PRIVATIZATION PROPOSALS IN OTHER STATES

for the Business, Labor, and Agriculture Interim Committee
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Introduction

Montana is not alone in its investigation of determining the most effective and efficient method of delivering services to the public. At least 14 states have created commissions to address competition and privatization during the last 10 years, and dozens of local governments have pursued efforts to mitigate the issues associated with government agencies offering services that the private sector can normally provide.[1] The purpose of this paper is to begin to tie the two components of the HB 515 study together and, with the information gathered from the Committee questionnaire, to begin to build a policy framework that identifies legislative options.

In other political jurisdictions, the issue of privatization hinges on two fundamental principles that share a common expectation. The first is a financial principle that suggests that government should strive to provide services without creating an undue burden on taxpayers. The second principle is a philosophical claim that the free market offers benefits not easily identifiable within the public sector. In essence, the competitive nature of the free market results in innovation, reduced costs, and flexible decisionmaking opportunities.

However one chooses to approach the question of privatization and reducing competitive inequities, the expectation seems to be the same. Customers, in this case the taxpayers, are entitled to receive the best service for the best value. If this is an appropriate expectation, as other states have determined, the Legislature must create conditions under which agencies review their current service delivery approaches and recommend changes that support the public's expectation.

A brief investigation into a few of the states listed below generated a reasonably consistent prescription for addressing policy issues associated with privatizing public service delivery systems. The four states that were chosen, Virginia, Michigan, Texas, and Colorado, represent a cross-section that should offer policymakers some guidance in making recommendations suitable for Montana. The common tie among the states that were reviewed seemed to be the establishment of an independent decisionmaking body, the recognition that a uniform cost accounting model was necessary, and the investigation into whether managed competition would generate positive changes to the efficiency and effectiveness of public service delivery.

Other State Actions

The following table represents the states that have established permanent reviewing entities tasked with the responsibility of developing recommendations concerning privatization options.

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[1] Privatization of State Government Services, NCSL LegisBrief, vol.6, no.6.

State Privatization Boards, Commission, and Councils	
State	**Entity**
Arizona	Private Enterprise Interview Review Board
Colorado	Commission on Privatization of Personal Services
Florida	Council on Competitive Government
Georgia	Governor's Commission on Privatization
Kansas	Kansas Council on Privatization
Kentucky	Governor's Commission on Privatization
Maryland	Council on Management and Productivity
Michigan	Michigan Public-Private Partnership Council
New Jersey	Advisory Commission on Privatization
New York	New York State Research Council on Privatization
Texas	Council on Competitive Government
Utah	Privatization Policy Review Board
Virginia	Commonwealth Competition Council
Wisconsin	Commission on Privatization

Source: Practices: A Review of Privatization in State Government, CSG

In 1997, the U.S. General Accounting Office (GAO) provided a privatization report at the request of the House Republican Task Force on Privatization. The GAO report reviewed the efforts of several states and municipalities in order to uncover where privatization methodologies were working and to establish a number of policy prescriptions for other political jurisdictions considering a similar approach. In their summary, the GAO identified six steps for success.[2] They are:

- Political Champion
  Privatization can best be introduced and sustained when a political leader champions it.

- Implementation Structure
  Government leaders need to establish an organizational and analytical structure to ensure effective implementation.

- Legislative and Resource Changes

[2] *Privatization Lessons Learned*, GAO/GDD-97-48, p. 4.

Governments may need to enact legislative changes and/or reduce governmental resources to encourage greater use of privatization.

- Reliable Cost Data
  Reliable cost data on government activities is needed to support informed privatization decisions and to assess overall performance.

- Strategies for Workforce Transition
  Governments need strategies to manage workforce transition.

- Monitoring and Oversight
  More sophisticated monitoring and oversight are needed to protect the government's interests when its role in the delivery of services is reduced through privatization.

Although each of the six findings are inherent in any successful privatization effort, this paper focuses on three specific recommendations: implementation structure, reliable cost data, and monitoring and oversight.

