



Keon S. Chi

Privatization in State Government: Trends and Issues

Keon S. Chi, Kelley A. Arnold and Heather M. Perkins

Privatization continues to be a controversial management issue in state governments. In the past five years, 1997-2002, the extent of privatization activities in the states has largely remained the same as in the previous five years or slightly increased. The main reasons for privatization are a lack of personnel or expertise and cost savings. In most cases, privatized services account for less than 5 percent of agency services, while reported costs savings range from none to less than 5 percent. But many state agency directors surveyed seem to have no clear ideas as to how much has been actually saved from privatization. Nevertheless, privatization is likely to continue in the states in the next few years as in the past decade.

Every year, new privatization initiatives are being implemented in the states. To cite just a few recent examples, Florida Gov. Jeb Bush in August 2002 signed a seven-year, \$280 million contract with a private firm to provide selected human resource services and save the state approximately \$80 million during the contract period. In early 2003, New York Gov. George E. Pataki proposed to privatize certain state assets to lower the Medicaid cost and other government programs. Nevada Gov. Kenny Guinn reported to the Legislature that privatization of the state workers compensation system resulted in a reduction of nearly 800 positions in the state government and relieved the state of a \$2 billion liability. He chose the state motor pool and printing operations as candidates for privatization. Virginia Gov. Mark R. Warner said he was planning to continue with public-private partnerships for education and transportation. Maine Gov. John Baldacci proposed privatizing wholesale and retail liquor operations for greater efficiency.

Rationale for privatization is difficult to generalize. Former Michigan Gov. John Engler seemed to represent the prevailing opinion of state policymakers who initiate privatization when he said:

It's my belief that the private sector is often better at getting the job done than government. First, the competition promotes operating cost effectively, and the greater accountability helps ensure quality products and services. The private sector also excels at using innovative technology to solve problems, while government agencies do not always have the same latitude to innovate or take risks. Finally, the private sector has vast resources in computer technology, high volume proceeding equipment, and specialized personnel, plus the flexibility to assign them wherever they are needed most.¹

Incumbent Michigan Gov. Jennifer Granholm in 2003 direct-

ed the state Department of Management and Budget to review all state contracts for cost overruns and potential cost savings.

On the other hand opposition to privatization efforts has been persistent over the years. Since the early 1990s, AFL-CIO has led anti-privatization initiatives by saying, "Privatization/contracting must be stopped, the dismantling of our governments cannot be tolerated." Similarly, Gerald W. McEntee, president of the American Federation of State, County and Municipal Employees (AFSCME), warns:

For public employees and the people we serve, the price of privatization is high—and getting higher. For workers, privatization threatens job security, pay and benefits, working conditions and career opportunities. For the public, it means less quality, less access and less accountability. For local economies, because privatization is often non-union, it means fewer good jobs and a reduced tax base.²

The topic of privatization — outsourcing or contracting — seems to have re-emerged recently as a controversial management issue for state policymakers. Governors, agency directors and legislators in many states are asking for either further promotion or curtailment of such public-private partnership cooperation to deal with the faltering economy and dwindling revenues in the past two to three years. There appears to be no consensus as to the effectiveness of privatization in part due to the lack of empirical data as well as the complexity of the issue. This article reports findings of a recent national survey of selected agency directors in the 50 state governments, offers lessons learned from the previous experiences and raises key issues for future privatization activities.

Trends in Privatization

Since the early 1980s, The Council of State Governments has monitored and disseminated information on privatization trends in state government. In 1993, CSG published a report, "Privatization in State Government: Options for the Future" in



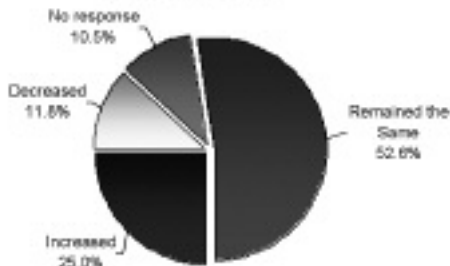
Kelley A. Arnold



Heather M. Perkins

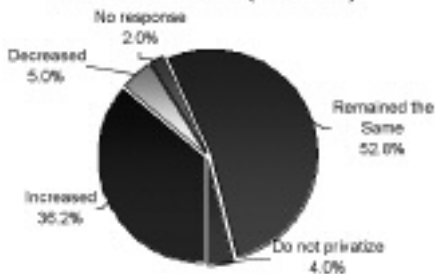
its *State Trends and Forecasts* series. In 1997, CSG's Center for State Trends and Innovations conducted a 50-state survey on privatization in 19 state agencies; the survey findings were reported in a 1998 monograph, *Private Practices: A Review of Privatization in State Government*.³ CSG conducted another national survey of state officials to identify recent privatization trends between October 2002 and December 2002. The survey was sent to 450 state budget and legislative service agency directors and heads of five executive branch agencies: personnel, education, health and human services, corrections and transportation. The survey yielded an overall response rate of nearly 77 percent.

Figure 1 Trends in Privatization Activity in the Past Five Years (1998-2002)



Source: Survey of state budget directors and legislative service agency directors, December 2002. Question: "Which of the following best describes the amount of privatization activity in the past five years?"

Figure 2 Trends in Agency Privatization Activity in the Past Five Years (1998-2002)



Source: Survey of directors from five executive agencies, December 2002. Question: "Which of the following best describes your agency's level of privatization activity in the past five years?"

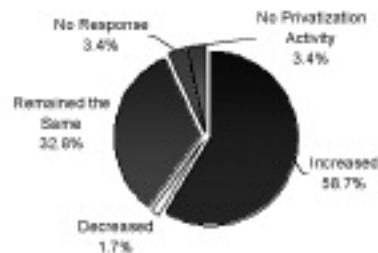
Budget and Legislative Service Directors

According to the 2002 CSG survey, the level or amount of privatization in the states between 1997 and 2002 has remained the same in most states or slightly increased in some states. Only five of the 38 state budget directors who responded to the survey reported privatization has decreased in their state in the recent past (Figure 1). Survey results from heads of the five line agencies in the states showed very much the same trend, confirming that privatization has become a routine management tool in state government in the past decade (Figures 2 and 3). As in the 1997 survey, most state agency directors indicated in the 2002 survey that the extent of privatized services and programs has remained relatively moderate, mostly less than 10 percent. When asked about the amount of privatization that has occurred within the state, 12 budget directors replied that their state has privatized on average at least 6 percent of the their services (Arizona, Connecticut, Indiana, Massachusetts, Minnesota, Missouri, North Carolina, Oklahoma, Virginia, Washington, Wisconsin, Wyoming).

