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Report to the Chairman, House Republican Task Force on Privatization

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PRIVATIZATION

Lessons Learned by State and Local Governments

GAO

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The Honorable Scott Klug
Chairman, House Republican Task
Force on Privatization

Dear Chairman Klug:

State and local governments have increased their use of privatization over the last several years, and Congress and the administration have indicated an interest in having the federal government also increase its use of privatization. In light of this interest, you asked us to identify major lessons learned by, and the related experiences of, state and city governments in implementing privatization efforts. This report, which responds to your request, discusses privatization lessons learned by, and the related experiences of, the states of Georgia, Massachusetts, Michigan, New York, and Virginia as well as the city of Indianapolis, Indiana. Each of these governments made extensive use of privatization over the last several years.

Background

Privatization is commonly defined as any process aimed at shifting functions and responsibilities, in whole or in part, from the government to the private sector. Privatization can take various forms. The most common form is contracting, which typically entails a competition among private bidders to perform government activities. With contracting, the government remains the financier and has management and policy control over the type and quality of services to be provided. Another form of privatization occurs when a government transfers ownership of assets, commercial type enterprises, or responsibilities to the private sector. This is called an "asset sale," and generally the government would have no role in the financial support, management, or oversight of a sold asset.

Another, more recent variation of privatization is "managed competition." Under it, the contracting process permits an agency (e.g., the highway department) of the government to prepare a work proposal and submit a bid to compete with private bidders (e.g., highway construction contractors). The government may award the contract to the bidding agency or to a private bidder. (App. I shows various forms of privatization and the frequency of their use by state governments as reported by the Council of State Governments in 1993.)

Over the past several years, state and local governments have increased their use of various types of privatization. The 1993 Council of State Governments' survey found that state agencies responsible for social services, transportation, mental health care, corrections, health, and education had all increased privatization activities since 1988. The Council reported that the survey results indicated a trend toward expanded privatization across major state agencies.[1] According to the International City/County Management Association, city governments have also increased the number and types of services contracted, such as child welfare programs, health services, street maintenance, and data processing.[2]

Recent federal laws, rules, and initiatives—especially the Government Performance and Results Act of 1993 (GPRA);[3] the Clinger-Cohen Act of 1996;[4] the revised handbook to Office of Management and Budget (OMB) Circular A-76;[5] and the Clinton Administration's major management reform initiative, the National Performance Review (NPR)—have given new impetus to federal agencies to operate more effectively and efficiently. One helpful approach in reaching this goal, according to NPR, is privatization. Certain of the cited laws and initiatives direct federal managers to review their programs by first considering whether government should be performing an activity, a step that can lead to privatization.

[1]State Trends and Forecasts: Privatization, Vol. II: No. 2 (Lexington, KY: November 1993).

[2]International City/County Management Association Municipal Year Book 1994: Alternative Service Delivery in Local Government, 1982-1992 (Washington, D.C.: 1994), p. 28.

[3]GPRA requires agencies to develop strategic plans, obtain input on desired goals from key stakeholders, and measure and report progress toward achieving those goals.

[4]The Clinger-Cohen Act was originally the Federal Acquisition Reform Act of 1996 and the Information Technology Management Reform Act (ITMRA) of 1996. It was renamed by section 808 of Public Law 104-208, enacted on September 30, 1996. ITMRA introduced new requirements for how information technology-related projects are to be selected and managed. These requirements closely parallel investment practices of leading organizations.

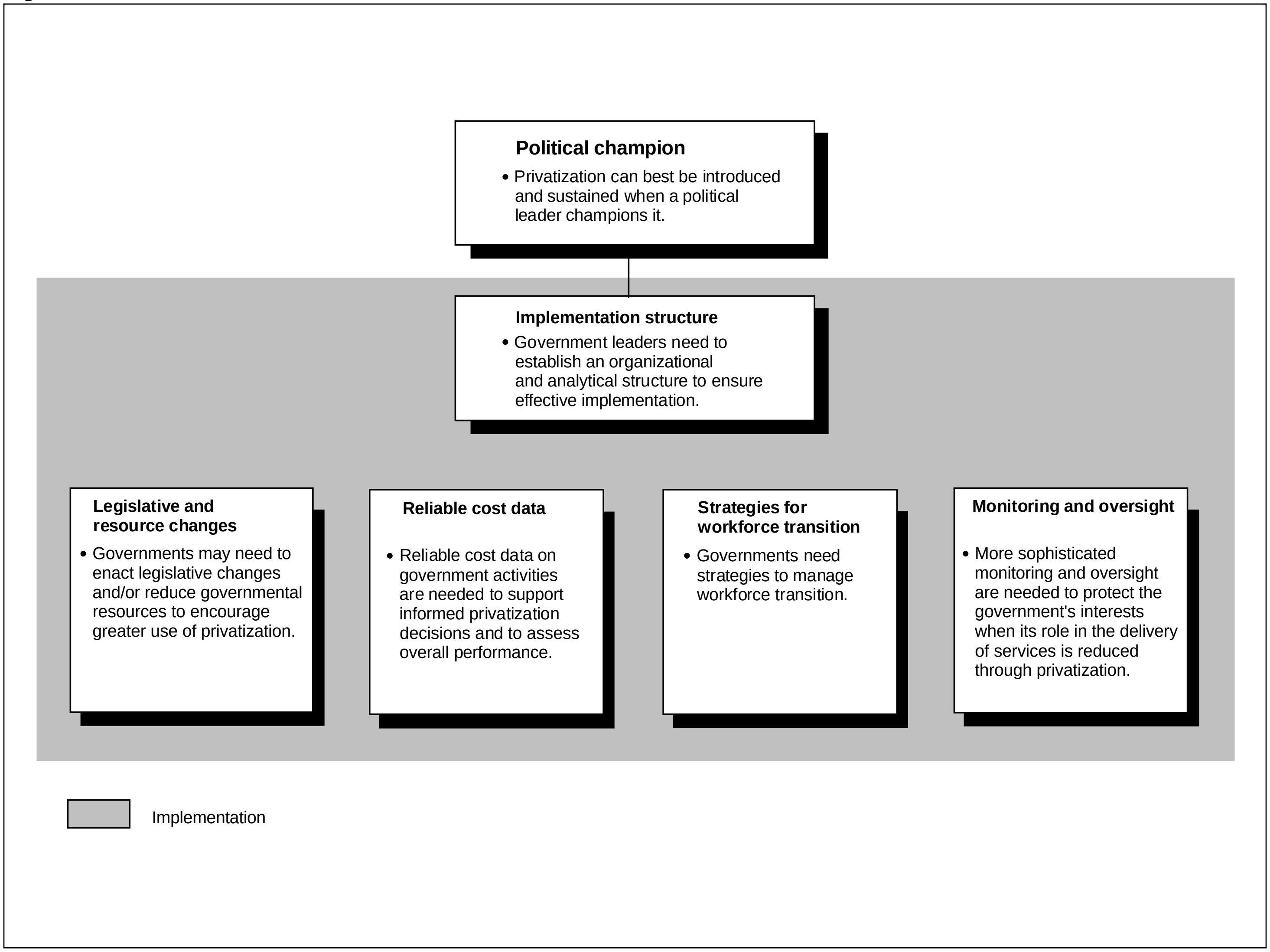
[5]OMB Circular A-76 sets forth federal policy for using commercial services. In March 1996, OMB revised the A-76 supplemental handbook to enhance federal performance through competition and choice, seek the most cost-effective means of obtaining commercial products and support services, and provide new administrative flexibility in agencies' decisions to retain services in-house or contract them out.

Results in Brief

The six governments we visited tailored their approaches to privatization to their particular political, economic, and labor environments.[6] On the basis of our literature review, the views of a panel of privatization experts, and our work in the six governments, we identified six lessons learned, as shown in figure 1, that were generally common to all six governments in implementing privatization initiatives.

[6]The predominant form of privatization that occurred in these six governments was contracting for goods and services, followed by asset sales and managed competitions.

Figure 1: Lessons Learned From Our Review of State and Local Privatization Efforts



Source: GAO analysis.

First of all, privatization can best be introduced and sustained when there is a committed political leader to champion it. In the six governments, a political leader (the governor or mayor), or in one case several leaders working in concert (state legislators and the governor), played a crucial role in introducing privatization. These leaders built internal and external support for privatization, sustained momentum for their privatization initiatives, and adjusted implementation strategies when barriers to privatization arose.

Second, governments need to establish an organizational and analytical structure to implement the privatization effort. This structure can include commissions, staff offices, and analytical frameworks for privatization decisionmaking. For example, five of the six governments established governmentwide commissions to identify privatization opportunities among government activities and to set policies to guide privatization initiatives.

Third, governments may need to enact legislative changes and/or reduce resources available to government agencies in order to encourage greater use of privatization. Georgia, for example, enacted legislation to reform the state's civil service and to reduce the operating funds of state agencies. Virginia reduced the size of the state's workforce and enacted legislation to establish an independent state council to foster privatization efforts. These actions, officials told us, enhanced privatization and sent a signal to managers and employees that political leaders were serious about implementing privatization.

