization projects: $13.9 million, according to the Commonwealth Competition Council (Governing 1998).
- In 1998, VDOT signed a contract with Virginia Maintenance Services (VMS), a private partnership of companies, to provide *maintenance duties for 2 highways* within the state's borders (250 miles of road). The company was paid $131.6 million for the five-year contract. In 1997, it took over maintenance on 101 miles of interstate in Virginia. VDOT estimates that it saved $2.7 million in the first year with VMS. VDOT estimates that it will save a total of $23 million by the summer of 2002. It spent $4.9 million to prepare for privatization in the 1997 budget year (Roanoke Times 7/14/98).
- Some problems have occurred since VMS took over maintenance responsibilities for VDOT, including delays in repairing damage that resulted from traffic accidents and a tornado, and the failure of a VMS subcontractor to replace a damaged median barrier with a new safety barricade. The Joint Legislative Audit and Review Commission, the watchdog arm of the General Assembly, voted to investigate VDOT's efforts to privatize interstate maintenance (Roanoke Times 7/14/98).
- VMS maintains 29 *rest areas* in Virginia, and in all cases the costs have gone up under VMS management compared to VDOT management. In some cases the increase is small and reflects typical inflationary

increases, but in others, the costs have more than doubled. VDOT said these increases reflect a higher level of service, such as attendants on duty around the clock at each rest area (Roanoke Times 12/7/98).

- "VDOT began looking for ways to increase its use of private contractors after large work force reductions under governors Douglas Wilder and George Allen made it difficult for the department to perform its work." For example, the five rest areas in the VDOT's Salem district needed at least six more people to handle maintenance than they had when the service was privatized (Roanoke Times 12/7/98).
- A study of *14 road and bridge projects* designed by private consultants showed the costs of private consultants to be at least 20% higher than if the work had been done in-house (Roanoke Times 8/29/99).
- Studies by VDOT indicate that the state is often able to provide the same service as the private sector for less: the agency paid private computer systems analysts as much as $72 an hour, compared with the $38 rate they pay in-house programmers; private bridge inspectors cost as much as $92 an hour, compared with the $44 maximum rate a state employee would earn. In one case, the state ended a maintenance contract with a private business after finding the company's $321 per-vehicle cost was substantially higher than VDOT's $207 rate (Roanoke Times 8/29/99).
- The inability of VDOT to fill all identified vacancies because of position cuts and maximum employee numbers costs taxpayers about $1 million a year because private (more expensive) workers have to perform the duties (Roanoke Times 8/29/99).
- A 2000 legislative report claims that privatizing the state's *food warehouse and delivery system for prisons and mental hospitals* could save $5 million to $6 million immediately and $1.6 million a year. However, these figures are disputed within the government and General Assembly (AP 4/4/00).
- Virginia Tech, a former customer of the *state food warehouse*, contracted with a private vendor in 1995 and reported average annual savings of $280,000 (AP 4/4/00).
- In 2001, Lt. Gov. John Hager claimed it was possible for taxpayers to save $350 million annually by, among other things, turning over state *computer services* and the management *of low-security prisons* to the private sector and strengthening efforts to collect back debts (Richmond Times-Dispatch 5/25/01).
- The Virginia Department of Transportation decided to privatize the daily operations of the *Elizabeth River tunnels and the Berkley Bridge*, the midtown and downtown tunnel complexes, in order to enhance efficiency (The Virginian-Pilot, 12/8/2004).
- The Western Virginia *Water Authority outsourced its billing operations* to a Maryland company, Regulus, in order to save money (Roanoke Times and World News, 7/12/2004).
- Several vendors to Virginia state *prison commissaries* sued the Department of Corrections to end a privatization plan they claim hurt Virginia businesses. Suppliers argue that the contract with Keefe Supply Co. of St. Louis is hurting businesses in Virginia by "granting a monopoly to a company based in another state" (Richmond Times-Dispatch, 9/9/2003).

Wisconsin Legislative Audit Bureau
http://www.legis.state.wi.us/lab/index.htm

The Legislative Audit Bureau is a nonpartisan legislative service agency created in 1965, which was created to assist the Legislature in maintaining effective oversight of state operations. It conducts financial and program evaluation audits of state agencies. The bureau works to ensure that financial transactions and management decisions are made effectively, efficiently, and in compliance with the law and that state agencies carry out the policies of the Legislature and the Governor.