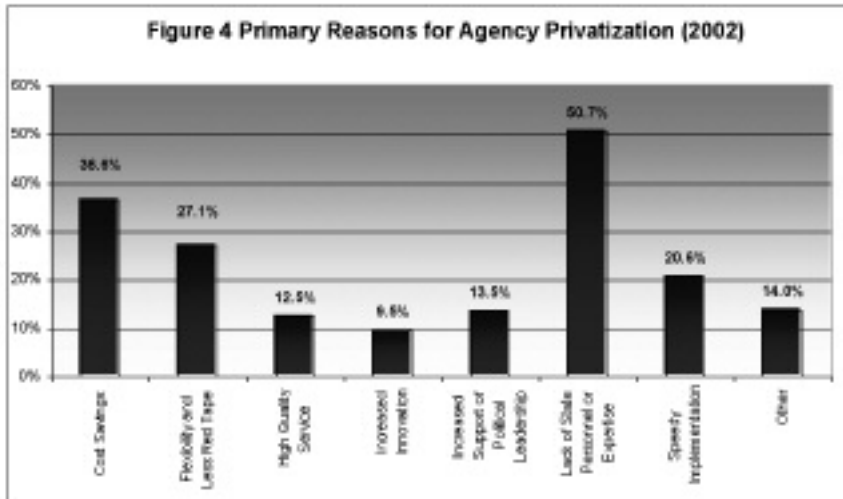
State budget and legislative service agency directors offered slightly different reasons for and cost savings estimates from privatization when compared with responses from line agency directors. For example, the primary reason for privatization given by a majority of the budget directors was cost savings, while the lack of personnel or expertise was the number one reason for contracting out according to a majority of state agency heads (Figure 4). In the 1997 survey, support of political leadership was cited as the second major reason, followed by cost savings, for privatization, but in the 2002 survey, support or pressures from political leadership was not mentioned as a main reason for privatization in most state agencies (Figure 5).

Contracting has been the most widely used method used by state governments to privatize, followed, to a much less extent, by public-private partnerships (Figure 6). For example, Michigan Governor's Education Technology Fund is a public-private partnership between the state and the Intel Corporation

Figure 3 Trends in State Privatization Activity in the Past Five Years (1993-97)

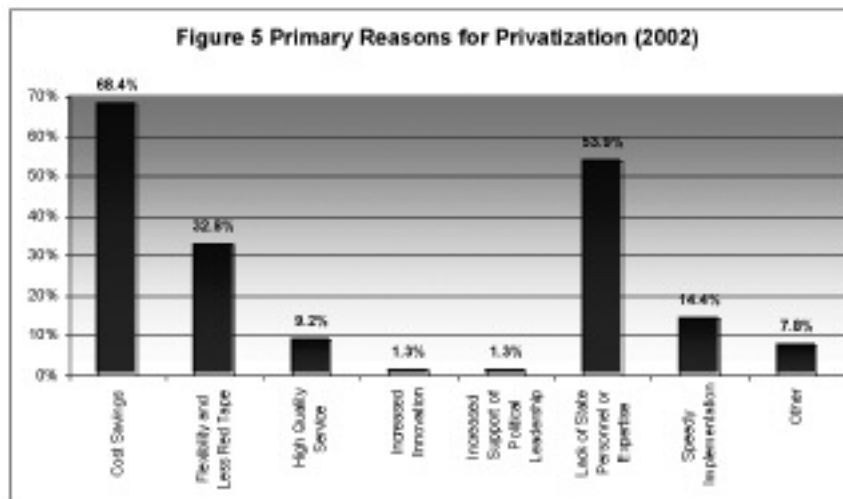


Source: Survey of auditors, budget directors, comptrollers and legislative service agencies, 1997. Question: "Which of the following best describes your state's level of privatization activity in the past five years?"



Source: Survey of directors from five executive agencies, December 2002.
Question: "What are the primary reasons for privatizing services in your agency?"

(along with several other businesses) and the purpose is to provide educators with online professional development opportunities through Michigan Virtual University. Several other states also have examples of using one of the three major methods of privatization. The Alaska Office of Management and Budget reported that the state recently implemented the largest privatization in the history of the state involving a telecommunication partnership. A Virginia respondent reported the recently enacted Public-Private Education Infrastructure Act was expected to increase the number of public-private partnerships throughout the Commonwealth. In addition, 15 states have reported passing legislation in past five years relating to privatization (Alaska, Arizona, Connecticut, Illinois, Kentucky, Massachusetts, Nevada, New Jersey, North Carolina, Oklahoma, Oregon, Vermont, Virginia, Washington,



Source: Survey of state budget directors and legislative service agency directors, December 2002.
Question: "What are the primary reasons for privatizing services in your state?"

Wisconsin). Washington passed a law in 2002 authorizing state agencies and institutions of higher education to contract out for services that were historically provided by classified civil service employees. It also allows those employees whose positions would be displaced by these contracts to form employee business units and these units will be able to compete for and bid on the contracts along with private companies.

