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FINAL

HCS FOR CS FOR SENATE BILL NO. 68()
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTIETH LEGISLATURE - FIRST SESSION

BY

Offered:
Referred:

Sponsor(s): SENATORS WARD, Wilken

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to the Task Force on Privatization; and providing for an
2 effective date."

3 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

4 * Section 1. FINDINGS AND INTENT. (a) The legislature finds that

5 (1) the annual cost of state government is exceeding the annual revenue of the
6 state;

7 (2) there may be functions of state government that could be performed more
8 efficiently by individuals or businesses in the private sector;

9 (3) other states are considering privatization of some of their governmental
10 functions;

11 (4) more information is needed before the legislature can determine whether
12 privatization is a feasible alternative for this state to pursue in controlling its fiscal problems.

13 (b) The legislature intends to consider all reasonable methods to deal with the state
14 revenue shortfall and control excess growth in government.

1 * **Sec. 2. TASK FORCE ON PRIVATIZATION ESTABLISHED.** (a) There is established
2 in the legislative branch the Task Force on Privatization consisting of

3 (1) three members appointed by the governor, one of whom shall be a public
4 member selected from a list of nominees submitted by labor organizations that represent state
5 employees primarily engaged in building or other trades, and one of whom shall be a public
6 member selected from a list of nominees submitted by labor organizations that represent state
7 employees that are not primarily engaged in building or other trades;

8 (2) three members of the senate appointed by the president of the senate; two
9 shall be members of the majority and one shall be a member of the minority;

10 (3) three members of the house of representatives appointed by the speaker of
11 the house; two shall be members of the majority and one shall be a member of the minority;

12 (4) two public members appointed by the president of the senate; and

13 (5) two public members appointed by the speaker of the house.

14 (b) The president of the senate shall select a member from among those appointed to
15 the task force by the president of the senate to serve as co-chair of the task force. The
16 speaker of the house of representatives shall select a member from among those appointed to
17 the task force by the speaker of the house of representatives to serve as co-chair of the task
18 force.

19 * **Sec. 3. COMPENSATION OF PUBLIC MEMBERS.** The public members of the Task
20 Force on Privatization are not eligible for compensation but are entitled to per diem and travel
21 expenses authorized for boards and commissions under AS 39.20.180.

22 * **Sec. 4. MEETINGS; OATH.** (a) The Task Force on Privatization shall meet as
23 frequently as the task force determines necessary to perform its work and may meet during
24 the interim as well as during legislative sessions. The task force may meet and vote by
25 teleconference.

26 (b) A co-chair of the task force may administer an oath to a witness appearing before
27 the task force.

28 * **Sec. 5. DUTIES.** The Task Force on Privatization shall

29 (1) review and evaluate the policies and recommendations of the other states
30 that are studying or have implemented recommendations to privatize any of their governmental
31 functions;

1 (2) review state contracting policy and procedures, including competitive
2 bidding procedures;

3 (3) identify functions of our state government that could economically and
4 appropriately be privatized, if any;

5 (4) solicit public comment about its subjects of consideration;

6 (5) submit a written report of its findings and recommendations to the governor
7 and the legislature by November 15, 1997, concerning state contracting policy and procedures
8 and privatization of state government functions in the Department of Transportation and Public
9 Facilities, the Department of Corrections, and the Department of Health and Social Services;
10 the report shall suggest legislation that may be needed to accomplish the recommendations;
11 and

12 (6) submit a written report of its findings and recommendations to the governor
13 and the legislature by November 15, 1998, concerning privatization of government functions
14 of state agencies not addressed in the first report; the report shall suggest legislation that may
15 be needed to accomplish the recommendations.

16 * Sec. 6. This Act is repealed on December 1, 1998.

17 * Sec. 7. This Act takes effect immediately under AS 01.10.070(c).

CS FOR SENATE BILL NO. 68(FIN)

IN THE LEGISLATURE OF THE STATE OF ALASKA

TV'ENTIETH LEGISLATURE - FIRST SESSION

BY THE SENATE FINANCE COMMITTEE

Offered: 3/26/97

Referred: Rules

Sponsor(s): SENATORS WARD, Wilken

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HOUSE COMMITTEE REPORT

(7)

Date Referred to Committee: April 4, 1997f

FURTHER REFERRALS:

Finance

Date of Committee Action: 4/22/97

The STATE AFFAIRS Committee considered:

CSSB 68(FIN)

CS FOR SENATE BILL NO. 68(FIN)

TASK FORCE ON PRIVATIZATION

"An Act relating to the Task Force on Privatization; and providing for an effective date."

recommends it be replaced with the following committee substitute CSSB 68 (STA) the same title a new title

additional referral to _____ Committee
 attached amendment(s)

ADOPTS: _____ Letter of Intent

ATTACHES NEW FISCAL NOTE(S): (Dept) _____ APPROVES PREVIOUS: (Dept/Date) _____
 fiscal note(s) _____ fiscal note(s) LAA, GOV

zero fiscal note(s) _____ zero fiscal note(s) _____

SIGNING WITH RECOM.MENDATIONS	DP	DNP	NR	AM
<i>Shannette James</i>	✓			
<i>J. K. S. [unclear]</i>		✓		
<i>Atta But</i>			✓	
<i>Mary Hogg</i>	✓			
<i>Fred [unclear]</i>	✓			
<i>[unclear]</i>	✓			
<i>[unclear]</i>	✓			

CHAIR'S SIGNATURE *Shannette James*

Alaska State Legislature

Senate

Sponsor Statement CS for Senate Bill 68

"An Act relating to the Task Force on Privatization;
and providing for an effective date"

JERRY WARD

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Fax (907) 283-3075

Privatization is the fundamental political and economic reassessment of the role of government and the private sector in the modern state. It is a variety of management techniques and activities encouraging more involvement of the private sector in providing government services. Markets are efficient only when they are competitive, however efficiency should not be government's only goal. Government must balance the pursuit of efficiency with effectiveness, while maintaining the confidence of the people it represents.

CSSB 68 was introduced to establish a task force that will review functions of state government that could easily be transferred to the private sector. The task force will have members from the public, legislative and executive branches of government.

This will be the first all encompassing look at privatizing governmental services in Alaska. Forty-eight other states, including Alaska, have privatized some governmental services. When enacted, this bill will evaluate which services could be provided more efficiently by the private sector as well as highlight those services that are better provided by the government. The report should provide a road map for reducing the size and cost of state government, without reducing service, while providing options for the future.

CSSB 68 will also look into the State's contracting procedures to make sure Alaskans are getting the most out of every contracting dollar spent.

This bill has been endorsed by the Alaska Trucking Association, Gold Belt Inc., Local 71 and several others. Privatization of governmental services is one of the top priorities of the Alaska State Chamber of Commerce.

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

130 Seward Street, Suite 409
Juneau, Alaska 99801-2105

MEMORANDUM

April 17, 1997

SUBJECT: Task Force on Privatization (CSSB 68(FIN))

TO: Senator Jerry Ward
Attn: Craig Johnson

FROM: Tamara B. Cook
Director *TBC*

The Task Force on Privatization is established in the legislative branch and consists of members appointed by the president of the senate, speaker of the house, and governor. You have asked whether the appointment authority granted to the governor violates the separation of powers doctrine. While the question is not entirely free from doubt, I do not believe that a court is likely to find a violation of the separation of powers doctrine.

The court has recognized that the separation of powers doctrine applies in Alaska and that appointment of executive officers is an executive function. (Bradner v. Hammond, 553 P.2d 1 (Alaska 1976)) However, the power to appoint to office is not exclusively an executive function, at least not so exclusively an executive function that it may not be exercised by the legislature or by the courts as an incident to the discharge of functions properly within their respective spheres. (16 C.J.S. 216) Furthermore, the ordinary constitutional distributive clause providing for the complete separation of governmental powers has generally been held insufficient to vest the appointing power solely in the executive. Creation of a commission with some members appointed by the legislature and some by the governor has been held in other states not to violate the separation of powers doctrine when the commission is performing legislative and executive functions as a cooperative venture. (16 C.J.S. 135)

The Task Force on Privatization is charged with studying the issue of privatizing governmental functions, a topic of interest to both the legislative and executive branches. The Task Force is strictly advisory. It cannot exercise any legislative power, despite its location in the legislative branch of government. Generally, in order to rise to the level of a constitutional question, a conflict between the executive and legislative branches must be clear. (16 C.J.S. 217) Because the Task Force is advisory only and because it is involved in studying a matter of concern to both branches of government, I do not see the clear conflict between the branches necessary to create a separation of powers violation.

TBC:lmb
97-060.lmb

Letters of Support

ALASKA STATE
HOSPITAL & NURSING HOME
ASSOCIATION

February 13, 1997

Senator Jerry Ward
Alaska State Senate
State Capitol
Juneau, AK 99801-1182

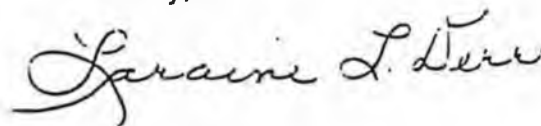
Re: Support, SB68, Task Force on
Privatization

Dear Senator Ward:

Members of the Alaska State Hospital & Nursing Home Association support SB 68, relating to the task force on privatization. We want to thank you for bringing this matter to the attention of the Legislature and Governor.

The challenge that the annual cost of state government is exceeding the annual revenue of the state is as true in the area of health care as in any other area. Because health care is such a big part of the state government cost's, the members of the Association would like to have one of their members sit on the Task Force. They are willing to spend the necessary time it will take to investigate the possibilities. We all need to work together in this time of declining resources.

Sincerely,



Laraine L. Derr
President/CEO

ALASKA TRUCKING ASSOCIATION, INC.

3443 Minnesota Drive • Anchorage, Alaska 99503 • PHONE (907) 276-1149 • FAX (907) 274-1946

February 12, 1997

Madam Chair and Members of the Committee:

My name is Frank Dillon. I am the Executive Director of Alaska Trucking Association, a 38 year old trade association, representing Alaska's truck users. We are testifying today in support of Senate Bill No. 68.

We would like to thank the sponsor for his introduction of this bill and are hopeful that it will quickly pass through the legislative process and be enacted. Over the past 30 to 40 years government has taken on many roles that rightfully belong in the private sector. We believe that in certain areas privatization will provide efficiencies, cost savings, and improved service to the citizens of Alaska. We are aware of a number of examples throughout the United States where privatization has worked and we are also enthused by examples here in the state where privatization is working. One example of this is in the area of commercial driver's licensing. The division of motor vehicles has entered into agreement with some private companies to provide licensing services to commercial vehicle drivers. Currently ATA is also working with the division of motor vehicles to privatize the issuance of truck and trailer registration through the association. We believe there are many examples where privatization makes sense and again would ask that you pass this bill. Thank you very much for your consideration and we would be happy to answer any questions.

Sincerely,



Frank J. Dillon
Executive Director



**PUBLIC
EMPLOYEES**



February 11, 1997

DON VALESKO
Business Manager

VALERIE K. BAFFONE
Secretary/Treasurer

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(907) 452-5024

710 West 9th Street
Juneau, Alaska 99801
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(907) 586-6993

Senator Jerry Ward
State Capital
Juneau, Alaska

Dear Senator Ward:

Public Employees Local 71 has looked at your proposed legislation for a Privatization Task Force, SB 68. We are willing to support SB68 but would like to see language to seat representatives from the affected labor organizations on the task force.

Local 71 believes that with fair representation from all concerned with privatization on the Task Force, the issue should be resolved.

Local 71 looks forward to working with the Task Force if SB68 is enacted.

Sincerely,

Don Etheridge, Business Representative

Board keeps controversial
book in schools

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Power plan all dried up

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Cougars
slide to
the top

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Elect the attorney general?

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Alaska Star

VOLUME XXVII, Number 7

24 pages plus inserts Successor to Chuglak-Eagle River Alaska Star

February 20, 1997

Privatization movement gains momentum in Juneau

By DEANNA THOMAS
Alaska Star Reporter

Pledging to make state government "smarter and smaller", Sen. Jerry Ward has introduced a bill that would require the state to start looking at privatizing all departments of state government.

If the bill is passed, the Legislature will form a task force that will be charged with analyzing the possibility of privatization in state government. To ensure all areas of government and the private sector are fairly represented, the composition of the task force would have to be approved by the governor.

"The public's interest is foremost. With budget deficits facing Alaska in recent years, privatization would force government to examine various types of cost-saving ideas," Ward said. "This will help deter the need for new taxes while making government more effective."

Ward said the task force will only recommend privatization if the service can be "done cheaper and as well as or better than private businesses."

While Ward said he doesn't expect entire departments to be turned over to private businesses, he said jobs within the departments would probably be better done through contracting.

For example, Ward said the state could contract out catering services for Alaskan prisons or snow plowing services for state highways. This, he said, could save the state money in maintenance fees and employee overhead.

Although Ward said he expects some state employees to be upset with his plan, he said the Alaska State Employees Association has been supportive of the bill and has only requested that a representative of the union be on the task force.

"They have no fear whatsoever of matching themselves against private enterprise," he said.

Ward said he has made it clear to the union that the bill's goal is "not to eliminate state employees." Instead, Ward said he only wants the task force to "get the hard dollars and take a look at them."

The task force would split its work into two years. This year, the task force would look at privatization in the departments of corrections, transportation, health and human services and public facilities. All totalled, the state spends \$1.4 billion on these four departments, Ward explained.

The second year, the committee would analyze the remaining state departments. Once the task force has come up with its results, Ward said "the report will be a road map for the future."

If approved, Alaska would be the 42nd state to create a privatization task force. Meanwhile, debates have been brewing over whether prisons and the Alaska Railroad should remain in state hands or be turned over to private enterprise.

Alaska State Legislature

Senate

JERRY WARD


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Memorandum

To: Representative Jeannette James
Chair, House State Affairs Committee

From: Senator Jerry Ward 

Re: Request for hearing CSSB 68

Date: April 7, 1997

OK

Please schedule, at your earliest convenience, CCSB 68 to be heard by the House State Affairs Committee. CSSB 68 calls for the creation of a task force to study privatization of all state agencies and departments. This task force will consist of members of the House, the Senate, the Administration, collective bargaining units and the private sector.

I have attached a sponsor statement and some backup information for your committee packets. Please let my staff person, Craig Johnson, know if we can provide additional information.

Thank you.

Senate Finance

SB 68

Privatization

Studies

and

Information

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ALASKA STATE
HOSPITAL & NURSING HOME
ASSOCIATION

February 13, 1997

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Alaska State Senate
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Laraine L. Derr
President/CEO

**PUBLIC
EMPLOYEES**



February 11, 1997

DON VALESKO
Business Manager

VALERIE K. BAFFONE
Secretary/Treasurer

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710 West 9th Street
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(907) 586-6993

Senator Jerry Ward
State Capital
Juneau, Alaska

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Sincerely,



Frank J. Dillon
Executive Director





AMERICAN CONSULTING
ENGINEERS COUNCIL

CONSULTING ENGINEERS COUNCIL OF ALASKA

March 4, 1997

Senator Jerry Ward
Alaska State Legislature
State Capital (MS 3100)
Juneau, Alaska 99801-1182

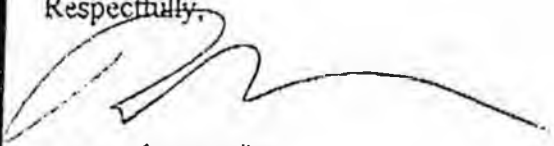
RE: SENATE BILL NO. 68 - PRIVATIZATION

Dear Senator Ward:

The Consulting Engineers Council of Alaska supports your SB 68 privatization bill. We represent 32 consulting engineering firms in the State of Alaska. Our national organization represents over 4200 firms in 51 States with approximately 130,000 employees. Both at the State level and the National level our organization supports design services being provided by the private sector because we feel it is more cost effective and brings to the projects an opportunity for a greater range of experience in the many fields of engineering that are needed in most design projects.

We congratulate you for trying to get the State to move towards more privatization in design services. Again we offer you our support for your bill.

Respectfully,



Rupert G. Tart, Jr.
President

D/F: 0304WARD.LTR



ALASKA STATE EMPLOYEES ASSOCIATION
AFSCME Local 52, AFL-CIO

February 11, 1997

Senator Lyda Green, Chair
Senate State Affairs Committee
State Capitol
Juneau AK 99801-1182

Re: SB 68 - Task Force on Privatization

Dear Senator Green:

We are pleased that SB 68 requires that any efforts to privatize be both economical and appropriate. We heartily concur with these criteria. ASEA/AFSCME Local 52's membership is in a unique position to assist the legislature in addressing their concerns regarding long-term costs and effectiveness of public service. While public service is not perfect, it does contain mechanisms of democratic accountability. Once these civic functions are sold, it is very difficult to turn back the clock.

ASEA/AFSCME Local 52 has serious reservations about privatization. When government functions are privatized very often there is no savings to the state but simply a redirection of moneys. Instead of state spending going into the pockets of many dedicated state workers and turning over in the community, it is funneled into the pockets of a very few entrepreneurs who often take that money outside. Many corporations have found big profits in privatizing public services and although they have increased their bottom line significantly, it has benefited the economy of the recipient state very little.

ASEA/AFSCME Local 52 is convinced that the best way to achieve efficiencies in public service is labor/management cooperation. Joint initiatives and labor-management cooperation are the best route to improving services and state workers are the ones with the knowledge to make this successful.

Sincerely,

Kathy Dietrich
Business Agent - Fairbanks
ASEA/AFSCME Local 52

cc: Senator Jerry Ward, Vice-Chair ✓
Chuck O'Connell, Business Manager

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New Jersey
Governor's
Report

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Introduction

In order to reduce the tax burden on taxpayers in New Jersey, Governor Christine Todd Whitman has promised to make government leaner and smarter. The Governor's objective is to deliver to the taxpayers necessary services at the least cost.

The use of competitive contracting and privatization* can help Governor Whitman achieve this goal.

Across the country and around the world, people are turning toward competitive contracting and privatization to achieve significant savings to the taxpayers while improving the quality of services.

To investigate the ways in which New Jersey can take advantage of savings in the marketplace, the Governor formed the New Jersey Advisory Commission on Privatization by Executive Order on June 19, 1994 (appendix 1).

The Commission Chairman is Lewis M. Eisenberg, Co-Chairman, Granite Capital International Group. Commission members are Philip Beachem, Executive Vice President of the New Jersey Alliance for Action; Jane Kenny, Governor's Chief of Policy and Planning; Thomas G. Labrecque, Chairman and CEO of Chase Manhattan Bank; and Arthur J. Maurice, Vice President of the New Jersey Business and Industry Association. It was assisted by John P. Mitchell, Vice President, and Michael Esposito, Executive Vice President, both of Chase Manhattan Bank; Linda Morrison, consultant for competitive contracting; Christine Steinberg, Assistant Attorney General; Larry Weitzner, consultant; and Mark Magyar, Special Assistant to the Governor.

The Governor, in her Executive Order, asked the Commission to perform the following functions:

- 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 generally;
- Conduct a feasibility study of New Jersey state government, including a cost-benefit and implementation analysis, to identify those areas where privatization would result in cost savings and quality improvements; and
- Propose appropriate and beneficial methods of implementing privatization in this state.

The Governor further asked the Commission to suggest methods for competitive contracting that would give state employees the opportunity to compete against the private sector.

This report is the result of five months of intensive review of state operations and the input of hundreds of people from the public and private sector. A public hearing was conducted on December 8 to solicit testimony from interested parties (appendix 2).

This report provides New Jersey with a blueprint for a successful competitive contracting program. The Commission believes that implementation of these recommendations will produce lower costs to the taxpayers, better services to the public and more jobs.

The emphasis of our study was to find practical opportunities for the state to save money and maintain the quality of services through competitive contracting. The Commission believes that the state can save in excess of \$200 million by following these recommendations.

The Commission recommends that it continue to investigate areas of state government it was unable to review during 1994, and that it serve as a catalyst toward seeing its recommendations carried through to implementation in 1995. The Commission is also available to study and report on how local governments and authorities can take advantage of the savings that can be realized through competitive contracting.

In the upcoming year, the Commission plans to hold round-table discussions focused on its recommendations.

The Commission worked closely with Treasury and OMB on these and other recommendations. As a result, some recommendations are already being implemented and may be included in the upcoming budget.

* Privatization can involve the sale of an asset by a governmental entity, the contracting out of services that had previously been provided by the government, or the deregulation of an area that had formerly been government's responsibility. For the purpose of this report, "privatization" will refer generally to the transfer to the private sector of services or assets. "Competitive contracting" will refer to the process of subjecting the provision of certain services to competition by comparing the true cost of government providing those services to the private sector.

Background

For the past two decades, state government spending in New Jersey has doubled every eight years. Local property taxes have risen at almost the same rate, giving New Jersey one of the highest tax burdens in the nation. That tax burden discourages new businesses from choosing New Jersey, drives away existing businesses, and takes too many dollars out of the pockets of our citizens.

The Commission believes that competition for the provision of government services will enable state and local governments to both cut costs and maintain or increase the quality or level of those services. This has been the experience of states and local governments across the country.

During its investigation, the Commission researched the concept of privatization and examined the experience of others who used privatization. The Commission met with experts in the field, mayors, legislators, government employees, and members of Governor Christie Whitman's cabinet. The Commission reviewed books, articles, pamphlets and other materials from many researchers, other commissions, academics, consultants, local governments, state governments, and the privatization experience of other countries. Privatization or competitive contracting is routinely used by thousands of governmental units.

Governments that have subjected services to competitive contracting have seen impressive results. In an 18-month period, Philadelphia subjected 21 services to competition, achieving annual savings of \$30 million. Some of the services Philadelphia privatized included custodial services in City Hall, saving \$344,000 a year; security guard services in the Philadelphia Art Museum, saving \$1.4 million; and turf maintenance in the parks, which reduced costs over 70%.

Shortly after the city government began the privatization process for the Philadelphia Water Department's sludge processing plant, department managers and employees produced a plan to drop costs by one-third. The operation was kept in-house.

Saving money is not the only reason to privatize. Privatizing the operation of the underutilized Philadelphia Nursing Home resulted in an increase in nursing home residents served, from 295 to 500; a \$4 million drop in costs; and the elevation of quality of care to meet industry standards. Privatizing the city's purchase and distribution of supplies guaranteed that office supplies would be delivered in 48 hours instead of six weeks and saved over \$1 million annually.

Philadelphia was able to implement its competitive contracting program by attrition—and no one was left unemployed. Displaced city workers were given first hiring preference by contractors and a re-deployment unit was set up in the city's personnel department to transfer workers to open positions in other functions.

Since 1991, Indianapolis has saved \$28 million a year from operations that have been privatized or where competition has prompted public employees to find alternative cost savings.

The city of Indianapolis recently signed the largest privatization contract for the operation of a wastewater treatment plant in the United States. Private management of the plant will save \$12 million in 1994. In addition, the city bid out ten trash collection districts. Four private companies won seven districts, while the Department of Public Works won three districts. Taxpayers won a three-year savings of \$15 million.

Indianapolis worked hard to implement its competitive contracting program without leaving individual workers jobless. They eliminated positions through attrition, reassigned workers and encouraged the private firms to hire government employees.

Mayor Richard Daley of Chicago has privatized 35 services in four years, including sewer maintenance, health care at city-run clinics, drug and alcohol treatment, and window washing. In every case, costs have dropped and quality has been maintained.

Most privatization to date has been accomplished at the local level. However, there is growing interest in the concept of privatization by state governments. According to the Council of State Governments' privatization survey of 1993, states are increasing their privatization activity in correctional support services, transportation services, social services, health care, and administrative and general services. More than 85% of state auditors, budget directors, and comptrollers responding to the survey predicted increased privatization in the next five years.

In recommending ways to deal with state problems, the National Governors' Association's *Action Agenda to Redesign State Government* observed that, "Privatization enhances government's ability to respond to these challenges by offering an innovative alternative to traditional methods of organizing, financing and delivering public service."

In Michigan, the state's liquor distribution system was privatized. Three warehouses and 66 state-owned liquor stores were closed, saving \$15 million per year.

In Massachusetts, the state has privatized highway road repair, ice skating rinks, a state mental health hospital, and prison food and health services.

The Texas legislature created a permanent Council on Competitive Government and directed it to review state services to determine whether competition would improve productivity. A new Texas law allows private firms to make unsolicited proposals to provide state services. Government agencies are then required to conduct an analysis and seriously consider the alternative presented.

National governments have also been successfully privatizing. Since 1980, Great Britain has been a leader in all forms of privatization, most notably its airports. British privatization efforts have transferred numerous state-owned companies back to the private sector, transferred ownership of public housing units to their tenants, and contracted out many municipal services. In 1988, the Compulsory Competitive Tendering Act was passed, requiring local governments to put services out to bid on a regular basis. Overall, 64% of British local government units saw some decrease in costs due to contracting out: 16% realized savings of over 20%, and 24% realized savings of 10-20%. This strategy has produced a number of useful indirect benefits, including better cost information and better management practices.

The city of London has the world's largest system of competitively-contracted bus service, with more buses under contract than are operated by all U.S. transit agencies except New York. Almost 50% of London Transport bus service is competitively contracted. Many contracts have been won by government managers and employees. As a result, both contracted-out and in-house bus costs per mile have declined more than 25% and service quality has improved.

Closer to home, in Mercer County, County Executive Bob Prunetti saved \$6 million by privatizing custodial services and maintenance for county buildings, food service at the jail, and the county engineering department. Public employees were offered jobs with the private firms or other government agencies. Bergen County Sheriff Jack Terhune saved \$1.8 million by contracting out food and medical service at the jail.

The township of North Brunswick has saved \$1.6 million since 1985, as a result of contracting out its water treatment operation. The borough of Caldwell saved taxpayers 33% on operating costs for their wastewater treatment plant through competitive contracting. Newark contracted out the operation and maintenance of its water treatment facility and cut annual costs by \$1 million.

The evidence is overwhelming that injecting competition in the provision of government services produces typical savings of 15-25%, while maintaining or increasing service quality.

Implementing a Competitive Contracting Program

AVOIDING THE PITFALLS

While the Commission reviewed many successful examples of privatization at all levels of government, some efforts did not deliver as promised. Although the Commission believes that these unsuccessful examples are the exception rather than the rule, they do provide some important lessons for any government agency considering privatization.

Public employee unions brought to the attention of the Commission instances where competitive contracting efforts were plagued by unqualified contractors, contracts that were ultimately more costly than if the service had remained in-house, poor contractor performance, and cutbacks in service. The unions emphasized that they should be included in efforts to improve service and save money, and they expressed their concerns about the potential negative impact of privatization on individual union members.

These are all serious concerns. Competitive contracting only makes sense if it can save the taxpayer money without diminishing the level of service.

The Commission concluded that, in most instances where privatization had not succeeded, the failure was directly attributable to a complicated process, inadequate planning, and a lack of quality control on the part of top management. Most of the mistakes were found in the following areas:

- The lack of good cost information on which to base decisions.
- Poor procurement procedure—especially regarding performance standards, contractor qualifications and contract monitoring.
- Assuming that privatization is always better and not giving in-house managers and employees an opportunity to improve their operation and keep the work.
- Poor implementation plans, especially regarding the impact of contracting out on existing employees.

However, the Commission believes that intelligent management of a competitive contracting program will ensure that these errors are avoided.

To avoid the possibility that one private contractor could hold unreasonable control over the provision of a service, competitive contracting should be attempted only where a sufficient pool of qualified bidders exists.

Quantifiable and measurable performance standards should be established and the contractor's performance should be carefully monitored.

Public employees currently providing a service should be given the opportunity to compete with private bidders. If a contract is awarded to an outside provider, any employment changes due to competitive contracting should be implemented in a manner that mitigates any negative impact on employees.

As the state moves forward on particular initiatives recommended in this report, special attention should be given to the following:

1. Cost Accounting

During its investigation, the Commission heard concerns about accurate and complete cost accounting. New Jersey State Senators Richard LaRossa and Peter Inverso were persuasive advocates for reliable and complete cost analysis in any competitive contracting program. They stressed, and the Commission agrees, that the state must have a good idea of its internal costs before awarding any contracts to private providers.

Cost analysis is a methodology used to determine the cost of providing goods or services. Total cost is defined as all direct and indirect (overhead) costs attributable to the service being analyzed. The major categories of direct costs are salaries, wages and overtime, fringe benefits, supplies and materials, equipment, purchased services, maintenance and repair, rent, utilities, insurance, and equipment and service monitoring costs.

2. Intelligent and Competitive Purchasing Process

In order to receive good service at a good price, the state must do a good job putting the service out for competition. The state must have a clear idea of the desired end-results, establish quantifiable and measurable performance standards, develop a contract monitoring plan, and consider only qualified contractors with good references. The state must make sure the contract's structure makes sense—especially concerning the size of the contract, how it is priced, and the length of the contract. Evaluation criteria should stress quality as well as price.

3. Allowing the In-House Operation to Compete

The Commission's investigation of efforts in other jurisdictions revealed that subjecting a service to competition provides a real incentive for the existing operation to make itself more efficient.

Departmental managers, employee union representatives, departmental fiscal officers, budget analysts, and others should work closely to formulate a plan that responds to the expected competition.

This may be the best time to employ Total Quality Management and Work Process Improvement procedures to respond to competition. We suggest these strategies be reviewed simultaneously with the bidding process.

RECOMMENDATIONS

Summary of Savings

Initiative	Estimated Annual Savings
1. Newark Airport	To be determined
2. Garden State Arts Center	To be determined
3. Toll Road Operations	To be determined
4. Inmate Health Care	\$16.1 million
5. Prison Food Service	\$14.4 million
6. Inmate Commissary	\$500,000
7. Prison Operations	\$7-14 million
8. Prescription Drugs	\$40 million
9. Medical Savings Account	\$25 million
10. Flexible Benefit Program	\$15-37 million
11. JUA/MTF Claims Settlement	\$50 million
12. Motor Vehicle Services	\$3-6 million
13. Technology	\$70 million
14. Revenue Collection	To be determined
15. Wastewater Treatment Plants	\$1 million
16. Capital Transportation Projects	To be determined
17. Veterans Memorial Home	\$3 million
18. Sports Authority	To be determined
19. Passaic Valley Sewerage Commission	To be determined
20. Miscellaneous Competitive Contracting Proposals	\$30 million

4. Implementation by Attrition

The most successful programs were implemented with the goal of minimizing the impact on affected employees. As much as possible, the state should implement job changes caused by competitive contracting through attrition. The state should offer workers displaced by competitive contracting "first hiring preference" for open positions in other areas of government and provide training, if necessary. In addition, every effort should be made to ensure that contractors give "first hiring preference" to existing state employees. For those for whom jobs cannot be found, the state should develop a severance pay system and an outplacement support program to help displaced workers make the transition to other work.

5. Legislative and Legal Issues

A close evaluation of all the legal issues relevant to any privatization or competitive contracting initiative discussed in this report will be necessary as specific proposals are developed. In some instances, legislation may be needed to facilitate the implementation of a particular program or initiative. In cases where an asset or improvement was acquired or constructed with the proceeds of a tax-exempt financing, the potential impact of any proposed initiative on the holders of any outstanding bonds should be considered. In such cases, restrictions imposed by current federal tax laws and subsequent rulings must be considered to preserve the tax-exempt status. In addition, the requirements of existing contracts and federal laws and regulations must be evaluated.

Newark Airport

BACKGROUND

Newark Airport is operated by the Port Authority of New York and New Jersey (PA) under a long-term lease with the city of Newark. The land in Elizabeth is owned by the PA. A majority of the terminals and parking are on land owned by Newark and leased to the PA.

25.8 million passengers used Newark Airport in 1993, up 6% over the previous year. It is one of the most trafficked airports in the country (JFK had 26.8 million passengers in 1993, down 3%).

Newark Airport generated a profit of \$52 million to the Port Authority in 1993.

Federal law restricts airport profits from being used for anything other than the airport. The Port Authority is exempt from this law and uses profits to subsidize money-losing operations such as PATH.

Many of the functions in the airports are operated by private contractors under contract with either the PA or individual airlines.

Airports operated by private firms include Burbank, Atlantic City, Stewart and Teterboro. No major U.S. airport is currently owned or operated by a private company.

CURRENT SITUATION

Private airport operators believe that they can operate the airport more efficiently and at a lower cost than the Port Authority. One private operator estimated a savings of at least 20% is possible.

Private operators at other airports have had great success in improving revenues by expanding retail operations.

The Reason Foundation and other research groups have argued that the private sector can improve the quality of airport operations—manage flight times better, attract new investments to the airports and improve the quality of service.

The British have had great success in privatizing their ten airports. Indianapolis issued an RFP to private firms to operate their airport for a term of up to ten years under a lease or management contract basis (Indianapolis serves 3 million passengers a year and would be the largest U.S. airport privately operated). Pittsburgh has improved its operations through private management and generated additional revenue by aggressive marketing of their retail operations.

Opponents of privatization argue that the Port Authority has successfully operated Newark Airport for many years. It is a growing and highly profitable enterprise. If it's not

broke—why fix it? They also argue that a private firm may not have the region's long-term interest at heart and may not be willing to make necessary capital investments.

Los Angeles and Albany both failed in efforts to sell their airports to the private sector, due, partly, to opposition from the FAA, airlines and unions.

CONCLUSIONS AND RECOMMENDATIONS

Given the short-term obstacles, selling the airport is an option that should not be pursued at this time.

The Commission recommends that the Port Authority finance a three-to-six month study of opportunities for improving airport operations through either a lease or management contract with a private airport operator. The study might be a coordinated effort among the PA, the Governor's office and the Commission.

Subject to the above study, if significant savings can be realized and we are assured of quality management, operation of Newark Airport should be subjected to competition.

The Port Authority should be allowed and encouraged to compete for this contract. If the PA wants to bid, a procedure would be needed to allow for a fair evaluation of their proposal as compared to the private proposals.

Under a management agreement, the PA might retain responsibility for bonding and for capital and long-term planning. The private firm could be charged with the responsibility of management of the airport and the related construction program.

A management contract would require the approval of the Board of the Port Authority and Governors Whitman and Pataki.

Garden State Arts Center

BACKGROUND

The Garden State Arts Center is operated by the New Jersey Highway Authority. When opened 27 years ago, this was a state-of-the-art amphitheater and very successful in attracting talent. However, in order to remain competitive in today's environment it will need to increase its current capacity of 10,802 (5,300 of which are under cover) by 10,000 to 20,000 additional seats.

The limited seating capacity has made attracting talent more difficult, led to higher ticket prices, and resulted in flat revenues and minimal profits for the past three years. This problem will only get worse as the facility obsolescence increases over time.

The trend in the amphitheater business is toward partnerships where government provides the land and infrastructure, and the private sector manages the amphitheater and takes the business risks.

Below are some examples:

Facility	Location	Operated by
Blossom	Ohio	M.C.A.
Nassau Veteran Coliseum	Long Island	Spectator Mgmt. Group (SMG)
Louisiana Superdome	Louisiana	SMG
Jones Beach Theater	Long Island	Delsner/Slater
Hartford	Connecticut	Nederlander Group
Camden	New Jersey	Sony/Pace

CURRENT SITUATION

The New Jersey Highway Authority has recently completed a Request For Proposals (RFP) designed to competitively contract/privatize their facility. The Authority left open the RFP options of sale versus long-term lease and whether or not alcohol will be sold.

The Highway Authority hopes to receive an annual fee from a successful bidder plus an additional override based on "real" profits.

CONCLUSIONS AND RECOMMENDATIONS

The Garden State Arts Center is an ideal opportunity for competitive contracting/privatization. The Arts Center is in need of a significant capital infusion to compete and continue to offer quality entertainment at reasonable cost to the residents of New Jersey. Successful competitive contracting/privatization of the facility to a private sector entrepreneur will provide private capital and could create a significant revenue source for the Authority.

Private investment is likely to benefit everyone—the taxpayers, the Arts Center customer, the state government, and the entrepreneur.

The Commission commends the Highway Authority for moving forward with the evaluation of privatization options for the Arts Center and for making the RFP as flexible as possible to ensure the maximum level of private sector interest in the project.

TIMELINE FOR IMPLEMENTATION

Earliest implementation 1996.

ESTIMATED SAVINGS

Undetermined at this time.

Toll Road Operation and Maintenance

BACKGROUND

New Jersey has three toll roads operating under state-created authorities. The South Jersey Transportation Authority operates the Atlantic City Expressway. The Turnpike Authority operates the New Jersey Turnpike. The New Jersey Highway Authority operates the Garden State Parkway.

The 1994 revenues of the South Jersey Transportation Authority were approximately \$30 million, expenses were about \$25 million, debt service was approximately \$5 million. A payment of \$2.5 million was paid to the state for the Transportation Trust Fund.

For 1994, the New Jersey Turnpike Authority's revenues were approximately \$345 million, operating expenses were about \$177 million, debt service was \$155 million and \$12 million was paid to the state for the Transportation Trust Fund.

The New Jersey Highway Authority operates the Garden State Parkway and the Garden State Arts Center. Annual revenues for the Parkway were approximately \$185 million, annual expenses were approximately \$123 million. Annual revenues for the Arts Center were \$13 million and expenses were \$11 million. Interest income was \$7 million, debt service was \$51 million, and \$10 million was paid to the state for the Transportation Trust Fund.

Because of stagnating revenues, rising operating costs and increasing debt payments, the toll roads are coming under increasing pressure to raise tolls.

CONCLUSIONS AND RECOMMENDATIONS

The Commission believes that private operation of the toll roads could reduce costs and increase revenues while maintaining or improving service. The savings from private operation might reduce the need for future toll hikes. Electronic toll collection and other new technologies that would improve customer service may be introduced sooner and at less cost by private contractors.

New roads in California and Virginia are being constructed, operated and maintained by the private sector. In Florida, the Orlando County Expressway Authority is contracting with Parsons Brinkerhoff to operate and maintain the expressway and beltway in Orlando.

The toll roads should explore private sector alternatives by soliciting privatization proposals from qualified, financially-strong private operators.

The scope of services for a private operator needs to be determined, but the Authority could retain title to the real estate and approval over toll and pricing policies.

Alternatively, the Authorities could consider contracting out further operations, such as toll collection and road maintenance.

An RFP, which contains performance standards and contract monitoring procedures, should be issued to qualified operators. The in-house managers and employees can be encouraged to submit a plan to be competitive with anticipated private contractor proposals. The Authority should award the contract to qualified private contractors if the Authority receives a proposal that would reduce costs without reducing the quality of service.

TIMELINE FOR IMPLEMENTATION

1-2 years.

ESTIMATED SAVINGS

If the Authorities were able to reduce costs by 10-15% and increase revenues 5-7%, substantial savings would be achieved.

Inmate Health Care

Department of Corrections

CURRENT SITUATION

The Department of Corrections operates 14 prison facilities dispersed throughout the state. A preliminary cost analysis shows that health care for 20,000 inmates housed in state facilities is approximately \$70 million. Inmates who need hospitalization are transported at considerable expense to a unit in St. Francis Hospital in Trenton. The annual per-inmate cost of the present in-house system is approximately \$3,500.

In the last ten years, a corrections health care industry has developed. There are a number of experienced, reputable and financially-sound competitors who would respond to an RFP. Corrections systems which have contracted out health care report significant cost savings and/or increases in service quality.

CONCLUSIONS AND RECOMMENDATIONS

The Commission believes that subjecting the provision of prisoner health care to competitive contracting would substantially reduce the cost to taxpayers of providing this service without sacrificing the quality of the service.

Massachusetts and the city of Philadelphia are among the many prison systems that have contracted out prison health care.

An RFP, which contains performance standards and contract monitoring procedures, should be issued to qualified operators. The in-house managers and employees can be encouraged to submit a plan to be competitive with anticipated private contractor proposals. The Department should award the contract to qualified private contractors if the Department receives a proposal that would reduce costs without reducing the quality of service.

TIMELINE FOR IMPLEMENTATION

An RFP could be issued by March 1 and a contract awarded by November 1.

ESTIMATED SAVINGS

Savings of \$16.1 million per year could be realized were the state able to reduce its per-inmate cost to \$2,700 through competitive contracting.

Prison Food Service Department of Corrections

CURRENT SITUATION

The Department of Corrections operates 14 prison facilities dispersed throughout the state. Preliminary cost analysis shows that the Department serves approximately 24.5 million meals to 20,000 inmates and 7,000 staff at a cost of approximately \$45 million or \$1.84 per meal. Inmates are trained and supervised in the preparation of meals. The Bergen County Sheriff's Department reported to the Commission that their service was contracted out at a cost of \$1.09 per meal.

The corrections food service industry is well-developed. There are a number of experienced, reputable and financially-sound competitors who would respond to an RFP. Correction systems which contracted out food service report significant cost savings, increase in service quality, and enhanced inmate culinary training programs.

CONCLUSIONS AND RECOMMENDATIONS

The Commission believes that subjecting the delivery of food service to competitive contracting would substantially reduce the cost to taxpayers of providing this service without sacrificing the quality of the service. The experience of Bergen and Mercer counties and other government jurisdictions shows that this service can be provided at costs well below what the state is now paying.

The Commission recommends a cost accounting be completed, showing all costs of delivering the service including service monitoring costs. An RFP, which contains performance standards and contract monitoring procedures, should be issued to qualified operators. The in-house managers and employees can be encouraged to submit a plan to be competitive with anticipated private contractor proposals. The Department should award the contract to qualified private contractors, if the Department receives a proposal that would reduce costs without sacrificing quality.

TIMELINE FOR IMPLEMENTATION

An RFP could be issued this spring and a contract awarded by January 1, 1996.

ESTIMATED SAVINGS

Savings could reach \$14.4 million per year based on \$1.25 per-meal cost.

Inmate Commissary

Department of Corrections

CURRENT SITUATION

The Department of Corrections operates 14 prison facilities dispersed throughout the state. Currently, the Department maintains 14 separate commissary operations that sell a variety of items such as toothpaste, cigarettes and potato chips to its 20,000 inmates. The commissaries are "pick and bag" systems where inmate workers select merchandise from a written order form. The merchandise is put in a bag by prison workers and is either delivered to individual inmates in their cells or picked up at a centralized location. State employees purchase the merchandise and handle the book-keeping and accounting for commissary transactions.

A preliminary review of the revenues and costs of the present system shows that these 14 commissaries are run at approximately break-even.

The corrections commissary industry is well developed. There are a number of experienced, reputable and financially-sound competitors who would respond to an RFP. Private commissary operators have been able to save other states money by taking advantage of their nationwide buying power. Private operators also employ sophisticated systems for ordering, inventory management and inmate account processing. Correction systems which have contracted out commissary services report increases in service quality, lower costs and additional income from more profitable sales.

CONCLUSIONS AND RECOMMENDATIONS

The Commission believes that subjecting the operation of commissary service to competitive contracting would substantially reduce the cost to taxpayers of providing this service without sacrificing the quality of the service.

It is also likely that the commissaries can be run more profitably by a private firm. Private commissary operators typically sign concession agreements where they are allowed to sell personal items to inmates and the prison system receives a percentage of the sales.

The Commission recommends a cost accounting be completed, showing all costs of delivering the service including service monitoring costs. An RFP, which contains performance standards and contract monitoring procedures, should be issued to qualified operators. The in-house managers and employees can be encouraged to submit a plan to be competitive with anticipated private contractor proposals. The Department should award the contract to qualified private contractors, if the Department receives a proposal that would reduce costs and increase profits without sacrificing quality.

TIMELINE FOR IMPLEMENTATION

An RFP could be issued by May 1, 1995 and a contract awarded by February 1, 1996.

ESTIMATED SAVINGS

Savings could be realized through increased revenues of about \$500,000.

Prison Operations

Department of Corrections

CURRENT SITUATION

The Department of Corrections operates 14 prison facilities dispersed throughout the state. There are approximately 20,000 inmates. Bayside State Prison in Cumberland County is a combined medium- and minimum-security prison with a population of approximately 2,000 inmates and operating costs of approximately \$52.6 million per year. Mid-State Correctional Facility in Burlington County is a medium-security prison with a population of 570 inmates and an annual operating cost of approximately \$21.5 million. A new prison in Bridgeton is being constructed for 3,000 inmates and is due to be completed in 1997.

Prisons are being operated by private firms in several states, including Texas, Florida, California, New Mexico, Arizona, Kentucky and Mississippi.

In the last ten years, a private corrections management industry has developed. There are a number of experienced, reputable and financially-sound corrections management firms which would respond to an RFP. Correction systems which have contracted out specific prisons report significant cost savings and/or increases in service quality.

CONCLUSIONS AND RECOMMENDATIONS

The Commission believes that subjecting the operations of prisons to competitive contracting would substantially reduce the cost to taxpayers of providing this service, without sacrificing the quality of the service.

The Commission recommends that a cost accounting be completed for both Bayside and Mid-State, showing all costs of delivering the service including service monitoring costs. An RFP, which contains performance standards and contract monitoring procedures, should be issued to qualified and experienced operators. Great care should be taken in this procurement process to allay concerns about public safety and loss of control to an unqualified contractor.

The in-house managers and employees should be encouraged to submit a plan that would be competitive with anticipated private contractor proposals. The Department should award the contract to qualified private contractors if the Department receives a proposal that would substantially reduce costs without sacrificing public safety.

An RFP should be issued in 1997 for the operation of the newly-constructed state prison in Bridgeton.

TIMELINE FOR IMPLEMENTATION

An RFP could be issued by June 1, 1995 and a contract awarded for Mid-State and Bayside by February 1, 1996.

ESTIMATED SAVINGS

It is difficult to estimate savings because each prison facility is unique. The Department will not know what savings or operational improvements are possible until an RFP is issued and qualified contractors respond. However, based on the experience of other governments, savings of 10-20%—or \$7-14 million—may be realized by subjecting both Bayside and Mid-State to competition.

Millions in avoided future costs might be saved by private operation of Bridgeton.

Prescription Drug Management Program

BACKGROUND

Prescription drugs represent one of the fastest growing cost components of the health care network. Management of prescription drug costs is common in the private sector. These programs typically save between 10% and 15% of prescription drug expenditures while improving monitoring of patient drug use. An estimated 47 of New Jersey's top 100 employers utilize prescription drug benefit management.

Benefit management reduces overall costs to government for prescription drugs and minimizes the opportunity for fraud and abuse.

CURRENT SITUATION

New Jersey governments subsidize prescription drug costs in various programs with no managed benefit system. These programs include Medicaid (\$165 million/year) and Pharmaceutical Assistance to the Aged and Disabled (\$169 million/year). State government has successfully applied managed benefit techniques in the government employee New Jersey Prescription Drug Program (\$67 million/year). There are, however, 300,000 government employees and 145,000 government retirees who do not participate in the New Jersey Prescription Drug Program and who may not receive the cost and service benefit of managed prescription drug benefits.

Drug manufacturer rebates are provided to state government in the Medicaid and PAAD programs. Even with these rebates—which equaled \$77 million for state purposes in the latest year—New Jersey's average prescription costs are higher than the industry average, due, in part, to less use of generics and higher provider compensation than in the private market.

CONCLUSIONS AND RECOMMENDATIONS

The Commission recommends that a prescription drug benefit management be implemented in all government prescription drug programs along the following lines:

- All pharmacists should be allowed access into any prescription benefit network as required under state "willing provider" legislation.
- State requirements for network access should exceed federal Medicaid standards providing maximum choice for recipients.
- Utilization reviews should be mandated under a prescription benefit program.
- The benefit managers should assure access to necessary medication. However, incentives should be created to encourage use of preferred drugs.

Medical Savings Accounts

BACKGROUND

The state's Health Benefit Plan covers approximately 310,000 employees—active and retired—in state government, school boards, municipalities, agencies, authorities and counties. Benefit costs are one of the single highest expenditure categories in the state budget.

Currently, the choices offered are traditional indemnity insurance with a low deductible and HMO-type plans where choice in care is limited. This coverage costs \$7,000 per family for an indemnity plan and \$6,000 for an HMO-type plan.

Under the current system, there is almost no incentive for the individual employee to shop for the best price and care or to limit the amount of care purchased.

CURRENT SITUATION

In the last few years, a growing number of private and government organizations have used Medical Savings Accounts to lower employee health care costs, including the Golden Rule Insurance Company of Indianapolis, Forbes, the Spurwink School in Portland, Oregon, and the United Mine Workers of America.

A typical plan works like this:

1. The employer purchases a high-deductible (\$2,000–\$3,000) catastrophic insurance policy for the employee. The premiums on these policies could be 40% lower than the premiums on low deductible policies.
2. The employer deposits the amount of the deductible in a special account for the employee to spend on medical expenses, including IRS-recognized care such as eye care, dental, physicals, preventive care, etc. The employee has total freedom in choosing who delivers the care. If the employee does not spend the full amount, the employee can keep the difference.

CONCLUSIONS AND RECOMMENDATIONS

Medical Savings Accounts will give power to consumers who will benefit financially from prudent spending. Medical Savings Accounts would turn the present incentives around, giving state employees the fruits of controlling health care costs. Benefit costs can be lowered without reducing the quality of health care.

The state should carefully review the experience of others who have used Medical Savings Accounts, and tailor a plan that would provide good medical coverage for employees and significantly reduce costs.

TIMELINE FOR IMPLEMENTATION

The Commission estimates that an agreement to establish Medical Savings Accounts could be negotiated with employee unions, necessary statutory changes made, and a new program implemented before the end of 1995.

ESTIMATED SAVINGS

Estimate: 5% savings of current costs. Savings to state budget: \$25 million.
Savings to other budgets: \$41 million.

Flexible Benefit Programs for Government Employees

BACKGROUND

New Jersey state government does not offer flexible benefit, or so-called "Section 125" cafeteria plans for its employees.

In their simplest form, these plans, which are common in the private sector, allow employees to make payroll contributions on a tax-deductible basis for health care and dependent care/child care spending accounts. The employee reduces his or her taxes and has money available to pay health care deductibles/copayments and other out-of-pocket expenses for child care. Employers save because no employer Social Security taxes are paid on amounts employees contribute to these plans.

Another advantage of flexible benefit plans is that they facilitate the offering of health insurance opt-out programs to government employees whose spouses have duplicative health insurance coverage.

There is a mature industry of vendors experienced in establishing flexible benefit plans for the private and public sectors who can craft plans that will maximize employee benefits and employer savings.

Health insurance opt-out programs encourage employees to drop duplicative health insurance policies where a family member also has coverage. The financial savings are great for employers who share their savings with participating employees in the form of incentive payments.

CURRENT SITUATION

Flexible benefit plans are common in the private and public sector. According to a recent national survey of private and public sector organizations with 1,000 or more employees, 59% of organizations offered health care spending accounts and 60% of organizations offered dependent care accounts.

The two most common flexible benefit plan programs—tax-free payroll contributions to health care spending and dependent care accounts—are popular options with employees that also reduce employer Social Security tax payments (typically 7.65% on most of the employee payroll contribution).

New Jersey is one of only two states that has not conformed its state tax law with federal tax code as regards health insurance opt-out plans. In New Jersey, an employee can be taxed on the value of the opt-out incentive payment even if the employee does not opt to take the incentive payment. The federal government and 48 states only tax the incentive payment, if received.

Many local governments would like the ability to offer "full service" flexible benefit plans to their employees. The program is supported by the League of Municipalities and the Association of Counties.

CONCLUSIONS AND RECOMMENDATIONS

The Commission recommends that:

- New Jersey law be modified as needed to permit governments to offer a full range of flexible benefit options to government employees;
- State government offer, at a minimum, health care and dependent care spending account options with a corollary incentive program to allow employees to opt out of duplicative health insurance coverage;
- The legislature move to enact legislation conforming the state tax code to the federal code as regards health insurance opt-out payments.

TIMELINE FOR IMPLEMENTATION

An RFP for health plan administrative services was issued in November 1994. Procurement of an administrator to establish and operate a flexible spending account could occur shortly. This program could start in 1996.

ESTIMATED SAVINGS

Applying the typical plan design and employee participation rates found in existing flexible benefit plans to New Jersey state government results in annual savings estimates of between \$15 million and \$37 million, once the plan is fully utilized.

JUA/MTF Automobile Insurance Claim Pools

BACKGROUND

The New Jersey Full Insurance Underwriting Association (JUA) and its successor, the New Jersey Market Transition Facility (MTF), were insurance companies created by state government to write "bad driver" policies. The companies stopped writing policies in late 1993. However, there are outstanding claims estimated at \$1.5 billion that must be settled and another \$500 million of deferred claims that must be paid.

CURRENT SITUATION

The JUA and the MTF have separate, duplicative administrative staffs and will spend approximately \$30 million during 1995 and 1996 on administration. Beginning in 1997, administrative costs will drop dramatically as the number of open claims decline.

Presently, 19 servicing carriers settle claims for the JUA/MTF. Servicers are compensated a set claim fee that varies by type of claim. There are no economic incentives for servicers to seek to reduce claim costs. Servicers are also compensated for direct expenses which have averaged \$11 million per month for the past year.

CONCLUSIONS AND RECOMMENDATIONS

The Commission believes the present system does not provide sufficient control nor incentives to reduce cost. Such controls and incentives could best be provided by private administrators.

The Commission recommends the following actions:

- The Department of Insurance should competitively consolidate and contract the management of the JUA and MTF pools;
- The private manager should negotiate termination contracts with inefficient carriers and be prepared to take over any remaining claims;
- The private manager should be given incentives to cost-effectively manage claim settlements and expense requests.

TIMELINE FOR IMPLEMENTATION

An award to administer the program could be made in four months. However, implementation of the full plan with removal of inefficient carriers may take longer.

ESTIMATED SAVINGS

Savings occur from several actions. Consolidating administration of the two pools would save \$4 million. Exit payments representing refunds of servicing fees paid in advance to terminated carriers could approximate \$7 million. Assuming a 3% improvement in claim cost settlements, a 10% reduction in expense reimbursements, and competitive vendor incentive payments, bringing in a qualified manager should produce savings of \$40 million. These estimated savings total approximately \$50 million.

Motor Vehicle Services

BACKGROUND

In most states, vehicle inspection is provided by licensed private garages. New Jersey is one of only three jurisdictions with a government-operated motor vehicle emissions and safety inspection system, although New Jersey also permits private inspection as an adjunct to its centralized system. New Jersey is presently negotiating with the federal Environmental Protection Agency (EPA) over changes in the vehicle emissions testing program to ensure compliance with the federal Clean Air Act. Nationwide, a private industry exists that specializes in the establishment, management and construction of enhanced systems to provide the required inspection services.

Because this is a new program, any changes will increase system capital and operating costs.

CURRENT SITUATION

New Jersey presently has 35 vehicle stations with 86 vehicle inspection lanes, operated at a cost of approximately \$30 million annually. This state-operated system is staffed with 600 employees. Additionally, there are about 4,000 private inspection centers that perform about 25% of all inspections.

