

## **A Review of Privatization Definitions, Options, and Capabilities**

for the Business, Labor, and Agriculture Interim Committee  
By Gordy Higgins, Research Analyst, Legislative Services Division

### **Introduction**

The primary study assignment of the Business, Labor, and Agriculture Committee (Committee) is to make a connection between the incidences of governments that compete unfairly with private sector service providers and the findings and conclusions regarding the implementation of privatization efforts. It has been demonstrated, at least generally by the survey responses, that besides a handful of industries, the concern may not be unfair competition stemming from the government's intrusion into the private market, but rather the lack of opportunity for private vendors, regardless of the industry segment, to challenge the service delivery infrastructure that is in place. If the previous assumption is correct, the question becomes one of whether privatization options would eliminate situations of unfair competition and offer private sector providers a framework that would ensure that the most efficient and effective provider delivers the service.

The following sections will offer Committee members a preliminary view into the various definitions of privatization, the arguments for and against implementing a privatization effort, a number of options that can be used to determine which services should be candidates for privatization, and options for implementing a privatization plan to increase the effectiveness of overall service delivery.

### **Definitions of Privatization**

While the term "privatization" generally conjures up a consistent theme, it is important to outline the continuum on which the term can and has been used by policymakers. This section offers several definitions for discussion as they relate to the Committee's competitive business environment theme. The Florida House of Representatives Committee on Governmental Operations conducted a review of the literature on privatization and offered the following spectrum of definitions:

- Engaging the private sector to provide services or facilities that are usually regarded as public sector responsibilities.
- Shifting from publicly to privately produced goods and services.
- Transferring government functions or assets, or shifting government management and service delivery, to the private sector.
- Attempting to alleviate the disincentives toward efficiency in public organizations by subjecting them to the incentives of the private market.
- Using the private sector in government management and delivery of public services.

Any of these definitions would be applicable under the policy umbrella being developed by the Committee. The Committee has attempted to gather information regarding competition between public and private service providers with an eye toward determining whether or not the competitive inequities identified could be remedied by incorporating a sensible privatization approach.

### **Arguments For and Against Privatization**

It should come as no surprise that the issue of privatization has vocal supporters and opponents. Proponents contend that privatization should be used for cost savings and administrative expediency. At a minimum, privatization is a tool that should be explored when a government service provider does not have the necessary expertise or personnel or when the service provider needs to complete projects quickly. In general, these justifications refer to the belief that private sector organizations are less bureaucratic than government agencies and can make decisions more rapidly to assign the necessary resources where the greatest need occurs.

Opponents of privatization efforts suggest that cost savings, the primary reason for pursuing a privatization policy, is never a guarantee. Detractors of privatization also claim that service quality suffers because private providers focus their attention on profit margins rather than on providing a valuable service. The foes suggest that if cost savings is the goal, existing institutional structure should be strengthened to allow government to restructure itself into a more efficient and effective service delivery agent.

Arguments in favor of privatization:

- Helps governments save money in management and delivery of public services.
- Allows for speedy implementation of certain programs.
- Provides high-quality services in some areas.
- Becomes necessary when government lacks the expertise or personnel to carry out certain programs.
- Uses more innovative approaches and technology.
- Helps dissolve unnecessary government service monopolies.
- Offers services more effectively due to flexibility and reduced red tape.
- Slows the growth of government or downsizes government.
- Introduces competition between government employees and private providers.
- Provides an alternative to traditional ways of improving government productivity.

The arguments against privatization include:

- Does not save taxpayers' money.
- Does not guarantee market competition and can result in private monopolies.
- Leads to corruption.
- Causes policymakers and managers to lose control over privatized services.
- Diminishes accountability of government.
- Private gain and public good do not always correspond.
- Is unnecessary given other productivity approaches available to public service providers.
- Compromises quality because of private vendor profit motive.
- Lowers state employee morale and contributes to fear of displacement.
- Destabilizes economically marginal communities.

### Methods of Privatization

The following table represents a variety of ways that the principle reason for privatization (established by the definitions) may be put into practice.

<b>Methods of Privatization</b>
<b>Asset Sale</b> The state sells or cashes out its assets to private providers to enlarge the tax base.
<b>Contracting Out</b> The state enters into agreements with private vendors to provide services. The state pays contractors to provide the services.
<b>Deregulation</b> The state removes its regulations from the service previously monopolized by government in favor of private provision of the service and competition against government agencies.
<b>Franchise</b> The state gives monopoly privileges to a private vendor to provide a service in a specific geographical area.