Fourth, reliable and complete cost data on government activities are needed to assess the overall performance of activities targeted for privatization, to support informed privatization decisions, and to make these decisions easier to implement and justify to potential critics. Most of the governments we surveyed used estimated cost data because obtaining complete cost[7] and performance data by activity from their accounting systems was difficult. However, Indianapolis and more recently Virginia used new techniques to obtain more precise and complete cost data. While the use of estimated cost data can save a government the time and cost associated with preparing more accurate data, the resulting imprecision can have negative consequences. For example, in Massachusetts, the State Auditor questioned savings reported from privatized activities because an "inadequate cost analysis" was done before the privatization.

Fifth, governments need to develop strategies to help their workforces make the transition to a private-sector environment. Such strategies, for example, might seek to involve employees in the privatization process,

[7]Complete costs are generally defined as the fully allocated costs of an activity. These include all direct and indirect personnel costs, as well as the costs of materials and supplies, equipment, capital depreciation, rent, maintenance and repairs, utilities, insurance, personnel travel, operations overhead, and general and administrative overhead.

provide training to help prepare them for privatization, and create a safety net for displaced employees. Among the six governments we visited, four permitted at least some employee groups to submit bids along with private-sector bidders to provide public services. All six governments developed programs or policies to address employee concerns with privatization, such as job loss and the need for retraining.

Finally, when a government's direct role in the delivery of services is reduced through privatization, a need is created for enhanced monitoring and oversight that evaluates compliance with the terms of the privatization agreement and evaluates performance in delivering services to ensure that the government's interests are fully protected. For example, Indianapolis officials said their efforts to develop performance measures for activities enhanced their monitoring efforts. However, officials from most governments said that monitoring contractors' performance was the weakest link in their privatization processes.

Objective, Scope, and Methodology

Our objective was to ascertain the lessons learned by, and the related experiences of, state and local governments in privatizing government activities. To meet this objective, we went through a multistep process to identify the governments to survey, developed an information collection framework refined with the assistance of a panel of experts, and then contacted various officials from the selected governments to obtain information and insights on their privatization experiences.

To develop a list of potential states and cities to survey, we first surveyed 50 individuals whom we identified as knowledgeable on privatization topics from congressional testimony, studies, and other published literature on the privatization of government activities. We asked the 50 individuals to name states and cities that had undertaken notable privatization efforts, and 33 of the individuals responded. From their responses, we compiled a list of 10 state governments and 10 city governments that the respondents had named most often as undertaking notable privatization efforts.

As agreed with your office, we focused the rest of our selection process on state governments rather than city governments. We focused on states because data indicated that states were generally involved in privatizing a wider variety of activities than were cities, and because lessons learned by state governments would be more likely than local government experiences to be instructive in the federal context. However, as agreed with your office, we included the city of Indianapolis in our survey because it was cited more frequently than any other city or state named by our experts.

A panel of 8 privatization experts reviewed our list of state governments and agreed that the 10 state governments and Indianapolis were the most appropriate candidates to survey. The panel members, most of whom were drawn from among the 33 respondents to our survey, are listed in appendix II. They were selected on the basis of their practical knowledge of privatization or their scholarly knowledge on the issue of privatization.

We contacted the 10 state governments to update privatization data that were reported on them and other states in a 1993 Council of State Governments report. On the basis of information in the 1993 report and the updated data from the 10 states, we selected Georgia, Massachusetts, Michigan, New York, and Virginia for visits and further research. We chose these states because they had the most extensive privatization efforts involving activities that correlate with those performed at the federal level. Their privatization efforts, and those of Indianapolis, covered a variety of mission-related activities, such as prison health care, delinquent tax collection, and vehicle maintenance.

Before meeting with various officials from the six governments, we developed from the relevant literature a list of key privatization factors that our panel of eight experts agreed were critical or important when considering whether to privatize public functions. These factors gave us a framework for collecting information on privatization experiences. We pretested this framework and data collection approach and made minor adjustments.

Using our framework of privatization factors as a guide, we interviewed, and obtained documents from, 117 officials in the 6 sites that we visited. These included policymakers (such as cabinet officers and directors of privatization offices), agency managers, and labor representatives who were involved with or knowledgeable about the privatization efforts of the six governments. To obtain an independent perspective, we interviewed audit and legislative oversight officials who had knowledge of their governments’ privatization efforts. We obtained from these various officials information on such topics as (1) the reasons for using privatization; (2) approaches taken to introduce, implement, and manage privatization efforts; and (3) barriers to privatization and strategies employed to overcome the barriers. In our interviews and document reviews, we focused attention on privatization efforts that occurred since 1991, were reported to have had high cost savings, were reported to have resulted in continued or improved service, and involved activities similar to those performed by the federal government.

In addition to our interview data, we reviewed such state, city, and agency documents as commission reports, planning documents, policy and procedural guidance, budget documents, legislative analyses, agency performance reports, audit reports, and pertinent legislation. From our analysis of the information obtained, we distilled a list of major lessons learned in privatizing state and local government activities. The list was not intended to be an exhaustive compilation of all possible or actual lessons learned or experiences in privatizing government activities.

Because our objective was to identify lessons learned by the six governments we visited, we relied on their own evaluations and assessment of their experiences. Using information they gave us, we summarized a number of the six governments' privatization projects that they selected (see app. III). We did not evaluate privatization results or independently verify the accuracy of the information provided by the governments. Because this report uses a wide variety of privatization terms, we also prepared a privatization glossary so that the types of privatization we refer to in this report can be understood in the context of the range of privatization efforts that can occur. The glossary appears at the end of the report.

We did our work at the selected states' capitals, Indianapolis, and Washington, D.C., from April 1996 through December 1996 in accordance with generally accepted government auditing standards. In February 1997, we provided the chief executives of the six governments with a draft of this report for review and comment. These governments concurred with the message of our report and provided clarifying comments, which we have included where appropriate.

Privatization Requires a Political Champion

According to our panel of experts and officials of the six governments we surveyed, privatization can best be introduced and sustained when a political leader champions it. The panel and officials said that, in introducing and sustaining privatization initiatives, political leaders should anticipate a need to develop and communicate a privatization philosophy and to garner public, business, and political support.

According to the government officials that we interviewed, the chief executive (the governor or mayor) was the political champion for the most recent privatization efforts in Georgia, Massachusetts, Michigan, New York, and Indianapolis. In Virginia, key state legislators and the Governor worked together to introduce new privatization initiatives. The political champions faced a variety of political and economic environments. In some cases, the political leaders introduced and built support for privatization within government workforces that were unionized and, in other cases, within workforces that were not unionized. Similarly, some political leaders introduced and built support for privatization during times when their respective governments were experiencing fiscal problems, and other leaders did so during times when their governments were stable financially. For example, the Governor of Massachusetts introduced privatization during a period when the state, which had a heavily unionized workforce, was experiencing a severe budget crisis. On the other hand, Virginia's leaders introduced privatization into a largely nonunionized workforce and saw it as an approach that could help the state government more effectively deliver services and maintain its sound fiscal condition.

While forceful leadership was reported to be an important ingredient in the success of privatization initiatives by the six governments, they also came to recognize a need for flexibility. When implementing privatization, political leaders found that they could encounter barriers that might require them to adjust their privatization strategy to maintain support. For example, when Indianapolis's initiative encountered early opposition from employee unions, the Mayor began formally involving the unions in the privatization process. In doing so, he moved from an approach that solely emphasized competing public activities among private-sector firms to one that included using managed competition, which gave city employees the chance to compete with the private sector. This change in approach, according to city and union officials, won employee support and allowed the privatization initiative to proceed.

According to Indianapolis officials, competition in the marketplace rather than privatization per se produces the most value for the taxpayer. This view was shared by most state officials we spoke with. A top Indianapolis official said that the primary advantages of managed competition were reduced costs, improved services, improved employee morale, and increased innovation. Massachusetts, New York, and Virginia now permit government agencies to bid on certain contracts that are open to the private sector.

Implementation Structure Needed to Guide Privatization Efforts

According to officials in the six governments, once political leaders introduce privatization, they need to establish a formal structure to ensure effective implementation. Such a structure can include a governmentwide commission to identify privatization opportunities and set privatization policy, a staff office that can support agencies in their privatization efforts and oversee implementation, and a framework for making privatization decisions.

Five of the six governments used governmentwide commissions to promote privatization, identify privatization opportunities, and establish policies and procedures to guide privatization initiatives. Massachusetts did not use a commission; instead, cabinet secretaries selected the government activities to privatize. The commissions were created either by the chief executive (Georgia, Michigan, New York, and Indianapolis) or jointly by the state legislature and chief executive (Virginia).

The memberships of the four state commissions included representatives of both government and the private sector. Indianapolis's commission was composed of private sector representatives, assisted by both private and public-sector employees. Although officials in the five governments saw commissions as useful, a former senior official from Michigan who studied his and other states' commissions[8] cautioned that a commission's effectiveness can be limited if it does not have a clear mission and a membership that reflects a balance between the public and private sectors.