According to the GAO report, once the decision to consider privatization has been made, a formal structure must be established to ensure the effective implementation of any policy recommendations. Governments that have successfully instituted large-scale privatization efforts generally establish a commission that is charged with identifying privatization opportunities, offering assistance to agencies engaging in a privatization effort, and developing a framework that allows for the consistent consideration of privatization benefits and costs. The GAO offered an important bit of advice for decisionmakers considering the establishment of a commission. They suggested that the commission's mission, goals, and authority be clearly established and understood by all of the affected parties. The GAO gave additional guidance by advocating for a balanced membership that reflects both public and private interests.

At a minimum, the GAO recommends that a consistent approach to making decisions be developed before any privatization activities are initiated. The framework should include the criteria for selecting the activities to privatize and should address the inventory of privatization candidates, cost comparison and evaluation methods, and procedures for monitoring the performance of privatized activities.

Reliable and complete cost data on government activities is needed to ensure a sound competitive process and to assess overall performance. Reliable data simplifies privatization decisions and makes the decisions easier to implement and justify. Virginia introduced a comprehensive cost analysis method based on the federal government's A-76 program. Using this methodology, the state was able to identify complete costs for nearly 50% of the services that were identified as privatization candidates. Virginia also worked closely with private firms to determine whether costs associated with public providers would translate into costs for private providers. These discussions also led to a better understanding of whether an appropriate pool of private vendors was available for service contracts and what changes, if any, were needed to accurately describe the scope and purpose of the service.

Regardless of the method chosen to incorporate a greater private involvement into the delivery of public services, the service recipient still pays for the service. Performance monitoring and oversight activities are a critical component of a successful privatization effort. According to the GAO report, the weak link identified by the individual government entities was performance monitoring. In essence, the way the monitoring process is structured is just as important as what conditions the state is monitoring.

Virginia[3]

In 1995, the Virginia General Assembly created and passed the Virginia Government Competition Act. The Act was an extension of a number of recommendations arising from a government reform study. Additionally, the Act created the Commonwealth Competition Council, an independent, appointed body that is responsible for administering an inclusive program of service delivery reforms. The Council's mission is made up of nine specific goals.[4]

1. Examine and promote methods of providing a portion or all of select government programs through the private sector by a competitive contracting program and advise the Governor, the General Assembly, and Executive Branch agencies of the Council's findings and recommendations.

2. Develop an institutional framework for a statewide competition within state government.

3. Establish a system to encourage the use of feasibility studies and innovation to determine areas in which competition could reduce government costs without harming the public.

4. Monitor the products and services of state agencies to bring an element of competition and to ensure a spirit of innovation and entrepreneurship to compete with the private sector.

5. Advocate, develop, and accelerate implementation of a program for state entities to ensure competition for the provision or production of government services, or both, from public and private sector entities.

6. Establish approval, planning, and reporting processes required to carry out the functions of the Council.

7. Determine the privatization potential of a program or activity; perform cost/benefit analyses; and provide for independent certification of the results of the comparison by the Secretary of Finance.

[3] Detailed information on the Commonwealth Competition Council can be found at: http://www.vipnet.org/ccc/home.htm

[4] 9-342, Code of Virginia

8. Devise, in consultation with the Secretary of Finance, evaluation criteria to be used in conducting performance reviews of any program or activity, that is subject to a privatization recommendation.

9. To the extent practicable and to the extent that resources are available, make its services available for a fair compensation to any political subdivision of the Commonwealth.

The Council held a series of public hearings that focused on gathering information about recognizing efficiencies in service delivery. While the Act was not conceived as a remedy to public-private competition, it did develop a regular review process, assisted by a proprietary accounting methodology (Cost Comparison Program), to analyze which service provider, public or private, would offer the best service for the best value.[5] The Cost Comparison Program, known as COMPETE, assists decisionmakers in understanding the fully allocated cost of a state function, the activity cost of service units of output in a state function, and a neutral cost comparison between in-house service providers and private sector vendors. In broad terms, COMPETE is based on:

- personnel costs;
- materials and supply costs;
- fixed assets and depreciation;
- other costs, including rent, insurance, utilities, travel, interagency charges, and outside contractors; and
- overhead/indirect costs.