<p><b>Grants and Subsidies</b> The state makes monetary contributions to help private vendors deliver a public service.</p>
<p><b>Private Donation</b> The state relies on private sector resources for assistance in providing public services. Private firms may loan personnel, facilities, or equipment to state agencies.</p>
<p><b>Public-Private Partnerships</b> The state conducts projects in cooperation with private vendors, relying on private resources instead of tax revenue.</p>
<p><b>Service Shedding</b> The state drastically reduces the level of a service or stops providing a service so that the private sector can assume the function with private sources.</p>
<p><b>Volunteerism</b> The state uses volunteers to provide public services.</p>
<p><b>Vouchers</b> The state allows eligible clients to purchase services available in the open market from private providers. As with contracting, the government pays for the services.</p>

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

### Outlining the Options

If the Committee determines that privatizing services is an approach to addressing public-private competitive inequities, it must first investigate what services the government should provide. Once the government services are established, the Committee should focus on deciding how best to provide those services. In essence, the government can directly provide goods and services or it can limit its involvement to making policy, regulating, managing, and protecting the public's interest. The Florida House of Representatives Committee on Governmental Operations reviewed the work of Keon S. Chi, a nationally known expert on privatization, and proposed five options for providing public programs and services:

- state management improvement without privatization;
- privatization of professional and support services;
- privatization of public works and infrastructure;
- privatization of service delivery to the public; and
- competition between public and private providers.

Briefly, each of the option's specifics are as follows:

#### Option 1: State management improvement without privatization

With this option, state agencies attempt to improve cost efficiency and productivity through in-house management techniques (e.g., civil service reform, innovation, improving internal efficiencies, incentives for improved performance). Chi continues by

suggesting that policymakers should not automatically assume that privatization is an answer to dissatisfaction of government service delivery methods.

#### Option 2: Privatization of professional and support services

State agencies may privatize professional and support services that do not directly involve state service delivery to the public (e.g., architectural, engineering, legal services, custodial and maintenance, printing, security, information technology, telecommunications). Chi recommends that savings, if that is the goal of the policymakers, come only through well-planned and well-managed initiatives.

#### Option 3: Privatization of public works and infrastructure

State agencies may privatize selected public works and infrastructure projects (e.g., construction and maintenance of highways and buildings). Privatization efforts across the country have focused on this option.

#### Option 4: Privatization of service delivery to the public

Agencies may privatize selected state programs and services that are provided to specific clients and constituents. These include mental health services, health care, Medicaid, social services, corrections, and education. Chi suggests that agencies most commonly cite lack of resources and personnel and cost savings as the rationale for adopting this option.

#### Option 5: Competition between public and private sectors

Commonly referred to as "managed competition", this option allows state agencies to compete directly with private sector vendors for the administration and delivery of certain services. According to Chi, competition is the breaking up of governmental monopolies by injecting a competitive process into the decisionmaking methodology.

### **Privatization Checklist**

The 1997 Council of State Governments Privatization Survey found that nearly 75% of the responding state government agencies and state officials did not use a formal or standard decisionmaking process to decide whether privatization of a particular service was in the best interest of the public service recipient. Most of the respondents did agree that a standardized approach would be an important tool for policymakers to decide not only to move forward with alternative service delivery options but also to monitor and evaluate the success of the efforts.

The following list represents a collection of questions that policymakers with privatization experience suggest should be answered before moving forward with any new initiative. The Committee may wish to consider answers to each of these questions as one method of creating a privatization process recommendation for review by the 57th Legislature. The answers may also generate a clear connection between the issue of unfair government competition and the policy framework regarding the creation of a competitive business

environment. (Note: the competitive business environment framework is discussed in a separate paper.)