Most budget and legislative service agency directors reported on savings from privatization to be 5 percent or less. But many of them could not answer whether privatization saved their state agency money or not, while 18 percent said it has resulted in no savings (Figure 7). Budget and legislative service agency directors in Arizona, Connecticut and Virginia reported much higher savings rates—more than 15 percent. It is interesting to note that these officials, based on their information on privatization on a statewide basis,

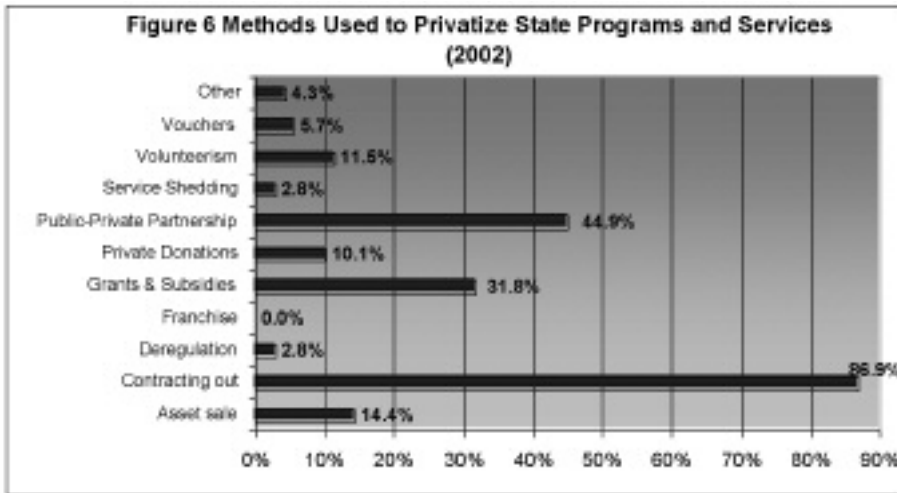
showed different estimates on cost savings from privatization. For example, 29 percent of agency heads reported cost savings to be more than 15 percent, and 33 percent of the agency heads reported no savings from privatization (Figure 8).

Selected State Agencies

Personnel

The level of privatization activities in state personnel agencies between 1997 and 2002 has remained the same as in the previous five years. The primary reasons for privatizing services among state personnel departments were a lack of state personnel and expertise, cost savings and high quality private services. The services that were privatized frequently by personnel divisions include workers' compensation claim processing, flexible spending benefits, training consultants and information technology services (Table 1). Kansas's personnel agency director reported that they outsource benefits services due "to the complexity of these services. There are also more employee self-service options with regards to benefits." Arizona utilized outside consultants to provide training services in order to supplement in house resources. South Dakota's claims administration for health and worker's compensation was contracted to a third party since 1998.

States that have privatized more than 10 percent of their personnel services include Connecticut and Florida. On the other hand, 10 agencies replied that their state agency did not privatize more than 1 percent of personnel services (Arizona, California, Idaho, Illinois, New Hampshire, South Dakota, North Dakota, Oregon, South Carolina and Washington). Contracting was the most widely used method in personnel privatization, but public-private partner-



Source: Survey of state budget directors and legislative service agency directors, December 2002.
Question: "Which of the following methods of privatization are used in your state?"

ships also were used frequently. Cost savings from personnel contracts were largely unknown or undocumented, according to the survey results, although a small number of the respondents reported some savings, ranging from less than 1 percent to more than 15 percent (Figure 9). Connecticut and Michigan reported a savings of more than 15 percent from personnel privatization.

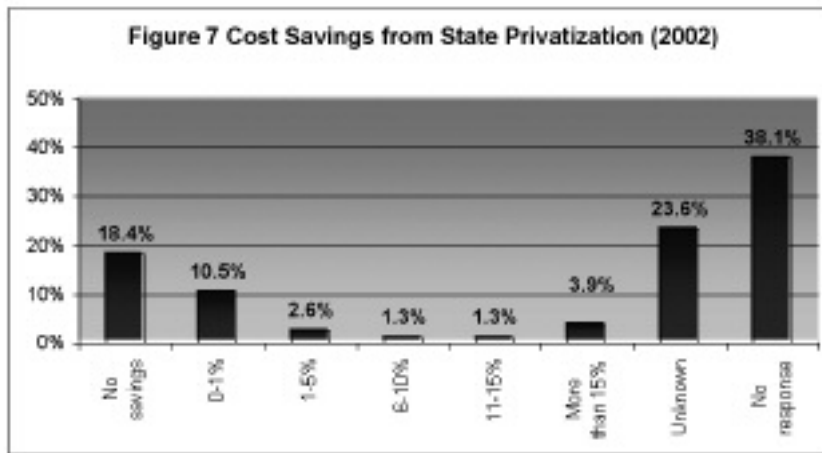
Education

In the past five years, the extent of privatization in state education agencies, responsible for K-12 education, has stayed the same in most states or increased somewhat in some states. Services privatized by education departments include information technology, statewide assessment testing, special education, and facilities services. Montana signed two contracts within the past five years for statewide student assessment tests with private testing companies. Alabama's head of the education department said that the use of professional services contracts increased to secure expertise not available in the department.

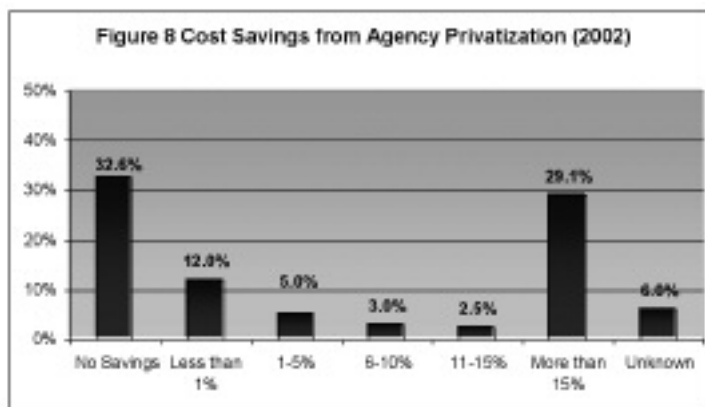
Michigan and Nebraska's education agencies privatized more than 15 percent of their programs and services, while most education agencies have privatized between 1 percent and 5 percent. The Michigan respondent said that contractual services increased in the past five years due to the department's inability to fill staff vacancies. Ohio hired more information technology contractors due to the lack of staff expertise; 25 education directors reported that the primary reason for privatizing education services was a lack of personnel and expertise. The percentage of education services privatized has been less than 15 percent in half the education agencies surveyed. Along with contracting, grants and subsidies and public-private partnerships also were used to implement education privatization. **Nearly one half the education agency heads surveyed said the savings from privatized services was less than 1 percent. Maryland and Montana reported cost savings from privatization to be between 11 percent and 15 percent (Figure 10).**

Health and Human Services

As in the education agencies, the percentage of human services privatization has also



Source: Survey of state budget directors and legislative service agency directors, December 2002.
Question: "What is your state's current cost saving percent due to privatization?"



