

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

2723 SCOMM 122: COMMISSION ON PRIVATIZATION. . . , 1999

Table 14

Checklist of Privatized Programs and Services

Listed in order of number of responding states privatizing the program or service

Program/Service	PRIVATIZED		BEING CONSIDERED FOR PRIVATIZATION	
	Number of States	States	Number of States	States
Banking services	9	LA, MI, MN, MO, NH, RI, TN, WI, WY	-	
Bond counsel	8	LA, ME, MI, MO, NC, NH, RI, WY	-	
Bond underwriters	6	LA, MI, MO, NH, RI, WY	-	
Computer maintenance	6	FL, ME, MI, MN, NC, WY	-	
Professional development training	4	MI, NC, RI, TN	-	
Unclaimed property	4	MI, MO, RI, WI	-	
Bond financing	3	NH, RI, WY	-	
Cash management services	3	NH, RI, WY	-	
Legal services	3	FL, MI, RI	-	
Collection of receivables	2	ME, MI	-	
Delinquent tax collection	2	ME, MI	-	
Expert witnesses	1	MI	-	
Retirement system administration	1	MI	1	RI
Tax receipt processing	1	MI	-	
Title searches	1	MI	-	
Additional programs and services*	9	-	-	
TOTALS:	63		1	

* Respondents were asked to list programs and services that are privatized by their agencies but that were not specified on the checklist.

Source: CSG survey on privatization in state government, 1997.



Alaska's Asset Portfolio

**Managing for
Maximum Return**

A Commonwealth North Study

December, 1998

Scott Goldsmith

Nancy Bear Usen

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1998 -1999

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About Commonwealth North

The mission of Commonwealth North is to educate its members and all Alaskans on relevant public policy issues and to assist in their resolution. The organization addresses state and national long-term issues and involves leaders from Alaska business, labor, education, public service, and Native community. The goals of Commonwealth North include: strengthening the private sector of Alaska's economy, understanding Alaska's role in the larger world, educating members on major issues affecting our state and nation, and influencing state and national public policy decisions.

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Executive Summary

Introduction

Alaska's financial health depends on the state's achieving a sustainable level of revenue sufficient to meet the needs of the state and its people. The Alaska Statehood Compact anticipated the use of publicly held assets for this purpose. Alaska received 104 million acres from the federal government at the time of statehood in 1959. The purposes for the endowment are set forth in Alaska's Constitution. It mandates that the state's land and resources be used, developed, and conserved for maximum benefit of its people.

If managed effectively, these assets have the potential of producing reliable and stable revenues for the state and providing continued economic benefit to the people of Alaska. This is critical to Alaska's future because no income or other individual tax will ever be sufficient to pay for necessary state services and infrastructure.

Commonwealth North wondered if the state could improve its return on these assets. Accordingly, it established a study group with 32 of its members to "identify and recommend unifying policies and principles to guide management of Alaska's public assets to maximize their return and assure their benefit to the people of Alaska."

The study group specifically looked at land and resource assets as well as the business and financial assets the state has created with its oil wealth over the past 20 years. These are the assets that are available for development and that can generate earnings. The study group did not look at conventional public assets such as public schools, office buildings, and transportation infrastructure.

Assumptions

The study's recommendations are predicated on a set of assumptions that reflect underlying

principles for successful management and the operating realities of public sector management. These basic assumptions are:

1. The assets which are derived from Alaska's land-grant should be managed consistent with the Constitutional mandate to maximize their use and benefit to the people of Alaska.
2. The Constitutional prohibition against dedicated funds is recognized as a policy principle which provides that the public interest is served when all state revenues, regardless of source, are available for appropriation by the Legislature to meet Alaska's total needs.
3. There are two types of returns derived from an asset's management: financial and beneficial, and each must directly or indirectly benefit all the people by serving a public purpose.
4. Asset management is most effective within a structure which provides flexibility for maximizing returns while assuring accountability to the state and its people.
5. Performance measures for determining efficiency, results and returns are essential for public accountability.
6. Private enterprise should be the first option for obtaining expertise, goods and services to develop public assets. To the extent that public sector programs compete with the private sector, their activities should be priced in a manner which minimizes adverse effects on private sector competition.
7. Maximizing returns for all assets will enhance revenue to the state as well as provide greater diversity and stability of state revenues.

Recommendations

The result of extensive research, interviews, and discussions is a set of five sequential recommendations for enhancing state revenue, assuring public accountability, and maximizing the use of state assets to benefit Alaskans.

1. Clarify Roles and Responsibilities

A. Elected leaders should establish policy and managers should be given authority and flexibility to implement those policies.

B. Assets available for development should be managed independently of the organizational authority responsible for promulgating regulations affecting the development of that asset.

C. Activities to develop assets and produce returns, to the fullest extent possible, should be carried out by, or in partnership with, the private sector.

2. Measure and Disclose Performance

A. Management performance and agency operations should be measured based on meeting mission, efficiency and financial objectives.

B. Three types of performance measures should be adopted to evaluate management of each asset:

1. Appropriate efficiency measures to evaluate the cost of operations.

2. Measures that show the organization's results in meeting its statutory mission.

3. Quantifiable measures that state the monetary value of the asset's beneficial and financial returns.

C. Financial and operational performance based on these measures should be reported to the public annually, for each asset under management, using consistent accounting and reporting standards.

3. Manage Assets as a Portfolio

A. The state should strategically manage its assets in a manner that provides for an integrated assessment of risk, potential return, debt, market conditions and cross investment opportunities.

B. Financial and beneficial returns on all assets under state management should be

annually reported to the public on both an aggregated and individual basis using consistent accounting standards.

C. The portfolio of assets should be used strategically to achieve long-term sustainable revenue and return objectives.

4. Pay Returns to the General Fund

A. To the extent that financial returns exceed the need for efficient operations, beneficial returns and appropriate capitalization as determined by the Legislature, they should be deposited into the state Treasury for allocation by the Legislature based on the state's overall priority needs.

B. Every asset management organization should have an expectation to contribute a financial return to the state General Fund based on a formula appropriate to its activities and maturity.

5. Create a System to Achieve These Recommendations

A. Establish an integrated system of portfolio management which oversees, monitors and reports asset management performance on an aggregated basis.

B. Incorporate state owned natural resources available for development into the state asset management portfolio.

Conclusion

It is in every Alaskan's interest to participate in developing a sustainable system for funding government that is adequate to fulfill the state's obligations. Income taxes, or other methods of individual taxation, will never be sufficient to meet Alaska's financial needs and responsibilities. The responsible development, use and management of Alaska's assets are the only means of achieving this goal.

Fortunately, Alaskans already have considerable experience with successful models for state asset management, and must capitalize on those successes. Our purpose in setting forth these recommendations is to stimulate a public dialog on the goals of public asset management and the best means of achieving those goals.

Background and Current Condition

Alaska received 104 million acres from the federal government at the time of statehood in 1959. The purpose for the endowment was to provide an economic base for the development of the state and to provide the revenues necessary to operate the new state.

The policy of the state, reflected in its Constitution, is to use, develop, and conserve this land and its resources consistent with the public interest for the maximum benefit of its people (Sections 8.1 and 8.2):

8.1. It is the policy of the state to encourage the settlement of its land and the development of its resources by making them available for maximum use consistent with the public interest.

8.2 The legislature shall provide for the utilization, development, and conservation of all natural resources belonging to the state, including land and waters, for the maximum benefit of its people.

The economic history of Alaska since statehood has been largely driven by the development of its petroleum resources, first in Cook Inlet and later on the North Slope. The development of the state's petroleum reserves has resulted in a flow of revenues that has paid virtually the entire cost of operating government and building the physical infrastructure to meet the state's needs.

However, recognizing that petroleum is a depleting resource, the state has invested a large portion of the revenue from oil in other, renewable assets with earnings potential. Although the Alaska Permanent Fund is the largest and best known of these, there is an entire portfolio of financial and real assets derived from the transformation of oil. For example, the

Alaska Housing Finance Corporation and the Alaska Industrial Development and Export Authority were both capitalized with oil revenues. Additionally, Alaska continues to hold a wealth of other resource reserves available for revenue generation through responsible development.

Although oil continues to be the dominant natural resource industry in the state, production has been declining since 1988, and revenues from oil are no longer sufficient to provide for all the needs of state government. Oil revenues will continue to be an important source of state revenues for the foreseeable future. However, the state must increasingly generate other revenues to take their place to provide a stable fiscal future.

The Permanent Fund has become the focus of public attention because it is Alaska's largest asset and because it pays a return directly to all Alaskans. But we cannot overlook the other assets in the state's portfolio that can also make a significant contribution to the state's economic welfare.

To maximize the return from these assets, they must be managed strategically and efficiently. The state has considerable experience with successful models for state asset management. However, the question was posed whether there is room for improvement. Accordingly, Commonwealth North formed a study group from its membership to explore the answers to this question and commended it with a charge to meet specific goals.



The Charge and Goals

The Charge

Commonwealth North's board of directors asked the study group to **identify and recommend unifying policies and principles to guide management of Alaska's public assets in order to maximize their return and assure that they benefit the people of Alaska.**

The Goals

The goals of the study are:

- To encourage and contribute to a public debate about the appropriate management principles applicable to Alaska's public assets;
- To produce a statement defining public expectations for management and return on Alaska's assets; and
- To recommend appropriate business management principles that can be used compatibly with government's obligations to protect the public interest.

Approach and Methodology

Thirty two Commonwealth North members participated in this study through a series of meetings, discussions and research assignments over a period of six months. Recognizing that a detailed investigation of all state assets was beyond its capabilities, the study group adopted the following guidelines:

1. The study group will evaluate general principles (not the specifics) of the management of Alaska's public assets.

2. The study group will develop a statement of general policy, principles, priorities and recommendations for the improved management of Alaska's public assets.

3. The study will be successful if it encourages and contributes to the public awareness of, and debate about, the appropriate overall management objectives applicable to Alaska's public assets.

The study group limited its investigation to Alaska's land and resource holdings received at the time of statehood, as well as the business and financial assets created with the state's oil wealth. This represents the portfolio of assets available for development and for the generation of earnings to benefit all Alaskans. Excluded from review were the conventional public assets used in the delivery of standard public services such as public schools, office buildings and transportation infrastructure.

Assets in the following agencies were identified:

State Resource Agencies

- Land, Real Estate
- Fish and Game
- Minerals
- Oil and Gas
- Timber

Business Management Agencies

- Marine Highway System
- International Airport System

Independent Agencies

Created in Statute/Boards Appointed by Governor

- Alaska Permanent Fund Corporation
- Alaska Railroad Corporation
- Alaska Housing Finance Corporation
- Alaska Industrial Development and Export Authority
- Alaska Science and Technology Foundation
- Alaska Aerospace Development Corporation

Independent Support Service Agencies

- Alaska Tourism Marketing Council
- Alaska Seafood Marketing Council
- Alaska Student Loan Corporation
- Alaska Mental Health Trust Authority

Five sub-groups were formed to investigate various categories of assets: financial assets; transportation; land; natural resources; and research, development and support activities.

The study group then adopted the following study plan:

Task 1: Gather information

Each sub-group collected information on as many assets as possible, using a standard format. This included information on the management structure of the agency in control of the asset, its mission and goals, its fiscal structure, reporting requirements, methods of evaluation, decision-making process, and planning and projections. (Report addendum available upon request from Commonwealth North.)

Task 2: Management interviews

Each sub-group engaged in a series of discussions with current and former asset managers. These discussions were used not only to collect information on current management practices but also to investigate what works, what does not work, and what improvements could be made in current practices.

Task 3: Determine findings

Based on information and interviews, each sub-group developed a list of preliminary findings covering management practices of the agencies reviewed. This list was synthesized as a result of a series of discussions among all study group members.

Task 4: Develop recommendations

Based on the findings, the entire study group developed a set of recommendations for management of public assets.

Defining Concepts

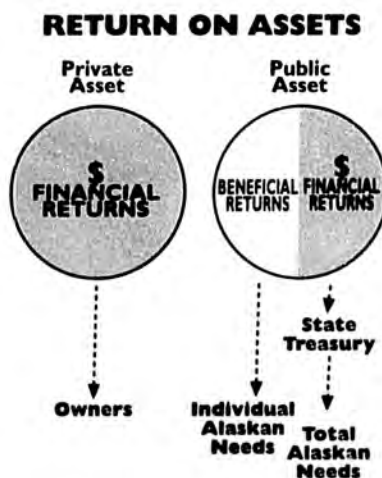
Critical to the review was reaching a common understanding of certain basic terms and concepts.

Returns on public assets

In a review of public assets, the concept of "returns" takes on a broader meaning than merely the financial bottom line. In fact, the use of public assets results in two distinct types of returns: financial and beneficial. They are mutually exclusive, but each directly affects the other. Both are intended to satisfy a public purpose.

Financial returns are paid to the Treasury and then appropriated to meet the state's needs. They directly contribute to the state's solvency. Through the appropriation process, these returns are also used to sustain management operations.

Beneficial returns benefit individuals directly through program subsidies, or indirectly through the multiplier effect of job creation and business activity. Beneficial returns serve a public purpose by providing goods and/or services otherwise unavailable or unaffordable to meet a perceived public need. But beneficial returns are not free. They are achieved by a reduction in the financial return potential.



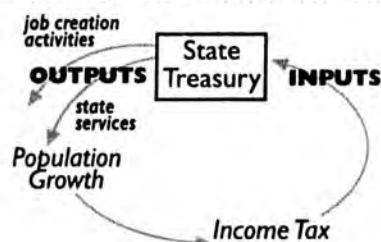
The Alaska Disconnect

The concept of economic development as a public purpose frequently surfaces in evaluating beneficial returns. Clearly, customers, vendors, contractors and others benefit when the state uses its assets for business activity. However, unlike revenue structures in virtually all other states, this business activity does not produce a financial return to the state from personal income tax revenues.

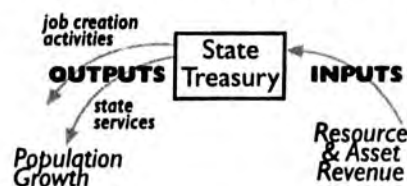
Consequently, the state's expenditures to promote economic development, while laudable, do not produce a direct return on investment. This "Alaska Disconnect" presents a paradox. The more jobs created, the greater the population growth—which results in greater demand for government infrastructure and programs. The demand for government services, including education, creates a need for greater revenue with no off-setting funding source.

This phenomenon points out the dramatic need to evaluate the cost of beneficial returns. Determining their value provides a means for measuring beneficial returns against the potential for financial return which could be used to help fund state services.

TYPICAL STATE REVENUE GENERATION



ALASKA DISCONNECT



Mission Creep

Most asset development agencies have a mission statement embedded in their authorizing statute. Over time, the activities, priorities and operation of these agencies will normally evolve due to changing needs and outdated programs. This can result in inconsistencies between the agency's activities and its stated mission.

Frequently, however, agency priorities will be driven by other factors that divert resources and interfere with an agency's ability to achieve its mission. These factors can include engaging in activities for which there is additional funding available, or responding to political pressure to participate in specified activities. The result can be performance tied to these external factors, rather than to the agency's primary mission. We call this diversion away from mission direct activities "mission creep".

TOTAL MANAGEMENT RESOURCE



Assumptions

To evaluate Alaska's current system of asset management, it is important to begin with a common understanding of management standards and performance expectations. The study group used the following assumptions as the basis for its analysis.

