

During the meet-and-confer session, CSEA pointed out other factors that could further affect the comparative costs of the operations:

In-house custodian, lead custodian, and supervisor positions may have been vacant and should not be counted as in-house costs.

All additional university costs for support and monitoring have not been included.

In-house positions may have been reassigned into the remaining in-house work area rather than eliminated.

No historical cost data has been utilized; estimates have used FTE.

CSEA provided its revised cost estimates to CSULB in a spreadsheet and two graphs detailing the different assumptions used by the parties. CSEA invited the campus to review the data and discuss the discrepancies so a mutually agreed set of costs could be used. CSU's bargaining team refused to respond.

CSEA was also dismayed that CSULB Plant Operations had not consulted several campuses with significant experience in contracting out custodial services, particularly San Francisco, Sacramento, and Stanislaus. CSU Stanislaus plant management produced a report on the problems it experienced with service and security under the contractor; San Francisco had many years of cost overruns and different security concerns.

Finally, the union warned the campus that false estimates of cost savings could have a ripple effect in the rest of the CSULB budget. High expected savings would not be realized and could result in unplanned cuts in other parts of the university program. CSEA was concerned that later cuts could result in unnecessary layoff of represented employees.

CSEA proposed the university and union jointly review the comparative costs of the in-house and contractor services. The union also proposed a threshold requirement be made for continuing the contractor service — objective cost savings as mutually determined by the parties.

CSEA noted a change in current custodial hours could produce a greater cost savings than contracting by eliminating shift differential costs. CSULB utilizes a graveyard shift - the highest compensated level of shift differential — while many campuses utilize a day shift (beginning at 4:00 a.m.) that has no shift differential and allows sufficient before-class work to be done.

CSU's management team adamantly refused to cooperate in any joint venture. They would not discuss the cost estimates nor agree that the university should use cost savings as a criteria in moving the work out of the bargaining unit. The meet-and-confer session ended in impasse because the university refused to make further proposals.

Recently the union opened dialogue with CSULB's newly appointed president, Robert Maxson. It's hoped the new president will re-evaluate the contracting out custodial proposal and make a decision not to contract out this work.

The CSULB custodial contracting out case is a classic example of how contracting out is not always cost effective and how management's calculations of costs are bloated or certain expenses just not included in the total.

Even though in this case local campus management is now working with CSEA toward a resolution of the issues, CSU's philosophy of supporting contracting out is intact.

VI. RECOMMENDATIONS

This report has attempted to show major problems with privatization/contracting out schemes in public jurisdictions in general and in California state government in particular.

CSEA is aware situations exist in state government in which contracting out services for a brief period is necessary. This is especially true in major disasters such as earthquakes, floods and forest fires. Contracting may also be necessary during some peak business periods to alleviate workload problems.

CSEA, however, opposes forms of contracting out summarized in this report and the philosophy that the private sector can always do it better, faster, and cheaper.

This philosophy has allowed the Department of General Services to approve more than 10,000 contracts per year with only seven attorneys reviewing the contracts. Obviously there are not enough attorneys to review these contracts thoroughly. Only a very small portion of the reviewed contracts are denied with the majority rubber-stamped and approved.

The State Personnel Board (SPB), required by law to review personal services contracts, only employs one staff analyst to review approximately 150-200 contracts per year.

The SPB is not performing the functions of a neutral party in the contracting out process. It is strongly dominated by the current pro-contracting out philosophy and assists the department to contract out what it wants.

Both the Department of General Services and SPB have a responsibility under the State Constitution and other California laws to monitor state contracts.

Much of this responsibility, however, has been delegated formally or informally to the various state departments. This is where the system breaks down.

Close monitoring by the departments, the SPB or General Services could have avoided wasting taxpayer dollars at the Department of Motor Vehicles, State Lottery and Department of Insurance.

CSEA proposes the following to get state government on the correct path:

1) The Legislature and governor should enact legislation to require a full-scale audit specifically targeted at departmental and campus contracting out practices. Currently practices are all over the map.

2) The state should amend current government and education codes to make contracting out practices more uniform and provide a true balance between the needs of the state and preserving a qualified and experienced workforce.

3) Employee unions, state and CSU management should negotiate improvements in work jurisdiction language. This language is necessary to give state employees a voice in the services provided to the state. Such language will guarantee the state benefits from the experience of its employees and removes the fear that state employees will be displaced when their jobs are contracted out.

4) Increase staffing for the State Personnel Board so that proposed personal services contracts are thoroughly analyzed and reviewed.

In addition, the board must adopt a neutral stance and enforce civil service laws.

5) Increase staffing of the Department of General Services Contracts Legal Division to strengthen evaluations of proposed contracts.

VI. CONCLUSION

This report clearly spells out eight major objections to privatization:

- Bad public policy.
- Costs more than it saves in the long run.
- Quality of services declines.
- Breeds corruption and conflicts of interest.
- Government loses control over contracted work.
- Age, race and sex discrimination increases.
- Increased isolation of citizens dependent on governmental services.
- Citizen participation in government decreases.

Legislators continue to introduce legislation to contract out more and more state services.