New Jersey's experience with private inspection stations has been a success. Motorists are familiar with the program; licensed private garages have successfully performed inspections and repairs; and motorists have favored the convenience option this provides to them. However, federal mandates limit the ability of combined inspection/repair private facilities to fully participate in the program. Although under the Clean Air Act inspection/repair private facilities will continue to play a role, EPA requires New Jersey to operate a centralized system for Clean Air Act inspections.

The state's Division of Motor Vehicles has explored competitive contracting options for this centralized system.

CONCLUSIONS AND RECOMMENDATIONS

The Commission recommends that New Jersey competitively contract operation of its state-operated emissions inspection system by including the following in the RFP:

- One or two vendors to operate the system.
- A 5-10 year contract, with determination of optimum number of lanes/locations based on state performance standards.
- Vendor lease or ownership of state-owned facilities, with rehab of lanes performed by the vendors.

- Vendor acquisition of new facilities/lanes; title transferred to state at end of contract.
- Vendor option as to policy vis-a-vis current employees, with a minimum requirement that current employees receive hiring preference.
- Minimizing of driver inspection fees.

However, the Commission recommends that the above not be included in statute, so managers can maintain maximum flexibility. The Commission also recommends continuation of the combined inspection/repair private option in the state's reconfigured emissions control system.

TIMELINE FOR IMPLEMENTATION

Much of the groundwork for drafting of an RFP has been accomplished. Therefore, the process can begin without undue delay. The following schedule is achievable:

RFP response preparation	3 months
Proposal evaluation and selection	3 months
Protest period/contract award	4 weeks
Implementation	12 months

ESTIMATED SAVINGS

Competitive contracting of existing emissions inspections will reduce annual state spending by approximately 10-15%, or based on the present system, a \$3-6 million savings.

Savings estimates do not include avoided operations and capital costs related to compliance with the Clean Air Act. Privatization of the Clean Air Act emissions system may provide an additional opportunity for savings.

Technology

BACKGROUND

State government's use of technology is extremely complex. The total scope of technology and the costs associated with it are not readily available. The Office of Telecommunications and Information Services (OTIS) is the central data center and has a budget of \$89 million. Their budget is exclusive of a variety of direct costs (i.e., employee benefits, depreciation, rent, etc.) which would normally be included in cost estimates developed by the private sector.

The growth of technology in state government has occurred without the benefit of a strategic game plan. This has created inefficiencies and promoted the expansion of technology related activities outside of OTIS. Estimates are that in excess of \$200 million per year is spent on technology in the State Department outside of OTIS. It is possible that this estimate could be in a range from \$300 million to \$400 million when all costs are factored in.

CURRENT SITUATION

New Jersey's major systems are currently run on a variety of hardware and much of the software and hardware are antiquated. Common standards and procedures do not exist. This impedes the implementation of cost-efficient technology.

A well-designed procurement system is critical to implementing state-of-the-art technology in a cost-effective manner. The current procurement process is time-consuming, cumbersome and does not maximize leverage or support the benefits of equipment standardization.

At a time when technology is dramatically growing, changing, and becoming more critical, as well as costly, New Jersey does not have a central point of responsibility and there is no overall vision or strategic plan for technology in state government.

To date, efforts to re-invent the technology area have been confined to OTIS, which comprises less than one-third of the technological activities in the Executive Branch.

OTIS has limited resources to respond to the day-to-day needs of its current customers and virtually no resources to dedicate to defining a strategic direction.

In addition to OTIS, virtually every department of state government has its own technological component. The costs associated with those individual components are difficult to identify and are understated due to the lack of a cost-accounting system.

An RFP to study OTIS has been issued. This focuses solely on OTIS and is not designed to deal with the overall issues of technology in the state.

CONCLUSIONS AND RECOMMENDATIONS

Given the critical importance of technology and information today and in the future, as well as the need for a strategic direction, consideration must be given to elevating this function within the Executive Branch or to the creation of a public corporation to manage all technology. Unless this function has departmental level authority, significant change is unlikely. Nine states have created a Chief Information Officer position, reporting directly to the Governor. The State of California has just completed an extensive study of technology—the first recommendation was for Governor Wilson to create a C.I.O. reporting to him.

In the short term, OTIS should move ahead with a baseline study of its organization and structure. OTIS is only a part of the problem; however, such a study should still identify savings opportunities in the \$5 million to \$10 million range.

The Treasury should prepare an RFP requesting a comprehensive study of all technology units in state government. The focus of the effort should be to derive efficiencies from consolidation and standardization. Technical experts indicate that this type of effort has typically resulted in savings from 20% to 40% prior to any privatization decision.

While privatization is possible in the short term, it appears to be premature, given the fragmented nature of the function as well as the potential for significant efficiencies prior to any privatization decision.

TIMELINE FOR IMPLEMENTATION

Immediate implementation should result in short-term savings in 12-18 months. Total implementation will probably take two to four years.

ESTIMATED SAVINGS

Annual technology expenses are in the \$300 million to \$400 million range and industry experts indicate typical savings deriving from this kind of effort from 20% to 40%.

Revenue Collection

BACKGROUND

The State of New Jersey collects \$14.8 billion in revenues annually. Over 50 separate units of government have a collection function. Changing collection techniques, as well as the need for sophisticated cash management skills, trends toward electronic collection, and the securitization of receivables, all impact on this critical function.

CURRENT SITUATION

Professional skills in the various collection units vary from highly sophisticated to nonexistent. Cash management practices vary, reducing revenue opportunities which reduces the state revenue potential by not maximizing the investment potential of taxes and fees.

Most units of government do not routinely maintain information on collection rates and receivable aging schedules, which is basic to any professional collection activity. The state does not presently package and sell aged receivables.

Electronic collection activities are just beginning to be undertaken in the state and will require increased expertise and capital.

CONCLUSIONS AND RECOMMENDATIONS

The consolidation of collection activities of over 50 units will offer significant opportunity to reduce costs based on efficiencies and competitive contracting opportunities. Consolidation and competitive contracting will bring to all revenue sources the benefit of professional cash management skills.

Professional collection and money management skills, if brought to all state collection units in a single focused collection unit, should substantially increase revenues. The increase in revenue collected will also increase investment return.

There is an opportunity for the state to package for sale aged, uncollected accounts receivables. The size of this opportunity is unknown, but perhaps significant. Many states and other governmental units are already using this approach.

With the assistance of this Commission, the Department of Treasury has issued a comprehensive RFP, requesting consulting assistance in a large-scale management and operational restructuring of revenue collection/debit recovery in the State of New Jersey.

The primary objective is to evaluate the current options and recommend an implementation plan for centralizing the function.

All options will be reviewed, including a state-developed and -operated solution; outsourcing; public/private partnerships; or other feasible alternatives.

TIMELINE FOR IMPLEMENTATION

An RFP has already been issued. Implementation is expected in early 1996.

ESTIMATED SAVINGS

Savings will need to be determined as part of the project. Given the size of the existing revenue base, as well as the current cost of operation, the potential for savings is significant.

State-Owned Wastewater Treatment Facilities

BACKGROUND

The State of New Jersey owns and operates wastewater treatment facilities. These facilities are owned and managed under the auspices of the Department of Human Services and the Department of Corrections, primarily at state institutions. Some of these facilities have been fined by the DEP for failure to comply with state environmental laws.

DEPARTMENT OF CORRECTIONS

The Department of Corrections is constructing a new 550,000 gallons per day (GPD) facility at the Bayside State Prison to achieve compliance with environmental regulations. The annual operating costs of the present facility are \$645,000.

Mountainview Youth Correctional Facility—Main Unit is constructing a 360,000 GPD plant under a design/build contract. Present operating costs of the existing facility are \$1.46 million per year. The facility, which serves the Mountainview Youth Correctional Facility—High Point Unit, has been cited for environmental violations and is forced to haul all raw sewage from the facility. However, a licensed plant operator must still be maintained at the facility to provide discharge monitoring reports to the DEP. Current operating costs, including sludge removal, are \$269,000.

Mountainview Youth Correctional Facility—Stokes Forest Unit has also been cited for violations, and has been hauling its raw sewage since 1991. Hauling costs are \$127,000 per year.

Violations have been identified at the New Jersey Training School—Jamesburg Facility, and the Department is moving to correct them. Operating costs are \$98,300 annually.

The Wagner Youth Correctional Facility's sewage treatment operation has also been cited for violations. The Department is in the process of requesting proposals for design/build of a new plant. A vendor presently operates the plant at a cost of approximately \$500,000.

DEPARTMENT OF HUMAN SERVICES

The Department operates wastewater and water treatment plants at 12 residential facilities: Ancora Psychiatric Hospital, North Princeton Developmental Center, Woodbine Developmental Center, Hagedorn Geriatric Center, Brisbane Child Treatment Center, Greystone Park Psychiatric Hospital, Marlboro Psychiatric Hospital, North Jersey Developmental Center, New Lisbon Developmental Center, Johnstone Training Center, Warren Residential Group Center, and Albert Elias Residential Group Center. Many of these plants have been cited for violations by the DEP and have paid fines.

A preliminary cost analysis shows operating costs of at least \$1.4 million for all of these facilities. In addition, over \$300,000 in fines and attorneys' fees have been paid.

CONCLUSIONS AND RECOMMENDATIONS

Contract operation and maintenance of water and sewerage treatment facilities is a growing industry. Across the United States there are numerous examples where local officials have improved quality and significantly lowered costs. The Commission has collected information from contracted facilities in New Orleans, LA; Indianapolis, IN; Newark, NJ; Maple Shade, NJ; Cranston, RI; Oklahoma City, OK; and others. Savings ranging from 30-40% are common. In the last 15 years, hundreds of Operation and Maintenance contracts have been entered into. This industry has grown and there are many experienced, qualified, reputable, well-financed firms who would submit a proposal for this type of business.

A cost accounting should be completed, showing all costs of delivering the service. Service monitoring costs should be included. RFPs, which contain performance standards and contract monitoring procedures, should be issued to qualified operators. The in-house managers and employees should work together to submit a plan to compete with anticipated private contractor proposals. The Department should award the contract to qualified private contractors if the Department receives a proposal that would reduce costs without sacrificing quality.

TIMELINE FOR IMPLEMENTATION

RFPs on many of these facilities could be issued by May 1 and contracts awarded before December 1, 1995.

ESTIMATED SAVINGS

Approximately \$1 million per year.

Public/Private Partnerships in Capital Transportation Projects

BACKGROUND

Many states are permitting the private sector to build and operate transportation projects which had been exclusively done by governmental entities. Examples include the Dulles Toll Road and four major highways in California. In the State of Washington, the "Public/Private Initiatives in Transportation" program provides a wide range of opportunities for businesses to propose and undertake all or a portion of the study, planning, design, financing, construction, operation and maintenance of transportation systems and facilities.

The New Jersey Department of Transportation is moving toward engaging the private sector in design/build projects. Based on the experience of other states, private design and construction of transportation projects has reduced costs and the amount of time it takes to complete a project.

CURRENT SITUATION

According to a Foundation of the New Jersey Alliance for Action study, New Jersey has transportation infrastructure needs of \$47.9 billion. They include:

- \$31.8 billion for state highways and bridges.
- \$3.5 billion for public transit.
- \$5.9 billion for toll road facilities.
- \$2.7 billion for bi-state authorities.
- \$4.0 billion for county and municipal roads and bridges.

The state's Department of Transportation reports that at current funding levels, the state will be unable to fund \$10.3 billion in needed highway and mass transit projects between the years of 1995 and 2002. These projects include rail transit expansion replacement buses, new bridges and added highway lanes.

In order to meet the state's backlog of unfunded transportation projects over the seven-year period, New Jersey needs to increase its transportation capital investment by \$1.3 billion annually—from \$1.5 billion to \$2.8 billion.

Participation of the private sector in the design, building, ownership and financing of many of these projects is needed.

CONCLUSIONS AND RECOMMENDATIONS

The Department of Transportation should evaluate all options for private design/build projects. The objective should be to enhance the Department's ability to complete a growing number of projects on a timely- and cost-effective basis.

The Commission also recommends adoption of a plan similar to the State of Washington's New Partners Public/Private Initiative in Transportation. This program has resulted in six significant projects being built by the private sector. Under the Washington program, private firms are invited to propose construction projects to be built and operated by the private sector. The state negotiates the details of each project with the private firms.

The enactment of a program like this in New Jersey has the potential for stimulating some creative and important transportation projects. Possible projects include the construction of S-92 in Middlesex County, the renovation and expansion of the Route 9 Bridge on the Raritan River, the construction of a new Route 9 Bridge, operation of the Hudson River Waterfront System, the extension of Patco in South Jersey, and many others.

TIMELINE FOR IMPLEMENTATION

Legislation may be needed before an RFP can be issued. Based on Washington state's experience, it should take a little over a year to draft an RFP, receive proposals and award a contract.

ESTIMATED SAVINGS

Savings cannot easily be determined, but the state might save hundreds of millions of dollars by avoiding major capital and operating expenses.

Veterans Memorial Home at Paramus

BACKGROUND

The State of New Jersey owns and operates a 334-bed veterans nursing home in Paramus.

The Veterans Memorial Home at Paramus was built in the late 1980s and was fully completed four years ago. The home serves veterans and veteran spouses (whose husbands are already in the home) and "Gold Star" parents—parents of veterans who have been killed in combat. The residents who have not depleted their personal assets pay for their care.

CURRENT SITUATION

The Veterans Memorial Home in Paramus is staffed by approximately 400 state employees, including managers, doctors, registered nurses, licensed practical nurses, health care aides, and building maintenance, food service, custodial and other support service workers.

The FY95 operating budget of the home shows \$17 million in operating expenses, including maintenance, and \$6.4 million in revenues—\$3 million from payments by private individuals and \$3.4 million from federal Veterans Administration reimbursements. The difference between operating expenses and revenues is made up by state taxpayers in the amount of \$10.6 million. If operating expenses were significantly reduced, this would have no effect on the amount of reimbursement provided by the Veterans Administration. Cost per bed is about \$140 per day.

The nursing home industry is well-developed, and there may be many experienced, reputable and financially-sound and competitive operators who would respond to an RFP and provide quality operation of this home.

CONCLUSIONS AND RECOMMENDATIONS

A cost accounting should be completed which shows all costs of operating and maintaining the home, including service monitoring costs. An RFP, which contains performance standards and contract monitoring procedures, should be issued to qualified and reputable operators. This is a very important service upon which hundreds of lives depend. Therefore, a great deal of care should be taken with this procurement process. Veterans service organizations should be consulted during this process.

The in-house managers and employees should be encouraged to submit a plan to restructure the in-house operation to be competitive with anticipated private contractor proposals. A comparison between private proposals and in-house reduction in operating costs should be made. The Department should award the contract to qualified private contractors if the Department receives a proposal that would reduce costs without sacrificing the quality of care.

AREAS UNDER STUDY

TIMELINE FOR IMPLEMENTATION

An RFP could be drafted and issued to qualified operators by March 1, 1995.

An award could be made by September 1, and service could begin by December 1995.

ESTIMATED SAVINGS

\$3 million in operating expenses.

The New Jersey Sports and Exposition Authority

BACKGROUND

The New Jersey Sports and Exposition Authority manages Monmouth Park; the Meadowlands Sports Complex, including Giants Stadium; the Byrne Arena; and the Meadowlands Racetrack. The existing Atlantic City Convention Center is leased and operated by the Authority. The Authority oversees the development of the new Atlantic City Convention Center. In addition, the Authority owns undeveloped land in the Meadowlands.

The Authority has \$947 million in bonds outstanding. Due to the restrictive covenants in the bonds and IRS regulations, a sale of any of the assets would be difficult.

In FY95, the state contributed \$35 million toward the payment of Authority debt service.

CONCLUSIONS AND RECOMMENDATIONS

The Commission commends the Authority for taking significant steps toward privatization of various functions. It is seeking a private operator to run the Atlantic City Convention Centers, a private developer to construct new elements of the master plan, and has contracted out many of its support services.

The Commission recommends a more intensive study of Authority activities be undertaken in order to determine the potential for reducing costs through the introduction of competition. Competition could generate new ideas and solutions for reducing the Authority's need for a state subsidy.

TIMELINE FOR IMPLEMENTATION

Due to the multifaceted nature of the Authority's activities and the complex legal restrictions in its bond covenants, an additional three to six months will be required for the Commission to complete the study.

Passaic Valley Sewerage Commission

CURRENT SITUATION

The Passaic Valley Sewerage Commission is a legislatively created authority which operates a sewerage treatment plant located in Newark. In 1993, revenues were \$114 million, operating expenses were \$75 million, repairs and maintenance were about \$12.5 million and annual debt service payments were \$19.7 million. Any surplus in annual revenues over expenses is returned at the end of the year to PVSC's customers.

The PVSC sewerage treatment plant is one of the largest in the country and serves 1.5 million people and 4,500 businesses in parts of Bergen, Essex, Hudson and Passaic counties. All of its operating and debt service costs are passed on to its customers. These charges make up a significant portion of the charges in customers' water and sewer bills.

Contract operation and maintenance of sewerage treatment facilities is a growing industry. Across the United States there are numerous examples where local officials have improved quality and significantly lowered costs. The Commission has collected information from contracted facilities in New Orleans, LA; Indianapolis, IN; Newark, NJ; Maple Shade, NJ; Cranston, RI; Oklahoma City, OK; and others. Savings ranging from 30-40% are common. In the last 15 years, hundreds of Operation and Maintenance contracts have been entered into. This industry has grown and there are many experienced, qualified, reputable, well-financed firms that would submit a proposal for this type of business.

CONCLUSIONS AND RECOMMENDATIONS

The Privatization Commission believes that subjecting the operation of the PVSC to competitive contracting could reduce the cost to ratepayers of providing this service without sacrificing the quality of the service.

The Commission recommends that the PVSC perform a cost accounting, showing all costs of delivering the service, including maintenance and service monitoring.

There is no accurate way to forecast how much a private contractor might save until the operation is subjected to competition in the marketplace. Therefore, the PVSC should be encouraged to issue an RFP to qualified operators for an Operations and Maintenance agreement, which contains performance standards and contract monitoring procedures.

The in-house managers and employees can submit a plan to compete with anticipated private contractor proposals. The Commission recommends the PVSC award the contract to a qualified private contractor, if the PVSC receives a proposal that would reduce costs without sacrificing the quality of services.

Miscellaneous Competitive Contracting Proposals

BACKGROUND

The Commission, working with Treasury, OMB and the departments, has uncovered a number of opportunities to competitively contract services at possible savings to the state without reducing the quality of services. Actions have been taken on some of these services, such as operation of day care centers in Human Services. Others are still under study.

Among the services under review are: custodial services; institutional grounds-keeping and food service; forensic medical exams; law enforcement data entry and collection; "bad driver" surcharge billing and collection; DMV accident reporting, licensing and testing; laboratory testing; state-run school district support services; state-operated adult training centers; fleet maintenance; and maintenance and reconstruction of NJ Transit rail track.

CONCLUSIONS AND RECOMMENDATIONS

The Commission recommends further consideration of the above services for competitive contracting. If these services can be performed at a lower cost without reducing the quality of services by a private firm, they should be competitively contracted.

The Commission recommends that a cost accounting be completed for each of the above, showing all costs of delivering the service including service monitoring costs. For each service that is subjected to competitive contracting, an RFP, which contains performance standards and contract monitoring procedures, should be issued to qualified operators. The in-house managers and employees can be encouraged to submit a plan to be competitive with anticipated private contractor proposals.

ESTIMATED SAVINGS

Based on a preliminary review of the costs of the above services that are performed by the private sector, as compared to costs for the state to operate them, a savings of \$30 million per year is feasible.

APPENDIX 1

STATE OF NEW JERSEY
EXECUTIVE DEPARTMENT

EXECUTIVE ORDER NO. 17

WHEREAS, saving tax dollars without compromising the availability and quality of State services is a cornerstone of this Administration; and

WHEREAS, State government must identify and pursue innovative methods of achieving these goals; and

WHEREAS, privatization, through reliance on private enterprise, market forces and competition for providing public services, may be one alternative by which to save tax dollars and maintain, and possibly improve, State services; and

WHEREAS, a comprehensive study should be conducted to analyze the feasibility of prudent privatization of selected government services and evaluate the potential consequences of such privatization;

NOW, THEREFORE, I, CHRISTINE TODD WHITMAN, Governor of the State of New Jersey, by virtue of the authority vested in me by the Constitution and by the Statutes of this State, do hereby ORDER and DIRECT:

1. There is hereby established the New Jersey Advisory Commission on Privatization, hereinafter referred to as the Commission.
2. The Commission shall consist of a chairperson and four (4) other members appointed by the Governor.
3. The Commission shall: (1) conduct a review of existing feasibility studies and actual experiences of governments that have initiated privatization efforts; (2) evaluate the advantages and disadvantages associated with privatization generally; (3) conduct a feasibility study of New Jersey State government, including a cost-benefit and implementation analysis, to identify those areas where privatization would result in cost savings and quality improvements; and (4) propose appropriate and beneficial methods of implementing privatization in this State.

New Jersey Advisory Commission on Privatization

STATE OF NEW JERSEY
EXECUTIVE DEPARTMENT

2

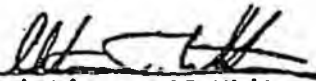
4. The Commission shall periodically report to the Governor and shall issue its recommendations in writing by December 31, 1994.

5. The Commission is authorized to call upon any department, office, division, or agency of this State to supply it with data and other information, personnel or assistance it deems necessary to discharge its duties under this Order. Each department, officer, division or agency of this State is hereby required, to the extent not inconsistent with law, to cooperate with the Commission and to furnish it with such information, personnel and assistance as is necessary to accomplish the purpose of this Order. The Attorney General, or her designee, shall act as legal counsel to the Commission.

6. This Order shall take effect immediately.

GIVEN, under my hand and seal,
this 18th day of APRIL
in the Year of Our Lord, One
Thousand Nine Hundred and
Ninety-Four and of the
Independence of the United
States, the Two Hundred and
Eighteenth.




Christine Todd Whitman
GOVERNOR

Attest:


Michael P. Torpey
Deputy Chief Counsel to the Governor

FILED

APR 18 1994

LONNA R. HOOKS
SECRETARY OF STATE

APPENDIX 2

Commission on Privatization and Competitive Contracting Public Hearing List

1. Personnel Commissioner - Linda Anselmini
2. Professor Steve Savas - Director, Privatization Research Organization, Baruch College
3. Esmor - James F. Slattery, President
4. Mercer County Executive Bob Prunetti
5. Metcalf & Eddy - Donald Deiso, President
6. CWA
7. Congressman Dick Zinmer
8. Systems Control - James Caffey, Marketing Representative
9. Bergen County Sheriff Jack Terhune
10. United Infrastructure - Senator Thomas Gagliano
11. AFSCME
12. GC Services - Lawrence Smith, Marketing Manager
13. System House - John Bay, Managing Director
14. Cherokee Solutions - Leonard T. Bier
15. Martin Marietta - Neal Linkon, Director of Public Affairs
16. Construction Industry Advancement Program - John Clearwater
17. Michael Francis - Chairman, New Jersey Sports & Exposition Authority
18. United Water Resources - Bob Senatore, Marketing Manager
19. Lewis Thurston - Executive Director, New Jersey Highway Authority
20. S.E.LU./I.F.P.T.E
21. New Jersey Turnpike Employees Union - Frank Forst, Consultant
22. Project Build - Fred Mihelic
23. Wheelabrator Clean Water Systems - Ken Gibson
24. Mercer Street Friends - John Connolly, Executive Director
25. Public/Private Partnership Council of New Jersey - Vince Miller
26. Construction Industry Advancement Program - John Clearwater

Colorado Bill

Privatization study
and questionnaire

1996

An Act

HOUSE BILL 96-1262

BY REPRESENTATIVES Pfiffner, Anderson, Pankey, Sullivant, and Taylor;
also SENATOR Johnson.

CONCERNING THE STATE PERSONNEL SYSTEM, AND MAKING AN APPROPRIATION IN CONNECTION THEREWITH.

Be it enacted by the General Assembly of the State of Colorado:

SECTION 1. 24-50-104 (8) (a) (I) and (8) (a) (III), Colorado Revised Statutes, 1988 Repl. Vol., as amended, are amended, and the said 24-50-104 (8) (a) is further amended BY THE ADDITION OF THE FOLLOWING NEW SUBPARAGRAPHS, to read:

24-50-104. Job evaluation and compensation - repeal.
(8) Salary administration. (a) (I) The state personnel director shall provide by rule, based upon a system of performance evaluation, for periodic salary increases which are based on demonstrated ability for satisfactory performance and quality of performance, for the withholding of such increases for less than satisfactory performance, and for payment of an incentive award in recognition of above-standard or outstanding performance by an employæ. This subparagraph (I) is repealed, effective ~~July 1, 1997~~ JULY 1, 2000.

(III) For the fiscal year beginning ~~July 1, 1994~~ JULY 1, 1998, and each fiscal year thereafter, the salaries of all employees may be increased or left unchanged based upon merit and performance or the expectation of performance of such employees, subject to the level of available appropriations therefor. The state personnel director shall prepare and transmit to the general

Capital Letters indicate new material added to existing statutes; dashes through words indicate deletions from existing statutes and such material not part of act.

~~assembly~~ JOINT BUDGET COMMITTEE AND THE HOUSE AND SENATE STATE, VETERANS, AND MILITARY AFFAIRS COMMITTEES, no later than ~~January 1, 1994~~ OCTOBER 15, 1996, ~~recommendations for changes in the statutes necessary to implement the provisions of this subparagraph (III)~~ A PERFORMANCE-BASED PAY PLAN. THE PERFORMANCE BASED PAY PLAN SHALL INCLUDE, BUT NOT BE LIMITED TO, THE FOLLOWING ELEMENTS:

(A) A SYSTEM FOR PERFORMANCE EVALUATION THAT PERMITS PERIODIC SALARY INCREASES BASED ON A DEMONSTRATED ABILITY FOR SATISFACTORY PERFORMANCE AND QUALITY OF PERFORMANCE, WITHHOLDING OF SUCH INCREASES FOR LESS THAN SATISFACTORY PERFORMANCE, AND THE ESTABLISHMENT OF A JOB RATE FOR EACH OCCUPATIONAL GROUP, AFTER WHICH NO ALLOWANCE FOR STEP OR LONGEVITY INCREASE SHALL BE MADE;

(B) ANNUAL SALARY INCREASES SHALL NOT BE GUARANTEED AND SHALL BE SUBJECT TO THE LEVEL OF AVAILABLE APPROPRIATIONS THEREFOR;

(C) A MINIMUM ANNUAL SALARY INCREASE SHALL NOT BE ESTABLISHED OR GUARANTEED;

(D) ANY ANNUAL SALARY INCREASE THAT MAY BE AWARDED BY THE APPOINTING AUTHORITY SHALL BE EFFECTIVE ON JULY 1, SUBJECT TO THE LEVEL OF AVAILABLE APPROPRIATIONS, AND SHALL NOT OCCUR OR BE DEPENDENT ON THE ANNIVERSARY DATE OF EMPLOYMENT.

(IV) THE JOB RATE DESCRIBED IN SUB-SUBPARAGRAPH (A) OF SUBPARAGRAPH (III) OF THIS PARAGRAPH (a) SHALL BE ESTABLISHED THROUGH THE ANNUAL TOTAL COMPENSATION SURVEY. THE TOTAL COMPENSATION ADVISORY COUNCIL SHALL ADVISE THE STATE PERSONNEL DIRECTOR IN THE INITIAL DESIGN AND FUTURE REVISIONS OF THE PERFORMANCE-BASED PAY PLAN DESCRIBED IN SUBPARAGRAPH (III) OF THIS PARAGRAPH (a). ON OR BEFORE DECEMBER 30, 1996, FOLLOWING CONSULTATION WITH THE JOINT BUDGET COMMITTEE, THE STATE PERSONNEL DIRECTOR SHALL FINALIZE THE PERFORMANCE-BASED PAY PLAN. THE JOB RATE ESTABLISHED FOR EACH OCCUPATIONAL GROUP SHALL BE REVIEWED AS PART OF THE ANNUAL PERFORMANCE AUDIT OF THE COMPENSATION SURVEY CONTRACTED FOR BY THE STATE AUDITOR.

(V) (A) THE STATE PERSONNEL DIRECTOR SHALL IMPLEMENT PERFORMANCE-BASED PAY OVER A PERIOD OF THREE YEARS IN THREE SEPARATE SEGMENTS PURSUANT TO SUB-SUBPARAGRAPHS (B), (C), AND (D) OF THIS SUBPARAGRAPH (V) FOR ALL OF THE STATE EMPLOYEES IN THE STATE PERSONNEL SYSTEM. THE PLAN SHALL DESCRIBE THE EMPLOYEE GROUPS, CLASSES, OR POSITIONS COMPRISING EACH OF THE THREE SEGMENTS.

(B) ON OR BEFORE JULY 1, 1998, PERFORMANCE-BASED PAY SHALL BE IMPLEMENTED FOR THE FIRST SEGMENT OF STATE EMPLOYEES DESCRIBED IN THE PERFORMANCE-BASED PAY PLAN.

(C) ON OR BEFORE JULY 1, 1999, PERFORMANCE-BASED PAY SHALL BE IMPLEMENTED FOR THE SECOND SEGMENT OF STATE EMPLOYEES DESCRIBED IN THE PERFORMANCE-BASED PAY PLAN.

(D) ON OR BEFORE JULY 1, 2000, PERFORMANCE-BASED PAY SHALL BE IMPLEMENTED FOR THE THIRD SEGMENT OF STATE EMPLOYEES DESCRIBED IN THE PERFORMANCE-BASED PAY PLAN.

(E) THE PROVISIONS OF SUBPARAGRAPH (I) OF PARAGRAPH (a) OF THIS SUBSECTION (8) SHALL NOT APPLY TO ANY EMPLOYEE WHO BECOMES COVERED BY THE PERFORMANCE-BASED PAY PLAN PURSUANT TO SUB-SUBPARAGRAPHS (B), (C), OR (D) OF THIS SUBPARAGRAPH (V).

SECTION 2. Part 5 of article 50 of title 24, Colorado Revised Statutes, 1988 Repl. Vol., as amended, is amended BY THE ADDITION OF A NEW SECTION to read:

24-50-504.7. Commission on the privatization of personal services - creation. (1) (a) THERE IS HEREBY CREATED A COMMISSION ON THE PRIVATIZATION OF PERSONAL SERVICES PERFORMED BY CLASSIFIED STATE EMPLOYEES CONSISTING OF THE FOLLOWING APPOINTED MEMBERS:

(I) THREE MEMBERS APPOINTED BY THE GOVERNOR;

(II) THREE MEMBERS OF THE SENATE APPOINTED BY THE PRESIDENT OF THE SENATE ONE OF WHOM SHALL BE A MEMBER OF THE MINORITY PARTY;

(III) THREE MEMBERS OF THE HOUSE OF REPRESENTATIVES APPOINTED BY THE SPEAKER OF THE HOUSE OF REPRESENTATIVES ONE OF WHOM SHALL BE A MEMBER OF THE MINORITY PARTY;

(IV) ONE MEMBER OF THE COLORADO ASSOCIATION OF PUBLIC EMPLOYEES, DESIGNATED BY THAT ORGANIZATION;

(V) ONE MEMBER OF THE AMERICAN FEDERATION OF STATE, COUNTY, AND MUNICIPAL EMPLOYEES, DESIGNATED BY THAT ORGANIZATION;

(VI) ONE MEMBER OF THE COLORADO FEDERATION OF PUBLIC EMPLOYEES, DESIGNATED BY THAT ORGANIZATION.

(b) THE COMMISSION SHALL MEET NO LATER THAN JULY 31, 1996, AND SHALL MEET AS OFTEN AS NECESSARY.

(c) IN CARRYING OUT ITS DUTIES UNDER THIS SECTION, THE COMMISSION MAY REQUEST STAFF ASSISTANCE FROM THE DEPARTMENT OF PERSONNEL. ALL SUCH STAFF ASSISTANCE SHALL BE PROVIDED WITHIN AVAILABLE APPROPRIATIONS.

(d) THE COMMISSION SHALL INVESTIGATE AND STUDY THE SUCCESSES AND FAILURES OF PUBLIC AND PRIVATE PERFORMANCE OF PUBLIC SERVICES IN THE STATE AND IN OTHER STATES. THE COMMISSION SHALL

REPORT TO THE GENERAL ASSEMBLY ON THE RESULTS OF THAT INVESTIGATION AND STUDY AND MAY MAKE RECOMMENDATIONS ON PERSONAL SERVICES CONTRACTS, PRIVATIZATION OF CERTAIN STATE SERVICES, AND APPROPRIATE LEGISLATION. THE REPORT SHALL INCLUDE, BUT NOT BE LIMITED TO, THE FOLLOWING:

(I) WHETHER PERSONAL SERVICES CONTRACTS INCREASE EFFICIENCY IN THE DELIVERY OF GOVERNMENT SERVICES IN THE STATE AND IN OTHER STATES;

(II) WHETHER THERE ARE OVERALL COST SAVINGS TO THE STATE AND IN OTHER STATES DURING THE TERM OF SUCH CONTRACTS;

(III) THE NUMBER OF PRIVATE ENTITIES EXISTING THAT PROVIDE THE PERSONAL SERVICES CONTRACTED FOR BY THE STATE AND IN OTHER STATES;

(IV) WHETHER STATE EMPLOYEES ARE ALLOWED TO SUBMIT A BID OR PROPOSAL TO PROVIDE THE PERSONAL SERVICES CONTRACTED FOR IN THE STATE AND IN OTHER STATES AND WHETHER SUCH BIDS OR PROPOSALS WERE MADE JOINTLY OR IN COOPERATION WITH A PRIVATE ENTITY.

(e) ON OR BEFORE SEPTEMBER 1, 1997, THE COMMISSION SHALL PREPARE AND TRANSMIT TO THE GENERAL ASSEMBLY A REPORT CONTAINING THE RESULTS AND RECOMMENDATIONS DESCRIBED IN PARAGRAPH (d) OF THIS SUBSECTION (1).

(f) THE REPORT REQUIRED BY PARAGRAPH (e) OF THIS SUBSECTION (1) SHALL BE FILED IN ACCORDANCE WITH SECTION 24-1-136 (9).

(2) THIS SECTION IS REPEALED, EFFECTIVE NOVEMBER 1, 1997.

SECTION 3. Appropriation - adjustment in 1996 long bill.

(1) In addition to any other appropriation, there is hereby appropriated, out of any moneys in the general fund not otherwise appropriated, to the department of personnel, for the fiscal year beginning July 1, 1996, the sum of fifty-six thousand six hundred ninety-six dollars (\$56,696) and 1.0 FTE, or so much thereof as may be necessary, for the implementation of this act.

(2) In addition to any other appropriation, there is hereby appropriated, to the department of law, for the fiscal year beginning July 1, 1996, the sum of ten thousand dollars (\$10,000) and 0.1 FTE, or so much thereof as may be necessary, for the implementation of this act. Such sum shall be from amounts appropriated to the department of personnel in subsection (1) of this section.

(3) In addition to any other appropriation, there is hereby appropriated, out of any moneys in the general fund not otherwise appropriated, to the legislative department, for allocation to the legislative council, for the fiscal year beginning July 1, 1996.

the sum of four thousand seven hundred fifty-two dollars (\$4,752), or so much thereof as may be necessary, for the implementation of this act.

(4) For the implementation of this act, appropriations made in the annual general appropriation act for the fiscal year beginning July 1, 1996, shall be adjusted as follows:

(a) The general fund appropriation to the capital construction fund outlined in section 3 (1)(c) and (1)(e) is reduced by sixty-one thousand four hundred forty-eight dollars (\$61,448).

(b) The capital construction fund exempt appropriation to the department of transportation, construction projects, is reduced by sixty-one thousand four hundred forty-eight dollars (\$61,448).


SECTION 4. Future appropriations. (1) It appears that this act will require appropriations for subsequent fiscal years, and the amount to be appropriated to the department of personnel for the fiscal year beginning July 1, 1997, is estimated to be five hundred seventy-nine thousand nine hundred twenty-four dollars (\$579,924) and 2.2 FTE.

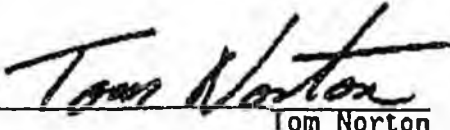
(2) The amount to be appropriated to the department of law for the fiscal year beginning July 1, 1997, is estimated to be twenty-nine thousand nine hundred ten dollars (\$29,910) and 0.5 FTE. Such sum shall be from amounts appropriated to the department of personnel in subsection (1) of this section.


(3) The amount to be appropriated to the legislative department for the fiscal year beginning July 1, 1997, is estimated to be one thousand one hundred eighty-eight dollars (\$1,188).

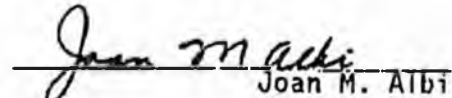
SECTION 5. Effective date. This act shall take effect at 12:01 a.m. on the day following the expiration of the ninety-day period after final adjournment of the general assembly that is allowed for submitting a referendum petition pursuant to article V, section 1 (3) of the state constitution; except that, if a referendum petition is filed against this act or an item, section.

or part of this act within such period, then the act, item, section, or part, if approved by the people, shall take effect on the date of the official declaration of the vote thereon by proclamation of the governor.

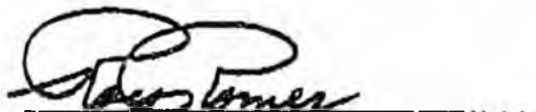

Charles L. Berry
SPEAKER OF THE HOUSE
OF REPRESENTATIVES


Tom Norton
PRESIDENT OF
THE SENATE


Judith M. Rodrigue
CHIEF CLERK OF THE HOUSE
OF REPRESENTATIVES


Joan M. Albi
SECRETARY OF
THE SENATE

APPROVED June 1, 1996 at 12:13 p.m.


Roy Romer
GOVERNOR OF THE STATE OF COLORADO

STATE OF COLORADO



Commission on Privatization

January 27, 1997

Charlie Brown
Legislative Council
200 E. Colfax, #029
Denver, CO 80203

Dear Mr. Brown

Charlie

We are writing to request that your department/agency, state college or university participate in completing the attached management survey questionnaire. Your participation in this survey is important to the Commission on Privatization's task of investigating the successes and failures of public and private performance in the delivery of state services in Colorado.

The Commission on Privatization was authorized by HB-96-1262 to study and to make recommendations to the General Assembly on the privatization of certain state services, personal services contracts and appropriate legislation. This survey questionnaire is designed to assist the Commission in determining current state government privatized practices, the factors in considering privatization, what forms of privatization exist and what are the impediments to further privatization.

The survey findings will result in helping the Commission to make substantive recommendations regarding the future of private competition within Colorado state government. Additionally, survey results will be compiled into the final Commission on Privatization report due the General Assembly later this year. Please have division directors and managers complete the questionnaire. We would like cross representation throughout your various divisions.

Completed surveys should be returned to General Support Services, Department of Personnel no later than Friday, February 14, 1997. On behalf of the Commission, we thank you for your prompt assistance in directing these surveys to be completed by appropriate personnel within the deadline date established.

If you or any person in your organization have further questions regarding the survey process, please contact the Commission administrator, Mr. Rick Garcia at 866-6575.

Sincerely,

Penn Pflüner

Representative Penn Pflüner
Chair
Commission on Privatization

André N. Pettigrew

André N. Pettigrew
Executive Director
Department of Personnel

Note: To complete this survey by email, go to the Commission on Privatization homepage, http://www.state.co.us/gov_dir/gss/edo/prlv/index.htm, and follow instructions. Email responses should be returned to Joi Simpson at Joi.Simpson@state.co.us.



PRIVATIZATION SURVEY QUESTIONNAIRE

DUE BY FEBRUARY 14, 1997
TO
COMMISSION ON PRIVATIZATION
C/O EXECUTIVE DIRECTOR'S OFFICE
COLORADO DEPARTMENT OF PERSONNEL
GENERAL SUPPORT SERVICES
1525 SHERMAN STREET #200
DENVER, CO 80203

AGENCY/DIVISION: _____



PRIVATIZATION SURVEY QUESTIONNAIRE

DUE BY FEBRUARY 14, 1997
TO
COMMISSION ON PRIVATIZATION
C/O EXECUTIVE DIRECTOR'S OFFICE
COLORADO DEPARTMENT OF PERSONNEL
GENERAL SUPPORT SERVICES
1525 SHERMAN STREET #200
DENVER, CO 80203

AGENCY/DIVISION: _____

JOB TITLE: _____

NAME(OPTIONAL): _____

PREPARED AND DISTRIBUTED BY
COLORADO COMMISSION ON PRIVATIZATION
AS AUTHORIZED BY HB 96-1282

Privatization Terms & Definitions

The following definitions and terms widely describe the forms of government privatization. The terms are provided only as a point of reference to assist the survey respondents' description of specific privatization experiences. In providing these terms, there is no assumption that any of the described forms of privatization are utilized or have been utilized in Colorado state government.

Contracting out - Government contracts all or a portion of a public service delivery to private firms (profit or non-profit). For purposes of this survey, contracting out would include "purchased services" as defined in The Code of Colorado Regulations, P13-1-1. Classic examples include trash collection, waste water treatment and building repair and maintenance. More recent examples include human services delivery, incarceration and public transportation. Some level of performance evaluation, compliance and contract monitoring is maintained by government.

Deregulation - The government removes its regulations from the service it previously regulated in favor of self or no regulation of the service.

Franchisees - Government awards either an exclusive or nonexclusive franchise to private firms to provide a service within a certain geographical area. Under most franchise agreements the citizen pays directly for service rendered. Likely municipal franchisees include cable television and utility services. Most public franchisees are associated with regulated public utilities.

Grants/subsidies - The government provides a financial or in-kind contribution to a private organization or individual to encourage them to provide a service so that the government does not have to provide it. An example is private business using Enterprise Zone tax benefits.

Leasing - A way for governments to have the use of certain goods or services without having to own them. Examples are government leasing vehicles or office space.

Load/Service Shedding - The government actually gives up responsibility for an activity but works with a private agency (profit or nonprofit) willing to take over responsibility. Perhaps this would involve a one-time grant or subsidy. A local example is the privatization of some RTD routes and the University Hospital reorganization model. In other states, service shedding can be described as selling off state-owned assets like a worker's compensation fund to a private firm or giving up internal fleet maintenance by having an outside company manage the leasing and acquisition of state vehicles.

Managed Competition - A public agency competes with private firms for the provision of public services under a controlled or managed process with clearly defined steps to be followed and roles of all the participants.

Partnerships (Joint public-private ventures) - Businesses in the community and the local government join forces for a major development such as a new shopping mall, downtown revitalization or a sports stadium. Often tax policy such as special improvement, incremental and special sales taxes accompany these types of ventures. Recent examples include Coors Field and the 16th Street business improvement district.

Procurement - The acquisition or purchase of goods that are not wholly manufactured or produced by state government. Examples are the purchase of office or cleaning supplies, electronic and computer equipment or vehicles.

Sale of Assets - The government sells its assets to the private sector. Sale of assets shifts government functions and ownership to the private sector. An example is a government that sells surplus property or equipment to the private sector.

Vouchers - The government provides vouchers to citizens needing the service, but the citizens are free to choose the organization from which to buy the goods and services. Popular examples include housing and food vouchers and more recent examples are educational choice vouchers.

The following definitions are to be used when completing question 1.

Quality of Performance and Service - this refers to the quality of service from the provider.

Service Level - Decrease or Increase - comparison of the level of services before and after privatization.

1. List all privatized functions/services that you have used within the last three years. Respond to each category as it pertains to the activity listed. Chart continued on back if additional space is needed.

Type of Privatization	Function or Service which was Privatized	Difficulty in finding provider		Length of Practice (In years)	Depth of Oversight		Frequency of Review		Quality of performance and service		Service level Decrease or Increase		Service objectives were met		Unsuccessful or Successful		Why Unsuccessful(Difficulties) or Successful (What worked)?
		No Diff	Extreme		Min	Max	Weekly	Annual	Poor	Excellent	D	I	Not Met	Met	U	S	
		1	2 3 4		1	2 3 4	1	2 3 4	1	2 3 4	D	I	1	2 3 4	U	S	
		1	2 3 4		1	2 3 4	1	2 3 4	1	2 3 4	D	I	1	2 3 4	U	S	
		1	2 3 4		1	2 3 4	1	2 3 4	1	2 3 4	D	I	1	2 3 4	U	S	
		1	2 3 4		1	2 3 4	1	2 3 4	1	2 3 4	D	I	1	2 3 4	U	S	
		1	2 3 4		1	2 3 4	1	2 3 4	1	2 3 4	D	I	1	2 3 4	U	S	
		1	2 3 4		1	2 3 4	1	2 3 4	1	2 3 4	D	I	1	2 3 4	U	S	

Type of Privatization	Function or Service which was Privatized	Difficulty in finding provider		Length of Practice (in years)	Depth of Oversight		Frequency of Review		Quality of performance and service		Service level Decrease or Increase		Service objectives were met		Unsuccessful or Successful	Why Unsuccessful(Difficulties) or Successful (What worked)?
		No Diff	Extreme		Min	Max	Weekly	Annual	Poor	Excellent	D	I	Not Met	Met			U	S
		1	2 3 4		1 2 3 4		1 2 3 4	1 2 3 4	1 2 3 4			1 2 3 4				
		1	2 3 4		1 2 3 4		1 2 3 4	1 2 3 4	1 2 3 4			1 2 3 4				
		1	2 3 4		1 2 3 4		1 2 3 4	1 2 3 4	1 2 3 4			1 2 3 4				
		1	2 3 4		1 2 3 4		1 2 3 4	1 2 3 4	1 2 3 4			1 2 3 4				
		1	2 3 4		1 2 3 4		1 2 3 4	1 2 3 4	1 2 3 4			1 2 3 4				
		1	2 3 4		1 2 3 4		1 2 3 4	1 2 3 4	1 2 3 4			1 2 3 4				

5. Assume for the moment that there were no legal, regulatory or procedural barriers to privatization. Which of your agency's activities would make the best candidates for privatization ?

6. List barriers that prevent your agency from taking advantage of the opportunities listed above. How significant are these barriers? Attach a separate sheet if more space is needed.

Table with 4 columns: Not at all Significant, Not very, Somewhat, Very Significant. Rows 1-8 with numerical ratings 1-4.

7. Has your agency used any means of obtaining customer satisfaction ratings in the past?

_____ Yes _____ No

List the methods that your agency has used or could use to measure customer satisfaction with the services or products of your organization.

Thank you for completing this survey.

New England
Privatization
Study & Report

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ALASKA STATE LIBRARY

*Privatization
of Local Public Services:
Lessons for New England*

As governments consider ways to provide public services more efficiently, privatization can seem like an attractive option. Yet the subject engenders sharp controversies. As noted in a recent report by the National Governors' Association, "Proponents of privatization believe private enterprise can deliver the same services government provides for less money, with higher quality of service and increased flexibility. . . . Opponents of privatization believe that such efforts undermine the quality of services, destroy public employee unions, invite corruption, and weaken government control of services key to the public interest" (1993, p. 43). In New England, the latter concerns appear to dominate, since local governments in the region generally have not engaged in as much privatization as those in other parts of the country.

This article examines the evidence on the relative merits of privatizing public services and attempts to determine whether these costs and benefits actually appear to explain local government behavior throughout the United States. The article begins with a broad description of the mechanisms used in privatization, followed by evidence on the extent to which state and local governments have privatized service delivery. Contracting with private vendors turns out to be more common than use of vouchers or subsidies. However, the tendency to contract out varies considerably across services. The advantages and disadvantages of contracting are then discussed, followed by an empirical analysis of why some localities contract out more or less than others. Measurable advantages and disadvantages vary by community, and explain part (but only part) of the differences in contracting across communities. The limited scope of privatization by New England local governments in particular defies explanation, suggesting that communities in the region may wish to reexamine their choices of how to provide services, if they have not done so recently.

Yolanda K. Kodrzycki

Senior Economist, Federal Reserve Bank of Boston. The author thanks Katharine Bradbury and Lynn Browne for comments on earlier drafts, and Karen Therien for able research assistance.

I. What Is Privatization?

Privatization refers to a shift from public to private production. This article focuses on privatization of traditional public services.¹ By definition, these are services for which purely private markets are considered inadequate (see the box). Privatization takes advantage of the perceived cost efficiencies of private firms. However, government intervention is required even after privatization in order to ensure that sufficient services are provided to residents. Privatization of public services has been largely a "bottom up" experience in the United States, with local governments in the vanguard and higher levels of government trailing behind. As a result, this article concentrates on efforts by local and, to a lesser extent, state governments.²

Under a common privatization arrangement, the government enters into an agreement specifying that a selected private entity (rather than a government agency) is responsible for producing particular services. The government chooses the service level and pays the amount specified in the contract, but leaves decisions about production methods to the private firm. Contracting may be used, for example, to privatize the disposal of hazardous waste or oper-

¹ In some countries, governments have privatized state-owned enterprises involved in the production of goods and services that elsewhere are commonly produced by the private sector. Western European countries, especially the United Kingdom and France, have sold off state-owned enterprises in industries such as automobiles, glassmaking, telecommunications, airlines, finance, and insurance (see Hemming and Mansoor 1988). The countries of the former Soviet bloc are now engaged in similar privatization efforts, on a more massive scale. Once enterprises have been sold, they function like any other private business. By contrast with foreign economies, the role of commercial and industrial public enterprises has been considerably more limited in the United States. Government enterprises have been estimated to account for only about 1 percent of total U.S. GDP, compared to a range of 4 to 16 percent in other OECD countries, and 65 to 97 percent in the former Soviet bloc prior to recent reforms (Schwartz 1993). Furthermore, government enterprises in the United States tend to specialize in a limited range of activities (primarily postal services, utility services, and liquor sales) rather than competing with private corporations on a broad scale. In light of the relatively limited role of the public sector in the United States, it is not surprising that only minimal sales of government enterprises or other government-owned assets have taken place. In 1990-91, for example, the share of general own-source revenue raised by selling property was only 0.45 percent for the federal government, 0.04 percent for state government, and 0.22 percent for local governments (U.S. Bureau of the Census 1993, Table 6).

² For discussion of privatization by the federal government, see Donahue (1989), especially chapter 6. Also, the article's emphasis on public services, as opposed to public goods, simply reflects the fact that governments in the United States rarely provide goods.

Public Goods and Services

Pure public goods and services are those for which consumption is nonrival (that is, adding another consumer imposes no additional cost of providing the goods and services) and nonexcludable (that is, preventing another person from consuming the goods and services is either very expensive or impossible). Other goods and services have some degree of "public-ness," even though they are not "pure." Traditional textbook examples of public services include national defense and fire protection.

Economic theory has demonstrated that, in the absence of government intervention, the private sector would underprovide public goods and services compared to the level that society as a whole would prefer. By contrast, the private sector is the preferred provider of those goods and services for which each consumer is charged a (nonzero) price equal to the added cost of supplying the good or service to him/her, and where it is feasible costlessly to exclude anyone who does not pay.

Another, somewhat different justification for government intervention relates to distributive justice. The citizenry may object to purely private markets in cases where the prices charged would deter some individuals from consuming what are viewed as socially desirable quantities. In these cases, the government charges needy residents a price below the cost of providing the goods or services, and it funds the difference through other mechanisms, principally taxation.

ation of homeless shelters (as well as a range of other services).

Another form of privatization is the franchise, whereby a private firm or firms are awarded the right to perform a specified service within a geographic area over which the government has jurisdiction. The company charges members of the public for services (rather than receiving payment from the government, as in a contract), while the government regulates the level of service and the price charged. Examples of services for which franchises are awarded include trash collection, vehicle towing, and operation of a public utility. These are services for which governments typically charge user fees even when the service is produced internally.

A final type of privatization maintains a funding role for government (in order to maintain some level of demand for the services), but permits individual consumers to choose providers. For example, governments may issue vouchers to residents for the purchase of private day care.³ Or they may provide subsidies to private service organizations, such as grants to private human services providers or capital equipment for use by citizen groups performing neighborhood improvement projects.

Privatization alters who produces public services, but it does not inherently alter who pays.

Privatization alters who produces public services, but it does not inherently alter who pays. Suppose that prior to privatization, a service was produced by government employees and funded by the government. Upon privatization, the service would be produced by private sector employees, but the government could continue its financing role. In other cases, government funds might be supplemented by user fees—both before and after privatization. To take a specific example, a contract could specify that a private company provide free bus services for riders (to be paid for totally by the contracting government), or it might allow the company to charge a fare (thereby reducing the size of the public subsidy). Similar funding options apply to government-operated transportation services: they may be paid for by taxpayers in general, by individual consumers, or by some combination of the two groups. To take another example, suppose that prior to privatization, trash is collected by public employees, but residents are charged a fee for this service. Under a franchise arrangement, residents would pay fees to a private company.

If privatization saves on overall costs, government outlays decline even if service levels and user fees remain unchanged. Governments engaging in privatization sometimes decide to cut back the share of costs covered by public funds. In these cases, government outlays decline further. Residents consuming public services pay more if the overall cost saving from privatization is less than the decrease in public funding.

II. The Scope of Privatization

Although state and local governments on the whole continue to use their own employees for the majority of services provided to residents, a great variety of public services are fully or partially privatized in a large number of localities. Contracting is the most common form of privatization.

Privatization by Local Governments

Methods of delivering local services vary considerably, and a locality may use a mix of different types of public and private providers for any given service. The International City Management Association (1989) conducted a poll of 1,681 cities and counties regarding 71 services that may have been available to their residents in 1988. In general, public employees were more important producers of public services than private employees. Services differed in the extent to which they were privatized. The services most likely to be performed exclusively by local government employees were street cleaning, meter maintenance and collection, cemetery administration and maintenance, inspection and code enforcement, utility meter reading, water distribution, water treatment, traffic control and parking enforcement, building security, payroll, secretarial services, personnel services, and public relations/information. For these services, three-quarters of responding localities indicated using only their own employees. Police and fire services, which are considered by many to be at the core of local government functions, were exclusively performed by local government employees in about 70 percent of cases.⁴

By contrast with these functions, other local government functions have been privatized to a greater extent (Table 1). The most commonly privatized service is vehicle towing and storage: 80 percent of respondents reported issuing contracts, and another 8 percent issued franchises. This may be because towing services are identical whether vehicles are towed from public or private property. Several other services that are commonly contracted out.

³ Special-purpose tax credits and deductions are equivalent to vouchers, even though they do not result in actual outlays by government. To emphasize their similarity to government spending programs, such credits and deductions often are referred to as tax expenditures.

⁴ Some of the remaining cities and counties used employees of another level of government to supply services, in addition to their own employees. Intergovernmental arrangements were especially common in the case of health and human services.