1. The assets derived from Alaska's land grant should be managed consistent with the Constitutional mandate to maximize their use and benefit to the people of Alaska.
2. The Constitutional prohibition against dedicated funds is recognized as a policy principle which provides that the public interest is served when all state revenues, regardless of source, are available for appropriation by the Legislature to meet Alaska's total needs.
3. There are two types of returns derived from an asset's management: financial and beneficial. Each must directly or indirectly benefit all the people by serving a public purpose.
4. Asset management is most effective within a structure that provides flexibility for maximizing returns while assuring accountability to the state and its people.
5. Performance measures for determining efficiency, results and returns are essential for public accountability.
6. Private enterprise should be the first option for obtaining expertise, goods and services to develop public assets. To the extent that public sector programs compete with the private sector, they should be priced in a manner which minimizes adverse effects on private sector competition.
7. Maximizing returns for all assets will enhance revenue to the state, and provide greater diversity and stability of state revenues.

Findings

The study group reviewed Alaska's asset management practices to reach an understanding of the public operating environment and conditions affecting return on assets. The findings listed below describe existing circumstances. Not all findings apply to all agencies or assets. However, each of the findings represents a condition that materially contributes to the state's ability to produce returns and develop its assets.

The findings are statements of fact as perceived by the study group. Most, if not all, of the findings can be interpreted either positively or negatively, depending on the reader's point of view.

Mission and Goals

1. Vague statutory mission statements result in broad and often inconsistent interpretations.
2. Goals are frequently defined by activity rather than by returns.
3. Missions may be adapted because of funding, political prioritization, and short-term expediency, which results in mission creep.
4. The public's interests are not clearly defined or reported.

Performance Standards and Accountability

1. There is no monetary value assigned to or reported on beneficial returns.
2. Performance measures, where they exist, are often tied to activities rather than to mission or returns.
3. There is no standard format for reporting operational costs and benefits returned.

Structure

1. Regulatory and asset management functions within a single agency are often incompatible for achieving optimum results.
2. Operational mandates created in statute and regulation do not allow for the flexibility necessary to efficiently adapt to evolving missions and priorities.
3. Independent agencies have greater flexibility than executive branch departments in operations and funding.
4. Assets are managed independently, with no portfolio integration that would ensure diversification of risk and return, compatibility in objectives, performance standards and measures, and coordination of activities and reporting.

Management

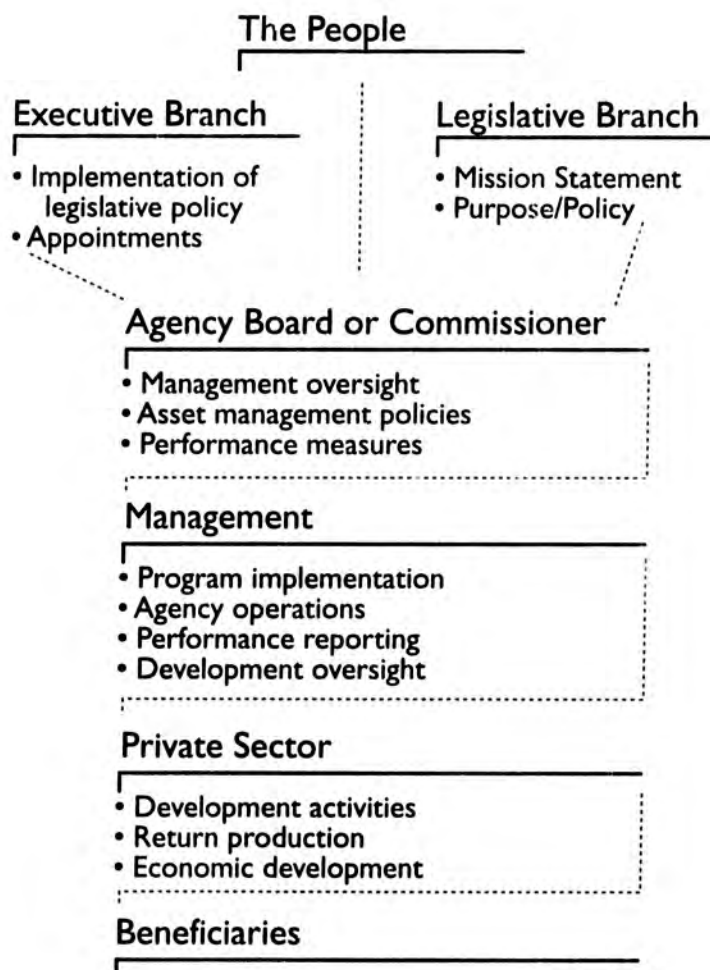
1. The state's annual budget process does not provide effective integrated review of asset management, does not promote a long-term view of returns, and instead focuses on operational activity as opposed to results.
2. The vagaries of the annual appropriation process and the volatility of state general fund revenues influence asset development potential.
3. Availability of, and access to, alternative funding sources influence operational activity.
4. Politicization of management appointments creates personnel turnover, which impairs continuity and returns.
5. There are few management or budgetary incentives for maximizing returns.
6. Long-term plans, and the accumulation of capital to meet long-term needs, may be used for political purposes, which creates a disincentive for strategic asset management.
7. Special interests significantly influence returns and allocation of returns.

Recommendations

After considerable debate, Commonwealth North offers the following recommendations to Alaskans for their consideration. The recommendations are progressive—that is, each builds on the previous ones toward a more effective asset management system.

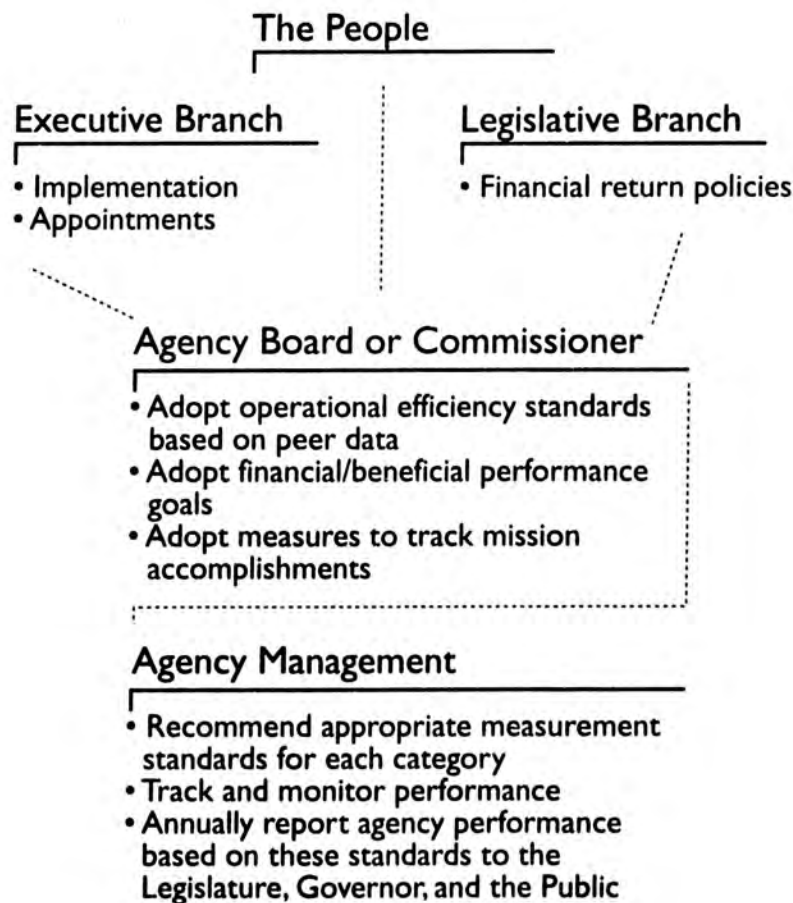
1. Clarify Roles and Responsibilities

- A. Elected leaders should establish policy, and managers should be given authority and flexibility to implement those policies.
- B. Assets available for development should be managed independently of the organizational authority responsible for promulgating regulations affecting the development of that asset.
- C. Activities to develop assets and produce returns, to the fullest extent possible, should be carried out by or in partnership with the private sector.



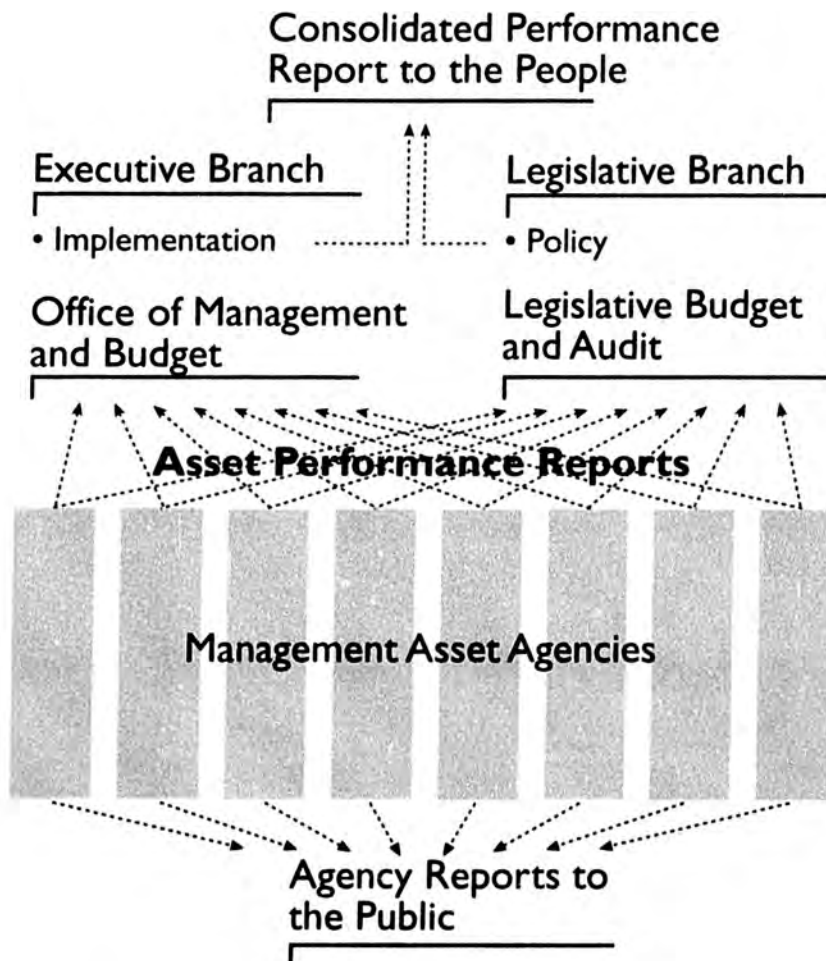
2. Measure and Disclose Performance

- A. Management performance and agency operations should be measured based on meeting mission, efficiency, and financial objectives.
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 - 1. Appropriate efficiency measures to evaluate the cost of operations.
 - 2. Measures that show the organization's results in meeting its statutory mission.
 - 3. Quantifiable measures that state the monetary value of the asset's beneficial and financial returns.
- C. Financial and operational performance based on these measures should be reported to the public annually for each asset under management, using consistent accounting and reporting standards.



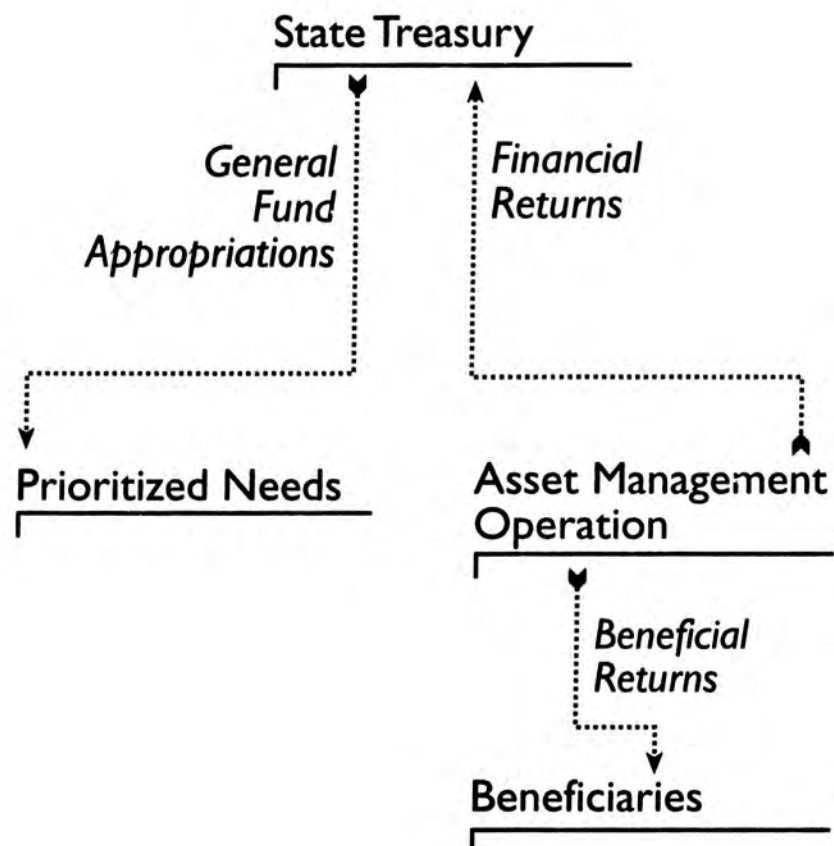
3. Manage Assets as a Portfolio

- A. The State should strategically manage its assets in a manner that provides for an integrated assessment of risk, potential return, debt, market conditions and cross investment opportunities.
- B. Financial and beneficial returns on all assets under state management should be annually reported to the public on both an aggregated and an individual basis using consistent accounting standards.
- C. The portfolio of assets should be used strategically to achieve long-term sustainable revenue and return objectives.



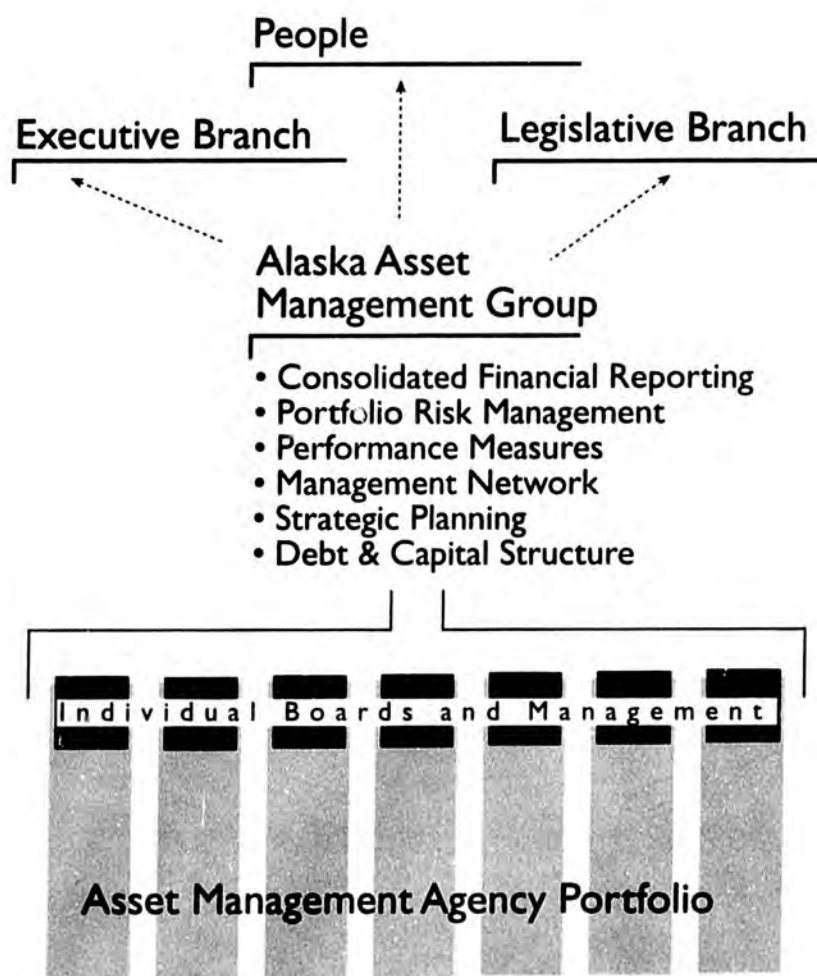
4. Pay Returns to the General Fund

- A. To the extent that financial returns exceed the need for efficient operations, beneficial returns, and appropriate capitalization as determined by the Legislature, they should be deposited into the State Treasury for allocation by the Legislature based on the State's overall priority needs.
- B. Every asset management organization should be expected to contribute a financial return to the State general fund, based on a formula appropriate to its activities and maturity.