Five of the six governments established offices or support staffs, which were attached to the privatization commissions, to provide guidance and technical assistance to agencies in the day-to-day implementation of privatization.[9] New York's office, the Empire State Development Corporation, was unique among the supporting organizations in that it was a government corporation. Massachusetts did not establish a separate support office. Instead, individual departments initially used internal teams to design and implement specific initiatives. Later the Executive Office for Administration and Finance provided guidance to departments.

[8]John M. Kost, New Approaches to Public Management: The Case of Michigan (Washington, D.C.: The Brookings Institution, July 1996).

[9]Michigan established a Privatization Division as part of its Department of Management and Budget in 1991, before the governor established a public-private partnership commission in 1992. The Privatization Division provided staff support to the commission before the commission was abolished in late 1992.

These support units, according to officials and documents we reviewed, typically used an analytical framework to evaluate the costs and performance of government activities and the risks and benefits of privatizing a particular activity. These analytical frameworks typically included a step-by-step decisionmaking process. Having a framework that provides a consistent approach for analyzing government activities was considered highly desirable by key officials in all six governments. Many of the frameworks established by the six governments shared common elements such as providing criteria for selecting activities to privatize, an inventory of privatization candidates, cost comparison and evaluation methods, and procedures for monitoring the performance of privatized activities. The frameworks used by Michigan, Virginia, and Indianapolis are described in more detail in appendix IV.

Legislative and/or Resource Changes May Be Needed to Promote the Use of Privatization

According to some officials, governments may need to enact legislative and/or resource changes to encourage or facilitate the use of privatization. These changes, the officials said, are necessary to signal to managers and employees that the move to privatization is serious and not a passing fad.

All five states and the city of Indianapolis used some combination of legislative changes and resource cuts as part of their privatization initiatives. For example, Virginia enacted the Virginia Government Competition Act of 1995, which created a permanent independent state council to promote privatization. The state also initiated an effort to reduce its workforce by 15 percent over 3 years. According to state officials, some departments, such as transportation, began facing work backlogs following this reduction. To ease this backlog, Virginia looked to the private sector to perform the work. Virginia officials said enabling legislation and staffing cuts together signaled the seriousness of Virginia's effort to increase the use of privatization and managed competition.

Georgia's legislature, with the Governor's support, passed civil service reform legislation that made it easier for the state to hire and fire employees. Georgia officials told us that this measure facilitated the use of privatization by state managers. In addition, the Governor instituted a budget redirection program in 1996 that required all agencies to prioritize their current programs and activities and identify those programs that could be eliminated or streamlined to the extent that the agencies would be able to make at least 5 percent of their total state-funded budgets available to be redirected to higher priorities. Each agency was asked to recommend how the 5 percent would be redirected to existing programs or to new programs within the agency. According to the Executive Director of Georgia's Commission on Privatization, the Governor, as part of his budget development process, reviewed these recommended redirections, as well as other statewide priorities, and shifted those identified funds within and among the agencies as determined to be most cost beneficial. This budget redirection initiative, according to the Executive Director, will continue for the remainder of the Governor's term, which ends in early 1998. According to a Georgia Privatization Commission official, agencies were given a 6-month notice that their budgets would be cut. State officials said these cuts required managers to rethink how they could perform the same activities for a lower cost. This led to contracting out more activities, such as vehicle maintenance and management services for a war veterans facility.

In Indianapolis, the Mayor eliminated selected middle-level management positions. According to the remaining supervisors with whom we spoke, this action sent a clear message that the city's privatization program was serious and that the city workforce would have to work differently and use new methods if it were to successfully compete to retain city work. Union officials said that these selective management cuts helped to build union support for the competition initiatives.

Reliable and Complete Cost Information Needed to Support Privatization

According to officials in the six governments and our panel of experts, reliable and complete cost data on government activities are needed to ensure a sound competitive process and to assess overall performance. Reliable and complete data, they said, simplify privatization decisions and make these decisions easier to implement and justify to potential critics.

All six governments developed information on the cost of government activities. Four governments made "best estimates" of a service's or function's cost because obtaining complete cost and performance data by activity from their accounting systems was difficult. Indianapolis and Virginia attempted to go beyond best estimates by making extensive efforts to identify all costs associated with performing a government function or service.

Indianapolis was nationally recognized for using an activity-based costing (ABC) approach. Indianapolis used this approach to help analysts derive the complete costs of providing a service or performing a function. Following ABC procedures, analysts were to identify all activities associated with producing a service or function and to evaluate the resources these activities consumed to achieve various levels of performance.

Virginia introduced a comprehensive cost analysis method based on the federal government's A-76 program and the state's contracting experiences to try to capture the complete costs associated with performing a service or function. Virginia reported that in fiscal year 1996 it was able to identify complete costs for 45 percent of the government activities identified as privatization candidates. Since 1995, Virginia has piloted an ABC approach in a number of agencies as a possible replacement for its existing analysis method. According to officials in Indianapolis and Virginia, obtaining more complete data was more time consuming but enhanced their governments' ability to identify cost savings and evaluate bid proposals.

Indianapolis officials told us they were able to obtain the information they needed to do ABC analyses from their current accounting system even though it did not provide cost data by activity. Officials used a system that took cost data (e.g., salaries, overhead) associated with a function (e.g., street maintenance) and assigned it for cost analysis purposes to activities (e.g., filling potholes, cleaning streets, repairing curbs). The city was assisted in this exercise by a private-sector firm with cost-analysis expertise.

Indianapolis and Virginia officials also said that working before privatization occurs with private firms with expertise in an activity slated for privatization was very beneficial in getting a better understanding of the cost and performance issues likely to be encountered during a privatization. For example, when Virginia's Department of Corrections planned its prison privatization project, the department publicly discussed its plans with private firms to better understand the issues that needed to be addressed and resolved in order to successfully privatize prisons. According to the Director of Virginia's Commonwealth Competition Council, after the department consulted with private firms, it better understood what the needs of the private sector were in terms of writing specific statements of work and better realized the potential cost-benefit to the state of the proposed prison privatization.

Attaining precision in cost data has tradeoffs, according to a number of government officials that we interviewed. In general, while cost estimates can be made more quickly and at less cost than more precise approaches such as ABC, their use also may have negative consequences. For example, Massachusetts, according to senior state administration and audit officials, used estimates because complete cost data on state activities were difficult to obtain from the state's accounting system. However, reports by the Massachusetts State Auditor called into question the reported savings of some privatization activities, citing inadequate cost analysis before privatization as well as a lack of substantiating data on the benefits claimed following privatization.

Strategies Needed to Manage Workforce Transition

According to most officials in the six governments and our expert panel, moving governments into privatization requires (1) employee involvement in the privatization process, (2) training to provide skills for either competing against the private sector or monitoring contractor performance, and (3) creating a safety net for displaced employees. Most officials said these strategies were necessary to mitigate employees' concerns with, and to bolster their support for, the privatization changes as well as to aid in the transition to a competitive environment.

All six governments developed workforce transition strategies to complement their privatization efforts. These strategies varied depending on local political factors and the relationship between the governments' top leaders and employee groups.

Employee Involvement

In the six governments, management of employee involvement in the privatizations was not only important to initial efforts but also set the tone for future privatizations. For example, Massachusetts officials said that their initial failure to involve state employee unions in their privatization plans led the unions to contest and block these plans. State officials said that following this initial confrontation, Massachusetts sought to improve labor-management cooperation by allowing unions to compete for several highway maintenance contracts. Nevertheless, according to state officials, union and state legislature concerns that employee protections were not being observed under privatization contributed to the passage of legislation in 1993, over the Governor's veto, that made privatization more difficult.[10] For example, the law required private firms that win state contracts to offer jobs to qualified state employees who were terminated because of the contracts and to compensate them at a rate comparable to their government pay and benefits. The Massachusetts State Auditor said that in the 2 years before the law, 6 Massachusetts departments privatized approximately 20 services, but only 2 privatizations occurred between the law's enactment and December 1996.

[10] Commonwealth of Massachusetts Privatization Law, Chapter 296 of the Acts of 1993.

According to privatization experts, Indianapolis presents a comprehensive example of how a government benefited by engaging employees and their unions in the privatization process. Indianapolis's management employees were involved in the privatization process when it began but union employees were not formally involved. Soon after introducing privatization, the Mayor moved to address employee concerns raised by unions about not being formally involved in the city's privatization efforts. According to city and union officials, the city used a multifaceted approach to effectively address the unions' concerns. This approach included the use of new management tools (such as ABC), training in use of the tools, a cooperative union-management effort, and permitting and enabling the workforce to compete against private vendors. This cooperative effort, we were told, was built on (1) empowering frontline workers to make decisions and act on their own initiative, (2) providing training and pay incentives for performance, (3) fostering a partnership with unions, and (4) establishing an employee safety net for displaced workers.

