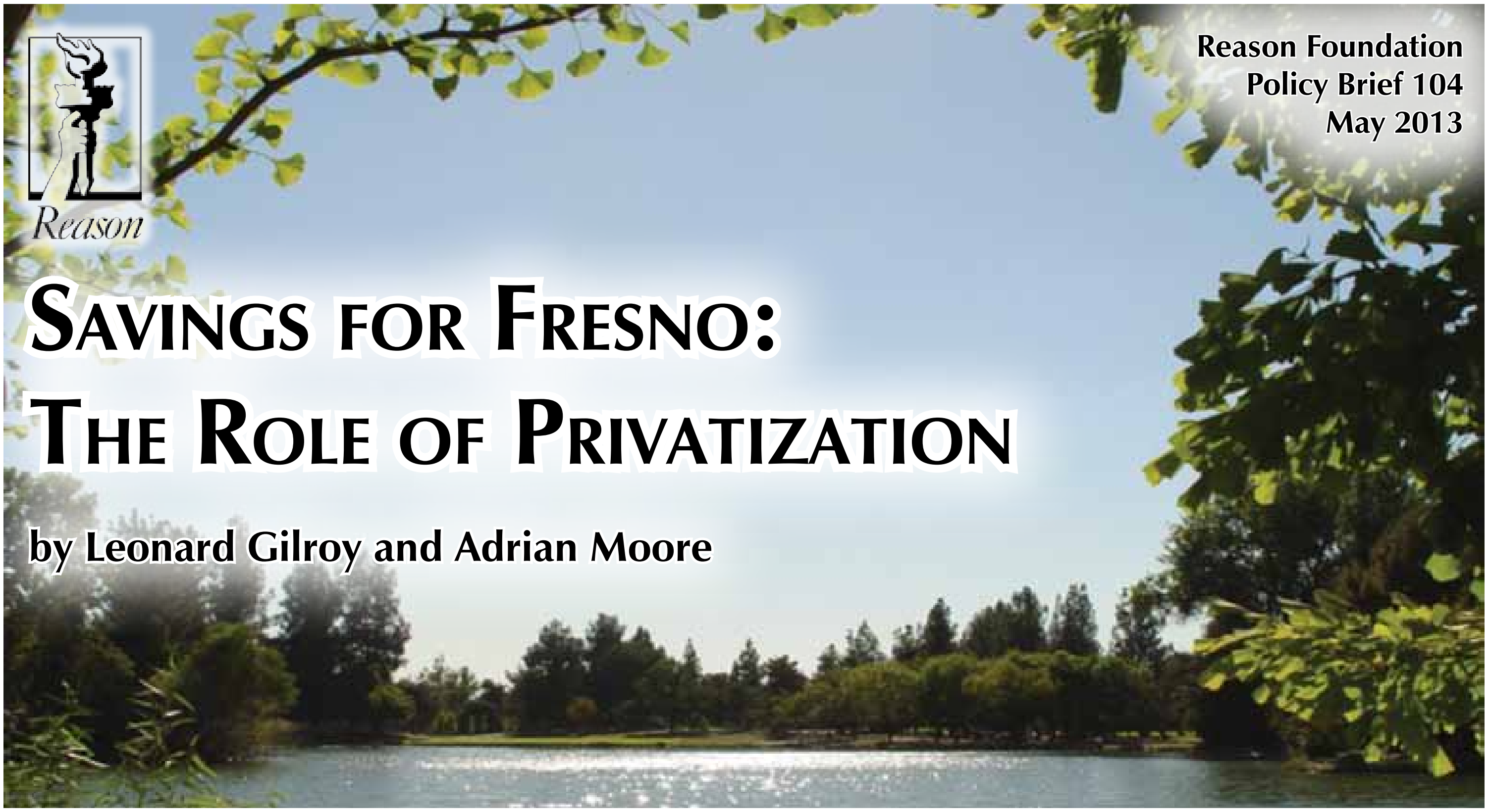

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Savings for Fresno: The Role of Privatization

by Leonard Gilroy and Adrian Moore

INTRODUCTION

"It is not a government's obligation to provide services, but to see that they are provided."

—former New York Governor Mario Cuomo

"Privatize everything you can."

—Chicago Mayor Richard Daley (advice to an incoming mayor)

Like their peers in many municipalities across the country, Fresno policymakers are currently considering what role privatization should play in addressing their current and future fiscal challenges. However, privatization is a complex subject and takes many forms, so it is helpful to have an overview of the subject in deciding how to use privatization moving forward.

Over the last half century, governments of all political complexions have increasingly embraced *privatization*—shifting some or all aspects of government service delivery to private sector provision—as a strategy to lower the costs of government and achieve higher performance and better outcomes for tax dollars spent.

Recent decades have seen privatization shift from a concept viewed as radical and ideologically based to a well-established, proven policy management tool.[1] Indeed, local policymakers in many jurisdictions in the U.S. and around the world have used privatization to better the lives of citizens by offering them higher quality services at lower costs, delivering greater choice and more efficient, effective government.

In the 21st century, government's role is evolving from service provider to that of a broker of services, as the public sector is increasingly relying far more on networks of public, private and non-profit organizations to deliver services.[2] Virtually every local government service—from road maintenance, fleet operations and public works to education, recreation and public health services—has been successfully privatized at some point in time somewhere around the world.

This trend is not confined to any particular region, or to governments dominated by either major political party. In fact, privatization is a bipartisan trend, embraced by pragmatic local policymakers from both sides of the aisle. The reason for the widespread appeal of privatization is straightforward: it works. Decades of successful privatization policies have proven that private sector innovation and initiative can do certain things better than the public sector. Privatization can also boost the local economy and tax base, as private companies under government contract pay taxes into government coffers and offer employment to communities.