Table 1
Private Provision of Public Services in a Sample of Cities and Counties, 1988

Percent of Respondents	Services and Method of Provision			
	Contract with Private Firm	Franchise	Subsidies	Volunteers
75 and higher	Vehicle towing and storage	—	—	—
50 to 74	Legal services	Gas	—	—
25 to 49	Solid-waste collection and disposal, street repair, traffic signal installation/maintenance, tree trimming/planting, bus system operation/maintenance, paratransit system operation/maintenance, airport operation, utility billing, street light operation, hazardous materials disposal, day care facility operation, operation of mental health/retardation programs/facilities, drug/alcohol treatment programs/facilities, operation of homeless shelters, food programs for the homeless, buildings/grounds maintenance, fleet management, vehicle maintenance, labor relations	Electricity	Operation of homeless shelters, food programs for the homeless	Programs for the elderly, operation of homeless shelters, food programs for the homeless, recreation services, operation of cultural/arts programs, operation of museums

Note: Where applicable, respondents indicated more than one method of providing a service. Fewer than 10 percent of respondents indicated using vouchers or regulatory and tax incentives for any service.

Source: International City Management Association (1989).

including legal services and maintenance of equipment and facilities, also are often purchased by the private sector. In addition, a variety of transportation-related and human services have been privatized by local governments. Localities commonly grant franchises for gas and electricity supply (though, interestingly, not for water). Compared to contracts and franchises, vouchers and subsidies were used relatively rarely. Volunteers—another way of minimizing government employment—were used in at least one-quarter of localities for certain human and recreational services, as well as by between 15 and 20 percent of fire, police, and ambulance departments.

The quinquennial Census of Governments includes information about privatization starting in 1987.⁵ One-third of all general-purpose local governments in the United States contracted out or issued franchises for at least one service shown in Table 2.⁶

⁵ Information from the 1992 Census of Governments was not yet available at the time this article was prepared.

⁶ General-purpose governments provide a variety of services. By contrast, school districts and special districts perform a single function. In the terminology of the Census, "contracting" includes franchise agreements. Henceforth, this article will adopt the Census terminology.

In broad consistency with the results of the ICMA poll, the Census data show that gas supply, public transport, and electric power often involve private sector employees, while the services of libraries, sewerage systems, fire protection, and water supply are usually supplied by public employees. The remaining services—airports, hospitals, landfills, nursing homes, and stadiums and conference centers—are intermediate cases.

On the whole, local governments were more likely to contract out for services that commonly are offered by the private sector or other levels of government. Conversely, they tended not to contract out for services that are commonly the responsibility of local government. For example, fire protection, sewerage systems, and water—which are among the least likely services to be contracted out—were provided by more local governments than was the case for the remaining services.⁷ Two potential explanations exist

⁷ For all 12 services, a simple regression explaining the percentage of all governments contracting out by the percentage of all governments providing the service (using either their own or private employees) yielded a significant negative coefficient for the explanatory variable. The adjusted R-squared was 0.33.

for this behavior, the first attitudinal and the second practical. Services commonly provided by local governments may be viewed as part of their essential mission, and therefore officials may be reluctant to allow them to be performed under contract. Furthermore, for this category of services, outside contractors may be in scarce supply.

Townships were more likely to contract out than municipalities or counties.⁸ In part, this reflects their limited size. Localities with under 10,000 in population generally were more likely to contract out than larger localities. For a variety of services, the largest local governments contracted out less often than medium-sized governments.

Contracting varies across geographic regions, with the Midwest (encompassing the West North Central and East North Central Census areas) and West South Central regions having the greatest and the South Atlantic the least tendency for private production (Table 2). New England was the second to lowest region, as only one-quarter of local governments have contracted out or issued franchises for the services indicated. Out of the nine Census regions, New England ranked seventh or lower in privatization of airports, electric power, fire protection, hospitals, landfills, libraries, and nursing homes. Only in the cases of gas supply, public transit, and water supply was New England's extent of private supply more extensive than the national average.

Local governments in New England are much more likely to provide fire protection, landfills, and libraries for their residents than is true nationwide.⁹ For the reasons noted above, this fact may contribute to limited contracting. Conversely, gas supply and water are provided by a relatively low fraction of general-purpose local governments in New England, which may contribute to an above-average willingness among the remaining local governments to contract out for these services.¹⁰ For the other seven services, however, contracting behavior in New En-

⁸ Only 18 states, concentrated in the Northeast and Midwest, have the township form of government. In other states, the smallest units are municipal governments. Municipalities serve specific population concentrations; townships serve inhabitants of geographic areas defined without regard to population concentrations. In some states, municipalities and townships serve overlapping territories, but this is not the case in New England.

⁹ The percentages of New England localities providing these services were 73.2, 60.7, and 54.5, respectively, compared to national averages of 50.6, 21.2, and 20.6 percent.

¹⁰ Only 1.5 percent of New England localities indicated that they were responsible for supplying gas, and 28.9 percent water, to their residents. The national averages were 5.7 and 36.9 percent, respectively.

land is not explained by a simple hypothesis about the extent to which they fall within the purview of local governments. Alternative hypotheses are examined later in this article.

Privatization by State Governments

According to the Council of State Governments, states have been slower to privatize services than have local governments, but their interest has accelerated sharply in the past several years (Chi 1993). Although comprehensive numerical data are not available, the New England states appear to be as active as others in privatizing a variety of services. Maine and Massachusetts are among 22 states issuing recent studies exploring the feasibility of privatization. Connecticut, Maine, Massachusetts, New Hampshire, and Vermont (along with 21 states outside New England) have reportedly privatized more than 15 percent of their mental health and mental retardation programs. Ten states (including Rhode Island and Vermont) have privatized more than 15 percent of their remaining health services programs, 14 (including New Hampshire and Vermont) social services, and 23 (including Maine, Massachusetts, and Vermont) transportation. However, no New England states were among those with high rates of privatization of general administrative services, corrections, or educational programs.¹¹

III. Advantages and Disadvantages of Privatization

Case studies have been used to evaluate particular experiences with privatization of state and local government functions. Taken as a whole, these studies do not indicate that contracting is uniformly better or worse than provision of services by public sector employees. But they do come to a consensus on the advantages and disadvantages of contracting in cases where it has been tried.

Reduced Costs and Other Potential Advantages

In a wide variety of cases, contracting has resulted in the same level of service being provided at

¹¹ Eight states report privatization of at least 15 percent of their general administrative services. Five states report privatizing 11 to 15 percent of their corrections programs and two have privatized an equivalent share of educational programs.

Table 2
Local Governments Contracting Selected Services as a Percent of Total Providing Services, by Type of Government, Population, Size, and Geographic Region, 1987

	Airports	Electric Power	Fire Protection	Gas Supply	Hospitals	Landfills	Libraries	Nursing Homes	Public Transit
Type of Government									
Counties	31.1	73.5	23.9	77.8	35.2	22.2	15.2	25.5	39.8
Municipalities	28.5	50.9	11.4	57.5	53.8	42.3	12.8	56.7	47.5
Townships	47.7	84.9	52.1	93.6	71.4	35.7	23.2	68.4	59.5
Population									
100,000 and over	15.6	32.7	13.3	53.3	27.8	22.8	7.9	12.8	40.1
50,000 to 99,999	34.0	35.7	11.3	60.0	41.0	20.5	19.7	20.0	40.3
25,000 to 49,999	35.3	31.9	10.3	63.9	41.5	28.1	7.3	28.3	37.6
10,000 to 24,999	38.5	33.1	11.3	55.9	40.9	29.3	15.4	44.4	48.8
Less than 10,000	28.3	58.9	29.1	62.0	53.0	40.2	16.4	53.5	56.2
Geographic Region									
New England	23.4	47.3	8.4	75.0	37.8	30.1	3.6	29.2	70.8
Mid-Atlantic	45.8	72.9	35.9	97.0	61.6	46.0	26.1	30.2	54.7
East North Central	38.1	62.6	35.5	81.9	51.6	42.2	21.0	41.2	48.6
West North Central	23.7	56.0	36.0	69.2	39.3	45.4	11.2	39.1	44.9
West South Central	24.6	56.2	36.0	67.8	38.2	39.9	11.0	40.2	48.6
South Atlantic	34.6	42.2	13.1	40.1	48.1	26.0	16.9	44.9	37.5
East South Central	36.5	45.0	5.7	26.6	41.7	33.8	14.4	51.9	45.6
Mountain	26.1	49.2	10.3	71.9	51.3	31.6	12.2	50.6	41.3
Pacific	27.5	42.0	13.5	67.6	43.8	37.3	24.6	52.3	50.2
All Local Governments									
	30.1	55.3	26.1	61.4	45.7	36.4	15.4	39.6	48.5
Memo: Number of Governments Providing Service									
	3,059	3,846	19,698	2,204	1,404	8,268	8,032	1,148	1,313

Source: U.S. Bureau of the Census (1988).

substantially lower cost, although utilities seem to be an exception. In a response to a 1987 survey, three-quarters of city and county executives with experience with contracting cited cost reductions as the primary benefit of contracting out, and most indicated that they were satisfied with the quality of the work performed by the private contractor (David 1988). Of those reporting some cost saving, 18 percent estimated it at below 10 percent, 39 percent between 10 and 19 percent, and the remaining 43 percent at 20 percent or more. In response to a survey by the Council of State Governments, many states cited savings in the range of 11 to 30 percent (Chi 1993). Transit authorities in the United States and the United Kingdom have saved in the range of 20 to 30

percent by privatizing bus services (Gómez-Ibáñez and Meyer 1993).

Econometric analyses have provided concurring evidence in some cases. One such study examined public and private suppliers of municipal services in the Los Angeles metropolitan area (Stevens, as cited in Donahue 1989). After controlling for the scale of service, the level and quality of service, and the physical conditions of the service area, the author estimated cost savings ranging from 37 percent for tree maintenance to 96 percent for asphalt overlay construction, with intermediate results for janitorial service, traffic signal maintenance, street cleaning, trash collection, and turf maintenance. Private contractors and public employees were equally efficient

Sewerage System	Stadiums, Auditoriums, Convention Centers	Water Supply	Total	Memo: Number of Governments
19.5	22.2	21.6	32.1	3,300
6.3	20.4	5.8	25.6	19,910
21.4	46.8	24.4	48.7	9,036
5.7	16.5	7.8	30.2	771
13.1	9.2	9.0	29.6	900
14.7	18.9	10.6	29.4	1,598
12.5	24.2	11.7	30.3	3,385
7.2	30.2	7.2	33.4	25,592
6.9	21.4	8.6	25.4	1,752
17.4	38.0	16.7	34.8	3,925
10.7	35.6	9.0	36.5	8,504
2.8	26.1	5.1	40.6	7,141
2.9	24.0	5.5	39.3	8,083
9.6	17.9	7.3	24.5	2,998
7.5	12.6	8.0	25.5	1,848
6.2	16.9	4.7	26.8	1,639
10.6	19.0	4.8	30.7	1,526
8.2	22.8	7.8	32.7	32,246
13,224	969	14,367		

in providing the remaining service, payroll preparation. Another econometric study found greater operating efficiency for privately owned than for publicly owned urban transit systems across the United States (Perry and Babitsky 1986).¹²

Studies of water and electric utilities are less decisive. Seven out of the thirteen studies cited in Donahue (1989) indicate no significant difference in costs between publicly and privately owned utilities, after controlling for other factors (such as the size of the service area) that might affect unit costs. Of the remaining six studies, all but one found publicly owned utilities to be more cost efficient than privately owned utilities.

Cost savings from using private contractors may

come from a variety of sources. Some authors contend that privatization reduces costs primarily by introducing competition into markets in which public agencies enjoyed a monopoly position (see, for example, Savas 1992 and Gómez-Ibáñez and Meyer 1993).¹³ Under this view, governments can foster cost efficiencies by encouraging bidding by multiple entities when a contract is up for renewal and by ensuring that the current supplier does not have an unfair advantage in the contract process.¹⁴ The argument also provides an explanation for the lack of cost savings from privatizing utilities. Because utilities are natural monopolies, with per customer costs falling as the service area increases, competition is not advantageous.

Additional studies point to specific cost advantages of private suppliers (see, for example, Kettl 1993a and 1993b, Dudek & Company 1988). Private firms may pay lower wages and fringe benefits (notably retirement benefits) than local governments. But they also often appear to have higher labor productivity. Private firms have more flexibility to use part-timers to meet peak loads, to fire unsatisfactory workers, and to allocate workers across a variety of tasks. In some cases, a private contractor may enjoy greater economies of scale or scope, or access to more productive capital. For example, the private contractor providing firefighting services to Scottsdale, Arizona also serves adjacent rural communities and designs its own specialized vehicles and equipment (Donahue 1989, p. 71).

While a private contractor may produce services more efficiently than public employees, governments incur new contracting and monitoring costs when they shift to private suppliers. The best studies of contracting have attempted to measure these additional costs in evaluating privatization efforts, although admittedly this is hard to do. Actions against contractors overrunning projected costs, not main-

¹² However, the authors found that private management of publicly owned transit systems did not result in cost savings; they attributed this result to a lack of sufficient incentives in contracts.

¹³ In a similar vein, Boardman and Vining (1989) concluded that previous studies comparing public and private enterprises failed to find greater efficiencies on the part of the latter largely because they examined markets with limited possibilities for competition. Their own study, which is limited to industrial markets where competition exists, finds greater efficiencies for private firms.

¹⁴ The United Kingdom introduced mandatory competitive bidding for local services starting in 1988. This provision covers refuse collection, street cleaning, and maintenance of vehicles and grounds, among others (Lauder 1992). However, Donahue (1989, p. 64) notes that open competition is an expensive option if it results in a loss of economies of contiguity.

taining quality standards, or perhaps even engaging in fraud are likely to engage multiple departments of government.

Burdens for Public Employees and Other Potential Disadvantages

The burdens of contracting are concentrated on the public sector work force. In some cases, privatization results in layoffs of public sector employees, although governments often lower the burdens on employees by reassigning them to other government jobs, placing them with private contractors, or offering early retirement programs. One study proposes that governments link the pace of privatization to the rate of public employee attrition, in order to avoid

The burdens of contracting out are concentrated on the public sector work force, and public employee unions oppose privatization.

disruptions for workers (Cox and Love 1992). Still, because burdens on civil servants often are not eliminated entirely, public employee unions oppose privatization. Surveys have indicated that, where present, this opposition lowers the likelihood that public services will be contracted out (Dudek & Company 1988; The Mercer Group 1990, 1992).¹⁵

On the whole, consumers do not appear to be hurt by contracting, and in some cases they actually benefit. For example, privately operated prisons have been found to result in higher satisfaction for inmates and guards, lower escape rates, and fewer disturbances (Thomas and Logan 1993). Studies of transit have found better maintenance, greater safety, and more innovations in the private sector (Perry and Babitsky 1986; Cromwell 1991; Gómez-Ibáñez and Meyer 1993).

Even though consumers as a whole may not suffer from privatization, certain subsets may be at risk. For example, contracting can be used to mask decisions to reduce services (Donahue 1989, p. 136). Contracting can be especially risky in human ser-

vices. Elderly residents and those with infirmities tend to be sensitive to the way services are provided, and government may have very imperfect measures of quality with which to measure performance by the contractor (see especially Kettl 1993a and Schlesinger, Dorwart, and Pulice 1986). Furthermore, part of what advocates of privatization call waste on the part of the public sector may be the inevitable consequence of a conscious effort to redistribute resources to particular parts of the population (Borcherding and Pommerhne 1982). Despite these natural obstacles to privatization of human services, many examples of contracting exist—in part because of legislative mandates that governments seek bids from outside vendors.¹⁶

Finally, scattered examples exist of contractors who failed to live up to expectations, even though the average experience does not appear to be negative. As a consequence, elected officials may feel they can more readily avoid political risks by having public services operated by public employees.

IV. Determinants of Contracting

The previous section suggests that contracting can result in savings if private sector firms are more cost-effective suppliers of services than the public sector, and if markets for contracted services are sufficiently competitive. On the other hand, public sector employees have an incentive to block privatization because their jobs and incomes are at risk. Public sector unionization may increase the effectiveness of opposition to privatization. This section tests whether these factors actually appear to explain contracting patterns among local governments in the United States.¹⁷

¹⁵ Unions may lobby for legislation that limits the potential cost savings from privatization, as well as directly opposing particular moves to privatize. For example, Chi (1992) reports that New York state has a law requiring government contractors to pay prevailing union wage rates.

¹⁶ For example, Schlesinger, Dorwart, and Pulice (1986) cite a Massachusetts law requiring all new contracts for mental health patient services valued in excess of \$40,000 to be competitively bid and all renewal contracts to be subject to competitive bidding at least once every three years. Before the enactment of the law, contracting existed but often was limited to designated private nonprofit organizations staffed at least in part by state employees.

¹⁷ By way of comparison, Abraham and Taylor (1993) found multiple explanations for contracting by private firms. These included a desire to reduce labor costs, make use of specialized skills, and meet volatile demands.

Potential Explanations for Contracting

This section describes how the extent of contracting and potential explanations for contracting are measured. Appendix Table I provides additional details.

Extent of Contracting. The data on contracting are taken from the 1987 Census of Governments.¹⁸ The sample consists of 655 municipalities and townships with population of at least 25,000 that provide at least four of the 12 services covered in the Census questionnaire.¹⁹ The extent of contracting is measured as follows. For each service j that it provides, locality i is assigned a contracting dummy d_{ij} , equal to 1 if the service is contracted out and 0 if it is not contracted out. Let μ_j equal the fraction of all localities that contract out for service j (in other words, the average value of d_{ij}). The overall contracting index for locality i is measured as the sum of the deviations of its contracting dummies from their average values for all localities:

$$C_i = \sum_{j \in J_i} (d_{ij} - \mu_j)$$

where J_i represents the set of services provided by locality i . A positive value of the contracting index indicates that the locality contracts out more than average, adjusting for the mix of services provided to its residents and the fact that not all services are equally likely to be contracted out. A negative value indicates below-average contracting.

It is important to bear in mind that C_i provides a somewhat imprecise measure of the extent of contracting. The Census data indicate that a community contracts out for a service whether or not the service is entirely provided by outside contractors. Frequently, only some aspects of a given service are contracted out. For example, a town may contract out for hookup of new water customers while using its own employees to read meters. Or it may operate a general public transit system while it contracts out for shuttle services for senior citizens. In the extreme

¹⁸ Note again that the Census of Governments uses "contracts" to encompass both contracts and franchises.

¹⁹ Counties are omitted from the study and are a relatively unimportant level of government in New England. The omission of municipalities and townships with population below 25,000 reduced the total sample size from 28,946 to 1,662. The sample was further reduced to 1,196 because some communities did not report on the manner in which they provide the services covered in the Census questionnaire. Omitting localities that provide fewer than four services and those that lacked some of the explanatory variables further reduces the sample to 655.

case, a single private sector manager may be hired to supervise civil servants. All these examples yield a contracting dummy equal to 1 in the Census survey, even though they represent different degrees of privatization. Unfortunately, no estimates of the dollar value of contracts or the number of contract employees exist for a broad sample of governments.

A potential problem with interpreting the Census data is that measured contracting includes cases when governments contract with other governments or quasi-governmental agencies. Therefore Census-measured contracting is not necessarily equivalent to privatization. The results of a small, informal survey confirm that the reported percentages of contracting for library and water services, though relatively low, indeed may overstate the degree of privatization.²⁰

Costs of Providing Services. All else equal, a community should be more likely to hire private contractors the higher the costs of providing services by public employees relative to the cost of providing them using workers from the private sector. Average monthly earnings of local government noneducational workers are used to measure costs in the public sector. Average revenues per employee in the business services industry are used as an indicator of the costs of hiring private contractors.²¹ Unfortunately, measures of non-wage cost differentials, which some studies find to be substantial, were not available.²²

As the literature summary indicated, in the absence of competition among contractors, the community may not achieve potential cost savings from privatization because contractors are able to earn monopoly profits. Small, remote localities are especially likely to encounter this problem. The regressions include a dummy variable indicating whether or not the community is located in a metropolitan area as a proxy for the availability of contractors.²³

²⁰ In connection with the current study, 22 communities in Massachusetts and Michigan were called in order to ascertain the nature of their contracts. All three communities contracting for library services, two (out of four) contracting for water supply, one (out of one) contracting for sewerage treatment, and one (out of four) contracting for transit did so with another government or public authority. Also, one administrator believed that the 1987 response to the Census of Governments regarding contracting for water was erroneous. In the cases of airports, hospitals, and landfills, the respondents confirmed that the contracts were with private firms.

²¹ This measure was used by Good (1992).

²² For example, Gómez-Ibáñez and Meyer (1993) note that more than one-half of the savings associated with transport privatization come from sources other than wages.

²³ Abraham and Taylor (1993) found this variable to be significant in explaining contracting behavior for two of the four private industries they studied.

Finally, abstracting from location issues, smaller localities may incur relatively high unit costs if they operate their own services as a result of not being able to achieve economies of scale. They may benefit from turning to a contractor that serves multiple communities. This hypothesis is tested by including the population of the locality among the explanatory variables.

Privatization may be more acceptable in fast-growing communities, where services are being expanded and contractors are less likely to displace public employees.

Opposition to Privatization. The study evaluates whether public employees may provide more effective opposition to privatization where they are unionized. In the regressions, the unionized percentage of local noneducational public employees varies by state, and is measured separately for municipalities and townships in cases where a state has these two forms of local government.²⁴ On the other hand, privatization may be more acceptable in fast-growing communities. If services are being expanded to cover new residents, contractors are less likely to displace existing public sector employees. The regressions use each locality's population growth rate over a six-year period.

Sensitivity to Costs. Even if two communities face identical cost differentials between private contractors and public employees, one may be more likely than the other to economize because its residents are less willing to pay for services. Per capita income provides one indication of the community's ability to pay. Income tends to be positively related to the value of property, which in turn is the major tax base for many communities. Furthermore, for a given value of property, a community will find it easier to raise revenues the higher the monetary income of its residents.²⁵

Another measure of sensitivity to costs relates to the number of local governments in a given geographic area. Where government density is higher, each locality will be under greater pressure to minimize the costs of providing a given bundle of services

(or to maximize the services it provides per dollar of revenue collected locally) in order to attract households and businesses. Eberts and Gronberg (1988) have shown that, all else equal, per capita government spending falls as the number of local general-purpose governments rises, a result they attribute to competition among governments.

Finally, contracting may vary with the number of services provided to residents. As the number of services increases, differences in the cost and effectiveness with which they are provided become more apparent. Prevailing pay scales or work rules may limit the possibilities for altering how public employees deliver services. Therefore, all else equal, localities providing diverse services may be more open to exploring private-sector alternatives than those localities where services are more limited.²⁶ The regressions include as an explanatory variable the total number of services covered by the Census questionnaire that are provided in the locality, whether by government employees or private contractors.

Other Determinants. The receptivity of a community to contracting may also depend on how residents view the role of their government. If citizens believe that local government should emphasize a narrow range of essential services, they might be relatively comfortable with using contractors in order to minimize the number of public employees. On the other hand, in places where the local government has a broader mandate to redistribute income, citizens may be less likely to support privatization. The first measure tested in the regressions is the percentage of the

²⁴ Information on the extent of unionization for individual municipalities and townships is not publicly available. For private firms, Abraham and Taylor (1993) found no systematic association between unionization and contracting out.

²⁵ Because information on contracting is available only for 1987, this study cannot distinguish factors that originally lead locality to contract out for services from those factors that continue to play a role. For this reason, the study does not examine direct measures of fiscal health or fiscal stress, since they tend to fluctuate with business cycles. Alm, McKee, and Skidmore (1993) found, for example, that in the earlier years of their sample, fiscal stress contributed to states' decisions to adopt lotteries. More recently, decisions have been more influenced by practices in neighboring states.

²⁶ Somewhat analogously, Abraham and Taylor (1993) find that firms requiring diverse skills are more likely to contract out for work that pays wages that lie outside company norms. Specifically: "Our finding that high-wage establishments are more likely to contract out for janitorial services suggests that these establishments cannot easily pay low wages to janitors on their own payrolls. Similarly, the finding that low-wage establishments are more likely to contract out for certain types of high-skill services suggests that these establishments cannot easily pay high wages to workers in selected occupational groups."

locality's general noneducational expenditures allocated to core services, here measured as police and fire protection. The other is the percentage spent on human services, measured as public welfare plus health and hospitals. Because these indicators are negatively correlated with each other, they are entered sequentially rather than simultaneously.²⁷ Finally, regional dummies are used to test for attitudes or other unspecified influences that may be widespread in a region rather than being specific to any given community.

Regression Results

The regressions reveal that, in deciding how to provide services, smaller localities respond more to economic variables than do larger localities. In both cases, attitudinal variables also matter, as do additional factors not taken into account in the regressions. Table 3 presents the most satisfactory regression results, while Appendix Table 2 presents results using a more comprehensive set of explanatory variables.²⁸

Costs are highly significant determinants of contracting for localities with a population under 50,000 (columns 1 to 3). These localities were more likely to contract out if the average wage in the public sector was high, if they were located in a metropolitan area, and if they were small. Costs mattered both for non-utility services and for utilities, though they mattered more for the former category.²⁹ Private sector revenues per employee were not significant (Appendix Table 2). Unionization and population growth were significant at the 10 percent level for non-utility services; they entered with the expected signs (negative and positive, respectively) for utility services, but were not significant. The number of services provided was a strong predictor of the likelihood of contracting. The performance of the other measures of sensitivity to costs—per capita income and the density of governments—was disappointing; often they were insignificant or entered with the wrong sign. As expected, localities where government expenditures are highly concentrated on health and human services were less likely to contract out. Conversely, places where the government concentrates on providing "core" services are more likely to contract out, although the significance of this variable was somewhat lower than the health and human services variable. (This latter version of the regression is not shown in the tables.)

Columns 4 to 6 report on regressions with se-

lected regional dummies.³⁰ The New England dummy enters with a negative coefficient that is significantly different from zero in the "All Services" equation. With the regional dummy variables, the unionization and population growth variables lose significance, which suggests that the exact causes of objections to or acceptance of privatization are hard to pin down. Finally, adjusted R-squared values in the range of 0.2 to 0.3 confirm that localities are strongly guided by factors that are not measured in the regressions—including perhaps the presence or absence of political leaders who support privatization, the reputation of local contractors, or differences in costs of providing fringe benefits or in productivity between the public and private sectors.

A smaller set of explanatory factors mattered for localities with population of 50,000 or more (columns 7 to 9). The larger localities in this group were a little less likely to contract out than localities with population under 50,000. Higher public sector wages contributed to contracting, but the coefficients were not as significant and were smaller than for communities with population of less than 50,000. Since all places with population of at least 50,000 are located in a metropolitan area, the availability of contractors was not an issue. Contracting was more prevalent in localities providing a greater number of services (among the 12 covered) or concentrating a greater share of expenditures on core services, and among those located in the Middle Atlantic states. Unionization and population growth were insignificant (even in the absence of regional dummies), and the explanatory power of the regressions was less than in the case of smaller communities.

²⁷ The omitted category of expenditures largely represents public infrastructure. It includes roads, recreational facilities, and community development.

²⁸ A separate set of regressions (not shown) used a probit model to examine privatization with respect to individual services. Variables generally entered with the same signs as in the regressions measuring the total extent of contracting, but the coefficients were less likely to be significantly different from zero. In another set of alternative regressions, contracting indexes were defined separately for localities with population under and over 50,000, based on each group's average contracting experiences. In other words, the values of μ_i were allowed to differ between the two groups. These regressions yielded results very similar to the ones reported, which used averages from the entire sample.

²⁹ The non-utility regressions are estimated for those localities providing at least four (out of nine) non-utility services. The utility regressions include localities providing at least two of the following three services: electricity, gas, and water. As a result of these criteria, the number of observations is much smaller for the utility equation than the other equations.

³⁰ Omitted dummies were rarely (if ever) significant in any regression.

Table 3
Contracting Regressions

Independent Variable	Population Between 25,000 and 49,999						Population 50,000 and Over		
	Without Regional Dummies			With Regional Dummies			All Services (7)	Non-Utility Services (8)	Utilities (9)
	All Services (1)	Non-Utility Services (2)	Utilities (3)	All Services (4)	Non-Utility Services (5)	Utilities (6)			
Costs									
Average wage in public sector	.8123*** (.1942)	.9780*** (.2148)	.5268** (.2446)	.7761*** (.1987)	.9646*** (.2218)	.5031** (.2354)	.3410* (.1859)	.2164 (.1676)	.0593 (.2554)
Location in metropolitan area	.6659*** (.1774)	.4445*** (.1649)	.4521** (.2248)	.6729*** (.1766)	.4613*** (.1656)	.4075** (.2348)			
Population	-.0195** (.0097)	-.0218** (.0102)	-.0146 (.0125)	-.0212** (.0097)	-.0223** (.0102)	-.0125 (.0129)	-.0004** (.0001)	-.0003*** (.0001)	-.0002 (.0002)
Opposition to Contracting									
Unionization	-.0053 (.0041)	-.0078* (.0043)	-.0057 (.0047)	-.0037 (.0047)	-.0073 (.0051)	-.0042 (.0057)	.0020 (.0053)	.0016 (.0046)	.0082 (.0087)
Population growth	.0033 (.0039)	.0107* (.0055)	.0040 (.0043)	.0023 (.0039)	.0093 (.0056)	.0031 (.0044)	.0037 (.0050)	.0037 (.0045)	.0021 (.0068)
Sensitivity to Costs									
Number of services	.3034*** (.0432)	.2580*** (.0447)	.2424*** (.0423)	.3148*** (.0433)	.2534*** (.0444)	.2431*** (.0427)	.2224*** (.0384)	.1568*** (.0354)	.1825*** (.0468)
Other									
Concentration on core functions							.0186** (.0094)	.0171** (.0087)	.0133 (.0129)
Concentration on health and human services	-.0139*** (.0051)	-.0096* (.0053)	-.0061 (.0054)	-.0134*** (.0051)	-.0094* (.0052)	-.0053 (.0056)			
New England dummy				-.4835** (.2255)	-.3081 (.2262)	-.3324 (.2986)	-.0481 (.3059)	-.0999 (.2621)	.3868 (.9377)
Middle Atlantic dummy				.1364 (.2584)	.3758 (.3677)	.0488 (.4140)	.8450*** (.2743)	.9106*** (.2656)	1.442*** (.3968)
West North Central dummy				-.4492* (.2558)	-.3555 (.2409)	-.3121 (.3724)	-.4801* (.2698)	-.3888* (.2260)	-.0362 (.3191)
Constant	-2.855*** (.5317)	-2.742*** (.5379)	-2.318*** (.6916)	-2.756*** (.5354)	-2.628*** (.5427)	-2.366*** (.7071)	-2.747*** (.5015)	-2.063*** (.4473)	-2.170*** (.7175)
Adjusted R-squared	.200	.240	.298	.215	.252	.291	.119	.128	.255
Number of observations	316	213	89	316	213	89	339	269	86

***Significant at 1 percent level.

**Significant at 5 percent level.

*Significant at 10 percent level.

Contracting Decisions in the New England States

The equations including regional dummies fit the New England averages very closely.³¹ Without the dummies, New England contracting is overpredicted. For example, for localities with population under 50,000, the regression excluding regional dummies

predicts the overall New England contracting index to be close to, rather than substantially below, the

³¹ For localities with population under 50,000, the nine regional values of the overall contracting index ranged from -0.32 to +0.60; New England's value of -0.26 was the second lowest (Table 4). For localities with population of at least 50,000, New England had the third to lowest value.

Table 4
Regression Variables

Variable	Population Between 25,000 and 49,999		Population 50,000 and Over	
	United States	New England	United States	New England
Contracting Index				
Overall	.09	-.26	-.12	-.24
Non-utility services	.08	-.24	-.12	-.30
Utilities	.07	-.14	.07	.
Average wage in public sector	2.00	2.03	2.19	2.05
Location in metropolitan area	.81	.90	1.00	1.00
Population	34.54	33.87	197.23	97.24
Unionization	35.49	53.80	36.78	64.39
Population growth	8.55	1.40	8.65	-.35
Number of services	5.52	5.73	6.10	5.97
Concentration on core functions	24.50	24.57	24.70	23.52
Concentration on health and human services	4.71	6.62	4.51	9.92

Note: The values shown for the independent variables are average values for localities providing at least four (of the twelve) services.
*Only one local government in New England was included in the utilities regression.

national average. In other words, the region's low contracting tendency remains a mystery.

Table 4 indicates the role of measurable influences on privatization. Given their cost factors, New England localities with population under 50,000 would be expected to contract out more than their counterparts in other parts of the country. Ninety percent are located in a metropolitan area, compared to 81 percent nationally. Also, the average New England locality pays slightly higher wages and is slightly smaller than the average included community in the nation. For localities with population over 50,000, cost factors are mixed.

Factors other than costs partly explain low privatization in New England. In other states, on average only about one-third of public sector employees are unionized, compared to over one-half in New England. Population growth has been minimal in the region, which means that there is little need for

expansion of public services. Therefore, private contractors would be likely to displace public employees. Finally, a relatively high share of government non-education spending is devoted to health and human services, which the regressions showed was a negative indicator of contracting.³²

V. Conclusions

Surveys and other analyses confirm that state and local governments can achieve savings, without sacrificing quality, by privatizing the delivery of services through judicious use of private contractors. Regressions indicate that localities do in fact tend to contract out to avoid paying high public sector wages. They also are more likely to contract out if they provide multiple services. A wide range of functions apparently makes cost comparisons across programs more feasible, while making it less likely that civil service rules produce desirable results for all programs. Local governments are more likely to contract out when they serve a small population and when they are located in a metropolitan area. In such circumstances, they may find it difficult to achieve sufficient scale economies on their own, but have access to a number of contractors to ensure competition.

These factors, while significant, do not explain much of the observed variation in the degree of contracting across localities. Attitudes are important. Places where government concentrates a greater share of resources on provision of basic public services such as police and fire protection are more likely to contract out than places where the government is charged with more active redistribution of resources. Unobservable factors—including perhaps the views of local politicians or relative non-wage costs between the public and private sectors—also affect government decisions.

In addition to this variation across localities, some services are less likely to be contracted out than others. In particular, basic public services such as fire protection are contracted out far less often than services that are commonly purchased individually by private businesses. The reason for this discrep-

³² A study by Tannenwald (1990) had found that New England's high priority on collective services and redistributive expenditures limited the extent to which the region could rely on user fees to finance public expenditures. An interesting extension of the work in that article and the current study would be to consider in a simultaneous model the effects of preferences for public services on methods of service delivery and financing.

ancy may be partly economic (the relative abundance or scarcity of private contractors for some services) and partly attitudinal (whether or not the service is viewed as the responsibility of local governments). For electric power and gas supply, contracting rates are relatively high, despite evidence that public utilities often can produce services at costs that are no higher, and may even be lower, than those of private utilities.

Cities and towns in New England have shown less willingness to privatize public services than their national counterparts. This discrepancy could not be explained. Despite historical opposition, however, there is reason to believe that contracting out and

other forms of privatization will become more popular in the future. A general move to improve cost efficiency and productivity in government has created considerable interest in privatization efforts, and some state officials in the region are actively exploring further use of this option. Equally important, New England's local governments serve communities that on average are smaller, but more likely to be located close to concentrations of population, than is true for the nation as a whole. Access to multiple service providers increases the likelihood of being able to produce meaningful competition among contractors, which is an important prerequisite to achieving cost savings.

Appendix Table 1
Variable Definitions, Sources, Means, Minimums, and Maximums

Variable	More Detailed Definition	Data Source	Mean (Observations for 1196 Localities)	Minimum	Maximum
Contracting Index	See text.	a	3.86e-10	-2.43	6.97
Average wage in public sector	Average October 1987 earnings of full-time employees, thousands of dollars.	b	2.15	.94	4.63
Location in metropolitan area	Dummy = 1 if the municipality or township is located in a metropolitan statistical area.	a	.94	0	1
Population	1986 population, thousands.	a	91.41	25.02	7,262.75
Unionization	Percent of public noneducational employees that are organized, by state. Computed separately for municipalities and townships.	b	37.73	1.31	93.67
Population growth	Population growth rate from 1980 to 1986.	a	9.85	-24.21	497.86
Government density	The number of county, municipal and township governments per square mile, by state. Computed separately for metropolitan statistical areas and other areas.	b & d	.03	.00	.08
Revenues per employee	Annual receipts for firms providing business services relative to the number of paid employees.	a	3,005.5	350.0	11,070.6
1987 income per capita	Per capita money income, thousands of dollars.	c	12.89	1.39	36.69
Number of services	Sum of the number of services operated and the number of services contracted.	a	4.43	0	12
Concentration on core functions	Expenditures on police and fire protection as a percent of total expenditures less education.	b	25.6	0	57.5
Concentration on health and human services	Expenditures on public welfare and health and hospitals as a percent of total expenditures less education.	b	3.4	0	79.8
New England dummy	Dummy = 1 if state = CT, MA, ME, NH, RI, or VT.	a	.1	0	1
Middle Atlantic dummy	Dummy = 1 if state = NJ, NY, or PA.	a	.17	0	1
East North Central dummy	Dummy = 1 if state = IL, IN, MI, OH, or WI.	a	.17	0	1
West North Central dummy	Dummy = 1 if state = IA, KS, MN, MO, NE, ND, or SD.	a	.07	0	1
South Atlantic dummy	Dummy = 1 if state = DE, DC, FL, GA, MD, NC, SC, VA, or WV.	a	.11	0	1
East South Central dummy	Dummy = 1 if state = AL, KY, MS, or TN.	a	.04	0	1
West South Central dummy	Dummy = 1 if state = AR, LA, OK, or TX.	a	.09	0	1
Mountain dummy	Dummy = 1 if state = AZ, CO, ID, MT, NV, NM, UT, or WY.	a	.08	0	1
Pacific dummy	Dummy = 1 if state = AK, CA, HI, OR, or WA.	a	.19	0	1

Source: U.S. Bureau of the Census: ^amachine readable data, 1988; ^b(1988); ^c(1993); ^dunpublished data.

Appendix Table 2
Contracting Regressions with a Comprehensive Set of Independent Variables

Independent Variable	Population Between 25,000 and 49,999								
	Without Regional Dummies			With Regional Dummies			Population 50,000 and Over		
	All Services (1)	Non-Utility Services (2)	Utilities (3)	All Services (4)	Non-Utility Services (5)	Utilities (6)	All Services (7)	Non-Utility Services (8)	Utilities (9)
Costs									
Average wage in public sector	.6534*** (.2199)	.8660*** (.2558)	.4186* (.2510)	.5064** (.2305)	.7845*** (.2737)	.2933 (.2743)	-.0797 (.2326)	-.0856 (.2091)	-.2763 (.2928)
Revenues per employee in private services sector	.0473 (.0756)	-.0237 (.0926)	.0082 (.1134)	.0355 (.0748)	-.0448 (.0921)	-.0070 (.1133)	.0070 (.0812)	-.0277 (.0734)	.0866 (.0906)
Location in metropolitan area	.5595*** (.1970)	.3983** (.1842)	.3205 (.2644)	.5437*** (.1950)	.4185** (.1836)	.3104 (.2740)			
Population	-.0138 (.0104)	-.0172 (.0111)	-.0134 (.0133)	-.0159 (.0103)	-.0176 (.0110)	-.0108 (.0134)	-.0004** (.0001)	-.0003** (.0001)	-.0001 (.0002)
Opposition to Contracting									
Unionization	-.0061 (.0044)	-.0083* (.0047)	-.0077 (.0053)	-.0028 (.0050)	-.0068 (.0055)	-.0033 (.0065)	.0066 (.0057)	.0055 (.0050)	.0073 (.0094)
Population growth	.0033 (.0042)	.0103 (.0064)	.0060 (.0046)	.0030 (.0041)	.0102 (.0063)	.0048 (.0047)	.0049 (.0053)	.0048 (.0047)	-.0017 (.0073)
Sensitivity to Costs									
Number of services	.3185*** (.0449)	.2706*** (.0459)	.2457*** (.0447)	.3323*** (.0446)	.2664*** (.0455)	.2473*** (.0441)	.2345*** (.0395)	.1608*** (.0364)	.1730*** (.0494)
Per capita income	.0302 (.0231)	.0252 (.0237)	.0430 (.0364)	.0505** (.0240)	.0369 (.0248)	.0670* (.0394)	.0821*** (.0282)	.0710*** (.0269)	.0616 (.0395)
Government density	-.3232 (3.821)	-.7637 (4.528)	6.715 (5.723)	1.634 (4.056)	1.285 (4.749)	7.281 (5.661)	.9190 (4.215)	.1050 (4.202)	-4.423 (6.380)
Other									
Concentration on core functions							.0215** (.0098)	.0181** (.0091)	.0178 (.0136)
Concentration on health and human services	-.0147*** (.0054)	-.0099* (.0054)	-.0064 (.0058)	-.0137*** (.0053)	-.0092* (.0054)	-.0046 (.0060)			
New England dummy				-.6974*** (.2489)	-.4454* (.2550)	-.6012* (.3203)	-.4719 (.3342)	-.4410 (.2940)	.7034 (.9613)
Middle Atlantic dummy				-.0019 (.2809)	.3082 (.3846)	.2980 (.4440)	.6046** (.3131)	.7869** (.3070)	1.409*** (.5114)
West North Central dummy				-.4525 (.2820)	-.3651 (.2743)	-.5339 (.4255)	-.4762* (.2870)	-.4049* (.2444)	.0013 (.3525)
Constant	-3.171*** (.5854)	-2.907*** (.6026)	-2.697*** (.7682)	-3.132*** (.5788)	-2.824*** (.5981)	-2.820*** (.7685)	-3.133*** (.5525)	-2.355*** (.4951)	-2.322*** (.8127)
Adjusted R-squared	.198	.236	.292	.220	.251	.310	.146	.149	.279
Number of observations	303	202	85	303	202	85	321	252	60

***Significant at 1 percent level.

**Significant at 5 percent level.

*Significant at 10 percent level.

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Factors Important In
Local Government's
Privatization Decisions

01

FACTORS IMPORTANT IN LOCAL GOVERNMENTS' PRIVATIZATION DECISIONS

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In this article, the author builds a model of local governments' decisions to contract out residential solid waste disposal services and empirically tests this model by using a new dependent variable—proportion of expenditures on a service that goes to expenses other than payroll. The important factors affecting the contracting-out decision are scale economies, nonproperty taxes, difference in private- and public-sector unionization rates, and income and bond rating, in that order. Political and ideological factors appear to be less determinative than economic considerations.

Privatization, in general, and contracting out, in particular, were popularized by such national leaders as President Ronald Reagan and Prime Minister Margaret Thatcher. Since then, many local governments have also been considering privatization. But what considerations enter into local government's decision to contract out a particular service? An examination of the privatization decision can draw on an extensive literature regarding the "make-or-buy" decision of private firms; Coase (1937), Alchian and Demsetz (1972), and Williamson (1979) provided early contributions. In this article's theoretical part, I will build on this literature and adapt it to the make-or-buy decision of local governments—that is, whether to contract out a service to a private firm. The objective of this article, thus, is to contribute to the privatization literature by presenting theories about the major considerations that enter local governments' privatization decisions, particularly contracting out. First, I will review some of the existing literature and indicate where this article fits in. Then I will build a model and subsequently test it empirically in relation to the decisions to contract out residential solid waste disposal services.

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PREVIOUS STUDIES

Studies in which scholars have examined factors that can affect local officials' decision to contract out services fall into two main categories: those in which mainly one privatization factor is examined (e.g., cost effects of contracting out) and those in which the emphasis is on building and empirically testing a comprehensive framework and a model with which to explain the contracting decisions and test them empirically. Many studies of the first type exist, but few of the second exist; this article is designed to be an addition to the second type.

SPECIFIC FACTOR STUDIES

Stevens (1984) studied the relative costs of service provision in 121 cities in Southern California and found that out of the eight services studied, seven exhibited significantly lower costs when produced by private firms. The highest savings of 96% were found in asphalt overlay construction, and there were 42% savings in refuse collection. She attributed these cost differentials to more efficient production techniques used by private firms rather than to wage differences and concluded that "on the average, these differences in cost were not associated with differences in the quality of service delivery" (p. 401).

A number of studies have provided reasons to interpret cost studies such as Stevens' (1984) with caution. In a study of nursing homes in New York, Gertler and Waldman (1992) found considerable variability in the quality of care across nursing homes of different sizes and specifically reported that "When quality is ignored, the estimates [of a quality-adjusted cost function] . . . suggest large economies of scale. However, estimates of a quality-adjusted cost function show diseconomies of scale for high-quality homes" (p. 1251).

Sullivan (1987) focused on the loss of control and social accountability concomitant with privatization and expressed concern that "By turning 'production' of public services over to private groups, governments can effectively evade constitutional restraints" (p. 462). This would imply an additional social cost not captured in simple accounting measures.

Ferris and Graddy (1991) and Prager (1993) focused on the fact that direct measurement of the cost of private production tends to understate the social cost. Ferris and Graddy found that additional costs related to monitoring the private service producer—that is, *transaction costs* of contracting—are found to influence the choice between private and public production. Prager

investigated the same issue under the label *external monitoring cost*, as opposed to *internal monitoring necessary* with in-house government production. He also distinguished between micro- and macrocontracting—for example, contracting out individual tasks rather than entire services—asserting that the macrocontracting is more difficult to monitor and, hence, is more costly than microcontracting.

A summary of studies of major services that have been contracted out in the United States is presented in Hirsch (1991). The services include solid waste disposal, management and operation of facilities and programs, security services, parks and recreation services, road services, vehicle maintenance and repair, and day-care services. For each service, there is a review of productivity comparisons, extent of contracting, and switching. The resulting picture shows mixed productivity results and not insignificant switching in and out of contracting.

COMPREHENSIVE MODELS OF THE CONTRACTING DECISION

Ferris (1986) developed a model designed to test conditions under which urban governments contract out. He focused on supply—that is, production cost and fiscal and political determinants. He constructed an index of overall privatization by adding the number of services contracted and analyzed how this index varied across 433 cities. This method effectively highlighted interjurisdictional variations while necessarily obscuring variation across services (e.g., certain services might be privatized in small cities but not in large cities or may be privatized to varying degrees). He found that in terms of supply factors, privatization is less common in cities with lower relative public-sector wages and in those that are neither metropolitan nor within the standard metropolitan statistical area with other large cities (indicating fewer competitive private suppliers of service). Within the fiscal category, a higher per capita tax burden, a higher level of intergovernmental grant revenue, and statutory fiscal limitations are found to increase the proportion of services privatized. Finally, among political variables, Ferris found less privatization as a city's proportion of residents aged 65 years or older, of public employees, and of residents aged 30 years or younger increased.

A second comprehensive model was constructed and implemented by McGuire, Ohsfeldt, and Van Cott (1987), who focused on school transportation. They found that privatization was more likely in cities in which strike activity, wage rates, and unionization rates in the public sector were higher and in which the government's proclivity to tax and spend was lower. The

line between political and economic determinants appears to be blurred. For example, political conditions within a jurisdiction may allow for higher taxes that will reduce the urgency of cost-cutting measures for school administrators. The authors interpreted their results as finding that "non-monetary constraints are an important factor affecting this choice of production modes" (p. 212).

Another model was built by Dubin and Navarro (1988). They used a choice-theoretic framework, focusing on economies of density as an economic determinant and on the power of rent-seeking interest groups and ideology as political determinants. By using solid waste disposal as their service, they could point to differences among private and public collectors concerning the exclusivity of territorial rights. In the case of private firm collectors, there can and does exist much competition for business in the same geographical area; governmental collectors have exclusive territorial rights and can significantly benefit from scale economies. Private firms may also benefit from scale economies if they win a contract for a large city. As to the role of ideological preferences, they found that privatization decisions were likely to diverge in both Democratic and Republican communities from the cost-minimizing alternative and impose real costs on the community (p. 236).

A theoretical model was presented in Hirsch (1991) that hypothesized that the decision to contract out a service is affected by accountability, cost and efficiency, and distributional considerations. No steps were taken to implement the model empirically.

THE MODEL

The privatization model that will be developed and empirically implemented in this article is in some sense a fusion and extension of my earlier theoretical model (Hirsch 1991) and the model implemented by Ferris (1986). The model is based on the assumption that the decision of local governments to contract out a given service depends on four sets of factors:

- Accountability
- Production, efficiency, and cost
- Political, institutional, and legal considerations
- Fiscal pressures facing the government unit

These four factors will be discussed in turn.

ACCOUNTABILITY

Accountability refers to the responsibility of ensuring that a service highly valued and/or deemed crucial by society is provided at an acceptable minimum level, particularly when the private sector's profit motive would involve extremely high transaction costs. Thus accountability is affected by the extent to which a service can be monitored and its providers punished. In relation to services from which society demands a high degree of accountability, privatization tends to be ruled out. Services for which accountability is an important consideration include those provided by judges, especially in criminal proceedings; by officials who must ensure the rights of minorities in law enforcement and incarceration; by planning officials; and by zoning officials. In short, before efficiency and other characteristics associated with a service are considered, those who are to decide on the efficacy of contracting out must determine whether accountability is a major issue. If it is, no examination of further factors may be needed.

PRODUCTION, EFFICIENCY, AND COST

Productivity enhancement and cost savings, which have been the overarching privatization determinants in the past, can be analyzed in terms of a number of major factors, scale economies being one of the most significant. They can result, for example, when a government service is provided by a large firm that contracts with many departments or with many governments rather than by a relatively small government department. Bulk purchases become possible, as does spreading relatively fixed management costs over a larger output. Econometric studies of urban government cost and production functions provide some partial confirmation of this proposition.¹

A second factor involves *economies of scope*, a term that refers to the increased efficiency that can result when several complementary services are under the direction of the same entity. Although economies of scope are less common than economies of scale, they arise, for example, when there are significant gains from complementary relations.² Although it may be inefficient to contract out certain services separately, it can become cost-effective to do so when some are bundled together to benefit from economies of scope. For example, rather than privatizing fire services alone, a government might privatize many or all emergency services.

Market competition is another factor. It must be remembered that markets for local public services are apt to be imperfectly competitive. Yet the more competitive the market, the greater the likely efficiency gains from contracting out. When privatization merely replaces the public monopoly with a

private one, the bidding process may fail to force the asking price of the winning firm down close to its opportunity cost. The relationship between the extent of competition and the final equilibrium bidding strategies depends on the structure of the auction and, in particular, on the possibility of collusion between bidders.³ In addition, if the service in question is not competitively provided, the equilibrium costs will include monopoly profits, and the cost advantages of privatization would thus be minimal.

INSTITUTIONAL POLITICAL AND LEGAL FACTORS

The institutional environment within which the privatization decision is made and which seriously affects privatization is complex and multifaceted. One of the circumstances that bears on the contracting-out decision is labor-management relations; often, legislatures prescribe restrictive hiring practices, work rules, and costly compensation patterns for public employees and, sometimes, for the employees of private firms that bid on public contracts. As a result, firms and governments face constraints on factor ratios and wages paid. In the case of unionized labor, these constraints can be given either explicitly through union contracts or implicitly by the fear of union political strength. In either case, the government faces a *de facto* technology in which the possibilities for input substitution can be more limited than in the actual technology.⁴ Because public unions are more powerful than those in the private sector, they tend to exert greater pressure on employers.⁵ Thus unionization may prove to be a barrier to contracting out for local governments that find the political pressures applied by unions difficult to resist. This condition can be looked upon as an additional cost of contracting out that is revealed not in factor ratios or wages but as a cost incurred by politicians when contracting out occurs.

Restrictive labor laws can be a further impediment to privatization, and much of the earlier analysis can be applied to such labor laws as prevailing wage laws, which compel governments to pay wages at least equal to those paid by the private sector for similar work, and residency laws, which restrict hiring of workers to those who are residents of the jurisdiction. These laws can impose serious constraints on the input mix of governments.

Furthermore, the dominant party affiliation of a community's residents can affect privatization as can the general income level. By and large, relatively well-off communities with conservative values tend to favor privatization; communities that have many residents who belong to unions and that have a large minority population tend to oppose privatization.

FISCAL PRESSURES

Financial exigencies are likely to exert pressure on local government to consider contracting out some services in an effort to reduce costs. A number of possible signals of the presence of such pressures can be identified. One such signal is the rating given bonds by major bond-rating firms, which testifies to the general fiscal health of the particular government as perceived by experts. Jurisdictions with a low rating usually are, or in the recent past have been, experiencing financial difficulties, which, in turn, can stimulate their exploration of such measures as contracting out to reduce cost.

Another indication can be the level of subsidies given to a local government by federal and state governments. If such subsidies make local officials feel less pressured to seek cost-reducing arrangements, the incentive to consider contracting out will have diminished. (Yet high subsidies may suggest strong fiscal pressures.)

Finally, when the responsibility to pay per capita taxes to local, state, and federal governments falls on residents and the taxes are relatively high and visible, citizens tend to pressure their government officials to explore ways to reduce costs so that their tax burden can be reduced. Such a scenario can prompt serious consideration regarding the contracting out of certain services.

IMPLEMENTATION OF THE MODEL

In the following empirical analysis, I will focus on a single service, residential solid waste disposal, which tends to be the third or fourth largest budget item of most municipal governments. It involves few accountability problems and is one of the most common of privately produced local government services.

MODEL SPECIFICATION

In the preceding section, a model of the determinants of the contracting-out decision was developed that can be stated as follows:

$$\text{PRIV} = f(\text{ACC}, \text{PROD}, \text{IPLE}, \text{FISC}),$$

where

PRIV = extent to which a local government contracts out a service,
ACC = accountability,
PROD = production efficiency and cost,

TABLE 1: Descriptive Statistics, 1980

Variable Abbreviation	Definition
PRIV	Proportion of residential solid waste disposal nonpayroll expenditures ^a
POP	Population (1,000s) ^b
POPSQ	POP squared/100,000 ^b
DENS	Density—1000/sq. mile ^b
METRO	1 if city is located in a metropolitan area of 50,000 or more, 0 otherwise ^b
UND	Difference between public employees' unionization and private employees' unionization rates (by state) ^c
INCO	City's median household income ^b
OWNER	Percentage of owner-occupied housing ^b
BOND	Moody's bond rating: A, Aa, or Aaa = 0; Bb or Baa = 1 ^d
SUBS	Per capita intergovernmental revenue transfers ^b
PTAX	Per capita city property tax ^b
OTAX	Per capita city nonproperty taxes ^b
STAX	State sales tax rate ^b

a. U.S. Bureau of the Census (1981a, 1981b).

b. U.S. Bureau of the Census (1983).

c. Troy and Shefflin (1985).

d. Moody's Bond Rating (September 1982).

IPLE = institutional, political, and legal environment, ar:1
FISC = fiscal pressures on governments.

Table 1 summarizes the variables that are included in the empirical analysis. Each of the variables will be discussed in the following sections.

Extent to Which a Local Government Contracts Out Residential Solid Waste Disposal with Firms (PRIV)

Data to directly measure PRIV do not exist. In previous research, Ferris (1986) and Ferris and Graddy (1991) used survey data to determine whether a service is or is not privatized. Such data have serious shortcomings because they are binary for any one service—that is, a given service is considered either privatized or not. In reality, privatization occurs along a continuum between total and no privatization.