Training

The majority of the top government officials and experts whom we surveyed said that having qualified employees with specific skills related to privatization was important to successfully implementing privatization. However, some officials said the need for new skills should not impede privatization since the skills could also be contracted for if not available within the government workforce.

Officials from the states and Indianapolis pointed out that to move into a more competitive environment, their governments had to improve the skills of their employees so they could (1) participate in managed competition and/or (2) prepare for and monitor contracting efforts. Public and union officials identified the following as helpful to employees involved in privatization: (1) knowledge of the existing government program, (2) ability to analyze work flows and processes, (3) ability to develop methods to eliminate inefficiencies, (4) knowledge of cost-estimation techniques, (5) ability to apply methods of financial analysis, (6) ability to determine and write concise and specific contract requirements to delineate exactly what the contractor is responsible for, and (7) knowledge of methods for monitoring the performance of contractors.

Safety Net

Providing a safety net for displaced workers was a component of the six governments' workforce transition strategies. These strategies included offering workers early retirement, severance pay, or a buyout, or, if the activity was taken over by a private firm, ensuring that employees' concerns about compensation issues involved in this transition were addressed.[11] Other strategies included placing workers in other government units if their jobs were eliminated and offering job transition assistance, such as career planning and training, to workers moving to the private sector. According to Virginia officials, for example, employees' concerns were one of the biggest barriers in that state's privatization efforts. The Governor directed state officials to examine and recommend measures to provide the opportunity for departing state workers to compete in the private sector. According to state officials and employee representatives, this led to the passage of the Workforce Transition Act, which mitigated some of the employees' concerns with privatization, such as job loss, training, and benefits.

In New York, according to state officials, new collective bargaining agreements were negotiated that allowed the state to lay off affected employees, provided they were accorded certain considerations such as 60 days written notice of intended separation, placement on a redeployment list, and an offer of redeployment if a fillable vacancy became available elsewhere in state government. If redeployment was not possible and the employee had no displacement rights under the state's Civil Service Law, the employee had the option of receiving a financial stipend for an identified retraining or educational opportunity, severance pay, or preferential consideration for employment with the contractor. Redeployment would ensure that the affected employees maintained their salary and titles comparable to former positions.

Enhanced Monitoring and Oversight of Performance Is Needed When Privatization Is Used

According to officials with the six governments, monitoring and oversight that not only evaluates compliance with the terms of the privatization agreement but also evaluates a private firm's performance in delivering services is needed when a government's direct role in the delivery of services is reduced through privatization. This is necessary to help ensure that the government's interests are protected and that accountability of both the government and the private party is maintained.

[11] To the extent that resources are provided by a government for services such as severance pay or training, the net financial savings resulting from the privatization may be diminished.

Monitoring Privatization

Officials in all six governments told us that monitoring of privatized activities is critical. According to experts, such monitoring consists of contract auditing and technical or performance monitoring. Contract auditing aims to ensure that contractors are paid as mandated by the contract and that all contractual obligations are fulfilled. Contract auditing also serves as an independent check on contractors and on the government's contract managers. Technical and/or performance monitoring aims to ensure that contractor-provided services are meeting contract specifications for quantity and quality.

The majority of the state and city officials we interviewed said that performance monitoring is more difficult than contract auditing and that their governments faced a much greater need to develop employee skills for performance monitoring than for contract auditing. Officials at all of the governments we visited said that one of the most important—and often most difficult—tasks in privatizing government activities was writing specific work statements for the privatization contracts. Officials noted that when contract requirements were vague, contractor performance was not easily evaluated, even if the government used sufficient and effective monitoring techniques. Given the importance of being able to specify work requirements and outputs, most of the six governments reported that they took steps to mitigate their risk. For example, Georgia and Virginia's guidance for evaluating whether a service should be considered for privatization focused on the ease with which the service's objectives could be defined and measured for monitoring purposes. Indianapolis officials said that its use of performance measures enhanced the writing of contract terms because they focused at the activity level (e.g., air and water quality assurance) and measured each activity's outputs (e.g., water samples collected and evaluated).

Officials from all but Indianapolis said that performance monitoring was their weakest link in the privatization process. Officials from all the governments said that they were working to enhance their employees' skills so that they could undertake more sophisticated monitoring. For example, officials said that monitoring the performance of complex activities, such as wastewater treatment or the medical care of prisoners, can require analytical skills that go beyond compliance checklist-type reviews. Monitoring performance, they said, sometimes required new or innovative approaches. For example, Virginia used a newly designed approach to measure the performance of its two contractor-operated child support enforcement offices. Because the offices were newly created, Virginia could not compare pre- and post-privatization costs. Instead, Virginia established quarterly and semiannual reporting requirements in the contract and used sophisticated statistical measures to compare the performance of its child support offices with a hypothetical average office with similar characteristics, such as size and demographics. In addition to having performance measures, the new system required new data collection skills for state employees, such as doing customer satisfaction surveys.

Oversight of Privatization

Officials in all six jurisdictions and our expert panel told us that independent oversight of privatization efforts was critical. Independent oversight by an office that is outside the control of the unit responsible for operating the activity provides a more objective and unbiased evaluation of privatized activities than is possible by senior government managers or program-level monitors. Virginia's Auditor of Public Accounts, for example, said that independent oversight can focus on such areas as automatic contract extensions to ensure that costs do not escalate without limit and that the program manager attempts to maximize competition in the award of contracts.

Each of the six governments had independent oversight functions, and these functions played different roles in the privatization process and provided varying degrees of oversight coverage. For example, beginning in December 1993, the Massachusetts State Auditor had formal review and approval powers related to proposed privatizations for activities costing over $100,000. Virginia's legislative and executive branches, according to officials of both branches, provided extensive oversight. In the executive branch, Virginia had an agency network of internal auditors, coordinated by the Department of the State Internal Auditor, to review privatized activities within their respective agencies. Virginia's legislature had the Joint Legislative Audit Review Commission (JLARC) and the Auditor of Public Accounts. JLARC's actions on a proposed privatization demonstrate the value of independent oversight. In 1996, JLARC raised concerns about a proposed computer systems privatization that was begun before the state government established its current privatization process. As a result of these concerns, the General Assembly subsequently delayed the proposed privatization and directed JLARC to conduct a more complete study of the project.

We are sending copies of this report to the Chairman and Ranking Minority Member of the Senate Committee on Governmental Affairs and the House Committee on Government Reform and Oversight; the Director, Office of Management and Budget; the Director, Office of Personnel Management; and other interested parties. Copies will be made to others upon request.

The major contributors to this report are listed in appendix V. Please contact me on (202) 512-9039 if you have any questions.

Sincerely yours,

Michael Brostek
Associate Director, Federal Management
and Workforce Issues

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Figures

Abbreviations

ABC	activity-based costing
CCC	(Virginia) Commonwealth Competition Council
CEO	chief executive officer
DMB	(Michigan) Department of Management and Budget
ESOP	employee stock ownership plan
GPRA	Government Performance and Results Act of 1993
GSE	government-sponsored enterprise
ITMRA	Information Technology Reform of 1996
JLARC	(Virginia) Joint Legislative Audit Review Commission
NPR	National Performance Review
OMB	Office of Management and Budget
PBO	performance based organization
PERM	(Michigan) privatize, eliminate, retain, or modify

Forms of Privatization and Frequency of Use in State Programs and Services

Forms of privatization	Administration/ General Services	Corrections
Contracting out	91.67%	92.09%
Grants	0.56	1.19
Vouchers	3.06	0.40
Volunteerism	1.39	3.56
Public-private partnerships	1.67	2.37
Private donation	0.56	0.40
Franchise	0.28	.00
Service shedding	0.28	.00
Deregulation	.00	.00
Asset sales	0.56	.00

Agencies' frequency of use					
Education	Health	Mental Health/ Retardation	Social Services	Transportation	Average by form of privatization
81.29%	69.57%	64.67%	71.32%	83.51%	78.06%
8.63	14.13	15.63	12.48	4.50	8.48
0.72	4.89	5.35	9.31	0.43	4.11
1.44	3.26	3.64	2.98	5.35	3.32
5.04	5.43	3.85	2.23	2.57	2.95
0.72	.00	2.57	0.19	1.28	0.96
1.44	1.09	1.71	0.37	1.50	0.91
0.72	1.09	0.86	0.74	0.43	0.58
.00	0.54	1.50	0.37	0.21	0.46
.00	.00	0.21	.00	0.21	0.17

Source: State Trends and Forecasts: Privatization, Council of State Governments, 1993.

Expert Panelists on GAO's Review of State and Local Privatization Efforts[1]

Keon S. Chi, Director, Center for State Trends and Innovations, Council of State Governments. Author, State Trends and Forecasts: Privatization, 1993, and Privatization and Contracting Out for State Services: A Guide, 1988, The Council of State Governments.

John D. Donahue, Professor, John F. Kennedy School of Government, Harvard University. Author, The Privatization Decision: Public Ends, Private Means, 1989.

William D. Eggers, Director of Privatization and Government Reform, Reason Foundation. Coauthor, Revolution at the Roots: Making Our Government Smaller, Better, and Closer to Home, 1995.