5. Create a System to Achieve These Recommendations

- A. Establish an integrated system of portfolio management which oversees, monitors, and reports asset management performance on an aggregated basis.
- B. Incorporate state-owned natural resources available for development into the State asset management portfolio.



Conclusion

It is in every Alaskan's interest to participate in developing a sustainable system for funding government that is adequate to fulfill the state's obligations. Income taxes, or other methods of individual taxation, will never be sufficient to meet Alaska's financial needs and responsibilities. The responsible development, use and management of Alaska's assets are the only means of achieving this goal.

The Alaska Constitution directs that all these state assets be used for both the development of the state and the maximum benefit of the people. This means that Alaska's assets, both those created by the transformation of oil and those received as an endowment at the time of statehood, must increasingly contribute to Alaska's economic welfare. The state can accomplish this goal by generating earnings that provide both financial and beneficial returns. Financial returns paid into the General Fund will help pay the necessary costs of public services for the benefit of all Alaskans. Beneficial returns will help achieve the targeted public purposes identified for each asset.

Fortunately, Alaskans already have considerable experience with successful models for state asset management, and must capitalize on those successes. Our purpose in offering these recommendations is to stimulate a public dialogue on the goals of public asset management and the best means of achieving those goals.

Acknowledgements

The study group thanks all those who helped in the development of this report, and without whom this study would not have been possible.

We particularly appreciate the contributions of former and present state asset managers who generously shared their time and perspective. Thanks also go to the Commonwealth North staff and the Hartig Fellow who aided considerably in the completion of this report.

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Alaska's Asset Portfolio: Managing for Maximum Return

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Privatization

'98

12th Annual Report on Privatization

Reason Public Policy Institute
Reason Public Policy Institute

STATE-LEVEL PRIVATIZATION

Trends

The Council of State Governments released an extensive survey of the use of privatization by state governments. The trends shown in the survey are revealing—more than half of the states have increased privatization over the last five years and plan to expand privatization over the next five years (see Figures 1-4). In most states, privatization is widespread across the services the states provide. Seven states have privatized more than 100 services and another 14 have privatized more than 50 services (see Figure 1-5).

The reasons for privatization are also revealing. Although saving money was still the dominant reason, other considerations—such as flexibility, speed, and innovation—were also very important. This conclusion is reinforced by the results of survey questions about cost savings. Few government agencies really know what it costs them to deliver services in-house, so they have difficulty calculating how much they save when services are provided privately. This might explain why less than half of those surveyed could provide savings estimates. Of those providing an answer, most reported savings of 5 percent or less; only 20 percent reported savings of more than 10 percent.

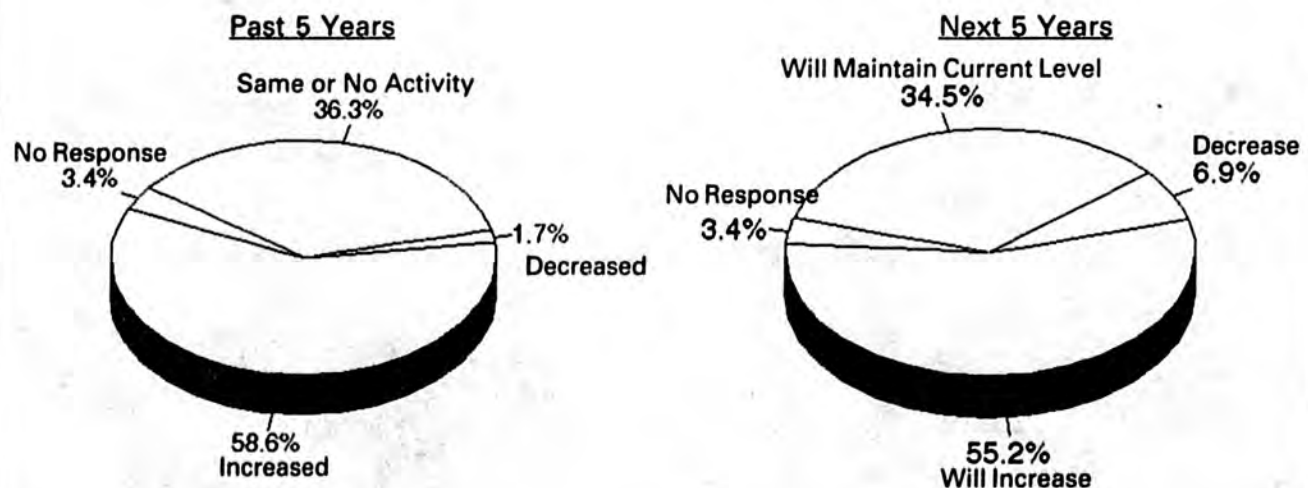
Programs

The states were not hotbeds of privatization activity or innovation in 1997. Few significant initiatives appeared, and even fewer made any noticeable progress. **Connecticut** Gov. John Rowland proposed privatizing several government functions, but his plans are still in the works (see box). **Colorado, Delaware, and Hawaii** each saw privatization reports or proposals, but no significant legislative followup.

In **Georgia**, Gov. Zell Miller's two-year-old Commission on Privatization of Government disbanded after claiming it had helped change the culture of state government and had launched projects that will save taxpayers millions. The responsibility for privatization projects will shift to state agency heads, under supervision of the governor's Office of Planning and Budget. According to commission chairman George Israel, "[This] is not the end of Georgia's privatization effort, only the beginning. State agencies have changed the way they think."

There were two key developments in 1997. In **Illinois**, the State Comptroller joined with Western Illinois State University to create the Center for Competitive Government. The center's mission is to conduct cutting-edge research demonstrating how to manage local government more effectively through privatization. They are already well on their way, having performed a comprehensive survey of the use of

Figure 1-4: State Privatization Trends



Source: CSG survey on privatization in state government, 1997.

Figure 1-5: Number of State Services and Functions Reported as Privatized

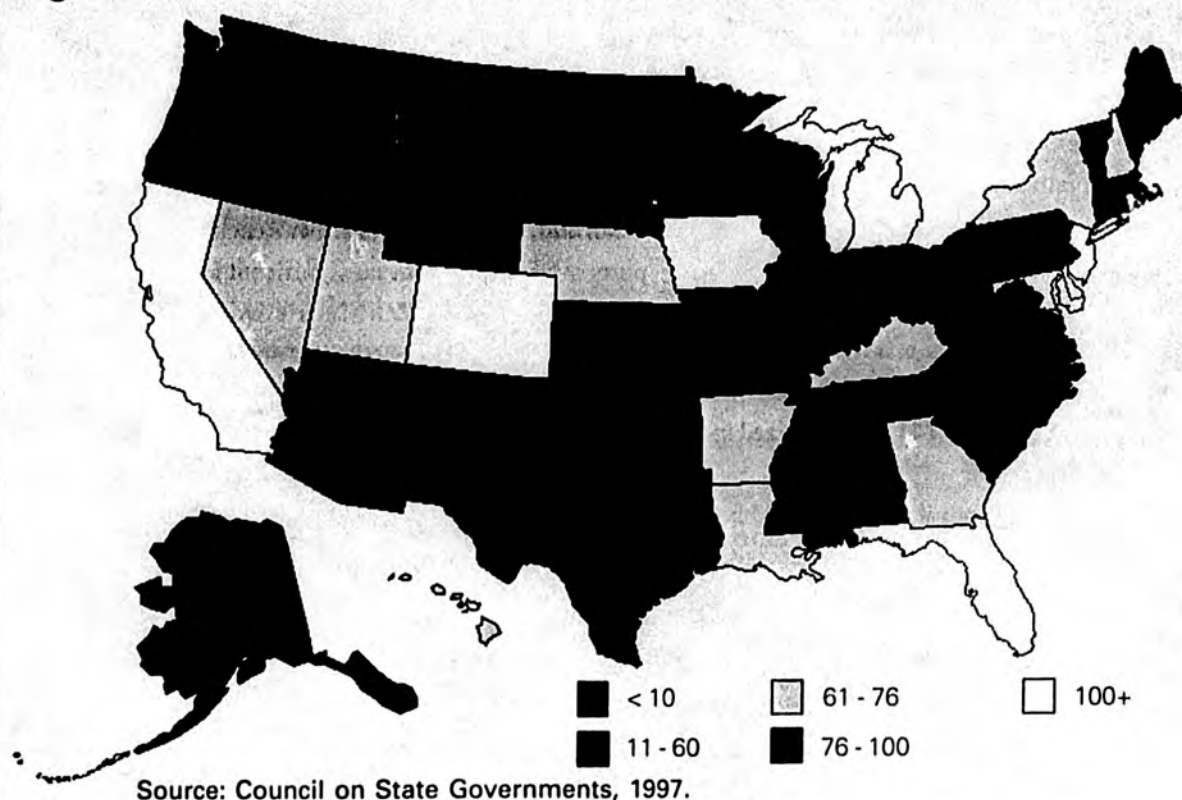
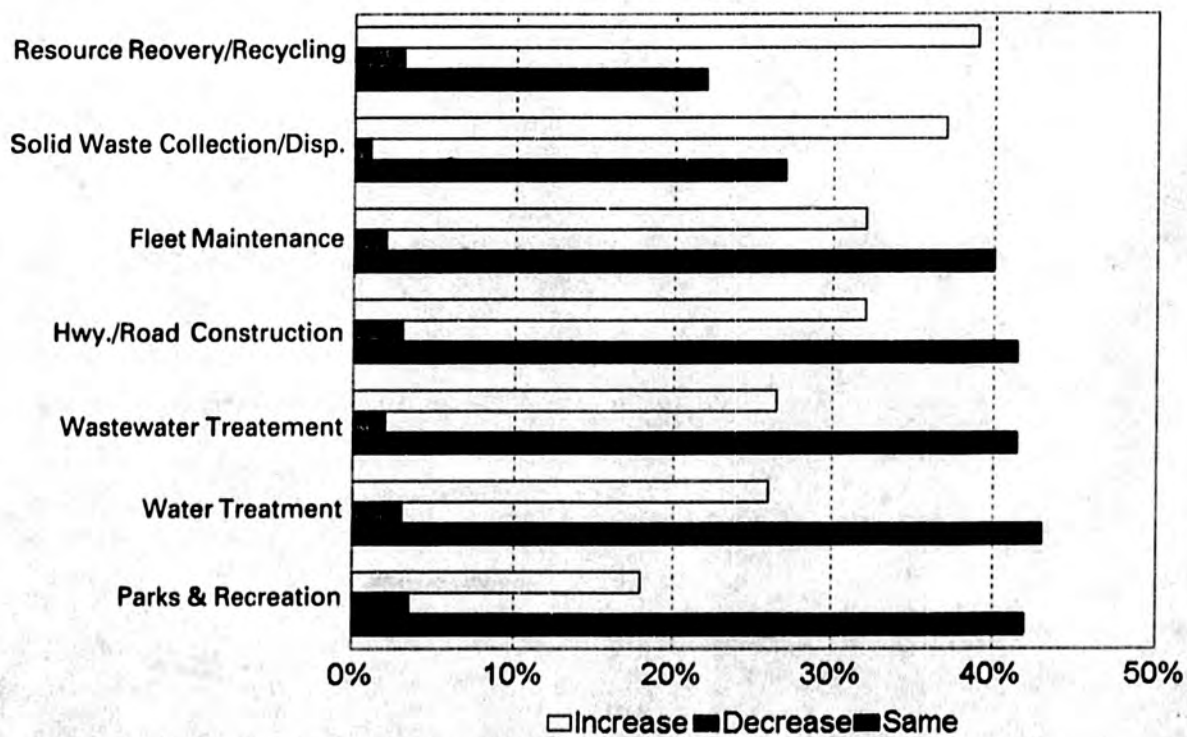


Figure 1-6: Projected Privatization Trends in Municipal Public Works



Connecticut Privatization Proposals

Gov. John Rowland has proposed that the state of Connecticut privatize a number of government functions, including:

- **Data Processing:** One private service would replace the state's fragmented system. Estimated savings: \$50 million per year.
- **Homes for the Mentally Retarded:** Operation of 22 group homes would be turned over to the private sector. Estimated savings: \$1.6 million per year.
- **Health Services:** Competitive bidding of pharmaceutical care and contract health care for low-income and indigent patients. Estimated savings: \$25 million per year.

The governor has also proposed privatization of child-support collection and some functions of the motor-vehicles department, but will face opposition from Democratic legislators and labor unions.

privatization in the state's municipalities, down to the smallest towns. The center used that information to publish *Competition for City Services: Has the Time Arrived?* This study details the trends of privatization in small communities, and highlights many key lessons learned. Director Robin Johnson's plans for 1998 include developing case studies of successful privatization efforts and practices by municipal and county governments in Illinois.

And Virginia continues to have perhaps the most cutting-edge state initiatives. Building on successful programs that have saved the state over \$100 million, the Commonwealth Competition Council devised an initiative to make employee ownership plans part of the state's privatization program. Based on the council's recommendation, the state House and Senate passed a joint resolution supporting the use of ESOPs "to convert appropriate government functions to the private sector...."

The council followed up on the resolution with detailed research and issued a report, *Methods to Privatize Appropriate State Government Functions Through the Development and Promotion of Employee-Owned Companies (ESOPs)*.

PRIVATIZATION IN SMALL TOWNS

Important survey evidence on privatization trends at the local level was released in 1997. *Public Works* magazine surveyed its readers, most of whom are public-works officials, on privatization trends in 1997 (see Figure 1-6). The survey results clearly reflect a growth trend, particularly in solid-waste management and vehicle-fleet and road maintenance.

More significant, though, was the release of a survey of towns and villages in Illinois that captures better than other surveys the story of privatization in small towns. The survey, conducted by the Illinois Center for Competitive Government, covers 516 cities and villages—of which almost 200 have fewer than 1,000 residents and more than 300 have fewer than 5,000 residents. We know of no other privatization survey with such a large sample of very small towns.

Illinois Small Towns Survey

Not every state will have the same privatization trends going on in its small towns, but it seems likely that the trends revealed in this Illinois survey are indicative of trends across the nation.

Extent of Privatization. The Illinois survey showed that the motives for privatization differ significantly with the size of the town. Smaller towns (with populations under 1,000) contract with the private sector to avoid expensive labor, such as computer repair experts, or specialized-equipment costs, like snow removal machines. Larger cities reflect the motives we are more familiar with, using privatization as a means to reduce costs or improve service quality.

These motives are effective in inducing widespread privatization. Almost every city in the survey contracts for at least one service, and 274 (53 percent) contract for at least 10 services. Table 2 shows which services more than 50 percent of the cities contract out.

A number of the towns rely very heavily on private services. Crestwood (pop. 11,000) and Machesney Park (pop. 19,000) have only a few municipal employees, relying on private firms and some volunteers to perform almost all public services.

Satisfaction/Future Outlook. Roughly two-thirds of the survey respondents said that privatization was a success in most cases, and only one percent said it was a failure in most cases. However, respondents from smaller towns were more likely not to know whether privatization was a success, as they do not have expertise in comparisons. One interesting note: in towns with fewer than 5,000 people, quality of work was the main reason for satisfaction reported; in larger cities, financial considerations were dominant.

Almost 20 percent of the respondents plan to increase privatization, and about 50 percent are satisfied with their current level of privatization. Less than one percent said they plan to cut back on privatization.