Legal challenges to current government codes and state constitutional provisions will escalate if the trend continues.

Experts and practitioners of privatization agree the trends show the privatization and contracting out of public services is accelerating and is embraced by conservative public sector managers.

Finally, a survey of current contracts issued by the state

shows more than \$2 billion in force for provision of goods and services. This debunks the assertion that article VII of the state constitution bars state agencies from contracting out.

This report summarized just a small number of the actual cases that show abuses and contracting out problems. These cases show:

1) Taxpayer dollars wasted on contracting out schemes.

2) Lack of contract monitoring to guarantee full delivery of promised services.

3) Conflict-of-interest problems that discredit government.

4) Decrease in quality of services.

5) Many taxpayer dollars are spent to defend the state in litigation over illegal or ill-supervised contracts.

CSEA's recommendations will significantly reduce these problems and the need to contract out state services on a wholesale basis. However, change must start at the top.

SOURCES

- Paul Starr, *The Limits of Privatization*.
- The Council of State Governments Privatization Survey, 1993, *Forms of Privatization and Frequency of Use In State Programs and Services*.
- The Council of State Governments, *Privatization Forms or Techniques*.
- John O'Leary, *Eighth Annual Report on Privatization*, 1994, Reason Foundation.
- Public Employee Department, AFL-CIO, *The Human Cost of Contracting Out*, 1993.
- Public Employee Department, AFL-CIO, *America — Not For Sale*, 1989.
- Lawrence V. Andreuccetti, *Privatization — Not A Panacea*, CSEA/SEIU Local 1000 AFL-CIO, CLC.
- Touche Ross, *An Opinion Survey of State Governments on Their Use of Privatization: Impediments to Privatization*.
- Joint Center for Political Studies for United States, *Department of Housing and Urban Development Study*.
- Economic Policy Institute, *The Emperor's New Clothes: Transit Privatization and Public Policy*, 1989.
- Article VII, California State Constitution.
- Assembly Bill 3336 - 1982.
- Senator Marian Bergeson, Senate Concurrent Resolution 72, 1992.
- SRI International - *Evaluation of The Organizational Structures and Management Practices of the California Department of Transportation*.
- A. Alan Post, *Cost Effectiveness of Using Consultants For Highway Engineering*, February 1994.
- Senator Marian Bergeson, Senate Bill 1209, 1993.
- Senators Marian Bergeson and Quentin Kopp, Senate Constitutional Amendment 46, 1994.
- Government Code Sections 19130 (a) and 19130 (b).
- CSEA vs. Department of Developmental Services*, Writ of Mandate, Sacramento Superior Court, 1986, CT 248-249.
- Council of State Governments, *State Trends Forecast*, November 1993.
- Professional Engineers In California State Government vs. Department of Transportation*, Sacramento Superior Court Case No. 336697.
- CSEA/SEIU Local 1000 AFL-CIO, CLC, Amicus Curiae Brief Before the Third Appellate District Court - CO 18317 - August 12, 1994.
- The Bureau of State Audits, *Poor Management Practices at the Department of Insurance's Conservation and Liquidation Division Warrant the Department's Continued Corrective Action*, May 1993, #93113.
- The Bureau of State Audits, *Restrictive Implementation Schedules Effectively Limited Competition For the California State Lottery's New On-Line Gaming System*, July 1994, #93119.
- The Bureau of State Audits, *The Department of Motor Vehicles and The Office of Information Technology Did Not Minimize the State's Financial Risk In the Database Redevelopment Project*, August 1994, #94107.
- State of California vs. Bill Honig*, Third Appellate District Court - CO 15357.
- CSEA/SEIU Local 1000 AFL-CIO, CLC, *The High Cost of Contracting Out: CSULB and Custodial Out-Sourcing*, July 19, 1994.
- Lawrence V. Andreuccetti, *Contracting Out of California State Services: The Union's Response*, CSEA/SEIU Local 1000 AFL-CIO, CLC, April 1994.
- Green, Stephen, *Sacramento Bee*, "DMV Report Blames Manager For Failure of Computer System," May 20, 1994.
- San Francisco Chronicle*, Associated Press, "State's Chief Auditor Asked To Probe DMV Computer Project," May 26, 1994.
- Ellis, Virginia, *Los Angeles Times*, "DMV Probe of Computer Deal Released", May 25, 1994.
- Davila, Roberta D., *The Sacramento Bee*, "State Auditor Blasts Past For Lottery," July 19, 1994.
- Haywood, Brad, *The Sacramento Bee*, "Nancy Honig Breaks Silence, Says Trial Was Unfair," May 7, 1993.
- Green, Stephen, *The Sacramento Bee*, "Auditor's Findings Rips DMV," August 18, 1994.
- Sebelius, Steve, *The Sacramento Union*, "Following the Honig's Money," June 24, 1991.
- Reomer, John, *San Francisco Daily Journal*, "It Started With What Sounded Like a Bribe."
- Hull, Tupper, *San Francisco Examiner*, "Honig's Way Was His Own Undoing," January 3, 1993.
- Prof. Robert Hebdon, Cornell University School of Industrial and Labor Relations, *The Perils of Privatization: Lessons for New York State*, December 1994.