An alternative measure, for which data are collected and published by the U.S. Bureau of the Census for cities with populations greater than 50,000, is

the proportion of expenditures on a particular service that goes to expenses other than payroll. There is good reason to conclude that cities for which this proportion is small compared to that of the average city (e.g., close to 0) privatize less than those for which the ratio is large (e.g., close to 1). (Thus, if a city completely contracts out a service, this ratio would be 1 because payroll expense on this service would be 0.)

Residential solid waste disposal is a service that lends itself well to empirical analysis. Its extent of privatization varies greatly across cities, from 0% to 100%, and government expenditure data are generally available.

It is conceded that the proposed measure of the degree of privatization (PRIV) has some flaws. Efficiency, possibly resulting from differential use of capital equipment, may affect this ratio.⁶ Moreover, the ratio may be influenced by a number of institutional arrangements altogether unrelated to the extent of contracting out. For example, both involvement of county governments in solid waste disposal within a city and the actual classification of spending by service vary across cities. Advantages of the proposed measure are, however, that it is not artificially constrained to be discrete and that a uniform and consistent source of data exists across cities. Its conceptual clarity is another advantage.

Production Efficiency and Cost (PROD)

Although a cost function is not directly estimated, four variables related to efficiency and cost are included in the equation: POP, POPSQ, DENS, and METRO. These variables are described as follows.

POP = City's population size. If a U-shaped cost curve for city service provision is hypothesized, as is theoretically plausible and has been empirically verified (Ladd 1992), population size is likely to affect the degree of privatization. Large cities with large sanitation departments will face diseconomies; smaller ones will experience economies in government provision of solid waste disposal. To test for a parabolic relationship between city size and privatization, I included population (POP) and population squared (POPSQ) variables (Hirsch 1965). If a U-shaped unit cost function does exist, a negative coefficient on POP and a positive coefficient on POPSQ should be found, suggesting economies of scale for smaller cities and diseconomies for large ones.

DENS = Density of population within city. Negative externalities or external effects are likely to assume greater importance as density increases. If city governments are better able to internalize negative externalities

associated with solid waste disposal, then a negative relation between density and private-sector provision seems likely.

METRO = City situated in metropolitan area. A dummy variable equal to 1 is used if the city is located in a metropolitan area with a population greater than 500,000 inhabitants, and 0 is used if it is not. Private-sector competition for contracts tends to be greater within large metropolitan areas than it is in small ones; therefore, more privatization can be expected in large areas, with firms likely to be of sufficient size to enjoy economies of scale. Competition among bidders should lead to lower cost contracts.

Institutional, Political and Legal Environment (IPLE)

Three variables reflecting IPLE are included in the analysis; UND, INCO, and OWNER. These are described as follows.

*UND = Difference between state's public and private unionization rates.*⁷ Unions are often a vocal and powerful political force in the decision to privatize city services. However, public and private unions have different interests; those in the public sector generally oppose privatization, and those in the private sector generally support it. Consequently, cities with large and influential public-sector unions and relatively little unionization in the private sector are likely to contract out relatively little of their solid waste disposal services, even though they are likely to have incentives to do so, and vice versa.

INCO: City's median household income. Because higher-income individuals tend to be politically more conservative than lower-income individuals and, therefore, are likely to be more ideologically opposed to large government, they can be expected to be also more favorably disposed to contracting out government services.

OWNER: Percentage of owner-occupied dwellings within a city. Home owners may be more concerned with the level of externalities associated with provision of government service than are renters. For example, they may be more likely to complain to local government about solid waste disposal noise, dirt, and smell and more likely to demand closer supervision to reduce those nuisances. They are likely to seek action, because reducing negative externalities may increase home values and, therefore, benefit even those owners personally not complaining about the externalities. Running counter to this effect, however, is that home owners tend to be more conservative and, hence,

more apt to support privatization than are tenants. Moreover, because they pay taxes directly to government, they are likely to be more concerned with cost of government services than are renters who pay taxes indirectly as part of their rent. A priori, it is, therefore, difficult to predict the direction in which home ownership will affect privatization.

Fiscal Pressures (FISC)

Five variables reflecting FISC are included in the analysis: BOND, SUBS, PTAX, OTAX, and STAX. These are described as follows.

BOND = City bond rating. A dummy variable equal to 1 is used if Moody's rating is low (i.e., Ba or Baa), and a dummy variable equal to 0 is used if the rating is high (i.e., A, Aa, or Aaa).⁸ The lower a city's bond rating, the more difficult and costly it is for the city to borrow and, hence, the greater the fiscal pressures it faces. Because privatization is often the result of cost-cutting measures in the wake of such pressures, a low bond rating is hypothesized to affect efforts to contract out positively and vice versa.

SUBS = Per capita intergovernmental revenue transfers. Cities able to obtain large subventions from other levels of government will often have their fiscal pressures alleviated and, therefore, usually have a less urgent need to attempt to reduce costs by contracting out.

PTAX = Per capita city property tax. Greater fiscal pressures to reduce costs through privatization may occur in cities that have relatively high per capita taxes than do those with low taxes, and vice versa. Because property taxes tend to be directly rather than indirectly paid by residents who own property, they tend to be better informed about their property tax payments than they are about other tax payments, particularly income taxes. As property taxes become relatively high, it is likely that the incentive to contract out, in the hope of reducing costs, will increase.

OTAX = Per capita city nonproperty taxes. Although, as stated earlier, residents who own property tend to know their property tax bills, nonproperty taxes, such as city sales, excise, hotel room, and income taxes, tend to be rather invisible and, indeed, are often paid by individuals and firms not located in the city. It is, therefore, possible for a city to collect relatively large amounts from these sources without causing major political pressure for privatization. Cities that provide a relatively large amount of services and

levy relatively high nonproperty taxes may show a negative relation between nonproperty taxes and contracting out.

STAX = State sales tax rate. Although local governments may levy their own sales taxes, by far the greatest source of variability in sales tax rates across cities results from differences in the state rates. If higher state sales tax rates are coincident with greater concern about the cost of government, these tax rates would be expected to be positively related with the extent of contracting out.

Six additional variables were considered but proved not to be significantly related to the privatization proxy. Because, purely on the basis of ideology, privatization might seem to be favored more by Republicans than by Democrats, two measures of party affiliation were included. One was a variable measuring the percentage of those who had voted for Ronald Reagan in the 1980 presidential election. The second was party affiliation of the state's governor, using a dummy variable that was given the value 1 if the governor of the state in 1980 was a Republican and 0 if not. The initial hypothesis that both variables would be positively related to privatization was not supported by the data. Similarly, because one may hypothesize that conservatives generally see privatization in a more favorable light than do liberals, a discrete variable testifying to the presence or absence of a right-to-work law in the state (such laws are generally antiunion and are thus favored more by conservatives in both parties) was introduced; it also was found to be statistically insignificant. Because conservative states are more likely than liberal ones to enact state tax limitations, a variable testifying to the existence of such a limitation was included; it also was found to be statistically insignificant. The fact that all four of these variables associated with political ideology and party affiliation were not found to be significant suggests that ideology and politics may not be a major determinant in the decision to privatize solid waste disposal.⁹

Finally, the percentage of city population that is nonwhite and whether the city had a manager- or mayor-type government were found to be statistically insignificant.

Data

All U.S. cities with populations in excess of 300,000 in 1980 were included in the sample.¹⁰ To gain insight regarding the importance of city size for privatization, it was considered desirable to include also some smaller cities. Toward this end, a random sample of cities across states with a population of between 75,000 and 300,000 was also included. The intent was

TABLE 2: Contracting Out (ordinary least squares) Regression (dependent variable is PRIV)

Regressor ^a	Coefficient	Standard Error	T Ratio	Beta Coefficient
INTERCEPT	.5541	.2024	2.74***	
PROD				
POP	-.0001	.0000715	-2.01**	-.5432
POPSQ	.0023	.001111	2.10**	.5549
DENS	-.0167	.009215	-1.82*	-.2818
METRO	.1094	.0499	2.19**	.2276
IPLE				
UND	-.0087	.003003	-2.88***	-.4101
INCO	.0205	.007426	2.77***	.3093
OWNER	-.0040	.002963	-1.34	-.1923
FISC				
BOND	.1739	.0691	2.52***	.2946
SUBS	-.0002	.0001272	-1.84*	-.2497
PTAX	.0002	.0002168	1.12	.1679
OTAX	-.0006	.0001822	-3.18***	-.4126
STAX	.0218	.0166	1.31	.1343

 $R^2 = .3702$
 $\bar{R}^2 = .2757$

Residual sum of squares = 2.9084

SD of dependent variable = .2240

Durbin-Watson statistic = 1.9590

F statistic $F(12, 80) = 3.9180$

SE of regression = .1907

Mean of dependent variable = .5828

Maximum of log-likelihood = 29.1609

a. For definitions, see Table 1.

*statistically significant at the 90% level. **statistically significant at the 95% level. ***statistically significant at the 99% level.

to include one city of this size range from each state.¹¹ Data for 1980-1982 were used because this was the period for which the richest data set existed when the empirical work commenced and which coincided with the period pertinent to Ferris's (1986) study.¹² As a result, the two studies can be readily compared.

RESULTS

Table 2 presents the contracting-out equation. The adjusted R^2 is .2757, which can be considered reasonably high for cross-sectional data with a sample of 93 observations.¹³ The presence of linear heteroscedasticity was tested for and rejected at the 95% confidence level, because a regression with

the log of the sum of the squared residuals on all right-hand side variables yielded an F statistic of 1.6, far below the critical value. As previously mentioned, several alternative specifications were examined with the general result that additional variables, usually political in nature, were not statistically significant and did not improve the overall fit of the regression.¹⁴

With regard to variables that relate to production efficiency and cost, a parabolic relationship was found between contracting out and population size. Both POP and its square value, POPSQ, were statistically significant at a 95% level and have the expected signs. The negative coefficient on POP and the positive coefficient on POPSQ are likely to be associated with the existence of a U-shaped average cost function for residential solid waste disposal services.¹⁵

The coefficient of $-.0167$ on density, DENS, has a T ratio of -1.82 and is significant only at the 90% confidence level. Its negative sign is consistent with the earlier hypothesis that the larger the density, the less privatization of solid waste disposal. (The coefficient $-.0167$ implies that all else being constant, a city with 1,000 more people per square mile on average will privatize 1.7% more than one with 1,000 fewer.) The coefficient of $.1094$ on METRO (significant at the 95% level) has the expected sign. It indicates that, ceteris paribus, cities that lie within a metropolitan area with more than 500,000 inhabitants will privatize on average 10.9% more than a city not in such a metropolitan area.

A coefficient of $-.0087$ was estimated for UND and found to be significant at the 99% level. Its sign is consistent with the hypothesis that cities with a large difference between the rate of unionization of public- and private-sector employees (the number of public-sector employees minus the number of private-sector employees—generally positive) tend to privatize less than cities in which the difference is small or even negative. (The regression coefficient suggests that a city with a 1% difference between the rate of public- and private-sector unionization, holding other city characteristics constant, has on average .87% less privatization than one without a difference.) For the median household income variable, INCO, a coefficient of $.0205$ is estimated and found to be significant at the 99% level. Its sign is consistent with the hypothesis that cities with a higher median household income are likely to privatize more than those with a lower income. (Specifically, cities with \$1,000 higher household income will privatize on average 2.0% more than cities without this higher income.) A coefficient of $-.0040$ on the percentage of owner-occupied houses, OWNER, has a T ratio of -1.34 and is not statistically significant.

The variable that represents the city's Moody's bond rating, BOND (1 when the rating is Baa or Ba and 0 when the rating is A, Aa, or Aaa), is statistically significant at about the 99% level and has the expected positive sign. (Specifically, cities with bond ratings of Baa or below are estimated to have on average 17% more privatization than those with ratings of A or better.) The estimated coefficient on per capita intergovernmental revenue, SUBS, is -.0002 and, with a *T* ratio of -1.84, is statistically significant at the 90% level; it has the expected sign. The coefficient implies that a city receiving \$100 more in intergovernmental revenue privatizes on average 2.3% less than a city receiving \$100 less in per capita transfers. Per capita property tax, PTAX, has a coefficient of .0002, which, with a *T* ratio of 1.12, is statistically not significant. Per capita city nonproperty taxes, OTAX, have a coefficient of -.0006, which is statistically significant at the 99% level and has the expected sign. (The coefficient suggests that a city that collects \$100 more from nonproperty taxes will on average have 5.8% less privatization than one with \$100 less.) Finally, the state sales tax rate, STAX, has a coefficient of .0218 but, with a *T* ratio of 1.31, is not statistically significant.

The importance of the different explanatory variables can be assessed through the construction of beta coefficients, which are included in Table 2. Such coefficients render the regression coefficients more readily comparable by subtracting their means and dividing them by their respective standard deviation. Their relative magnitude suggests that population, per capita nonproperty taxes, and difference between public- and private-sector unionization rates, in that order, are the most important explanatory variables of the decision to contract out solid waste disposal. Next in importance are income and bond rating.

The regression equation with an R^2 of .3702 (and \bar{R}^2 of .2757) is quite robust and has relatively high explanatory value for a sample of 93 cities. For policy makers, the following results of the contracting-out equation should be of interest: The population variable, which relates to scale economies and has a parabolic relationship with contracting out, was the most important factor influencing the decision, followed by nonproperty taxes, differences in private- and public-sector unionization rates, income, and bond rating variables, in that order. The finding that efficiency and cost are the most important decision considerations but that institutional factors as well as fiscal-pressure-related factors are also important in contracting-out decisions is consistent with conclusions of studies reviewed earlier.

Public officials facing a decision whether to privatize solid waste disposal thus might assess the position of their city with regard to the aforementioned factors. They are likely to be favorably disposed to an affirmative decision if their jurisdiction is small or middle-sized, levies relatively low per capita

nonproperty taxes, and has a low bond rating. At the same time, however, such officials face a confusing situation with regard to unions; although communities in which public-sector unions are stronger than private-sector unions tend to have a significant incentive to privatize, powerful union resistance will seek to prevent it.

NOTES

1. In studies of fire services (Hirsch 1959) and high schools (Riew 1966), some scale economies for populations up to 100,000 were found. In relation to hospitals, Ro (1968) also found some scale economies. Dolan (1990) found that fragmentation of government entities in Illinois increased service costs, and Ladd (1992) found a U-shaped relation between per capita spending on government services and population density. Finally, there is evidence of economies of scale in street cleaning, traffic signal maintenance, and asphalt overlay construction, as well as in janitorial services, payroll preparation, and turf and tree maintenance (Stevens 1984).
2. Prager (1993) gave as examples of economies of scope "street maintenance crews . . . trained to drive snow plows . . . and even to handle infrequent calls for rescue or first aid services" and "hospital-based social workers (who) . . . can handle . . . dysfunctional families, home-based senior citizens, drug-addicted teenagers, alcoholics and so on" (p. 20).
3. Theory indicates that first-bid, sealed-bid auctions, which are most common in contracting auctions, yield the best solution from the government's perspective for any number of bidders greater than one, but with only one bidder, the government does much worse (Milgrom 1989).
4. An example of a restriction on government's technological possibilities is found in mass transit. Because mass transit has a peak-hour demand pattern, severe constraints in its use of labor are often encountered. For example, the 1985 Agreement Between the Southern California Rapid Transit District and the Amalgamated Transit Union, Division 1277, prohibited subcontracting except under unusual circumstances. The agreement also stated that "regular operators shall be guaranteed eight hours' pay time per day within a spread of ten hours from the initial sign-on time" (p. 5).
5. In 1987, the percentage of local government employees working full-time in the United States was as follows: fire protection, 64.9%; teaching, 58.1%; police protection, 53.7%; sanitation, 50.2%; public welfare, 48.4%; and highway repair, 44.4% (U.S. Bureau of the Census 1991). Hospital and noninstructional education employees had somewhat lower rates—38.6% and 34.5%, respectively.
6. PRIV can also be influenced by the capital-labor ratio applicable to a particular solid waste disposal operation. A highly automated collection process would tend to have a high PRIV value and vice versa. However, it could be argued that the purchase of capital equipment is a form of privatization, because the equipment is produced in the private sector. The focus, thus, would shift more to public employment of labor rather than to either private employment of labor or private production of capital goods. A further issue is that what usually is referred to as waste disposal is actually waste management composed of waste collection and disposal, and the costs of disposal are likely to be little affected by contracting out.
7. Corresponding data on a city level are not available.
8. No city in the sample had a bond rating below Ba.
9. Admittedly, the absence of city data, which made it necessary to use state data, might also be responsible for the results.

10. Because most urbanites live in the very largest cities of the United States and because I wanted that fact reflected in the sample, I decided to include all cities with populations in excess of 300,000. Moreover, for these large cities, I had information on all the right-hand variables of interest to me, which I did not have for the smaller cities.

11. There were two reasons why this proved impossible. First, some states had no cities with populations between 75,000 and 300,000 for which a complete set of the required data was available. These included Delaware, Hawaii, Maine, Maryland, Montana, New Mexico, North Dakota, Vermont, and West Virginia. To maintain a sufficient number of small-city observations, one additional randomly selected small city was chosen from Florida, Illinois, Louisiana, Nevada, Ohio, Virginia, and Washington, and two additional observations from Massachusetts were selected. Second, the following cities were deleted because of incomplete data: Tulsa, Oklahoma; Honolulu, Hawaii; Macon, Georgia; Boise City, Idaho; Gary, Indiana; and Yonkers, New York. Following these deletions and adjustments, the sample size was 93, with 48 of the cities having populations of more than 300,000 and 47 having between 75,000 and 300,000 in 1980.

12. For example, the most recent unionization data for the public and private sectors that could be found were for 1982.

13. Admittedly, as happens so often, the available data lack some of the ideal properties one would like them to have to justify all aspects of the regression analysis performed. For example, the dependent variable is restricted to values between 0 and 1; hence, the assumption of normality for the true error term is not valid. To test for the severity of this problem, a log-odds ratio of the dependent variable was formed, which transformed its possible ranges of values to between positive and negative infinity. Although the standard errors of the coefficients were affected, not one of the signs of the coefficients was altered. Heteroscedasticity was tested for and found not to be a significant problem. In addition, correlations between the explanatory variables were not large enough to require corrective measures.

14. Also, in recognition of the fact that each city in the small-city sample represented many cities of similar size, a weighted least squares regression was run that resulted in only minor differences from findings in Table 2.

15. The bottom of the U-shaped contracting-out curve relative to population occurs at 3.07 million inhabitants. Thus the declining portion covers most U.S. cities. Using the two coefficients, one can estimate the net effect on contracting out (PRIV) when a city's population increases.

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Child Welfare
Contracting:
Market Forces and
Leverage

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29. U.S. House Committee on Ways and Means, *1993 Green Book* (n. 6 above), p. 1052.

30. National Commission on Children, *Beyond Rhetoric: A New American Agenda for Children and Families* (Washington, D.C.: National Commission on Children, 1991), p. xxi.

31. A child living in a family of three (parent and two children) with a head of household who works full-time at the minimum wage will be assured of the income security of \$2,371 a year (\$1,685 from the EITC plus \$686 from the refundable tax credit). $\$1,685 = \$3,370$ (the maximum EITC) $\div 2$ (the number of children). In the case of a child living in a comparable family of two (parent and one child), the income security for the child will be \$2,726 a year (\$2,040 from the EITC plus \$686 from the refundable tax credit).

32. Scholz (n. 9 above), p. 2.

33. Michael W. Horrigan and Ronald B. Mincy, "The Minimum Wage and Earnings and Income Inequality," in Danziger and Gottschalk, eds. (n. 3 above), p. 272.

34. Thomas Gabe, *The Earned Income Tax Credit (EITC) Current Law and the Clinton Proposal: Characteristics of Eligible Families*, CRS report for Congress no. 95-546 EPW (Washington, D.C.: Congressional Research Service, May 25, 1995), p. CRS-8.

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Child Welfare Contracting: Market Forces and Leverage

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In this article, we examine patterns of privatization in the Illinois child welfare system using data from state payment records and a survey of organizational providers. We describe the state contract system and show which providers are active in it and how important they are to the state agency involved. We hypothesize (1) that market forces will favor those providers that match most closely the needs of the state agency for specific expertise and (2) that power and leverage will operate to favor those who can bring the most resources to bear on contract negotiations. Multiple regression analysis shows support for both hypotheses.

Social scientists have long examined the nature and extent of public mandates, addressing such issues as how much the public sector spends for welfare in comparison to defense, what accounts for differences in spending patterns across nations (or states), and how and why spending changes over time. These are important issues, but they fail to consider the interorganizational structures under which the mandates are executed.

Two of these structural features are particularly important: intergovernmental funding relations and privatization of services by contracting with nonpublic organizations to deliver publicly financed services.¹ Both features are of long standing in the United States. They

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also share some common attributes in that they require effective cooperative arrangements among independent organizations. The role of intergovernmental funding structures has attracted considerable attention in the face of continuing efforts to curtail growth in social spending since the mid-1970s. As Martha Derthick showed almost 20 years ago in her pioneering work on social services grants, certain forms of intergovernmental transfers may result in uncontrollable public spending.² Others have emphasized the special problems of control and accountability that may occur when one level of government depends on another to execute its mandates.³

The subcontracting of public services has also received more attention in recent years. It was an integral part of the Reagan administration's efforts to redefine the role of the federal government, just as it is central to the new Republican "Contract with America" platform. Political enthusiasm notwithstanding, the empirical question of whether subcontracting promotes more effective and efficient services is still unresolved.⁴ Certainly, studies on negotiating processes and transaction costs involved show the complexity of establishing and operating public-private contract systems.⁵ From an organizational perspective, these latter findings suggest that the contract system provides important opportunities to analyze patterns of resource dependency among organizations involved in the system.

In this article, we examine the pattern of subcontracted service provision in the child welfare field in Illinois.⁶ The field is characterized by a complex system of intergovernmental relationships in which the state plays a key role. There is also long-standing, extensive reliance on nonprofit agencies to deliver key services, dating back in some form to the latter part of the nineteenth century.⁷ Consequently, our analysis is of a mature, fully institutionalized contract system, not one that has only recently come into existence or been subject to major renegotiations. This means that resource relations are likely to be stable and well developed, features that make these relations attractive to subcontractors because they lower uncertainties and reduce transaction costs as providers are able to affirm their expertise and management experience over time. At the same time, it raises the question of which characteristics are associated with success in this particular market, that is, what kinds of organizations receive the largest volume of subcontract dollars—those that provide services in greatest demand or those with well-established clout and influence?

We draw on a unique body of data that allows us to examine these questions in greater detail than is usually the case. Where most previous research has surveyed state contracting administrators or recipient organizations about their attitudes toward and assessments of the contract experience, we analyze the actual flow of dollars in the contract system. We then link this flow to characteristics of the provider organi-

zations in order to determine which subcontractor features are most strongly associated with success in the contract market. Because we present only cross-sectional data for a subsector of a particular contract system and do not have data on all relevant aspects of the contract relationship, we cannot provide a definitive test of our hypotheses. However, the patterns of association that we observe are revealing and certainly suggestive for further research.

Our data come from the Illinois Department of Children and Family Services (DCFS) and the system of providers that delivers the bulk of its services. We first answer two key descriptive questions: who is involved in the provider system, and how important are they to DCFS, that is, how much funding do they receive? We then examine differences in the amount of funding received by a subset of key providers.

We hypothesize that two processes operate to determine the amount of funding levels. First, we argue that market forces—the provider's competitive market strengths—favor those that match most closely DCFS's demand for particular types of expertise and specialized services. Second, we suggest that organizational power and leverage favor those providers that can bring the most resources to bear on contract negotiations. A better understanding of how these dynamic processes operate is important for assessing the costs and benefits of privatization and for addressing questions of whether and how privatization serves to control public spending.

The Child Welfare Contract Market in Context

The child welfare field ranks low on the national agenda, if the volume of public spending is any indication. All social services combined (not just child welfare) account for only 3 percent of combined federal, state, and local spending for social welfare purposes. However, child welfare is important in other respects. An increasing number of children and youth experience conditions that threaten their ability to build strong foundations for adulthood. Abused, neglected, or "just" poor, they lack the physical, emotional, or social support that would allow them to develop into healthy, productive adults.

In Illinois, DCFS is the primary state agency responsible for addressing the needs of troubled children and their families. Its mission statement declares that it, "in partnership with others, will provide services to children and families to protect and advocate on behalf of children and youth who are, or who are at risk of, being abused, neglected, or removed from their families." The phrase "in partnership with others" acknowledges that DCFS does not render these services alone, nor does the state finance all the services from its own funds. In fact, throughout the 1980s, DCFS consistently received close to half of its revenues from the federal government and used

two-thirds of its annual budget appropriations to purchase services from individuals and organizations through its grants and contracts system.

This pattern of state responsibility for and control over services, substantial dependence on federal funds, and significant reliance on other service providers is typical of the social service field in Illinois. In 1984, the state provided only 35 percent of all public spending on social services for the Chicago and Cook County area from its own revenue base, with the federal government providing 59 percent and local government, the remaining 5 percent. However, the state dispersed 64 percent (including some of the federal funding) and controlled 76 percent of the spending (including funds passed on to local governments and dispersed by them).⁸ Almost half (47%) of the public spending for social services was subcontracted to nonprofit agencies and another 4 percent to for-profit organizations, leaving public agencies with less than half of the spending for direct service delivery.

Public spending for other service fields differs notably from the social service pattern (and that of DCFS) on one or more of these four dimensions, that is, the fields show different combinations of revenue origins, levels of government at which funds are dispersed, extent to which various levels of government exercise control over the funding, and composition of the service delivery system.⁹ Child welfare systems in other states may differ from the Illinois pattern on some or all of these dimensions as well.

In Illinois, DCFS is responsible for licensing all day-care agencies in the state, for diverting children and youth from the criminal justice system, and for investigating and responding to all reports of child abuse and neglect (currently more than 100,000 reports per year). To provide adequate care on a continuing basis for abused or neglected children and their families, DCFS must insure that a full range of services is available, including substitute care, counseling, family support, adoption, outreach, prevention, and so forth.

The child abuse and neglect mandate is especially important to the department. By law, DCFS must respond in a timely manner (within 24 hours) to all reports, insure that children do not come to any further harm, and accept responsibility for the future development of children who become wards of the state. Increases in the number of child abuse and neglect reports and in the serious nature of families' problems pose major challenges to DCFS. The need to respond immediately to crisis situations means that DCFS must have ongoing access to certain critical services (e.g., substitute care). However, solving immediate crises and finding appropriate substitutes for the natural family are tasks fraught with difficulties. Mistakes or errors in judgment may harm children and subject DCFS to highly emotional and troublesome public criticism (including court cases).

The high risk and human cost of failure mean that controlling the delivery of services is extremely important for DCFS. But this is difficult to do. The recipients of service (and, by extension, DCFS and its providers) have little objective basis for assessing the quality of services. The service market, therefore, represents a classic case of transactions under conditions of "contract failure," where trust and reputation, rather than agreed-on and easily assessed standards of performance, are paramount.¹⁰

The service context in which DCFS operates, therefore, leads to our two hypotheses, as noted above. First, the need for ready access to particular types of services suggests that possession of relevant expertise should be closely related to the level of contract funding private providers receive from DCFS. If, as this hypothesis predicts, the DCFS contract system favors providers that exhibit the most pertinent expertise, then competition and straight market factors are at work. This should keep transaction costs low because providers can perform their specialties and do not need to learn difficult new activities. Correspondingly, DCFS can reduce monitoring efforts aimed at insuring that it gets what it pays for.

Indeed, the entire free market economy is based on the underlying assumption that the unrestricted operation of market forces will minimize overall transaction costs and promote the efficient production of goods and services. In many respects, then, this first hypothesis is so obvious that findings that run contrary to it would deserve attention.

Second, difficulties in objectively judging the quality of services mean that DCFS operates under conditions of contract failure as discussed above. When expertise is difficult to assess, nonmarket characteristics may come to rival or overshadow pure market advantages. Providers that appear legitimate or trustworthy, are politically powerful, or otherwise are able to exert leverage over DCFS can bring a wide range of organizational resources and strategies to bear on the contract relationship. As a result, these types of providers may come to dominate the contract system and obtain larger payments from DCFS than would be expected if only market forces operated.

The providers have strong incentives for developing contractual relationships with DCFS. Not only is public funding a major source of revenue to many social service agencies, but public grants and contracts for these types of services appear to be remarkably stable and predictable sources of revenues. Case studies of public grants and contracts received by social service agencies show that most such contracts are in the form of new or continuing awards. Very few contracts are terminated, although the levels of funding may fluctuate.¹¹

The DCFS system constitutes an especially attractive market to provider agencies because DCFS rarely opens up the contracts to open

bidding, and then only in some service categories, in some regions, and in some years. That makes the DCFS funding system fairly difficult for contractors to enter, but it is predictable and ongoing once they obtain access to it. The need to provide vulnerable children with continuity of care justifies the closed funding system, just as the need to protect national security does in the case of defense contractors.

Methods

The sheer volume of efforts and transactions in which DCFS is engaged is impressive. During the fiscal year of 1989, DCFS contracted with almost 19,000 providers to deliver services on behalf of the department. Simply describing the provider system is a monumental task. As we discovered, developing an appropriate database to describe and analyze this system presents formidable technical challenges as well.

Our analysis of the DCFS provider system combined two sources of data: administrative data from the department's financial payment system and a mail survey of human service and day-care facilities listed in the DCFS provider database. The financial payment database allowed us to describe how the DCFS service market is structured and to assess the sample and response rates of the mail survey. The survey provided a wide range of data about the organizations themselves. We merged the two databases in order to test the two hypotheses outlined above.

We used the DCFS board and voucher payment systems for the 1989 fiscal year (July 1, 1988–June 30, 1989). The board system tracks monthly payments to service providers caring for clients in residential placement (e.g., foster homes and group homes). The voucher system records payments (usually monthly) for all other services, including administrative activities (e.g., printing and staff travel) and client services (e.g., day care and counseling). The payment records contain a separate record for each check issued (if no client is involved) or, in the case of client services, a separate record for each client every time a check is issued for services to that client. In the latter case, the records include information on the type, cost, dates, and recipient of the service.¹²

The combined board and voucher payment files totaled over 600,000 records for 1989. We first eliminated payment records for purely administrative services. Then, to use service providers (rather than each client-related payment) as the unit of analysis, we undertook an extensive series of aggregations and recodes to create a record for each service provider.¹³ As a result of these efforts, we obtained data on the amount of client-related payments by DCFS to a total of 18,778 providers in 1989.¹⁴

In the winter of 1990–91, we also conducted a mail survey of the social service and day-care program units included in the DCFS pro-

vider database, a cumulative list of individuals or program units that DCFS has authorized payments to over several years, licensed (in the case of day-care centers), or otherwise recognized as relevant service providers.¹⁵ The 180,528 records in the provider database include entries for DCFS staff members, commercial vendors (for office supplies, travel, etc.), individual foster parents, lawyers, doctors, as well as organizations providing direct services to DCFS clients.

To identify organizations involved in client services, we undertook an extensive review process that resulted in a listing of 2,669 eligible providers, including 1,871 day-care centers.¹⁶ Because of the large number of day-care centers, we drew a stratified random sample of them, but included all the remaining 798 service units in the survey for a total sample of 1,091.¹⁷ After eliminating those that appeared to be out of business (123), inappropriate (19), or duplicates (207), we received usable responses from 465 organizations, about 63 percent of the valid sample. The response rate was significantly lower for the two day-care samples (50%–53%) than for all other organizations (71%).

As a final step, we merged the financial payment and mail survey data in order to examine links between a provider's experience in the DCFS service system and the organization's characteristics.¹⁸ Of the organizations originally included in the sample, 516 (or 70% of the valid sample) could be matched to the financial payment database.¹⁹ Of this initial pool of 516 matches, 63 percent (354) responded to the survey, including 63 organizations that did not receive DCFS payments in 1989 but had done so at some point over the 1985–88 period. The analysis presented here is based on the 291 matched organizations that received DCFS funding in 1989.

These 291 matched survey respondents represent 11 percent of the 2,631 organizations from which DCFS purchased client-related services in 1989. However, they account for 61 percent of DCFS funding to provider organizations in that year. The remaining 39 percent of the funding is split between organizations included in the sample that failed to respond to the survey (24%)²⁰ and those excluded from the original sample because they were nonsampled day-care organizations (6%) or because we did not believe our questionnaire items would be relevant to them (e.g., businesses and schools, 9%). Our survey data thus capture information about most of the organizations with the largest stake in the DCFS provider system.

The DCFS Provider Markets

There are two distinctive markets in the DCFS system: the market of individual service providers and the market of organizational providers. In the former market, DCFS competes with other social service

agencies for qualified foster parents, homemakers, counselors, and so forth. The department assumes direct responsibility for supervising the services these individuals provide. They are like part-time staff or consultants whom DCFS uses on a more or less continuing basis.

In the organizational provider market, DCFS competes with other state and local government agencies for access to particular types of service infrastructures, for example, group homes, counseling agencies, and day-care centers. In this part of the system, DCFS has transferred responsibility for direct supervision of staff, foster parents, and so forth, to the provider agencies. The direct management responsibilities of DCFS itself are limited to client referral and efforts to maintain and monitor the contract relationship. We review both markets but pay most attention to the latter because it bears directly on our survey findings.

Of the 18,778 providers from which DCFS purchased services during fiscal year 1989, the vast majority (86%) were individuals and only 2,631 (14%) were organizations.²¹ However, the latter received the lion's share (78%) of the \$244 million that DCFS paid to providers in 1989, reflecting the greater service capacity of organizations in comparison to individuals. The provider system, then, is one in which DCFS purchases small amounts of service from a large number of individuals and a large volume of service from a modest number of organizations.

To examine the individual and organizational provider markets in greater detail, we looked at the volume of services that DCFS purchases in different service fields and the types of providers that are most heavily involved in these fields. To facilitate the analysis, we grouped the 268 detailed service codes from the financial payment systems into 13 major service categories.²²

The Individual Provider Market

The Department of Children and Family Services purchases services from a variety of individuals—foster parents, adoptive parents, homemakers, counselors, advocates, day-care workers, doctors, psychologists, lawyers, and the like—people with special motivations or skills to assist families and children in trouble. Table 1 shows the distribution of individual providers and payments to them across the 13 service categories. The table shows that the individual provider market is dominated by foster care, accounting for 60 percent (9,657) of the individual providers (col. 1) and 72 percent of all payments to individual providers (col. 3). This is also the service field with the greatest interpenetration of individual and organizational markets. Roughly half (52%) of all spending for foster care goes to foster parents who worked as individual providers, as shown in column 5. The remaining

Table 1
INDIVIDUAL PROVIDERS: NUMBER AND FUNDING BY TYPE OF SERVICE, FISCAL YEAR 1989

Type of Service	Number of Individual Providers (1)	Total Dollars to Individual Providers (\$) (2)	Percentage of All Individual Provider Dollars (%) (3)	Total Dollars to All Providers (\$) (4)	Percentage of All Dollars to Individual Providers (%) (5)
Foster care	9,657	38,588,000	72	75,918,000	52
Institutions/group home	...	...	...	55,284,000	...
Youth in transition	501	531,000	1	4,923,000	11
Adoption	3,142	9,443,000	18	10,568,000	91
Counseling	253	843,000	2	12,235,000	7
Homemaker services	132	530,000	1	5,722,000	9
Day care	2,525	2,743,000	5	47,716,000	6
Unmarried mothers services	...	...	...	122,000	...
Protective services	...	...	...	567,000	...
Youth services	3	27,000	...	14,646,000	...
Children's personal/physical	5,378	417,000	1	2,999,000	...
Support services	654	650,000	1	14,468,000	14
Other services	...	...	...	1,387,000	4
Total	16,147*	53,772,000	100	244,164,000	22

* Column sum is greater than total indicated because some individuals provide more than one service.

48 percent goes to agency providers who supervise their own foster families.

Column 5 of table 1 also shows that individual providers (i.e., adoptive parents) dominate the market for adoption services, receiving 91 percent of all spending for these services. Adoptive parents also account for the second largest proportion (18%) of all dollars to individual providers, as shown in column 3. Jointly, foster parents and adoptive parents account for 79 percent of all individual providers and receive 89 percent of all payments to individual providers and 20 percent of all provider dollars. In all remaining service fields, individual providers receive only a small fraction of DCFS payment for services rendered (col. 5).

The Agency Provider Market

The Department of Children and Family Services also purchases services from social service agencies, day-care centers, schools, health-mental health facilities, commercial businesses, schools, and various other organizations. Some of these specifically target the children and families for whom DCFS is responsible. Others (e.g., commercial businesses) have objectives that overlap only indirectly with the DCFS client population. Some 595 social service agencies in the provider system (most of which were included in our sample list) clearly overshadow all other types of organizations in their importance to DCFS.²³ Although they account for only 23 percent of the organizations with DCFS payments in 1989, they received \$163.5 million, or about 86 percent of what DCFS paid to all organizations and 67 percent of payments to all providers.

As table 2 shows, social service agencies dominate most service fields, absorbing more than 85 percent of spending in eight of the 13 service categories and about half or more of total funding in 11 of the 13 categories (col. 5). Adoption services and children's personal and physical maintenance services are the only exceptions to these patterns. The social service agency market is less concentrated than the individual provider market. No single service field accounts for the bulk of funding, although institutions and group homes come closest, with a 33 percent share (col. 3).

The remaining types of provider organizations, that is, the 587 day-care centers, 375 schools, 202 health-mental health facilities, 618 commercial businesses, and 254 miscellaneous other organizations, play only a peripheral role in the DCFS provider system. They received only 11 percent of the fiscal year 1989 contract dollars, with the majority (68%) of this funding paying for day-care services.

From this analysis, it is clear that social service agencies are the principal service providers in the DCFS grants and contracts system.

Table 2

SOCIAL SERVICE AGENCIES: NUMBER AND FUNDING BY TYPE OF SERVICE, FISCAL YEAR 1989

Type of Service	Number of Social Service Agencies (1)	Total Dollars to Social Service Agencies (\$) (2)	Percentage of All Social Service Agency Dollars (%) (3)	Total Dollars to All Service Providers (\$) (4)	Percentage of All Dollars to Social Service Agencies (%) (5)
Foster care	82	35,143,000	21	73,918,000	47
Institutions/group home	126	54,612,000	33	55,284,000	99
Youth in transition	36	4,379,000	3	4,923,000	89
Adoption	121	450,000	7	10,368,000	4
Counseling	169	10,805,000	3	12,235,000	88
Homemaker services	36	5,186,000	3	5,722,000	91
Day care	74	26,818,000	16	47,716,000	56
Unmarried mothers services	4	114,000	...	192,000	56
Protective services	4	367,000	...	367,000	86
Youth services	111	13,198,000	8	14,646,000	100
Children's personal/physical	166	770,000	...	2,999,000	90
Support services	135	10,269,000	6	14,468,000	26
Other services	20	1,385,000	1	1,387,000	71
Total	595*	163,496,000	100	244,164,000	100
					67

* Actual sum is greater than total indicated because many social service agencies provide more than one service.

To a lesser degree, day-care centers and foster parents play a significant role, but mainly because of their large numbers and not the amount of funding each of them receives. Yet, these aggregate patterns do not fully demonstrate another crucial point: some providers are much more important to DCFS than others. Some 34 social service agencies received at least \$1 million each from DCFS in 1989. These top 34 social service agencies jointly accounted for \$108 million in fiscal year 1989. This is equivalent to 66 percent of the funding to social service agencies, 57 percent of the funding to organizations, and 44 percent of the funding to all service providers.

Figure 1 displays the skewed distribution of DCFS funding to social service agencies.²⁴ Two-fifths (41%) received less than \$10,000, and 70 percent received less than \$100,000. Thus, the bulk of DCFS funding is directed to a very small percentage of providers. These findings raise several critical questions: What are the characteristics of provider organizations that are most pivotal to DCFS—the social service and day-care agencies? And what factors account for the spectacular success of some of these providers in the DCFS contracting system?

Hypothesized Effects of Market Forces and Leverage

As discussed earlier, we hypothesize that two sets of factors account for the differential success of provider organizations in the DCFS funding system: (1) market forces, which favor those that match most closely

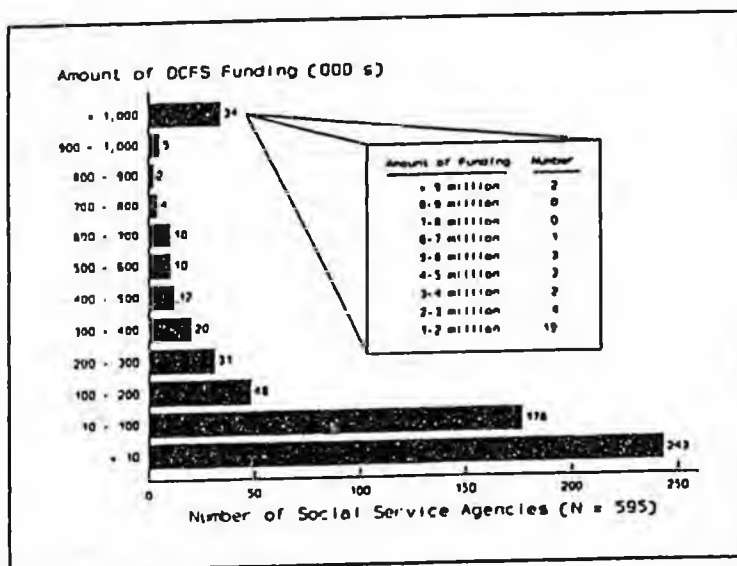


FIG. 1.—Fiscal year 1989 distribution of Illinois DCFS funding to social service agencies.

the needs of DCFS for particular types of expertise in terms of services (e.g., residential services) or approaches (e.g., focus on children and youth or minorities), and (2) leverage or influence factors, which favor providers that can bring more resources (e.g., legitimacy) to bear on their negotiations with DCFS. To address these hypotheses, we rely on the mail survey for information about the types of services agencies provide, the clients they target, the service approaches they use, their finances and contractual relations, and their involvement with other nonprofit organizations.²⁵ Several survey measures relate directly to the two broad concepts of market forces and leverage in the DCFS grants and contract market.²⁶

Market Forces: Attractiveness to DCFS

Interviews with DCFS grants and contract staff, as well as findings from the broader Children's Policy Project, suggest that several criteria are likely to make providers especially attractive to DCFS: service expertise, comprehensiveness of services, appropriateness of target population, and accessibility of services. Appendix A lists these attractiveness-market forces, the independent variables we used to measure them, and the hypothesized relationship between each variable and the amount of DCFS funding received by the organization. We explain each criterion below.

Expertise.—The Department of Children and Family Services spends most of its contract dollars on a few key services. Substitute care for children (e.g., residential services and foster care) and day care receive the most funding, with smaller shares for youth services, counseling, and support services. Organizations that specialize in these well-funded services should have greater opportunities to obtain a significant share of DCFS contracts than those with little or no expertise in these fields. The department's confidence in the experience and skills of providers allows it to reduce its own monitoring efforts correspondingly. We use information on the primary mission of the organization and the extent to which its major services are of particular interest to DCFS.

The major purpose or mission of an organization dictates a long list of important organizational decisions: the primary services to offer, the expertise of staff members to be hired, the variety of facilities to secure, the clients to serve, and even the types and volume of resources to which it should seek access.²⁷ We coded an open-ended question about the organization's major purpose or mission using the National Taxonomy for Exempt Entities, a hierarchical, highly detailed coding system organized into major service groups.²⁸ We then combined the categories into six major groupings (MISSION): residential and institutional care organizations (23% of the matched organizations), other social service agencies (18%), day-care and preschool agencies (18%), child and youth service organizations (14%), nonresidential mental

health organizations (20%), and miscellaneous other types of organizations (8%).

The DCFS should also favor providers that can deliver several core services within one agency. This minimizes the number of providers with which DCFS must establish relationships, negotiate contracts, and train. We asked survey respondents to indicate which of 52 different types of services (spanning nine major fields) they provide and which six are their major or most important services.²⁹ We designated 18 of the 52 services as core services of particular relevance for the DCFS service system (e.g., counseling, foster care, adoption, group home, and day care), noting the number of these services in which each provider was engaged (ALL_CORE). The average was 5.7 core services, but some listed as many as 17.

We also noted the number of core DCFS services that the provider defined as among its own "major" services (MAJ_CORE). The larger the number for a given provider, the closer the fit between DCFS service needs and provider expertise. Some providers reported no DCFS core services among their own major services; others as many as nine. The average was 2.4.

Comprehensiveness of services.—Although DCFS may fund only certain types of services, its clients are likely to need help with a full range of other problems, including literacy, employment, housing, drug abuse, and so on.³⁰ Organizations that provide a broad range of services should, therefore, be attractive to DCFS because they can more easily insure that clients receive the necessary range of services without having to resort to difficult and fragile referral systems with other organizations.³¹ We defined organizations that checked a large number of the 52 services (ALL_SERV) as providing more comprehensive services than those that provide only a few services. Only counseling, parent education, support groups, and information and referral were checked by half or more of the organizations. The average number of services was 11.6, ranging from one to 39. We also asked whether providers believe that they provide directly most of the services that are needed by those of their clients who are children, youths, or families (SELFSERV). The great majority (81%) said they did.³²

Target population.—In addition to particular services, DCFS needs providers that have experience with the types of clients that come to its attention.³³ Providers whose primary client commitments match DCFS client types should be attractive to DCFS because they are likely to have expertise in serving such clients and to devote their own resources to meeting the needs of these clients.

Expertise with children, youths, and their families and with racial and ethnic minorities are especially important to DCFS.³⁴ We asked those providers that indicated that they target some client or population group to describe the most important target group. We followed

with two additional questions about the extent to which this target group was composed of children, youths, and their families (CHLDTARG) and members of racial or ethnic minorities, such as African Americans, Hispanics, Asian Americans, or Native Americans (RACETARG). The great majority (78%) did target children, youths, and their families. However, although racial and ethnic minorities made up about 75 percent of children in publicly supported substitute care under the guardianship of DCFS in 1991, only 31 percent of the providers reported that their primary target group is mainly or entirely composed of minorities.³⁵

Outreach and accessibility of services.—Accessibility of services is also important, especially for clients who are young, not fully informed about available services, or not assertive in insisting on the services they want and need. Most DCFS clients have one or more of these characteristics. We used several indicators of this concept. Everything else being equal, organizations that have multiple sites (MUL_SITE) make themselves accessible to more clients than those that maintain only one location. About half of the organizations had multiple sites.

We also asked organizations to indicate the best description of their geographic service focus from among several statements provided. Organizations that view themselves as "entirely community-based and community-organized" may develop close relationships with local clients, reducing cultural and social barriers to accessing services. About one-third (35%) of the organizations defined themselves in this manner (COM_BASE).³⁶ Finally, we asked respondents to indicate the extent to which most, some, or only few of their in-person contacts with clients normally took place in a variety of different settings. We categorized the settings as being more or less external to the organization (SERV_SET).³⁷ Only 27 percent of the organizations provided most or all of their services in external settings.

Given the closed nature of the DCFS contract market described above, one might expect that this list of market factors would constitute a minimum set of qualifications that all DCFS contractors would meet to have entered the contract system in the first place. Such is not the case. As noted above, substantial proportions of the providers fail the criteria in full or in part—their major services include only a few core DCFS services, and most do not target minority groups or engage in extensive outreach. We can therefore examine whether some market factors are more important than others in differentiating among more or less successful providers in the DCFS contract system.

Leverage: Agencies' Capacity to Exert Influence over DCFS

A second set of forces that shapes the relationship between DCFS and its service providers is the influence or power that providers are able

to wield in their ongoing relationship with the department. Large organizations with proven staying power, those well established in the public funding market, with recognized legitimacy, and active participation in networks of like-minded organizations may have sufficient power and legitimacy to resist DCFS initiatives that they define as contrary to their interests.³⁸ These types of organizational resources may even allow them to become active participants in shaping the initiatives themselves. These expectations derive mainly from the literature on resource dependency and institutional theory.³⁹ Appendix B lists these forces, describes how we measure them, and indicates the hypothesized relationship with amount of DCFS funding.

Resource strength.—We used two measures of resource strength: size of revenue and the age of the organization. We expect that larger (and older) organizations will find it easier to obtain public funding than smaller (and younger) organizations. Large organizations have more staff and can develop higher degrees of specialization, including expertise in fund raising or contract negotiations.⁴⁰ They have more organizational slack or resilience and are less likely to be affected by staff turnover or loss of a single contract (even if it is large). Size confers visibility, legitimacy, and access to external resources. Similarly, organizations that have survived a minimum number of years have overcome the liability of being a new organization, struggling for survival. Over time, they develop experience and expertise; obtain visibility, contacts, and recognition; become established in their fields; and institutionalize their external funding relationships.

Size of revenues gives broad indications of the capacity and amount of infrastructure that an organization controls. We asked organizations to report their total revenues for the most recently completed fiscal year (usually 1990) and also to indicate the number of full-time (FT_STAFF) and part-time staff members as of July 1, 1990. Because of the highly skewed distribution of revenues, we used the log value (LOG_SIZE) in all subsequent analysis (as we did for total DCFS payments). Data on the year of establishment (YEARESTB) show the average year of founding to be 1951, but half the agencies were established in 1970 or later.

Revenues, of course, have a built-in relationship with DCFS funding because total revenues include what the provider receives from DCFS. However, we cannot easily resolve the confounding because the two measures come from different years (1989 for DCFS funding, 1990 for total revenues), and we are reluctant to assume that revenues are stable over time.⁴¹ Although this is an important conceptual issue, the zero-order correlation between the log values of total revenues and of DCFS funding is only $r = .16$, suggesting that the confounding is not of major practical import.⁴²

Access to competing funding sources.—Providers may have well-established relationships with public funders other than DCFS that also

desire access to their services. Such providers are likely to be less dependent on DCFS since they will find it easier to replace DCFS funding with other public funding sources than those without immediate access to such alternative relationships. Their competitive position is strengthened further because they can point to their role in providing important services for the public sector. They are also likely to be skilled in negotiating the public funding market and managing the grants and contract system, with all of the restrictions it imposes on recipient organizations.⁴³ We have information on the distribution of revenues by five major categories for 1990 as well as on the number of different public agencies from which organizations receive funding. We hypothesize that the larger the proportion of funding from public agencies and the larger the number of public funding sources, the more DCFS funding agencies obtain.

The types of revenues on which providers depend are important because funding relationships become institutionalized over time. Organizations become familiar with and skilled in managing the contingencies associated with major funding sources and their respective degrees of flexibility, discretion, external control, and predictability. We use the proportion of total 1990 revenues from government funding (PCT_GOV), fees (PCT_FEE), or donations (PCT_DON).⁴⁴ As in the case of total revenues (and for the same reasons), we cannot disentangle any built-in relationship between the dollar amount of DCFS funding and the percentage of revenues from all public sources combined. Fortunately, the relationship is not very direct in this case because a provider may receive a small dollar amount of funding from DCFS, yet it may constitute a large proportion of its total revenues.⁴⁵ We have information on whether the organization reports DCFS as a major funder in 1990 (providing 10% or more of total revenues). Almost half (45%) did. We use this variable (DCFS_MAJ) as a control on the assumption that it is a relatively stable indicator of degree of involvement with DCFS.

The larger the number of public funding sources, the more likely the organization is to have access to alternative funding and to use its connections with such sources to influence decisions made by DCFS. We asked the organizations to indicate whether, during the most recently completed fiscal year, they received any grants, contracts, or reimbursements directly from any of 16 different state agencies.⁴⁶ We then summed the number of such funding contracts (STAT_CON). Some received funding from all 16, but the average number was only 2.5. Funding relationships with a core group of state human service agencies are especially important because these state agencies also provide extensive services to children and youth and rely extensively on other organizations to deliver mandated services.⁴⁷ We summed the number of such relationships reported by the service providers (STAT_CORE). The average was 2.1 and went as high as seven.

We also asked providers to report the total number of local governments (LOC_CON) and federal agencies (FED_CON) from which they received funding during that year. More than half (59%) reported no funding from local governments, and the average was only 1.5, but the maximum was funding from 32 different local governments. Only 18 percent had any direct federal funding, including some with funding from six different federal agencies. Finally, we computed the total number of governmental units involved (GOV_CON). The number of public funding links range from one to 36, with a mean of 4.4.

Legitimacy.—Rendering services under contract with public funding sources involves provider organizations directly in the production of public goods. That is itself an important source of legitimacy. However, some organizations have their own built-in sources of legitimacy, which they can use as leverage in negotiations with public funders. Nonprofit organizations receive official recognition as contributing to the public good when their revenues and contributions are exempted from taxes (within certain limits). Their claim to serve the best interests of the community and clients is not easily rejected by public authorities.⁴⁸ The great majority (78%) of the organizations operate under nonprofit auspices (NP_AUSP). Some nonprofit organizations are also affiliated with religious institutions (RELAFFIL). For the 17 percent with such affiliations, that may not only confer additional legitimacy but may also secure access to other external resources in the form of funding and influence.⁴⁹

Nonprofit networks.—In addition to maintaining direct and extensive relationships with public agencies, public subcontractors also have a broad range of affiliations with each other. Some of these involve formal agreements about resource relationships, whereas others are more political in nature. We have data on the number of contractual relationships that organizations maintain with other nonpublic agencies and that involve public funding.⁵⁰ We asked whether the organization subcontracted any of its public funding to other nonpublic organizations and whether it received public funding indirectly by means of subcontracts with other nonpublic agencies. If the answer was yes, we asked with how many different organizations the agency had each of these types of subcontractual relationships. We assume, but do not know for sure, that most of these subcontracts occur among nonprofit organizations rather than for-profit ones. Overall, 39 percent engage in some form of subcontracting of public funding to or from other nonpublic organizations (NP_CONTR), involving as many as 16 other organizations, but the average was only 1.2.

We also asked the organizations to indicate whether they belonged to, or received funds on a regular basis from, any United Way organization, religious federations, or any other federated charity. We counted the total number of such funding sources (NPFNDFED). More than

half (58%) belonged to federations, mainly United Way (54%) rather than religious federations (19%). The survey also listed five major statewide associations or coalitions active in services for children and youth and asked the organizations to indicate whether they belonged to any or all of them (CHLDCOAL).⁵¹ Almost two-thirds (53%) had such connections, and some belonged to all five. Finally, we measured the overall degree of involvement in nonprofit networks (NPNETWRK) by adding the number of subcontractual relationships with other nonpublic agencies, memberships in funding federations, and affiliations with statewide coalitions. Only 17 percent had no such network connections, but some had as many as 18, and the average was 2.9.

Findings

Column 1 in table 3 reports on the zero-order correlations between the log value of amount of funding from DCFS (dependent value) and the two sets of measures of market forces and leverage (independent variables). These correlations show that both market and leverage variables are significantly related to the amount of funding received by agencies. All but three of the 29 zero-order correlations are significant. Only self-defined comprehensiveness, degree of community base, and number of funding relations with units of local government fail to reach significance. A fourth variable (reliance on donations) has only borderline significance ($p < .10$) and is in the opposite direction to what we expected.