Cost Savings. Sometimes privatization is intended to improve or expand services, but cost savings are usually achieved as well. Privatization saved money in all cases for 18 percent of the respondents, and another 56 percent said that privatization often saved them money. One-quarter reported that privatization did not cut costs but met other goals.

Crestwood again is a notable example. Savings due to extensive privatization have enabled the city to periodically rebate property taxes to citizens.

Effects on Municipal Employees. In most towns, privatization does not have a catastrophic effect on municipal employees. It had no effect on municipal employees in 65 percent of the towns, and only 3 percent reported layoffs. Where services once provided by municipal employees were privatized, most of the employees were transferred, were hired by the private firms, or retired. Perhaps most significant, only 10 percent of the respondents reported that private-sector wages were lower than municipal wages, and only 13 percent said employee benefits were lower.

Small-Town Privatization Stories

Statistics are instructive, but actual stories and examples can be more useful. Small towns often take two approaches toward privatization: (1) widespread privatization of whole service areas, or (2) a process of starting small and then expanding but taking each service one at a time.

Killingly, Connecticut took the latter approach. It began privatization several years ago in a small way with contracts for grounds maintenance, street sweeping, and

street striping. These programs were successful, making city officials and residents willing to accept greater private-sector involvement. This was important when the need arose for significant capital investment in the town's sewer system. Rather than try to raise the needed \$300,000 themselves, city officials proposed contracting out operation and maintenance of the system to a private firm. In June 1997, JMM Operational Services won the five-year contract, which not only included making the \$300,000 capital investment in the first year, but also provided \$170,000 per year in operational cost savings for the city. This year the town plans to follow up on that success by contracting out operation of its landfill.

A good example of a town that has evolved a more comprehensive approach to privatization is **Hoffman Estates, Illinois** (pop. 50,000). This town has been outsourcing for more than 10 years, with contracts for over 100 services or activities using more than 50 vendors. Contracted services range from the large (sidewalk/curb maintenance, janitorial services, and paving) to the small (reprographics, towing services, and pest control). All this has saved about \$250,000 per year in salary costs, and it has eliminated the need for specialized training and equipment. Privatization did not

Table 1-2: Services Privatized in Illinois (Selected)

	% of Municipalities with Privatized Services
Commercial Solid Waste	92.6%
Residential Solid Waste	87.7%
Electricity	87.3%
Gas	86.2%
Recycling	77.1%
Solid Waste Disposal	84.5%
Vehicle Towing & Storage	76.2%
Yard Waste Collection	64.0%
Street Light Operation	61.0%
Day Care Facility Operation	53.4%
Hazardous Materials Disposal	50.0%

Source: *Illinois Municipal Privatization Survey, 1997.*

result in layoffs—the workforce shrank gradually through normal attrition.

An interesting variation on the theme of systematic privatization is found in towns that contract out their entire public-works departments at once. According to the Illinois survey, this is most common in towns with populations under 5,000. The survey report singles out Pecatonica, Illinois (pop. 1,800) as an example. This town's contract with Environmental Management Corporation (EMC) covers the water and sewer utilities, all street repair and maintenance, and other public-works functions. Initially, the contract cost \$250,000 per year, about \$10,000 less than it cost the village to do the work itself. But after two years, EMC took on additional functions, including rate studies, safety equipment, and planning, while the contract price remained the same. EMC essentially functions as the village's public-works administrator.

Another good example is Pleasant Ridge, Michigan (pop. 2,700). The town faced difficulties keeping up with the need to expand services without raising taxes, and its

public-works department had some inherent problems. The workforce was bare bones, so during peak vacation times, not all services could be delivered. And the department owned a lot of equipment that was needed only occasionally and cost a lot to maintain. To get around each of these challenges, the city decided to outsource in one contract all of its public works except refuse collection, which had long been contracted out to a private firm. The existing employees, a neighboring city, and a private firm bid for the contract. The winning bidder was City Municipal Services (CMS), which guaranteed the city 15 percent lower annual costs for public works (\$59,500 off the \$396,000 annual budget). Also, CMS purchased all of the department's capital equipment at fair market value. On top of the guarantee to cut costs, the contract established an incentive for greater efficiency—CMS will keep half of any savings over 10 percent as a bonus. In July 1997, the end of the first year of the contract, CMS exceeded the guarantee and saved the town 22 percent—over \$87,000.



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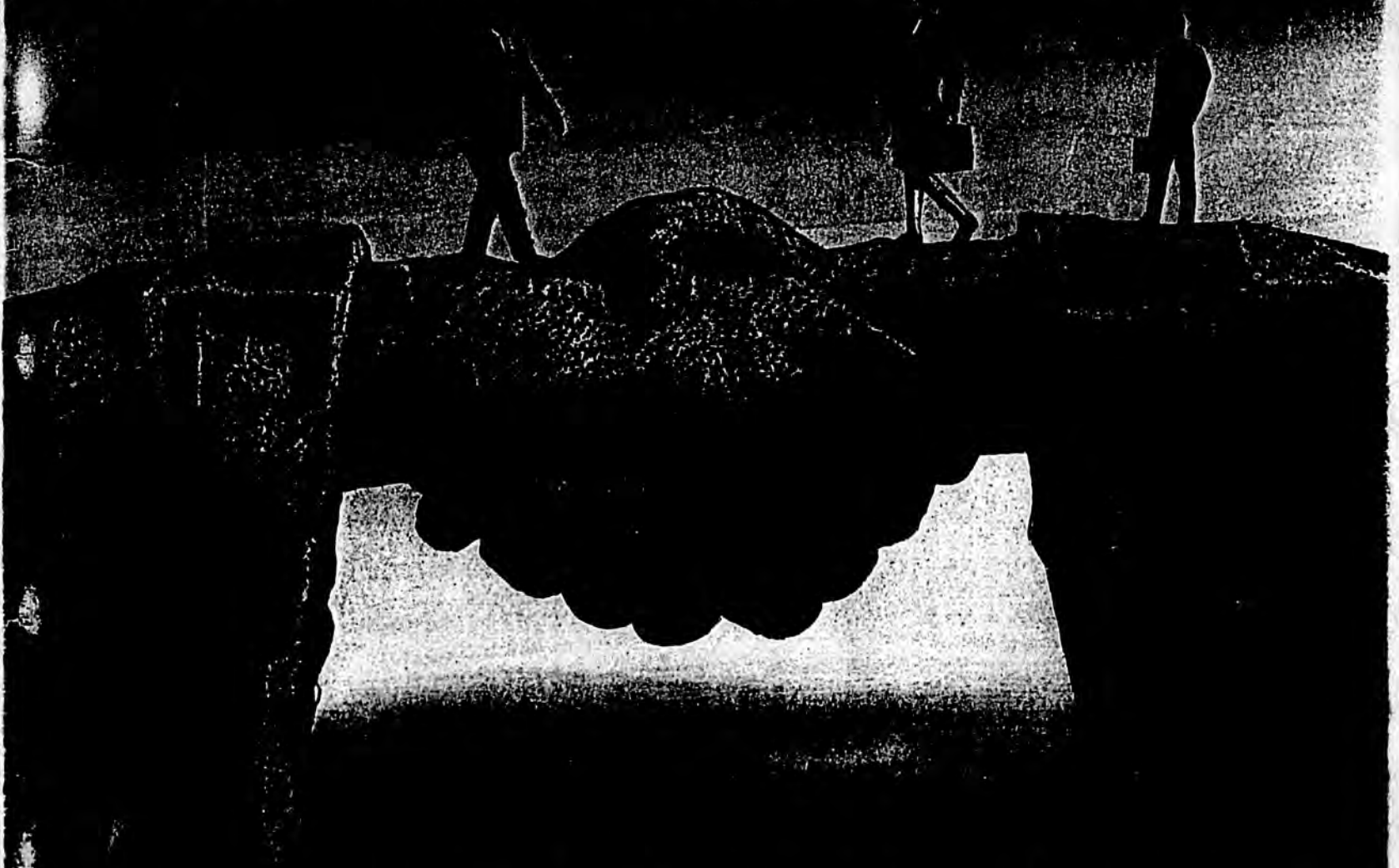
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Privatization 1999

The 13th Annual Report on Privatization



by Reason Public Policy Institute

The primary issue facing many governments is what to do with the surpluses. Tax cuts are a method of returning funds to taxpayers and bolstering economic growth. The ALEC report found that cutting sales, personal-income, and corporate taxes actually induced substantially higher revenues in 1995-98 (see Table 1-2).

In addition, permanent tax cuts are more effective than temporary ones, according to recent work done by Professor Barry Poulson of the University of Colorado, in conjunction with the Independence Institute. When tax cuts are permanent, administrative costs are significantly lower; special-interest groups are less likely to lobby for tax money, and businesses and individuals are more likely to increase savings, productive work, and investment.

FEDERAL PRIVATIZATION

Privatization at the federal level experienced few major breakthroughs in 1998, and it continues to lag behind state and local government efforts.

The U.S. Department of Defense (DOD) has taken a big step forward with its National Security Agency (NSA) Breakthrough Program. This unique program will oversee the voluntary transition of federal employees into the private sector over a five-year period. The program involves contracting with a private-sector vendor to reduce both staff and costs. The contract was awarded to Computer Science Corporation (CSC), which will be maintaining the NSA's computer-systems operations and related operations. The value of the contract will be over \$10 million during the first three years of the five-year contract and will rise to a total of \$20 million by the end of the fifth year.

A number of other agencies will be following the progress of the NSA Breakthrough Program and may follow suit if

the program proves successful. Stephen Tate, chairman of the NSA's strategic direction team, believes that this program will enable the DOD to save taxpayers' money and increase value at the same time. As he reported in *Computer Reseller News*, "Breakthrough is a firm, fixed-price contract with all the work being performance-based, with measures built into service-level agreements and tied to an award fee plan."

One of the unique features of the program is the voluntary transition of DOD employees from the public sector to the private sector. Under the agreement with CSC, DOD employees who sign on with CSC during the initial three-month transition period will receive 100 percent of their current salary and public-sector benefits; a \$25,000 signing bonus; and an extra five days of vacation and 10 days of sick leave. Those signing up after the transition period will still be eligible for comparable pay and benefits and will still receive 10 percent of their salary as a signing bonus.

Through this contract with CSC, the DOD will be able to reduce costs and staff while ensuring high levels of service through the use of performance-based payments.

After a long delay, the U.S. Air Force awarded a contract for depot maintenance of KC-135 tankers and A-10 ground-attack planes to a public-private partnership. Hill Air Force Base, in Ogden, Utah, will care for the A-10 fleet, while Boeing will maintain the KC-135s on the grounds of the closing Kelly Air Force Base, near San Antonio. They beat out a bid by Lockheed Martin, which had proposed keeping the work at McClellan Air Force Base, near Sacramento, California.

The \$1.6 billion contract will run for nine years and save the air force a total of \$638 million on maintenance costs. McClellan will lose about 1,600 jobs, and Hill and Boeing will each gain about 800 jobs. According to the air force,

Table 1-2: State Revenue Increases Due to Tax Cuts (in millions), 1995-1998

Type of Tax	Size of Tax Cut	Revenue Growth	% Increase in Revenue
Sales	\$1,667	\$23,841	21%
Personal Income	\$9,571	\$34,444	29%
Corp. Income/Franchise	\$2,216	\$7,213	28%

Source: "\$74 Billion Windfall," American Legislative Exchange Council, 1998.



this contract not only saves money but also helps meet the base-closure mandate.

One of the more groundbreaking federal privatizations in 1998 was the public offering of the United States Enrichment Corporation (USEC). USEC produces 75 percent of the United States' nuclear fuel and plays a critical role in the "Megatons to Megawatts" program, which helps transition Russian weapons-grade uranium to fuel for civilian uses. The sale of USEC, long considered to be one of America's most strategic businesses, was the largest public offering ever made by the federal government and its first major public offering since Conrail 10 years ago. Much of the impetus for privatization came from the corporation's falling market share, which had dropped from a high of 100 percent to its current 40 percent.

The USEC privatization had to comply with two major restrictions: to keep the corporation under domestic control and to choose the option that would generate the greatest proceeds. Another innovation was the use of a "dual path" in the selection process: the government could either make an equity offering or sell the corporation to another firm. The federal government pursued both options as a means of generating maximum proceeds and ensuring the long-term survival of USEC. In June 1998 the final decision was made to select the equity option. Despite the fact that Lockheed Martin's bid would have generated the most proceeds, the government concluded that it did not guarantee the continued long-term operation of USEC.

The offer was managed by Morgan Stanley Dean Witter and generated \$1.425 billion, with roughly 50 percent purchased by retail investors. The government will receive an additional \$1.7 billion from a loan pass-through and retained revenues from USEC with the U.S. Treasury. The sale of USEC comes as the culmination of several attempts, dating back to the 1970s, to privatize the facility. The effort picked up momentum after USEC's corporatization under the 1992 Energy Policy Act, which forced USEC to operate more like a private firm.

Federal Financial Management Reforms

The U.S. government has experimented with a range of financial reforms. Historically, cash appropriations and accounting gimmicks have been an integral part of the "prom-

ise now, pay later" philosophy. In a long history of minimal accounting and reporting, the federal government has tried management reform after management reform, some coming from the legislative branch, others from the executive branch. Unfortunately, the U.S. government does not have a broad, coherent framework for financial management reform; reforms evolved in a patchwork fashion:

- The Chief Finance Officers Act of 1990 was focused on obtaining clean audit opinions for the financial statements of the agencies.
- The Government Performance and Results Act of 1993 prescribed developing unit-level performance indicators.
- The Government Results and Management Act of 1994 created a requirement for a consolidated financial report for the government as a whole.

These reforms did not encompass accrual budgeting or accrual appropriations. Nor did they place prices on outputs and structure those prices into budgets and performance contracts. The result is that progress has been far from stellar. Many took time in 1998 to look back at what these reforms have brought; for example, there were forums in *Government Executive* (www.govexec.com/) and *The Public Manager*. They concluded that there has been a lot of progress in understanding the problems with the current system but not much progress in changing how things are done.

STATE-LEVEL PRIVATIZATION

Texas

Texas is the nation's leader in one particular model of government reform—the performance review process. The Texas Performance Review (TPR; <http://www.cpa.texas.gov/tpr/tpr.html>), a commission under the state comptroller, started off in 1991 with a comprehensive report detailing almost 200 proposals to improve and streamline state government. Recommendations included internal reengineering, privatization, and sometimes adding new services or redirecting resources to new areas. In the end, around two-thirds of the recommendations were implemented, saving the state \$2.4 billion. The next three years saw the TPR repeat its success, conducting in-depth examinations of state gov-

ernment functions and devising hundreds of specific legislative or administrative reforms—ranging from common-sense to revolutionary—and generating billions of dollars in savings.

In 1998, the TPR began an in-depth examination of the state's school districts. Even more significant, realizing that its methods had become a national model, the TPR published "Home Improvements: A Manual for Conducting Performance Reviews" (www.cpa.texas.gov/tpr/home/ch1.html). It provides detailed guidance on conducting performance reviews, drawing on a wealth of real-world experience.

California

Back in 1996, Gov. Pete Wilson stepped forward with a very ambitious statewide privatization plan, proposing to privatize everything from road maintenance to the state worker's compensation fund. Two years later, his successes in privatization could be counted on one hand, with a few fingers to spare. His only really significant success came in August 1998, with the gigantic, \$929 million contract to operate the state government's telecommunication network.

So what happened? In many ways, Gov. Wilson's story is reminiscent of that of Massachusetts governors William Weld and Paul Cellucci—all three underestimated the opposition they would meet and were not willing to fight the tough battles required to convince people that privatization was the right policy choice. The bills Gov. Wilson introduced mostly died quietly and with little evidence of any serious effort on his part to push them through. One exception was the 1996 passage of AB 2660, which gave local governments the authority to enter into public-private partnerships for infrastructure development and reduced the restrictions on how such partnerships could be structured. Other legislation, as well as a ballot measure, all fizzled.