Besides the proprietary accounting program, the Council developed a lengthy list of policy alternatives under the general umbrella of privatization. By defining privatization as broadly as possible, the state found itself with a variety of options that met its goal of more efficient service delivery. The Council considers each of its policy options as being in one of four categories. The four categories are:

- Transferring ownership of government assets to the private sector.

- Contracting with private sector vendors to provide services previously provided by government agencies.

- Involving the private sector in the financing and development of public capital improvement projects.

- Competition through either public-private, public-public, or private-private scenarios.

[5] In fact, the Act was designed in some part to spur competition between public and private sector vendors. The belief was that competition results in cost savings and greater efficiencies. However, the Virginia General Assembly also recognized that in order to effectively facilitate competition, a reasoned and fair comparison between the two primary providers was critical.

The primary action of the Council is to review agency-generated Public/Private Performance Analyses. Each analysis is divided into two levels. Level I includes a description of the potential for competition, an estimate of the cost of the activity to the government, and any policy considerations that address serving the safety and welfare of the public. Level II allows the agency to propose procedural plans and how the competition would be implemented.

While the Council does not require a government agency to engage in a privatization effort, they do make recommendations to the Governor and the Legislature about which services would ultimately be candidates for an alternative form of delivery. The process that the Council employs provides decisionmakers with timely information that facilitates informed decisions.

<u>Michigan</u>[6]

Michigan established its privatization framework, known as PERM, in 1992 by incorporating a set of procedures for analyzing government activities.[7] Initially, Executive Branch agencies in Michigan used a report written by the Public-Private Partnership Commission to choose functions or services that should be analyzed for their appropriateness under a privatization model.[8] Each analysis was accomplished using a three-part analytical model developed by the Department of Management and Budget. The three components used by the Executive Branch agencies are:

1. Historical analysis: identified the factors that caused government to become involved in the activity and whether those factors have changed. This phase also tracked the state's level of responsibility throughout its involvement.

2. PERM analysis: recommended whether the function should be privatized, eliminated, retain in its current form, or modified. This analysis included evaluating the potential effects of any recommendation on service recipients and other state activities. The agencies also studied potential barriers to achieving any recommendations that called for changing the manner in which services were delivered.

3. Cost analysis: prepared reports that accounted for the costs associated with delivering a service. Included within the cost analysis was an investigation of what costs an alternative service provider would incur.

Following the completion of the three-part analysis, the agency would decide what action it

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[6]*Privatization Lessons Learned*, GAO/GDD-97-48.

[7]PERM is the acronym for Privatized, Eliminated, Retained, or Modified.

[8]The Public-Private Partnership Commission was abolished in late 1992. Its functions were given to the Privatization Division.

would take. The agency action was reviewed by the Department of Management and Budget and, if approved, implemented according to agency specifications.

Since 1995, most of the analysis concerning privatization has been conducted under the direction of the Privatization Division of the Department of Management and Budget and has focused on services that are duplicated with individual agencies. The Privatization Division reports their findings to the Governor's Office and the individual agency. If the Governor approves the recommendations, the plan is implemented. According to Michigan officials, most decisions calling for privatization can be implemented by the Executive Branch and do not need legislative approval. When legislative approval is necessary, the appropriate statutory language is introduced.

Texas[9]

In 1995, the Texas Legislature created the Council on Competitive Government and charged it with identifying and determining services that government should not be performing. Put another way, the mission of the Council is to recommend areas where government should focus its energies and resources on functions that it can provide efficiently and effectively. The Council is somewhat unique among similarly tasked bodies in other states in that the Governor, two other statewide elected officials, and the Speaker of the Texas House of Representatives serve as members.