This report prepared by:

Lawrence V. Andreuccetti, Principal Researcher
Terri Tomasello, Programs and Research Secretary
CSEA Communications Department

CSEA Civil Service Division Officers:

Perry Kenny, Division Director
Barbara Glass, Deputy Division Director — Finance
Jack Woodard, Alternate Deputy Division Director —
District Labor Councils
Barbara Wilson, Alternate Deputy Division Director — Bargaining
Tut Tate, Civil Service Division Administrator

Initial printing Friday, September 23, 1994
Revision Monday, December 11, 1995

#2

Memorandum

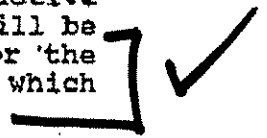
TO: ASTPHLD Members

FROM: Burton W. Wilcke, Jr., Ph.D.
Director, Public Health Laboratory

DATE: August 9, 1991

RE: Privatization of Public Health Laboratory Services

The ASTPHLD ad hoc committee on contracting for public health services (Burt Wilcke, Bob Martin, Pauline Bouchard and Kathy Meckstroth) will be presenting a session at the upcoming ASTPHLD Planning Conference in Seattle Washington. The session is entitled "Public Health Laboratories in Crisis: How do we deal with privatization and budgetary cutbacks?" Although the session will contain presentations, the committee would like to see active participation in the discussion of this issue. Ample time will be provided to hear comment on the topic. In preparation for the session please read Bob Martin's brief essay on the topic which follows:



PRIVATIZATION OF PUBLIC HEALTH LABORATORY SERVICES

The need for an effective state public health laboratory system is greater today than ever before. In the modern world of rapid transportation of both people and food, infectious and non-infectious disease once considered exotic or exclusive to a specific area appear world-wide. Public health laboratories represent a first line of defense in the rapid recognition and prevention of the spread of many of these diseases. Because of the overriding interest in providing analysis of information affecting communities or populations rather than concentrating on treatment of a specific patient, the public health laboratory must be an essential, dynamic component of public health in each state. When properly supported and used, the public health laboratory is a critical source of information; when not supported, an essential and well-established resource is wasted. Public health laboratories with diminished capacity cannot be quickly revitalized to deal with new public health emergencies and priorities.

Over the years, the public health laboratory has been scrutinized many times to determine the possible benefits or drawbacks of privatization. Rather than to reanalyze this issue

1

as it applies specifically to public health laboratories, it is worthwhile to look at this issue in a more global sense, i.e. privatization of any services currently provided by government.

In The Privatization Decision, by John Donahue, he recounts that in the past, ideology had little to do with the provision of basic government services. Performance was all that mattered. Today, however, ideology does play a role. The conservative position is to turn government services over to the private sector and the liberal position is to keep certain services in the public domain to maintain regulatory control and to preserve municipal jobs. Unfortunately, privatization of services quickly becomes an ideological issue and evidence is often absent in the decision making process.

The answer to specific questions of what is appropriate for government and what is appropriate for the private sector can only be answered on a case by case review. Privatization may work for some functions in certain settings, but is impossible to generalize. There are many specific instances in which privatization of a traditionally government service has been successful. However, there are also many cases in which initial arrangements (contracts) work well only to find that as time goes on, problems arise. The natural tendency for the private contractor will be to save money, even at the expense of quality. After all, the goal of for-profit business is to maximize profit. It is unrealistic to ask that a profit-oriented business take into account public good as its primary goal. Therefore, the important question becomes, "What is the impact of poor quality of the contracted service?"

It is important to recognize that public health laboratories are a part of a nationwide public health system. They need to address issues of importance to public health. In a presentation on June 4, 1990, Dr. Walter Dowdle, then Acting Director of the Centers for Disease Control, discussed the role of the public health laboratory. He defined the core public health functions as assessment, policy development and assurance. In this context, the laboratory plays a key role in assessment.

"Every laboratory specimen should represent some carefully planned aspect of assessment."

It is important to note that fees and cost effectiveness are not key determining factors in the provision of public health laboratory services. Fees should not be interpreted as an indication that the test belongs in either the private or public sector; fees are simply a financial reality and are dependent upon the financial environment in each locality or state.

What, then, is the role of today's public health laboratory? There are some broad areas of involvement that could be applied to public health laboratories in response to national initiatives to attain a basic quality of health for all citizens:

1. Services to complement and indicate direction for prevention and control programs (maternal and child health, environmental programs, support of epidemiology programs).
2. Training for laboratory personnel in regional laboratories, both private and public.
3. Development and/or oversight of proficiency testing programs for laboratories performing work to support public health programs.
4. Development of new laboratory methods to address specific public health problems.

Assessment of the community health is a vital component of the testing being offered.