David Seader, Senior Manager, Privatization and Infrastructure Group, Price Waterhouse. Former Executive Director, Privatization Council, Inc., a nonprofit educational organization devoted to developing and expanding the concept of privatization and public-private partnerships.

Dennis Houlihan, Labor Economist, Department of Research and Collective Bargaining Services, American Federation of State, County, and Municipal Employees.

Ronald W. Jensen, Private Consultant. Former Public Works Director, Phoenix, Arizona. Developed city program on privatization; specifically initiated the innovative process of various city operations competitively bidding against private contractors.

Linda Morrison, Private Consultant. Former Director of the Mayor's Competitive Contracting Office, Philadelphia, Pennsylvania, and former competitive contracting advisor to the State of New Jersey.

Larry Gupton, Deputy Auditor, State of Colorado. Coauthor of Privatization in Colorado State Government: Performance Audit, 1989, and the follow-up performance audit report, 1993.

[1] The panel helped us identify governments to visit and validated our framework of privatization factors, which we used as a guide in data collection.

Overview of Recent Privatization Efforts in the Six Governments

This appendix provides an overview of selected recent privatization efforts in the six governments we surveyed. Officials from the six governments provided the following key initial actions, primary reasons for governmentwide privatization efforts, and an overview of select projects.

Government	Key initial action	Primary reasons for governmentwide privatization efforts
Georgia	Governor created commission on privatization of government services in 1995.	Limit growth of government. Reduce scope of government. Improve government efficiency.
Massachusetts	Governor called on department managers to privatize functions and services in 1991.	Reduce state budget deficit. Reduce costs of government services. Improve quality of government services.

Overview of governments' select projects

Project	Primary reason	Type of privatization[a]	Reported results[b]
Milledgeville War Veterans Home	Privatization Commission analysis showed that costs were much higher than in six benchmark states.	Outsourcing	• Estimated cost savings of 57 percent for 5 years. • Staff are more responsive to family concerns and inquiries. • Quality of life enhancements include: cleaner home, better food, and cable television.
State maintenance of autos	Not a core function of state.	Outsourcing	• Estimated cost savings of $300,000 per year. Estimated savings represent a projected 40 percent savings over government provision of service.
Lake Lanier Islands recreational area	Not a core function of state.	Outsourcing	• Projected revenue of $300 million to $350 million over the 50-year contract.
Prison health care	Reduce prison health care costs and improve medical care and access to care.	Outsourcing	• Estimated annual cost savings of $8 million over 5-year contract. • Expenses for state employee benefits have been reduced. • State shielded from liability because single vendor has become responsible for all inmate patient care and held responsible for all malpractice awards and legal costs. • Ten of 20 state prisons now meet National Commission on Correctional Health Care accreditation standards (previously none of the prisons met these standards). • Trips by prisoners to outside hospitals have been reduced from over 100 every day to 100 per week. This has reduced personnel and transportation costs.
Essex County highway maintenance	Improve quality of highway maintenance.	Outsourcing/ managed competition	• Dollar savings from the first year of the contract were $2 million in direct operating costs, $1 million in reallocated equipment, and $1.5 million in reallocated personnel. • Maintenance overtime costs reduced by $252,000 in the first year of the contract. • Highway maintenance services have improved and include new bridge washing service, increased mowing of grass, roadway sweepings, and guardrail maintenance.
Social services revenue management operations	Apply private-sector technology to increase revenue collections.	Outsourcing	• Overall increase in collections of $87 million during first 2 years of contract (federal fiscal years 1994 and 1995). • Before privatization an estimated $49 million to $70 million was not collected annually. • Agency has increased its annual level of revenue generation by 40 percent and reduced its per-dollar cost of revenue collection by 30 percent. • Additional revenue has been used to boost the agency's preventive services, adoption, foster care and other child welfare initiatives.

(continued)

Government	Key initial action	Primary reasons for governmentwide privatization efforts
Michigan	Governor created public-private partnership commission in 1992.	Reduce the state's budget deficit. Shrink size and scope of government.
New York	Governor established an advisory commission on privatization and a research council on privatization in 1995.	Reduce size and scope of government. Reduce cost and improve the quality of government services.

Overview of governments' select projects

Project	Primary reason	Type of privatization[a]	Reported results[b]
Workers Compensation Accident Fund	State determined that the fund should no longer be a government function.	Asset sale	• The state gained $261 million from the sale of the Accident Fund. • The private Accident Fund Company has reduced rates by an average of 9.2 percent in the first year of operations. • Quality service at competitive rates. • Removes potential for political interference in the ratemaking process. • The private Accident Fund Company has introduced new products for participants, such as group dividend programs which offer the potential for rebates on insurance premiums if the overall loss ratio for the group remains low.
Physical security at military facilities	Cost savings.	Outsourcing	• Estimated savings of approximately $1.2 million over fiscal year 1996 costs from contracting security programs at Camp Grayling, Alpena Combat Center, and Battle Creek Air National Guard Base. • Estimated cost savings represent a savings of 70 percent over fiscal year 1996 costs. • Allows the state's Department of Military Affairs to meet federal security requirements at all three sites within the limitations of available federal funding. • Camp Grayling increased level of security with enhanced monitoring coverage.
Sales of armories	Excess, unused armories that resulted from national defense downsizing were no longer needed.	Asset sale	• State gained $407,900 from the sale of the St. Joseph and Benton Harbor armories. • Sale proceeds from armory asset sales deposited in Michigan National Guard Armory Construction Fund to be used for acquisition and construction of facilities and other purposes, thereby offsetting future1 general fund expenditures. • State no longer responsible for oversight of vacant facilities.
Vista Hotel	Owning/operating hotel was not considered to be a governmental function.	Asset sale	• Hotel was sold in 1995 by the New York-New Jersey Port Authority for $141.5 million.
Tax form processing	To enhance cost savings and the efficiency and effectiveness of processing tax returns.	Outsourcing	• Estimated annual savings of $7.5 million.
Economic development and housing loan portfolio servicing	Reduce costs and improve services.	Outsourcing	• Approximately $3 million estimated annual cost savings.

(continued)

Government	Key initial action	Primary reasons for governmentwide privatization efforts
Virginia	Key legislators and governor created a competition council in 1995.	Improve service and productivity of government services. Reduce cost of operations.
Indianapolis	Mayor created a private-sector advisory group in 1992.	Reduce size and scope of government. Increase the quality and decrease the cost of services.

Overview of governments' select projects

Project	Primary reason	Type of privatization[a]	Reported results[b]
Delinquent tax collection	Increase collections.	Outsourcing	• Estimated $6.8 million in collections in first year. • Improved collection of previously uncollectable accounts.
Education loan authority	Not considered to be a government function.	Asset sale	• State gained $62 million from sale of loan portfolio and building facilities that housed loan authority staff operations.
Child support enforcement	Need to respond to increased caseload and take advantage of private sector technology.	Outsourcing	• Administrative cost of private office to collect $1 dollar support was 60 percent lower than public office during an 18-month period. • Improved customer service satisfaction. • Increased number of clients served.
Wastewater treatment	Cost savings.	Outsourcing	• Estimated $65 million cost savings between 1994 and 1998. • Estimated cost savings represent a 42 percent savings over government provision of service. • Increased capacity to treat effluent with fewer staff. • Improved effluent quality. • Better maintenance program resulted in improved equipment reliability. • Combined sewer overflows reduced by 50 percent.
Airport management	Promote economic development.	Outsourcing	• Estimated $105 million in cost savings or new revenues between 1995 and 2004. • Estimated cost savings represent a 28-percent savings over government provision of service. • 16.5 percent reduction in the cost per enplaned passenger from 1994 to 1995. • 22 percent reduction in airline landing fees from 1994 to 1995. • Increased retail selection and quality for passengers.
Street maintenance	Cost savings.	Outsourcing/ managed competition	• Estimated $700,000 in cost savings between 1992 and 1996. • Estimated cost savings represented a 30-percent savings over previous costs. • Increased chuckhole crew daily productivity by 68 percent. • A 200-percent annual average increase in lane miles repaired (cracks sealed) between 1993 and 1996 compared to 1993 baseline.
Audio-visual/ microfilm services	Cost savings.	Outsourcing	• Estimated $1.5 million in cost savings between 1992 and 1995. • Estimated cost savings represented a 54-percent savings over government provision of service. • Eliminated prior 3-year backlog of service requests. • Consistent achievement of turnaround requirements. • Improved service to citizens using microfilm archives.

(continued)

Government	Key initial action	Primary reasons for governmentwide privatization efforts
Indianapolis (continued)		

Overview of governments' select projects

Project	Primary reason	Type of privatization[a]	Reported results[b]
Maintenance of city vehicles	Cost savings.	Managed competition	• Estimated $4.2 million in cost savings between 1995 and 1997. • Estimated cost savings represent a 21-percent savings over government provision of service. • Fewer labor grievances in first year of contract compared to prior 1-year period. • Cost of workers compensation claims decreased by two-thirds since 1994.

