



The Ohio Society of CPAs

Ohio Budget Advisory Task Force Issue Paper

Privatization in Ohio Government

ISSUE: Privatization in Ohio Government

Privatization, the act of shifting some or all aspects of targeted product or service delivery from public-sector to private-sector providers, can strategically and effectively lower the cost of government, while maximizing each tax dollar spent, resulting in more efficient, high performing state and local government institutions.

In recent decades, privatization has evolved from a concept viewed as “radical and ideologically based” to an effective, widely used, and well-proven public management tool.¹ Policymakers in states including Georgia, Florida, West Virginia, New Jersey, and Indiana have used privatization to better the lives of citizens. Privatization produces higher-quality services at lower costs, delivers greater choice, and ultimately yields a more efficient and operative government.

The 50 states face a combined budget gap of approximately \$200 billion in 2010. In addition, as a result of declining tax revenues and, in some cases, a declining tax base, many local governments are in a state of fiscal emergency. State governments are conscious of the fact that “creative budgeting” is no longer sufficient to avoid the need to cut spending. One approach to help reverse Ohio’s financial challenges may lie in the examples set by thousands of national, state and local government agencies in the United States: privatizing services. Researchers from the Reason Foundation have documented the successful privatization of airports, electric and telecommunications utilities, prisons, schools, transportation, to list just a few.²

Privatization of some of those areas could make sense for our own state, and merits a closer look.

Recent *Wall Street Journal* articles have suggested that during the Great Recession of 2007-2009 many high capitalization privatization projects that sought to sell state enterprises -such as real estate properties, turnpikes and lotteries - went unfunded. A necessary component of privatization is the ability of the capital market to create viable investment opportunities. As the current economy improves with stable interest rates, greater access to the credit market will exist to actively pursue large privatization projects.

That said, with Ohio’s economy on the decline, it makes sense to explore all cost saving opportunities, including privatization options. Evidence from other states shows that increased privatization could allow Ohio to experience improvements in quality, cost savings, risk

¹ Gilroy, Leonard. *Local Government Privatization 101*. Reason Foundation.

² Gilroy, Leonard. *Ten Principles of Privatization*. The Reason Foundation.

management, innovation and timeliness. Privatization also allows Ohio to gain access to outside expertise, and accommodate fluctuating peak demand. Once implemented, privatization could prove to be an effective tool to maximize taxpayer-funded products and services.

Cost Savings

Competition encourages would-be service providers to keep costs to a minimum, lest they lose the contract to a more efficient competitor. Cost savings may be realized through economies of scale, reduced labor costs, better technologies, innovations or simply a different way of completing the job. A review of over 100 privatization studies showed that cost savings ranged between 5% and 50% depending upon the scope and type of service; however, as a conservative rule of thumb, cost savings through privatization typically range between 5% and 20%, on average.³

Improved Risk Management

Under a privatization model, private sector contractors, rather than the government, are responsible for cost overruns, strikes, delays and other risks. Transferring these risks to the private sector can allow governmental entities to better control financial exposure by building cost containment provisions into contracts. In addition, contracting may be used to shift major liabilities from the government (i.e., taxpayers) to the contractor, such as budget/revenue shortfalls, construction cost overruns, and compliance with federal and state environmental regulations.⁴

Quality Improvements

Competition brings out the best among organizations or individuals, whether it's in sports or in the business of providing services. Bidders are incentivized to offer the best possible combination of price and service quality to beat their rivals.

³ Cost Savings from Privatization: A Compilation of Study Findings, Reason Foundation How-to Guide No.6, (Los Angeles: Reason Foundation, 1993).

⁴ Gilroy, Leonard. Local Government Privatization 101. Reason Foundation.

Timeliness

"Time is money" for contractors footing the bill, or if contracts with a government body include penalties for delays. Contractors can recruit additional workers or provide performance bonuses to meet or beat deadlines - options that often are unavailable to in-house staff. Contracting may be used to speed the delivery of services by seeking additional workers or providing performance bonuses unavailable to in-house staff.

Accommodating Fluctuating Peak Demand

The cost of providing a public service can increase considerably by the capital and manpower needed to satisfy demand at peak periods, even though those peaks may last only for a few hours a day, a few days a week, or a few months a year. For example, changes in seasonal and economic conditions may cause staffing needs to fluctuate significantly. Contracting also allows governments to acquire additional help when it's most needed so that services are uninterrupted for residents without permanently increasing the labor force.

Access to Outside Expertise

Contracting allows governments to obtain staff expertise that they don't have in-house on an as-needed basis. In some cases, specialized knowledge of unique programs and services is not needed for a department, agency or an organization on a consistent basis. Further, the cost to retain staff with specific knowledge or training may be cost prohibitive. In both of those circumstances, contracting those services out simply makes sense.