Even more frustrating to privatization proponents were the court cases—public employees, especially state architects and engineers, sued a number of times to stop the administration's outsourcing contracts. The courts ultimately ruled that privatization of state functions is legal as long as the private contractor can do the job for less money, state workers lack special expertise, or there is an emergen-

cy. But, since there is no legislation laying out strict criteria for making such determinations, public employees challenge many state contracts, forcing the state to prove to the court that one of the conditions is met. California's experience highlights two important lessons: (1) implementing privatization requires leadership and political capital, and (2) a first step is often to legislate clear authority to implement privatization policy.

Virginia

The nation's most innovative and effective state privatization program continued to lead the way in 1998. Virginia's Commonwealth Competition Council had a busy year pushing the envelope of state privatization, as it had in past years. This time the innovation was the use of employee stock ownership plans (ESOPs) as a method of privatizing state agencies. After the state legislature passed a resolution declaring that ESOPs have the potential to permit privatization where it might otherwise be technically or politically impossible to do, the council initiated an in-depth examination. The result is a detailed report that both lays out how ESOPs may be used to privatize state services and provides a thorough pre-assessment of three state activities: professional and occupational regulation, child-support enforcement, and alcohol and beverage control.

Not satisfied with merely exploring exciting and innovative new ways to privatize services while ensuring employee security and service quality, the council completed two other major projects in 1998. The first is a comprehensive survey of the commercial activities engaged in by state agencies, documenting which are conducted in-house and which are contracted. The survey was published in the council's annual report and is the basis for an evaluation of inconsistencies, thus allowing agencies to share experiences and ideas. The second project is "The Privatization/Competition Manual," which covers the most-typical questions asked about privatization and details processes for taking inventory of commercial activities, creating a competition process, and conducting computerized cost comparisons of in-house service-delivery costs.

More information on the work of Virginia's Commonwealth Competition Council, including its publications, is available at www.vipnet.org/ccc/home.htm.

Keys to Successful Performance-based Budgets



Define performance in terms of measurable, quantifiable outcomes, not just goals or mission statements. For example, two performance measures from Arizona agencies are: reduction in percentage of youth under 18 using tobacco (used by the Department of Health Services) and increase in percentage of MA graduates employed in their profession within one year after graduation (used by a university's Department of Architecture).

There must be executive and/or legislative leadership. Agency heads won't put their scarce time into improving performance if there is no emphasis from the top. And the leaders must demand that agencies achieve performance, not just define it.

Create incentives to perform. Rewarding for success and punishing for failure will cause more change than any other single action. It also creates a will to experiment and to learn from other agencies' successes and failures.

Create an independent oversight agency. The oversight agency should have separate divisions, one to assist agencies in achieving performance and another to audit agencies to ensure compliance. Leadership and incentives may not be enough if agencies don't have good information on how to go about reforming or if legislators don't know whether agencies are reforming.

However, the nature and effectiveness of those requirements vary widely—beginning with defining performance. To most people, performance is the link between activities and outcomes. But not all states hold themselves to so high a standard. For example, Nevada requires only that agencies include a mission statement and measurement indicators in their budgets—not that they actually track any performance. At the other end of the spectrum is Texas, which has an integrated and comprehensive approach to ensuring that government agencies achieve performance goals. It combines performance requirements in agency budgets with a strategic-planning process that incorporates cyclical feedback and improvements, and it has a state-wide independent performance review agency, the Texas Performance Review (www.cpa.texas.gov/tpr/tpr.html).

States also vary widely in how they encourage performance and how they measure compliance. The GSU study found that most states require only the setting of goals—only seven have explicit guidelines for attainment of agency goals. Five of those states offer rewards such as gain sharing or employee bonuses for success in meeting performance goals. Only two of those five, Texas and Florida, also include adverse actions for noncompliance, such as restricting budgets or withholding funds.

Some of the same states have also done the most to measure compliance. The GSU study highlights the importance and effectiveness of executive offices created to assist and oversee performance measurement and attainment.

Besides the Texas Performance Review mentioned above, one of the most famous is the Oregon Progress Board (www.econ.state.or.us/opb/), which has pioneered some of the best state-level service benchmarking. Another is Florida's Office of Program Policy Analysis and Government Accountability (www.oppaga.state.fl.us/), which conducts thorough audits of state agencies for performance compliance.

PITFALLS IN PRIVATIZATION IMPLEMENTATION

Although privatization and outsourcing have become increasingly popular, there are still many barriers to implementation and pitfalls in application. Difficulties arise from a variety of factors, any one of which is capable of derailing the best of intentions. Some of the more common pitfalls are political resistance, poorly designed or implemented contracts, and fear of misrepresentation. It is not uncommon to find one or more of these problems with floundering privatization endeavors.

Political barriers can be the most intransigent, often arising during initial discussions of privatization and persisting all the way through the process. According to former Congressman Scott Klug, "Everyone supports privatization until you try to privatize something in their district." Politicians often seek to protect their interests and fend off

any attempts to privatize organizations that are under their jurisdiction. The U.S. Department of Energy has been trying for years to outsource its power-marketing administrations, with little success. "We want to privatize, but our hands are tied," says the deputy assistant administrator in the Energy Department's power-marketing liaison office, Rodney Adelman. "We can't even initiate a study on our own," due to an energy and water development appropriations act that was passed in the 1980s. A revision to the act was proposed in 1995, but it never made it out of the conference committee. Political will is one of the most-critical elements in privatization; without it, most attempts are destined to fail.

Once it has been decided to privatize a service, the design and implementation of the contract are paramount. Any privatization plan is only as good as its contract; a poorly designed contract will invariably lead to disappointing results and a general disenchantment with privatization.

Hawaii's privatization of book selection and purchasing for all 49 of its public libraries serves as a reminder of contract pitfalls, in both design and implementation. The state's mistakes were twofold: the contract failed to ensure that the private firm would have the same goals as the state, and the contractor was not given appropriate information. The contractor believed that its "primary purpose is to meet the popular reading habits of the public," while the state was more interested in "giving the public a high-quality, diverse array of materials." This created an immediate conflict between the contractor and the state once the libraries began to receive "popular" titles and fewer of the "high-quality, diverse" titles.

In addition, because of delays and legal challenges, the contractor did not receive enough information on library profiles and needs. This, combined with a deadline for book purchases, resulted in the contractor having to purchase approximately 60,000 titles without any clear information on what its clients' needs or desires were, a major failure in implementation. According to the contractor's senior vice president, "A vendor is only as good as the information we're given."

Fear of misrepresentation is often an unspoken barrier to privatization. The privatization process often involves gathering basic data on costs and performance, to better judge any competitive bid and to obtain a more accurate picture of what services the government organization provides and how well it is performing. Regrettably, this infor-

mation can be used inappropriately for a variety of purposes, many of them detrimental to the organization's goal of providing better, more cost-effective services.

In 1997 one of the Big Six accounting firms conducted a performance audit and released a report showing that the Prince William County (Virginia) police department's rate for clearing cases was much lower than in other departments across the nation. This resulted in a public uproar and a meeting of the police chief with the county board of supervisors to explain the poor ranking. The chief explained that the problem was not the police department's performance but how it defined clearance rates. While other departments count any case in which they feel confident they know who "pulled the job" as being cleared, in Prince William County a case is not cleared until an individual has actually been arrested and convicted. Adjusting for these differences in measurement placed the department at the top of the scale, not the bottom.

Charlie Deane, chief of police in Prince William County, says that "performance measures have real value as an internal management tool, but those kinds of statistics shouldn't be used to make comparisons." Many organizations may be leery of any attempts to quantify what they do and how it is done, because of concern about how the information will be used. While he feels this is a legitimate concern, the county manager of Prince William County, Henry Ewert, believes "it's good to be uncomfortable. I think it's healthy for the chief to have to address the issues raised by that study." Jonathan Walters, of *Governing* magazine, puts it this way: "Using the performance measurement process to bring some reason and science to the messy business of government is the logical next step."

Privatization does have pitfalls, but it is possible to learn from the experiences of others, to incorporate successful strategies, and to avoid the pitfalls.

Key Techniques for Avoiding Pitfalls

1. Learn from other's successes and failures.
2. Keep special interest concerns in perspective.
3. Write clear, complete contracts that align the contractor's interests with the taxpayers.
4. Benchmark performance, but be aware of the limits of measurement.





INFORMATION TECHNOLOGY

Information technology (IT) service is becoming one of the most-active areas of local government privatization in the nation. Government agencies find it increasingly difficult to keep up with technological changes and often lack qualified personnel.

The June 1998 issue of *Government Finance Review* contained results of a survey of 104 Florida cities by Florida Atlantic University regarding outsourcing of IT services. It provides a useful look at how cities are responding to changing needs for government information systems. Some interesting results include:

- As city size decreases, a greater percentage of city resources is spent on IT services, possibly indicating that IT services have economies of scale.
- In the aggregate, about 10 percent of IT service expenditures go to outsourced services.
- Cities with fewer than 25,000 residents are 50 percent more likely to outsource IT services than cities with more than 50,000 residents. The main cause of the difference appears to be the difficulty smaller cities have in hiring and retaining adequately trained professional staff. For all city sizes, greater need for specialized staff meant greater likelihood of outsourcing.
- Cities run by professional managers are more than twice as likely as mayor-run cities to outsource IT services.

- Cost reduction is not always the most important reason for outsourcing. Other benefits cited include freeing up management resources, upgrading hardware, and accessing new services.

By far the most-important breakthrough of the year came from the state of Connecticut. Currently, over 30 states operate their IT services wholly in-house, while the rest have outsourced only portions of their IT services. This may begin to change as Connecticut paves the way for complete privatization.

In a first-of-its-kind contract, the state of Connecticut will outsource all of its IT services, maintaining only an oversight team of IT planners and managers. According to Connecticut's chief information officer, Rock Regan, the primary impetus for outsourcing was a need to realize both greater savings and greater efficiency. Although the specifics of the contract have yet to be worked out, the state chose a private consortium led by EDS.

EDS will be providing everything from PC and main-frame operations to application development and system integration. The state has been spending approximately \$300 million per year on IT services, and the seven-year contract with EDS is estimated to be roughly \$1 billion. Both sides believe that there is substantial room for improvement, noting that state licensing issuance is currently done through 25 different agencies with 25 different IT systems.

Equally important, the state recognizes the need to maintain oversight authority and oversee the success of the

contract. The state will maintain a 90-person oversight team. As CIO Regan reported in *Computer World*, "The key to success will be managing this relationship; we're certainly not giving EDS and their team carte blanche."

IT outsourcing similar to Connecticut's is being considered in a number of states. So if Connecticut's contract provides the anticipated savings and increased efficiency, it could have far-reaching effects.

TOURISM AND RESORTS

Privatization of resorts and other tourist facilities is likely to continue as governments focus on core areas and as facilities require increasingly expensive capital expenditures for maintenance, repairs, and renovations.

The leasing of New Hampshire's Mount Sunapee ski area was spurred on by an overriding concern to have a first-class ski area, coupled with the possibility of decreased state funding. A member of the executive council told the *Union Leader*, "the Legislature holds the purse strings and they have indicated they just might allow it [the Mount Sunapee ski area] 'to wither on the vine.'"

By including Okemo Mountain Resort in the lease, the state will receive \$150,000 annually, as well as 3 percent of gross receipts. In addition, the private contractor paid for a \$4 million renovation program. This cut the time it takes for the ski lift to reach the summit (from 15 minutes to 6 minutes), added greater snow-making capabilities, and included a number of other upgrades to the ski area. The leasing of the resort did not result in the loss of any jobs. In fact, the contract made special provisions for the state employees, who were guaranteed the same salary and seniority and a comparable benefits package. The protection of existing jobs was cited as a critical factor by several of the executive council members and helped allay public concerns over the impact of privatizing the operation and management of the facility.

Faced with an aging rest area at their Minnesota border, Iowa's Department of Transportation (DOT) and Department of Economic Development's Division of Tourism sought ways to remedy the situation. Tourism is the third-largest industry in Iowa and as such is critical to both local and state revenues; therefore, state officials believed it was

imperative that the facility in question, expected to service upwards of 600,000 travelers in 1998 alone, make as good an impression as possible on tourists entering the state.

The DOT's initial review of the case determined that it would cost approximately \$4 million to upgrade the current two-sided rest area or \$6.5 million for a new facility—a costly endeavor either way.

That was when Top of Iowa Welcome Center, a local 501(c)3 nonprofit corporation, stepped in and began negotiations with the DOT and the Division of Tourism. They had an attractive proposal: more and better services for \$2.5 million at a new site with lower yearly operational costs. Their plan called for the consolidation of the current two-sided rest area and the addition of a welcome center (for tourists from Minnesota and other states), just off a preexisting exchange. By moving the facility off the highway, they were able to greatly reduce costs by avoiding the mandates of the Davis-Bacon Act, which requires that wages be comparable to local unionized wages.

The nonprofit managed the entire project on behalf of the DOT and the Division of Tourism. They handled everything from the hiring of architects to construction to yearly operation upon completion. In addition, they arranged for some of the private organizations that were interested in setting up businesses in the new center to provide feedback on the overall design and layout of the facility. This resulted in a more-attractive and efficient site plan, because the private organizations were able to voice their concerns and recommend ways of improving the site's commercial appeal.

Looking to the future, the nonprofit installed water and sewer infrastructure for commercial and industrial development, with the hope that businesses would begin to locate around the new facility. They projected a two-year lag period after construction before any business would show interest, because most businesses are more concerned with actual traffic flows than projected flows. However, there was so much interest in this location that they already had one commitment and several others pending even before the facility opened in June 1998.

The agreement between the state agencies and the nonprofit provides for a 30-year management contract. In addition, the nonprofit retains possession of excess real estate. When the state sought land for the project, it had to buy

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offices or move to EDS' proposed "technology transformation center," or some of each. Major technology decisions would remain with the state, according to the CIO's office. The private company would provide the computer services to make government more efficient. It isn't clear who would own the hardware and software used to run the state government.

At this point, the process has dragged out years longer than expected. The plan was set in motion in 1996 after a consultant's report found the state's computer systems to be seriously outdated and poorly run. The request for proposals was issued in February 1997, and the administration was hoping to outsource the state's systems by mid-1997. Instead, the privatization effort became part of the budget process in 1997 when the governor projected \$50 million in savings from outsourcing. Legislators insisted on an unusual provision, opposed by the governor, saying that either chamber of the legislature could veto the contract with a three-fifths majority.

By February 1998, three companies—EDS, Computer Sciences Corp. and IBM—were in final contention for the contract, along with the Connecticut State Employees Union, which promised an in-house consolidation that would save the state \$30 million to \$40 million. EDS, based in Plano, Texas, won the contract after a review of the proposals by an eight-member evaluation committee with members from four executive-branch agencies, under a "best value" process that was based on 17 criteria, price being just one. Regan says EDS offered the state some innovative proposals that included job creation, outreach to the education community, economic development benefits and high-technology training that would benefit residents as well as state employees.

Rowland's office now hopes a contract can be implemented by the first of September. But Regan insists he will not shortcut the contract work that needs to be done just to meet an arbitrary target date. "It's a complex process," he says. "There are a lot of issues we're trying to resolve. We're obligated to protect state interests."

Once the contract negotiations are completed, the contract will go to the auditor of public accounts, who will have 75 days to review it. It then will take effect automatically 45 days after the auditors send their report on the contract to the General Assembly, unless either house of the legislature rejects it by a 60 percent margin. In the House, that would mean 91 votes in a chamber that has 96 Democrats and 55 Republicans. The Senate has only a two-seat majority.