To understand more fully the factors related to success in the DCFS provider market, we undertook multiple regression analyses using the two sets of independent variables to predict the amount of funding providers receive from DCFS (log value). Four pairs of independent variables are highly correlated with one another and, therefore, present a problem of multicollinearity in the multiple regressions.⁵² We dropped one variable from each of these four pairs based on the relative clarity or importance of its conceptual link to the dependent variable. In two of the four pairs, the application of this criterion eliminated the variable with the lowest correlation with the dependent variable. For one pair, the eliminated variable (COR_SERV) has a stronger correlation with the dependent variable than the one we kept (ALL_SERV) but has a more tenuous conceptual link to service comprehensiveness. For the final pair (PCT_FEE and PCT_GOV), there is no clear conceptual basis for distinguishing between their relationship to the dependent variable. We therefore display results from separate analyses to examine whether the inclusion of one as opposed to the other affects the overall findings.

Columns 2-5 in table 3 present the results of our multiple regression analyses. Column 2 shows the results of a multiple regression

Table 3

REGRESSION RESULTS ON AMOUNT OF DCFS FUNDING IN FISCAL YEAR 1989 (Log Value)

VARIABLE NAME AND TYPE	ZERO-ORDER CORRELATIONS	STANDARDIZED REGRESSION COEFFICIENTS IN MULTIPLE REGRESSION			
		Without Control for DCFS Dependence		With Control for DCFS Dependence	
		With % Government Funding	With % Fees	With % Government Funding	With % Fees
Market forces:					
Expertise:					
+ RESID .....	.16**	.14	.14	(.11)	(.12)
+ SOCIAL .....	.23***	(.12)	(.12)	(.10)	(.10)
+ DAYCARE	-.21***	...	...	...	...
+ YOUTH .....	.11*	...	...	...	...
- MENTAL	-.15**	...	...	...	...
- MISC	-.18***	(-.09)	(-.09)	...	...
+ MAJ_CORE .....	.30***	(.08)	(.08)	...	...
Comprehensiveness:					
+ ALL_SERV .....	.26***	...	...	...	...
+ SELFSERV .....	.02	(-.07)	...	...	...
Target focus:					
+ CHLDTARG .....	.25***	.19**	.20**	.12*	.12*
+ RACETARG .....	.21***	(.07)	(.08)	(.07)	(.07)
Outreach:					
+ MUL_SITE .....	.16**	(.07)	...	.09	.09
+ COM_BASE	-.04	...	...	...	...
+ SERV_SET .....	.22***	...	...	...	...
Leverage:					
Resource capacity:					
+ LOG_SIZE .....	.16**	...	...	...	...
- YEARESTB	-.51***	-.12	(-.10)	-.13*	-.12*
+ FT_STAFF .....	.13*	...	...	...	(.07)
Funding mix:					
+ PCT_COV .....	.31***	.21**	N.A.	.16**	N.A.
- PCT_FEE	-.36***	N.A.	-.18**	N.A.	-.13*
- PCT_DON .....	.08	...	-.15**	...	-.12*
Alternative sources:					
+ GOV_CON .....	.13*	...	...	...	...
+ STAT_CORE .....	.18***	...	...	...	...
+ FED_CON .....	.16**	...	...	...	...
+ LOC_CON .....	.05	...	...	...	...
Legitimacy:					
+ NP_AUSP .....	.33***	.12	.11	(.08)	(.08)
+ RELAFFIL .....	.16**	...	...	...	...
Nonprofit networks:					
+ NPFNDFED .....	.30***	...	...	...	...
+ CHLDCOAL .....	.37***	.12*	.12*	...	...
+ NPNETWRK .....	.40***	.11	.12	(.09)	(.09)
Control:					
+ DCFS_MAJ .....	.54***	N.A.	N.A.	.33***	.33***
Multiple r .....		.65***	.64***	.70***	.70***
Adjusted R ² .....		.36	.35	.44	.43

NOTE.—Sign in front of variable name indicates hypothesized relationship with amount of Department of Children and Family Services (DCFS) funding (dependent variable). Only standardized regression coefficients significant at .20 level of significance or better are included. Coefficients with significance levels between .20 and .10 are shown in parentheses, those with significance levels between .05 and .10 are shown without notation, otherwise, * = $p < .05$, ** = $p < .01$, and *** = $p < .001$. In cols. 2 and 4, PCT_FEE is excluded from the analysis. In cols. 3 and 5, PCT_GOV is excluded. N.A. = not available.

analysis including reliance on public funding (PCT_GOV) but not reliance on fees (PCT_FEE). Column 3 displays results when including reliance on fees but not public funding. Columns 4 and 5 show the results when also controlling for relative dependence on DCFS funding (DCFS_MAJ). For the sake of clarity, standardized regression coefficients that fail to reach the .20 level of significance are not presented.

We draw three conclusions from these analyses. First, market forces and leverage together account for a relatively large proportion of the variance in the amount of DCFS funding. As shown in column 2, the 29 independent variables have a multiple correlation coefficient of $r = .65$ and explain 36 percent of the variance. The coefficients and amount of variance explained are slightly smaller if reliance on fees, rather than reliance on government funding, is included in the analysis (col. 3). If we control for the relative importance of DCFS funding to the organizations (cols. 4 and 5), we explain an additional 8 percent of the variance (43%–44%).

Second, in each case, three or four variables are significantly related to funding (at the .05 level or better): whether the agency targets children and families (CHLDTARG), the year the agency was established (YEARESTB), funding mix (PCT_GOV or PCT_FEE and PCT_DON), and the number of memberships in child welfare coalitions (CHLDCOAL). Several more variables approach significance at the .10 level or better (numbers not in parentheses). The number of relevant variables increases only slightly if we consider those with significance levels of .20 or better as well (numbers in parentheses). All significant relationships are in the hypothesized directions and in the same directions as the zero-order correlations. That is also the case for all regression coefficients of borderline significance.

Third, the leverage variables appear very important in accounting for differences in the amount of DCFS funding received. They account for seven of the eight zero-order correlations with $r > .30$ and all the significant variables in the multiple regression except for one measure of target focus (CHLDTARG). Fourth, the overall patterns do not change substantially if we allow stepwise regression techniques to select the best set of predictor variables, whether or not we include DCFS as a major funding source (DCFS_MAJ), overall size (LOGSIZE), or the organization's primary purpose (MISSION).⁵³

Discussion

We found support for both our hypotheses. The success of providers in the DCFS funding market (as measured by the amount they received from DCFS in 1989) does have some relationship to the type of expertise they have and therefore how well they match the needs of

DCFS for certain types of providers (market factors). Their success is also related to the legitimacy to which they can lay claim and the amount of influence or resources to which they have access (leverage factors).

But, as our findings show, some of these factors are more important than others. The amount of DCFS funding providers receive is related mainly to whether they target children, youths, and their families; whether they are old, established agencies; whether they have expertise with public funding (or alternatively avoid fees); and how extensively they are involved in coalitions focusing on children and youth.⁵⁴ We speculate that the importance of involvement in statewide coalitions reflects at least in part how the policy arena itself is structured, that is, in Illinois, state government plays a major role in controlling and administering expenditures in the child welfare field.

These are important findings. Although market factor variables are related to the amount of DCFS funding that providers receive, their contributions are weakened when leverage variables are included as well.⁵⁵ The pattern is consistent with what we would expect, given DCFS's long-standing and extensive reliance on external (mainly nonprofit) providers to deliver complex services that are difficult to evaluate. These are ideal conditions for allowing reputation and legitimacy to take on a major role in negotiating grants and contractual relationships. The findings suggest that contractual relations in the child welfare system (as least as structured in Illinois) are likely to be very stable over time and to respond only imperfectly to shifts in market forces.

We acknowledge, however, that this is also a tentative argument. We do not know the extent to which our findings would be modified if we had been able to incorporate a more complete set of variables in our analysis, especially measures of provider performance. Nor do we have time-series data that would allow us to test the causal direction of relationships. Our cross-sectional analysis allows us only to confirm that there are strong associations between provider success in the DCFS contract system and the various independent variables we have included in the analysis, especially leverage and influence factors.

However, our argument about the greater importance of leverage rather than market forces gains plausibility from the substantial barriers that providers must overcome to enter the system in the first place. Moreover, according to our informants among agency providers and DCFS staff, a series of events that took place in 1987 reveals in some detail the power and leverage that existing providers are able to exercise over DCFS.

The occasion was a first-ever decision by the Cook County regional office of DCFS to invite new providers to submit bids for counseling contracts and allow them to compete on par with providers with cur-

rent contracts. When several current providers, whose bids were ranked lower than new providers on the evaluation criteria, were notified that their contracts would not be renewed, they protested the decision. Eventually, they took their case to the governor's office and succeeded in having the contracts that had already been awarded to new providers cancelled on the day before the new providers were to begin to deliver services. Protests by the new providers, many of whom had hired staff and rented space to accommodate the contract work, fell on deaf ears. Although such open displays of raw political power are rare, their occurrence highlights the importance of paying careful attention to leverage and its various sources.

Of course, in spite of tendencies toward inertia in the contract system and reliance on incremental budgeting processes, the DCFS grants and contracting system is not immutable. Client needs, provider capacities, department financial resources, and service monitoring are just some of the conditions that exert and promote change in the provider contract system. A 1-year snapshot of the service provider system may or may not accurately reflect what the system looks like over a period of time. Nor is it certain that the factors that account for the amount of funding a provider received in 1 year necessarily explain that provider's success or failure over time.

Future work in this area should explore more long-term measures of organizational success in the public grants and contracts system. We plan to do so by (1) examining the number of years providers participate in the funding system over the 5 years for which we have data,⁵⁶ and, for those that are continuous providers, (2) examining the growth or decline in the amount of DCFS funding a provider has received over that period of time, and (3) exploring the extent to which providers have diversified or specialized their base in the DCFS funding system by adding or dropping funded services.

Analysis of data from financial payments systems can make an important contribution to understanding the composition of a provider market. These systems present valuable tools for revealing the operation of public bureaucracies by making it possible to track trends in the numbers and types of providers over time; identify patterns of continuity, exit, and entrance; and understand how narrow, specialized, or diverse is a set of services a given provider may deliver to the public agency.

It is our impression that this type of analysis is rarely done and that our data set is unique. While most public agencies and other human service organizations keep track of their expenditures and contract relationships, they rarely employ a longer time perspective than 2 or 3 fiscal years (last, current, or next) or address the types of broader policy and planning concerns outlined in this article. Of course, human service organizations (whether public or private) often lack the internal

resources to perform an extended financial analysis. Nor do policy researchers use this resource to its full potential, perhaps because of the difficulty in obtaining and reorganizing financial data.

Efforts to describe both the provider funding systems and the characteristics of the organizations that participate in a system have implications beyond the set of organizational issues identified in this article. Empirical evidence of the role of market forces and leverage in privatized systems can help policy makers assess the benefits and the problems of such systems and move to improve the ways in which they function. Without careful attention to the interplay of these forces, policy makers are likely to face unexpected obstacles in their efforts to formulate new resource development strategies, improve service coordination and monitoring, develop cost-effective services, streamline the contract and grant process, and improve licensing processes.

Appendix A

Table A1

DESCRIPTION OF ATTRACTIVENESS/MARKET FORCES VARIABLES INCLUDED IN ANALYSIS

Variable Name	Description and Type of Variable
Expertise:	
MISSION	Primary purpose of organization: residential services (+), other social services (+), day care (+), child/youth services (+), nonresidential mental health (-), other miscellaneous (-) (dummy)
+ ALL_CORE*	Total number of core DCFS services provided (numeric)
+ MAJ_CORE	Number of core DCFS services also defined as provider's major services (numeric)
Comprehensiveness:	
+ ALL_SERV	Total number of different services provided (numeric)
+ SELF_SERV	Self-assessment of service comprehensiveness (dummy)
Target focus:	
+ CHLD_TARG	Major target group composed entirely/mainly of children, youth, and their families (dummy)
+ RACE_TARG	Major target group composed entirely/mainly of racial or ethnic minorities (dummy)
Outreach:	
+ MUL_SITE	Operates in multiple sites (dummy)
+ COM_BASE	Extent to which organization is community focused (ordinal)
+ SERV_SET	Extent to which organization operates in accessible service settings (ordinal)

NOTE.—Sign in front of variable name indicates hypothesized relationship with amount of Department of Children and Family Services (DCFS) funding (dependent variable).

* Dropped from the analysis because of potential problems of multicollinearity (see text).

Appendix B

Table B1

DESCRIPTION OF LEVERAGE/POWER VARIABLES INCLUDED IN ANALYSIS

Variable Name	Description and Type of Variable
Resource capacity:	
+ LOG_SIZE	Log value of total revenues in 1990 (numeric)
+ FT_STAFF	Number of full-time staff (numeric)
- YEARESTB	Year established (numeric)
Funding mix:	
+ PCT_GOV*	Percentage of 1990 revenues from public sources (numeric)
- PCT_FEE*	Percentage of 1990 revenues from fees (numeric)
- PCT_DON	Percentage of 1990 revenues from donations (numeric)
Alternative sources:	
+ GOV_CON	Number of all public agencies with which organization contracted in 1990 (numeric)
+ STAT_CON*	Number of all state agencies with which organization contracted in 1990 (numeric)
+ FED_CON	Number of federal agencies with which organization contracted in 1990 (numeric)
+ LOC_CON	Number of units of local government with which organization contracted in 1990 (numeric)
+ STAT_CORE	Number of core state agencies with which organization contracted in 1990 (numeric)
Legitimacy:	
+ NP_AUSP	Nonprofit auspices (dummy)
+ RELAFFIL	Religious affiliation (dummy)
Nonprofit networks:	
+ NP_CONTR*	Number of subcontractual relationships with other nonprofits (numeric)
+ NPFNDFED	Number of nonprofit funding federations in which organization has a membership (numeric)
+ CHLDLCOAL	Number of child welfare coalitions in which organization has a membership (numeric)
+ NPNETWRK	Size of nonprofit network in which organization is active (numeric)

NOTE.—Sign in front of variable name indicates hypothesized relationship with amount of Department of Children and Family Services (DCFS) funding (dependent variable).

* Dropped from the analysis because of potential problems of multicollinearity (see text).

Notes

The views expressed are those of the authors and do not necessarily reflect the views of the U.S. Department of Health and Human Services or the John D. and Catherine T. MacArthur Foundation.

1. A second form of privatization not considered in this article—load shedding—involves transferring public services entirely to private providers.

2. Martha Derthick, *Uncontrollable Spending for Social Service Grants* (Washington, D.C.: Brookings Institution, 1975).

3. T. Field Benton and R. Millar, *Social Services: Federal Legislation vs. State Implementation* (Washington, D.C.: Urban Institute, 1978); Walter Williams, *Government by Agency: Lessons from the Social Program Grants-in-Aid Experience* (New York: Academic Press, 1980).

4. James T. Bennett and Thomas J. DiLorenzo, *Unfair Competition: The Profits of Nonprofits* (Lanham, Md.: Hamilton Press, 1989); E. S. Savas, *Privatizing the Public Service: How to Shrink Government* (Chatham, N.J.: Chatham House, 1982); John Rehfuss, *Contracting Out in Government: A Guide to Working with Outside Contractors to Supply Public Services* (San Francisco: Jossey-Bass, 1989); H. Orlans, ed., *Nonprofit Organizations: A Government Management Tool* (New York: Praeger, 1980).

5. Susan R. Bernstein, *Managing Contracted Services in the Nonprofit Agency: Administrative, Ethical, and Political Issues* (Philadelphia: Temple University Press, 1991); Ruth H. DeHoog, *Contracting Out for Human Services: Economic, Political, and Organization Perspectives* (Albany: State University of New York, 1984); Donald F. Kettl, ed., *Third Party Government and the Public Manager: The Changing Forms of Government Action* (Washington, D.C.: National Academy of Public Administration, 1987); Robert R. Nakamura and Frank Smallwood, *The Politics of Policy Implementation* (New York: St. Martin's Press, 1980); Philip J. Cooper, "Government Contracts in Public Administration: The Role and Environment of the Contracting Officer," *Public Administration Review* 50 (September–October 1990): 459–68; Nelly Hartoge, Nelly Weber, and Joseph Weber, *Impact of Government Funding on the Management of Voluntary Agencies* (New York: Greater New York Fund/United Way, 1978); Kirsten A. Grønberg, *Understanding Nonprofit Funding: Managing Revenues in Social Service and Community Development Organizations* (San Francisco: Jossey-Bass, 1993).

6. The analysis builds on and further extends the work conducted for the Children's Policy Project, a comprehensive reassessment of the Illinois Department of Children and Family Services (DCFS) conducted by the Chapin Hall Center for Children at the University of Chicago. See Matthew Stagner, "Re-thinking Child Welfare Services in Illinois: A Summary of Findings from the Children's Policy Project" (report prepared for Chapin Hall Center for Children, Chicago, 1993). For a more detailed description of the data used in this analysis, see Ted H. Chen, Kirsten A. Grønberg, and Matthew W. Stagner, "An Analysis of Financial Payments to Service Providers of the Illinois Department of Children and Family Services" (report prepared for Chapin Hall Center for Children, Chicago, 1992); Kirsten A. Grønberg and Matthew W. Stagner, "Meeting the Needs of Children and Youth in Illinois: The Role of Direct Service Providers" (report prepared for Chapin Hall Center for Children, Chicago, 1992). Support for the project was provided by the Spencer Foundation, the Chicago Community Trust, the Field Foundation of Illinois, the Helen V. Brach Foundation, the McCormick Tribune Foundation, the Ford Foundation, and the Illinois DCFS. Neither these funders nor the Chapin Hall Center for Children bears any responsibility for the analysis and interpretation presented in this article.

7. Arlien Johnson, *Public Policies and Private Charities: A Study of Legislation in the United States and of Administration in Illinois* (Chicago: University of Chicago Press, 1931); James Brown, *The History of Public Assistance in Chicago, 1833 to 1893* (Chicago: University of Chicago Press, 1941).

8. Grønberg, *Understanding Nonprofit Funding* (n. 5 above), p. 171.

9. *Ibid.*

10. Henry Hansmann, "The Role of Nonprofit Enterprise," *Yale Law Journal* 89 (1980): 835–901, and "Economic Theories of Nonprofit Organizations," in *The Nonprofit Sector: A Research Handbook*, ed. Walter W. Powell (New Haven, Conn.: Yale University Press, 1987), pp. 27–42; Burton Weisbrod, *The Voluntary Nonprofit Sector* (Lexington, Mass.: Lexington Books, 1977), and *The Nonprofit Economy* (Cambridge, Mass.: Harvard University Press, 1968).

11. Grønberg, *Understanding Nonprofit Funding* (n. 5 above).

12. Chen, Grønberg, and Stagner (n. 6 above).

13. We retained only payments to providers involved in any of 268 different client service codes and regrouped these into 13 major categories. Then, using a social security number for individuals or a federal employer identification number (FEIN) for organizations, we aggregated the payments into one annual payment record per service provider. Finally, we categorized each service provider as either an individual or an organization and distinguished among different types of individuals (e.g., foster parents, adoptive parents, day-care workers, counselors, and homemakers) and organizations (e.g., social service agencies, day-care centers, schools, health facilities, commercial businesses, and other organizations) based on the detailed set of services each provided and the pro-

vider's name. We found some inconsistency among these criteria, e.g., individual providers being paid to deliver agency-based foster care.

14. We undertook this process for each of the 5 years over the 1985-89 period and merged the 5 years into a single data set of some 58,000 providers engaged in contractual services for DCFS clients at some point during the 5 years. We present only data from 1989 in this article.

15. Grønberg and Stagner (n. 6 above).

16. We eliminated duplicate listings, individuals, schools, townships, commercial vendors, medical and legal professionals, or units not in Illinois. We included 12 social service organizations that serve only administrative purposes for DCFS (e.g., the Salvation Army). Because of problems in identifying headquarters, we included all distinctive program units under a given FEIN, but eliminated responses (30) that were duplicates. An additional 177 program units screened themselves out on the same basis.

17. We drew a 10 percent random sample (161) of the 1,607 single-site day-care organizations and a 50 percent random sample (132) of the 264 multiple-site day-care organizations. Many of the day-care organizations in the provider database have no contractual relationship with DCFS but are included in the database because they must be licensed by DCFS in order to operate. At the time we conducted the survey, we had not completed our analysis of the payment database and were, therefore, unable to distinguish between licensed-only day-care organizations and those with DCFS payments. By sampling only a portion of the day-care organizations, smaller organizations are underrepresented in the survey. We considered, but rejected, the possibility of weighing survey responses to compensate for this undersampling because it would have been difficult to establish valid weighing factors, given the lack of detailed information about providers in the payment database and complexity in dealing with different response rates to the survey.

§ 18. We matched the two data sets by FEINs and compared the names as recorded in each data set to verify the matches. We redefined two cases as "unmatched" because the names clearly denoted different organizations. We defined one case as a "match" because the same name was associated with FEIN numbers that differed only by a reversal of the first two digits. We matched three survey respondents without FEIN numbers on the basis of name but could not do so for another three.

19. We assume, but do not know for sure, that the remaining organizations in the sample are licensed day-care centers that had no DCFS funding, organizations that had DCFS funding only prior to 1985, or were among those that we deleted from the financial payment database because their DCFS payments were not related to direct client services. We were unable to eliminate these organizations from the sample prior to conducting the survey because technical problems delayed our ability to match the sampling frame and the financial payment database and because the sampling frame contained insufficient information about DCFS service activities. To avoid eliminating appropriate organizations from our sample, we decided to err on the side of inclusiveness in drawing the sample.

20. Including, unfortunately, the single largest recipient of DCFS funding, the Chicago Department of Human Services, which received about \$18.5 million in day-care funds in 1989, most of which are redistributed to private day-care programs.

21. Service providers with multiple last names—"Smith and Smith" or "Smith and Associates"—were counted as organizations; those with a single name—"Smith"—were coded as individuals.

22. A full description of service categories is available on request.

23. All 595 social service agencies should have been included in our sample list, but 35 percent were not. The missing organizations appear to be those with sufficiently ambiguous names that we did not recognize them as social service agencies when we screened the provider database for appropriate organizations to include in the survey. These erroneously excluded agencies accounted for 3 percent of all dollars to social service agencies and 4 percent of dollars to all provider organizations in 1989.

24. In order to compress the figure into a reasonable format, the two ends of the distribution have different y-axis scaling.

25. The survey also included questions designed to measure the extent and nature of changes experienced by providers over the past 3-5 years, i.e., revenues and funding sources in 1985, changes in service mix over the previous 3 years, and changes in affiliations with key nonprofit funding federations.

26. We use statistical tests of significance to indicate whether there is a substantial association between the amount of funding received from DCFS and a particular characteristic of the provider. As noted above, we do not have a genuine random sample of the DCFS providers, and significance tests may not be fully appropriate. However, we have most of the important DCFS providers in our survey, and the tests describe the strengths of existing patterns.

27. In fact, "mission" turned out to be one of the key variables that explained most other differences among the responding organizations. See Grønberg and Stagner (n. 6 above).

28. National Center for Charitable Statistics, "NTEE: Mapping the Nonprofit Sector: The National Taxonomy of Exempt Entities" (Washington, D.C.: The Independent Sector, 1990).

29. The nine major service fields are social services, institutional/residential care, mental health, health, employment/income support, education/research, housing/community development, legal/advocacy services, and recreation/culture/arts.

30. Irving Spergel and Mary Ann Hartnett, *Evaluation of the DCFS Comprehensive Community Based Youth Service System: Final Report* (report prepared for Chapin Hall Center for Children, Chicago, 1990).

31. Mark Jacobs, *Screwing the System and Making It Work: Juvenile Justice in the No-Fault Society* (Chicago: University of Chicago Press, 1990).

32. We view this claim with some skepticism, reflecting either self-delusion or limited attention to client needs beyond those the provider has any interest in addressing.

33. The two are closely related. Certain services are entirely directed at particular client groups.

34. We have some data on the extent to which the organizations voluntarily identify other special target groups of particular interest to DCFS: low-income, victims of crime or abuse, mentally ill or substance abusers, etc. However, very small proportions identified these target groups, and all organizations may not have reported on them because we used an open-ended question. Even so, the proportions are consistent with other survey data that explicitly asked about these groups. See Kirsten A. Grønberg, Aml Nagle, Lauree Garvin, and Lori Wingate, *Nonprofit Human Service Facilities in Illinois: Structure, Adequacy, and Management* (report prepared for the Illinois Facilities Fund, Chicago, 1992).

35. Most likely, providers located in the Chicago metropolitan area are more likely to target minority populations than those in downstate Illinois. We do not have sufficiently detailed information on the geographic service area of providers to allow for a test of this hypothesis. Although only 31 percent of DCFS providers target minority groups, this is a substantially higher percentage than the 6 percent of Illinois nonprofit human service organizations (broadly defined) that reportedly targeted minority groups in 1991. Among these organizations, a somewhat larger proportion of Chicago-based agencies (7%) than those located in other regions of the state (2%) reported that they targeted minority groups (*ibid.*, pp. 1'-21).

36. However, close links between service staff and community may be a problem for clients who prefer to receive certain types of services under greater conditions of anonymity than might be possible in community-based organizations.

37. We categorized organizations as operating mainly in external settings if most of their in-person contacts took place in client or foster homes, in schools, in the courts, or in such locations as streets, shops, or parks. These settings should make services more accessible to clients and indicate aggressive outreach efforts. We coded organizations as engaging in intermediary outreach if they reported that some, but not most, contacts took place in any of these settings. The remaining organizations provided most of their services in internal settings, i.e., agency offices, residential facilities, or other agencies.

38. Michael R. Sosin, "Decentralizing the Social Service System: A Reassessment," *Social Service Review* 64 (December 1990): 617-36.

39. Jeffrey Pfeffer and Anthony Leong, "Resource Allocation in United Funds: Examination of Power and Dependency," *Social Forces* 55 (March 1978): 775-90; Jeffrey Pfeffer and Gerald Salancik, *The External Control of Organizations* (New York: Harper & Row, 1977); Michael T. Hannan and John Freeman, "The Population Ecology of Organizations," *American Journal of Sociology* 82 (1977): 929-64; "Structural Inertia and Organizational Change," *American Sociological Review* 49 (1984): 149-64; Keith G.

Provan, Janice M. Beyer, and Carlos Kruytbosch, "Environmental Linkages and Power in Resource-Dependence Relations between Organizations," *Administrative Science Quarterly* 25 (1980): 200-24; John W. Meyer, John W. Scott, and Richard Scott, eds., *Organizational Environments: Ritual and Rationality* (Beverly Hills, Calif.: Sage, 1983); Carl Milofsky, ed., *Community Organizations: Studies in Resource Mobilization and Exchange* (New York: Oxford University Press, 1988); Jitesdra Singh, Robert J. House, and David J. Tucker, "Organizational Change and Organizational Mortality," *Administrative Science Quarterly* 31 (1986): 587-611; Paul J. DiMaggio and Walter W. Powell, "The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields," *American Sociological Review* 48 (1983): 147-60.

40. Organizational size could be viewed as one of the market force variables, if one assumes that large size reflects greater organizational capacity to perform DCFS services and that DCFS will prefer to contract with large-capacity organizations in order to minimize the number of contracts it must supervise. However, given the number of providers with which DCFS contracts during a given year, we do not find this a compelling argument by itself. Moreover, anecdotal evidence and interviews with DCFS staff suggest that DCFS staff tend to view large providers as difficult to control, suggesting that provider size should be grouped with the leverage variables.

41. Year-by-year analysis shows that between one-quarter and one-third of human service organizations have annual shifts in a major funding source (e.g., government funding) that change the organization's size by at least 25 percent. See Kirsten A. Grønberg, *Responding to Community Needs: The Missions and Programs of Chicago Nonprofit Organizations* (prepared under the Urban Institute, Washington, D.C., 1986); Grønberg, *Understanding Nonprofit Funding* (n. 5 above).

42. The zero-order correlation between the raw dollar values of total revenues and total DCFS funding is $r = .44$, so that total revenues account for less than 20 percent of the total variance in DCFS funding amounts. We do not know how the likely underrepresentation of small agencies, especially day-care centers, affects these correlations.

43. Grønberg, *Understanding Nonprofit Funding* (n. 5 above).

44. We also asked about revenues from special events (or other fund-raising activities) and "other" sources but dropped them from the analysis because they averaged less than 4 percent of revenues.

45. The correlation between the percent of revenues from public sources (in 1990) and the log value of 1989 DCFS payments is only $r = .31$, suggesting that the confounding of these two variables is not very important.

46. While the amount of funding from public sources may fluctuate from year to year, social service agencies tend to have fairly persistent relationships with public agencies. See Grønberg, *Understanding Nonprofit Funding* (n. 3 above).

47. They include the Departments of Public Aid, Mental Health and Developmental Disabilities, Alcoholism and Substance Abuse, Corrections, Public Health, and the State Board of Education.

48. Sosin (n. 38 above).

49. Most major religious denominations have their own advocacy organizations and well-established links to state and local governments.

50. We asked only about subcontracting relationships that involved some level of public funding because we were interested in this particular relationship for other research purposes. Moreover, case-study data suggest that agencies find subcontracting relationships troublesome and mainly undertake them if funding sources demand that a particular complement of services be provided. Only public funding sources tend to impose such demands (see Grønberg, *Understanding Nonprofit Funding* (n. 5 above)).

51. They are the Child Care Association of Illinois, Day Care Action Council of Illinois, Illinois Action for Children, Illinois Caucus on Teen Pregnancy, and Illinois Collaboration on Youth.

52. Number of core services (ALL_CORE) and number of total services (ALL_SERV, $r = .84$); reliance on fees (PCT_FEE) and government funding (PCT_GOV, $r = -.76$); number of funding relationships with state agencies (STAT_CON) and with seven core state agencies (STAT_CORE, $r = .88$); and number of nonprofit subcontract relationships (NP_CONTR) and overall size of nonprofit network (NPNETWRK, $r = .87$). All other intercorrelations are at the .50 level or less.

53. These findings are not reported in detail here.

54. One other measure of provider expertise (focusing on residential care services, or operating in multiple sites when controlling for DCFS as a major source of funding) approaches significance, as do two additional measures of leverage (operating under nonprofit auspices and size of nonprofit network in which the provider is involved).

55. When just market variables are included in the regression analysis, they account for 25 percent of the variation in DCFS funding levels.

56. We will also examine year-to-year patterns to see if service providers entered, exited, stayed, or cycled in and out of the system during the fiscal year 1985-89 period.

Privatization
of
Seaports

Privatization Of Seaports?

Though hardly a recent phenomenon, "privatization" of publicly owned assets has come increasingly into vogue as a solution to perceived problems of fiscal scarcity and institutional inefficiency. The underlying assumption appears to be that private sector participation is needed both to relieve governments of burdensome financial responsibilities and to promote investment and efficiency in a manner that the public sector is inherently incapable of providing.

by Rexford B. Sherman

Among the targets of privatization at the inter-national level have been state owned enterprises such as banks; trading companies; tele-communications; utilities; steel and petroleum companies; and transportation entities such as railroads, shipping lines, highway systems, airlines and ports. The most obvious examples have been the transition to the free enterprise system of the communist economies of Eastern Europe, the former Soviet Union, and even the remaining communist states such as Vietnam and especially China. However, it is occurring with comparable rapidity elsewhere — in Britain under the Conservative governments of Prime Ministers Thatcher and Major, Argentina under President Menem and the Mexico of former President Salinas, for example, — with the reversal of socialist policies of the past by public divestiture of previously nationalized and other state-owned companies, and the adoption of policies aimed at encouraging rather than constraining market-oriented behavior in the private sector.

Public ports have become increasingly inviting targets of opportunity for privatization over the past decade. The

first and arguably the most successful occurred in 1981 with the sale by the British government of the 21 ports controlled Transportation Board to a joint-stock company known as Associated British Ports Holdings. Other countries where port privatization is well underway are Argentina, Chile, Colombia, Malaysia, Mexico, New Zealand, the Philippines, and Venezuela. The process has accelerated within the last two years, according to the British trade journal "Port Development International", which estimates that 30 ports worldwide "will, in some way or another, be privatized in the short-term."¹ In total, more than 40 countries are said to be pursuing "port privatization in one form or another."²

In the United States, privatization initiatives thus far have typically entailed the contracting out of to vendors of services handled by public employees such as solid waste disposal, nursing home operation, wastewater treatment, traffic adjudication, prisons, school lunch programs, and child support services.³ Even the Federal Government has not remained immune. Examples include the sale to the private sector of Federal Barge Lines and Conrall; quasi-

privatized institutions such as the U.S. Postal Service and the National Passenger Railroad Corporation (or "Amtrak"); and the recent proposal for privatizing the federal air controller service as part of the reorganization of the U.S. Department of Transportation.

Only recently, however, has the debate in this country begun to embrace the privatization of U.S. public port agencies. A 1993 study by The Reason Foundation which touts "greater private sector participation" as a solution to the "many problems" faced by U.S. public ports" such as "lack of exposure to full commercial competitive pressures .. to operate efficiently" and undue "political interference."⁴ More specific proposals have come from the prospective Executive Director of The Port Authority of New York and New Jersey⁵ and a reorganization plan for the Port of Los Angeles, which among other things, recommends the contracting out of certain "non-essential" port functions and the privatizing of others such as pilotage.⁶

The merits of these ideas can be effectively evaluated, however, only by precisely defining what is meant by privatization, actual privatization experiences elsewhere in the world, and how they relate, if at all, to the situation to public port governance in the United States.

"Privatization" simply stated means the transfer, sale, or lease of public assets, functions, or services to private sector entities. Furthermore, privatization defines not one but rather a spectrum of options ranging from the "complete" sale of public port assets on one extreme to contractual or leasing arrangements in which ownership remains in the public sector but operational control is delegated in some fashion to private sector concessionaires. A World Bank study⁷ outlines these "progress-

sively increasing degrees of private participation:"

- (a) publicly owned and operated port
- (b) Private stevedoring in publicly owned facility
- (c) Private shore-side cargo-handling and stevedoring in public facility
- (d) Private operating concession in public facility
- (e) Privately owned and operated terminal

A more recent delineation⁸ predicts that port privatization ventures "to the year 2000 and beyond ... will not necessarily entail a full-blooded switch from public to private ownership ... but [instead] will involve a broad based cultural change from public cost-benefit thinking to private sector commercial values." "Common strategies," beyond the "selling off [of] public ports lock stock and barrel" will include:

"Partial privatization of terminal operations where the government retains an equity stake and exerts control in line with this."

"The full privatization of terminal operations where facilities are leased on a term basis and the role of the port authority becomes a management and coordinating one without direct involvement in operations."

"The port authority may opt to contract to perform other key functions, for example, towage duties, infrastructure and plant maintenance and navigation duties."⁹

Other, though less likely options, include:

"The contracting of private sector management expertise to run a given facility."

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"The leasing of entire ports."¹⁰

A decision to privatize ports can be driven by a variety of forces. The most obvious is to relieve a financially strapped government by turning to the private sector for an infusion of capital required to modernize and sustain port operations — or to bolster the national treasury. Another can be to seek the economic benefits from competition by cutting labor costs, eliminating publicly sanctioned monopolies, reducing bloated port labor forces, and removing other institutional barriers that discourage innovation and isolate and indeed protect port management from the exigencies of the global market place.

Inefficient and costly port operations can seriously impair the competitiveness of a nation's export industries and artificially raise the cost and thus constrain the availability of imported goods. Thus, privatization in certain circumstances holds the promise of stimulating economic growth and higher living standards for society at large as well as those whose livelihood depends directly on port activity and trade.

However, privatization carries certain risks that must be carefully weighed before decisions are made. There is the danger, for example, as Britain's experience with certain of its "trust ports" underscores,¹¹ that the below-market sale of public assets can deprive government of the full value and thus the full financial benefit of a port asset divestiture.

Determination must be made as to what if any role should be retained by the public sector; what restrictions or limits should be placed on private operators; and, what safeguards are needed to prevent abuses. In this respect, it is important to note the recent emergence and expanding holdings on an interna-

tional scale of fewer than two dozen privately-controlled terminal operating companies whose corporate headquarters are often far removed from the port properties they own or manage.¹² These entities have typically been the successful bidders of late for terminal concessions in Latin America, Asia, and Europe. While these companies have much to offer in the form of capital, managerial expertise, and market acumen, their interests are global rather than local or regional, corporate rather than public, profit maximization rather than economic benefit — factors that argue well for adequately safeguard public and national security interests in any port privatization strategy.

It should also be remembered that ports are but one link in the international trading system and that care should be taken to ensure that reform extends beyond the port itself. If, for example, inefficiencies or monopolistic practices are allowed to persist elsewhere in the system, the benefits from port privatization may be compromised or forfeited altogether. A modern, efficient container port serves no useful national purpose if it is served by poorly maintained or inadequate rail or highway facilities.

Similarly negative consequences can ensue from unnecessary and/or corruptly managed government regulatory practices, from a failure to trim bloated public port bureaucracies, to implement meaningful labor reform, or to sensitize port operations to market rather than political forces. Clearly, the challenge is to promote economic efficiency while preserving and protecting the public interest in a modern, viable port system. In the last analysis, the guiding strategy must be in ensuring the uninhibited flow of waterborne trade rather than short term and, one might

say, short-sighted politically motivated fiscal goals — the danger, as one astute commentator puts it, of "milking for cash, not trade."¹³

Port privatization experiences to date have for the most part focussed on the sale of operating concessions (in Argentina, China, Mexico, and the Philippines, for example)¹⁴, joint-public-private ventures (Malaysia and Vietnam)¹⁵, privately-oriented but port authority controlled operating subsidiaries (Saint Lucia)¹⁶, or the dissolution of government-owned cargo handling monopolies in favor of competitive private sector stevedoring companies (Chile and Dublin).¹⁷ The "lock stock and barrel" sales of public ports in New Zealand and Great Britain are rather the exception than the rule. Only a few months ago, for example, "a barrage of criticism from users, unions, and shipowners" forced the Victoria State Government in Australia to abandon its pursuit of "port reform" through the sale of the shore-based and non-port-related assets of the Port of Melbourne Authority.¹⁸

Proponents of privatization argue that U.S. public ports many cases operate at a loss and, furthermore, "lack exposure to full commercial competitive pressures" which "may have reduced incentive to operate efficiently" and "are often subject to political interference."¹⁹ They point with approval to privatization success stories in Great Britain and Malaysia, for example,²⁰ and in so doing imply that because port privatization is occurring elsewhere in the world, it ought to be done in the United States. The underlying assumption is that public ports systems are the same everywhere, and that what makes sense for Malaysia, Argentina, or Mexico, makes equally good sense for the United States.

That assumption is seriously flawed. Unlike most other port systems, particularly in the developing world, the

U.S. port system is decentralized, highly competitive (which is the major reason why many have difficulty turning a profit), and is already "privatized" to a large degree. To say that U.S. public ports are unresponsive to competitive pressures is to ignore the billions of dollars they have invested in facilities and services to ensure that they do in fact remain competitive.

The operating philosophies of public seaport agencies in the United States are dictated largely by local circumstances — by decisions of port managers as directed by their governing boards and the enabling charters of the agencies themselves rather than by administrative fiat of the national government. Indeed, in the United States, there is no single national port authority. Rather authority is diffused through all three levels of government — federal, state, and local. This stems from the federal character of the U.S. Constitution, which reserves certain powers for the national government and delegates others to the states.

The U.S. Constitution grants the federal government exclusive jurisdiction over the navigable waters of the United States, including its deepdraft channels and harbors. However, landside port development, with certain restrictions, is a state and local government prerogative. Port authorities in the United States are instrumentalities of state or local government and established pursuant to laws or grants of authority extended by state legislatures.

Neither Congress nor any federal agency has the power, or even the right, to appoint or dismiss port commissioners or staff members, or to amend, alter, or repeal a port authority charter — with one exception. That exception pertains to the enabling charters of bi-state agencies, which, because of their interstate character, are subject to Congress-

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sional approval: In addition, by federal law, ports may not give undue or unreasonable preference or refuse to deal with a person, locality or type of traffic. Port tariffs are filed with a federal regulatory agency to ensure compliance with the law, and lease and service agreements must be made available to the agency upon request.

However, port investment and management decisions are a local, state or private sector function. So far as port development and investment is concerned, the federal function has historically been restricted to navigation channel construction and maintenance. Shoreside development has been left to the non-federal public and private sectors. Indeed, the U.S. Constitution stipulates that the federal government shall give "no preference by any regulation or commerce or revenue to the ports of one State over those of another." Thus, port development in the United States is a shared responsibility between the federal government on the one hand, and local and state government and the private sector on the other. Because U.S. port agencies are state or local government entities, the decision to privatize rests with the legislatures and not with the federal Congress. This contrasts with the case in Britain where port agencies are subject to Parliamentary oversight.

Private sector terminal operations are widespread in the United States, occurring in virtually every port. These include private sector tenants of public port agencies as well as facilities which are both privately owned and privately managed. The latter are functionally, corporately, and legally independent of any public port agency, and many even compete with public port agencies. In addition, most port services such as railroads, trucking, towage, pilotage, bunkers, and so forth are typically pri-

vate rather than public sector function.

As previously noted, port privatization elsewhere has typically favored the sale of operating concessions rather than the outright sale of public port assets, with the port authority as a landlord and terminal operations being formed by its tenants. This, in fact, is already a widespread phenomenon in the United States, particularly among though by no means restricted to the nation's largest container ports. A recent survey by the American Association of Port Authorities of its U.S. port members identifies 31 "operating", 34 "non-operating" (or "landlord") and seven "limited" operating port agencies.²¹ "Operating" ports are those in which cargo handling inland from the pier are performed by port authority employees performed by employees of those agencies. At "landlord" ports, by contrast, these functions are performed by port authority tenants. "Limited operating" ports combine characteristics of first two categories, leasing some facilities and operating the others.

In several instances, a desire to commercialize public port operations have led U.S. port authorities to establish quasi-private operating subsidiaries. Examples include the Virginia Port Authority (Virginia International Terminals, Inc.), Maryland Port Administration (Maryland International Terminals, Inc.), Tampa Port Authority (Tampa Bay International Terminals, Inc.) and, most recently, the Delaware River Port Authority (The Ports of Philadelphia and Camden, Inc.).

Longshore services, meaning the physical loading or unloading of vessels at pierside, are almost universally performed by private sector stevedoring companies — at both landlord and operating ports. The terminal operator, be it the port authority or a port authority tenant, contracts with the stevedore,

which in turn, hires longshore labor based on the terms of its contract with the longshore union — the International Longshoremen's Association for ports on the Atlantic, Gulf, and Great Lakes Coast and the international Longshoremen's and Warehouseman's Union for ports on the West Coast. These labor agreements historically have been concluded between the unions and local terminal operator and/or steamship associations. Port authorities traditionally have been excluded from these negotiations, except in an observer status. This arms-length relationship with longshore labor negotiations appears to have been dictated by political sensitivities and in some cases by state laws that flatly forbid such involvement by state agencies (such as port authorities). Non-union terminals or terminals operated by unions other than the ILA or ILWU exist in some U.S. ports.

What is more, the U.S. public port system is vast and highly competitive, presenting shippers with an array of routing alternatives that include ports in neighboring countries. East coast ports, for example, compete with their West Coast counterparts and their Canadian counterparts for market share in the U.S. midwest. Terminal operators and other port service providers frequently compete with one another locally as well as with ports elsewhere. Thus the port monopolies that are often the target of port privatization in other areas of the world, particularly in the developing countries, simply do not exist in the United States.

As to the issue of subsidy, while it may occur, many port authorities no longer enjoy ready access to public funds, but are instead being forced to rely on what they generate from earnings to cover their costs and satisfy the exacting demands of private capital markets. In fact, what we are seeing, is

growing instances of "reverse subsidy" such as in the recent case of California, with port authorities being called upon to bail out financially strapped state and municipal governments.

It is important to remember that port authorities were established in the United States to end private sector monopoly and abuse (particularly by railroads), to ensure equal harbor access, and to provide essential facilities and services that the private sector was unable or unwilling to provide. Public access to the waterfront and the discriminatory practices of port facility owning railroads were recurring issues at AAPA conventions in the years immediately following its founding in 1912.²³ While railroads monopolies are no longer at issue, there nevertheless remains an abiding public interest in the management of waterfront development.

Port activities create substantial economic and international trade benefits for the nation, as well as local and regional economies. According to the U.S. Department of Transportation, in 1992 commercial port activities generated 1.5 million jobs, contributed \$73.7 billion to the Gross Domestic Product, provided personal income of \$52 billion, generated federal taxes of \$14.5 billion, state and local taxes of \$5.5 billion.²⁴

Facilities owned by public port agencies also serve nation's strategic interests as staging points for the deployment of U.S. Armed Forces in the event of war or other international military contingency. During the Persian Gulf conflict of 1990/91, for example, more than 3.0 million measurement tons of military cargo was loaded out of U.S. commercial ports in support of Operation Desert Shield/Desert Storm.²⁵

The shoreside infrastructure requirements of waterborne commerce face growing competition for suitable waterfront land from commercial real

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estate developers, residential housing, recreation boating, historic preservationists, and other interests. Striking a fair and equitable balance that best serves the public economic growth and the quality of life as it related to harbor development is an ongoing challenge to ports and local government as well as those whose livelihood depends on maritime activity. A viable port authority helps assure that the requirements of trade do not go unheeded.

In brief, the private sector is already well entrenched in the U.S. port system.

Furthermore, the highly competitive nature of the system obviates any danger from monopoly to the flow of U.S. waterborne trade. Further privatization of public ports is most likely to be selective — security, pilotage and other discrete functions, along the lines of what is being contemplated in Los Angeles — or the conversion to landlord status by operating ports.

Whatever the case, care must be taken to protect and preserve the overriding public interest in the flow of waterborne commerce so vital to the nation's economy and security.

Endnotes

1. Robin Martens and Ed Boatman, "Trade Expansion Through Privatization," *Port Development International*, September 1994, p. P7.
2. *Port Development International*, September 1994, p. P4.
3. Peter Behr, "Solving the Privatization Puzzle," *Washington Business*, February 13, 1995, pp. 1, 12-13.
4. David Haarmeyer and Peter Yorke, *Port Privatization: An International Perspective* (Los Angeles: The Reason Foundation, April 1993), p. 1.
5. *The New York Times*, February 10, 1995, p. B4.
6. Port of Los Angeles, Press Release, January 11, 1995.
7. Zvi Ra'anan, "Port Administration: Should Public Ports Be Privatized?" (Washington, DC: The World Bank, March 1991), p. 15.
8. Mike Mundy, "Port Development," *Lloyd's Nautical Yearbook 1995*, (Colchester, UK: Lloyd's of London Press, 1994), p. 97.
9. Ibid.
10. Ibid.
11. *Port Development International*, May 1994, pp. 31-34.
12. Mundy, pp. 104-105, 107-108.
13. *Port Development International*, December 1994, p. 25.
14. *Port Development International*, September 1993, pp. P15, P20-P21.
15. Haarmeyer and Yorke, pp. 3-8; *Port Development International*, December 1994, p. 5.

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16. *AAPA Advisory*, February 6, 1995, p. 6.

17. *AAPA Advisory*, November 8, 1993, p. 4; Economic Commission for Latin America and the Caribbean. "The Distribution Chain and the Competitiveness of Latin American Ports." (Santiago, Chile: CEPAL, December 1989), pp. 25-26.

18. *Port Development International*, December 1994, p. 3.

19. Haarymeyer and Yorke, pp. 3-4.

20. *Ibid.*, pp. 5-6, 9-16.

21. U.S. Constitution, Section 9, Article 1.

22. American Association of Port Authorities, *Annual Salary Survey* (Alexandria, VA: September 1994).

23. See, for example, *Proceedings of the First Meeting of the National Association of Port Authorities of the United States Held at New York City December 9 and 10, 1912*, pp. 25-28. Note: The organization was renamed American Association of Port Authorities in 1914.

24. U.S. Maritime Administration, *A Report to Congress on the Status of the Public Ports of the United States 1992-1993* (Washington, DC: U.S. Department of Transportation, October 1994), p. 1.

25. Rexford B. Sherman, "Ports at War," *Defense Transportation Journal*, April 1992, p. 10.

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Privatizing Vehicle Registrations, Driver's Licenses and Auto Insurance

It is conceivable that all of the functions of MVD could be privatized. Issuing registrations and driver's licenses are the major tasks performed by MVD. Other tasks (like issuing titles and collecting taxes) could be contracted out. The Ports-of-Entry could be consolidated into the Department of Public Safety. Arizona's innovation in this area could serve as a model for other states.

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by John Semmens

In Arizona, the law requires owners of vehicles to carry liability insurance in order to register their vehicles. The idea is that vehicle owners be made responsible for any damage they may create in operating their vehicles. Yet, a considerable portion of the vehicles on the roads are without this required insurance. The All-Industry Research Advisory Council's survey of 1989 found that an estimated 8 percent of households in the nation admitted to operating at least one vehicle without insurance.¹ The Arizona Department of Transportation's Motor Vehicle Division also estimates that about 8 percent of the vehicles operating on Arizona's roads do not have the required insurance.² This survey, though, relied upon the self-reported assertions of individuals. Since most states require liability coverage, many individuals may have been reluctant to admit breaking the law. Obviously, statistics on the number of persons breaking the law are prone to data collection difficulties. Aware of this, some

observers have asserted that at any given time, up to 30 percent of the vehicles on the streets may be operated without insurance.

Uninsured vehicles are only half the problem. Other vehicles are grossly underinsured. Arizona state law permits vehicles to be operated with liability coverages as low as \$15,000/\$30,000/\$10,000. What this means is that the insurer will cover bodily injury damages up to \$15,000 for a single victim, up to \$30,000 total for multiple victims, and up to \$10,000 for property damage. It doesn't take much of a wreck to total a car. Replacing one totaled car could easily cost more than \$10,000. Considering that about 75 percent of the traffic accidents in Arizona involve more than one vehicle,³ it should be readily apparent that many crashes will produce property damage in excess of the minimum mandated liability coverage. As it is, the average cost of a "property damage only" accident in Arizona is \$6,500.⁴ Next to this, the \$15,000 to \$30,000 coverage for

injuring or killing someone is ludicrously inadequate. Minor injury accidents result in costs averaging over \$10,000 per accident. Major injury accidents generate an average cost of over \$32,000. Fatal accidents produce damages in the \$880,000 range.⁵

When the damage caused by a driver is not covered by his liability insurance (either because he has none or is underinsured) it is borne by the victim. In terms of what the insurance industry pays for claims by its policy holders who have purchased "uninsured" and "underinsured" coverage this amounted to around \$30 million per year in the mid-1980s in Arizona.⁶ Even though the accident rate has declined since the mid-1980s (from 3.2 per million vehicle miles of travel to 2.6 per million miles)⁷ the cost of each accident has risen. This would give us an estimate of around \$80 million per year as the current amount paid by insurers to cover damages done to their policy holders.⁸

These payments made by insurers understate the actual damages for several reasons. First, the "uninsured" and "underinsured" coverages offered by insurers cover only bodily injury medical expenses. They do not cover damage to property. Neither do they cover lost wages, pain and suffering or other tort-related damages. Second, not everyone who is insured purchases these coverages. Medical expenses charged to a person's medical insurance rather than to his auto insurance under his "uninsured" or "underinsured" coverage would not be counted in this calculation. Finally, the uninsured losses borne by individuals are also not captured by this estimate (for example, if one uninsured driver causes damages to another uninsured driver). So, in terms of the order of magnitude of the problem, we are probably talking about \$100 million per year in costs imposed on the victims of accidents or their insurers.

Modeling a Solution

There are two models useful in analyzing this situation. On the one hand, we could view roads as falling into the "ballpark" model. In the ballpark customers are warned that the management assumes no responsibility for any injuries or damages suffered by its customers in the event that they are harmed by baseballs, bats, or players in the normal course of the game. If this model was applied to the roads, anyone who paid the price of admission to the roadways (i.e., purchased the necessary licenses and vehicle registrations) would have access. Road agencies would assume no responsibility for any injuries or damages. Users would determine whether to buy insurance or not. Anyone venturing onto the roads would do so at his own risk and with the explicit warning that he might be harmed by others who would not be able to compensate for any damage done.

The chief advantage of the "ballpark" model is that it would remove the ambiguity regarding who should bear the responsibility of insurance. No one could venture onto the roadways under the impression that the state has guaranteed him that the other drivers are insured. The knowledge that there are no insurance requirements would inspire those who desire to be indemnified against damages that may be caused by other drivers to purchase their own adequate levels of insurance coverage. Those willing to bear the risks of going without insurance would be permitted to do so. Since the accident rate in Arizona is about one per 400,000 vehicle miles of travel, the odds of any one driver being in a crash are very small. Given a typical annual 12,000 miles of travel for each automobile, there is a 97 percent chance that the vehicle won't be involved in an accident in any one year. When we fac-

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tor in the possibility that one can significantly reduce the chances of accident involvement by adopting safer driving habits (i.e., obeying traffic rules, keeping the vehicle in good running order, and not consuming alcohol), the decision to go without insurance may not be entirely unreasonable. In fact, on an actuarial basis, the estimated annual cost of Arizona traffic accidents averages around \$600 per vehicle.⁹ If the cost to obtain insurance for a vehicle is greater than this amount, going without insurance becomes a logical economic decision.

The chief disadvantage of the "ballpark" model is that driving might become more financially risky. Even though the reduction of the impact of "moral hazard" (i.e., the tendency for humans to exert less care in preventing events that are covered by insurance) on driving behavior in the "ballpark" model would tend to reduce the frequency of traffic accidents, the financial impact on those unfortunate enough to experience them could be substantial. Those without insurance could easily sustain major losses. Those who do purchase insurance might well have to buy larger amounts of coverage since there would likely be larger numbers of uninsured drivers. So, even though the aggregate social cost of traffic accidents would likely be lower if the "ballpark" model was implemented, the redistribution of financial burdens to those risk-averse enough to purchase insurance might be viewed as undesirable by many.

An alternative to the "ballpark" model is the "Disneyland" model. In Disneyland, customers are covered by the business' liability insurance. Consequently, the management puts its own risk reducing restrictions on who may use various facilities. Customers may

be barred from some rides or attractions for being too small, too big, too frail, too pregnant, etc. Since the business is held strictly liable for any damages suffered by those entering the park, management will undertake a substantial effort to enforce its rules in order to avoid having to compensate injured parties for any harm done to visitors while in the park.

Enforcement of the insurance requirement would be achieved by having the insurers issue the licenses and vehicle registrations.