In a review of priority health care issues listed in the Healthy People 2000 Report, public health laboratory directors identified the following specific areas as priority issues requiring "substantial laboratory support":

1. Reducing environmental hazards (monitoring and investigation).
2. Preventing and controlling AIDS and other sexually transmitted diseases.
3. Immunizing against vaccine preventable disease [vaccine production, serological testing and culture (viral and bacterial)].
4. Maternal and child health (prenatal laboratory services, newborn screening, etc.).
5. Preventing, detecting and controlling high blood cholesterol, high blood pressure, cancer and other chronic disease (monitoring populations at risk).

We hope this brief review of the issue will provide a basis for our discussions of the issues of privatization and the role of the public health laboratory.

Minnesota #1

Checklist for contracting out for laboratory services.

Price:

- what is it,
- what does it cover,
- are there opportunities for extra charges by the contractor
- for how long is the price good
- are there escalator (price) clauses built in, for ceiling on increases at stated intervals

Overall contract:

- for how long is it in place?
- who are the major decision makers on issues such as problems w/ quality, delays in performing the work, inability to provide service as promised. . .
- how to amend
- maximum and minimum commitments?
- what are state or govt constraints on contracting, if any?
- get govt unit legal advice before signing anything
- there should be no verbal understandings outside the written contract
- how much notice is needed before cancellation, by one or the other party,
 - reason for cancellation may warrant different notice intervals
- does service provider have responsibility to find another lab of equal quality
 - if they fail to deliver, loss of capacity due to emergency, or whatever other reason
- what criteria for quality will be used/must lab meet to satisfy purchaser?
 - does purchaser want to impose addn'l quality checks, eg., to inspect
- how long must lab retain records,

Techniques for periodic updates back and forth

Specimen/sample information

- who prepares, sends sample containers, postage and other delivery charges,
- who collects samples or instructs sample collectors
- forms for specimen collection and reporting
- electronic reporting, frequency/bunching of reports, how sent
- how to handle outdated samples
- what is lab holds sample beyond prescribed holding time
- sample rejection criteria/policy

Billing

- how, frequency, sent to whom, who checks bills against service rendered
- does govt unit want to withhold some portion of payment till satisfied?
 - some states have such laws

Other issues:

- disposal of samples, specimens, and wastes, who's responsible, what is cost?
- safety of workplace, assurances thereof
- to whom are data reported and who cannot receive results

7/5/95

*Draft checklist.
(P. Bouchard)*

*Task Force
draft info*

#3

Developing a list of arguments for and against contracting out public health laboratory services is complicated by a lack of information. This problem is addressed at several points below. Drawing conclusions about the the pros and cons of contracting out lab services would be facilitated if we had answers to the following questions:

- Are private lab charges, on average, higher or lower than the costs incurred by the states to provide the same services?
- What has been the experience of public health labs which have contracted out certain services?
- How much is the private sector willing to "give up" if performance is not adequate? Might the state have to agree to a lower level of service than it could provide.?

POINTS IN FAVOR OF CONTRACTING OUT:

1. A CDC lab management report summary distributed at the ASTPHLD Annual Meeting in June, 1990, included a section on privatization which lists the factors listed below as those often offered in favor of contracting out lab services. The factors are grouped according to whether the assumptions which underlie them are verifiable or not, or might be countered by equally valid contrary information.

- a. The following factor may or may not be true under all circumstances and may not have been verified over long periods of time:
 - reduces government labor costs
 - produces better management by reducing supervisor responsibility for operations
- b. The following factors appear true on their face:
 - limits government growth and need for administrative staff support
 - avoids large initial capital outlays
 - promotes organizational flexibility in managing program size and content
 - provides measure for comparing public-private performance
 - promotes increased managers' awareness regarding program performance and costs
- c. The following factors can be countered with assumptions which are equally valid:
 - provides access to new technology and generates enhanced management information. There is no evidence that the same level of access to new technology in state labs does not exist, and support for the assumption that state managers of laboratory information are not as far along as is the private sector is not available.
 - avoids vulnerability to work slowdowns or stoppages. The private is not immune to this problem.

- 2. Other arguments in favor of contracting out:
 - reduces existing space needs and eliminate need for expansion planning
 - promotes expansion of the private sector
 - may save state dollars if private lab prices are cheaper AND can be protected against increases which far exceed inflation costs

10
11
12

13
14

15
16
17
18
19

20

21
22
23
24
25

Prospects for Privatization

by Steve H. Hanke
The Academy of Political Science

Contracting Out: A Painless Alternative to the Budget Cutter's Knife:

During the 1970s New York City golf course was losing money and in poor repair at a cost of \$200,000. Now it is in good repair and making money *"Despite slightly higher greens fees..."*
The City contracted out to American Golf Corporation

...All over the country, private firms have contracted with public agencies to repair streets, fight fires, collect the garbage, clean buildings, recover debts, and even manage the government operations. Contracting out has become such an accepted cost-cutting practice that, according to John Goodman, president of the National Center for Policy analysis, "there is not a single city service that is not being contracted out to a private firm somewhere in the U.S."

When the government contracts out a public service, it retains its funding responsibility but hires a private company to provide the service. The primary motive for contracting out is to cut government costs by employing more economically efficient private vendors. (?) The injection of competition into the procurement process is the critical feature of contracting out that drives down the expense of government goods and services from 20 to 50 percent. Contracting out allows public agencies to exploit the efficiency and specialized skill offered by the private sector that may be unavailable within government.