Innovation

Competition to win and retain contracts incentivizes the discovery of new, cutting-edge solutions. Without competition, even top-notch employees may stop looking for ways to improve how they meet customers' needs. The need for lower-cost, higher-quality services under competition encourages providers to create new, cutting-edge solutions to help win and retain government contracts.

Divestiture

Some forms of privatization involve governments getting out of a service, activity or asset entirely, often through outright sales. Some local governments routinely sell off aging or underutilized land, buildings and equipment, returning them to private commerce where they may be more productively used. For example, in the late 1990s, New York City sold off two city-owned radio stations and a television station. Orange County, California raised more than \$300

million through real asset sales and asset sale-leaseback arrangements over the course of 18 months to help recover from collapse into bankruptcy in 1995.⁵

Examples of Privatized Services

One privatization expert at the City University of New York identified over 200 city and county services that have been contracted out to private firms (including for-profit and non-profit).⁶ Some of the most prevalent areas of local government privatization include:

- Accounting, financial and legal services
- Administrative human resource functions (e.g., payroll services, recruitment/hiring, training, benefits administration, records management, etc.)
- Core IT infrastructure and network, Web and data processing
- Risk management (claims processing, loss prevention, etc.)
- Planning, building and permitting services
- Printing and graphic design services
- Road maintenance
- Building/facilities financing, operations and maintenance
- Park operations and maintenance
- Zoo operations and maintenance
- Stadium and convention center management
- Library services
- Mental health services and facilities
- Animal shelter operations and management
- School construction (including financing), maintenance and non-instructional services
- Revenue-generating assets (garages, parking meters, etc.)
- Major public infrastructure assets (roads, water/wastewater systems, airports, etc.)

⁵ Gilroy, Leonard. Local Government Privatization 101. Reason Foundation.

⁶ E.S. Savas, Privatization and Public-Private Partnerships (Chatham House Publishers: New York, NY, 2000) p. 72-73.

New Jersey Privatization Task Force

Established by New Jersey Governor Chris Christie under Executive Order #17, The New Jersey Privatization Task Force (Task Force) identified a set of privatization tools and strategies that is estimated to “save the state over \$210 million annually if fully implemented”.⁷ “The Task Force outlined best practices and institutionalization strategies to create a solid and sustainable privatization process. In short, it designed a process to help the state do privatization *well* and avoid some of the pitfalls that befell botched privatization initiatives in previous administrations.”

Major cost savings identified

The Task Force identified dozens of privatization opportunities that, if fully implemented, would realize cost savings and/or other benefits totaling *over \$210 million on an ongoing, annualized basis*.⁸

The Task Force noted it was impossible to quantify potential savings for a number of the individual privatization recommendations. Although the recommendations included the disposal of surplus state land, the analysis did not attempt to estimate the potential revenues from divestiture, which likely total in the tens of millions.⁹ As a result, the group felt the potential savings were likely underestimated.

Focus on institutionalizing a sound privatization process

Beyond individual privatization opportunities, the Task Force clearly recognized the value of a sound privatization process, outlining a series of institutionalization strategies designed to make smart privatization a routine part of public management in Trenton. Notably, it recommended that Gov. Christie announce, as an administration priority, that achieving efficiency through private sector competition become standard policy for all state agencies.

One of the key recommendations for doing so involved establishing a centralized privatization entity for the state to fulfill functions. This is similar to Florida's Council on Efficient Government, a privatization "center of excellence" established in 2004 and a key component of a strategy

⁷ Gilroy, Leonard, NJ Privatization Task Force Report Offers Reform Roadmap, Over \$210 Million in Annual Savings. Reason Foundation.

⁸ Zimmer, Richard. The New Jersey Privatization Task Force. Final Report.

⁹ Gilroy, Leonard, NJ Privatization Task Force Report Offers Reform Roadmap, Over \$210 Million in Annual Savings. Reason Foundation.

that ultimately helped Florida government realize over \$550 million in cost savings through over 130 privatization and competition initiatives.¹⁰

Additional Task Force recommendations on institutionalization includes applying a set of best practices in project selection and contracting, creating a process for unsolicited privatization proposals, and ensuring that privatization initiatives reflect the state's environmental policy priorities.

Focus on lessons learned from previous privatization challenges in NJ:

The recommendation that New Jersey create a comprehensive system for managing the privatization process is in part based on the state's previous challenges in privatization project implementation. While there have been many privatization successes in New Jersey in recent decades, the state had its share of troubled initiatives where privatization was implemented poorly. The challenges shared some common themes—poor design, unclear goals, superficial due diligence, inexperienced contractors, misconduct/conflicts of interest and poor government monitoring and oversight. These are precisely the sorts of challenges that an institutionalized privatization process is intended to address.