Source: Survey of directors from five executive agencies, December 2002.
Question: "What is your agency's cost saving percent due to privatization?"

Table I Most Popular Privatized Services

Privatized Corrections Programs and Services	
Program or service	States
Medical/health care services	AL, AK, AR, DE, FL, IN, KS, ME, MD, MA, MN, MS, NE, NV, NJ, NM, NY, NC, ND, OH, PA, SD, TN, VA, WV, WY
Food services	AZ, FL, IN, KS, MD, MA, MN, MS, NE, NM, OH, PA, RI, SD, TN, VA, WV
Substance abuse treatment	AZ, DE, FL, ID, MA, NM, TX, UT
Mental health services	AK, ID, KS, MD, OH, TN, WV
Private prisons	IN, MS, MT, OK, TN, TX, WY
Inmate housing	AK, AZ, FL, HI, ID, KY, NM
Privatized Education Programs and Services	
Program or service	States
Information technology	GA, LA, MD, MI, MO, NJ, ND, OH, OR, RI, SD, TN, TX, VT, WI, WY
Professional development/training	MI, NH, RI, SC, SD, TN, VT
Statewide student assessment	MT, OR, TN, VT, WY
Product/program development	IA, MD, MI, VT, WY
Special education	IA, MT, OR, RI, TN
Privatized Health & Human Services Programs	
Program or service	States
Mental health services	AK, AZ, DE, GA, ID, MD, OK, PA, UT, WV
Child welfare services	AK, GA, MO, NM, ND, OK, PA, UT
Substance abuse treatment/prevention	AK, AR, DE, FL, NJ, ND, PA
Child support administration	GA, ID, NE, NM, OH, OK
Medical services/staff	FL, KY, NE, RI, WV
Privatized Personnel Programs and Services	
Program or service	States
Training program staff/development	CA, CT, IA, LA, MI, ND, OK, TN, WA, WY
Information technology	CT, FL, ID, IL, MN, MT
Workers' compensation claims processing	CT, IA, SD
Health insurance claims processing	MT, SD
General program administration/support	IL, IA
Consultants	ID, IA
Collective bargaining negotiations	FL, IA
Privatized Transportation Programs and Services	
Program or service	States
General project design/engineering	CO, CT, DE, HI, KS, LA, MI, MS, MT, NE, NC, OK, OR, PA, TN, TX, VT, WI, WY
General construction/maintenance	CT, HI, IA, KS, MI, MS, MT, NE, NJ, NC, OK, OR, PA, TN, WA, WI
Information technology	IA, KS, MN, MT, OR, PA, TN, TX, WI
Inspections	AR, CT, DE, KS, MN, MS, OK, RI
Grass mowing	AR, DE, LA, MS, MT, SC, VT
Rest area operation/maintenance	IN, LA, MN, MT, SC, WI, WY
Highway construction/maintenance	AZ, AR, CT, IA, KY, LA, TX

Source: Survey of directors from five executive agencies, December 2002.
Question: "Please list the services that have been privatized by your agency."

remained the same in the past five years. Only Ohio reported a decrease. Ohio made a decision to shift its management information system staffing from contract staff to state employees in

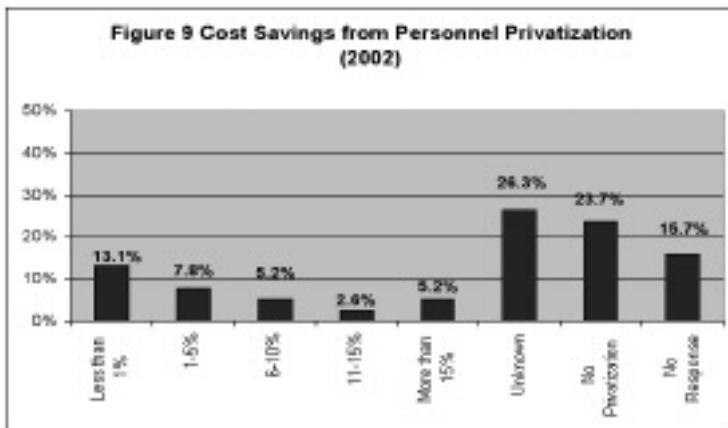
order to save money. The lack of personnel or expertise in the agencies, along with flexibility and less red tape, was the primary reason for privatization; only one out of four cited cost savings as the primary reason for privatized services. Thirteen directors of health and human services agencies reported that more than 10 percent of their services were privatized. Among privatized services in these agencies, case management, child support enforcement services and community-based services, mental health and drug treatment programs, have been the most popular areas.

Oklahoma reported that future cost savings and cost avoidance was projected in a recent outsourcing of a state school for the developmentally disabled. Ten additional states also reported that cost savings was a primary reason for privatizing services offered by the health and human services agencies. Maryland was downsizing facilities for developmental disabilities and transferring the clients to private sector community programs. The state was also closing many county-run mental health clinics and contracting with private sector organizations to provide the care. Like in the other agencies, contracting has been most widely used. But slightly more than one-third of the respondents reported cost savings from privatization as less than 1 percent. Nearly half the agency directors could not give the amount of cost savings (Figure 11).

Corrections

Nineteen states, or 44 percent of the state corrections agency directors who responded to the survey, reported an increase in privatization between 1997 and 2002. About 40 percent of the survey respondents put percentage of privatized corrections services between 1 percent and 10 percent, while 14 state corrections department directors reported that more than 10 percent of their services were privatized; these states include Alaska, Colorado, Hawaii, Kansas, Louisiana, Massachusetts, New Mexico, Oklahoma, New Mexico, Oklahoma, Tennessee and Wyoming. Medical care for inmates was reported as a service privatized by at least 23 states. The Nevada Department of Corrections requested a proposal to privatize pharmacy services. A lack of state beds and prison overcrowding prompted several states to seek arrangements with private prison facilities. Connecticut contracted out with the Virginia Department of Corrections to house 500 inmates due to lack of facilities. Alaska and Hawaii reported having contracts with out-of-state jails and prisons. According to the Alaska Department of Corrections, "it costs approximately \$114 per day in-state and out-of-state it only costs \$62."