...hiring outside management consultants to advise city officials on cutting costs...

...1973 to 1982, the number of cities contracting out legal services increased from 187 to 788. The number of cities contracting out data processing rose from 9 to 337....

Between 1970 and 1980 the number of government contracts with private firms to provide social and human services doubled...

The Local Experience with Contracting Out:

Mario Cuomo, ...recently affirmed: "It is not government's obligation to provide services but to see that they're provided." This philosophy seems to be the new rallying cry for hundreds of cities across the country....

States and cities have demonstrated during the 1980's a remarkable willingness to experiment with innovative public management techniques in their efforts to cut costs without cutting service benefits. The long list of alternative approaches to service delivery adopted by the cities and states in recent years includes issuing vouchers for education and health care, relying on volunteers and nonprofit groups to provide certain social services, enacting work for welfare programs, coordinating procurement policies with neighboring communities to take advantage of

Page 2

quantity discounts, and hiring outside management consultants to advise city officials on cutting costs.

Over the period 1973 -82, the number of cities contracting out legal services increased from 187 to 788. The number of cities contracting out data processing rose from 9 to 337. Only 5 cities contracted out park maintenance in 1973; by 1982, 142 cities did. Meanwhile, the dollar amount of service contracts joining municipal governments with private firms tripled, from \$22 billion in 1972 to \$66 billion in 1980.

In 1981, chief executives of 57 public agencies that contract out social services in the San Francisco Bay Area were asked to identify the major advantages to contracting out. Contracting with nonprofit groups was seen as superior in five areas; flexibility in initiation and terminating services, reduced cost, specialized competence of the contractor, effectiveness in reaching clientele, and less bureaucracy.

How much have cities saved by contracting out?

Over the past five years at least a dozen studies have been conducted, quantifying the cost savings generated on the local and county levels from contracting out public services. Researchers have almost universally (?) concluded that contracting out is more economical than paying city employees to perform the commercial service. The real issue seems to be not whether the city will save money but how much it will save by contracting out.

- ▶ Phoenix has saved \$5.3 million each year by contracting out seventeen city services, according to the city's auditors.
- ▶ The southern California association of governments reported that townships in the Southern California area have reduced public transit subsidies from \$5 million to \$500,000 annually, by contracting out 22 bus lines.
- ▶ The city of Los Angeles estimated that it has saved \$200 million annually out of its \$7 billion budget through its extensive contracting-out program. Over 200 contracts have been issued since the passage of Proposition 13 in 1978.
- ▶ Elk Grove, Illinois, one of the first cities to contract out its fire-fighting service, has saved \$200,000 from the switch to private fire fighters.

Two reasons why contracting out is capable of generating out seventeen city services, according to the city's auditors.

- 1) ...the private sector is more efficient than government in performing commercial activities,
...because private firms are driven by the profit motive, they have powerful incentive to seek innovative approaches to reducing service costs. Arthur Bernaccia, president of Liberty Lines, a private transit firm, stated the point succinctly: "If we don't operate efficiently, we don't make any money - it's as

Page 3

simple as that." *No such incentive exists in the public sector, where cost increases merely require digging deeper into the taxpayers' pockets and where the "reward" for efficiency improvements is reduced funding in the next fiscal year.*

- 2) ...second reason that contracting out is less expensive...is competition. When government services are not subjected to competitive bidding, the agency acts as monopolist, charging the government whatever it pleases... To win the contract, each private vendor has an incentive to offer its services at the lowest possible price....(shop around)...the real issue is not so much public versus private; it is monopoly versus competition."

The Federal Experience with Contracting Out:

...the limited Federal experience with contracting out these services has been highly favorable. Defense Secretary Caspar Weinberger, for instance, has call contracting out the Pentagon's "most successful cost saving program." The budget figures support his claim: and exhaustive (?) Defense Department study completed in 1984 reviewing 235 service contracts issued between 1980 and 1982 found that, on average, costs were trimmed by 30 percent. These numbers were confirmed in 1985 when the U.S. Air force examined the cost of 132 functions contracted out to private firms. The study concluded that contracting out had led to a 33 percent reduction in program costs.

...The Federal Aviation Administration (FAA) has discovered that when it contracts out air-traffic control operations to private operators, costs have been cut by 25 to 50 percent. In 1981 private operators ran the control tower in Farmington New Mexico, for \$99,000; the year before the FAA had operated the tower itself at a cost of \$287,000. The U.S. Department of Transportation saved \$725,00 in 1983 by simply contracting out its computer operations.

... The Department of Defense through GAO compared the cost of uniforms from a private owned firm and a Government factory. GAO said "it cost the [government factory] twice as much as commercial contractors to produce coats."