The 40 privatization recommendations in the report ranged from broad to narrow. Following are three main recommendations that, once enacted, New Jersey believes to be the most promising:

Privatization of state psychiatric hospitals:

According to the Task Force, the experience in other states demonstrates that important mental health services could be more efficiently and effectively provided by private sector organizations. The Task Force recommends that the state initially consider privatizing one of the psychiatric hospitals it operates as a first step toward possibly privatizing the entire mental health system.

Correctional services privatization:

Several privatization opportunities emerge in the area of corrections, including inmate medical services, correctional food services (including the distribution and support services infrastructure) and the inmate high school education and GED program.

¹⁰ Gilroy, Leonard, NJ Privatization Task Force Report Offers Reform Roadmap, Over \$210 Million in Annual Savings. Reason Foundation.

Public-private partnerships to finance the construction and maintenance of new or expanded state infrastructure:

Many have written about the benefits of using public-private partnerships (PPPs) to modernize and expand critical transportation, water, energy and other infrastructure assets. The Task Force recommended passing broad-based and flexible infrastructure PPP legislation that encompasses new projects and some already in-progress. Further, the Task Force recommended creating a state advisory body for PPP projects, possibly along the lines of California's Public Infrastructure Advisory Commission. If implemented, these recommendations would give the state powerful new tools for financing and delivering infrastructure in tough economic times.

Beyond these three, additional privatization opportunities identified by the New Jersey Task Force include:

- Vehicle fleet maintenance and management;
- Performance-based highway maintenance (e.g., bundled “fence-to-fence” maintenance contracts);
- Surplus asset divestiture;
- Emergency service patrols on state highways and interstates;
- State parking facilities;
- Water;
- Printing services;
- Workers’ compensation claims processing;
- State rest areas;
- NJ Turnpike toll collection;
- NJ Transit bus routes and vehicle maintenance;
- Statewide vehicle emission inspections;
- Motor vehicle titling and registration;
- Higher education facility maintenance;
- Child support services;
- Hospital debt collection;
- Golf course management; and
- Housing and construction code enforcement.

Georgia House Bill 1134 Advisory Council on Public–Private Partnerships

Like New Jersey, Ohio and other states, Georgia faces a fiscal crisis that requires immediate action and a solution. Several organizations, such as the National Governors Association and the National Association of State Budget Officers, are predicting what is known as a fiscal “lost decade” for states. If Georgia does not find a solution, the state will continue to suffer.¹¹

One main factor contributing to Georgia’s current financial state is that “over the years government at all levels have expanded into hundreds of activities”, and while commercial in nature, these functions serve the bureaucracy. Most of these functions are not unique to government but in fact are commonly found in the Yellow Pages in any town across the country. This raises a concern among many Americans who “believe that government should be focused on performing its core functions well and should not be in competition with its own citizens to perform non-core functions.”¹²

If Georgia mirrors other states’ experiences, then legislators can assume that “thousands of Georgia state employees are engaged in activities” which could be performed by “private sector firms at a lower cost and higher level of quality.”

Research conducted by The Reason Foundation found that privatization, on average, “...can lower the costs of government service delivery between 10 to 25%”.

Georgia’s piece of legislation known as HB 1134 represents a monumental step in striving for a “centralized, independent decision-making body”, designed to “manage privatization and government efficient initiatives.”

Experiences from other states that have implemented versions of this state competition and efficiency council concept demonstrate that having a standardized method for procuring and managing contracts will result in more accountability, transparency and competition.

Privatization managed under Florida’s Council on Efficient Government was a key component of a strategy implemented by former Governor Jeb Bush that ultimately helped realize over \$550

¹¹ Gilory, Leonard. *Testimony on Georgia House Bill 1134, Advisory Council on Public-Private Partnerships*. Reason Foundation

¹² Gilory, Leonard. *Testimony on Georgia House Bill 1134, Advisory Council on Public-Private Partnerships*. Reason Foundation

million in cost savings through 130 privatization and managed competition initiatives.¹³ Virginia's Commonwealth Competition Council put forth privatization recommendations that are estimated to be saving state taxpayers at least \$40 million per year. And as reported in Reason Foundation's *Annual Privatization Report 2008*, Utah passed legislation in the spring of 2008 to strengthen that state's Privatization Policy Board and give it more tools to advance sound privatization policy.