The main reasons for privatizing correctional services include cost savings, lack of state personnel or expertise and flexibility. Alabama reported that inmate medical services were contracted out because it offered a higher quality of service and the state had a lack of personnel to staff the services. Connecticut placed individuals in privately contracted non-profit halfway houses because it cost less than incarceration. Thirty-one additional states, besides Alabama and Connecticut, also reported that privatization was used mainly as a cost-savings tool. Contracting is the most often used method in privatizing corrections services. Alaska and Mississippi reported



Source: Survey of state personnel directors, December 2002.
Question: "What is your agency's cost saving percent due to privatization?"

their cost savings from privatization to be more than 15 percent. But most respondents said cost savings has been less than 5 percent (Figure 12).

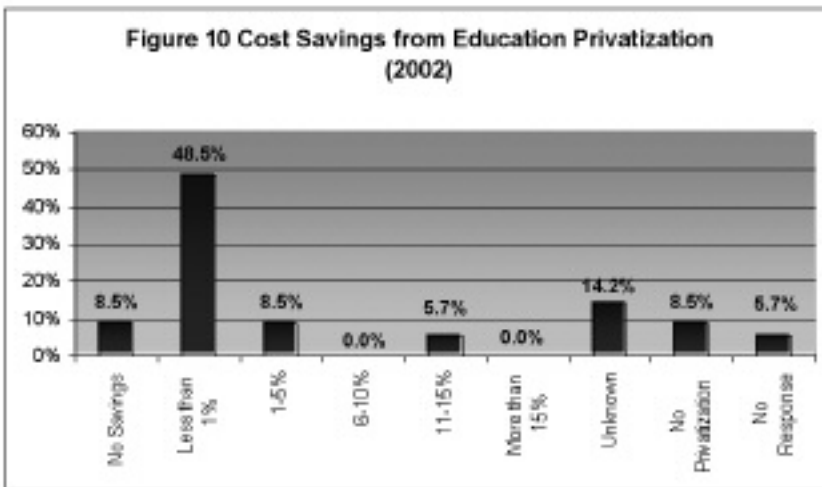
Transportation

Directors of 24 state departments of transportation, or 59 percent of the transportation survey respondents, reported an increase in privatization over the past five years, while 17 directors said the level of privatization has remained the same in the past five years. Respondents from 20 state transportation departments, or 40 percent of the respondents, reported that more than 15 percent of their services and programs had been privatized. On the other hand, five states (Colorado, Florida, Georgia, Michigan and Montana) reported a drastic decrease in transportation privatization.

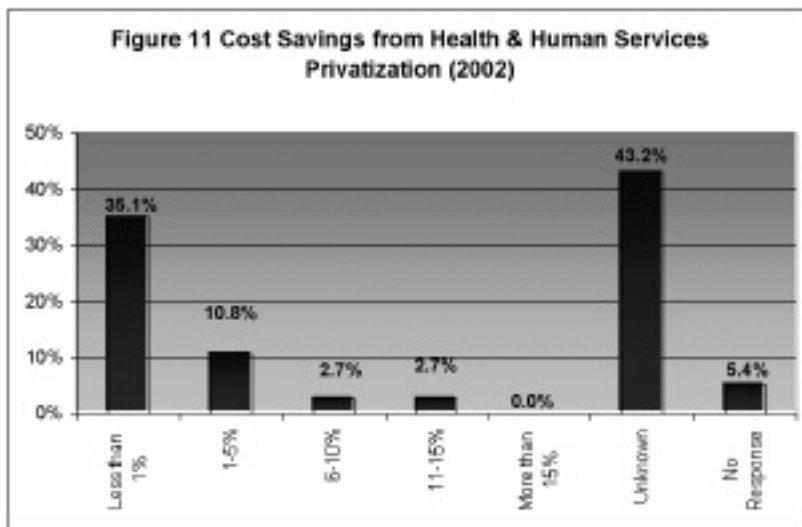
Privatized services included highway construction and maintenance, design and engineering, information technology and inspections. Wyoming's transportation agency head stated that it was easier to hire temporary consultants and contractors rather than to put permanent employees on payroll; this practice created less concern for layoffs. California contracted out for special engineering services due to a lack of staff with specialized skills. A California's respondent said, "The department contracts out for special engineering services for which it does not have the expertise on staff." In addition, 29 state departments of transportation cited a lack of state personnel and expertise as one of the primary reasons for privatizing services. North Carolina's director said his department must use outside sources due to the difficulty in hiring qualified people. Most privatization projects took the form of contracting, but public-private joint projects were used by at least 10 states. Nearly 39 percent of the transportation agency directors who responded to the survey said their cost savings from privatization was less than 1 percent (Figure 13). Connecticut and Kansas's reported cost savings exceeded 10 percent.

Next Five Years

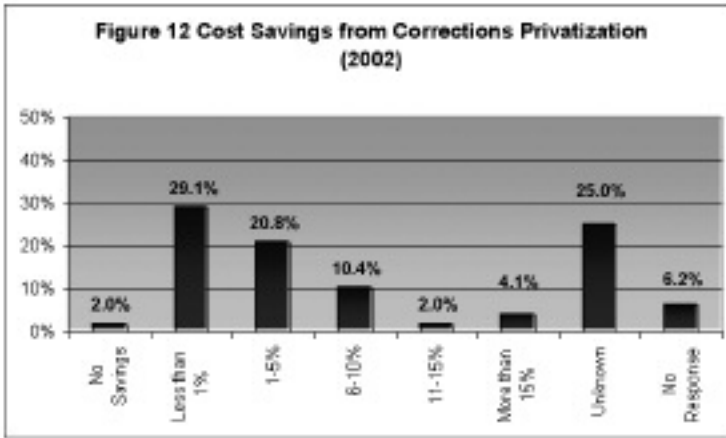
Privatization as a management approach is likely to continue in state agencies. Nearly half the state officials who responded to the 2002 CSG survey said privatization in their state or agency was likely to increase, and the other half said the extent of privatization was likely to remain the same in their state (Figures 14-20). This forecast seems quite plausible in view of the lingering fiscal crisis in the states, dwindling federal aid to state and local governments, governors' management improvement efforts and the most recent



Source: Survey of state education directors, December 2002.
Question: "What is your agency's cost saving percent due to privatization?"