- Over the past decade, state spending on contracting has more than doubled, with an increase in state spending as well (Wisconsin State Journal 9/26/2004).
- Wisconsin has saved $10 million in public-private partnerships in *welfare ref*orm, according to the Reason Foundation (Telegraph Herald 8/10/98).
- Wisconsin could save $633,000 annually if the Department of Natural Resources, Department of Transportation and University of Wisconsin-Madison contracted for *vehicle maintenance and fuel*, according to Reason Foundation (Telegraph Herald 8/10/98).
- The Wisconsin Department of Agriculture saved $1.3 million and cut 148 positions (without layoffs) over 10 years by contracting for *custodial services* (Telegraph Herald 8/10/98).
- Wisconsin cut 100 jobs in the Department of Workforce Development by private contracts with the *state's welfare-to-work program* (Telegraph Herald 8/10/98).
- The Wisconsin Department of Transportation paid HNTB Corp., a consulting company, nearly $80 an hour to maintain a road sign inventory that was recently overseen by a state employee making $11.38 an hour plus benefits. It is reported that the state "is spending nearly $165,000 to contract out a job keeping track

of road signs, rather than keep the work in-house for about $51,000 a year." (Capitol Times, 8/16/2004).

Privatization in Other States

- A 1997 Mississippi legislative investigation found that a private *child support collection* agency that operated in two counties had higher costs than the state's public child support agencies on both a cost-per-dollar and per-case basis (AP 2/9/00).
- In 1997, Montana created a *managed-care* system to privatize its *mental health* system, but problems have arisen. The contractor, Magellan Health Services, was not paying claims on time, was not reimbursing some providers at all and was losing a million dollars a month. Consequently, in spring 1999, the state cancelled its $40 million 5-year contract with the company. It was the single largest mental health privatization in US history, and there is consensus that it was simply too massive and sprawling to work effectively (Governing Magazine March 2000).
- In 1987, Oklahoma began to contract out *employment training and placement* for developmentally disabled and mentally ill people, and companies were reimbursed on the amount of time they spent. The results were higher costs and fewer people than expected placed in jobs. A new reimbursement system was created in which companies were paid upon "milestones" of progress in getting people into jobs, which lowered costs to the state (Governing Magazine June 1999).
- The West Virginia legislature is considering a proposal to privatize the administration of its workers' compensation program (Herald-Dispatch 1/26/2005).

(Footnotes)

[1] Jean Schumacher provided research assistance for this project.

[2] Council on Efficient Operations: Bearing down on Efficient Public Service, 1996. The Council was an outgrowth of work done by the Commission on Management and Productivity, established by Governor Carnahan in 1994. The Council was terminated by Governor Bob Holden in Executive Order 01-19 (2001).

[3] Privatization survey conducted by the Oversight Division, Mickey Wilson, Director, for the Joint Committee on Privatization, November 7, 2003, available on the Missouri Senate website, www.senate.mo.gov. Some state departments did not respond to the survey and their privatization activities are not included in this discussion.

[4] Senate Concurrent Resolution 13 terminated December 31, 2004 and HB 1676 was not Truly Agreed To.

Appendix 2

CCC-PPPA (approved 5/15/96)

Commonwealth of Virginia
Commonwealth Competition Council

Public/Private Performance Analysis Submittal

Agency Name		Code	
Agency Address			
Telephone		Fax	
Date of Submittal			

Description of function or activity under consideration

Code *of Virginia* statute establishing this agency/institution:	§§
	§§

Funding source and percent of funding for this function/activity:

General ____ % Federal ____ % Special Revenue ____ %

Other (please specify): ____________ %

Cite item number(s) of the current Appropriation Act: (19)

Signature of Preparer: ____________
Printed Name ____________
Title ____________
Date

Signature of Reviewer: ____________
Printed Name ____________
Title ____________
Date

Signature of Agency Head or Head of Institution: ____________
Printed Name ____________
Title ____________
Date ____________

Recommended for competition

Yes	No

Commonwealth of Virginia
Commonwealth Competition Council

Public/Private Performance Analysis

Methodology to Evaluate Competition Opportunities

Level 1 Three main steps to determine whether a function, task, operation or activity should undergo competition with the private sector:

I. Analyze the potential for competition
II. Estimate the cost of the activity to the government
III. Consider the public policy issues best serving the public safety and welfare of Virginia citizens

Level 2 Two steps in planning and implementing the competitive process:

IV. Plan the necessary procedures
V. Implementation

These steps should be viewed as guides to assess competition opportunities. Not all questions, factors or analysis are applicable to every analysis. At the conclusion of each step, if the review of the activity continues to lend itself to a competitive effort, it is appropriate to proceed to the next step. If this is not the case, the reason(s) that would prohibit continued evaluation must be provided at the end of Level 1.

Level 1

I. Analyze the Potential for Competition

The objective of this analysis is to assess whether the specific activity lends itself to competition.

The questions and factors below are general in nature and are meant to ascertain whether more specific and serious analysis is warranted. The responses to these questions should be "yes" in order to proceed further for more serious evaluation. However, a "no" to one of the questions does not necessarily preclude going forward, but special consideration(s) may be required to assure success.