This year's session

continue to play out as they have to this point. Opponents say they worry about turning the technology so many state agencies depend on over to one prime contractor and about losing IT employees and the institutional memory they hold. They also say they don't understand how a company can promise better pay and benefits for Connecticut's IT workers and buy and install new and improved technology, while saving the state \$50 million a year and making a profit. They also wonder if signing a seven-year contract so entwines the state with one vendor that it will be difficult to extricate itself from the contract if need be. They fear that if the state becomes so dependent on one vendor, that vendor could demand changes in



legislative session. The auditor's report is in hand for debate during the regular session and may not even see the contract before adjourning. For there to be a veto vote, a special session would have to be called, something traditionally done by the governor, who, in this case, would have little interest in calling a session that has the potential of killing his initiative. However, the Senate president pro tem and the House speaker together have the power to call the legislature into session for a veto vote.

That seems likely to occur if the politics

is unknown about the technology infrastructure. The contract is being written. In April, the Department of Information Technology was still updating an inventory of state agencies' computer systems. That original inventory, started after the Department of Information Technology was created in 1997, took more than 18 months to complete.

At the beginning of April, House Speaker Moira Lyons sent dozens of questions to Regan about the deal. She asked for details about where the \$50 million in savings would be found, how privacy of state information would be protected, who would own the equipment and how the state could "dis-

entangle" itself from the vendor should problems arise. She also wanted information about contract management and EDS' past performance, and on how the state could know seven years out that it would still be getting the best technology deal. "This is a giant leap for Connecticut," she says. "We are all aware our current information technology systems have huge drawbacks. But it is correct to question if we should go to a total huge privatization of every entity under one vendor."

The CIO's answers weren't specific enough to satisfy her. For instance, on the matter of savings, Regan wrote that "provisions now being negotiated will determine the savings pattern" and that details would be provided soon. On a question about how quickly the state would be able to provide basic services to residents if the state had to get out of the contract, the written response was "immediately." Many are dubious about that. Even Regan admits that if the services had to be brought back in-house, it would not be easy. Nor would former state employees who would have moved over to EDS be obligated to return to state service.

EDS offers assurances that if disentanglement were necessary at any time, the company would give the state access to people, assets, equipment and software, to use or buy. But it's clear that bringing the executive branch's computer operations back in-house would be costly for the state. "The state has a right to tell us they want to get out," says Bill Dvoranchik, managing director of the EDS Partnership for Connecticut, the team of 10 companies EDS put together to run the Connecticut project. "How that works out has to make sense. If not, if I make all those investments in two years and the state says goodbye, it doesn't make sense."

Since there is no contract to review, Lyons admits it's too early to open or close the door on the proposal. But the sheer magnitude of the endeavor is cause for apprehension in the speaker's mind. "I'm uncomfortable with the size of what we're undertaking, given there's no past experience with it."

That discomfort has led some lawmakers to introduce legislation that would layer new requirements onto the outsourcing plan. "It's kind of like boxing with smoke until you see the contract," admits Representative Alex Knopp, a Democrat who chairs the Joint Government Administration and Elections Committee. One provision would require the contractor to



Connecticut CIO Rock Regan says the outsourcing program would be the most tightly managed contract in the state's history.

submit a performance bond for up to 100 percent of the total due under the contract. Another would create an Office of the Privacy Counsel and authorize it to bring actions for disclosure violations. A third would require oversight by a state information technology review board, which would monitor the contract and report to the legislature periodically. The bills have been passed out of Knopp's committee.

The Connecticut State Employees Union says it can't think of a private contract with the state that has come in on time and under budget, and argues that such a large project is a huge risk. The union points to a contract between the Department of Social Services and Maximus Inc. for privatizing the child care subsidy program. When the initial contract proved to be inadequate, leading to delays in getting subsidies to day care providers, the contract had to be modified to give the company a 50 percent increase in per-client fees.

The union concedes that the state's information technology is antiquated, but it argues that instead of turning the whole thing over to the private sector, a vendor should be brought in to reengineer processes for state workers. Rick Melita, the union's political education coordinator, says the state has done an "abysmal" job of overseeing smaller-scale contracts. "How will it develop the expertise to oversee the big ones?"

The answer, says Regan, is for the state to develop performance measures, penalize the vendor if it doesn't do well and reward the vendor if it does. In the past, he says, projects were not managed well and outcomes were not well defined, and this would be the most tightly managed contract in the state's history. A core group of about 50 to 70 people would remain state employees, get additional training and function as overseers of the contractor.

The union and legislative opponents have an ally in elected Comptroller Nancy Wyman, who is looking into a prior troubled contract between the social services department and EDS. Under Connecticut law, a breach of contract by EDS in past dealings with the state could disqualify the company from the pending contract.

Legislators have complained that there has not been a satisfactory explanation from Rowland's office for why EDS was chosen for the executive-branch outsourcing contract. A provision in one of the measures passed out of the House committee asks the auditor to review the selection process and ranking mechanism that resulted in the choice of EDS. "If there's a significant flaw in the ranking process, it might influence how the contract is viewed," says Knopp.

Outsourcing opponents point out there have been contract failures involving EDS in several other states; that EDS is in the middle of a lawsuit with Xerox, one of its

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The headquarters of the Connecticut Department of Information Technology in Hartford is a drab, squat building that sits on a corner downhill from the ornate gold-domed capitol and a gleaming legislative office building. Visitors walk past a dumpster in the back to enter, sign in with a guard and use an ancient elevator to get to the upper floors. The path to the office of Gregg "Rock" Regan, Connecticut's chief information officer, is via a corridor of stained, worn carpeting and scuffed walls. The structure literally leans to one side.

The state's information technology is in similar condition. It is a morass of disjointed systems with computers in one department unable to communicate with those in another. Information is fragmented and unnecessarily duplicated. There are at least a dozen e-mail systems, and many don't link up well with each other. Information technology has historically been poorly managed in Connecticut, and the state hasn't done a good job of procuring new systems. Nor is the security of the systems the best available. No one knows exactly how many computers the state owns.

Connecticut's IT infrastructure is in such poor condition, says Governor John G. Rowland, that the departmental tug-of-war over technology resources so common in other states aren't happening in his state. There's so little to fight over, he says, "there are no turf battles," the

"They're at the nonconformity, parochial stage. They don't care what other departments are doing."

Rowland has vowed to clean up the mess, and he thinks he knows exactly how to do it. For four years, he has been pushing relentlessly to turn nearly all of the execu-

agency turf wars and procurement difficulties that often make it such a headache for governments to upgrade and connect departments with up-to-date technology.

But the outsourcing plan, which is being spearheaded by Regan, is a move fraught with political risk for the governor, who has

Connecticut's governor wants to take state computers private. It would be a billion-dollar leap into the unknown.

tive branch's IT systems over to the private sector. "We shouldn't be in the business," he says. But such a wholesale outsourcing is a great leap into the unknown, a dramatic step that no other state has undertaken. CIOs from other states and even some local governments—most notably the nation's fourth-largest county, San Diego—are watching with keen interest.

If things work out as the governor hopes, the move could elevate Rowland as a trailblazer who successfully solved the state's technology troubles and turned Connecticut into a showcase of world-class information technology. He would be the first governor for other states mired in

made it a major initiative for his Republican administration. There are several ways for it to go down in flames: Either house of the Democratically controlled legislature has the power to veto the deal. Or it could go through and still fail to solve the state's information technology problems. Or costs could escalate, surging beyond the estimated \$1 billion cost of the seven-year deal.

This spring, as Rowland's administration continued to negotiate contract terms with the vendor that won the outsourcing contract, Electronic Data Systems, things seemed to be starting to unravel on the legislative front. The House speaker was publicly expressing dissatisfaction with the information about the plan that she was getting from Regan's office.

With no final contract on the table yet, the arguments for and against outsourcing primarily have fallen on either side of a partisan and ideological divide. Supporters, mainly Republicans, believe the private sector can do the job better, faster and cheaper than state workers can. Skeptics, mainly Democrats, are doubtful of that proposition and more inclined to line up behind state workers, whose union is bitterly opposed to the plan.

If Rowland gets his wish, somewhere between 500 and 700 state employees would become private-sector employees, but which ones would fall under the scope of the contract—and where they would end up working and what they would be doing—is not clear. It's undetermined whether they would stay at their desks in state

BY ELLEN PERLMAN





Speaker Moira Lyons: 'I'm uncomfortable with the size of what we're undertaking, given there's no past experience with it.'

major partners on the Connecticut contract; and that EDS is laying off 1,200 employees worldwide, raising concern about what would happen to state workers absorbed by the company.

One of the contract failures occurred in Virginia, where EDS agreed in 1997 to terminate a \$45 million contract and pay the state \$2.3 million to settle the issue of not setting up a system to track Medicaid payments more than a year after it was promised. In that case, Dvoranchik says it was too difficult for the two sides to reach agreement on a contract for a new system with client-server technology during a time when the federal government was in the middle of overhauling welfare.

In Florida, there were massive problems with a \$240 million system for processing welfare applications installed in 1992. EDS officials say the Florida contract ran into unforeseen problems when state welfare caseloads increased due to a hurricane and a downturn in the economy and that the company needed more money to add hardware and software to accommodate the changes. When Florida refused to pay the balance of the contract, EDS sued for \$58 million. The Florida welfare agency contended that the computer system was defective when EDS turned it over to the state and filed a counter-claim for \$90 million for work that would have to be done to bring the system up to par. A state circuit court judge agreed with EDS, and after a six-year court battle, Florida agreed to pay \$43 million to the company to settle the case.

While it's true that EDS has been laying off employees, Dvoranchik says the cuts have been in EDS' sales staff and that the

company has been hiring programmers and analysts in the government area, so layoffs would not affect the Connecticut contract. In any case, the contract will guarantee two years of employment to former state employees. As for the Xerox lawsuit, Regan says Xerox has provided a letter saying the lawsuit doesn't affect the business relationship between the two companies in Connecticut. In all, Regan adds, Connecticut has done hundreds of reference checks on the company, checking with state agencies and other governments and companies that have contracted with EDS. Regan and EDS say the company doesn't sue often and, when it does, it continues to provide all services until there's a resolution.

Even if the project clears all of the political hurdles, it faces other possible roadblocks. Not the least of those is the fact that the federal government must sign off on the plan, since so much of the state's computer work deals with entitlement programs such as Medicaid and food stamps. If the federal government doesn't approve, the state could lose federal payments for those programs. Because of that possibility, one of the provisions passed out of Knopp's committee says the state shouldn't send the contract to the auditor until it has obtained all federal approvals.

Connecticut's may be the largest state or local government IT outsourcing in this country to date, and the furthest along, but Connecticut certainly is not the only government to consider privatizing information technology systems on such a large scale. San Diego County is asking three technology companies to bid on a 10-year,

\$500 million to \$700 million contract for outsourcing its computer and telephone systems. The RFP went out in February, and the three companies in the running are the same ones that bid on the Connecticut contract: CSC, EDS and IBM. The county hopes to award a contract by early fall.

A management consultant's report estimates the county spends \$98.5 million on information technology and telecommunications services annually. Of that, \$66.5 million of the services would fall under the outsourcing contract. Not surprisingly, San Diego has experienced many of the same difficulties as Connecticut, from delays in meeting target dates for the process to unions complaining about losing jobs and arguing that the move would be costly and ineffective.

But the San Diego outsourcing project continues to move forward. In Indiana several years ago, a similar proposal blew up quickly. Former Indiana CIO Dan Houlihan says the problem was that decisions were made by a closed group that left out the legislature, the unions and state technology workers. "When the decision was announced, it was a major shock to everyone's system," he says.

Houlihan believes the state would have encountered major problems if it had gone ahead with the large outsourcing approach. "When you blanketly approach outsourcing of everything from telephones to mainframes to networks to applications development, it becomes so massive to control," he says. "Deliverables are hard to nail down. The vendor relationship becomes complicated, and it tends to unravel over time." Indiana also found that information technology employees, fearful of what would happen to their jobs, were fleeing in droves.

Michigan and Iowa also thought about outsourcing state systems but decided consolidation was a more cost-effective strategy. Pennsylvania is in the process of outsourcing its data centers, but it's not a project as massive as what Connecticut is doing.

It's the fact that Connecticut would be the first to dive into technology outsourcing on this scale that has many of the players on both sides worried. Rowland, however, thinks being first would actually be an advantage for the state. After all, the contractor will be hoping to reap profits from replicating a successful arrangement with other jurisdictions. "When you're the first one on the block," Rowland insists, "the company's going to give you the best deal and do the best performance. Failure is not an option." 

Alaska's Asset Portfolio: Managing for Maximum Return A Commonwealth North Study

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CORRECTION

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Agency groupings used in "Alaska's Asset Portfolio: Managing for
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PRODUCTION AND MANUFACTURING

Department of Fish and Game
Division of Forestry
Alaska Correction Industries
Oil and Gas Development
Division of Mining
Division of Agriculture

RESEARCH AND DEVELOPMENT AND SUPPORT SERVICES

Alaska Seafood and Marketing Institute
Alaska Tourism Marketing Council
Alaska Science and Technology Foundation
Alaska Aerospace Development Corporation

LOANS AND INVESTMENTS

Alaska Industrial Development and Export Authority
Alaska Housing and Finance Corporation
Alaska Permanent Fund Corporation
Alaska Fish and Agriculture Bank
Municipal Bond Bank
Student Loan Corporation

AVAILABLE FOR DEVELOPMENT AND REAL ESTATE

Division of Land
Alaska Mental Health Trust Authority
University of Alaska Lands
Department of Transportation Public Facilities
Pioneer Homes
Alaska Psychiatric Hospital

TRANSPORTATION

Alaska Railroad Corporation
Alaska Marine Highway
International Airports
State Airports and Harbors

Appendix B
Factual Summary of Agencies

Management Review

Mission, Structure & Measures

Asset: Alaska Aerospace Development Corporation (AADC)

Mission: To promote the general welfare by establishing & operating a commercial space launch facility. To promote aerospace related economic growth and to develop corresponding technology & support services.

Business Activities: Launch facility currently being built. Business is being sought for this facility.

Management Structure:

Chief Executive: Pat Ladner, Executive Director.

Management Oversight: 9 member board composed of 1 member of the UAA board of Regents, President of UAA, Director of UAA's Geophysical Institute, Executive Director of ASTF, Commissioner of DCED, 2 space industry members, 1 public member.

Financial Oversight: Through State Legislature.

Financial Overview:

Total Revenues: No operating revenue as AADC is in the startup mode.

Total Operating Budget: \$1M, \$641K of which \$520K held in cash designated for the current construction of the launch facility.

Fund Balance: \$.5M

Contributions to State of Alaska Operating Budget: None

Performance Measures: None

Present Return on Asset/Activities:

Primary Return: None

Secondary Return: Expect a positive impact on Alaska's economic growth and stability.

Public Benefit: Possible job creation.

Historical Footnotes Affecting Returns: AADC is in the startup phase of its development. The current construction of the rocket launch facility is using Air Force funds (\$18M), ASTF funds (\$5M) and NASA funds (\$5M).

Asset: Alaska Correctional Industries

Mission: Assist in the rehabilitation of prisoners by providing realistic work experiences as much like those that prevail in private industry. Operate a work program for prisoners that will be nearly self-supporting.

Business Activities:

- Juneau commercial & hospital laundries.
- Kenai office systems and metal plant.
- Palmer auto body plant.
- Palmer meat processing plant.
- Fairbanks garment/flat goods shop.
- Seward furniture plant and assembly /repackaging of electrical supplies.

Management Structure:

Chief Executive: Correctional Industry Commissioner

Management Oversight: 9-member board of directors. 7 appointed by the Governor plus Commissioners of Administration and Corrections.

Financial Oversight: Board reviews annual budget.

Financial Overview:

Total 1997 Revenues: \$3,316,165

Total 1997 Operating Budget: \$3,149,511

Fund Balance : \$166,654

Contributions to State of Alaska Operating Budget:

Performance Measures: Undetermined.