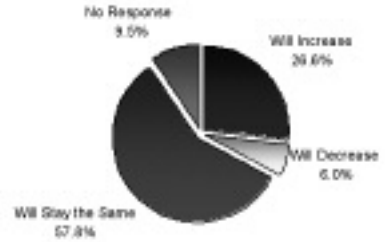


Source: Survey of state health & human services directors, December 2002.
Question: "What is your agency's cost saving percent due to privatization?"

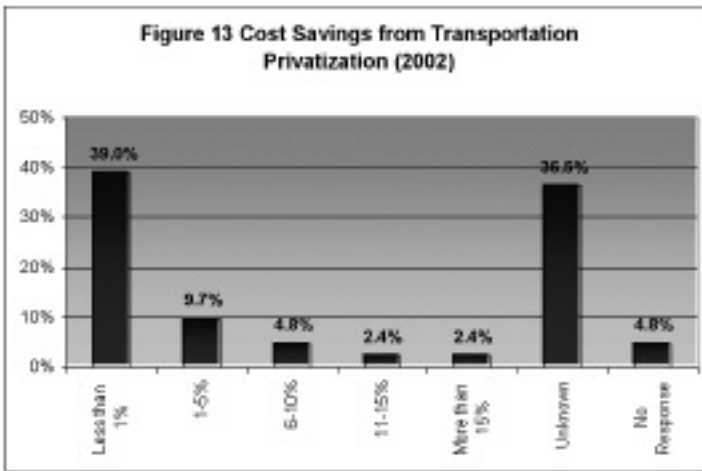


Source: Survey of state corrections directors, December 2002.
Question: "What is your agency's cost saving percent due to privatization?"

Figure 15 Trends in Agency Privatization Activity in the Next Five Years (2003-07)

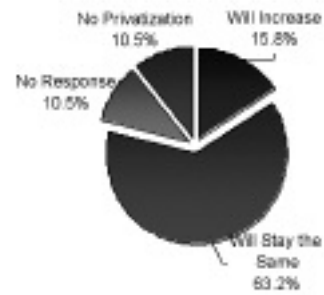


Source: Survey of directors from five executive agencies, December 2002.
Question: "In regards to your agency, do you see privatization: increasing in the next five years, decreasing in the next five years or remaining the same?"



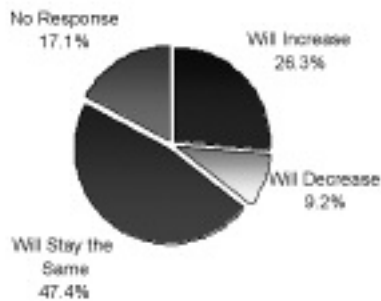
Source: Survey of state transportation directors, December 2002.
Question: "What is your agency's cost saving percent due to privatization?"

Figure 16 Trends in Personnel Privatization Activity in the Next Five Years (2003-2007)



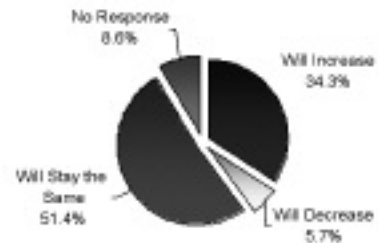
Source: Survey of state personnel directors, December 2002.
Question: "In regards to your agency, do you see privatization: increasing in the next five years, decreasing in the next five years or remaining the same?"

Figure 14 Trends in Privatization Activity in the Next Five Years (2003-07)



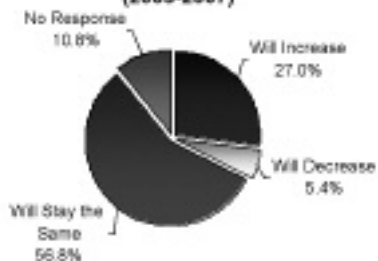
Source: Survey of state budget directors and legislative service agency directors, December 2002.
Question: "In your state, do you see privatization increasing, decreasing or remaining the same in the next five years?"

Figure 17 Trends in Education Privatization Activity in the Next Five Years (2003-2007)



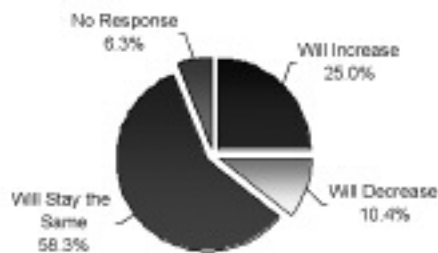
Source: Survey of state education directors, December 2002.
Question: "In regards to your agency, do you see privatization: increasing in the next five years, decreasing in the next five years or remaining the same?"

Figure 18 Trends in Health & Human Services Privatization Activity in the Next Five Years (2003-2007)



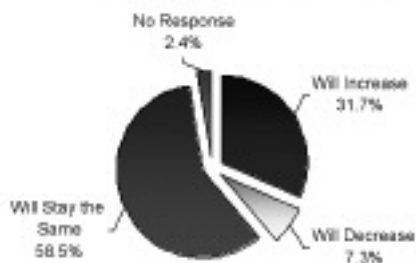
Source: Survey of state health & human services directors, December 2002.
Question: "In regards to your agency, do you see privatization: increasing in the next five years, decreasing in the next five years or remaining the same?"

Figure 19 Trends in Corrections Privatization Activity in the Next Five Years (2003-2007)



Source: Survey of state corrections directors, December 2002.
Question: "In regards to your agency, do you see privatization: increasing in the next five years, decreasing in the next five years or remaining the same?"