Note: The six governments selected the projects to illustrate the range of activities that they have undertaken in their recent privatization efforts.

[a]See the end of this report for our glossary of privatization terms.

[b]All results are as reported by the governments. We did not verify these results.

Sources: Georgia, Massachusetts, Michigan, New York, Virginia, and city of Indianapolis government officials.

Analytical Frameworks Used by Indianapolis, Michigan, and Virginia

Most of the state and local government officials and experts we surveyed said that having a framework or process was key to implementing privatization because it provided a consistent approach for analyzing government activities. All six governments used some form of analytical framework to guide their decisionmaking. Some said that the repeated use of such a framework shortened the learning time in analyzing government functions.

These analytical frameworks typically included a step-by-step decisionmaking process. Many of the frameworks established by the six governments shared common elements, such as providing criteria for selecting activities to privatize, an inventory of privatization candidates, cost comparison and evaluation methods, and procedures for monitoring the performance of privatized activities. Indianapolis, Michigan, and Virginia had the most formalized frameworks and they are described below.

The Indianapolis Costing and Competitiveness Model

After introducing competition into government in 1992, Indianapolis included city employees through their union in the process for competitive bidding for contracts to deliver city services. Once a number of activities had been identified as candidates for competition, city officials developed a three-phase approach to implementing a managed competition process. The three phases were (1) determining the costs of government services using activity-based costing, (2) openly and competitively bidding for functions or services and contracting with either a city agency or private-sector firm to provide those functions or services, and (3) evaluating the level of performance of functions and services delivered using a system of citizen and customer satisfaction surveys and measures of cost and performance. The costing and competitiveness model is shown in figure IV.1 and worked as follows.

First, city officials, after a discussion with the affected unions, decided whether or not to open competitive bidding for an activity. If the decision was to compete, the city then issued a request for proposals. City officials provided a bid package to the union at the same time as other potential bidders.

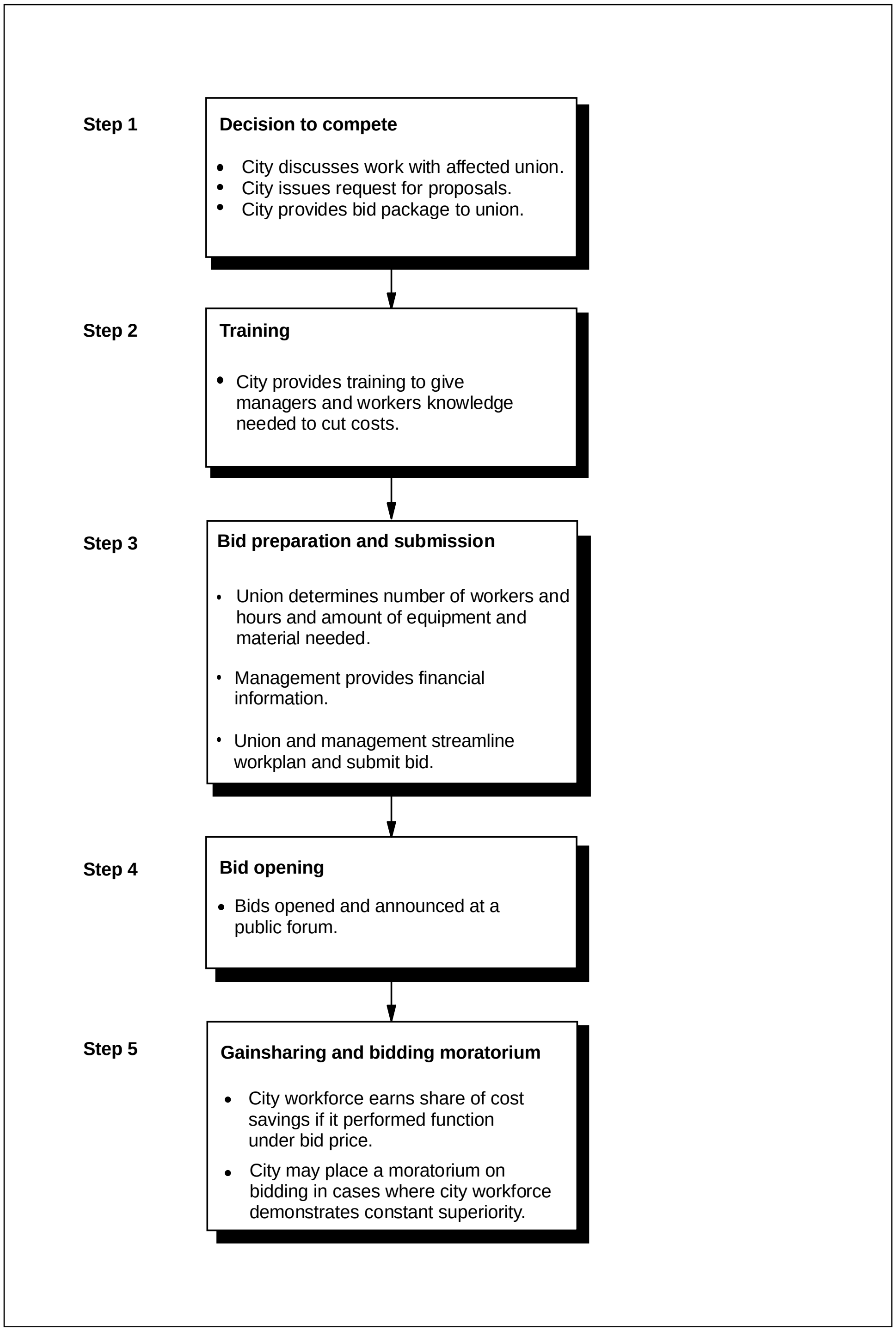
Second, to ensure that city employees were equipped to participate in the process, the city provided managers and union members with the analytical training they needed to spot inefficiencies, and with the knowledge needed to analyze and reduce costs. The city also provided consultants to help city employees prepare their proposals.

Third, a union-management bid team reviewed the bid document and determined (1) the number of employees and hours needed to perform the function as well as the amount of equipment and materials needed and (2) the necessary financial and performance information, which was provided by management. The team then worked to streamline the work processes and rewrite the workplan. Often with the help of consultants provided by the city, the team then prepared the bid package which was submitted along with private bids.

Fourth, at a public forum, all public and private-sector bids were opened together and the winning bid was announced.

Finally, if the public sector won a competition and the union-management team performed the activity at the desired level of performance for less than it bid, the team received a share of the savings at the end of the year. The city, after it tracked performance over a period of years, could place a moratorium on bidding for areas for which city employees had demonstrated performance excellence and in which they consistently outbid private competitors.

Figure IV.1: The Indianapolis Approach: Costing and Competitiveness in the Delivery of Public Services



Source: City of Indianapolis.

Michigan's PERM Process

Michigan established its framework in 1992. The framework provided a set of procedures for analyzing government activities to determine if they should be privatized, eliminated, retained in current form, or modified (PERM). To accomplish these objectives, the PERM process included the steps described below. Michigan's operating agencies, Privatization Division, and private contractors have performed PERM studies of state activities and functions. Figure IV.2 illustrates this process.

Initially, agency directors used the Public-Private Partnership Commission's list of suggested activities[1] to choose functions and services to be analyzed. The analyses were to be done using a three-part analytical model developed by the Privatization Division in Michigan's Department of Management and Budget (DMB). First, an historical analysis of the activity was done to identify factors that caused the state government to become involved in the activity and whether those factors have changed. This analysis also tracked the state's level of responsibility throughout its involvement.

Second, the agency prepared a report which recommended whether the function should be privatized, eliminated, retained in current form, or modified. This included evaluating the potential effects on customers and other state activities of changing a function or service. It also included a quantitative assessment of activity operations, as well as results to be achieved and in what time frames. Issues involved in resolving potential or pending issues (legal, liability, confidentiality, etc.) were also assessed.

Third, the agency prepared an analysis of the function or service's current costs, as well as a basis for determining the cost of operations if they would be changed. For example, if the initial decision were to privatize an existing state activity, the third part of the analysis would include both the cost of the current program as well as an estimate of what the privatized activity would cost. The latter would include estimates of the costs associated with the transition from government operation to privatized status. Agency management then reviewed the PERM analysis and decided what action was to be taken. This decision was forwarded to the DMB's Privatization Division for review. Each recommendation was either agreed to or, if not, it was renegotiated or studied further.

Since 1995, the focus has shifted from agency-initiated PERM studies to Privatization Division-initiated PERM studies, particularly on functions and

[1]Final Report-PERM: Privatize, Eliminate, Retain or Modify, Michigan's Public-Private Partnership Commission, December 1992.