Present Return on Asset/Activities:

Primary Return: Program is self-supporting and prisoners directly benefit from its activities.

Secondary Return: Wages earned by prisoners are required to be disbursed in the following order of priority: prisoner's dependents, reimbursement to the State, payment of civil judgements, payment of fees, purchase of commissary items, payment of restitution.

Public Benefit: Returning prisoners to society with the skills to succeed in the labor force.

Historical Footnotes Affecting Returns:

- Wages paid to prisoners may not exceed 50% of minimum wage unless there is another requirement for higher wages.
- Work activities must have a minimal negative impact on an existing private industry or labor force.

Asset: Alaska Housing Finance Corporation (AHFC)

Mission: Manage capital assets and grants to provide Alaskans equal access to safe, quality, affordable housing and in so doing, affirmatively create jobs and value-added industries.

Business Activities:

- Mortgage loan financing to low and moderate income borrowers, veterans and those living in rural areas of the state.
- Principle source of residential financing in the state and functions as a secondary mortgage market.
- Operate state public housing and subsidize rents.
- Provides funding for the construction and acquisition of public buildings for lease to the state.
- Provides grants to non-profit organizations.

Management Structure:

- Self-supporting, non-stock public corporation.
- Management Oversight: Seven member Board of Directors, 4 of whom are appointed by the Governor, plus the Commissioners of Revenue, Community and Regional Affairs and Health and Social Services.
- Financial Oversight: Annual operating and capital budgets are reviewed by the Governor and Legislature.

Financial Overview:

1997 Total Revenues: \$328,000,000.

1997 Total Operating Budget: \$30,000,000 (\$18,000,000 HUD).

1997 Fund Balance: \$1.8 Billion.

1997 Contributions to State of Alaska Operating Budget: \$50,000,000.

Performance Measures: Annual HUD Public Housing Management Assessment Program required. AHFC also conducts surveys on home ownership and homelessness, the number of program participants, number of awards received.

Present Return on Asset/Activities:

Primary Return: 2.4%

Secondary Return: Undetermined

Public Benefit: Creates jobs, reduces unemployment by maintaining a healthy home-building industry; reduces dependencies on public housing and welfare programs through Family Self - Sufficiency Program. Reduces energy bills via the Weatherization Program.

Historical Footnotes Affecting Returns:

- Most investments purchased with the proceeds of tax-exempt bonds are subject to interest rate yield restrictions of 1.125% to 1.15% over the yield of the bonds.
- Some of the tax-exempt bonds are subject to rebate provisions that may result in a payment due to the IRS.

Asset: Alaska Industrial Development and Export Authority (AIDEA).

Mission: To promote, develop and advance the general prosperity of the people of Alaska. To relieve the problems of unemployment and to create additional employment by providing various means of financing and facilitating the financing of industrial, manufacturing, export and business enterprises and other facilities within the State.

Business Activities:

- Acts as a secondary market for financial institutions by purchasing loan participations and providing guarantees on bank originated loans.
- Issue general obligation indebtedness to own certain development projects. The investment is repaid through user fees.
- Invests a portion of its liquid assets in investment securities that are primarily short to medium term Treasury and Agency obligations.

Management Structure:

- Public corporation of the State
- Management Oversight: Five-member board consisting of 3 gubernatorial appointees, the Commissioner of the Department of Revenue and the Commissioner of the Department of Commerce and Economic Development.
- Financial Oversight: Board of Directors, Legislature.

Financial Overview:

1997 Total Revenues: \$66,800,000.

1998 Total Operating Budget: \$4,000,000.

1997 Fund Equity: \$916,000,000.

1997 Contributions to State of Alaska Operating Budget: \$16,000,000.

Performance Measures: Earnings, number of loans participated in or guaranteed, number of jobs created or retained and number of development projects are all measures of agency performance.

Present Return on Asset/Activities:

Primary Return: 3.64% in 1997.

Secondary Return: Undetermined.

Public Benefit: Creation and retention of jobs.

Historical Footnotes Affecting Returns:

- Reduced levels of financing, beginning in 1987, due to statewide economic recession and changes in federal tax laws, reduced uses of tax-exempt debt for economic development.
- Statutory limitation placed on interest rate charged on funds obtained by bonds.

Asset: Alaska Mental Health Trust Authority.

Mission: To administer the Mental Health Trust established in perpetuity, to have the fiduciary responsibility to its beneficiaries to enhance and protect the trust and to provide leadership in advocacy, planning, implementing and funding of a comprehensive, integrated mental health program to improve the lives and circumstances of its beneficiaries.

Business Activities: To manage its asset consisting of: 500,000 acres of Federal land, 500,000 acres of replacement land, and \$200 Million in cash.

Management Structure:

Chief Executive: Executive Director.

Management Oversight: Undetermined.

Financial Oversight: \$200 Million in cash is combined with the assets of the Permanent Fund for investment purposes. Division of Natural Resources manages the land assets.

Financial Overview:

Total 1997 Revenues: \$2,507,000.

Total 1998 Operating Budget: \$759,900.

Fund Balance: Undetermined.

Contributions to State of Alaska Operating Budget: Undetermined.

Performance Measures: Undetermined.

Present Return on Asset/Activities:

Primary Return: Undetermined.

Secondary Return: Undetermined.

Public Benefit: Creation and sustenance of comprehensive mental health programs for Alaskans.

Historical Footnotes Affecting Returns: Undetermined.

Asset: Alaska Permanent Fund Corporation (APFC)

Mission: To provide a means of conserving a portion of the state's revenue from mineral resources to benefit all generations of Alaskans. To maintain the safety of the principal while maximizing total return. To use the fund as a savings device managed to allow the maximum use of disposable income from the fund for the purposes designated by law.

Business Activities: Invest money received via oil revenues, legislative appropriations and earnings on investments to earn income.

Management Structure:
Public Corporation.

Executive Director appointed by the Board of Trustees and is not a member of the Board. The Governor appoints the six-member board. And includes the Commissioner of the Department of Revenue.

Management Oversight: Board of Trustees and Governor

Financial Oversight: Board of Trustees and Legislature

Financial Overview:

Total 1997 Revenues: \$2.1 Billion

Total 1998 Operating Budget: Estimated at \$30 Million

1997 Fund Balance: \$17.9 Billion

1997 Contributions to State of Alaska Operating Budget: \$1.7 Million. \$746.8 million distributed to the residents of the State.

Performance Measures: The market.

Present Return on Asset/Activities:

Primary Return: 9.2% return in FY 97

Secondary Return: \$746.8 million distributed to the residents of the State.

Public Benefit: Lower unemployment.

Historical Footnotes Affecting Returns: Statutory restrictions as follows:

- The fund may at no time own more than 5% of the voting stock of a corporation.
- Domestic stocks, except for bank and insurance company stocks, must be listed at the date of purchase on an exchange registered with the SEC.
- At the time of each investment, the aggregate investment of the fund in each stated category of investment may not exceed the following percentages: 15% mortgages, 15% real estate, 20% CD's or term deposits, 50% corporate stocks.

Asset: Alaska Railroad Corporation (AKRR)

Mission: To provide safe, economic and efficient rail transportation to freight users, businesses, passengers and military installations in the state. To foster and promote the long term economic growth and development of the state. To develop and implement plans for a rail transportation network. To foster and promote the development of the state's land and natural resources.

Business Activities: Provides freight and passenger service throughout the railbelt. Owns and manages 578 miles of rail right of way from the Port of Seward, through Anchorage and to Fairbanks, with a line from Fairbanks to Eielson AFB. The Corporation owns approximately 38,000 acres of land including the rail right of way.

Management Structure:

- Independent corporation owned by the state of Alaska.
- Management Oversight: Seven-member board of directors appointed by the Governor.
- Financial Oversight: The Board approves the annual budget and all capital projects. Legislative oversight provided by the Legislative Budget and Audit Committee.

Financial Overview:

Total 1997 Revenues: \$76,386,000, Grant Revenues: \$1,230,000.

Total 1997 Operating Budget: \$75,200,000.

Equity Balance: \$84.040,000, which includes State of Alaska investment of \$34,174,000.

Contributions to State of Alaska Operating Budget: None.

Performance Measures: An annual Performance Audit is prepared by an outside expert in the railroad business. The railroad also submits to the legislature an annual report of the year's activities.

Present Return on Asset/Activities:

Primary Return: 1997 Net income of \$10,590,000.

Secondary Return: Undetermined

Public Benefit: Undetermined

Historical Footnotes Affecting Returns:
Undetermined.

Asset: Alaska Science & Technology Foundation (ASTF)

ASTF was created through statutory authorization (37.17.01 0). Funded by an endowment of \$101 million.

Mission: Enhance the development and application of science and technology for the direct benefit of Alaskans. ASTF will help establish an environment where Alaska has the confidence, know-how, technology and risk capital to grow an economy of sustainable wealth.

Business Activities:

- Makes grants to technology-based firms with preference to startups and existing firms branching into new products or processes.

Management Structure:

- Independent Agency.
- Management Oversight: Board of directors appointed by the Governor; Legislative confirmation required.
- Financial Oversight: Governor appointed board of directors makes all funding decisions and the Legislature approves the budget.

Financial Overview:

Total 1997 Revenues: Two types: Investment income and grant/loan repayments
Total 1997 Operating Budget: Approximately \$9 million.

Fund Balance (if any): Endowment is \$101 million with additional earnings of \$15 million.

Contributions to State of Alaska Operating Budget: None.

Performance Measures: Undetermined.

Present Return on Asset/Activities:

Primary Return: Increased science and engineering capability to sustain the economy.

Secondary Return: More R&D and headquarter functions to aid in gaining control over Alaska's economic destiny.

Public Benefit: Latest evaluation shows 615 jobs as a result of ASTF projects.

Historical Footnotes Affecting Returns: ASTF's goal is to help finance and put together projects to reach the above goals. The Board has discussed the possibility of privatizing the ASTF, but are not at all clear that the Legislature would want to accept this loss of control or accountability. Moving to a two-year budget would be an improvement on the existing system thus eliminating the threat to the future of the organization each year. There is a concern that certain non-revenue functions of ASTF would go away if privatized. The threat to ASTF's existence is to transfer the endowment to support a perceived financial crisis.

Asset: Alaska Seafood Marketing Institute

Mission: To increase the consumption of Alaska seafood and to promote the quality and superiority of Alaska seafood products.

Business Activities: Promote through marketing programs the consumption of Alaska seafood. To promote within the industry a program to improve the quality of Alaska seafood.

Management Structure:

Chief Executive: Barbara Belkamp, Executive Director.

Management Oversight: Oversight is by a 25-member board. Twelve members are fishermen and twelve members are processors. One member is from the general public.

Financial Oversight: Through the State Legislature.

Financial Overview:

Total Revenues: Revenue is obtained by a 1% salmon tax, a .3% processor tax and some federal export monies that require a state match. FY97: \$6.2 M (\$3.5 M from the 1% salmon tax, \$2.7 M from the .3% processor tax).

Total Operating Budget: \$.9M Administration, \$.2M R&D, the balance to programs.

Fund Balance: Minimal.

Contributions to State of Alaska Operating Budget: None.

Performance Measures: Internally they have well defined performance measures in the marketing program, restaurant usage and quality programs. The one problem area is in getting information from retailers and they consider such information confidential.

Present Return on Asset/Activities:

Primary Return: None

Secondary Return: Undetermined.

Public Benefit: Jobs in the seafood industry.

Historical Footnotes Affecting Returns: Since the majority of the monies spent are from self-taxation or federal sources, the organization is not a drain on the general state treasury.

Asset: Alaska Tourism Marketing Council

Mission: To stimulate statewide economic growth, diversification and employment through the promotion of Alaska as a visitor destination.

Business Activities:

- Design and execute an integrated marketing program directed at U.S. and Canadian markets determined to have the greatest potential for producing new and repeat visitors.
- Dissemination of visitor information by media advertising, public relations and research.

Management Structure:

Chief Executive: Director of the Division of Tourism

Management Oversight: 21-member board, 10 appointed by the Governor, 10 appointed by Alaska Visitor's Association, plus the Director.

Financial Oversight:

Financial Overview:

Total Revenues: No direct revenues generated.

Total FY97 Operating Budget: \$5,310,600.

Fund Balance : N/A

Contributions to State of Alaska Operating Budget: No direct contributions, however tourism yields \$124 Million in taxes and fees.

Performance Measures: Undetermined.

Present Return on Asset/Activities:

Primary Return: Increase in the number of year-round visitors from the U.S. & Canada.

Secondary Return: Increase in jobs in the tourism industry. Additional fees going to state and municipal treasuries.

Public Benefit: Allows small businesses with affordable access to a national marketplace. Increased tourism benefits the overall economy.

Historical Footnotes Affecting Returns:

- ATMC is a public corporation within the Department of Commerce & Economic Development.
- A joint venture between the State and private sector. The Alaska Visitor's Association represents the private sector.

Asset: Department of Natural Resources, Division of Agriculture

Mission: To administer promotional and experimental work, agricultural projects and long term, low interest loans for the purpose of promoting and developing the agricultural industry within the state.

Business Activities:

- General agricultural development and administration.
- State Fairs
- North Latitude Plant Materials Center (NLPMC) which supports industry through production and development of plant materials.
- Agricultural Revolving Loan Fund (ARLF).

Management Structure:

Chief Executive: Division Director

Management Oversight: Commissioner of DNR.

Financial Oversight: Governor submits the budget to the Legislature for review and approval.

Financial Overview:

Total Revenues: \$352,000 of Federal funds and \$508,000 from ARLF.

Total 1997 Operating Budget: \$940,000 for NLPMC.

Fund Balance:

Contributions to State of Alaska Operating Budget: None

Performance Measures: None found.

Present Return on Asset/Activities:

Primary Return: Undetermined.

Secondary Return: Undetermined.

Public Benefit: Agricultural commodities priced at market-clearing rates.

Historical Footnotes Affecting Returns:

Legislature has replaced General Fund support for the Division with assets from ARLF.
Assets are declining as they are appropriated for the Division's operating costs.

Asset: Department of Fish & Game

Mission: To maintain and enhance the health and population of the various species of fish and animals, including habitat protection, and then to allocate the harvest of fish and game among sport, subsistence and commercial users, and escapement, using the principle of sustained yield.

Business Activities:

- Strategic management and allocation of the various resources.

Management Structure:

Chief Executive: Commissioner of the Department of Fish & Game.

Management Oversight: Board of Fish & Game.

Financial Oversight: Legislative.

Financial Overview:

Total Revenues: Unavailable.

Total Operating Budget: Unavailable.

Fund Balance: Unavailable.

Contributions to State of Alaska Operating Budget: Unavailable.

Performance Measures: Undetermined.

Present Return on Asset/Activities:

Primary Return: Undetermined.

Secondary Return: Undetermined.

Public Benefit: Sustained resource.

Historical Footnotes Affecting Returns: Undetermined.

Asset: Alaska Department of Natural Resources, Division of Forestry.

Mission: To protect the State's forested land and forest resources and to manage them for multiple use and sustained yield.

Business Activities: Manage timber sales and issue personal use fuelwood, houselog and sawlog permits. Fight wildfires, plant seedlings, support public education and research. Administration of Rural Community Fire Protection Grants.

Management Structure:

Chief Executive: State Forester who is under the Commissioner of DNR.

Management Oversight: Alaska Board of Forestry appointed by the Governor.

Financial Oversight: Legislature.

Financial Overview:

1997 Total Revenues: \$1,200,000.

1997 Total Operating Budget: \$9,826,800.

1997 Fund Balance: None.

1997 Contributions to State of Alaska Operating Budget: None.

Performance Measures:

- Number of timber sales, volume of timber sold.
- Numbers of firefighters trained and number of fires fought and controlled.
- Numbers of acres inventoried and assessed for insect and disease conditions.
- Number of permits for public use.
- Research results from collaborators at U of Alaska or federal agencies.