Like the "ballpark" model, the "Disneyland" model would also reduce the ambiguity concerning who will be responsible for damages. In this case, obtaining insurance would be a prerequisite of venturing out onto the roadways. Enforcement of the insurance requirement would be achieved by having the insurers issue the licenses and vehicle registrations. This differs from the current system wherein the mandatory insurance is sold by private vendors, but is enforced by the public sector. The State of Arizona does not assume liability for damages done by drivers that fail to comply with the insurance requirement. There is no significant financial consequence to the State for failure to enforce the insurance requirement. Hence, we must rely upon the bureaucracy's devotion to duty as the main motivation for enforcement of the mandatory auto insurance law. As dedicated to duty as many individual bureaucrats may be, bureaucracy itself is not noted for efficiency or effectiveness.

Meanwhile, private insurance companies have very weak incentives to guard against persons buying inadequate insurance or cancelling coverage once their vehicle obtains the desired

registration tags from the Motor Vehicle Division. Inasmuch as insurance premiums are directly related to amount of coverage and the risk of having to pay, rates will vary. Some of the worst drivers - those most likely to inflict substantial damages on others - buy only the minimum amount of coverage allowed by law. These drivers form the pool of "underinsured" risks on our roadways.

Keeping these high risk drivers off the roads, then, could create some hardship for them by greatly reducing their mobility.

The insurance industry knowingly sells these inadequate policies because the insurer's liability is capped by the low amounts of coverage provided. So, while the premiums paid by these high risk drivers are sufficient to cover the losses of the insurers, they are not sufficient to cover the full actuarial cost of the damage that is the likely result of their driving behavior. These costs will be shifted to the victims of these drivers.

In addition to buying an inadequate amount of coverage, another way of flouting the mandatory auto insurance law is to buy a policy in order to obtain the vehicle registration tags, but cancel the coverage after the tags are received. When the policy is cancelled, the insurer is required to notify the Motor Vehicle Division. On average, there will be about two weeks elapsed time between the termination of a policy and the notification of the Motor Vehicle Division. Once notified the Motor Vehicle Division sends a letter to the vehicle owner to let him know that the State is now aware that he has cancelled his insurance. If there is no response from the vehicle owner, this failure to carry insurance will be entered into a computerized database accessible

by law enforcement officers. Then, if these officers have occasion to call for information on the vehicle, the lack of insurance will be one of the pieces of information they will be given. Obviously, an individual could drive around for a considerable period with no insurance. If, during this period, there is an accident, the victim or victims will have no assurance that they will be compensated for any damages caused by this uninsured individual.

The chief advantage of the "Disneyland" model is that it would provide a much stronger incentive to keep bad drivers off the

roads. If insurers had to accept full liability for whoever they issued a license and registration to the problem of "underinsureds" would vanish. By definition, there would be no limit to the liability assumed by the insurer. The insurer would, in fact, be insuring that whatever damage was caused by one of its policy holders would be covered. Bad drivers would not have the option of buying a woefully inadequate policy. They would be forced to pay the full cost of their actuarial risk in order to obtain a driver's license and vehicle registration. The insurance company would see to this as a matter of business survival.

The chief advantage of the "Disneyland" model is also, in many people's view, its chief disadvantage. Many high risk drivers would not be able to purchase insurance. Either the price to cover the likely damages they would cause would be higher than they would be willing or able to pay, or they may be unable to find an insurer willing to sell them coverage at any price. This would effectively deny them the legal right to drive on the state's roads. Keeping these high risk drivers off the roads, then, could create some hardship for them by

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greatly reducing their mobility.

As we can see, each of the above models has its advantages and disadvantages. Either could work because the responsibility is clearly assigned. The current mandatory auto insurance law fits into neither model. The idea that users of the roads should be responsible for the damages they may cause is not a bad one! However, the enforcement of the current mandatory auto insurance law has proven troublesome. The fine for failure to carry liability insurance is only \$250 for a first offense. The amount of this fine is less than the typical six month insurance premium on most vehicles. Even then, the fine may be waived if the cited individual purchases insurance prior to his court appearance.¹⁰ Many financially irresponsible drivers may choose to go without insurance when facing these cost trade-offs. So, even though the state nominally requires users to be insured, since the state is not held liable for allowing uninsured vehicles onto the roads the incentives to enforce the mandatory insurance law are weak. As a result, victims of high risk underinsured or uninsured drivers must suffer an estimated \$100 million per year (or more) in uncompensated costs.¹¹

Outline for Restructuring this Activity

Given the problem of a significant annual burden due to uncompensated costs that are being inflicted on victims of underinsured and uninsured drivers a coherent solution is needed. The contrasting "ballpark" and "Disneyland" models each offer a coherent solution. However, it is my opinion that the "Disneyland" model provides a solution that most people would find more satisfactory. While each model is likely to make the roads safer, the "ballpark" model does this by imposing more of the burden on the cautious drivers. The

"Disneyland" model, in contrast, would make the roads safer by removing more of the high risk drivers.

Assuming that we'd like to explore the "Disneyland" model in more detail before deciding whether to implement it, let's take a look at how it might work. Conceivably, one might assert that the same entity that issues the licenses and registrations ought to supply the insurance. This would entail the State of Arizona getting into the insurance business. While plausible on paper, government insurance schemes have not fared well in practice. The Old Age, Survivors' and Disability Insurance (i.e., Social Security) program has had repeated financial problems. Government medical insurance (i.e., Medicare and Medicaid) has seen expenses soar beyond the government's planned outlays on a regular basis. Government insured student loans have an extraordinary non-payment percentage. So, if having the State run an auto insurance program is a bad means of consolidating the insurance and licensing/registration functions, the alternative of having the insurers issue the licenses and registrations merits examination.

Having insurers issue licenses and registrations amounts to a "privatization" of this activity. Nominally, a privatization law would state that vehicle registrations and drivers' licenses would be issued by those willing and able to assume full responsibility for any damage caused by the vehicle and its driver. Normally, we would expect that this would mean that insurance companies would issue the registrations and driver's licenses. Since it would be absolutely clear who was responsible for a particular vehicle being on the road, insurers would have a strong incentive to make sure that every vehicle and driver is adequately insured. Insurers would also have a strong incentive to make sure that uninsured vehicles and drivers did not use the roadways.

To clarify financial responsibility for potential damages done on the roadways, the privatization law would state that as long as a vehicle bore the license plate of an insurer, that insurer would be held liable for any damages caused by that vehicle. It is likely that insurers would only issue plates after investigating the driving record of who they are insuring and receiving an adequate premium from the insured individual. Insurers could not escape liability by later showing that the insured lied on his application to purchase the insurance. This may seem hard on the insurers, but consider the alternative. When an insurer can bail

given the greater degree of responsibility placed on each insurer, it seems likely that steps to improve the "visibility" of license plates would be undertaken. For example the, much-tested but little deployed, "electronic license plate" would be a likely innovation under a privatized licensing system. Under this scenario, plateless vehicles would be even more conspicuous.

The dodge of buying insurance just to obtain a vehicle registration tag and then cancelling the insurance once the tags are received would become much more difficult. Since the insurer is responsible for damages done by vehicles

bearing the insurer's plates, there is a very strong incentive to require a substantial insurance payment or deposit that will only be refunded when the plates are turned back

Each insurer would be free to establish its own criteria for issuing policies and license plates.

out of a policy, this means that the victims of the erstwhile insured party are apt to be left without any recourse for ameliorating the damages they have suffered. Potential victims have no reasonable means of investigating all potential high risk drivers prior to an accident. On the other hand, insurers do have a reasonable means of conducting such an investigation prior to issuing a policy. If an insurer is not satisfied that a prospective customer is truthful or a good risk, it can refuse to issue a policy. Under the proposed privatization scheme, suspect applicants will not be able to legally use the roads until they can find an insurer willing to issue them a policy.

Since issuing an auto insurance policy and issuing license plates would be simultaneous events, those without insurance would be easier to spot on the roads. They would be operating vehicles without plates. This would be a more obvious sign of lack of insurance than is currently the case. In fact,

to the issuer. While this return-for-refund process may be less convenient than cancelling one's insurance by phone, it should virtually eliminate the problem of uninsured vehicles resulting from cancelled policies. Given the many insurance sales locations and the interconnection of these offices via computer networks, obtaining or returning plates ought to be a lot more convenient than it is to deal with the Motor Vehicle Division on these issues in the current environment.

Individuals would be free to shop for the best registration/insurance deal they could find. Each insurer would be free to establish its own criteria for issuing policies and license plates. Some insurers may opt to cover only low risk drivers. Other insurers may opt to cover high risk drivers at correspondingly higher premiums. Insurers may wish to give written and/or road tests to prospective customers. Insurers may wish to encourage or require some or all ve-

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hicles they insure to be equipped with safety-enhancing devices (for example, an ignition that can only be activated after the driver passes an automated, on-board breathalyzer test). Customers may choose to accept some limitations on their driving in exchange for reductions in premiums. Other may prefer to pay more in order to escape restrictions. In short, there is likely to be a wide variety of payment/license options available. Nevertheless, those who could not meet the minimum requirements of any insurer would not be issued vehicle plates. Insurers would have no incentive to assist individuals in "beating" the system. Vehicles without license plates would be easier for police to spot and remove from the roads.

Privatizing the issuance of licenses and registrations in this fashion would also do away with underinsured vehicles. Since the issuer of the vehicle plates would be responsible for whatever damage is caused by one of its policyholders, there would be no motive for selling low dollar coverage. The current policy of allowing "judgment proof" drivers (i.e., those who do not fear the financial consequences of the damage they may do because they are unable to pay) to buy insurance that may fall far short of compensating victims for any harm they suffer at the hands of these "judgment proof" drivers is irresponsible and, in many instances, inhumane.

Estimate of Potential Savings

The potential savings would occur in two areas. We have already estimated that the current system causes the victims of uninsured and underinsured drivers to

be burdened by \$100 million per year in uncompensated costs. The proposed reform would shift these costs off of the innocent victims of bad driving and back onto those who cause the accidents. In one sense, this is not so much an elimination of costs as a displacement of costs. Nevertheless, as the perpetrators of damage were forced to bear a larger share of the consequences of their actions we could expect some modifications in their behavior. Insurers, in order to make a profit and stay in business, would have to do a good job of matching premiums to risk. This would motivate them to take actions that would reduce risk. A price structure that accurately reflected risk would push drivers toward safer behavior. A refusal to insure the worst risks would take many of the really dangerous drivers off the roads entirely. So, over the long run, not only would the \$100 million of uncompensated losses be

A price structure that accurately reflected risk would push drivers toward safer behavior.

shifted, it is also likely to be reduced in total as driving behavior improves and the worst risks are taken off the roads.

The other source of potential savings would come from eliminating functions of the Arizona Department of Transportation. Currently, the Motor Vehicle Division of ADOT is budgeted for an annual expenditure of around \$30 million.¹² While the costs of specific activities are not published, I estimate that about half of this outlay is the result of vehicle registration activity. Of the remaining activities (issuing driver's licenses, recording vehicle titles, collecting highway user taxes, and manning the ports-of-entry) issuing driver's licenses is probably the most expensive. So, if we privatize the

registration and driver's license functions we could probably reduce public sector spending by about \$20 million per year.

Some may argue that the \$20 million per year saving of public expenditure will be offset by an increase of private sector spending as insurers undertake the effort to issue registrations and driver's licenses. This apparent offsetting expense, though, may be exaggerated. As it now stands, auto dealers must compile all the data necessary to register newly sold vehicles. This data is then forwarded to the Motor Vehicle Division for entry on the state's database. Selling insurance and issuing registrations on the spot might actually be easier than the current process. The perception that this might be the case inspired the Linda Brock dealership to volunteer to pilot test a program wherein the dealership would issue the registration.¹³ ADOT estimates that this "third party" registration could save up to \$1 million a year if adopted statewide. One third of the savings are in postage alone.¹⁴ The law now permits the Director of the Motor Vehicle Division to authorize "third parties" to issue vehicle registrations.¹⁵ The potential for "one-stop-shopping" convenience under privatization would appear substantial. One could buy a car, get it registered, and insured all at one location. The insurers and auto dealers would have an incentive to make the process as expeditious as possible. In fact, competition among insurers and dealers would help promote efficiency and convenience.

Consider a typical transaction with the current Motor Vehicle Division. It's your lunch hour. You have chosen this opportunity to take care of some business down at the Motor Vehicle Division office. Maybe you need to renew a driver's license, register a vehicle, or obtain a title. Your first task is to find the local MVD office. They're not always conveniently located. They're certainly scarcer than any other related business location you

might have need of. As your search for the MVD office drags on you pass numerous gasoline stations, a half-dozen auto parts stores, several auto insurance sales offices, and a few auto dealerships.

Finally, you locate the MVD branch office. You walk in and join the line of people waiting for service. Your advance to the head of the line is not hastened by the fact that a goodly percentage of MVD personnel have also chosen this time to take their lunch hour. When your turn finally arrives you are greeted by an employee whose occupation was ranked last in a survey of civility published by the *Wall Street Journal*. That is, on a scale of zero to ten (with zero being bad and ten being good), MVD employees have been rated 0.2. This is below ratings received for comparable customer contact employees like sales clerks (7.5), grocery check-out cashiers (7.0), gas station attendants (6.2), bank tellers (6.0), stadium ticket sellers (3.5), city bus drivers (1.6), and utility company employees (0.8).¹⁶

You think the service could be more convenient, expeditious, and courteous, but it isn't and won't be likely to get that way. The monopoly position of the state agency authorized to handle matters relating to the operation of vehicles on public roads pretty much assures that it won't. After all, it is not as if you could take your "business" elsewhere. Reducing the incidence of the above mentioned type of transactions would be another benefit of privatizing the vehicle registration and driver's license functions of the Motor Vehicle Division.

Possible Legal, Political, and Other Obstacles

Shifting the issuance of vehicle registrations and driver's licenses to the private sector would require legislation. Any prospective legislation must overcome the normal obstacles of the legis-

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lative process. A bill privatizing registrations and driver's licenses would have to clear committees in both Houses of the Legislature, get a majority vote in each House, and be signed by the Governor. This is an arduous process that trips up many a bill.

This proposal will likely be resisted by the MVD bureaucracy. After all, if the Motor Vehicle Division is no longer needed to register motor vehicles some may well question whether it is needed at all. At the very least, MVD may be talking about a 50 percent cutback in its budget. Hundreds of people would see their public sector jobs eliminated. These prospective impacts will inspire those affected to object to the proposed reform.

We may also expect some initial opposition from the auto insurance industry. At the outset, the increased responsibility thrust upon the insurance industry will provoke uncertainty. Businesses generally do not like uncertainty. Uncertainty increases risk. New means of coping and making a profit would have to be learned. However, once the insurers understand that they will be compensated by their customers for the costs of issuing registrations and licenses they should be more receptive to the idea. The opportunity to play a more direct role in controlling the risk of the roadway environment should be perceived as a means of reducing underwriting losses over the long term. As the environment becomes safer, insurer's losses will fall (ultimately, premium rates would be expected to fall, as well, but not as rapidly as underwriting losses). This should improve profitability. Then, too, many of those currently evading the mandatory insurance law will become the reluctant customers of the insurance industry. This also should increase profitability.

The general public may be apprehensive about letting the private sector insurers decide who gets onto the roads.

As it now stands, though, private sector businesses decide who can and can't obtain credit and at what price. Obtaining a loan to buy a house or a car must pass private sector scrutiny. We have learned to live with this system. We expect the decisions to be made on rational criteria. And they are. Reflection upon how the private sector has handled this vital segment of contemporary life combined with the greater convenience of the hours kept by insurers and the assurance that responsible drivers would not have to pay high premiums to cover damage done by uninsured or underinsured drivers should help to alleviate some of the general public's apprehension.

Of course, that segment of the population that is currently flouting the mandatory insurance law or exploiting it by underinsuring their vehicles would be expected to raise quite a fuss over this reform proposal. While we should not be persuaded by the objections of those who wish to continue passing the burdens of their own actions on to others, we can envision some means of addressing their legitimate concerns.

The cast most deserving of sympathy is that of the individual whose past driving behavior has taught him a lesson. It is unfortunate for such individuals that many more proclaim to have learned lessons that actually have. Consequently, individuals with bad driving records would undoubtedly have trouble obtaining insurance and permission to use the roads. I would expect insurers to establish methods of serving this market niche. One method would be to require the vehicle of such a person to be equipped with devices that enhance the safe operation of the vehicle. We already mentioned the possibility of a "breathalyzer-ignition" link. Other options could include vehicles that could only run during daylight hours (perhaps having a solar collector connection to the engine or transmission) or ve-

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hicles whose maximum speed could not exceed a low setting (perhaps having "speed governors" placed on the engine). Insurers might see fit to require regular safety inspections of the vehicle as a condition of issuing a registration. Insurers might see fit to require regular driving tests for individuals whose driving behavior has been demonstrated to be more hazardous than normal.

It may then be feasible for some high risk, but repentant, drivers to work toward a full reinstatement of driving privileges by demonstrating meritorious performance under limited driving privileges. For others, though, the outlook will be less sanguine. There are some people who should not be behind the wheel of a car. Stopping them from driving not only helps to preserve the health and lives of others, but also may save the driving-deprived individual from killing himself. Incompetent drivers must find other means of

meeting their transportation needs. Carpooling is one obvious option. Living or working closer to the places one needs to travel is another option. Riding the bus is another, albeit inconvenient, option. Society is not obliged to bear the risk of allowing persons who cannot cover the costs of any damage they are likely to cause to drive vehicles on the roadways.

It may be preferable to try this reform in a pilot project in one county prior to full scale statewide implementation. This would enable insurers to gain some experience with the process before having to rely on it for three million vehicles registered in Arizona. The selection of a specific county should be made jointly by the insurance industry and the Arizona Department of Transportation. This will enable ADOT to better anticipate any transitional difficulties and prevent them from taking on a crisis proportion.

Endnotes

1. *Uninsured Motorists* (All-Industry Research Advisory Council, 1200 Hanger Road, Suite 310, Oak Brook, IL 60521, 1989), p. 3.
2. Estimate provided by Charles Ramsey, Administrative Service Officer, Mandatory Insurance Section, Motor Vehicle Division, Arizona Department of Transportation, June 10, 1994.
3. *Arizona Traffic Accident Summary for 1992* (Arizona Department of Transportation, Traffic Engineering Section, Traffic Records Branch, 206 S. 17th Ave., Room 064R, Phoenix, AZ 85007), p. 22.
4. *Ibid.*, p. 5.
5. *Ibid.*
6. *Uninsured Motorists*, *op cit.*, p. 22 and 1993 *Arizona Transportation Factbook* (Arizona Department of Transportation, Transportation Planning Division, 206 S. 17th Ave., Room 300B, Phoenix, AZ 85007), p. 13.
7. *Arizona Traffic Accident Summary for 1992*, *op cit.*, pp. 4 & 6; and *Arizona Traffic Accident Summary for 1986* (Arizona Department of Transportation, Traffic Engineering Section, Traffic Records Branch, 206 S. 17th Ave., Room 064R, Phoenix, AZ 85007), p. 4.
8. In 1986 the average cost per accident was about \$7,200 (*Arizona Traffic Accident Summary for 1986*, *op cit.*, pp. 4 & 5). In 1992 the average cost per accident was about \$29,800 (*Arizona Traffic Summary for 1992*, *op cit.*, pp. 5 & 6). The ratio of these two figures (19,800/7,200 = 2.75) is \$30 million ÷ \$80 million.

PRIVATIZING VEHICLE REGISTRATIONS, DRIVER'S LICENSES AND AUTO INSURANCE

9. Using figures from Arizona Traffic Accident Summary for 1992, op cit., pp. 5 & 6: \$1,776,900,000 in accident costs, divided by 89,862 accidents, multiplied by the 3 percent probability that any one vehicle would be in an accident in a given year, yields a figure of around \$600.

10. Arizona Revised Statutes Title 28, Section 1251

11. See footnote #8 and the paragraph of text following it.

12. Arizona Department of Transportation budget summary prepared in accordance with Arizona Revised Statutes, Title 28, Section 101, p. 439

13. Mark J. Scarp, "Brock Auto Mall Tests License Plate Program," *Scottsdale Progress/Tribune* (October 15, 1993), p. A-1

14. Ibid

15. Arizona Revised Statutes, Title 28, Section 1471

16. Donald G. Smith, "Rating Occupations on a Civility Scale," *Wall Street Journal* (1986)

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Privatization
and the Emergence
of For-profit
Prisons

Privatization and the Emergence of For-Profit Prisons

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Abstract

This paper demonstrates that the for-profit prison is almost exclusively a Southern phenomenon, formed and shaped by the unique social and especially economic characteristics of that region. Unionization rates and wages of correctional employees provide a statistically significant and theoretically sound basis for privatization in the southern states. The authors conclude that, when comparing the American South to the Northeast and Mid Atlantic, states with the lowest inmate increases have privatized while states with the largest increases have not privatized.

Introduction

The growth of the American criminal justice system, particularly its correctional component, has been truly phenomenal in the past 20 years. In 1992, 743,984 inmates were held in state correctional institutions, and another 12,688 adjudicated state inmates were held in private prisons. With the addition of the approximately 336,000 inmates held in jails and detention facilities (*Vital Statistics in Corrections*, 1991, p. 66), and inmates in Federal institutions, the number of incarcerated individuals in the United States is well over one million.

As prison populations grow, so does the emergence of the for-profit prison. This paper is about for-profit prisons and seeks to explain the socioeconomic reasons why contemporary for-profit prisons are located, for the most part, in the American South as opposed to the Northeast and Mid-Atlantic regions.

Private Sector Involvement

From Lilly and Knepper's perspective (1992), the private prison sector consists of three parts: (1) private prison financing and construction; (2) private prison ownership and/or management; and (3) corporations under contract with governmental units and private management firms to provide goods and services, such as lavatory units. They conclude that, "The ownership and operation of secure facilities for adults constitute, in actual numbers alone, the least significant area of private sector involvement in corrections" (p.176). When considering sheer numbers and their corollary, the expenditure of funds, this statement is probably accurate. The totality of the corrections commercial complex greatly transcends the singular effort of private sector involvement in the management and ownership of prisons. However, when one considers the growth pattern of private state facilities in relation to state inmate growth, private sector involvement no longer seems "least significant." The authors estimate from 1991 to 1992 total public sector state inmates grew by 5.4% while those in the private sector grew by nearly 41%. In other words, state private inmate populations outpaced public sector state populations by over 750%. In a recent business article for *The New York Times*, Ramirez (1994) proclaimed that, "Despite a checkered past the future is looking brighter for the private prison industry" (p. 5).

The growth and proliferation of a privatization ideal in the corrections market is embodied in the philosophy, management style, and budgetary practices of the for-profit prison. The for-profit prison is unrestrained by competitive bids, union contracts, direct government oversight, and the countless regulations unrelated to inmates to which government units must adhere. The private for-profit prison represents the quintessential ideal of the corrections commercial complex. It can tap into, acquire, and develop a market at lightning speed, while the ponderous state apparatus crawls along at a snail's pace. Philosophically, the private prison's *raison d'etre* corresponds to the contemporary popular punitive concept of incarceration. The authors agree with

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McShane and Williams (1989) as well as Lilly and Knepper (1992,1993) when they suggest that private for-profit prison interests have actually contributed to a retributive warehousing approach to correction.

As of December 31, 1992, over 80% of all privatized state inmates were held in four southern states: Kentucky, Louisiana, Tennessee and Texas (Table 1). The corporate headquarters of the three largest corrections corporations are located in the South: Corrections Corporations of America (CCA), Nashville, Tennessee; United States Corrections Corporation (USCC), Louisville, Kentucky; and Wachenhut Corrections Corporation (WCC), Coral Gables, Florida. Of the 21 corrections corporations listed in Thomas and Foard's directory (1992), 13 (62%) are located in the South and most of the others are located in far western states; those in the North are nonprofit corporations, such as Volunteers of America.

Southern Industrial Growth and Northern Decline-Their Link to Prison Privatization

The pattern of southern industrial growth and northeastern decline is well documented in the literature of the 1970s and 1980s. We believe that the same economic forces which contributed to the "Third Wave of Corporate Migration" are also shaping the formation of for-profit prisons. Prison privatization is, in addition, facilitated by the conservative crime control philosophy and practice of the southern region. Labor intensive firms, of which private prisons are an example, will view areas of the country where unions are strong as the least desirable location for investment.

All of the southern states in our analysis (Tennessee, Texas, Louisiana) except one (Kentucky) have some form of "right to work law" in place; in contrast, no state in the Northeast or Mid-Atlantic regions has such laws. Right to work laws are the product of a long standing alliance between political and business elites (Ichniowski & Zax, 1991). Miller

and Canak (1988) document, in their quantitative analysis, the significance of opposition to unions in the American South. Business also lobbied against public sector unions by advocating legal limits on collective bargaining rights of civil servants and stiffer laws against public employees' strikes. In Miller and Canak's words, "the statistical evidence indicates rather persuasively that business influenced policy makers against collective bargaining in the public sector" (p. 275).

Virtually all prisons, whether public or private, locate in rural, economically depressed regions. Consequently, private prisons must rely on the reserve of rural labor (Wenger and Bonomo, 1993). Marginality is a key feature of the low wage labor process and is readily utilized by capital. In developed societies capital expands principally within the service sector, of which prisons are a component. All research indicates that service workers on average receive less pay and benefits and have less job security than industrial workers. Workers who move into service jobs from some other sector are much more likely to be marginalized. Based on the authors' interviews with corporate administrators in both CCA and USCC, wages in private prisons are lower than for comparable positions in state facilities, and wages in Southern facilities, as noted in the paper data, are considerably lower than those of Northeastern states.

Privatization and Geographic Region: Method of Analysis

As noted in the above, four southern states (Kentucky, Louisiana, Tennessee, and Texas) account for 80.6% of all privatized state inmates. These states were compared to seven northeastern states (Connecticut, Delaware, Maryland, New Jersey, New York, Pennsylvania, Vermont) and the District of Columbia which comprise the member states of the Mid-Atlantic States Correctional Association. The

Table 1:
Percentage of State Inmates Privatized by Correctional Employees Unionized or in Employee Associations (1992)

State	% Private Inmates	Private	Public	TOTAL	% Private	% State Corr Employee Union
KY	8.6	1,095	8,531	9,626	11.4	0
LA	17.8	2,282	14,576	16,858	13.4	10 ¹
TN	11.3	1,438	9,677	11,115	12.9	55 ²
TX	42.8	5,438	51,214	56,650	9.5	0

¹ Includes staff in both adult and juvenile facilities, represented by American Federation of State, County and Municipal Employees (AFSCME) [American Federation of Labor (AFL) - Congress of Industrial Organization (CIO)]

² Career employees are represented by the Tennessee State Employees Association and only the non-supervised employees at Brushy Mt. are represented by AFSCME (AFL-CIO).

northeastern states have no privatized state inmates in secure facilities. The central tenets in Rusche and Kirchheimer's thesis (1939) regarding the significance of economic and fiscal variables are analyzed with data derived from the American Correctional Association's (ACA) publications *Vital Statistics* (1991) and the ACA's *Directory of Adult Facilities* (1992, 1993) as well as the *Statistical Abstract of the United States* (1993). The most consistent, comparable data are available for states rather than counties and of course the Federal Bureau of Prisons system does not distinguish among regions.

If in fact these regions are distinct, significant statistical differences should manifest themselves with respect to some or all of the following social, economic, and fiscal variables: (1) unionization rates of correctional employees, (2) starting salaries of correctional officers, (3) percentage increase of state inmate populations, (4) percent change per capita debt, (5) percent increase in state revenues, and (6) percent increase in operating budget (Table 2). The two regions, Northeastern and Southern, are the explanatory X variables which are compared by an analysis of variance. The hypothesis is that there is no significant statistical difference ($p=.05$) between the regions in relationship to the five criterion-dependent variables.

Presentation of Data

(1) *Unionization rates.* Table 2, column 1, compares unionization rates between correctional employees in each region for 1991. There is a significant statistical difference between regions in correctional employees' unionization rates.

(2) *Correctional officers' starting salaries.* Column two examines the starting salaries of correctional officers as of December 31, 1990. There is a significant statistical difference between regions in correctional officers' starting salary.

(3) *Increase in state inmate population.* Column three presents growth patterns in inmate populations over a ten year period, 1983-1992. Mean imprisonment rates have grown at a much faster pace in the Mid-Atlantic region than the South: 99.3% in the former and 40.8% in the latter. These differences cannot be explained by a corresponding growth in private inmate populations in the South since the percentage of private inmates within these states ranges only between 9.5% in Texas and 13.45% in Louisiana. In other words, the percentage increase in the private sector is too low to reduce the growth rate in the South's public sector prisons (See Table 1). There is a significant statistical difference between regions in increases in state inmate populations.

Table 2:
Relationship Between Regions and Dependent Variables

Mid-Atlantic States (MAS) X_1 South States (SS) X_2	% Adult Corr. Employees Unionized 1991 Y_1	Starting Salary C.O. 12/31/90 Y_2	% Increase State Inmate Population 1983-1992 Y_3	Per Capita Debt 1983-1990 % Change Y_4	% Increase State Revenue 1983-1990 Y_5	Operating Budget % Increase 1983-1992 Y_6
CT	80%	\$22,958	113.6%	40.7%	43.8%	310.8%
DC	72%	\$22,655 ¹	138.3%	—	—	146.7%
DE	85%	\$17,702	83.8%	17.7%	57.0%	88.0%
MD	66%	\$20,772	65.0%	-43.8%	25.0%	165.6%
NJ	90%	\$26,045	121.0%	2.4%	35.7%	303.0%
NY	91%	\$21,338	102.0%	-18.7%	24.5%	168.1%
PA	80%	\$17,734	124.0%	-48.7%	18.0%	265.4%
VT	85%	\$16,661	46.4%	11.6%	46.7%	115.3%
MAS MEAN =	82.4%	\$20,658	99.3%	-5.1%	36.0%	198.0%
KT	0%	\$13,668	92.3%	-43.1%	47.5%	214.1%
LA	10% ²	\$13,778	23.3%	14.2%	11.0%	98.9%
TN	55%	\$13,560	8.3%	-66.5%	23.4%	132.4%
TX	0%	\$15,576	39.2%	-75.9%	11.0%	417.8%
SS MEAN =	16.25% ³	\$14,148	40.8%	-42.83%	23.2%	215.8%
SIG. DIFF. BETWEEN MID-ATLANTIC AND SOUTH ANOVA $p =$	.0001	.0028	.0166	.1248	.2109	.7894

¹Information obtained from contact with Department of Corrections, Personnel Division.

²Include staff in both adult and juvenile facilities, Department of Corrections, represented by AFSCME.

³The 16.25% is inflated because of qualifications.

(4) *Per capita state debt reduction.* Column four examines trends in per capita state debt reduction within both regions. Debt reduction from 1983-1990 is greater in southern states than in the Mid-Atlantic corrections region. Even though there is a difference of over 37% between these regions, we fail to reject the hypothesis. There is not a significant statistical difference between regions in per capita state debt reductions.

(5) *Increase in state revenues.* Column five compares the increase in state revenues from 1983-1990. Revenue differences between the two regions are similar. The Mid-Atlantic region increased its revenues on average 36% while the South increased its amount on average by 23.2%. Given this similarity, it is to be expected that we fail to reject the hypothesis. There is not a significant statistical difference between regions in their respective increase in state revenues.

(6) *Operating budget for department of corrections.* Column six examines the department of corrections operating budget increases from 1983-1992. The two regions are very similar; operating budgets on average increased 198% in the Mid-Atlantic region and 215.8% in the South. As expected, we fail to reject the null hypothesis; there is not a significant statistical difference between regions in department of corrections operating budget increases.

Discussion of Data

A researcher would expect states with a larger *per capita state debt* relative to other states to be inclined to privatize since private prison corporations maintain that they can provide a comparable or superior service at a lower cost, thus reducing state expenditures. However, the authors' cost benefit analysis indicates numerous hidden costs in privatization (Haririan and Bonomo, 1994). The southern states have reduced their debt by over 800% in comparison to northeastern states (-42.83% in the South versus -5.1% in the Northeast), whereas one would expect the reverse trend. The degree of state debt does not appear to impact the decision to privatize, although a non-statistically significant trend is apparent in which states with the greatest amount of debt reduction have chosen to privatize and states with continuing higher amounts of per capita debt have not privatized.

In a similar vein, *increase in state revenue* between the two regions demonstrates no significant statistical difference. State revenues increased only 12.8% more in the Mid-Atlantic states (36.0% versus 23.2% in the southern region). If this gap were larger, one could argue that a lack of revenues contributed to privatization.

When *department of corrections' operating budgets* are compared, virtually no statistical difference is demonstrated. One cannot argue that states which

have privatized have significantly larger corrections' budget increases. Logic seems to dictate that a motive behind private prison formation is the more rapid growth in corrections' budgets, hence the need to turn to a more cost effective solution. The authors indicate that this is not the case. Likewise, debt reduction and revenue increases cannot explain the motives behind privatization.

A significant statistical relationship is observed when examining the *increase in state inmate populations*. A researcher would expect those states where inmate populations have increased the most to be more inclined to privatize. The authors indicate the reverse trend. The Northeast, where incarceration rates have grown over two times faster than the South, 99.3% versus 40.8%, has not privatized; while the South, with much lower growth rates, has chosen to privatize. This fact is startling since private corrections corporations maintain that their speed of coming on line with less cost is a major advantage over public facilities managing rising inmate populations. It can be said with reasonable certainty of these regions, that states with the lowest inmate increases have privatized while states with the largest increases have not privatized.

Summary and Conclusions

It is appropriate to examine the structural conditions in the American South which predispose the formation of private prisons. Larger labor and capital relations provide significant theoretical insights to private prison formation in the South. The authors conclude that *unionization rates* and *correctional officers' starting salary* explain why private prisons have chosen to locate where they have. Within the southern region, wages are lower and greater corporate top-down control is exercised over employees. Private prisons would find it difficult to offer a competitive salary in the northeast region. Although actual wage rates are difficult to obtain for the private sector, it is generally recognized that starting correctional officers' salary as well as the salary for any comparable year of service in a particular state is lower in the private than in the public sector. Democratically oriented unions, which participate in work place issues under the umbrella of collective bargaining and the right to strike, are not compatible with southern management styles. Oligarchical management practices tie easily into low unionization rates and larger social policy issues, such as "right to work" laws, which exist in most of these southern states. Furthermore, this study shows that, when comparing the American South to the Northeast and Mid Atlantic, states with the lowest inmate increases have privatized while states with the largest increases have not privatized.

Endnotes

- ¹ I am dedicating this article to the memory of my dear friend and collaborator, Thomas Bonomo.

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Buyer Beware:
State Control over
Privatization

Buyer Beware

State Controls over Privatization

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By Dr. Charles J. Russo and Dr. J. John Harris, III

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THE RECENT infatuation with the privatization of educational services has supporters who seem to present it as a panacea for all that ails public education. Yet, two recent developments have cast dramatically differing perspectives on this controversial practice. In *School District of Wilkesburg v. Wilkesburg Education Association* (1995) the Supreme Court of Pennsylvania affirmed the denial of a request by the teachers' union to enjoin the local board from entering into a contract with Alternative Public Schools Incorporated (APSI) from Nashville, TN, a private firm, for the operation and management of one of its elementary schools. The teachers were concerned because if the board followed through on the contract, then APSI would be free to hire its own faculty and staff at the school, a move that could cost 30 teachers their jobs. The ruling in *Wilkesburg* cleared the way for the board to enter into the contract with APSI. Conversely, shortly after the decision in *Wilkesburg*, Educational Alternatives Incorporated (EAI), one of the leading firms in the move toward privatization, lost its contracts to

operate schools in Baltimore (Walsh, 1995) and Hartford (Walsh, 1996).

In light of these very different results, this article examines state oversight, or rather, the lack thereof, and legal controls over the new breed of educational organizations such as EAI and the Edison Project, perhaps the two best known private contractors for instructional services. The article begins by briefly examining background issues on privatization along with reviewing arguments regarding its adoption. The second section notes the virtual lack of governmental controls and regulation of privatization. The final portion raises lingering legal questions that remain in the apparently head-long rush to privatization.

Overview of Privatization

Privatization, coined after the concept introduced by Peter Drucker in 1968 (Bast & Walberg, 1994), refers to the practice whereby public school districts enter into contracts with private, for-profit organizations to deliver a variety of educational goods and services. The range of contracts stretches from managing entire school systems,

to providing instructional media such as Channel One, to contracting out student transportation, food services, maintenance and custodial services and photo copiers.

Advocates of privatization offer at least three related arguments to bolster their position. Perhaps the major point raised in support of privatization is that it brings the efficiency of the marketplace to public education. A closely related view is that since public schools have failed to keep pace with international standards, they must respond to the competitive demands of the marketplace. A third set of arguments maintains that privatized schools would be more accountable, would be cost effective and would promote innovation as educators are forced to become more entrepreneurial.

Opponents respond that privatization in the form of for-profit schools and deregulation is influenced by social Darwinism and the survival-of-the-fittest concept and may simply allow for the rich to get richer and the poor to get poorer. Such a result has been evident in other realms of public service including education and health care as privatization has, ac-



ording to Brown and Contreras (1991), done little more than "create economically, socially and racially stratified communities, and there is no evidence that this stratification is the direct result of competition between communities to offer superior public services" (p. 145). The legitimate fear of critics is that to offer privatization without creating an accompanying mechanism to regulate its spread or considering its impact on communities most in need risks further stratification of schools and society.

The move toward privatization is compounded by the fact that although many use the term almost interchangeably with charter school, there is no universal agreement on its meaning. An example of the differences between these two types of schools can be seen by comparing legislation in Minnesota and California. Charter schools in Minnesota, identified as outcome-based schools (Minnesota Statutes, § 120.064, 1994), are legally autonomous, while in California (California Education Code, §§ 47600-47615, 1994), the board negotiates not only a charter but also who may hire or dismiss personnel.

Howard Fuller, the superintendent of Milwaukee Public Schools, offers another interesting perspective. Fuller maintains that Wisconsin's statute is not a charter school law since staff members in these schools would be employed by the local board rather than a private contractor; as such, they would be subject to existing collective bargaining agreements and state laws.

Privatization has received mixed support at best. That is, in response to a question about whether private, for-profit corporations should be permitted to enter into contracts to operate public schools, a national poll of attitudes toward the schools

revealed that 45 percent of respondents favored the idea, 47 percent opposed it, and 8 percent did not know what to think (Elam, Roser, & Gallup, 1994). This poll also indicates that 54 percent of respondents are of the opinion that charter schools are a positive development, while 39 percent disagree and seven percent did not know what to think (pp. 53-54).

The competition between private contractors has continued to intensify. In other words, while EAI's efforts at privatization remain underway in Dade County, FL, it has been ousted in



Baltimore and Hartford, and its proposals have been rejected by school systems in Arkansas, Florida, Minnesota, New Jersey, and New York.

Further, the Edison Project has gained contracts in Kansas and Massachusetts (Schmidt, 1994; Walsh, 1994), and local firms are negotiating agreements in Nashville, TN, and Osceola County, FL (Schmidt, 1994). Even so, as these developments gather momentum, plans for legal oversight have not kept pace.

State Regulation Of Privatization

The related concept of autonomous publicly-supported charter schools, which have been adopted by 19 states with 10 more states likely to do the same later this year (Toch, 1996), has been accompanied by appropriate oversights. The same is not true about privatization. In fact, with the exception of guidelines created by the Minnesota Department of Education

(Randall, 1992), these agreements are apparently a matter of a private contract between entrepreneurs and school systems.

Clearly, public schools have had long-standing business relationships with private vendors for such "hard" goods as books and supplies that are closely monitored by state statutes (Kentucky Revised Statutes, § 45A.33 et seq., 1992). This kind of business relationship is a mixed blessing. On the one hand, schools are protected if the cost of an item increases during the life of a contract as the supplier is bound to provide the good(s) at the agreed upon price. Conversely, if a price declines during the term of a contract, the schools are bound to pay the higher price.

The current wave of privatization on instructional services began in 1990 when EAI entered into a contract with

Dade County, FL, the fourth largest school system in the nation (David, 1992). The relationships being created by firms such as EAI differ from the roles of suppliers of hard goods in two significant ways. First, they are seeking to provide the "soft" professional service of instruction.

Second, unlike laws regulating competitive bidding and quality control, there are virtually no state controls, explicit or implicit, to oversee the critical process of assuring that the delivery of educational services will meet the needs of the students being served. Moreover, one of EAI's strongest selling points is its stated concern with saving school systems money. Yet, as witnessed by its difficulties in Baltimore it is not clear how EAI can accomplish this goal if it is locked into a pre-existing contract for hard goods or soft services should some external factor change the cost of doing business.

At the same time, unlike the non-public schools, which his-

torically have been largely exempt from the same degree of state oversight as public schools, it is not clear whether private contractors will enjoy the same degree of freedom. Thus, although private contractors are not likely to be operating under recognized statutory exceptions from compulsory attendance, as public schools they will be acting "under color of state law." As such, they will fall under the full regulatory umbrella of federal laws and regulations.

Along with federal law, privateers are likely to be bound by a wide array of state laws ranging from procurement codes, to teacher certification, to class size, to the length of the school year. Moreover, not the least of the areas where potential conflict looms is labor relations as both the American Federation of Teachers and National Education Association are wary of privatization efforts (Schmidt, 1994). The effect of potential labor strife in California, Minnesota or Maryland (Diegmüller, 1992), all of which have moved toward privatization while explicitly recognizing the right of school employees to organize and bargain collectively, could be telling.

The growing tension between management and labor in the face of privatization can give rise to a whole new set of legal problems. Just as *Wilksburg* illustrated how tempers can flare between a board and its teachers, a recent lawsuit in Minnesota (*Independent School District No. 88, New Ulm, Minnesota v. School Service Employees Union Local 284*, 1993), the home of EAI, illustrates another type of dilemma that can present itself in a move toward privatization.

At issue in *New Ulm* was the school board's decision to contract out its food services operation. The Supreme Court of Minnesota affirmed that although the collective bargaining agreement between the parties recog-

nized contracting out as an inherently managerial right, the board was required to submit to binding arbitration over the impact of its action. The court was concerned over the rights of the school personnel who would be affected during the remainder of the contract period. The court concluded that arbitration was especially appropriate because the board's actions effectively eliminated the entire bargaining unit while the contract remained in effect. Consequently, where privatization seeks to suspend a bargaining agreement or leads to labor strife upon the expiration of a contract, one can only wonder what such a disruption would mean in the lives of the students whose rights virtually have been ignored in this discussion.

Other potential trouble areas loom. For example, to the extent that contracts between private vendors and school districts are public business, they are subject to state disclosure laws. Where an EAI or Edison Project enters into a contract to operate a school district, it is unclear whether all of a state's bidding laws will apply or whether contracts and other legal agreements will be subject to disclosure provisions, sunshine laws and freedom of information acts.

Lingering Legal Questions

The rush towards privatization has been unaccompanied by adequate legal analysis. Consequently, as districts head into previously uncharted legal waters, the following issues are raised in order to help school business officials and other educational leaders gain a clearer understanding of whether private, for-profit organizations can deliver on their promise to reverse the declining fortunes of the public schools.

First, public education in this country cannot jump at simplistic solutions to the multifaceted problems they face. By merely

tinkering with the system, effective long-term benefit is unlikely to occur. While the need to improve the delivery of educational services is evident, the dramatic shift in resources that privatization suggests should be well-reasoned and supported by research rather than changing simply for the sake of change.

Accordingly, privatization must be accompanied by appropriate legislative and administrative enactments as a means of providing legal guidance.

Insofar as public education is a function of the State, law makers would be foolish to allow local school systems to delegate their responsibility without first considering what is taking place and determining responsibility in advance. Legal concerns in this regard include day to day matters such as contracts; compliance with state and federal mandates; school safety in terms of student supervision and hiring of personnel; and the constitutional rights of students, teachers, parents and taxpayers.

A second, and closely related issue is that just as the performance of school personnel is subject to legal scrutiny, an appropriate measure must be developed to effectively evaluate moves toward privatization. Unfortunately, few, if any, of the privatization contracts seem to include systematic, reliable provisions for its evaluation.

Thus, as reform-minded states such as Kentucky have enacted elaborate statutory and regulatory mechanisms to ensure accountability, privatized schools would be wise to follow their lead. For example, these schools can help to ensure that they will meet appropriate levels of performance either by including explicit statements that they will comply with state requirements or by voluntarily holding themselves to higher standards of student achievement.

Third, those most directly associated with public educa-

tion—students, teachers, parents and taxpayers—must be empowered to realize that they are the true owners of the system. These stakeholders must be aware of what is being purchased in their names. As such, any move toward privatization should include meaningful input from its key stakeholders. In an era of entitlement, it is at best unwise to not seek as broad a base as possible for ensuring educational improvement.

For example, where privatized schools attempt to eliminate programs such as extracurricular academic activities or interscholastic sports, their contracts should include mechanisms such as public hearings to afford stakeholders with the opportunity to voice their input. Hearings may not guarantee that all participants will accept, or even be happy with, a decision, but at least they can be satisfied in knowing that their concerns will have been considered.

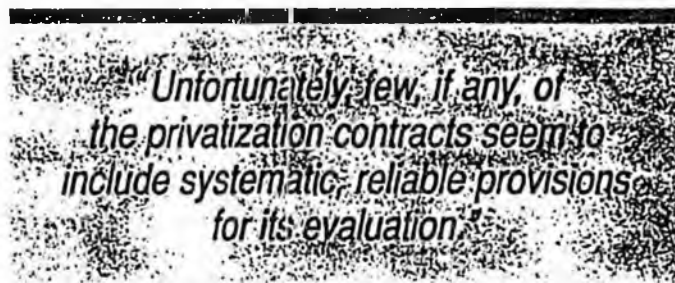
Fourth, the impact of privatization must be looked at in terms of cost-benefit analysis. In other words, rhetoric aside, there are little, if any, data on the financial costs associated with a move to privatization or on how such a change might disrupt the orderly operation of school districts.

Consequently, even if private corporations are able to conserve some financial resources, in light of the monetary difficulties that EAI experienced in Hartford, it is unclear how savings can, or will, be accomplished.

Moreover, should privateers be able to save a few dollars, it does not appear that any serious thought has been given to how non-financial costs such as labor strife and lost school days to students are factored into the equation. The hidden costs asso-

ciated with squandered or misused human capital may wind up costing the schools, and the country, much more in the long run as students are short-changed in their educational experiences.

In sum, despite ample evidence suggesting the need for caution, proponents of privati-



zation seem to present it as the cure-all for public education. However, before acting in haste, school business officials and other educational leaders should keep the old adage in mind—if something is too good to be true, then it probably is. Let the buyers beware!□

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Buyer Beware

State Controls over Privatization

By Dr. Charles J. Russo and Dr. J. John Harris, III

THE RECENT infatuation with the privatization of educational services has supporters who seem to present it as a panacea for all that ails public education. Yet, two recent developments have cast dramatically differing perspectives on this controversial practice. In *School District of Wilkesburg v. Wilkesburg Education Association* (1995) the Supreme Court of Pennsylvania affirmed the denial of a request by the teachers' union to enjoin the local board from entering into a contract with Alternative Public Schools Incorporated (APSI) from Nashville, TN, a private firm, for the operation and management of one of its elementary schools. The teachers were concerned because if the board followed through on the contract, then APSI would be free to hire its own faculty and staff at the school, a move that could cost 30 teachers their jobs. The ruling in *Wilkesburg* cleared the way for the board to enter into the contract with APSI. Conversely, shortly after the decision in *Wilkesburg*, Educational Alternatives Incorporated (EAI), one of the leading firms in the move toward privatization, lost its contracts to

operate schools in Baltimore (Walsh, 1995) and Hartford (Walsh, 1996). In light of these very different results, this article examines state oversight, or rather, the lack thereof, and legal controls over the new breed of educational organizations such as EAI and the Edison Project, perhaps the two best known private contractors for instructional services. The article begins by briefly examining background issues on privatization along with reviewing arguments regarding its adoption. The second section notes the virtual lack of governmental controls and regulation of privatization. The final portion raises lingering legal questions that remain in the apparently head-long rush to privatization.

Overview of Privatization

Privatization, coined after the concept introduced by Peter Drucker in 1968 (Bast & Walberg, 1994), refers to the practice whereby public school districts enter into contracts with private, for-profit organizations to deliver a variety of educational goods and services. The range of contracts stretches from managing entire school systems,

to providing instructional media such as Channel One, to contracting out student transportation, food services, maintenance and custodial services and photo copiers.

Advocates of privatization offer at least three related arguments to bolster their position. Perhaps the major point raised in support of privatization is that it brings the efficiency of the marketplace to public education. A closely related view is that since public schools have failed to keep pace with international standards, they must respond to the competitive demands of the marketplace. A third set of arguments maintains that privatized schools would be more accountable, would be cost effective and would promote innovation as educators are forced to become more entrepreneurial.

Opponents respond that privatization in the form of for-profit schools and deregulation is influenced by social Darwinism and the survival-of-the-fittest concept and may simply allow for the rich to get richer and the poor to get poorer. Such a result has been evident in other realms of public service including education and health care as privatization has, ac-

tion—students, teachers, parents and taxpayers—must be empowered to realize that they are the true owners of the system. These stakeholders must be aware of what is being purchased in their names. As such, any move toward privatization should include meaningful input from its key stakeholders. In an era of entitlement, it is at best unwise to not seek as broad a base as possible for ensuring educational improvement.

For example, where privatized schools attempt to eliminate programs such as extracurricular academic activities or interscholastic sports, their contracts should include mechanisms such as public hearings to afford stakeholders with the opportunity to voice their input. Hearings may not guarantee that all participants will accept, or even be happy with, a decision, but at least they can be satisfied in knowing that their concerns will have been considered.

Fourth, the impact of privatization must be looked at in terms of cost-benefit analysis. In other words, rhetoric aside, there are little, if any, data on the financial costs associated with a move to privatization or on how such a change might disrupt the orderly operation of school districts.

Consequently, even if private corporations are able to conserve some financial resources, in light of the monetary difficulties that EAI experienced in Hartford, it is unclear how savings can, or will, be accomplished.

Moreover, should privateers be able to save a few dollars, it does not appear that any serious thought has been given to how non-financial costs such as labor strife and lost school days to students are factored into the equation. The hidden costs asso-

ciated with squandered or misused human capital may wind up costing the schools, and the country, much more in the long run as students are short-changed in their educational experiences.

In sum, despite ample evidence suggesting the need for caution, proponents of privati-

Unfortunately, few, if any, of the privatization contracts seem to include systematic, reliable provisions for its evaluation.

zation seem to present it as the cure-all for public education. However, before acting in haste, school business officials and other educational leaders should keep the old adage in mind—if something is too good to be true, then it probably is. Let the buyers beware!□

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A State Action Doctrine
For An Age of
Privatization

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A STATE ACTION DOCTRINE FOR AN AGE OF
PRIVATIZATION

Daphne Barak-Erez[†]

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State (in the broad sense of the notion, either at the state or the federal level) is responsible for the infringement.⁸

However, the Supreme Court has acknowledged that there are circumstances in which a seemingly "private" action should be considered a State Action. When the State is deeply involved in a private activity, this activity is perceived as being (substantively) a state action, despite its private appearance. It is this application of the doctrine that is of interest in the context of privatized enterprises and services. Privatization usually stands for substitution of public services by private actors - resulting in the government being only "involved" in them (usually by operating the regulatory process).⁹ And the question is, whether privatized services should be considered as completely private, or rather, also as public to a certain degree, and therefore as state actions (at least, in some circumstances).

II. PRIVATE ACTIONS AS STATE ACTIONS ACCORDING TO CURRENT DOCTRINE

The Supreme Court has accepted the view that, in special circumstances, private actions should be viewed as state actions. However, it has applied this view very narrowly, considering most actions as private despite clear traces of government involvement. I will first review this approach, and then evaluate it. Considering the purpose of the discussion, it will not be a complete review of the state action doctrine. It is aimed only at the possible application of the doctrine to private enterprises facing state action claims.¹⁰

8. This statement of the law is subject, of course, to changes originating from state constitutional law. See *PruneYard Shopping Ctr. v. Rubins*, 447 U.S. 74 (1980); see also Jennifer Friesen, *Should California's Constitutional Guarantees of Individual Rights Apply Against Private Actors?*, 17 HASTINGS CONST. L.Q. 111 (1989).

9. For the interchangeability of public-ownership and regulation, see STEPHEN BREYER, *REGULATION AND ITS REFORM* 181-83 (1982).

10. The state action doctrine has long been criticized for its lack of clarity and indefinite scope. For broader discussions of the doctrine, see Harold W. Horowitz, *The Misleading Search for "State Action" Under the Fourteenth Amendment*, 30 S. CAL. L. REV. 208 (1957); Charles L. Black, Jr., *The Supreme Court 1966 Term - Foreword: "State" Action, Equal Protection, and California's Proposition 14*, 81 HARV. L. REV. 69 (1967); Ira Nerken, *A New Deal for the Protection of Fourteenth Amendment Rights: Challenging the Doctrinal Bases of the Civil Rights Cases and State Action Theory*, 12 HARV. C.R.-C.L. L. REV. 297 (1977); Erwin Chemerinsky, *Rethinking State Action*, 80 NW. U. L. REV. 503 (1985); LAURENCE H. TRIBE, *REFOCUSING THE "STATE ACTION" INQUIRY: SEPARATING STATE ACTS FROM STATE ACTORS IN CONSTITUTIONAL CHOICES* (1985); see also Barbara Rook Snyder, *Private Motivation, State Action and the Allocation of Responsibility for Fourteenth Amendment Violations*, 75 CORNELL L. REV. 1053 (1990), and the list of articles

A. Easy Cases of State Action

1. Coercion and Authorization

There are some obvious cases of state action, i.e., when private activity is coerced by law or specifically authorized by an official exercising statutory authority. In these examples, the private action derives its validity from a real state action, and therefore is substantively a state action. This form of state action is exemplified by the decision in *Public Utilities Commission v. Pollak*.¹¹ In this case, the proceedings followed a decision of a street railway company operating in the District of Columbia to amplify radio programs in its streetcars and buses, allegedly depriving passengers of liberty without due process of law.¹² The Court was willing to discuss this state action complaint because the relevant state authority - the Public Utilities Commission of the District of Columbia - investigated the decision of the company and approved it.¹³ From the Court's perspective, it was important that the official approval was explicit and addressed the current complaint.¹⁴ In *Jackson v. Metropolitan Edison Co.*,¹⁵ the Court did not deem sufficient an implicit authorization.¹⁶ This case addressed a consumer's complaint that her electric services were terminated without affording for a hearing, and therefore allegedly without due process of law.¹⁷ The company's right to terminate services for nonpayment appeared in its general tariff filed with the Public Utility Commission, and was never disapproved.¹⁸ However, the implicit authorization was not considered a sound basis for a state action claim.¹⁹

However, the obvious case of a specific authorization is not the right prototype for the current discussion. Privatization initiatives are

compiled there in note. For a general survey of the current doctrine, see LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW 1688-1720* (chapter 18) (2d ed. 1988).

11. 343 U.S. 451 (1952).

12. *Id.* at 456-57.

13. *Id.* at 462-63.