Figure 20 Trends in Transportation Privatization Activity in the Next Five Years (2003-2007)



Source: Survey of state transportation directors, December 2002.
Question: "In regards to your agency, do you see privatization: increasing in the next five years, decreasing in the next five years or remaining the same?"

federal privatization initiatives. In November 2002, the Bush Administration announced that it would place 850,000 federal jobs—nearly half the federal civilian employees—up for competition from private contractors in the next few years. While its impact on state governments is unknown, it is safe to conclude

that privatization will continue to be a public option in most state agencies at least in the next several years.

Issues in Privatization

There are a number of key issues for state policymakers to consider when contemplating privatization either on a statewide or agency-wide basis. Such issues and questions include legal restrictions, lessons learned from previous privatization experiments, productivity, employee displacement, the role of government and accountability due to the blurring line between the public and private sectors

Restrictions

In many states, privatization initiatives have encountered various challenges. To implement privatization initiatives, constitutional provisions had to be clarified in some states, while, in other states, legal restrictions had to be lifted by legislative measures. In several cases, state civil service systems were blamed as a barrier to privatization.

In addition, in certain cases, federal laws and regulations posed some obstacles to privatization efforts. For example, the major federal barriers that inhibit privatization of state and local enterprises include grant requirements, regulatory requirements and tax policy. According to a Joint Economic Committee staff report released in 1996: "Grant requirements dictate that state and local governments return any undepreciated portions of their federal grants to the federal government. This makes privatization more expensive and encourages continued government control. Regulatory requirements inhibit private investment. For example, tolls are prohibited on most interstate highways. Without tolls, private investors have no way to raise revenues and investment will not occur. Tax policy subsidizes government-owned enterprises but not privately-owned businesses. As a result, competition does not take place on a level playing field, which makes state-owned enterprises appear more efficient than they are and discourages private competitors."⁴ In 1996, the National Governors Association adopted a policy asking Congress to remove such federal barriers to allow greater opportunities for privatization, particularly in asset sales, in state and local government.

Lessons

Until recently, as one observer put it, the subject of privatization has been discussed by scholars, politicians and practitioners in an exaggerated and dogmatic manner.⁵ It seems that now is the time to engage in more serious discussions since we now have more information and some empirical data on privatization, albeit still insufficient, than we had in the past. Any meaningful debate on the merits and demerits of privatization should be based on practical lessons policy-makers and public administrators have learned over the years; some of the lessons from privatization experiences in state government may be highlighted in four areas.

First, thus far privatization has proven to be neither a cure-all panacea for ineffective government nor a dangerous concept harmful to government operations. As the CSG survey findings

would indicate, state policymakers now tend to consider privatization as a cost saving device or as a way to manage their agencies and deliver public services without hiring new staff or experts in certain areas. It appears that privatization has now become a less ideological, less partisan, pragmatic approach for policymakers to consider.

Second, state policymakers should not treat all privatization initiatives equally. For example, contracting out facilities maintenance by a state agency has less serious implications as privatizing management of state prisons or running a mental health facility. Selling off state assets is different from contracting out janitorial services in state agencies. Privatization in state agencies is not the same as it is in city governments either. Privatization has different implications and consequences depending the nature and forms of privatization.

Third, there is no question that government can be more effective than businesses in certain program areas, especially when it comes to customer services.⁶ There is no reason to propose privatization when citizens and service clients are satisfied with ongoing government programs and services. Privatization may be considered when policymakers decide that they can deliver more or better services with less taxpayer money by using the private sector.

Fourth, it should be noted, one of the purposes of privatization, according to its supporters, is to dismantle government monopoly in service delivery in favor of private competition. If there is no real competition among able and willing private providers, a privatization initiative is unlikely to realize its stated goals and objectives because such a situation is likely to replace government monopoly with private monopoly. This lesson is particularly pertinent in an era of business restructuring and mergers.

Lastly, it is important to assess practical lessons learned from state and local experiences for successful privatization projects. Two useful sources of such information are available: one by the U.S. General Accounting Office and another by The Council of State Governments. Based on its study of selected states and cities, the GAO identified the following six components of a successful privatization initiative: a committed political leader to champion it; a government organizational structure to implement it, legislation to reduce resources to government agencies as an incentive to privatize, reliable cost data, plans for government employee transition to the private sector and monitoring results of privatization.⁷ One previous report by The Council of State Governments also offered specific suggestions for successful implementation of privatization projects. These include: political leadership and support, clear and measurable goals, data collection, monitoring, evaluation, safe guards, team efforts and employee participation in the privatization-planning phase.⁸

Productivity

One key issue is on contracting or outsourcing. Is contracting out a better tool to improve government productivity — effectiveness and efficiency — compared to traditional, in-house productivity techniques? With some exceptions, a majority of

state officials who responded to the 1997 and 2002 CSG surveys estimated the savings from their privatization activities to be less than 5 percent. But a more interesting finding from the surveys is that many agency directors could not provide estimates of cost savings from privatization. Nonetheless, state officials have continued to privatize due to the perceived efficiency the private sector might have demonstrated. Some critics and opponents of privatization have focused on the way government is calculating cost-savings from privatization.⁹ One review of the literature on early privatization activities concluded that privatization may well result in economy but the achievement of productivity is problematic.¹⁰ It is important to follow up with case studies of reliable empirical data.

In addition, there are a number of questions to address the efficiency issue at operational levels when contemplating contracting out government services. For example: Which government office should conduct a cost analysis — a central agency or the agency seeking to privatize? Should an employee group, a potential contractor and private consultant be designated to perform a cost comparison? When should cost analysis be conducted — before or after a contractor is chosen? What should be included in contractor costs — contract price, contract administration and oversight costs, transition costs, conversion costs? What costs should be included in total government costs — direct costs, cost of benefits, indirect costs, avoidable costs? Should there a minimum threshold of cost savings to privatize a service or function? And, what performance period should be used to determine projected cost savings — one year or several years?