Present Return on Asset/Activities:

Primary Return: \$1,268.656 return from 1996 timber harvest.

Secondary Return: Response to wild fires, wildlife habitat improvement, and forestry research.

Public Benefit: Permit issuance for personal use timber, timber sales provide employment, public education on forestry issues.

Historical Footnotes Affecting Returns: Undetermined.

Asset: Department of Natural Resources, Division of Mining

Mission: DNR's mission statement is, "To develop, conserve and enhance natural resources for present and future Alaskans". Mining Division adds, "To facilitate the development and stewardship of Alaska's mineral resources...by processing major mineral and coal actions necessitated for tracking title and compliance requirements".

Business Activities:

- Regulation of the mining industry
- Resource development
- Program administration
- Public safety
- Property rights

Management Structure: The Division of Mining & Water Management is a division of the Department of Natural Resources that answers to the Governor.

Chief Executive: Director of the Division of Mining & Water Management.

Management Oversight: Alaska Mineral Commission, Department of Natural Resources, Governor.

Financial Oversight: Annual State budget process.

Financial Overview: FY 98

Total Revenues: \$3,450,000

Total Operating Budget: \$3,888,900

Fund Balance: N/A

Contributions to State of Alaska Operating Budget: Undetermined.

Performance Measures:

- Input from interested groups: Alaska Miner's Association, Div. Of Geological & Geophysical Surveys, Div. Of Trade and Development, Division of Fish & Game, Alaska Minerals Commission, Environmental groups.
- DNR-Division of Mines provides performance criterion.

Present Return on Asset/Activities:

Primary Return: Mineral royalties, rental fees, lease fees, permit fees, and permit assistance fees.

Secondary Return: Job creation, infrastructure development, and resource development.

Public Benefit: Same as Secondary Return.

Historical Footnotes Affecting Returns:

- Assets consist of state lands for mineral production
- Revenues are derived from taxes on mining, claim rental fees, net license tax, mine application assistance, net royalty from state owned lands, corporate income tax
- Additional revenues come from federal abandoned mine program grants
- Expenditures in FY 98 are \$3,889,000 and will be cut to \$1,996,000 in FY 99.

Asset: Department of Natural Resources, Oil & Gas Development

Mission: To maximize economic and physical recovery to the state from its oil and gas resources. Five items are important to decision making:

- Economic and physical recovery
- Maximizing competition
- Maximizing use of Alaska's human resources
- Encouraging assessment of the state's resources
- Minimizing adverse impact

Business Activities: Issuing and controlling oil & gas leases.

Management Structure:

Chief Executive: Director of management unit

Management Oversight:

Financial Oversight: Legislative budget and audit as part of the annual budget process.

Financial Overview:

Total Revenues: Undetermined.

Total 1997 Operating Budget: \$4.2 million.

Fund Balance: Undetermined.

Contributions to State of Alaska Operating Budget: Undetermined.

Performance Measures: Undetermined.

Present Return on Asset/Activities:

Primary Return: Undetermined.

Secondary Return: Undetermined.

Public Benefit: Undetermined.

Historical Footnotes Affecting Returns: Undetermined.

Asset: University of Alaska Lands. Statewide Office of Land Management (SOLM).

Mission: The purpose of land ownership is to support the operations of the University.

Business Activities: SOLM currently generates the majority of University real property income from timber harvesting, residential/recreational subdivision and other land sales, and from commercial leasing. More than 50% of the land does not produce income, but does incur costs such as monitoring trespass/theft of resources, processing requests for easements and protecting the land from environmental contamination.

Management Structure:

Chief Executive: Martin Epstein, Director

Management Oversight: Accountable to the University Board of Regents.

Financial Oversight: SOLM reports to the University's VP of Finance.

Financial Overview:

Total Revenues: FY 97: \$5.8 M, FY 98: \$9.0 M, (Forecast) FY 99: \$7.5 M, FY 00: \$8.0 M.

Total Operating Budget: \$2.6 M.

Fund Balance: 6/30/97 \$80 M.

Contributions to State of Alaska Operating Budget: None.

Performance Measures: The University's Statewide Office of Land Management publishes an annual report which includes a Financial Report, Annual Progress Report toward their Strategic Plan and a review of both investment property and educational property projects.

Present Return on Asset/Activities:

Primary Return: Provides for the University students.

Secondary Return: Jobs are created as a result of certain land office transactions/timber harvests, etc.

Public Benefit: The presence of a University for Alaska.

Historical Footnotes Affecting Returns: Gross revenues from real property have increased from \$200,000 in FY 85 to \$10 M in FY 94 as a result of change of focus in the management and development office. The University is running out of prime land holdings for generating income.

Appendix C
Agency Interview Questions

1. Are the public purposes well defined and relevant?
2. Is the fiscal structure sound and realistic given the purpose?
3. Does the management structure adequately balance the beneficiary purposes of the agency/asset against the interest of the equity owner and other public purposes?
4. Are there current performance measures? Is this reporting adequate?
5. Does the agency know and track its beneficiaries? Does it monitor its effectiveness in meeting its public purpose with these beneficiaries?
6. To what extent does this entity compete with the private sector for goods or services?
7. What are the explicit or implicit expectations of beneficiaries, the legislature, the general public and others with this agency/asset?
8. What changes to the structure of the agency/asset management would the managers themselves make?
9. Does this agency/use of this asset have an appropriate public purpose?
10. What other paradigms/structures might be appropriate for the management of this asset?
11. Most assets are managed for dual objectives—either ownership/regulatory (land) or public service/return on investment. How is the balance between these objectives handled within the management of the agency/asset?

Appendix D
Biographies of Co-chairs

N A N C Y B E A R U S E R A

Nancy Bear Usera is currently Senior Vice President for Corporate Relations at Alaska USA Federal Credit Union. Prior to accepting that position in 1995, Usera served in key positions in the Administration of Governor Walter J. Hickel. Over the four-year term she served as Commissioner of Labor, Commissioner of Administration and as the Governor's Chief of Staff. She also served on a number of state boards including the Alaska Permanent Fund Corporation and Alaska Housing Finance Corporation.

Prior to state service, Usera spent 20 years representing a variety of state and national trade associations and was active in civic affairs. She currently serves on the boards of Commonwealth North, Anchorage Economic Development Corporation and the Alaska State Chamber of Commerce.

Before moving to Alaska in 1981, Usera was vice president of a Washington, D.C. association management and lobbying firm. She currently resides in Anchorage and has three sons.

O L I V E R S C O T T G O L D S M I T H

Professor Scott Goldsmith was been a faculty member of the Institute of Social and Economic Research, a public policy research arm of the University of Alaska, Anchorage, for 23 years. He holds a joint appointment in the College of Business and Public Policy at UAA. His research interests include regional economics, Alaska fiscal policy and energy demand. He has constructed several Alaska economic models that are regularly used at the Institute for a variety of political analyses and projections. He is the principal author of the ongoing *Fiscal Policy Paper* series, which examines the fiscal implications of the dominance of petroleum in Alaska's tax base. Professor Goldsmith contributes the results of this research regularly to academic journals as well as to a more general audience through Institute publications and frequent speaking engagements. His teaching interests include business forecasting and mathematics for economists.

Professor Goldsmith is active in professional service to the community, having served as Chairman of the Anchorage Municipal Budget Advisory Commission, as a member of the Alaska Bypass Mail Post Office Task Force and the Child Support Enforcement Task Force, as well as on various other councils and boards over the years. He is also a member of the United Way of Anchorage Allocation Panel and on the boards of a number of Anchorage athletic events.

Professor Goldsmith is a native of Chicago, a graduate of Princeton, and holds a Ph.D. in Economics from the University of Wisconsin. He is married and has two daughters.

Appendix E

Study Group Members

PRODUCTION AND MANUFACTURING:

(Fish & Game, DNR timber, Alaska Correctional Industries, oil & gas, mining, agriculture)

Chair: Cheryl Frasca – C. Frasca Co.

Sole proprietor of government relations consulting firm with expertise in the legislative process and state fiscal policy issues. Past positions include Deputy Chief of Staff to the Governor; Director, Division of Budget Review; and Chief of Staff to the Senate President. Civic board/leadership positions include Anchorage Chamber of Commerce; Budget Advisory Commission; Small Business Development Center Advisory Board; American Society for Public Administration; and Alaska Council on Economic Education. Ms. Frasca holds a Master of Public Administration from University of Alaska Southeast, and a BA. in political science from California State University Hayward.

Matthew Cronin – LGL Alaska Research Associates, Inc.

Mark Dawson – Swalling Construction, Inc.

David Hudspeth – First National Bank

James Kenworthy – Alaska Science and Technology Foundation

Steven Rieger – S. Rieger & Co.

Kirk Wickersham – Attorney at Law

RESEARCH AND DEVELOPMENT AND SUPPORT SERVICES:

(ASMI, ATMC, ASTF, Alaska Aerospace Development Corp.)

Co-chair: Mary Ann Pease – Aurora Power Resources, Inc.

Vice President of Aurora Power Resources, Inc., and is the former Finance Director for Municipal Light and Power. She has a master's degree in finance from the University of Bridgeport, Connecticut. She is on the board of directors for Alaska Children's Services and is on the Anchorage Chamber of Commerce Municipal Committee.

Co-chair: Tim Wiepking – Cardiff Wireless Communications

Operations Manager for Cardiff Wireless Communications. He has a BS degree in Business Administration from the University of Colorado in Boulder and is currently working toward his MBA degree from the University of Alaska, Anchorage. His past employment includes operating his own business and Budget and Policy Analyst for the Municipality of Anchorage.

John Hoyt – Brigadier General (retired)

Dave Kester – Ribelin Lowell & Co.

Gene O'Hara – Providence Alaska Medical Center

Jerry Strang – Remax Properties

LOANS AND INVESTMENTS:

(AIDEA, AHFC, APFC, Alaska Fish & Agriculture Bank, Municipal Bond Bank, Alaska Student Loan Corp.)

Chair: Phoebe Wood – ARCO Alaska, Inc.

Vice President of Finance, Planning and Control for ARCO Alaska, Inc. Responsibilities include ARCO Alaska's information systems, materials, purchasing, contracting, planning, evaluation, accounting and financial analysis. Ms. Wood has been Vice President for Business Development at Vastar Resources, Inc., Vice President of Finance, Planning and Control at ARCO British Ltd., Planning and Evaluation Manager for ARCO International Oil and Gas Company, and Manager of Corporate Finance at ARCO Corporate. She currently serves on the Board of Trustees of Alaska Pacific University, and on the Executive Committee of the Boys and Girls Clubs of Greater Anchorage. Ms. Wood is a graduate of Smith College and holds a MBA degree from UCLA.

Richard Barnes – Enstar Natural Gas Co.

Carla Beam – BP Exploration (Alaska), Inc.

Joe Griffith – Chugach Electric Association

Max Hodel – Commonwealth North Founding Member

Jo Li Sellin – National Bank of Alaska

Mead Treadwell – Institute of the North

AVAILABLE FOR DEVELOPEMENT AND REAL ESTATE:

(Division of Land, Mental Health Trust, U of A lands, DOT public facilities, Pioneer Homes, Alaska Psychiatric Hospital)

Chair: Patricia DeMarco, Ph.D. – AEDC

President of Anchorage Economic Development Corporation. A graduate of University of Pittsburgh with degrees in the field of genetics. She spent seven years conducting biochemical research at Yale University and Boston University Medical Center prior to entering the field of energy and environmental policy analysis. She served as Executive Director of the Power Facilities Siting Council and as Senior Rates Specialist to the Department of Public Utility Control for Connecticut. Dr. DeMarco operated a consulting firm for four years, and in 1989 joined the Connecticut Municipal Electric Energy Cooperative as Senior Policy Advisor, where she was instrumental in founding the technology transfer company, TECHCONN, Inc. Dr. DeMarco is a member of the Anchorage Downtown Rotary and the Log Cabin Quilters.

Don Dietz – Port of Anchorage

Mano Frey – Alaska State AFL-CIO

Gov. Walter J. Hickel – Hickel Investment Co.

Lana Johnson – Northwest Strategies

TRANSPORTATION:

(AKRR, Marine Highway, International Airports, State airports, harbors and ports)

Chair: John Copeland – Elmendorf Air Force Base

Chief Information Officer for the 611th Air Support Squadron and Federal Mediator and counselor for the 3rd Wing at Elmendorf. Previous positions have included remote radar sites at Shemya Island for the 5099th Civil Engineer Squadron, the Alaska Railroad, IBM Corporation, and the United States Air Force at Elmendorf Hospital.

Wiley Brooks – Wiley Brooks Co.

Milton Byrd – Charter College

Darrell Chambers – ARCO Alaska (former Hartig Fellow)

Joseph Henri – Southcentral Timber Development, U of A Regent

Loren Lounsbury – International Management Group



Privatization
Database

Types and Techniques of Privatization

A variety of alternative service delivery techniques can be employed to maximize efficiency and increase service quality. Some methods will be more appropriate than others depending on the service. In searching for ways of cutting costs and increasing delivery, consider using a combination of these techniques:

- **Contracting Out (also called "outsourcing").** The government competitively contracts with a private organization, for-profit or non-profit, to provide a service or part of a service.
- **Management Contracts.** The operation of a facility is contracted out to a private company. Facilities where the management is frequently contracted out include airports, wastewater plants, arenas and convention centers.
- **Public-Private Competition (also called "managed competition," or "market testing").** When public services are opened up to competition, in-house public organizations are allowed to participate in the bidding process.
- **Franchise.** A private firm is given the exclusive right to provide a service within a certain geographical area.
[See Franchising and Privatization by Antony W. Dnes]
- **Internal Markets.** Departments are allowed to purchase support services such as printing, maintenance, computer repair and training from in-house providers or outside suppliers. In-house providers of support services are required to operate as independent business units competing against outside contractors for departments' business. Under such a system, market forces are brought to bear within an organization. Internal customers can reject the offerings of internal service providers if they don't like their quality or if they cost too much.
- **Vouchers.** Government pays for the service; however, individuals are given redeemable certificates to purchase the service on the open market. These subsidize the consumer of the service, but services are provided by the private

sector. In addition to providing greater freedom of choice, vouchers bring consumer pressure to bear, creating incentives for consumers to shop around for services and for service providers to supply high-quality, low-cost services.

- **Commercialization (also referred to as "service shedding").** Government stops providing a service and lets the private sector assume the function.
- **Self-Help (also referred to as "transfer to non-profit organization").** Community groups and neighborhood organizations take over a service or government asset such as a local park. The new providers of the service also are directly benefiting from the service. Governments increasingly are discovering that by turning some non-core services—such as zoos, museums, fairs, remote parks and some recreational programs—over to non-profit organizations, they are able to ensure that these institutions don't drain the budget.
- **Volunteers.** Volunteers are used to provide all or part of a government service. Volunteer activities are conducted through a government volunteer program or through a non-profit organization.
- **Corporatization.** Government organizations are reorganized along business lines. Typically they are required to pay taxes, raise capital on the market (with no government backing—explicit or implicit), and operate according to commercial principles. Government corporations focus on maximizing profits and achieving a favorable return on investment. They are freed from government procurement, personnel and budget systems.
- **Asset Sale or Long-Term Lease.** Government sells or enters into long-term leases for assets such as airports, gas utilities or real estate to private firms, thus turning physical capital into financial capital. In a *sale-leaseback* arrangement, government sells the asset to a private sector entity and then leases it back. Another asset sale technique is the *employee buyout*. Existing public managers and employees take the public unit private, typically purchasing the company through an Employee Stock Ownership Plan (ESOP).
[See Guide for Divesting Government-Owned Enterprises
The Esop Association
Virginia Competition Council --choose ESOP]
- **Private Infrastructure Development and Operation.** The private sector builds, finances and operates public infrastructure such as roads and