PLEASE CHECK THE APPROPRIATE ANSWER FOR THE FOLLOWING QUESTIONS:

		Yes	No
1.	Can the service be, or is it already, available from the private sector?		
2.	Is there more than one private contractor capable and interested in providing the activity to ensure competition?		
3.	Can the activity or function be specified in advance with clear objectives and outcomes?		
4.	Can the delivery of the activity be measured adequately to monitor performance?		
5.	Is the economical delivery of the service more important than control and/or accountability?		
6.	Would the funds/revenues presently available continue to be available if the private sector performs the activity?		
7.	Can the private sector implement and deliver the activity quicker?		
8.	Does the agency/institution have the ability and resources to manage/control/regulate the contract?		
9.	Is the total function /activity suitable for contracting out?		
10.	Are there current legal or regulatory barriers to contracting out the service?		
11.	Will the agency/institution submit a proposal to perform the service?		

Provide explanation for negative answers in Section I above by specific number:

Level 1

II. Estimate the Cost of the Activity to the Government

The objective of this section is to determine what it costs government to perform the activity and what future costs government can avoid by transferring the activity to the private sector during the course of the proposed contract.

Please provide estimated costs of the government activity for the base contract plus all option years for the following categories:

- personnel costs (full and part-time positions, including salaries, overtime, fringe benefits, etc.)
- operating costs (repairs and maintenance, vehicles, equipment, rent, utilities, materials and supplies, travel)
- capital costs (present and anticipated)
- capital leases
- insurance/liability costs
- operations overhead[1] costs
- general and administrative overhead[2] costs
- any other costs related to providing the service not included above

Total estimated government costs for base year plus option years:

Cost Category	State Performance Costs	Contract Administration and Support Costs[3]	Future Costs Eliminated If Activity Transferred To Private Sector
Personnel costs			
Operating costs			
Capital costs			
Capital leases			
Insurance/liability costs			
Operations overhead[1]			
General and administrative overhead[2]			
Any other costs related to providing the service not included above			
Total	0	0	0

Estimated contractor cost to provide service for base contract plus all option years $ ______

[1]Operations overhead is the cost incurred in support of the function by the supervisory workforce **one level** above the studied function.

[2]These are support costs, other than operations overhead, incurred in the support of the studied function. Examples are accounting functions, human resources, data processing and procurement.

[3]Estimated costs to assure contract compliance (contract payments, reviewing contract compliance).

Level 1

III. Consider the public policy issues best serving the public safety and welfare of Virginia citizens

The objective of this analysis is to determine if the services can be transferred to the private sector without public harm. The evaluation should address the following issues:

		Yes	No
1.	Can the private contractor be replaced relatively easily during the term of the contract?		
2.	Is the economical delivery of the service more important than control and/or accountability?		
3.	Can the contract provide for the transfer of liability/or risk?		
4.	Is the public safety and/or welfare of the citizens protected in case of default?		
5.	Is the proposed privatization activity consistent with State law, rules and regulations?		
6.	Is the total function suitable for competition with the private sector?		
7.	Has the service been successfully contracted out in other public entities? Please identify:____		

Detailed Explanation

Provide explanation for negative answers in Section III above by specific number:

If the function is not recommended for competition, please provide rationale and detailed explanation:

Level 2

The following are considerations in preparing the necessary procurement documents.

IV. Plan the Necessary Procedures

The objective of this step is for the agency to evaluate the parameters of the proposed competition. This evaluation should address issues such as:

- Timing
  - Are there issues raised from Level 1 that need to be resolved prior to proceeding?
  - Does the timing of the competition effort affect potential cost savings?
  - How long will it take to award a contract?
  - What is the specific time schedule required to implement the contract?
- Personnel
  - What is the transition plan if contracting out the function impacts on State employees?
  - Will current State employees have an opportunity to present a proposal?
  - Will the private vendor be required to offer the right of first refusal or absorb existing State employees?
  - Can internal reorganization and different management techniques accomplish the same or similar goal?
- Cost
  - Is there a savings goal, short and long-term, without which privatization will not be considered?
  - Have performance measures been developed for this activity?
- Agency Impact
  - Does the privatization of this activity affect other programs and responsibilities (for example, other State agencies, departments)?
  - Are there alternative public solutions?
- Other
  - What is the best way to structure the competition (lease, contract, sale, partnership, pilot program)?
  - What process will be put in place to take over activity in case the contractor fails?

Level 2

V. **Implementation**

- Prepare Request for Proposal (RFP) and/or prepare proposal specifications
- Conduct procurement
- Review RFP responses
- Evaluate technical, cost realism and management issues of private performance vs. public performance
- Establish quality assurance oversight procedure or implement most efficient government organization
- Prepare required transition plan

Identify and discuss any barriers or impediments identified in Level 2.

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