Employee Displacement

One of the most difficult issues faced by state policymakers when implementing privatization is its impact on government employees. Not surprisingly, the strongest resistance to privatization usually comes from employee unions and state employees, including those whose jobs may be affected. In fact state employees in several states filed lawsuits against their government to oppose privatization. In some cases, agency directors have addressed such employee concerns by reassigning personnel within government, allowing them to compete with private vendors or consulting with employee organizations. They also have adopted measures to deal with employees affected by privatization by requiring private contractors to give preferential treatment in hiring, offering enhanced severance packages or allowing an early retirement option. Some have expressed concerns about the impact of privatization on minorities in the public services.¹¹ Little research has been done to determine whether racial minorities and women have been negatively affected by privatization initiatives.

The Role of Government

As many researchers on privatization contend, the privatization movement was initiated in part to reduce the role of government by handing over, or eliminating, some of its functions or services to the private sector. David Osborne, the co-author of *Reinventing Government*, disagreed with this widely held

assumption by saying, "Privatization is simply the wrong starting point for a discussion of the role of government. Services can be contracted to the private sector, but governance cannot."¹² Under privatization, policymakers should not delegate its authority or responsibility to oversee private contractor performance. As long as privatized services are financed by taxpayers, policymakers are accountable for private providers' performance, including their mismanagement, and must pay attention to the dangers of corruption, service interruption and unfair labor practices by the private sector.

When addressing the role of government under privatization, state policymakers should also identify core functions and services government must perform by itself for public interest. But there is no consensus on such activities called "inherently governmental activities." In general terms, inherently governmental activities include those that "require either the exercise of discretion in applying government authority or the making of value judgments in making decisions for the government. Government functions normally fall into two categories: the act of government and monetary transactions and entitlements."¹³ In the privatization debate, the concept of "governmental" received little attention from public administration researchers.¹⁴ Whether any inherently governmental activities should be privatized is an important question to consider.

Sector Blurring

The recent privatization trend has further intensified the blurring of the lines between the public and private sectors. In addition to sale of assets, contracting out and traditional public-private partnership projects, for example, many states have recently replicated private management practices, notably strategic planning and benchmarking, quality management, and performance measurement. Some states reformed their civil service system to incorporate private sector practices such as broad-banding, performance-based pay and hiring of at-will employees under a radically reformed personnel policy.

How should we react to the further blurring of private and public sectors? Alarmists have argued that privatization might contribute to the "disintegration of government" because they view the public and private sectors as adversaries, competing against each other. One observer said, "sector blurring violates sound constitutional principles and ultimately threatens the ability of elected and appointed officials to maintain an orderly and responsible democratic government."¹⁵ Others have countered the alarmist view by saying that "sector blurring does not mean that public law is any less important or that the Constitution is any less the centerpiece of American government."¹⁶ However, many privatization advocates would agree that the two sectors should be regarded as partners and collaborators. As one observer put it, "They are not opposing alternatives. Business and government are not engaged in a zero-sum game.... The public management skills needed for sustained, successful public-private partnerships require leadership and clarity of executive responsibility."¹⁷ Nonetheless, the question of whether sector blurring should be considered a blessing or a

curse needs to be debated continuously by policymakers and researchers from the perspective of future public administration and management.

Endnotes

- ¹ John Engler, "Privatization: Heed the Call," *ASI Solutions*, Bala Cynwyd, PA: Assessment Systems, Inc. (Winter 1996), 2.
- ² www.afscme.org/private/ October 10, 2003.
- ³ Keon S. Chi and Cindy Jasper, *Private Practices: A Review of Privatization in State Government*, Lexington, KY: The Council of State Governments (1998).
- ⁴ Joint Economic Committee Staff Report, "Federal Barriers to State and Local Privatization," U.S. Senate (1996).
- ⁵ Charles T. Goodsell, "Privatization and the Public Interest." Remarks presented at the Conference on Contracting for Services (April 24, 1986), Atlanta.
- ⁶ George Frederickson, "When It's Better to Be A Customer of Government," *Governing* (April 1996), 10.
- ⁷ U.S. General Accounting Office, *Privatization: Lessons Learned by State and Local Governments*, Washington, D.C. (1997).
- ⁸ Keon S. Chi and Cindy Jasper, *Private Practices: A Review of Privatization in State Government*, Lexington, KY: The Council of State Governments (1998).
- ⁹ Elliott Sclar, *The Privatization of Public Service*, Washington D.C.: Economic Policy Institute (1998).
- ¹⁰ Timothy K Barnekov and Jeffrey A. Raffel, "Public Management of Privatization," *Public Productivity & Management Review* (Winter 1990), 135-52.
- ¹¹ Dennis J Palumbo, "The Political Side of Privatization," *Journal of Management Science & Policy Analysis* (Winter 1989), 25-40.
- ¹² David Osborne, "Privatization: One Answer, Not the Answer," *Governing* (April 1992), 83.
- ¹³ U.S. General Accounting Office, *Terms Related to Privatization Activities and Processes*, Washington D.C., (1997).
- ¹⁴ Larkin Dudley, "Questions Unanswered: Comparing Federal and State Arguments Surrounding Inherently Governmental Functions," Paper presented at the 55th Annual Meeting of the American Society for Public Administration, Kansas City (1994).
- ¹⁵ Ronald C. Moe, "Exploring the Limits of Privatization," *Public Administration Review* (November/December 1987), 453-60.
- ¹⁶ Barry Bozeman, "Exploring the Limits of Public and Private Sectors: Sector Boundaries as Maginot Line," *Public Administration Review* (March/April 1988), 672-75.
- ¹⁷ Annamarrie Hauck Walsh, *Privatization: Implications for Public Management. IPA Report* (Spring 1996), 1-9.

Bios

Keon S. Chi is editor in chief of *The Book of the States and Spectrum: The Journal of State Government*; kchi@csg.org.

Kelley A. Arnold, editorial associate of *The Book of the States*, is a publications and customer service coordinator, karnold@csg.org.

Heather M. Perkins, editorial associate of *The Book of the States*, is an editorial associate for CSG; hperkins@csg.org.

The Council of State Governments, P.O. Box 11910, Lexington, KY 40578, (859) 244-8000.