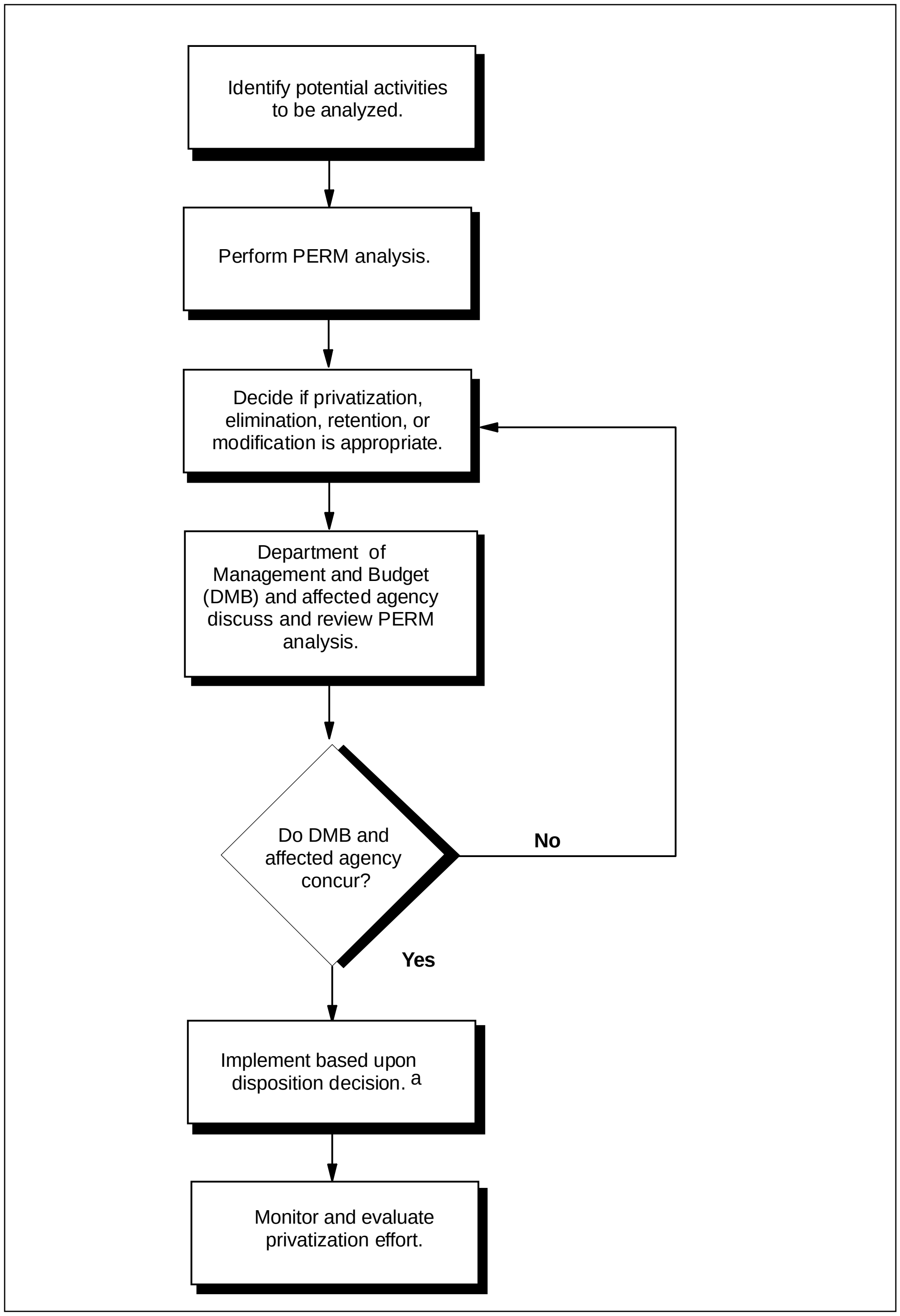
services that cross agency lines. Thus, the process changed in that DMB's Privatization Division would conduct studies, using the three-part analytical model described above, after obtaining approval from DMB and the Governor's office. Privatization Division staff would then submit their PERM analysis to the affected agency for review and comment. After DMB and the affected agency negotiated the recommendation made in DMB's PERM study, both parties agreed on a decision to implement.

Michigan has also contracted out to have PERM studies conducted. The state's Office of Information Technology maintains a list of preapproved PERM contractors, which agencies can contract with to perform PERM studies. These are usually done in consultation with the Privatization Division staff and the affected department and address issues outlined in the three-part analysis model outlined above.

According to Michigan officials, most decisions calling for privatization, elimination, retention, or modification could be implemented by executive branch administrative actions. When privatization was recommended, Michigan's Civil Service Department reviewed agency proposals to contract for personal services.[2] A proposed privatization also could be subject to legislative approval if authorizing legislation needs to be created, changed, or repealed.

[2]As defined by Michigan's Civil Service Commission Rules, personal services are services that the state contracts for with persons who are not classified as employees of the state.

Figure IV.2: Michigan's PERM Process for Analyzing Functions and Services



[a]Submit decision information to appropriate entities as required (e.g., Attorney General, Civil Service, Contract Management, Facilities, Purchasing).

Source: Michigan's Department of Management and Budget, Privatization Division.

Virginia Commonwealth Competition Council Process

Virginia's framework, known as the Commonwealth Competition Council (CCC) Process, was used to implement governmentwide privatization efforts for the first time in 1996 (see figure IV.3). State officials told us that most of the previous privatization efforts used a similar approach. This process is dynamic as state government organizations may be at different steps depending on their respective agency performance requirements.

In step 1, the Council held hearings to solicit input from citizens, business interests, and government employees. Using this input and information from functional departmental reviews, the CCC developed an inventory of functions or services that could be opened to competition with the private sector. The inventory for future years is published in the Council's annual report.

In step 2, agencies conducted a public-private performance analysis of selected activities to determine whether they should be opened to competition with the private sector. The performance analysis consisted of five parts. The first part evaluated an activity's potential for competition, assessing such aspects as the private sector's capacity and the state's ability to measure performance for evaluation purposes. The second part assessed the full cost of operating the current activity as well as the estimated cost of the contract for the function or activity considered for privatization. The third part focused on public policy issues related to public safety and welfare. The fourth considered issues involved in planning the competition, such as personnel and transition considerations, as well as contract administration. The fifth component considered implementation issues such as procurement requirements and quality assurance evaluation procedures.

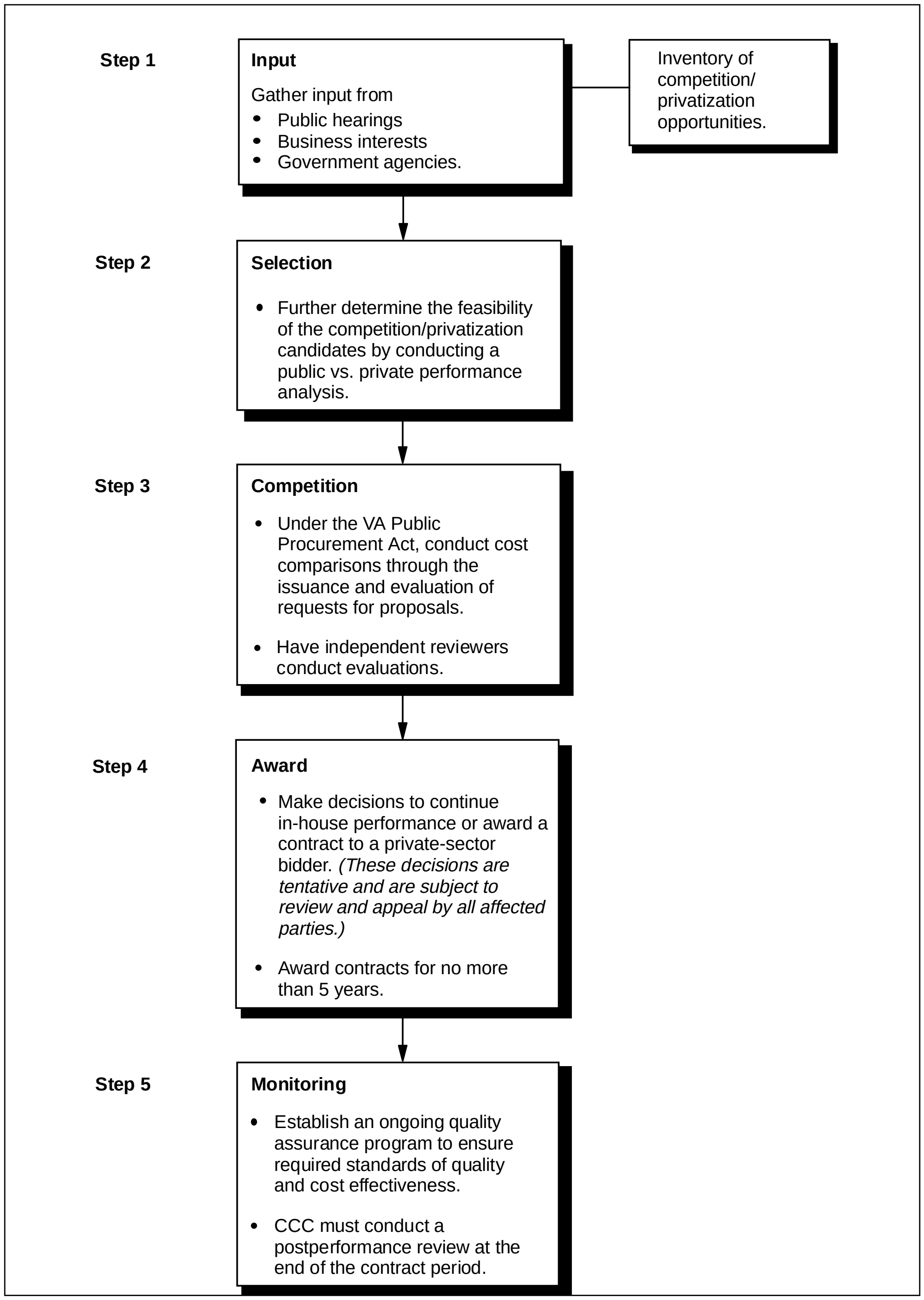
In step 3, the agency requested proposals from private-sector firms and, in certain instances, state agencies. The Council staff oversaw the cost comparison evaluation process. An interagency team did an independent review of in-house costs to ensure the government costs were complete, accurate, and reasonable. The team was selected by and reported to the Council and included officials from the offices of the Attorney General, Planning and Budget, Purchases and Supplies, State Internal Auditor, Joint Legislative Audit and Review Commission, the Virginia Institute of