With widespread state fiscal crises deepening across the country, other state policymakers are increasingly looking to the example set by Florida and the other states that have pioneered this concept as they struggle to close large budget deficits. For example, Louisiana policymakers established a Commission on Streamlining Government to review and evaluate government activities, functions, programs and services to eliminate, streamline, consolidate, privatize or outsource them. In December 2009, the Commission released a set of 238 government downsizing recommendations including a recommendation for a "center of excellence" in privatization, as well as over a dozen specific privatization proposals estimated to save over \$1 billion. Policymakers in Arizona, Virginia and Oklahoma also advanced major privatization board proposals that passed one or both legislative houses in 2009.¹⁴

The Yellow Pages Test

Experts from the Nevada Journal believe that "competition is more desirable and more likely to be successful when the service is not part of government's core mission" and a way to increase competition can be reached by performing the "Yellow Pages Test". If the local Yellow Pages listings include multiple vendors providing the same services as a governmental entity, then the state may benefit by privatizing. The Yellow Pages test helps focus government resources on activities that the government does well and contracting out services that are more efficiently and cost effectively operated by the private sector.¹⁵

In the early 1990s, Indianapolis and its local economy were still restructuring from an earlier time in which durable manufacturing jobs had been lost; the population of Indianapolis was 15,000 lower than in 1970. While the city had begun to diversify into services such as health care in the 1980s, only the government sector had grown materially. Further, property tax and

¹³ Gilory, Leonard. *Testimony on Georgia House Bill 1134, Advisory Council on Public-Private Partnerships*. Reason Foundation

¹⁴ Gilory, Leonard. *Testimony on Georgia House Bill 1134, Advisory Council on Public-Private Partnerships*. Reason Foundation

¹⁵ Goldsmith, Steven, *The Yellow Pages Test*. The Nevada Journal.

county income tax rates had exploded, and were up 25% and 350%, respectively, during the 1980s.¹⁶

Mayor Stephen Goldsmith took office in 1992, and was committed to a turnaround based on privatizing city services, and creating a climate more conducive to entrepreneurship. During his eight-year tenure as mayor, the city's population increased by nearly 50,000 residents, induced by a more business-friendly environment and its corollary, smaller government.¹⁷

Indianapolis also developed the "Yellow Pages test" in which dozens of city services - from janitorial to print shop to sewer billing to golf course management - were analyzed to see if private-sector vendors offered the service in the Yellow Pages. If so, a bidding occurred for government entities and private sector companies alike to compete for contracts to provide the service

Eventually, 75 services were put to competition. Sometimes, city employees won the contract; sometimes a private firm won. In all cases, huge savings and efficiencies emerged. *This* is how Indianapolis cut 43% (1,200 workers) of its non public safety workforce, and shave \$480 million from its budget in 8 years.¹⁸

Stephan Fantauzzo, executive director of Council No. 62 of the American Federation of State, County, and Municipal Employees, noted, "By bringing city workers into the bidding process, we've been able to save jobs, improve services and save taxpayers millions of dollars." ¹⁹

"What distinguishes Indianapolis is the hard stuff—increased communication, better (not more) management, empowerment of workers, incentives rather than threats and an attempt to be a real partner in the process."

Indianapolis' privatization program has won accolades from around the country. Los Angeles Mayor Richard Riordan declared, "Indianapolis is on the cutting edge of a new way to run government."

¹⁶ Chapman, John L. *The Privatization of Public Services*. The Mises Institute

¹⁷ Chapman, John L. *The Privatization of Public Services*. The Mises Institute

¹⁸ Chapman, John L. *The Privatization of Public Services*. The Mises Institute.

¹⁹ Goldsmith, Steven, *The Yellow Pages Test*. The Nevada Journal.

Workers' Compensation - West Virginia

In 2005, West Virginia abolished the public sector administration of its Workers' Compensation system. The state contracted with a sole source provider for a limited time and, in 2008, put the fund out for competitive bid. Since the switch, West Virginia's Insurance Commissioner Jane L. Cline has repeatedly touted its benefits.

In the July 2008 issue of the *Insurance Journal*, Cline noted the benefits as the following

- Claim protests have fallen 68%
- The overall appeals process has been streamlined resulting in claims disputes being resolved in a shorter time
- Claimants have received better claim management by claims adjusters having fewer claims to manage
- The unfunded liability on "old fund" claims has dropped from \$3.1 billion to \$1.5 billion

Conclusion - What should Ohio and its leaders do next?

Recommendation: Ohio should establish a standing Commission that meets annually to produce a report to the governor and the General Assembly that outlines government programs and process that could be delivered by private industry. The report should also include a fiscal analysis that outlines potential savings to the state. Specifically, this Commission should examine, at a minimum, the following broad categories:

- Workers' Compensation
- Transportation - construction, design, and upkeep
- DAS - personnel and benefit functions
- Corrections - guards, food service, education and administrative function
- Development - negotiation of development packages for relocating businesses
- Medicaid - payments to vendors and administrative services

In addition, the Commission should be responsible for overseeing the progress and cost savings of any and all privatization initiatives that are implemented. Given that privatization initiatives are only helpful to state government if they produce a positive cost/benefit ratio to government and taxpayers, the Commission should review any initiative not meeting that test for modification or cancelation. Lastly, we recommend the governor make achieving efficiency

through private sector competition standard policy for all state agencies and an administrative priority.