<b>Privatization Decisionmaking</b>
<b>Initiation of the Privatization Project</b> Who will begin the process; Governor, individual agencies, Legislative Branch, etc.?
<b>Legal Barriers</b> What, if any, are the legal issues associated with privatizing public service delivery systems?
<b>Functions to be Privatized.</b> What kind of formal and consistent identification process should be established to review current in-house operations?
<b>Goals and Criteria for Privatization</b> What are the goals and who should be involved in establishing the goals and evaluation criteria?
<b>Methods of Privatization</b> Is the method of privatization static or dynamic?
<b>Benefits of Privatization</b> Are the benefits of privatization consistent for each chosen program or service?
<b>Availability of Private Vendors</b> Are willing and reliable vendors available to provide a service?
<b>Risk and Cost Overruns</b> What risks are present in a privatization effort? Are those risks contained in every effort? What policies and procedures are needed to address cost overruns?
<b>State Employees</b> How will state employees be affected by privatization efforts?
<b>Request for Proposals</b> Do the existing RFPs contain the necessary factors to effectively evaluate alternative providers?
<b>Awarding of the Contract</b> Are the existing laws adequate to address the awarding of contracts?
<b>Cost Analysis</b> Who should conduct the cost analysis?
<b>Monitoring</b> Who should monitor the private vendor? Is a monitoring program regularly conducted or is monitoring done on a case-by-case basis?

**Performance Measurement**

How should the performance of a private vendor be measured? What provisions are needed to ensure contractor performance?

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

**Potential Recommendations for Success**

According to the Council of State Governments, most states have been able to implement privatization options under their existing constitutional and statutory provisions. The Committee's legal staff is preparing a legal memo that reviews the existing law to determine whether any obvious impediments exist to moving forward with a proposal to privatize certain services.

The Council of State Governments, along with other entities that have reviewed privatization efforts in state and local governments, states that the arguments for and against privatization give a good indication of what groups are typically included in any discussion of reviewing the current methods of providing public services. A basic suggestion may be to include all of the affected interests during the development stage to ensure that any resources spent on determining whether a movement toward expanding the role of private vendors in the process of delivering public services results in a successful outcome.

Given the complexity of implementing a unified privatization effort, it is recommended that a thorough analysis be conducted to determine what conditions are present in Montana that could result in a less-than-efficient process. The following table highlights a number of recommendations collected from the experiences of other states and generally mirrors the privatization checklist necessary for making informed decisions.

<b>Process Recommendations</b>
<b>Political Leadership and Support</b> Strong support from policymakers along with appropriate enabling legislation will offer greater guarantees that any widespread privatization effort is successful.
<b>Clear and Measurable Goals</b> Establishing goals with accompanying performance measurements before engaging in privatization efforts helps success rates.
<b>Delegation of Authority</b> Depending on what privatization method is used, decisionmakers must establish a clear description of the role of government agency employees (i.e., overseers v. doers).
<b>Data Collection</b> Decide what entity will gather data for decisionmakers to address. This includes but is not limited to cost data, performance evaluation data, and preliminary cost-benefit analysis data.

<p><b>Monitoring</b></p> <p>A monitoring methodology must be developed and circulated to alternative providers to ensure that the expectations of decisionmakers are well-known and understood.</p>
<p><b>Evaluation</b></p> <p>Establish a regular and consistent evaluation process based on the predetermined goals and objectives. Third party evaluators may be used.</p>
<p><b>Safeguards</b></p> <p>Consider a pilot program before moving to fully implement a privatization effort. Develop transition plans in the event that a private provider is unable or unwilling to continue the delivery of services.</p>
<p><b>Competition in Management and Delivery of Services</b></p> <p>Analyze the conditions present in the current service delivery methodology and decide whether a managed competition process between private and public sector service providers would yield positive results.</p>
<p><b>Employee Participation</b></p> <p>Involve and inform employee organizations in the planning process. Consider any appropriate employee protection measures that may ease the transition to a private provider.</p>
<p><b>Cost Overruns</b></p> <p>Include cost adjustment provisions in any contract.</p>

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

## Conclusion

The topic of privatization invokes a number of responses from everyone affected by its implementation. Although this Committee is not the first to debate the merits and faults of creating conditions for alternative service delivery, it may be among the first to address the problem of unfair government competition using principles found in privatization efforts.

However, if the Committee chooses to consider the experiences of other state and local governments and develop an overarching privatization methodology that weighs each service against some stated criteria, the concerns of some private members that the government is competing unfairly may be mitigated. A privatization policy, if well-considered and implemented appropriately, will most certainly address the issues raised by the vendors who are seeking a more open opportunity to demonstrate the advantages of choosing a private provider.

CI2255 0101ghxa.