Government, Auditor of Public Accounts, and Council of Higher Education.

In step 4, the agency received sealed proposals from the private firms, and if a managed competition was used, from public employees, and announced a tentative decision to continue in-house performance or to award the contract to a particular bidder. Contracts were awarded for a period not to exceed 5 years.

Step 5 required that the agency establish an ongoing quality assurance program to ensure that quality and cost standards established in the contract were met. The agency was required to conduct a postperformance review at the end of the contract period.

Figure IV.3: Virginia's Commonwealth Competition Council Process



Source: Virginia's Commonwealth Competition Council.

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Glossary of Privatization-Related Terms

Asset Sale

An asset sale is the transfer of ownership of government assets, commercial type enterprises, or functions to the private sector. In general, the government will have no role in the financial support, management, or oversight of a sold asset. However, if the asset is sold to a company in an industry with monopolistic characteristics, the government may regulate certain aspects of the business, such as the regulation of utility rates.

Competition

Competition occurs when two or more parties independently attempt to secure the business of a customer by offering the most favorable terms. Competition in relation to government activities is usually categorized in three ways: (1) public versus private, in which public-sector organizations compete with the private sector to conduct public-sector business; (2) public versus public, in which public-sector organizations compete among themselves to conduct public-sector business; and (3) private versus private, in which private-sector organizations compete among themselves to conduct public-sector business.

Contracting Out

Contracting out is the hiring of private-sector firms or nonprofit organizations to provide a good or service for the government. Under this approach, the government remains the financier and has management and policy control over the type and quality of services to be provided. Thus, the government can replace contractors that do not perform well.

Divestiture

Divestiture involves the sale of government-owned assets or commercial-type functions or enterprises. After the divestiture, the government generally has no role concerning financial support, management, regulation, or oversight.

Employee Stock Ownership Plans

Under an employee stock ownership plan (ESOP), employees take over or participate in the management of the organization that employs them by becoming shareholders of stock in that organization. In the public sector, an ESOP can be used in privatizing a service or function. Recently, for example, the Office of Personnel Management established an ESOP for its employees who perform personnel background investigations.

Franchising of Internal Services

Under the franchising of internal services, government agencies may provide administrative services to other government agencies on a reimbursable basis. Franchising gives agencies the opportunity to obtain administrative services from another governmental entity instead of providing them for themselves.

Franchising-External Service

In the franchise-external service technique, the government grants a concession or privilege to a private-sector entity to conduct business in a particular market or geographical area, such as concession stands, hotels, and other services provided in certain national parks. The government may regulate the service level or price, but users of the service pay the provider directly.

Government Corporations

Government corporations are separate legal entities that are created by Congress, generally with the intent of conducting revenue-producing commercial-type activities and that are generally free from certain government restrictions related to employees and acquisitions.

Government-Sponsored Enterprises

Government-sponsored enterprises (GSE) are privately owned, federally chartered financial institutions with a nationwide scope and limited lending powers that benefit from an implicit federal guarantee that enhances a GSE's ability to borrow money in the private sector. They are not agencies of the United States but serve as a means of accomplishing a public purpose defined by law.

Joint Ventures

See public-private partnership.

Leasing Arrangements

Leasing arrangements are a form of public-private partnership. Under a long-term lease, the government may lease a facility or enterprise to a private-sector entity for a specified period. Maintenance, operation, and payment terms are spelled out in the lease agreement. Under a sale-leaseback arrangement, the government sells an asset to a private-sector entity and then leases it back. Under a sale-service contract or lease-service contract, an asset sale or long-term lease is coupled with an arrangement with the purchaser to furnish services for a specified period. Leases in which the government leases a facility (e.g., a building lease) are considered a form of contracting out, rather than a public-private partnership.

Managed Competition

Under managed competition, a public-sector agency competes with private-sector firms to provide public-sector functions or services under a controlled or managed process. This process clearly defines the steps to be taken by government employees in preparing their own approach to performing an activity. The agency's proposal, which includes a bid proposal for cost-estimate, is useful to compete directly with private-sector bids.

Outsourcing

Under outsourcing, a government entity remains fully responsible for the provision of affected services and maintains control over management decisions while another entity operates the function or performs the service. This approach includes contracting out, the granting of franchises to private firms, and the use of volunteers to deliver public services.

Performance Based Organizations

Under a performance based organization (PBO), policymaking is to be separated from service operation functions by moving all policymaking responsibilities to a Presidential appointee. The service operations are moved to an organization to be headed by a chief executive officer (CEO), hired on a competitive contract for a fixed term. The CEO's contract defines expected performance and in exchange for being held accountable for achieving performance, the CEO is granted certain flexibilities for human resource management, procurement, and other administrative functions. As of March 1997, several PBOs had been proposed but no PBO had been authorized in the federal government.

Privatization

The term privatization has generally been defined as any process aimed at shifting functions and responsibilities, in whole or in part, from the government to the private sector.

Public-Private Partnership

Under a public-private partnership, sometimes referred to as a joint venture, a contractual arrangement is formed between public- and private-sector partners, and can include a variety of activities involving the private sector in the development, financing, ownership, and operation of a public facility or service. It typically includes infrastructure projects and/or facilities. In such a partnership, public and private resources are pooled and their responsibilities divided so that each partner's efforts complement one another. Typically, each partner shares in income resulting from the partnership in direct proportion to the partner's investment. Such a venture, while a contractual arrangement, differs from typical service contracting in that the private-sector partner usually makes a substantial cash, at-risk, equity investment in the project, and the public sector gains access to new revenue or service delivery capacity without having to pay the private-sector partner.

Service Shedding

Divestiture through service shedding occurs when the government reduces the level of service provided or stops providing a service altogether. Private-sector businesses or nonprofit organizations may step in to provide the service if there is a market demand.

Subsidies

The government can encourage private-sector involvement in accomplishing public purposes through tax subsidies or direct subsidies, such as the funding of low-income housing and research and development tax credits.

User Fees

User fees require those who use a government service to pay some or all of the cost of the service rather than having the government pay for it through revenues generated by taxes. Charging entry fees into public parks is an example of a user fee.

Volunteer Activities

An activity in which volunteers provide all or part of a service and are organized and directed by a government entity can also be considered a form of outsourcing. Volunteer activities are conducted either through a formal agency volunteer program or through a private nonprofit service organization.

Vouchers

Vouchers are government financial subsidies given to individuals for purchasing specific goods or services from the private or public sector. The government gives individuals redeemable certificates or vouchers to purchase the service in the open market. Under this approach, the government relies on the market competition for cost control and individual citizens to seek out quality goods or services. The government’s financial obligation to the recipient is limited by the amount of the voucher. A form of vouchers are grants, which can be given to state and local governments that may use the funds to buy services from the private sector.

GAO Privatization Products Related to State and Local Governments

Child Support Enforcement: Early Results on Comparability of Privatized and Public Offices (GAO/HEHS-97-4, Dec. 16, 1996).

Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports (GAO/RCED-97-3, Nov. 7, 1996).

Child Support Enforcement: States' Experience With Private Agencies' Collection of Support Payments (GAO/HEHS-97-11, Oct. 23, 1996).

Private and Public Prisons: Studies Comparing Operational Costs and/or Quality of Service (GAO/GGD-96-158, Aug. 16, 1996).

Child Support Enforcement: States and Localities Move to Privatized Services (GAO/HEHS-96-43FS, Nov. 20, 1995).

District of Columbia: City and State Privatization Initiatives and Impediments (GAO/T-GGD-95-194, June 28, 1995).

District of Columbia: Actions Taken in Five Cities to Improve Their Financial Health (GAO/T-GGD-95-110, Mar. 2, 1995).

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