Dwight Eisenhower was the first president to establish a Federal contracting out policy...."the federal government will not start or carry on any commercial activity to provide a service or product for its own use if such a product or service can be procured from private enterprise."...this statement was repudiated in 1966 with new directives for the Federal agencies to conduct detailed cost comparisons between "in-house government suppliers" and private vendors. The agency must choose the cheapest alternative. (?) This cost-comparison process is so unfairly tilted against private contractors that it acts as a formidable impediment to moving Federal commercial services into the private sector. Some of the handicaps imposed on commercial firms include:

Page 4

- ◆ The private contractor's bid must beat the in-house estimate by at least 10 percent to cover government "transition costs" or the function remains in house.
- ◆ The private bidder must submit a "firm contract" proposal with a fixed price, whereas the agency is only required to submit a cost *estimate*. This places the private bidder at a significant disadvantage; if the private bidder's actual costs exceed its expected costs, it will not receive additional Federal funds and may take a loss on the contract. By contrast the agency is not penalized for submitting low-cost estimates, as it can simply request additional agency funds midway through the project.
- ◆ The commercial firm's bid must include an allowance for indirect costs, while the agency's need not. The U.S. Chamber of Commerce estimated that this alone constitutes a 20 to 30 percent handicap to the private bidder.
- ◆ Costs are added to the bid submitted by private providers for government monitoring of contract performance, while no cost for quality assurance is included in the agency cost estimate.
- ◆ In negotiated procurement, very low bids may be rejected as being "outside the competitive range." This means that the selected proposal from private bidders is not always the lowest bid and hence more awards are won by the agency provider.

Altogether, these handicaps in the cost-comparison process have placed private bidders at an estimated 35 percent cost handicap. Consequently, many activities that would be less costly if they were contracted out must remain in-house. *As unfair as this cost-comparison process is, private vendors nonetheless win the majority of these competitions.*

... attitude my most government managers...clearly ..will not voluntarily reduce the size of the work forces under their command.

Objections to Contracting Out:

Charge: "contractors frequently cut corners by hiring inexperienced, transient personnel at low wages, by ignoring contract requirements, or by providing inadequate supervision.

Charge: " Contracting out involves laying off public employees...laid-off public employees are entitled to unemployment compensation paid by the employer ...and they may also qualify for various public welfare programs. These are all hidden costs."

Charge:" The costs of contracting out are out of control like wildfire . Billions of taxpayer dollars have been wasted to pay for excessive costs over and above original bids."

Page 5

Recent scandals in Pentagon procurement have cast a dark shadow over federal contracting our policy. Ironically, while study after study documenting huge taxpayer savings of 20 to 30 percent and hundreds of millions of dollars from contracting out at the Pentagon have received barely cursory notice from the media, the occasional horror story of .. Purchases of \$7,600 coffee pots and \$400 hammers have commanded headlines throughout the country.

Charge: "Contracting out builds a rival government of favored companies...Defense contractors in competing with career-federal workers-have been given a fast track in their run for big profits."

One of the genuine dangers of contracting out is that by awarding lucrative contracts to the private sector, the government creates a powerful prospending constituency. There is evidence that this has occurred in the Department of defense, where large defense contractors, whose economic survival depends on congressional approval of big ticket items, are now spending millions of dollars each year lobbying for a continued rise in the pentagon budget. The same is true on the domestic side of the budget

How to Promote contracting Out on the Federal Level:

The city of Imperial Beach, California, serves as an ideal case study...Following the passage of Proposition 13, Imperial beach became contracting out a vast array of services-including its ambulance services, recreation centers, and transit systems. The size of the city workforce was cut by 65%.

Cities have begun contracting-out because at the local level they see a direct connection between wasteful spending and the size of their local tax bill.

Four step strategy to neutralize political obstacles to turning over services to private contractors.

1. Limit Federal aid payments to the states and cities.... move service funding responsibility to lower levels of government would stimulate an expansion in contracting out.
{assumption} The federal government no distributes more than \$100 billion in federal grants to state and local governments....e.g. the Federal Urban Mass Transit Administration distributes about \$5 billion annually to pay for local transit systems. If this was transferred to the cities would reject the expense and move to private-transit operations.
{assumption}. Similarly, Federal wastewater-treatment grants, which until recently paid 75% of the cost of construction of new water-treatment {sic} plants, reward cities for building costly new public plants rather than turning to more economical private systems {?}. "The message is clear: forcing local residents to finance services with their own tax dollars is the best method of encouraging economical approaches to public service delivery.
2. Mobilize countervailing constituencies to thwart union objections. (Federal employees union).

Page 6

3. Move the contracting-out decision out of the hands of the affected agency. The cost-comparison process initiated by OMB circular A-76 has been an unmitigated failure. Having the agency itself make the in-house-cost estimate and the determination as to whether contracting out is the more efficient route is like the asking the PLO to arbitrate a border dispute between Israel and Syria.

Local governments have developed innovative approaches to handling the cost comparison process that could serve as a model for Federal policy. Phoenix has taken the lead.

The Federal government should experiment with such an approach by reacting an auditing office in the OMB or GAO

The reform would offer three improvements over the present system. (1) bureaucratic foot dragging would no longer act as a restraint, since the agency's failure to make a cost estimate would simply result in functions being contracted out by default. (2) in-house cost estimates would be more accurately measured, thereby transferring a greater number of contracts to more economical private vendors (?) (3) service quality would improve, since performance standards would apply equally to contractors and the agencies.