14. According to the Court: "We rely particularly upon the fact that that agency, pursuant to protests against the radio program, ordered an investigation of it and, after formal public hearings, ordered its investigation dismissed on the ground that the public safety, comfort and convenience were not impaired thereby." *Id.* at 462.

15. 419 U.S. 345 (1974).

16. *Id.* at 354.

17. *Id.* at 347-48.

18. *Id.* at 355.

19. *Id.* at 354-57.

company] operates a public utility on the streets of the District of Columbia."³²

The significant curtailment of the public function theory started in the seventies, when Justice Renquist ruled that it is limited to activities traditionally and exclusively identified with the state,³³ a reservation first introduced in *Jackson*.³⁴ As mentioned before, this case addressed electricity services, and the plaintiff contended that their supply should be regarded as fulfillment of a public function.³⁵ The contention was flatly rejected by Justice Renquist, who wrote for the majority. In his view, a state action may be found only when the function operated is one that was "traditionally the exclusive prerogative of the state,"³⁶ or "traditionally associated with sovereignty."³⁷ This narrowing theory prevailed in later cases, although its basis was never fully explained. It allowed a differentiation between the company-owned town and modern activities like electricity services, but the appropriateness of this differentiation was far from self-evident.

The *Flagg Bros.* case was the next to raise the public function issue.³⁸ Due to an unpaid debt to a warehouse, the plaintiff's property stored there was about to be sold in accordance with a state law authorizing satisfaction of a lien without prior recourse to the courts.³⁹ The plaintiff argued that her due process rights were infringed, the creditor being in these circumstances a state actor - acting in the public sphere of dispute resolution.⁴⁰ Justice Rehnquist, who delivered the opinion of the court, dismissed the public function argument once again. He explained that "the settlement of disputes between debtors and creditors is not traditionally an exclusive public function."⁴¹ Later in

32. *Id.*

33. Another line of narrowing interpretation of *Marsh* discussed in its First Amendment context. The application of the precedent to speech in shopping centers, in *Food Employees Local 590 v. Logan Valley Plaza*, 391 U.S. 308 (1968), was overruled in *Hudgens v. NLRB*, 424 U.S. 507 (1976). I chose not to concentrate on this line of cases, because it also entangles considerations specific to the free speech debate. However, the judicial tendency to limit the significance of *Marsh* is also evident here. For a discussion of these cases, see Frederick Schauer, *Hudgens v. NLRB and the Problem of State Action in First Amendment Adjudication*, 61 MINN. L. REV. 433 (1977).

34. 419 U.S. 345.

35. *Id.* at 352.

36. *Id.* at 353.

37. *Id.*

38. 436 U.S. 149.

39. *Id.* at 153.

40. *Id.* at 157.

41. *Id.* at 161.

the opinion, Justice Rehnquist made it clear that the current doctrine does not apply even to "a number of state and municipal functions. . . which have been administered with a greater degree of exclusivity by states and municipalities than has the function of so-called 'dispute resolution.' Among these are such functions as education, fire and police protection, and tax collection."⁴² Not even police protection! However, in regard to these relatively exclusive functions, words of reservation were added: "we express no view as to the extent, if any, to which a city or State might be free to delegate to private parties the performance of such functions and thereby avoid the the strictures of the Fourteenth Amendment."⁴³ From the context, it is not clear whether these words were meant to be confined to intentional circumvention of constitutional duties through the delegation of functions. However, the narrow understanding is supported by the fact that this reservation was never mentioned again in the Chief Justice's opinions. For example, in *Rendell-Baker v. Kohn*,⁴⁴ he rejected the suggestion to apply public function theory in regard to a school that served as a de-facto substitute to a public school. Most of the students were both referred to it and financed by government authorities.⁴⁵ In the Court's view, the decisive fact was that education was not "traditionally the exclusive prerogative of the State"⁴⁶ while ignoring the reservation in *Flagg Bros* which specifically addressed semi-exclusive public functions like education.⁴⁷ The same can be said about *Blum v. Yaretsky*,⁴⁸ in which the Court denied an application of the public function theory in regard to nursing homes attending Medicaid patients. Again, the ruling precedent was the "traditionally the exclusive prerogative of the state" formula.⁴⁹ A more recent precedent is *San Francisco Arts & Athletics v. United States Olympic Committee*.⁵⁰ Here, the state action claim concerned the United States Olympic Committee (USOC), a corporation endowed by law with the sole authority to represent the United States in the Olympic Games. The USOC had refused to allow the use of the word "Olympic" for a sport event organized by the petitioner as the "Gay Olympic

42. *Id.* at 163.

43. 463 U.S. at 163-64.

44. 457 U.S. 830 (1982).

45. *Id.* at 832.

46. *Id.* at 842 (quoting *Jackson*, 419 U.S. at 353).

47. 436 U.S. at 63-64.

48. 457 U.S. 991 (1982).

49. *Id.* at 1011.

50. 483 U.S. 522 (1987).

monopoly of local public transportation, and was operating under an elaborate regulatory scheme.⁶⁸ However, the Court was not willing to draw a state action conclusion from these factors alone.⁶⁹ This conclusion was based upon a specific authorization of the private decision, pursuant to an official investigation of it. *Pollak* preceded *Burton*, but later cases prove that the narrow view expressed by it outlived *Burton*.

An important case subsequent to *Burton* was *Moose Lodge No. 107 v. Irvis*.⁷⁰ Here, the plaintiff was a black person discriminated against in a private club because of his race.⁷¹ The state action claim was based on the fact that the club got a liquor license and was regulated as a liquor licensee.⁷² The license was partially exclusive in nature (though not monopolistic in the strict sense) due to a quota system administered in liquor licensing.⁷³ However, according to the majority's opinion, "here there is nothing approaching the symbiotic relationship between lessor and lessee that was present in *Burton*."⁷⁴ The description of the relationship in *Burton* as "symbiotic" limited the potential of this precedent. Symbiosis infers reciprocity, and therefore is not established even by substantial governmental involvement.

There may be good reasons for the denial of a state action claim in the circumstances of *Moose Lodge*.⁷⁵ The background of the case was a relatively standard scheme of licensing. It would be exaggerated to argue that in the modern administrative state almost every licensee is a state actor. However, the question remains whether, and in what sense, reciprocity should be part of the test, i.e., is it essential that the government will have a pecuniary interest in the private action, as in *Burton*?

Later, the narrow application of *Burton* was not limited to such relatively standard licensing situations as the one discussed in *Moose Lodge*. *Jackson*⁷⁶ is a representative example. Here, a much deeper governmental involvement with the private actor was still short of state

68. *Id.* at 462.

69. *Id.*

70. 407 U.S. 163 (1972).

71. *Id.* at 164-65.

72. *Id.* at 165.

73. *Id.* at 177.

74. *Id.* at 175.

75. 407 U.S. 163.

76. 419 U.S. 345.

action.⁷⁷ As previously noted, the Court declined to acknowledge the provision of electricity services as state action under the public function theory.⁷⁸ But, this was not the only line of argument. Under the circumstances of the case, the petitioner based her argument also on other factors: extensive regulation and the monopolistic status of the utility.⁷⁹ These were the same factors discussed in *Moose Lodge*, but more intensified - heavy regulation (rather than standard regulation) and a clearer monopolistic status. However, the majority of the Court still thought that this was insufficient to constitute state action:

All the petitioner's arguments taken together show no more than that [the utility] was a heavily regulated, privately owned utility, enjoying at least a partial monopoly in the providing of electrical service within its territory Under our decision this is not sufficient to connect the State of Pennsylvania with the respondent's action so as to make the latter's conduct attributable to the State for purposes of the Fourteenth Amendment.⁸⁰

b. *Financial Support and Financial Dependence*

The licensing and regulation cases discussed previously lacked a trait that had significant influence on the *Burton* decision - the pecuniary aspect. It is therefore important to evaluate to what extent a financial relationship with the government may have bearing on the willingness of the Court to recognize state action. It was already noted that the Court invalidated subsidies to racist organizations.⁸¹ However, it seems that these precedents were confined to ex-gratia government support, excluding payments for services the government buys from private entities. The latter did not suffice the Court when applying the nexus test.

This distinction was drawn by two later cases decided on the same day, *Blum*⁸² and *Rendell-Baker*.⁸³ In *Blum*, the plaintiffs were residents of private nursing homes that were paid by the government, via Medicaid benefits, for the plaintiffs' treatment.⁸⁴ The plaintiffs challenged the decisions of the institutions' doctors reassessing the level

77. *Id.* at 352.

78. *Id.* at 353.

79. *Id.* at 351, 357.

80. *Id.* at 358.

81. See *supra* notes 20-23 and accompanying text.

82. 457 U.S. 991.

83. 457 U.S. 830.

84. *Blum*, 457 U.S. at 993.

context, the initiatives of privatization in the corrections system may serve as a representative example.¹⁰³

The state action doctrine, as it has been shaped in the majority decisions of the Supreme Court, does not constitute a sound enough basis for arguments of state action in regard to privatized services. Generally speaking, both the public function theory and the nexus theory seem applicable. However, they were fatally impaired. From the perspective of the public function theory, most of these services were not "traditionally and exclusively" reserved to the state. After all, the concept of a state that supplies services like education and health is a modern one. From the perspective of the nexus theory, privatization will usually not result in a financially symbiotic relationship between the state and the private actor. The government will probably license and regulate it and even buy its services, but not gain a pecuniary profit (as in *Burton*).¹⁰⁴

Are the results of the current doctrine satisfactory? I venture to say that they are not. What this means is that once services are privatized, the citizens who are in need of them (for example, Medicaid residents) or subjected to them (prisoners or troubled children attending special schools) may be stripped of the constitutional guarantees awarded to them before by not being entitled to due process and by being treated in a discriminatory way (in the absence of a specific statutory or regulatory limitations).

It is probable that the deficiencies in the current doctrine will be less likely to circumvent constitutional rights in the context of privatization of corrections. Confinement of prisoners is part of the enforcement of criminal law, which is a traditional characteristic of sovereignty.¹⁰⁵

Contracting Out: For What? With Whom?, 46 PUB. ADMIN. REV. 332 (1986). For statistics of privatization of public services in the United States, see E.S. Savas, *Privatization and Prisons*, 40 VAND. L. REV. 889, 890-93 (1987).

103. For a Symposium dedicated to the privatization of prisons, see 40 VAND. L. REV. 813-1024 (1989) (number 4).

104. 365 U.S. 715.

105. For a discussion of the state action doctrine in the context of privatization of prisons, see Susan L. Kay, *The Implications of Prison Privatization on the Conduct of Prisoner Litigation Under 42 U.S.C. Section 1983*, 40 VAND. L. REV. 867 (1987); Ira P. Robbins, *Privatization of Prisons: An Analysis of the State Action Requirement of the Fourteenth Amendment and 42 U.S.C. Section 1983*, 20 CONN. L. REV. 835 (1988); Harold J. Sullivan, *Privatization of Corrections and the Constitutional Rights of Prisoners*, FED. PROBATION 36 (1989); Charles W. Thomas & Linda S. Calvert Hanson, *The Implications of 42 U.S.C. Section 1983 for the Privatization of Prisons*, 16 FLA. ST. U. L. REV. 933 (1989).

In *West v. Atkins*,¹⁰⁶ the Supreme Court accepted a state action claim in regard to the actions of a private physician under a contract with the state to provide medical services for inmates at a state prison (a "mini privatization"). The case for the state action claim in regard to a broader policy of privatization in the correction system is supported also by the decision of the Texas District Court in *Medina v. O'Neill*.¹⁰⁷ In this case, inmates attacked the practices of a privately run facility for confinement of illegal immigrants. The Court accepted the state action claim, stating that both immigration and detention are powers "traditionally and exclusively" reserved to the state.¹⁰⁸

In practice, the results of the present doctrine are more likely to threaten constitutional norms already established in social services. Let us consider the example of the celebrated due process rights of welfare recipients as recognized in *Goldberg v. Kelly*.¹⁰⁹ Should these rights disappear if the operation of the welfare process is administered by a private agency having a contract with the state? The intensiveness of official supervision of the private agency may have some influence, but not necessarily, taking into consideration the low significance attributed by the court to intensive regulation. Moreover, it seems that the form of supervision is not the right test. Should constitutional guarantees depend on the details of the contract? It is important to emphasize that the question of privatization of social services is not limited to circumstances in which the state is motivated by an illegal motive (to evade constitutional duties, as in the case of *Evans v. Newton*).¹¹⁰ Putting aside the problematic question of the significance of motive in constitutional law,¹¹¹ it is possible to accept the economic reasons for the privatization of welfare services (by contracting them out), and still recognize the importance of safeguarding the due process rights of welfare recipients.

The case for the present doctrine (as applied by the court) is based on the interest of preserving freedom in the private domain, the basic idea underlying the *Civil Rights Cases*¹¹² (as well as federalism concerns). Looked at more closely, however, the argument regarding

106. 487 U.S. 42 (1988).

107. 589 F. Supp. 1028 (1984).

108. *Id.* at 1038.

109. 397 U.S. 254 (1970). The argument in the text is valid even when the curtailment of the precedent, in *Mathews v. Eldridge*, 424 U.S. 319 (1976), is taken into consideration.

110. 382 U.S. 296 (1966).

111. This is a controversial issue, see *Washington v. Davis*, 426 U.S. 229 (1976).

112. 109 U.S. 3.

for editorials as an infringement of the First Amendment.¹²² The Court had to confront the claim that policies of broadcast licensees are state actions.¹²³ The Court dismissed the claim.¹²⁴ Formally, it involved a narrow application of the "symbiotic relationship" test of the *Burton* decision.¹²⁵ However, substantively, it declined to recognize state action because it was aware of the vital independence of the media.¹²⁶ Viewing the same question from the public function perspective, it is possible to support the decision by recognizing that in the United States editorializing is certainly not a function of the state.

V. A STATE ACTION DOCTRINE FOR AN AGE OF PRIVATIZATION

The current challenge is how to update the state action doctrine in a way that preserves the distinction between state and private actions and is still capable of recognizing new forms of activity in the public sphere. This is not an argument against the basic premise of the American Constitution that the government carries a special burden of Constitutional duties, which is not applicable to private actors.¹²⁷ It is an argument against the premise that the definitions of government action can be detached from the changes in real life.

Having mentioned *Brown*,¹²⁸ I will try to explain the constitutional challenge posed by privatization in regard to alternative methods to fulfill the responsibility of the state for the education of children. Usually, the states guarantee basic education by the operation of public schools. In these circumstances, the schools are owned by public authorities (the "state"), and there is no doubt as to their constitutional accountability. Let us assume that as an alternative method of operation (for economic reasons), the state chooses to close its public schools and pay for the services of privately-owned institutions (by financing the enrollment of students). Now, the question is whether there should be a difference in the scope of the constitutional rights of the students in these two modes of operation. Even if private schools participating in

122. *Id.* at 97.

123. *Id.* at 114-15.

124. *Id.* at 120.

125. *Id.* at 119.

126. *Columbia Broadcasting Sys.*, 412 U.S. at 121.

127. For the public-private distinction in American law and its curtailment, see MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1870-1960*, 10-11, 206-08 (1982). The future of the distinction was discussed in a Symposium published in 130 U. PA. L. REV. 1289-1609 (1982) (Number 6).

128. 347 U.S. 483.

privatization projects are not likely to adopt racist policies,¹²⁹ there are still other constitutional concerns, i.e., what will be the scope of First Amendment rights of the students (regarding both freedom of speech and freedom of religion); will they have due process rights? Obviously, the total disappearance of the public schools system is not likely to happen.¹³⁰ However, similar changes do and will happen, even in the field of education.¹³¹ Although education for the average child is still administered by the public schools system, significant numbers of troubled children are now educated in private institutions, financed and supervised by the state (as in *Rendell-Baker*).¹³² These children should not have lesser constitutional rights while in school, simply because the government chooses not to form a special school for them. In *Rendell-Baker*, the Court could avoid the question of the rights of the enrolled students, because the petitioners were employees of the institution.¹³³ However, it did not form a theory of state action that is capable of distinguishing between the two. In the same year, in *Milonas v. Williams*,¹³⁴ The Court of Appeals of the Tenth Circuit recognized the existence of state action, in a case similar to *Rendell-Baker*, in all respects, except that the plaintiffs were students claiming infringements of their constitutional rights (referring to use of a polygraph machine, monitoring and censoring mail, use of isolation rooms and use of excessive physical force).¹³⁵ The circuit court explained that the *Rendell-Baker* decision was not ruling, because of the difference in the identity of the plaintiffs.¹³⁶ For reasons already given, the recognition of a state action in the above circumstances was justified. However, it is doubtful, whether it is founded on the precedents of the Supreme Court.

129. Title IV of the Civil Rights Act of 1964 prohibits racial discrimination in any program receiving federal assistance.

130. A pathologic example of a decision to close all public schools was discussed in *Griffin v. County School Board*, 377 U.S. 218 (1964). In this famous case, all public schools in Prince Edward County, Virginia, were closed for four years, in order to avoid desegregation. Here, the racist motive of the "privatization" policy was clear, and the Supreme Court overruled it on equal protection grounds.

131. For privatization experiments in the public education system, see Julie Huston Vallarelli, *State Constitutional Restraints on the Privatization of Education*, 72 B.U. L. REV. 381 (1992).

132. 457 U.S. 830.

133. *Id.* at 836.

134. 691 F.2d 931 (10th Cir. 1982).

135. *Id.* at 935.

136. *Id.* at 940.

application. In particular, it is limited to old notions regarding the functions of the state. In an age of privatization, the consequences of these limitations may be the inadequate protection of constitutional rights in operation of state services and activities, administered by or with the cooperation of private bodies. It is suggested that the application of the current doctrine be updated by developing the theories already ingrained in it. More specifically, it is suggested that a seemingly "private" activity should be considered as a state action if: (i) it is public in nature (according to present understanding of the responsibilities of the state); and (ii) the state refrains from operating an equivalent service (and thereby renders citizens to be dependent on the public services supplied by the private entities). This two-prong test is capable of securing constitutional standards in services the state chooses to contract out, without infringing upon the liberties of voluntary organizations operating community services independent of the state.

THE RISE OF THE LIMITED LIABILITY COMPANY: EVIDENCE OF A RACE BETWEEN THE STATES, BUT HEADING WHERE?

Carol R. Goforth[†]

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INTRODUCTION

It is widely acknowledged that states compete for corporate charters.¹ Any state which induces a significant number of businesses

[†] Associate Professor of Law, University of Arkansas School of Law; J.D. 1984, University of Arkansas School of Law. Many of the citations in this article were added by the editors of the SYRACUSE LAW REVIEW in an attempt to conform with the *The Bluebook, A Uniform System of Citation (Fifteenth Edition)*.

1. Professor William Cary is credited with initiating much of the current debate over the competition for corporate charters. See William Cary, *Corporate Law and Federalism: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974). Cary argued that modern corporate law trends reflect a "movement toward the least common denominator." *Id.* at 663. According to Cary, Delaware, motivated by a desire to increase state revenues, adopts rules which appeal to the self-interests of corporate directors who generally make the decision of where to incorporate. *Id.* at 668. Other states, aware of the potential loss of future revenues if they fail to respond, are pressured to adopt similarly biased legislation. See *infra* Section III.

Even those who disagree with this vision of corporate law, however, generally concede that there is a real competition among the states. See, e.g., Herzel & Richman, *Delaware's Preeminence by Design*, in R. BALOTTI & J. FINKELSTEIN, *THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS* ix (Supp. 1989); Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709 (1987); Peter Dodd & Richard Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" versus Federal Regulation*, 53 J. BUS. 259 (1980).

State Agency Transfers
of Personal Services
Funds

Legislative Audit Committee

State of Montana



Report to the Legislature

December 1990

State Agency Transfers of Personal Services Funds

Analysis of Privatization Proposals

House Bill 100 of the 51st Legislature

Direct comments/inquiries to:
Office of the Legislative Auditor
Room 135, State Capitol
Helena, Montana 59620

90SP-45



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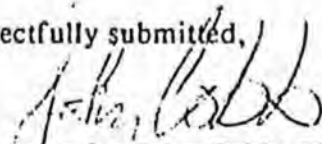
December 1990

The 52nd Montana State Legislature:

This report is in response to Section 7 (1) of House Bill 100. House Bill 100 requires the Legislative Audit Committee to review and report to the 52nd Legislature on long-term budget impacts resulting from agency transfers from personal services to other categories. This report presents information on transfers made from personal services to other categories, our analysis of privatization proposals, and projected cost savings.

We wish to express our appreciation to the Office of Budget and Program Planning and the departments involved for their cooperation.

Respectfully submitted,


Representative John Cobb, Chairman
Legislative Audit Committee


Senator Greg Jergeson, Vice-Chairman
Legislative Audit Committee

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Chapter I

Introduction

Purpose of Study

The Legislative Audit Committee is required, by House Bill 100 of the 51st Legislature, to review and report on transfers made from personal services to any other expenditure category. The purpose of the review is to determine and report the long-term budget impacts of such transfers. HB 100 of the 51st Legislative Session contained language on transfers of personal services funds. This language is paraphrased below:

- No funds appropriated for personal services or indicated in legislative intent as having been appropriated for personal services may be expended under any other category. Except, an agency may request a transfer of funds from the approving authority if it is based on documented cost savings.
- In addition, if an agency is unable to recruit and hire professional positions funded in the appropriation, funds appropriated for personal services may be used to fund an agreement or contract to provide services that are identical to those services performed by an authorized position. The amount used for the agreement or contract may not be more than the amount authorized for the position less any vacancy savings requirement. The agency director shall certify that the agency is unable to fill the position and that the services performed by that position are necessary.
- The approving authority shall submit its analysis of the documented cost savings to the Legislative Auditor. Wages and fringe benefits must be separately documented from other cost savings. The Legislative Audit Committee shall review the approving authority's analysis and report to the 52nd Legislature on potential long-term budget impacts.

The approving authority for executive branch agencies is the Office of Budget and Program Planning (OBPP). OBPP issued Management Memo 2-90-1 which discusses transfers from personal services to other categories and the required documentation for making transfers. Executive Branch agencies are required to provide OBPP with information on salaries, benefits, and operating expenses associated with all transfers from personal services. We received transfer information from OBPP

Chapter I Introduction

throughout the last year. We received transfer documentation after the transfers were approved by OBPP. We received no transfer information from other approving authorities (Supreme Court, legislative committees, and Board of Regents).

State Payments for Contracts For Services

Contracting for services is a common method for state agencies to accomplish goals. Some of the transfers discussed above increase expenditures for contracts with private vendors. In fiscal year 1989-90, state agencies spent almost \$195 million on contracts for services with vendors outside of state government. Approximately \$134 million of these contracts were Department of Highways contracts for road construction. State agencies also spent \$18.5 million on services from other state agencies.

The following table lists expenditures on contracts for state agencies which made transfers with long-term impact. The amounts shown are all contracts for services with private vendors, and do not include services from other state agencies.

Table 1

Expenditures on Contracts for Services
with Private Vendors
For Fiscal Year 1989-90

<u>Agency</u>	<u>Expenditure</u>
Department of Administration	\$4,284,422
Department of Commerce	6,634,757
Department of Institutions	2,233,190
MI Developmental Center	119,167
Department of Social and Rehabilitation Services	8,122,192

Source: Compiled by the Office of the Legislative Auditor from the Statewide Budgeting and Accounting System.

Chapter II

Temporary Transfers

Introduction

We reviewed each transfer and determined whether it had a long-term budget impact. Some transfers were made to alleviate a temporary problem; for example, hiring a temporary employee to fill in for an ill employee. We performed a limited review of temporary transfers because there is no long-term budget impact. We mention them here for informational purposes only.

Temporary Transfers

- The Department of Fish, Wildlife and Parks transferred \$46,825 to contracted services for a study of the Little Missouri River Basin Water Reservation study. The department granted the money to MSU's Cooperative Fisheries Unit. This eliminated the need for 1.5 temporary FTE and achieved a cost savings of approximately \$7,500. Since this was for a single study, there is no long-term budget impact.

- The Department of Natural Resources and Conservation transferred \$477 to contracted services to hire a work study student during the extended absence of an employee. The department estimated a one-time cost savings of \$1,257.

- The Department of Revenue transferred funds to contract with the private sector for mail handling during receipt of income tax returns. The department estimates fiscal year 1989-90 savings at \$1,170. The department will contract with the private sector in future years only if favorable bids are received.

Chapter III

Transfers with Long-Term Impact

Introduction

There are several different types of transfers an agency can make. Transfers to contracted services can involve contracting a service with the private sector or with another state agency or state program. Some contracts with private sector businesses were necessary because the state agency was unable to fill a position with a qualified applicant. Agencies have also transferred personal services funds to equipment. Cost savings occur because updated equipment can increase efficiency and lower FTE requirements.

We projected costs for future years using a 2.5 percent inflationary factor. We used 2.5 percent because it was the amount of increase provided to state employees in the past two fiscal years and personal services are the major share of costs for services reviewed. We also used a 2.5 percent inflationary increase for contract costs, unless the contract was established for the entire period (i.e., fiscal years 1990-91, 1991-92 and 1992-93).

This chapter details agency transfers which impacted expenditures in this biennium and should impact budgets for the next biennium.

Department of Administration

The Department of Administration contracted with the private sector for janitorial, security, and data entry services.

Janitorial Services

The department contracted all janitorial services as of July 1, 1989. The department estimates actual savings of approximately \$120,000 for fiscal year 1989-90. Contracts for years with legislative sessions will generally have less cost savings, so the contracts for fiscal year 1990-91 were more expensive than previous contracts. We projected cost savings from contracting janitorial services of \$92,102, \$97,644, and \$98,500 for fiscal years 1990-91, 1991-92, and 1992-93, respectively.

Chapter III

Transfers with Long-Term Impact

Security Services

The department contracted for capitol security services as of November 1, 1990. The department entered into a three-year contract with a private vendor. As a result, costs should stay the same over the three-year period. We projected cost savings of \$31,546, \$49,454, and \$56,891 for fiscal years 1990-91, 1991-92, and 1992-93, respectively. The first year of the contract is only a partial year; therefore, first year cost savings are lower. According to department officials, the actual costs of the contract will be \$3,000 less than expected due to negotiations with the contractor.

Data Entry Services

The department contracted for data entry services as of October 12, 1990. The department entered into a three-year contract with a private vendor at a set rate. Contract costs should remain steady over the three-year period. We projected cost savings from contracting at approximately \$100,000 less over the three-year period than the department's projections because we believe the department will realize the \$100,000 in cost savings from lower keystroke volumes rather than from contracting. Keystroke volumes are lower because state agencies are now keying in their own payroll and accounting data. We projected the department's total cost savings (from contracting and from lower volume) at \$72,831, \$103,659, and \$110,374 for fiscal years 1990-91, 1991-92, and 1992-93, respectively. The first year of the contract is only a partial year; therefore, first year cost savings are lower.

In addition to analysis required by HB 100, we completed legislative requests for specific information on each of DoFA's requests for transfers. Information gathered for legislative requests varied depending on information requested by legislators. Copies of request information are available from the Office of the Legislative Auditor.

Chapter III Transfers with Long-Term Impact

Department of Commerce

The Department of Commerce contracted for services for various functions within the department.

Weights and Measures Bureau

The bureau eliminated a full-time position and contracted for temporary services during peak season for issuing licenses. The bureau determined a full-time permanent position was no longer needed. We projected the department's cost savings for Weights and Measures at \$29,674, \$30,416, and \$31,176 for fiscal years 1990-91, 1991-92 and 1992-93, respectively.

Health Facilities Authority

The authority was relocated to the Board of Investments in June of 1989. The relocation allowed the authority to eliminate two FTE and receive administrative support and professional consultation from board staff. In September of 1990 the Board of Investments requested and was granted an additional FTE, partially because of work related to the authority. The authority will pay for one-half of the new position. As a result, the department's overall cost savings through relocating the authority will not be as high as projected initially. We projected the department's cost savings at \$24,324, \$20,991, and \$21,575 for fiscal years 1990-91, 1991-92 and 1992-93, respectively. Cost savings go down in fiscal year 1990-91 because the authority will then be paying for a full year's costs for the new position at Board of Investments.

Office of Research and Information Services

The department had an economist position which had been vacant since 1989. The department chose to contract for economic analysis rather than hire for the position because of current needs for several economic studies. The department determined the change will be permanent. Assuming the position had been filled and subsequently privatized, we projected cost savings for the department of \$10,008, \$10,258, and \$10,514 for fiscal years 1990-91, 1991-92 and 1992-93, respectively.

Chapter III

Transfers with Long-Term Impact

Department of Family Services, Pine Hills School

The Department of Family Services, Pine Hills School, contracted with a private chemical dependency service to provide treatment for residents at Pine Hills School. Treatment was previously provided by a state employed counselor. The contract will provide a wider range of services and resources. Projected cost savings are \$2,050, \$2,101, and \$2,153 for fiscal years 1990-91, 1991-92 and 1992-93, respectively.

Department of Institutions, Montana Developmental Center

The Department of Institutions, Montana Developmental Center, purchased a new food service system to meet Department of Health and federal Health Care Financing Administration standards. The new system requires less manpower and less weekend work for food preparation. The department eliminated 10 FTE as a direct result of the new system. In addition, habilitation staff now are able to devote more time to habilitation training rather than serving food. In addition to cost savings from personal services, department officials believe cost savings will be achieved through less food waste and food savings, however the system has not been in place long enough to estimate food cost savings yet. Projected cost savings are \$168,062, \$172,687 and \$182,160 for fiscal years 1990-91, 1991-92 and 1992-93, respectively.

Department of Social and Rehabilitation Services

The Department of Social and Rehabilitation Services eliminated a clerical position and purchased word processing equipment for quality control field staff. The clerical position would have involved several part time positions to provide assistance to field staff. Prior to this change quality control field staff were hand writing correspondence. The equipment purchase was a one time expense; therefore, there were no cost savings in fiscal year 1989-90. Projected cost savings are \$16,462, \$16,874, and \$17,296 for fiscal years 1990-91, 1991-92 and 1992-93, respectively.

Chapter III
Transfers with Long-Term Impact

OBPP Budget Process

OBPP officials indicated the Executive Budget for fiscal years 1991-92 and 1992-93 will contain recommendations for decreases in agency budgets where agencies indicated there will be long-term impact.

Chapter IV

Summary

Summary

We projected cost savings for each agency based on actual costs for fiscal year 1989-90. We added an inflationary factor of 2.5 percent to all state costs, and to contract costs if contracts were not in place through 1992-93. We also determined which funds cost savings will affect. OBPP officials indicate the Executive Budget will include recommendations for decreases in agency budgets for agencies achieving cost savings.

The following table summarizes total projected cost savings and funds affected, by agency, by project.

Chapter IV Summary

Table 2

Total Projected Cost Savings
Personal Services Transfers
For Fiscal Years 1990-91, 1991-92, and 1992-93

<u>Agency/Program</u>	<u>Fund</u>	<u>FY</u> <u>1990-91</u>	<u>FY</u> <u>1991-92</u>	<u>FY</u> <u>1992-93</u>
Department of Administration				
Janitorial	Proprietary*	\$ 92,102	\$ 97,644	\$ 98,500
Security	Proprietary*	31,546	49,454	56,891
Data Entry**	Proprietary*	72,831	103,659	110,374
Department of Commerce				
Weights & Measures	General	\$ 29,674	\$ 30,416	\$ 31,176
Health Facilities	Proprietary	24,324	20,991	21,575
Research & Information	General	10,008	10,258	10,514
Department of Family Services	State Special			
Pine Hills School	Revenue	\$ 2,050	\$ 2,101	\$ 2,153
Department of Institutions				
MT Developmental Center	General	\$168,062	\$172,687	\$182,160
Department of Social and Rehabilitation Services	50% General 50% Federal	\$ 16,462	\$ 16,874	\$ 17,296
Total For All Agencies		<u>\$447,059</u>	<u>\$504,084</u>	<u>\$530,639</u>

*State agencies pay for janitorial and security services through rental assessments. Actual cost savings may affect various agencies and funds. Data entry fees are assessed to agencies using services by the department.

**Includes totals from contracting and from lower keystroke volume.

Source: Compiled by the Office of the Legislative Auditor

Cost Savings of Privatization



PRIVATIZATION CENTER

MARCH 1993

How-To GUIDE No. 6



**COST SAVINGS FROM
PRIVATIZATION:
A COMPILATION OF STUDY FINDINGS**

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COST SAVINGS FROM PRIVATIZATION: A Compilation of Study Findings

by
John Hilke

EXECUTIVE SUMMARY

Opponents of privatization and other methods of increasing competition in government-financed services frequently claim that privatization/competition rarely results in cost savings for government or society at large. In fact, some argue that privatization increases costs to the taxpayer.

These claims are refuted by a substantial body of research that has documented significant savings from privatization/competition. More than 100 studies over the course of the last 20 years have demonstrated privatization/competition cost savings in service areas from airport operation to weather forecasting.

The wide variety of reasons for the cost savings include, for example: 1) better management techniques; 2) better and more productive equipment; 3) greater incentives to innovate; 4) incentive pay structures; 5) more efficient deployment of workers; 6) greater use of part-time and temporary employees; 7) utilization of comparative-cost information; and 8) more work scheduled for off-peak hours. All these benefits stem primarily from the introduction of competition into the bidding process to perform the service.

Insulated from competition, most government units have lower incentives to—or are even prohibited from—adopting the productivity-increasing techniques of private firms. When government units compete against private bidders to provide a service, cost savings are significant regardless of who wins the contract because the government unit typically responds by cutting its costs greatly.

The following service-by-service table is a compilation of cost studies that compare the costs of in-house (sole-source) government agencies versus alternative—and mostly private-sector providers. It is derived from my book, *Competition in Government Financed Services*, published by Quorum Books in 1992. The over 100 independent studies typically found cost reductions of 20 percent to 50 percent that resulted from privatization and, more importantly, increased competition.

UPDATED COST SAVINGS RESEARCH FINDINGS

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Privatization Cost Savings

INTRODUCTION

This table updates and expands an earlier 1982 compilation of studies on the effect of competition on the costs of government services.¹ It references over one hundred independent studies of increased competition in specific government services and the cost discrepancies observed. Studies that collected quantitative results usually demonstrated cost savings of 20 percent to 50 percent as a result of increased competition.

The primary method of increasing competition is contracting out public services to private firms. However, this is not the only method of increasing competition examined in the studies presented in the table. Findings from two other methods of increasing competition are also detailed.

One alternative is allowing management and workers of the in-house government unit to bid against private firms. The other method is termed intergovernmental contracting and refers to agreements between two or more government jurisdictions to purchase service from another government. Competition takes place between in-house units in all the jurisdictions that might contract with each other.

RESEARCH FINDINGS

UPDATED COST SAVINGS RESEARCH FINDINGS		
Arranged Alphabetically by Service Category		
SOURCE	COMPARISON	FINDINGS
1: AIRLINE OPERATION AND AIRPLANE MAINTENANCE		
Savas 1987	In-House versus contract maintenance support for air force bases.	Contract maintenance reduced costs by 13% while improving availability of parts and planes. Cost savings were primarily attributable to use of 25% fewer personnel by contractors.
Davies 1971, 1977	Australia/sole private airline versus its lone public counterpart.	Efficiency indices of private airline were 12% to 100% higher.
Domberger and Piggott 1986	Survey article dealing with many services. Focus on Australian Airlines.	Concludes that private firms are generally more efficient, unless the public firms are faced with equivalent competition.

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Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS

Arranged Alphabetically by Service Category

SOURCE	COMPARISON	FINDINGS
2. AIRPORTS		
Auditor General of Canada 1985	Tax-supported Canadian airport operations versus comparable U.S. airport authorities that must borrow in capital markets to finance their facilities.	Airports subject to capital market discipline are much more efficient. Work-year requirements are 30% to 40% lower. Canadian government workers have inflexible work assignments and procedures. Canadian airports are overbuilt and neglect many commercial opportunities. Fail to monitor trends in operating costs. Overall savings rate is 40%.
Moore 1987	In-house versus contract air-traffic control.	Government pricing policies for landing rights and other airport services lead to inefficient congestion and inability to finance expansion of facilities.
Roth 1987	Government-managed versus private-managed airports.	Government pricing policies for landing rights and other airport services lead to inefficient congestion and inability to finance expansion of facilities.
3. ALL SERVICES		
Deacon 1979	In-house versus intergovernmental production of all services.	Intergovernmental contracting saved 14% relative to in-house production.
David 1987	In-house versus private contracted services.	Surveyed local administrators reported that cost savings were achieved in 98% of contracting efforts. The range of operating-cost savings was large: 10% reported more than 40% savings. The weighted average cost saving was 19%.
Savas 1987	Los Angeles county in-house services versus contracted services from 1979 to 1984.	Cost of contracted services averaged 30% less than in-house services.
Moore 1987	In-house versus contract in Mirada, California.	Contracting has 30% lower costs.
4. ASSESSING PROPERTY TAX (financial administration) (also see Payroll and Data Processing (service category 28))		
Stocker 1973	In-house versus private contractors in Ohio.	Private assessments provided 50% cost savings and were found to be more accurate.

Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS		
Arranged Alphabetically by Service Category		
SOURCE	COMPARISON	FINDINGS
5. BANKS		
Davies 1982	Australia/one public versus one private bank.	Sign and magnitude of all indices of productivity, responsiveness to risk, and profitability favor private banks.
6. BUS SERVICE (Utilities) also see Electric Utilities and Water Utilities (service categories 10 and 43)		
Morlok and Moseley 1986	Municipal in-house agency versus competitive contracts.	Contract winners supplied services at 28% lower costs.
Morlok and Viton 1985	Municipal in-house agency versus contracts awarded in competitive bidding versus noncompetitive contracts.	Contract providers had cost 50% to 60% lower than municipal agencies they replaced. Noncompetitive contracts were similar to municipal agency costs.
Oelert 1976	Municipal in-house versus private bus service in W. Germany.	Public bus services have 160% higher costs per kilometer than private equivalents.
Walters 1987	Municipal in-house versus private bus service in various cities.	Private bus services typically charge similar prices, but have 50% to 65% lower costs.
Perry and Babitsky 1986	Private versus cost-plus contract versus municipal in-house versus regional in-house authority bus operators.	Private operators are significantly more efficient. Cost-plus contractors and municipal bus lines are less efficient. Inefficient private operators are sold to government.
Prommehne and Schneider 1985	In-house versus private firms in West Germany.	Private costs were 60% lower than public costs for commercial bus operations.
Talley and Anderson 1986	In-house motor bus versus contracted dial-a-ride service.	Substituting dial-a-ride for scheduled service decreased costs by reducing overtime and idle time and utilizing less costly vehicles. It also reduced costs indirectly by encouraging competition with traditional services of the agency.
Teal, Guiliano, and Morlok 1986	In-house versus competitive contract operators.	Competitive contract operations provided cost savings from 10% to 50% (larger fleets). Cost savings are due both to less overhead/greater productivity and lower wages.
Rice Center 1985	In-house versus contract express commuter services.	Contract operators have 30% to 60% lower costs.

Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS		
Arranged Alphabetically by Service Category		
SOURCE	COMPARISON	FINDINGS
7. CLEANING SERVICES (General maintenance of public buildings) also see Security Services (service category 37)		
Bundesrechnungshoff 1972	In-house versus private contracting of cleaning services in West German post offices.	In-house service 40% to 60% more costly.
Hamburger Senat 1974, Fischer-Menshausen 1975	In-house versus private contracting out in West German public buildings.	Public service 50% more costly than private alternative.
Kaiser 1977	In-house versus contract services in schools.	Contracting saved 13.4% of costs.
Pommerehne and Schneider 1985	In-house versus private-sector costs of services in West Germany.	Private costs were 33% lower than public costs for commercial cleaning services.
U.S. GAO 1981b	In-house staff versus GSA contractors versus private landlords.	Private window cleaning costs averaged 47% lower than GSA staff while contractor costs were 38% lower. Higher costs were due to higher wages as well as more workers.
Stevens 1984	In-house versus contract janitorial services.	Contract service had 42% lower costs even after accounting for quality, service levels, and economies of scale.
U.S. GAO 1982b, Fixler and Poole 1987	In-house versus contracted janitorial services in post offices.	Contracted janitorial services were 50% less costly than in-house services.
8. DAY CARE CENTERS		
Bennett and DiLorenzo 1983	In-house versus private providers of equivalent services. Article is based on GAO studies.	Private day care was found to be 45% less costly because of fewer teachers, lower wages, and fewer nonteaching staff.
9. DEBT COLLECTION		
Bennett and DiLorenzo 1983	In-house versus private providers of equivalent services.	Private debt collection procedures were faster and 60% less costly.

Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS

Arranged Alphabetically by Service Category

SOURCE	COMPARISON	FINDINGS
Bennett and Johnson 1980	In-house versus privately contracted equivalent services.	Government 200% more costly per dollar of debt pursued.
10. ELECTRIC UTILITIES (Utilities) also see Bus Services and Water Utilities (service categories 6 and 43).		
Bennett and DiLorenzo 1983	In-house federal agencies versus private hydroelectric plants.	Private utility costs averaged 17% lower due primarily to federal overstaffing.
Hellman 1972	In-house versus electric utilities that compete versus regulated private monopolies.	Competition produced lower rates than regulation. Government production produced the lowest rates due to tax exemptions.
Meyer 1975	In-house versus private firms, sample of sixty to ninety U.S. utilities.	Slightly higher costs of private production. Threat of competition improved cost efficiency somewhat.
Moore 1970	In-house versus private U.S. utilities.	Overcapitalization greater in public firms. Total operating costs of public firms higher.
Primeaux 1975	In-house versus private U.S. utilities.	Municipal utilities facing competition have 11% lower cost on average. Economies of scale offset X-inefficiency at big firms.
Spann 1977	In-house versus private firms in Texas and California.	Private firms, adjusted for scale, are as or more efficient in operating cost and investment.
Atkinson and Halvorsen 1986	U.S. public utilities.	Public Utilities are as efficient as private utilities.
Wallace and Junck 1970	In-house versus private firms by region of the U.S.	Operating costs 40% to 75% higher in public mode. Investment is 40% higher (per kilowatt) in public mode.
Bellamy 1981	Monopoly versus competing utilities.	Competing utilities had 20% lower prices.
FINANCIAL ADMINISTRATION See Assessment, Property Tax (service category 4), and Payroll and Data Processing (service category 28).		
11. FIRE PROTECTION		
Ahlbrandt 1973, 1974 Moore 1988	In-house (Seattle) versus private (Scottsdale, Arizona).	Municipal fire departments 39% to 88% higher per capita.

Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS

Arranged Alphabetically by Service Category

SOURCE	COMPARISON	FINDINGS
Hilke 1986	In-house versus varying degrees of use of volunteers in New York, and Pennsylvania cities (not suburbs) with populations between 10,000 and 50,000.	Use of volunteers reduced firefighting costs. Cities in New York with all-volunteer departments had 62% lower costs per capita. Pennsylvania's all-volunteer cities saved an average of 79% per capita. A 10% increase in use of volunteers provides a 2.8% decrease in costs.
Kristensen 1983	In-house versus major private provider in Denmark.	The principal private firm provided services at 65% lower costs. Differences in costs due to economies of scale, lower input costs, and especially part-time reservists and lower X-inefficiencies.
McDavid and Butler 1984	In-house versus major private provider in Denmark.	Mixed fire departments averaged 33% lower costs than purely municipal departments.
Poole 1976, Smith 1983	Private versus contract fire fighting.	Switching to private contract fire fighting reduces costs by 20% to 50%.
12. FORESTRY		
Bundesregierung Deutschland 1976	In-house versus private in West Germany.	Annual operating revenues 45 DM per hectare higher in private forests (approximately \$6 per acre).
Pfister 1976	In-house versus private in the state of Baden-Wurttemberg, Germany.	Labor input twice as high per unit of output in public as compared with private firms.
GENERAL MAINTENANCE OF PUBLIC BUILDINGS See Cleaning Services (service category 7) and Security Services (service category 37).		
13. HEALTH SERVICES also see Nursing Homes (service category 25).		
Schlesing, Dorwart, and Pulice 1986	In-house versus contract mental health services.	Nominally competitive-contracting procedures resulted in sole-source supply with little increase in efficiency.
Valente and Manchester 1984	In-house supply of substance abuse programs versus volunteer-based program.	Systematic volunteer program allowed service expansion with cost savings to the community.

Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS		
Arranged Alphabetically by Service Category		
SOURCE	COMPARISON	FINDINGS
14. HIGHWAYS		
Deacon 1979	In-house (local) versus intergovernmental provision of street repair.	Intergovernmental contracting saved 30%.
Stevens 1984	In-house versus contract provision of asphalt overlay and traffic light maintenance.	Contracting out was half as costly with equivalent quality. Contractors used more experienced staff and more equipment. Cost savings in the traffic light maintenance averaged 36%.
15. HOSPITALS		
Lindsay 1975	In-house Veterans Administration (VA) versus private.	VA hospitals have lower costs and lower quality. Resource use is distorted towards outputs that are easily monitored by Congress. Actual costs per medically necessary hospital stay may be higher in VA hospitals after controlling for length of stay.
Robinson and Luft 1988	Investor-owned versus public hospitals using a sample of 5,490 hospitals.	Cost increases at public hospitals were 15% lower than those in investor-owned hospitals from 1982 to 1986 after controlling for various demand and cost factors.
Becker and Sloan 1985	Investor-owned versus nonfederal government hospitals.	Government hospitals had no higher costs per admission.
Shortell and Hughes 1988	Investor-owned versus nonfederal government versus nonprofit private hospitals.	No differences in quality, measured in death rates between different types of hospitals.
Register and Bruning 1987	Investor-owned versus thirty-six nonfederal state and local government owned and operated hospitals.	No significant efficiency differences between types after controlling for size and other factors that should effect efficiency.
Grannemann, Brown, and Pauly 1986	Investor-owned versus nonfederal government hospitals using a national sample of short-term hospitals.	Investor-owned hospitals had 24% higher costs than nonfederal government hospitals.

Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS

Arranged Alphabetically by Service Category

SOURCE	COMPARISON	FINDINGS
Noether 1987	Investor-owned versus nonprofit hospitals including nonfederal government hospitals sampled from 223 metropolitan areas.	Investor-owned hospitals are significantly more efficient once tax payments are taken into consideration.
Lindsay 1976	In-house Veterans Administration versus private.	Cost per patient day less in VA hospital, unadjusted for type of care and quality. Less "serious" cases and longer patient stays were observed in the VA facilities. The VA had a higher proportion of minority group professionals compared to proprietary hospitals.
Benton 1979	In-house versus private home care.	Government had 43% lower cost. No controls for quality were made in the study.
Wilson and Jadow 1978	In-house versus private in 1,200 U.S. hospitals providing nuclear medicine services.	Proprietary hospitals more efficient than public hospitals.
Hatry 1983	In-house managements versus contract management.	Experience with contract managements has varied. Seven out of fifteen large California public hospitals signing new management contracts with private management firms between 1973 and 1980 terminated the contracts. The hospitals noted small savings, service problems, and the hospital's ability to learn and then duplicate the cost-saving management techniques of private contractors.
16. HOUSING AND COMMUNITY DEVELOPMENT		
Muth 1973	In-house versus private construction costs in U.S. cities.	Public agencies 20% more costly per constant quality housing unit.
Rechnungshof Rheinland Pfalz 1972	In-house versus private cost of supplying large public projects in West Germany.	Public agencies 20% more costly than private contracting.
Schneider and Schuppener 1971	In-house versus private construction in West Germany.	Public firms significantly more expensive suppliers.

Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS

Arranged Alphabetically by Service Category

SOURCE	COMPARISON	FINDINGS
Pommerehne and Schneider 1985	In-house versus private costs in West Germany.	Private costs were lower than public costs for commercial services generally, 17% for construction.
President's Commission on Privatization 1988	Publicly constructed versus various privatization alternatives.	Public housing costs per unit over twenty years total \$69,863 versus \$27,892 to obtain private units through housing subsidies to individual need families.
Weicher 1980	Government-financed construction versus private.	Government-financed construction 25% more costly. Government management is also more costly.
17. INSURANCE CLAIMS PROCESSING		
Hsiao 1978	In-house versus private.	Equivalent claims processing costs of private insurers were between 15% and 26% lower. Most of the differences were attributable to compensation and organizational differences. Some cost difference were attributable to efforts by public insurance programs to control medical costs generally.
18. INSURANCE SALES AND SERVICING		
Finsinger 1981	In-house (five firms) versus private (seventy-seven firms) liability and life coverage in West Germany.	Competition between public and private firms prompted equivalent efficiency.
Kennedy and Mehr 1977	In-house (in Manitoba) versus private (in Alberta).	Private insurance quality and service higher than those of the public insurance with equivalent costs.
19. LAUNDRY SERVICE		
Pommerehne and Schneider 1985	In-house versus private in West Germany.	Private costs were 46% lower than public costs for commercial services in laundry services.

Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS

Arranged Alphabetically by Service Category

SOURCE	COMPARISON	FINDINGS
20. LEGAL SERVICES		
Houlden and Balkin 1985	Ordered assigned counsel versus contract counsel for indigents.	Contract counsel had at least 50% lower costs. Contract counsel processed cases in half the time of assigned counsel. The authors note that since fees per hour are roughly equal, the primary difference is due to less attorney time per case under the contract system. This may imply a lower quality of service with contracts, but this does not affect the average jail term.
21. LIBRARIES		
White 1983	In-house libraries before and after federal aid.	After federal aid started in 1960s, productivity slowed as libraries added federally sponsored programs with lower marginal impact on output and fewer volunteers. Total factor productivity was at least 27% lower as a result.
22. LIQUOR STORES		
Simon and Simon 1987	In-house versus private.	State stores have higher compensation rates, but higher sales per hour. If hours of operation (quality) are considered, private stores have lower costs.
23. MILITARY SUPPORT SERVICES		
Bennett and Dilorenzo 1983	In-house versus private providers of equivalent services.	Average cost savings in base support services were 15%.
U.S. GAO 1985b	Precontract bids versus post-contract costs for competitive Department of Defense contracts.	Most post-contract prices were in accord with bids. Some unsatisfactory performance seen in 33% of the contracts. Personnel turnover and low staffing were main problems. Contract prices increases due largely to contract changes and Davis-Bacon wage regulations.
U.S. GAO 1981a	In-house versus contract.	Savings from both higher employee productivity and lower wages.

Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS

Arranged Alphabetically by Service Category

SOURCE	COMPARISON	FINDINGS
U.S. GAO 1985b	Contract bids versus actual contract experience.	Contract costs increased over time in 95% of sample. In 89%, increases were too small to eliminate the net savings from contracting. (Contracts were rebid in 35% of the cases due to failures of the initial contractor.) Main causes of the cost increases were general wage increases, rebidding of contracts, contract errors, or additional requirements not originally included.
24. MOTOR VEHICLE MAINTENANCE		
Campbell 1988	In-house versus contract services.	Contractor costs are 1% to 38% below municipal costs for equivalent or higher levels of service. In conversions to contracting, wage levels generally remain similar, but the number of operating and overhead employees is reduced because of greater productivity.
Pommerehne and Schneider 1985	In-house versus private costs in West Germany.	Private costs were 50% lower than public costs for automobile motor maintenance repairs.
Stolzenberg and Berry 1985	Noncompetitive in-house versus competitive contract versus competitive in-house.	Competition resulted in lower costs through large reductions in personnel. Contracting saved approximately 17%. The lowest costs occurred where an in-house operator won competitive contracts. Costs averaged over 40% lower at these bases. Quality of maintenance was similar, but slightly better in government operations operating under competitive conditions. Higher government costs came from staffing for peak-load demand, higher government fringe benefits and difficulties in hiring and firing.
25. NURSING HOMES (health services) also see Health Services (Service Category 13)		
Lindsay 1975	In-house (VA) versus contract.	Contract operated homes had 45% lower per day costs.

Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS

Arranged Alphabetically by Service Category

SOURCE	COMPARISON	FINDINGS
26. PARKING		
Caponiti and Booher 1986	In-house versus contract parking meter and parking restrictions enforcement.	Contracting is less costly, primarily because of lower fringe benefits and greater flexibility in meeting staffing requirements. Productivity (violations ticketed) improves as much as 10%, averaging 5%.
27. PARKS AND RECREATION		
Stevens 1984	In-house versus contract park turf maintenance.	Contract service had 28% lower costs and equivalent quality of service.
Savas 1987	Government versus privately constructed sports facilities.	Costs of privately constructed sports arenas averaged 31% less than those of public arenas.
Holmes 1985	In-house versus contract recreation program.	Cost savings of 20% obtained by privatizing. Savings come from more use of volunteers and better use of employees.
Poole 1980	In-house versus private facilities operations and programs.	Cost savings of 20% obtained by privatizing. Savings come from more use of volunteers and better use of employees.
Fixler and Poole 1987 Valente and Manchester 1984	In-house versus contracted profit and nonprofit organizations.	Contracting allowed maintenance of quality recreation services, even though budgets were reduced under California's Proposition 13 by as much as 50%.
28. PAYROLL AND DATA PROCESSING (financial administration) also see Assessment, Property Tax: (service category 4).		
Valente and Manchester 1984	In-house versus private competitive contractors.	Contractor performed higher quality data processing service with cost savings of 15%.
Stevens 1984	In-house versus private contractors.	No cost differences found after accounting for quality and other factors.
29. POLICE		
Deacon 1979	in-house (local) versus intergovernmental.	Intergovernmental contracting saved 42%.

Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS

Arranged Alphabetically by Service Category

SOURCE	COMPARISON	FINDINGS
Mehay 1979	In-house (local) versus contract with county (Lakewood Plan).	Contract costs were lower due to fewer police officers per capita. However, contract cities experienced higher rates of violent and property crime. Net effects were probably negative for contract cities. Problem attributable to inability of contract cities to specify quality of service and monitor performance.
Mehay and Gonzalez 1985	In-house monopoly versus in-house production with competition to serve additional jurisdictions.	Costs in counties that sell their police services to other jurisdictions are estimated to be 9% to 20% lower. The authors conclude that competition encourages police departments to keep their costs down.
30. POSTAL SERVICE		
U.S. GAO 1982a	In-house versus contracted routes.	Contracted delivery routes save up to 66% on delivery costs.
Hanke 1985a	In-house versus contracted window service.	Contractors (retail stores with postal services) provided window service at 88% lower cost than USPS operated.
Savas 1987	In-house versus private parcel delivery services.	Private firms have lower rates, faster delivery, lower losses from damage, better tracking systems, wider variety of services, and lower costs.
31. PRINTING		
Pommerehne and Schneider 1985	In-house versus private in West Germany.	Private costs were 33% lower than public costs for commercial printing services.
32. PRISONS		
Grant and Bast 1987	In-house versus contract facilities and services.	Contractor prison construction costs are at least 45% lower than government averages. Service contracts for prison operations are at least 35% below average per prisoner costs in recent cases.
33. PUBLIC WELFARE		
Poole 1980	In-house versus private variety of welfare services.	Privately supplied programs operating under competitive bidding saved 20% to over 60%.

Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS

Arranged Alphabetically by Service Category

SOURCE	COMPARISON	FINDINGS
Hatry 1983, Wedel, Katz, and Weick 1979	In-house versus private contracting for vocational rehabilitation, childrens' protective services, and programs for the elderly.	Competitive contracting efforts have often devolved into single source contracting with little evidence of efficiency gains. Nonprofit firms are the predominate suppliers. Improved program characteristics are the primary objective of contracting, but no quantifiable quality information is available.
34: RAILROADS		
Bennett and DiLorenzo 1983	In-house versus private providers of equivalent track repair. Article is based on GAO studies.	Private railroads repaired ties, replaced track, and surfaced rails at least 70% more efficiently.
Caves and Christensen 1980	In-house (Canadian National) versus private (Canadian Pacific) costs and productivity differences.	No current productivity differences. The public firm substantially increased its efficiency after competition increased in 1965.
35: REFUSE COLLECTION (Sanitation, other than Sewerage) also see Street Cleaning (service category 41).		
Collins and Downes 1977	In-house versus private contracting-out in St. Louis area.	No significant cost differences. Private firms lost density economies because several firms served the same areas. Public suppliers had monopoly status.
Savas 1974, 1977a,b, 1980; Stevens and Savas 1978; Edwards and Stevens 1979	In-house versus private monopoly franchise versus private nonfranchise firms.	Public supply was 40% to 60% more expensive than private. Private monopoly price was only slightly 5% higher than price of private non-franchised collectors. Density economies offset otherwise higher costs.
Stevens 1984	In-house versus competitive contract.	Cost savings of 22% were found, controlling for quality.
Hirsch 1965	In-house (St. Louis City-County area) versus private firms.	No significant cost differences. Private competing suppliers lost density economies.
Kemper and Quigley 1976	In-house versus private monopoly contract versus private nonfranchise versus municipal firms in Connecticut.	Municipal collection costs were 14% to 43% higher, but private nonfranchise costs were 25% to 36% higher than municipal collection. Loss of density economies increased costs of nonfranchise suppliers.

Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS		
Arranged Alphabetically by Service Category		
SOURCE	COMPARISON	FINDINGS
Kitchen 1976	In-house versus private firms in forty-eight Canadian cities.	Municipal suppliers were more costly than proprietary firms.
Petrovic and Jaffee 1977	In-house versus private contracting in midwestern cities.	Cost of city collection was 15% higher than the price of private contract collectors.
Pier, Vernon, and Wicks 1974	In-house versus private firms in Montana.	Municipal suppliers appear to be more efficient, not controlling for quality and community characteristics.
Savas 1977a	In-house versus private firms in Minneapolis.	No significant cost differences if suppliers compete through tight control of municipal costs imposed by legislature using private costs as a comparison.
Savas 1981	In-house and franchise contractors in a single district jurisdiction versus contractors and in-house in a multidistrict setting.	The average number of bids per area increases when cities are divided into small districts. Competitive bidding leads to lower costs for contractor service. Cities that actively monitor municipal agencies using private contractor costs have lower average costs. No benefits are obtained without these policies.
Spann 1977	In-house versus private firms. (Survey of literature.)	Public firms were 45% more costly.
36. SCHOOLS		
Peterson 1981	In-house versus private contractor-operated public schools.	Private contracting prompted small gains in math and reading and losses in other subjects. No cost savings.
37. SECURITY SERVICES (general maintenance of public buildings) also see Cleaning Services (service category 7)		
Hanke 1985a	In-house versus private security guards.	Private security services save 50% or more.
38. SEWERAGE/WASTEWATER TREATMENT		
Hanke 1985a	In-house versus contractor-built and operated treatment facilities.	Contractor costs averaged 20% to 50% less due to shorter construction lags and lower construction costs. Competition also reduces operating costs 20% to 50%.

Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS

Arranged Alphabetically by Service Category

SOURCE	COMPARISON	FINDINGS
Savas 1987, Moore 1988	In-house versus outside contracts	Contracted wastewater service is 20% to 50% less costly because federally financed projects involve higher construction (Davis-Bacon Act) and design costs.
39. SHIP REPAIR AND MAINTENANCE		
Bennett and Johnson 1980	In-house versus commercial tankers and oilers.	U.S. GAO reports that the private ship repair costs averaged 80% less than the U.S. Navy's costs.
40. SLAUGHTERHOUSES		
Pausch 1976	In-house versus private firms in 5 major West German cities.	Public firms were significantly more costly because of overcapacity and overstaffing.
41. STREET CLEANING (refuse collection) also see Refuse Collection (service category 35).		
Stevens 1984	In-house versus competitively contracted.	Contract cities have 43% lower costs after accounting for quality and other factors.
42. TOWING		
Kaiser 1976	In-house versus contractors in New York.	Contract towing bids provided cost savings of more than 40%.
TRANSIT see Bus Service (service category 6).		
UTILITIES see Bus Service (service category 6), Electric Utilities service category 10), and Water Utilities (service category 43).		
43. WATER UTILITIES (utilities) also see Bus Services and Electric Utilities (service categories 6 and 10).		
Crain and Zardkoohi 1978	In-house versus private suppliers; comparisons of 112 firms and detailed case study of 2 firms that switched type of ownership.	Public firms were 40% less productive. Private firms had 25% lower costs. Public firms going private had 25% increase in output per employee. Private firm going public had an output per employee decrease of 40%.
Feigenbaum and Teeple 1982	In-house versus private water companies.	No cost differences were found after controlling for other cost factors.
Mann and Mikesell 1976	In-house versus private suppliers.	Found public modes were 20% more expensive after adjusting for input prices.
Morgan 1977	In-house versus private suppliers covering 143 firms in six states.	Costs 15% higher for public firms.

Privatization Cost Savings (Continued)

UPDATED COST SAVINGS RESEARCH FINDINGS		
Arranged Alphabetically by Service Category		
SOURCE	COMPARISON	FINDINGS
44. WEATHER FORECASTING		
Bennett and DiLorenzo 1983	In-house versus private. Based on U.S. GAO studies.	Private weather forecasting contractors provided equivalent weather forecasting with 35% lower cost.

SOURCE: John Hilke, *Competition in Government-Financed Services*, 69-94.

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John C. Hilke is a Staff Economist in the Federal Trade Commission's Bureau of Economics, specializing in issues relating the role of competition to improved economic performance. He is also the co-author of *U.S. International Competitiveness: Evolution or Revolution?*

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ENDNOTE

1. Borcharding, T., W. Pommerehne, and F. Schneider, "Comparing the Efficiency of Private and Public Production: the Evidence from Five Countries," *Journal of Economics* (suppl. 2), 1982, 127-56.



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A STATE ACTION DOCTRINE FOR AN AGE OF
PRIVATIZATION

Daphne Barak-Erez[†]

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State (in the broad sense of the notion, either at the state or the federal level) is responsible for the infringement.⁸

However, the Supreme Court has acknowledged that there are circumstances in which a seemingly "private" action should be considered a State Action. When the State is deeply involved in a private activity, this activity is perceived as being (substantively) a state action, despite its private appearance. It is this application of the doctrine that is of interest in the context of privatized enterprises and services. Privatization usually stands for substitution of public services by private actors - resulting in the government being only "involved" in them (usually by operating the regulatory process).⁹ And the question is, whether privatized services should be considered as completely private, or rather, also as public to a certain degree, and therefore as state actions (at least, in some circumstances).

II. PRIVATE ACTIONS AS STATE ACTIONS ACCORDING TO CURRENT DOCTRINE

The Supreme Court has accepted the view that, in special circumstances, private actions should be viewed as state actions. However, it has applied this view very narrowly, considering most actions as private despite clear traces of government involvement. I will first review this approach, and then evaluate it. Considering the purpose of the discussion, it will not be a complete review of the state action doctrine. It is aimed only at the possible application of the doctrine to private enterprises facing state action claims.¹⁰

8. This statement of the law is subject, of course, to changes originating from state constitutional law. See *PruneYard Shopping Ctr. v. Rubins*, 447 U.S. 74 (1980); see also Jennifer Friesen, *Should California's Constitutional Guarantees of Individual Rights Apply Against Private Actors?*, 17 HASTINGS CONST. L.Q. 111 (1989).

9. For the interchangeability of public-ownership and regulation, see STEPHEN BREYER, *REGULATION AND ITS REFORM* 181-83 (1982).

10. The state action doctrine has long been criticized for its lack of clarity and indefinite scope. For broader discussions of the doctrine, see Harold W. Horowitz, *The Misleading Search for "State Action" Under the Fourteenth Amendment*, 30 S. CAL. L. REV. 208 (1957); Charles L. Black, Jr., *The Supreme Court 1966 Term - Foreword: "State" Action, Equal Protection, and California's Proposition 13*, 81 HARV. L. REV. 69 (1967); Ira Nerken, *A New Deal for the Protection of Fourteenth Amendment Rights: Challenging the Doctrinal Bases of the Civil Rights Cases and State Action Theory*, 12 HARV. C.R.-C.L. L. REV. 297 (1977); Erwin Chemerinsky, *Rethinking State Action*, 80 NW. U. L. REV. 603 (1985); LAURENCE H. TRIBE, *REFOCUSING THE "STATE ACTION" INQUIRY: SEPARATING STATE ACTS FROM STATE ACTORS IN CONSTITUTIONAL CHOICES* (1985); see also Barbara Rook Snyder, *Private Motivation, State Action and the Allocation of Responsibility for Fourteenth Amendment Violations*, 75 CORNELL L. REV. 1053 (1990), and the list of articles

A. Easy Cases of State Action

1. Coercion and Authorization

There are some obvious cases of state action, i.e., when private activity is coerced by law or specifically authorized by an official exercising statutory authority. In these examples, the private action derives its validity from a real state action, and therefore is substantively a state action. This form of state action is exemplified by the decision in *Public Utilities Commission v. Pollak*.¹¹ In this case, the proceedings followed a decision of a street railway company operating in the District of Columbia to amplify radio programs in its streetcars and buses, allegedly depriving passengers of liberty without due process of law.¹² The Court was willing to discuss this state action complaint because the relevant state authority - the Public Utilities Commission of the District of Columbia - investigated the decision of the company and approved it.¹³ From the Court's perspective, it was important that the official approval was explicit and addressed the current complaint.¹⁴ In *Jackson v. Metropolitan Edison Co.*,¹⁵ the Court did not deem sufficient an implicit authorization.¹⁶ This case addressed a consumer's complaint that her electric services were terminated without affording for a hearing, and therefore allegedly without due process of law.¹⁷ The company's right to terminate services for nonpayment appeared in its general tariff filed with the Public Utility Commission, and was never disapproved.¹⁸ However, the implicit authorization was not considered a sound basis for a state action claim.¹⁹

However, the obvious case of a specific authorization is not the right prototype for the current discussion. Privatization initiatives are

completed there in note. For a general survey of the current doctrine, see LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 1688-1720 (chapter 18) (2d ed. 1988).

11. 343 U.S. 451 (1952).

12. *Id.* at 456-57.

13. *Id.* at 462-63.

14. According to the Court: "We rely particularly upon the fact that that agency, pursuant to protests against the radio program, ordered an investigation of it and, after formal public hearings, ordered its investigation dismissed on the ground that the public safety, comfort and convenience were not impaired thereby." *Id.* at 462.

15. 419 U.S. 345 (1974).

16. *Id.* at 354.

17. *Id.* at 347-48.

18. *Id.* at 355.

19. *Id.* at 354-57.

company] operates a public utility on the streets of the District of Columbia."³²

The significant curtailment of the public function theory started in the seventies, when Justice Renquist ruled that it is limited to activities traditionally and exclusively identified with the state,³³ a reservation first introduced in *Jackson*.³⁴ As mentioned before, this case addressed electricity services, and the plaintiff contended that their supply should be regarded as fulfillment of a public function.³⁵ The contention was flatly rejected by Justice Renquist, who wrote for the majority. In his view, a state action may be found only when the function operated is one that was "traditionally the exclusive prerogative of the state,"³⁶ or "traditionally associated with sovereignty."³⁷ This narrowing theory prevailed in later cases, although its basis was never fully explained. It allowed a differentiation between the company-owned town and modern activities like electricity services, but the appropriateness of this differentiation was far from self-evident.

The *Flagg Bros.* case was the next to raise the public function issue.³⁸ Due to an unpaid debt to a warehouse, the plaintiff's property stored there was about to be sold in accordance with a state law authorizing satisfaction of a lien without prior recourse to the courts.³⁹ The plaintiff argued that her due process rights were infringed, the creditor being in these circumstances a state actor - acting in the public sphere of dispute resolution.⁴⁰ Justice Rehnquist, who delivered the opinion of the court, dismissed the public function argument once again. He explained that "the settlement of disputes between debtors and creditors is not traditionally an exclusive public function."⁴¹ Later in

32. *Id.*

33. Another line of narrowing interpretation of *Marsh* discussed in its First Amendment context. The application of the precedent to speech in shopping centers, in *Food Employees Local 590 v. Logan Valley Plaza*, 391 U.S. 308 (1968), was overruled in *Hudgens v. NLRB*, 424 U.S. 507 (1976). I chose not to concentrate on this line of cases, because it also entangles considerations specific to the free speech debate. However, the judicial tendency to limit the significance of *Marsh* is also evident here. For a discussion of these cases, see Frederick Schauer, *Hudgens v. NLRB and the Problem of State Action in First Amendment Adjudication*, 61 MINN. L. REV. 433 (1977).

34. 419 U.S. 345.

35. *Id.* at 352.

36. *Id.* at 353.

37. *Id.*

38. 436 U.S. 149.

39. *Id.* at 153.

40. *Id.* at 157.

41. *Id.* at 161.

the opinion, Justice Rehnquist made it clear that the current doctrine does not apply even to "a number of state and municipal functions. . . which have been administered with a greater degree of exclusivity by states and municipalities than has the function of so-called 'dispute resolution.' Among these are such functions as education, fire and police protection, and tax collection."⁴² Not even police protection! However, in regard to these relatively exclusive functions, words of reservation were added: "we express no view as to the extent, if any, to which a city or State might be free to delegate to private parties the performance of such functions and thereby avoid the the strictures of the Fourteenth Amendment."⁴³ From the context, it is not clear whether these words were meant to be confined to intentional circumvention of constitutional duties through the delegation of functions. However, the narrow understanding is supported by the fact that this reservation was never mentioned again in the Chief Justice's opinions. For example, in *Rendell-Baker v. Kohn*,⁴⁴ he rejected the suggestion to apply public function theory in regard to a school that served as a de-facto substitute to a public school. Most of the students were both referred to it and financed by government authorities.⁴⁵ In the Court's view, the decisive fact was that education was not "traditionally the exclusive prerogative of the State"⁴⁶ while ignoring the reservation in *Flagg Bros* which specifically addressed semi-exclusive public functions like education.⁴⁷ The same can be said about *Blum v. Yaretsky*,⁴⁸ in which the Court denied an application of the public function theory in regard to nursing homes attending Medicaid patients. Again, the ruling precedent was the "traditionally the exclusive prerogative of the state" formula.⁴⁹ A more recent precedent is *San Francisco Arts & Athletics v. United States Olympic Committee*.⁵⁰ Here, the state action claim concerned the United States Olympic Committee (USOC), a corporation endowed by law with the sole authority to represent the United States in the Olympic Games. The USOC had refused to allow the use of the word "Olympic" for a sport event organized by the petitioner as the "Gay Olympic

42. *Id.* at 163.

43. 463 U.S. at 163-64.

44. 457 U.S. 830 (1982).

45. *Id.* at 832.

46. *Id.* at 842 (quoting *Jackson*, 419 U.S. at 353).

47. 436 U.S. at 63-64.

48. 457 U.S. 991 (1982).

49. *Id.* at 1011.

50. 483 U.S. 522 (1987).

monopoly of local public transportation, and was operating under an elaborate regulatory scheme.⁶⁸ However, the Court was not willing to draw a state action conclusion from these factors alone.⁶⁹ This conclusion was based upon a specific authorization of the private decision, pursuant to an official investigation of it. *Pollak* preceded *Burton*, but later cases prove that the narrow view expressed by it outlived *Burton*.

An important case subsequent to *Burton* was *Moose Lodge No. 107 v. Irvis*.⁷⁰ Here, the plaintiff was a black person discriminated against in a private club because of his race.⁷¹ The state action claim was based on the fact that the club got a liquor license and was regulated as a liquor licensee.⁷² The license was partially exclusive in nature (though not monopolistic in the strict sense) due to a quota system administered in liquor licensing.⁷³ However, according to the majority's opinion, "here there is nothing approaching the symbiotic relationship between lessor and lessee that was present in *Burton*."⁷⁴ The description of the relationship in *Burton* as "symbiotic" limited the potential of this precedent. Symbiosis infers reciprocity, and therefore is not established even by substantial governmental involvement.

There may be good reasons for the denial of a state action claim in the circumstances of *Moose Lodge*.⁷⁵ The background of the case was a relatively standard scheme of licensing. It would be exaggerated to argue that in the modern administrative state almost every licensee is a state actor. However, the question remains whether, and in what sense, reciprocity should be part of the test, i.e., is it essential that the government will have a pecuniary interest in the private action, as in *Burton*?

Later, the narrow application of *Burton* was not limited to such relatively standard licensing situations as the one discussed in *Moose Lodge*. *Jackson*⁷⁶ is a representative example. Here, a much deeper governmental involvement with the private actor was still short of state

68. *Id.* at 462.

69. *Id.*

70. 407 U.S. 163 (1972).

71. *Id.* at 164-65.

72. *Id.* at 165.

73. *Id.* at 177.

74. *Id.* at 175.

75. 407 U.S. 163.

76. 419 U.S. 345.

action.⁷⁷ As previously noted, the Court declined to acknowledge the provision of electricity services as state action under the public function theory.⁷⁸ But, this was not the only line of argument. Under the circumstances of the case, the petitioner based her argument also on other factors: extensive regulation and the monopolistic status of the utility.⁷⁹ These were the same factors discussed in *Moose Lodge*, but more intensified - heavy regulation (rather than standard regulation) and a clearer monopolistic status. However, the majority of the Court still thought that this was insufficient to constitute state action:

All the petitioner's arguments taken together show no more than that [the utility] was a heavily regulated, privately owned utility, enjoying at least a partial monopoly in the providing of electrical service within its territory . . . Under our decision this is not sufficient to connect the State of Pennsylvania with the respondent's action so as to make the latter's conduct attributable to the State for purposes of the Fourteenth Amendment.⁸⁰

b. *Financial Support and Financial Dependence*

The licensing and regulation cases discussed previously lacked a trait that had significant influence on the *Burton* decision - the pecuniary aspect. It is therefore important to evaluate to what extent a financial relationship with the government may have bearing on the willingness of the Court to recognize state action. It was already noted that the Court invalidated subsidies to racist organizations.⁸¹ However, it seems that these precedents were confined to ex-gratia government support, excluding payments for services the government buys from private entities. The latter did not suffice the Court when applying the nexus test.

This distinction was drawn by two later cases decided on the same day, *Blum*⁸² and *Rendell-Baker*.⁸³ In *Blum*, the plaintiffs were residents of private nursing homes that were paid by the government, via Medicaid benefits, for the plaintiffs' treatment.⁸⁴ The plaintiffs challenged the decisions of the institutions' doctors reassessing the level

77. *Id.* at 352.

78. *Id.* at 353.

79. *Id.* at 351, 357.

80. *Id.* at 358.

81. See *supra* notes 20-23 and accompanying text.

82. 457 U.S. 991.

83. 457 U.S. 830.

84. *Blum*, 457 U.S. at 993.

context, the initiatives of privatization in the corrections system may serve as a representative example.¹⁰³

The state action doctrine, as it has been shaped in the majority decisions of the Supreme Court, does not constitute a sound enough basis for arguments of state action in regard to privatized services. Generally speaking, both the public function theory and the nexus theory seem applicable. However, they were fatally impaired. From the perspective of the public function theory, most of these services were not "traditionally and exclusively" reserved to the state. After all, the concept of a state that supplies services like education and health is a modern one. From the perspective of the nexus theory, privatization will usually not result in a financially symbiotic relationship between the state and the private actor. The government will probably license and regulate it and even buy its services, but not gain a pecuniary profit (as in *Burton*).¹⁰⁴

Are the results of the current doctrine satisfactory? I venture to say that they are not. What this means is that once services are privatized, the citizens who are in need of them (for example, Medicaid residents) or subjected to them (prisoners or troubled children attending special schools) may be stripped of the constitutional guarantees awarded to them before by not being entitled to due process and by being treated in a discriminatory way (in the absence of a specific statutory or regulatory limitations).

It is probable that the deficiencies in the current doctrine will be less likely to circumvent constitutional rights in the context of privatization of corrections. Confinement of prisoners is part of the enforcement of criminal law, which is a traditional characteristic of sovereignty.¹⁰⁵

Contracting Out: For What? With Whom?, 46 PUB. ADMIN. REV. 332 (1986). For statistics of privatization of public services in the United States, see E.S. Savas, *Privatization and Prisons*, 40 VAND. L. REV. 889, 890-93 (1987).

103. For a Symposium dedicated to the privatization of prisons, see 40 VAND. L. REV. 813-1024 (1989) (number 4).

104. 365 U.S. 715.

105. For a discussion of the state action doctrine in the context of privatization of prisons, see Susan L. Kay, *The Implications of Prison Privatization on the Conduct of Prisoner Litigation Under 42 U.S.C. Section 1983*, 40 VAND. L. REV. 867 (1987); Ira P. Robbins, *Privatization of Prisons: An Analysis of the State Action Requirement of the Fourteenth Amendment and 42 U.S.C. Section 1983*, 20 CONN. L. REV. 835 (1988); Harold J. Sullivan, *Privatization of Corrections and the Constitutional Rights of Prisoners*, FED. PROBATION 36 (1989); Charles W. Thomas & Linda S. Calvert Hanson, *The Implications of 42 U.S.C. Section 1983 for the Privatization of Prisons*, 16 FLA. ST. U. L. REV. 933 (1989).

In *West v. Atkins*,¹⁰⁶ the Supreme Court accepted a state action claim in regard to the actions of a private physician under a contract with the state to provide medical services for inmates at a state prison (a "mini privatization"). The case for the state action claim in regard to a broader policy of privatization in the correction system is supported also by the decision of the Texas District Court in *Medina v. O'Neill*.¹⁰⁷ In this case, inmates attacked the practices of a privately run facility for confinement of illegal immigrants. The Court accepted the state action claim, stating that both immigration and detention are powers "traditionally and exclusively" reserved to the state.¹⁰⁸

In practice, the results of the present doctrine are more likely to threaten constitutional norms already established in social services. Let us consider the example of the celebrated due process rights of welfare recipients as recognized in *Goldberg v. Kelly*.¹⁰⁹ Should these rights disappear if the operation of the welfare process is administered by a private agency having a contract with the state? The intensiveness of official supervision of the private agency may have some influence, but not necessarily, taking into consideration the low significance attributed by the court to intensive regulation. Moreover, it seems that the form of supervision is not the right test. Should constitutional guarantees depend on the details of the contract? It is important to emphasize that the question of privatization of social services is not limited to circumstances in which the state is motivated by an illegal motive (to evade constitutional duties, as in the case of *Evans v. Newton*).¹¹⁰ Putting aside the problematic question of the significance of motive in constitutional law,¹¹¹ it is possible to accept the economic reasons for the privatization of welfare services (by contracting them out), and still recognize the importance of safeguarding the due process rights of welfare recipients.

The case for the present doctrine (as applied by the court) is based on the interest of preserving freedom in the private domain, the basic idea underlying the *Civil Rights Cases*¹¹² (as well as federalism concerns). Looked at more closely, however, the argument regarding

106. 487 U.S. 42 (1988).

107. 589 F. Supp. 1028 (1984).

108. *Id.* at 1038.

109. 397 U.S. 254 (1970). The argument in the text is valid even when the curtailment of the precedent, in *Mathews v. Eldridge*, 424 U.S. 319 (1976), is taken into consideration.

110. 382 U.S. 296 (1966).

111. This is a controversial issue, see *Washington v. Davis*, 426 U.S. 229 (1976).

112. 109 U.S. 3.

for editorials as an infringement of the First Amendment.¹²² The Court had to confront the claim that policies of broadcast licensees are state actions.¹²³ The Court dismissed the claim.¹²⁴ Formally, it involved a narrow application of the "symbiotic relationship" test of the *Burton* decision.¹²⁵ However, substantively, it declined to recognize state action because it was aware of the vital independence of the media.¹²⁶ Viewing the same question from the public function perspective, it is possible to support the decision by recognizing that in the United States editorializing is certainly not a function of the state.

V. A STATE ACTION DOCTRINE FOR AN AGE OF PRIVATIZATION

The current challenge is how to update the state action doctrine in a way that preserves the distinction between state and private actions and is still capable of recognizing new forms of activity in the public sphere. This is not an argument against the basic premise of the American Constitution that the government carries a special burden of Constitutional duties, which is not applicable to private actors.¹²⁷ It is an argument against the premise that the definitions of government action can be detached from the changes in real life.

Having mentioned *Brown*,¹²⁸ I will try to explain the constitutional challenge posed by privatization in regard to alternative methods to fulfill the responsibility of the state for the education of children. Usually, the states guarantee basic education by the operation of public schools. In these circumstances, the schools are owned by public authorities (the "state"), and there is no doubt as to their constitutional accountability. Let us assume that as an alternative method of operation (for economic reasons), the state chooses to close its public schools and pay for the services of privately-owned institutions (by financing the enrollment of students). Now, the question is whether there should be a difference in the scope of the constitutional rights of the students in these two modes of operation. Even if private schools participating in

122. *Id.* at 97.

123. *Id.* at 114-15.

124. *Id.* at 120.

125. *Id.* at 119.

126. *Columbia Broadcasting Sys.*, 412 U.S. at 121.

127. For the public-private distinction in American law and its curtailment, see MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1870-1960*, 10-11, 206-08 (1982). The future of the distinction was discussed in a Symposium published in 130 U. PA. L. REV. 1289-1609 (1982) (Number 6).

128. 347 U.S. 483.

privatization projects are not likely to adopt racist policies,¹²⁹ there are still other constitutional concerns, i.e., what will be the scope of First Amendment rights of the students (regarding both freedom of speech and freedom of religion); will they have due process rights? Obviously, the total disappearance of the public schools system is not likely to happen.¹³⁰ However, similar changes do and will happen, even in the field of education.¹³¹ Although education for the average child is still administered by the public schools system, significant numbers of troubled children are now educated in private institutions, financed and supervised by the state (as in *Rendell-Baker*).¹³² These children should not have lesser constitutional rights while in school, simply because the government chooses not to form a special school for them. In *Rendell-Baker*, the Court could avoid the question of the rights of the enrolled students, because the petitioners were employees of the institution.¹³³ However, it did not form a theory of state action that is capable of distinguishing between the two. In the same year, in *Milonas v. Williams*,¹³⁴ The Court of Appeals of the Tenth Circuit recognized the existence of state action, in a case similar to *Rendell-Baker*, in all respects, except that the plaintiffs were students claiming infringements of their constitutional rights (referring to use of a polygraph machine, monitoring and censoring mail, use of isolation rooms and use of excessive physical force).¹³⁵ The circuit court explained that the *Rendell-Baker* decision was not ruling, because of the difference in the identity of the plaintiffs.¹³⁶ For reasons already given, the recognition of a state action in the above circumstances was justified. However, it is doubtful, whether it is founded on the precedents of the Supreme Court.

129. Title IV of the Civil Rights Act of 1964 prohibits racial discrimination in any program receiving federal assistance.

130. A pathologic example of a decision to close all public schools was discussed in *Griffin v. County School Board*, 377 U.S. 218 (1964). In this famous case, all public schools in Prince Edward County, Virginia, were closed for four years, in order to avoid desegregation. Here, the racist motive of the "privatization" policy was clear, and the Supreme Court overruled it on equal protection grounds.

131. For privatization experiments in the public education system, see Julie Huston Vellacelli, *State Constitutional Restraints on the Privatization of Education*, 72 B.U. L. REV. 381 (1992).

132. 457 U.S. 830.

133. *Id.* at 836.

134. 691 F.2d 931 (10th Cir. 1982).

135. *Id.* at 935.

136. *Id.* at 940.

application. In particular, it is limited to old notions regarding the functions of the state. In an age of privatization, the consequences of these limitations may be the inadequate protection of constitutional rights in operation of state services and activities, administered by or with the cooperation of private bodies. It is suggested that the application of the current doctrine be updated by developing the theories already ingrained in it. More specifically, it is suggested that a seemingly "private" activity should be considered as a state action if: (i) it is public in nature (according to present understanding of the responsibilities of the state); and (ii) the state refrains from operating an equivalent service (and thereby renders citizens to be dependent on the public services supplied by the private entities). This two-prong test is capable of securing constitutional standards in services the state chooses to contract out, without infringing upon the liberties of voluntary organizations operating community services independent of the state.

THE RISE OF THE LIMITED LIABILITY COMPANY: EVIDENCE OF A RACE BETWEEN THE STATES, BUT HEADING WHERE?

Carol R. Goforth[†]

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INTRODUCTION

It is widely acknowledged that states compete for corporate charters.¹ Any state which induces a significant number of businesses

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1. Professor William Cary is credited with initiating much of the current debate over the competition for corporate charters. See William Cary, *Corporate Law and Federalism: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974). Cary argued that modern corporate law trends reflect a "movement toward the least common denominator." *Id.* at 663. According to Cary, Delaware, motivated by a desire to increase state revenues, adopts rules which appeal to the self-interests of corporate directors who generally make the decision of where to incorporate. *Id.* at 668. Other states, aware of the potential loss of future revenues if they fail to respond, are pressured to adopt similarly biased legislation. See *infra* Section III.

Even those who disagree with this vision of corporate law, however, generally concede that there is a real competition among the states. See, e.g., Herzel & Richman, *Delaware's Preeminence by Design*, in R. BALOTTI & J. FINKELSTEIN, *THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS* ix (Supp. 1989); Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709 (1981); Peter Dodd & Richard Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" versus Federal Regulation*, 53 J. BUS. 259 (1980).

Privatization '95

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*The best way to deal with monopoly
is to expose it to competition.*

—Vice President Al Gore's National Performance Review

American government is undergoing a dramatic transformation as bureaucratic monopolies give way to dynamic, competitive systems. The private sector is proving it can help government deliver more for less.

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Soon after George Allen took office as Governor of Virginia, he signed Executive Order Number One, establishing the Governor's Commission on Government Reform. On November 14, 1994, Blue Ribbon Strike Force Chairman Otis Brown released the Commission's final report to the governor. The report "suggested major changes limiting the role of government in the lives of our citizens."

Among the commission's proposals was to establish a Competitive Council to "develop an institutional framework for a statewide competitive program" for state government. This Competitive Council would, where appropriate, move services into the private sector. Membership is to be drawn from the legislature, the private sector, and gubernatorial appointments. Among the 12 functions explicitly recommended for evaluation were the Virginia Lottery, prison construction, central garage and fleet maintenance, and child-support collection.

Municipal Privatization Trends

The historic movement of reform-minded big-city mayors to downsize and privatize inefficient, bureaucracies continued to pick up steam in 1994. Drawing on the successes of 1990s, privatization leaders in Indianapolis, Phoenix, Philadelphia, Chicago, New York City, San Diego, Charlotte, and Cleveland launched or continued comprehensive privatization programs in 1994. The use of contracting continued in smaller cities as evidence of the benefits of contracting accumulate.

New York City

For decades, New York City has been synonymous with inefficient municipal government, bureaucratic bloat, and soaring taxes. Under Mayor Rudolf Giuliani, New York City appears poised to become one of the country's leaders in moving services and assets from the public to private sector.

"We're trying to bring the city government into the 21st century—kicking and screaming, I must say," General Services Commissioner William Diamond told the *New York Times*. Within a few years, the city intends to be competitively contracting out more work (in dollar terms) than the next ten largest cities combined and have plans to privatize a number of major assets, according to city officials.

The city-owned United Nation's Plaza Hotel is expected to be sold by Fall 1995. Other future asset sale possibilities include: the city's television and radio licenses, \$50 million of city-owned real estate, thirteen parking garages, three sewage treatment plants, Kennedy and La Guardia airports, and the Off-Track Betting Corporation.

In December of 1994, the city launched competition pilot projects in a number of service areas such as park upkeep, building maintenance, fleet maintenance, street repaving, traffic-sign making, running homeless shelters and custodial services. Assuming the pilot projects are successful, these services will be opened up to competition city-wide in late 1995 or early 1996. "We're eliminating monopolistic service delivery," says Richard Schwartz, who directs the city's competitive contracting pro-

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Table 1.3: Estimated Annual Savings from Competition to New York City

Service	Annual Savings (\$ Millions)
Solid Waste: Collection and Disposal or Recycling	\$80-\$134
Street Sweeping	15
Wastewater Treatment and Sludge Disposal	25
Private Bus Operations	25
Parking Meter Maintenance and Collection	5
Traffic-Sign Installation and Maintenance	60
Public-Building Maintenance and Repair	\$125-\$160
Heating Plant Operation and Maintenance	\$30-\$75

Source: "The Privatization Advisory Report for the Mayor-elect Rudolph Giuliani," December 1993.

gram. "No one has a lock on the right to deliver better services to the public."

The pilot program for park maintenance in southwestern Queens was already producing results by early 1995. The private contractor's bid was 23 percent less than the city's in-house costs. "We're trying to learn from empirical experience whether the private sector can do this well," says Schwartz. The city plans to bid out all 59 park districts by the end of 1995.

The city is also exploring contracting out the operation of its nine wastewater treatment plants in its upstate watershed and at least two of its eleven hospitals. "This year will see a rapid acceleration of privatization and other downsizing initiatives at H.H.C. (Health and Hospital Corporation)," said Mayor Giuliani in the introduction to his FY 1996 financial plan.

Schwartz believes that competitive bidding will eventually result not only in massive cost savings but also in a better city work force: "In the long term we will have a more energized work force because they will feel the pressure, challenge and exhilaration of winning bids."

Philadelphia

Philadelphia continued its aggressive contracting-out program in 1994 as 11 services were opened up to competition, including workers' compensation, park maintenance and parking garage operation. All told, under Mayor Ed Rendell almost 30 services have been shifted from monopoly to competition.

The threat of privatization has also spurred in-house units to dramatically reduce costs. "The knowledge that your department can be bid out is an enormous motivating factor," says Mayor Rendell. "Ironically, privatization is the most effective way we know to restore productivity and the taxpayer's faith in government."

In late 1993, Philadelphia's sludge-processing plant was put on the list to be considered for contracting. Faced with the prospect of losing their jobs, within a little over one month the plant's managers—working with the union—came back to the mayor with a radical cost-cutting plan. The city agreed to go with the slimmed down in-house unit after it reduced the number of workers by 79 employees (from 214 to 135) and cut costs by one-third, saving \$8 million dollars annually.

Indianapolis

Under Mayor Stephen Goldsmith, Indianapolis is a trendsetter in the area of competitive government. With the majority of the city's services already opened up to competition over the previous three years, only a few services were privatized in 1994. The city's Abandoned Vehicles Operation was privatized, tripling the number of abandoned vehicles removed from Indianapolis neighborhoods and saving approximately \$1.4 million. "This is a perfect example of how private management can help us deliver better service for less money," says Mayor Stephen Goldsmith.

The White River Environmental Partnership assumed operation of the Indianapolis wastewater facilities in January 31, 1994 to start a five-year contract. In the first year of operation, the facility has reduced cost from \$30.1 million to \$17.6 million, reduced the labor force from 322 to 196 (with no layoffs), and reduced effluent violations from seven during the final year of city operation to just one. Despite the reduction in work force, employees seemed happy with the new management, as grievances dropped from 38 to 1 between 1993 and 1994.

Goldsmith's largest pending privatization project is the Indianapolis International Airport Competitiveness Initiative. In December 1994, the Indianapolis Airport Authority received proposals to operate the airport from four private firms and one from the current airport management. Facing the prospect of privatization has already induced airport employees to come up with \$1.7 million in cost-saving ideas. The Airport Authority is expected to award a bid by mid-1995. "Regardless of the ultimate decision, we are confident that the managed competition process will have met the goal to provide the highest quality and efficiently operated airport in the world," says Mike Wells, the president of the Airport Authority.

Charlotte

Charlotte has a reputation for being one of the better-run big cities in America. Property taxes are near the lowest of any urban areas in the state, and *Financial World* magazine ranked it number one in the country in economic development. But Mayor Richard Vinroot and a majority of the city council aren't resting on their laurels. The city is stressing continuous improvement and cost-cutting in city operations by introducing competition.

Approximately 17 percent of city services will be opened up to competition over the next four years. Cemetery operation, vacant lot and building maintenance, physical fitness programs for police officers and landscaping were put out to bid in 1994; trash collection for one-third of the city went out to bid in early 1995.

To prepare in-house units for the competitive process, the city is conducting "Competition 101" workshops. City employees are taught everything from how to find out their true costs to how to increase productivity. "We break them up into groups and tell them to pick a business the city is in," says David Cooke, who heads the city's competition program. "We then say pretend you're starting your own private firm to compete with the city in this business. What would you do differently than the city is doing today?"

Charlotte is also systematically examining its assets for privatization opportunities. An asset valuation of the city's old convention center revealed that it is virtually useless in its current form but could yield \$10 million if the city sold it to a private developer. A recommendation to sell the asset is expected to go before the city council sometime in 1995. Other asset sales being studied include the Charlotte airport, surplus properties and the Charlotte Coliseum. Selling the coliseum heated up when Charlotte Hornets' owner made an unsolicited bid of \$65 million for the stadium in January 1995.

Cleveland

Mayor Michael White's drive to expose city hall to private-sector competition was temporarily derailed in 1994 when the city council voted down his pilot plan to force city crews to compete with private vendors for asphalt paving. After the mayor unveiled his plans for competitive government called, "Cleveland Competes," discussions between Mayor White on one side and city council and the unions on the other became heated. "He [the mayor] is bent on a mission of destruction," council president Jay Westbrook told the *Cleveland Plain Dealer*. The council overwhelmingly rejected White's initial proposal.

Not to be deterred, the mayor continued discussions with council members in an effort to seek common ground, going so far as to send council members to Philadelphia and other cities during 1994 to learn more about competitive service delivery. In early 1995, the mayor came back with plans to seek competitive bids for operating the city's convention center, golf courses, parking lots, street resurfacing and downtown waste collection (receptacles only) and dead animal pickup. The city has lost almost \$28 million on the convention center since 1990 and \$2.4 million on the golf courses since 1989. Still, it is unclear if "Cleveland Competes" will gain the political support needed.

The local public-employee unions have vowed to fight privatization. "I don't believe nobody can do it better than we can," Paul Wells, president of Local Laborers 1099 told the *Cleveland Plain Dealer*. "Nobody."

Los Angeles

It appears that the administration of Mayor Richard Riordan is unlikely to aggressively pursue any widespread initiatives to bring competition to city services in Los Angeles. Though he has backed the concept of privatization in the past, Mayor Riordan has not made it a priority of his administration.

In November 1994, the Reason Foundation published a report, "Competitive Government for a Competitive Los Angeles," detailing how the City of Los Angeles could save nearly \$120 million annually by competitively contracting in just seven city services. For example, the report found that privatization of trash collection, the third largest item in Los Angeles' general fund, could yield an estimated 27-percent savings, or \$42 million annually (see Table 1.4).

The report also found that Los Angeles has some of the most costly Emergency Medical Services (EMS) in the nation. To achieve savings of up to 67 percent, the report recommended the city develop a public-private partnership with the fire department and private ambulance services, move from a mixed Advanced and Basic Life Support (ALS/BLS) fleet to an all-paramedic-ambulance

Table 1.4: Estimated Annual Cost Savings Through Injecting Competition into Los Angeles Government

Service	Savings (\$ Millions)	% Savings
Building Maintenance/ Custodial Services	\$2.2	28%
Emergency Medical Services	30.7	67%
Golf Courses	3.5	N/A
Parking Enforcement	19.0	N/A
Trash Collection	42.0	27%
Workers' Compensation	22.4	24%
Zoo	N/A	N/A
TOTAL	\$119.8	N/A

Source: Reason Foundation

fleet, and develop stringent contractual provisions in order to guarantee lower costs and quality service.

In addition, the report examined privatization possibilities for worker's compensation, parking enforcement, the city zoo, golf courses, building maintenance and custodial services, as well as Los Angeles International Airport, the Department of Water and Power, and the Convention Center.

To date, the city has adopted the report's recommendations to privatize workers' compensation, and it appears likely that the proposal to turn the zoo over to a nonprofit operator may be implemented in 1995 or 1996. The other recommendations have so far faced stiff political opposition in the Los Angeles City Council and have not been pursued by the mayor's office.

Crestwood, Illinois

Big governments could learn a lot from little Crestwood, Illinois. A bedroom suburb of Chicago, Crestwood has a population of 12,000, yet has only 17 full-time employees. A nearby town with about the same population has around 150 workers. Despite the small city staff size, Crestwood's services are extensive and generally regarded as high quality.

In 1993, Crestwood gave residents a 26-percent refund on their county property taxes. The city hopes to eliminate all local property taxes. "By 1997, we plan to give back 100 percent refunds on property taxes," says Mayor Chester Stranczek, the driving force behind Crestwood's contracting program. "All the resident has to do is bring in their property tax bill receipt and we will hand them a check."

Crestwood's secret? The city contracts out virtually everything, from street maintenance to bookkeeping to sewer repair. The city has no full-time firefighters.

Why haven't more cities followed Crestwood's example? "It's all a question of politics," says the mayor. "You're talking about a lot of patronage jobs. Neighboring mayors have told me, if they implemented these reforms they would never get re-elected."

Fort Worth, Texas

The release of "The City of Fort Worth's Privatization Report" showed how Fort Worth had used competitive contracting over the past several years to save hundreds of thousands of dollars. In 1990-1994, the city privatized the mowing of parks, medians, and the grounds around city facilities, saving \$362,801.

CONTRACTING PROVISIONS OF CURRENT COLLECTIVE BARGAINING AGREEMENTS

UNIT:	GENERAL GOVERNMENT	SUPERVISORS	LABOR, TRADES, AND CRAFTS	PUBLIC SAFETY	AVTECH	CORRESPONDENCE STUDIES
	Feasibility study or operational analyses required before contracting unit work.	Formal feasibility study must address potential cost savings and other benefits.	Must conduct a cost efficiency study before contracting unit work that will result in layoff of unit member.	If decision to contract has potential of displacing members, must conduct feasibility study or review of operational analyses.	Formal feasibility study required before contracting unit work.	If decision to contract has potential of displacing members, must conduct formal feasibility study.
	Feasibility study or operational analyses must cover potential costs and benefits.	Formal feasibility study must include all costs, including wages, benefits, administrative costs, agency overhead, program supervision, and audits.	Cost efficiency study must show work can be performed with less cost before layoff can occur.	Feasibility study or review of operational analyses must address potential costs and benefits.	Formal feasibility study must address potential cost savings and other benefits.	Formal feasibility study must address potential cost savings and other benefits.
	Must notify union within two weeks of decision to initiate study or review operational analyses.	Formal feasibility study must also determine the cost of performing the work with members.	Contractor required to pay contractual hourly rates plus at least \$2.55 per hour in lieu of benefits.	Decision to contract unit work cannot precede feasibility study or review of operational analyses.	Decision to contract unit work cannot precede formal feasibility study.	Decision to contract unit work cannot precede formal feasibility study.

UNIT:	GENERAL GOVERNMENT	SUPERVISORS	LABOR, TRADES, AND CRAFTS	PUBLIC SAFETY	AVTECH	CORRESPONDENCE STUDIES
	<p>Notice must include job classifications and work areas affected.</p>	<p>Must notify union within one week of decision to conduct a formal feasibility study, including job classifications and work areas affected.</p>	<p>Contractor must furnish certification of wages and/or certified cost of benefits upon written request.</p>	<p>Must notify union within 2 weeks of decision to initiate study or review operational analyses.</p>	<p>If contracting would displace members, must notify union of decision to conduct formal feasibility study, indicating work to be contracted.</p>	<p>Must notify union of decision to conduct formal feasibility study.</p>
	<p>Must notify union of results of feasibility study or review of operational analyses with all pertinent statistical and analytical information to be considered in contacting decision, including total cost savings.</p>	<p>Must notify union at least 30 days in advance of intent to issue bids where result would be displacement of member.</p>		<p>Notice must include job classifications and work areas affected.</p>	<p>Must notify union of results of feasibility study with all pertinent information considered in contacting decision.</p>	<p>After formal feasibility study must notify union at least 30 days in advance of intent to issue bids.</p>

UNIT: GENERAL GOVERNMENT	SUPERVISORS	LABOR, TRADES, AND CRAFTS	PUBLIC SAFETY	AVTECH	CORRESPONDENCE STUDIES
Must notify union of final decision regarding contracting.	Notice must include all pertinent information upon which the decision to contract is based, including total cost savings anticipated.		Must notify union of results of feasibility study or review of operational analyses with all pertinent statistical and analytical information to be considered in contacting decision, including total cost savings.	After formal feasibility study must notify union at least 15 working days in advance of intent to issue bids.	During 30 day period, state cannot release any bids.
If decision is to contract and will directly displace employees, must provide union with 30 days notice of intent.	During 30 day period, state cannot release any bids.		Must notify union of final decision regarding contracting.	During 15 working day period, state cannot release any bids.	During 30 day period, union will have opportunity to submit an alternate plan.
Union may submit an alternate plan, if submitted within 15 days, plan must receive fair consideration.	During 30 day period, union will have opportunity to submit an alternate plan.		After formal feasibility study must notify union at least 30 days in advance of intent to issue bids if contract will result in layoff of members.	Union will have opportunity to submit an alternate plan.	State must give fair consideration to alternate plan.

UNIT:	GENERAL GOVERNMENT	SUPERVISORS	LABOR, TRADES, AND CRAFTS	PUBLIC SAFETY	AVTECH	CORRESPONDENCE STUDIES
	Placement of affected employees to be discussed during 30 day period.	State must give fair consideration to alternate plan.		Union may submit an alternate plan, if submitted within 15 days, plan must receive fair consideration.	State must give fair consideration to alternate plan.	No bargaining unit work may be contracted which results in layoff unless supported by the formal feasibility study.
	No employee can be laid off and work contracted unless feasibility study or review of operational analyses shows contracting costs less.	No bargaining unit work may be contracted which results in layoff unless the contracting action will cost less.		Placement of affected employees to be discussed during 30 day period.	No bargaining unit work may be contracted which results in layoff unless supported by the formal feasibility study.	
	Must make good faith effort to place employees elsewhere in state government.	Must make every effort to place employees elsewhere in state government.		No employee can be laid off and work contracted unless feasibility study or review of operational analyses shows contracting costs less.	Must make a good faith effort to find a laid off teacher a vacant teaching position in AVTECH or elsewhere in department of education.	
		Where members have been displaced, union may request cost effectiveness audits at state expense.		Must make good faith effort to place employees elsewhere in state government.		

FISCAL NOTE

STATE OF ALASKA
1997 LEGISLATIVE SESSION

NO. _____
BILL No. 1
PUBLISHER: Bill Verson: CS5B 68(FIN)
(S) Publish Date: 3-26-97

Revision Date: _____
Title: "An Act relating to the Task Force on Privatization; and providing for an effective date."
Sponsor: Senator Ward
Requestor: Senate Finance Committee

Department Affected: Legislative Affairs Agency
BRU: All
Component: All

COMPONENT SERIAL NO:

Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	13.1	10.0	0	0	0	0
CONTRACTUAL	4.8	2.4	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	17.9	12.4	0	0	0	0

CAPITAL	0	0	0	0	0	0
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REVENUE FUND SOURCE	0	0	0	0	0	0
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FUNDING: (Thousands of Dollars)

GENERAL FUND	17.9	12.4	0	0	0	0
FEDERAL FUNDS						
OTHER FUND SOURCE						
TOTAL	17.9	12.4	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

Estimate of current year impact: _____

ANALYSIS: (Attach a separate page if necessary)

CS SB68(FIN) establishes a 13 member Task Force on Privatization consisting of 3 members appointed by the Governor, 2 of whom are public members, 4 public members appointed by the presiding officers of the Alaska State Legislature and 6 Legislators. This task force will review and report to the Legislature and the Governor regarding the feasibility of privatization of some government functions.

Prepared By: Karla Schofield, Deputy Director *Karla Schofield* Phone: 465-3852
Division: Administrative Services Date: 3/23/97

Approved By: Pamela A. Varni, Executive Director *Pamela A. Varni*
Agency: Legislative Affairs Agency Date: 3/23/97

Distribution (by preparer): Leg. Finance, Legislative Sponsor, Requestor, OMB, Gov. , & Impacted Agency(ies).

Travel

Travel costs for one Governor's appointee will be paid for by the Office of the Governor. FY 97 travel costs for the two public members appointed by the Governor, Legislators and public members appointed by the presiding officers will be absorbed within existing Legislative budgets. This Fiscal note contains FY98 and FY99 travel amounts for the public members.

If the task force begins work in FY97 it is expected to travel once in FY97, 4 times in FY98, and 3 times in FY99 to hold meetings. Any other meetings of the task force will be conducted by teleconference.

For the purposes of this fiscal note, 2 public members are assumed to be from Fairbanks, 3 from Anchorage, and 1 from Ketchikan. 2 days of per diem are calculated for each meeting.

	Per Diem	Travel	
<u>FY 98</u>			
2 Anchorage Meetings			
3 Anchorage members	0	0	
2 Fairbanks members	1,736	1,328	
1 Ketchikan member	868	1,240	
1 Fairbanks Meeting			
3 Anchorage members	1,026	996	
2 Fairbanks members	0	0	
1 Ketchikan member	342	690	
1 Juneau Meeting			
3 Anchorage members	1,026	1,398	
2 Fairbanks members	684	1,148	
1 Ketchikan member	342	268	
Total FY98 Travel	6,024	7,068	13,092

<u>FY99</u>			
2 Anchorage Meetings			
3 Anchorage members	0	0	
2 Fairbanks members	1,736	1,328	
1 Ketchikan member	868	1,240	
1 Juneau Meeting			
3 Anchorage members	1,026	1,398	
2 Fairbanks members	684	1,148	
1 Ketchikan member	342	268	
Total FY99 Travel	4,656	5,382	10,038

Contractual

	Phones \$100/month	Postage \$50/month	Advertisizing 750/meeting	TOTAL
FY98	1,200	600	3,000	4,800
FY99	700	350	1,500	2,550

Teleconference charges and expenses for printing the report will be absorbed by the Agency.

FISCAL NOTE No. 2

STATE OF ALASKA
1997 LEGISLATIVE SESSION

Bill Verson: CSSB 68 (FIN)

(S) Publish Date: 3-26-97

Revision Date: 2/24/97
Title: An Act relating to the Task Force on Privatization.

Dept. Affected: See analysis below

BRU: _____

Component: _____

Sponsor: Senator Ward
Requester: Senate State Affairs Committee

COMPONENT SERIAL NO. _____

Expenditures/Revenues

(Thousands of Dollars)

OPERATING EXPENDITURES	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	*****	*****	*****	*****	*****	*****

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()						
------------------------	--	--	--	--	--	--

FUND SOURCE

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other						
TOTAL	*****	*****	*****	*****	*****	*****

Estimate of any current year (FY97) cost: \$ *****

POSITIONS

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

This bill would establish a Task Force on Privatization, which would, among other tasks, "identify functions of our state government that could economically and appropriately be privatized, if any."

Most of the state's labor agreements include provisions which require the state to conduct feasibility studies determining potential costs and benefits before any decisions are made on contracting out work currently performed by state employees. Therefore, before any decisions are made on implementation of the Task Force's recommendations to privatize state functions covered by these labor agreements, the feasibility studies required by the labor agreements would need to be conducted.

Prior feasibility studies of this type have cost from approximately \$20,000 to \$50,000 per study. However, because the need for feasibility studies will depend on the recommendations of the Task Force, these costs, and the departments affected, cannot be estimated now. This is why asterisks are shown on this fiscal note.

In addition to feasibility studies, the labor agreements require other procedures to be followed before work can be contracted out.

Prepared by: Annalee McConnell, Director Phone: 465-4560
Division: Office of Management and Budget Date: 2/24/97

Approved by Commissioner: Jim Ayers, Chief of Staff Date: 2/24/97
Agency: Office of the Governor

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FISCAL NOTE

No. 3

Bill Verson: CSSB 68 (FIN)

(S) Publish Date: 3-26-97

STATE OF ALASKA
1997 LEGISLATIVE SESSION

Revision Date: _____ Dept. Affected: Office of the Governor
 Title: "An Act relating to the Task Force on BRU: Executive Operations
 Privatization; ..." Component: Executive Office
 Sponsor: Senators Ward, Wilken
 Requester: Senate Finance Committee COMPONENT SERIAL NO. 6

Expenditures/Revenues

(Thousands of Dollars)

OPERATING EXPENDITURES	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
PERSONAL SERVICES						
TRAVEL	*****	*****				
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	*****	*****	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()						
------------------------	--	--	--	--	--	--

FUND SOURCE

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	*****	*****				
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other						
TOTAL	*****	*****	0.0	0.0	0.0	0.0

Estimate of any current year (FY97) cost: \$ 0.0

POSITIONS

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

The composition of the task force envisioned by the bill involves both executive and legislative membership. This involves constitutional issues, for which the Administration may urge changes in this bill. However, as written the bill states that two of the three members appointed by the Governor will be public members. It is assumed that travel expenses will be incurred by members to attend meetings. Traditionally such costs are budgeted by the agency or branch housing the task force. This fiscal note assumes that the travel costs for all public members are included in the Legislative Affairs fiscal note.

Due to the nature of the subject in this bill, it is likely that the Administration's third appointee would be a state official in the Executive Branch. Historically, agencies involved pay the costs of Executive Branch state official participation. Should this be the case, fiscal impact in travel funding for FY98 would be 2.0, and .6 in FY99.

Prepared by: Michael Nizich, Administrative Director
 Division: Administrative Services
 Approved by Commissioner: Jim Ayers, Chief of Staff
 Agency: Office of the Governor

Phone: 465-3876
 Date: 3/24/97
 Date: _____

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Fiscal note assumes one of the Governor's appointees will be from the Executive Branch and a resident of Juneau. After discussion with Legislative Affairs, the note further assumes travel costs for this appointee to attend task force meetings as follows:

FY98**2.0**

4 meetings total:

2 Anchorage:

airfare -	\$444 x 2 trips =	\$ 888
per diem, lodging, grd. trans.	\$194 x 2 =	\$ 388

1 Fairbanks:

airfare -	\$574 x 1 trip =	\$ 574
per diem, lodging, grd. trans.	=	\$ 194

1 Juneau: no cost

FY99**0.6**

1 Anchorage:

airfare -	\$444 x 1 trip =	\$ 444
per diem, lodging, grd. trans.	=	\$ 194

1 Juneau: no cost