The Council's main objective is to identify commercially available services being performed by state agencies and determine, through a cost accounting approach (similar to most other models reviewed), whether those services can be provided more effectively or efficiently by contracting or privatizing those services. Inherent within the Council's activities is the consideration that identifying a commercial service does not automatically trigger a privatization plan or contracting agreement. In fact, the Council has recommended that, under the auspices of reorganization or reengineering, another state agency may be chosen to provide the service. It is assumed that if a service were subjected to reengineering, a cost analysis was conducted and the outcome showed that a public sector provider could meet the overall mission of improving public service quality.

An additional reason for highlighting the Texas experience is the fact that the Legislature's role in privatization policymaking concluded with the creation of the Council. Under the structure proposed, the Executive Branch had the ability to make service delivery changes without having first proposed those recommendations to the Legislature for possible statutory authorization. This gives rise to an important consideration for the members of the Business, Labor, and Agriculture Committee to consider as they develop their own findings and recommendations.

[9]The discussion of the Texas Council on Competitive Government can be found at the following website: http://www.window.state.tx.us/ccg.

Colorado[10]

The Colorado Commission on Privatization prepared a report to the General Assembly, along with two pieces of recommended legislation that attempted to restructure the manner in which public services are delivered. Although the recommendations forwarded by the Commission on Privatization were designed to establish a formal structure within which privatization decision were to be made, a secondary benefit was identified. The Commission concluded that proposed privatization plans seemed to result in internal improvements in service delivery quality and efficiency without a widespread and concentrated effort to implement the plans. This outcome, if still apparent, seems particularly important given the fact that neither of the pieces of proposed legislation were approved by the General Assembly. Regardless of the outcome of the Colorado legislation, the recommendations of the Commission are illustrative of the important considerations that must be debated.

The following recommendations represent the key issues studied by the Commission. They include:

- The creation of a permanent commission to determine ongoing privatization implementation by recommending policy, *not* specific functions to privatize.

- The development of a consistent, reliable, and complete cost accounting function throughout state government.

- The initiation of competitive market testing.

- The establishment of the ability of public agencies to compete with private sector providers.

- The directive to increase the use of performance-based contracting and effective contractor monitoring.

- The creation of public sector labor/management cooperation councils within state agencies.

For the purposes of Committee discussion, two of the six recommendations, the permanent commission and the establishment of a cost accounting system, will be explored in greater detail.

The recommendation calling for the creation of a permanent commission was made based on the recognition that individual agencies cannot determine the role of state government or independently decide which services should be provided by in-house units or privatized. In Colorado, the laws related to contracting authority do not make broad findings about whether certain services should be performed by nonstate providers. A permanent organization tasked

[10]The information contained in the discussion of the Colorado proposal can be found in a 1997 report entitled: *Promoting a More Competitive Government: A Report to the General Assembly by the Commission on Privatization*.

with that duty would provide the guidance to state agencies that they lacked under an ad hoc system. Specifically, the permanent commission would recommend both the functions that are appropriate for the state to be engaged in and any policy or statutory changes that would facilitate a change in a service provider.

The second recommendation addressed a statewide cost accounting approach. In Colorado, the State Comptroller advised the Privatization Commission that the existing accounting system was not designed to generate accounting reports according to full cost accounting principles. The recommendation was expanded to include the need to determine the costs of implementing a full cost accounting system. The components of the Commission's full cost accounting model included the costs found in most other full cost accounting models (e.g., direct costs, indirect costs, avoidable costs, and unavoidable costs).

Again, though the bulk of the recommendations were not approved, Colorado seems to have benefited from the exercise. Service delivery performance measures have been implemented, and service delivery efficiency and accountability have increased.

Conclusion

In this brief look at other state actions, the common denominator is the desire to achieve greater efficiencies in service delivery. In each case, this was attempted by encouraging competition. Regardless of the success of any individual approach, investigating what other states have attempted yields some useful information. Each state applied a common set of principles that required a regular review of government service delivery activities, an independent decisionmaking body, and within the required review of services, a methodology that accurately compared the costs borne by government and private providers.

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