Eventually, the Federal government should contract out the contracting out process. A private auditor could be made responsible for calculating cost estimates, awarding decisions, and monitoring performance problems. The auditor would receive payment based on savings to the government and satisfactory performance of the contracts it awarded and managed.

4. Turn certain contracted services over to Federal-employee-owned businesses. One means of overcoming union resistance to privatization is to turn Federal employees into private contractors by encouraging worker buy-outs. Great Britain has privatized many of its government activities with this approach.

Conclusion:

The primary objective in government procurement was set down by the 1972 Commission on Federal Procurement: to acquire "products and services of the needed quantity at the lowest reasonable price available." ...In 1985 there were more Federal workers performing commercial activities than there have ever been. In short, the privatization revolution that is taking place on the state and local levels is passing the Federal government by.

While the Federal government is in the initial stages of the Gramm-Rudman era of deficit reduction, a unique opportunity exists for similar budgetary reforms in Washington.

The Limits of Privatization
by Paul Starr
(synopsis)

...The original contribution of American proponents of privatization is that they would like to privatize the full gamut of public assets and services, including many forms of public provision, such as public schools, national parks, public-transport infrastructure, and prisons, whose origins and rationale fall comfortably within the ambit of the classical liberal state. In privatization they believe they have found a sovereign remedy against stall ailments to the body politic, good for stimulating economic growth, improving the efficiency of services, slimming down the state, and expanding individual freedom, including the opportunities of disadvantaged minorities, too.

...we rarely meet up with so happy a possibility of simultaneously making the economy larger, the government smaller, and virtually all of us better off.

...Most of all, it must recognize that markets are not natural creations; they are always legally and politically structured. Hence the choice is not public or private but which of many possible mixed public-private structures works best. And "best" cannot mean only most efficient, for a reasonable appraisal of alternatives needs to weigh concerns of justice, security, and citizenship.

...Privatization refers to a shift from publicly to privately produced goods and services. Policies that encourage such a shift include (1) the cessation of public programs and disengagement of government from specific kinds of responsibilities; (2) sales of public assets, including public lands, public infrastructure, and public enterprises; (3) financing private provision of services- for example through contracting out or vouchers- instead of directly producing them; and (4) deregulating entry into activities, such as first-class mail, that were previously treated as a public monopoly.

These forms of privatization vary greatly in their consequences...they do not eliminate but may reduce the accountability of public officials for the results of the expenditures... By shifting only the locus of service production, they privatize the means of policy implementation but not the functional sphere of government action. These partial forms of privatization need to be sharply distinguished from the sale of assets and cessation of programs (sometimes called "load-shedding" a term which itself is politically loaded, since it defines public programs as a burden).

{ Thoughts: To truly privatize a lab such as water micro it would preclude the putting out of bids and allow the lab doing the best job for the lowest price to gain market by true competition. Putting the load out for bid is not moving away from the control of the government. }

Yet even the more thorough forms of privatization may involve indirect forms of public subsidy and control. For example, many proposals for asset sales and program termination contemplate the use of tax incentives to stimulate private substitutes for public services. Such incentives influence market outcomes and represent a source of lost revenue (that is, a tax expenditure). Hence there is no certainty that these policies lead toward budgetary balance.

Page 2

There is a way of liberalizing without privatizing - that is, to introduce competition into the public sector without transferring ownership. For example, governments may require public enterprises or operating agencies to compete for capital or contracts from higher-level authorities. Indeed, it is even possible to nationalize and liberalize at the same time.

When Continental Illinois was on the verge of collapse in 1984, the Reagan administration did not hesitate to rescue it.

By having highways constructed by private contractors, we do not reduce the pressure for bigger construction appropriations. Medicare has done for medical and hospital associations what no liberal persuasion could do - turned them into advocates of higher public spending.

(medicine is now private but people are wanting to take it to nationalization. If private is better than people would want it to remain the same.)

Advocates of privatization show an undue tenderness toward private contractors and an undue hostility toward public employees. They indulge private contractors their history of cost overruns; they rebuke public employees for their history of wage increases. But their preference for private provision actually reflects a deep underestimate of the skills that private firms can deploy. They underestimate the contractors' capacity to influence political decisions, either illegitimately through bribery or legally through campaign contributions and lobbying. Missing from the case for privatization is any clear sense of feedback effects- the reaction back upon the government of the enlarged class of private contractors and other providers dependent on public money.

So, if partial privatization is to reduce public spending, it cannot be expected to achieve its effect by reducing spending pressure. Private firms have to be far more efficient. Some evidence does suggest that private producers have lower costs, but the picture is complicated by the following: First, contrary evidence from other studies shows no difference in costs or even higher costs among commercial providers. Second, there are pervasive differences in the services performed by public and private organizations, particularly because of differences in the services performed by public and private organizations, particularly because of differences in their clientele... Third, studies usually lack any evidence about the quality of services, thereby making it difficult to judge whether lower costs result from greater efficiency or deteriorating quality. And, fourth, some private firms' lower costs stem from lower wage levels and greater use of part-time workers with fewer fringe benefits. If privatization enables governments to cut wages and break unions, it is a means of imposing losses on public employees.

...if contracting were always superior to direct employment, no large corporations would exist. Everyone would be a contractor; no one would be an employee.

To be sure, contracting out may give government the flexibility of switching among alternative suppliers, thereby enhancing its bargaining power. However, the advantages are worthwhile only

Page 3

if the government can assure itself of both the reliability of service and the ability to maintain competition at later points of contract renewal.

Although privatization aims to shift services from the public to the private sector, it could end up making private institutions more like public ones. If public money flows to private providers, the voter and their representatives are likely to demand greater accountability.

...privatization is no guarantee that subsidies will stop. Private companies are not bashful about asking for help, usually in the form of tax benefits. And if privatization occurs without liberalization, privatized monopolies can obtain subsidies through regulatory protection.

The illusory appeal of privatization is to provide a single solution for many complex problems. But if the idea of privatization has any merit, it is to force us to rediscover the rationale of the public services we need and to remind us, if we had forgotten, that the public-private mix ought not to be considered settled for all time.

100

100

100

100

100

Privatizing Water Works
by Steve Hanke and Stephen Walters
(synopsis)

In England the conservative government of Prime Minister Margaret Thatcher has proposed to alter the current system of regionalized waterworks monopolies.

The objectives of privatizing waterworks are numerous. The most frequently cited goals include improving the economic performance and service functions of the assets; depoliticizing economic decisions; generating public-budget revenues through public-offering receipts; reducing public outlays, taxes, and borrowing requirements; reducing the power of public-sector unions; and promoting popular capitalism through wider share ownership.

Private versus Public Enterprises

Private enterprises should be expected to be more efficient than public enterprises precisely because a private owner stands to gain enhanced wealth from improvements in efficiency, reductions in cost, and the like. To put it another way, a private owner stands to forgo wealth if improvements in efficiency, reductions in cost, and the like are not pursued. In essence, private owners face significant incentives to monitor the behavior of managers and employees so that they will supply what consumers demand and do so in a cost-effective way. Private owners are "residual claimants" who have a strong interest in seeing that there is indeed a residual, or profit, to claim.

Monitoring by owners can be quite costly. The necessity for owners to monitor managers, however, can be mitigated by providing the managers with compensation packages that include profit sharing or stock options. These packages are designed to make the manager's interests coincide with those of the owners.

The combination of monitoring and incentive compensation packages tends to make managers operate private firms in an efficient manner. If managers do not maximize owners' residual claims, however, the market for shares acts as a court of last resort. If the actions of incumbent managers are inappropriate, profits and share prices will be lower than they should be. ...

Public enterprises, by contrast, lack a "residual claimant" in any meaningful sense. Ownership shares in public enterprises generally cannot be bought or sold, so that takeovers are impossible. And it is rare to see the compensation of managers of public enterprises tied to their firm's performance. "Profits" generated via enhanced efficiency in a public enterprise could be refunded to taxpayers through tax reductions, but such refunds would be spread over many taxpayers, and any individual's benefit would be small. Though the preponderance of public and private firms. One of the most widely cited is David G. Davies' comparison of Australia's two interstate airlines- one public the other private. Davies found that even though the private airline labored under heavy regulatory constraints it was more efficient: it carried 103 percent more freight and mail and 17 percent more passengers per employee than the public airline but earned 12 percent more revenue per employee.

Page 2

Most relevant to the central concern of this essay, w. Mark Crain and Asghar Zardkoobi have compared the performance of public and private water utilities in the United States. They found that operating costs are significantly higher in the publicly owned utilities. They established that public firms' low labor productivity and underutilization of capital equipment led to operating costs about 25% higher than in the private companies.... Hanke found that customer cross subsidization (that is, overcharging some consumers so that other consumers can be sold water at prices below cost) is more common in public water companies than in private ones..

....it is possible to find examples of seemingly well-run public firms. John R. Baldwin, for example, reported that the Canadian airline industry, with a nationalized firm playing a key role, operated with higher load factors and lower markups than the privately owned ... United States industry. Richard Hellman has argued that some publicly owned electric utilities may also operate at lower average unit costs than regulated private utilities, though comparisons are clouded by water-rights differences and other disparities.

But this is the crux of the problem regarding waterworks. Since water utilities generally qualify as natural monopolies, it may be that some form of government regulation of even privately owned utilities is inevitable.

Conclusion

Both theory and evidence strongly support the notion that private supply is more efficient than governmental supply. Waterworks, however, are true natural monopolies; consequently, many argue against privatization. ... The benefits of large scale single-firm operations can be secured at competitive prices. This can be accomplished by employing Chadwick's system of franchise bidding in which the rights to a franchise are awarded to the firm that offers the best terms to the public.

.... The privatization of waterworks and the proper use of competitive franchising can and should generate substantial benefits for water consumers and reduced resource waste by society as a whole (Bull Shit). No proof in this article for this conclusion.