WHAT IS PRIVATIZATION?

Privatization—sometimes referred to as contracting out, outsourcing, competitive sourcing or public-private partnerships—is really an umbrella term referring to a range of policy choices involving some shift in responsibility from the government to the private sector, or some form of partnership to accomplish certain goals or provide certain services. It covers everything from simple contracting to asset sales and joint ventures (common forms of privatization are discussed below).

Though many tend to think of privatization as involving governments partnering with for-profit firms to deliver services, many different types of privatization involve partnering with non-profit organizations or volunteers for a range of activities that include volunteer fire services, the operation of city zoos and aquariums, the upkeep of parks (such as New York City's Central Park Conservancy), and the delivery of recreation programs.

All forms of privatization are simply policy tools—they can be effective when used well and ineffective when used incorrectly. The reason privatization works is simple: it introduces competition into an otherwise monopolistic system of public service delivery. Governments operate free from competitive forces and without a bottom line. Thus, program structures and approaches often stagnate, progress is not measured, and success is hard to discern or replicate. Worse, since budgets are not linked to performance in a positive way, poor performers in government too often get rewarded as budget increases follow failure.

Competition done right drives down costs and incentivizes performance. Private firms operating under government contracts have strong incentives to deliver on performance—after all, their bottom line would be negatively impacted by the cancellation of an existing contract or losing out to a competitor when that contract is subsequently re-bid. On the government's side, applying competition forces management to identify the true cost of doing business, and, with efficiency as a goal, compels an agency to use performance measurement to track and assess quality and value. At its root competition promotes innovation, efficiency and greater effectiveness in serving customers. Oftentimes, this allows contractors to provide comparable or even superior wages and benefits while reducing costs and improving service levels.

COMMON GOALS OF PRIVATIZATION

Government managers use privatization to achieve a number of different goals:

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

Improved Risk Management: Through contracting and competition, governments may be better able to control costs by building cost containment provisions into contracts. In addition, contracting may be used to shift major liabilities from the government (i.e., taxpayers) to the contractor, such as budget/revenue shortfalls, construction cost overruns, and compliance with federal and state environmental regulations.

Quality Improvements: Similarly, a competitive process encourages bidders to offer the best possible service quality to win out over their rivals.

Timeliness: Contracting may be used to speed the delivery of services by seeking additional workers or providing performance bonuses unavailable to in-house staff.

Accommodating Fluctuating Peak Demand: Changes in season and economic conditions may cause staffing needs to fluctuate significantly. Contracting allows governments to obtain additional help when it is most needed so that services are uninterrupted for residents without permanently increasing the labor force.

Access to Outside Expertise: Contracting allows governments to obtain staff expertise that they do not have in-house on an as-needed basis.

Innovation: The need for lower-cost, higher-quality services under competition encourages providers to create new, cutting-edge solutions to help win and retain government contracts.

FORMS OF PRIVATIZATION

Privatization can take many different forms, depending on the nature of public/private agreements (e.g., short-term contract, long-term franchise/concession, voluntary provision, etc.), the scope of private activity, whether it involves the sale of an asset versus continued government ownership, and more. Some of the most common types of privatization are:

Contracts: The most common form of privatization in local governments occurs when governments contract with private sector service providers, for-profit or nonprofit, to deliver individual public services, such as road maintenance, custodial services, fleet maintenance and water system operations and maintenance. Local governments also routinely contract with private firms to provide administrative support functions, such as information technology, accounting and human resources. Local governments are also increasingly using "bundled" service contracts that integrate more functions or responsibilities into a single contract, such as a contract to outsource an entire city public works department.

Franchises: In a franchise arrangement—also referred to as a lease or concession—government typically awards a private firm an exclusive right to provide a public service or operate a public asset, usually in return for an annual lease payment (or a one-time, upfront payment) and subject to meeting performance expectations outlined by the public sector. As an example, in many jurisdictions common utility services—such as telecommunications, gas, electricity and water—are provided through long-term franchise agreements. Franchise-based privatization initiatives may involve the privatization of an existing government asset, such as a toll road, water/wastewater plant or airport, though similar arrangements can be used to finance, build and deliver new infrastructure assets as well. Chicago's $1.8 billion lease of its Chicago Skyway toll road and recent long-term leases of parking assets in Chicago and Indianapolis are recent examples of the franchise approach.

Divestiture: Some forms of privatization involve governments getting out of a service, activity or asset entirely, often through outright sales. Local governments routinely sell off aging or underutilized land, buildings and equipment, returning them to private commerce where they may be more productively used. For example, in the late 1990s New York City sold off two city-owned radio stations and a television station, and Orange County, California raised more than $300 million through real asset sales and asset sale-leaseback arrangements over the course of 18 months to help recover from collapse into bankruptcy in 1995. More recently, Tulsa, Oklahoma has sold over 40 parcels of land since 2009, including an old city hall building that had sat vacant for years. The city sold the downtown building to a private developer for $1 million, and it is currently being redeveloped into a convention hotel. Not only did the city shed tens of thousands of dollars in annual maintenance costs for a vacant, unused building that was delivering no value to taxpayers, but when redevelopment is complete, the building will begin to generate additional property, hotel, and sales taxes for the city, in addition to the $1 million generated from its sale.[4]

HOW LOCAL GOVERNMENTS USE PRIVATIZATION

Local policymakers often ask a very simple question: "where can we apply privatization?" However, the answer is somewhat more complicated.

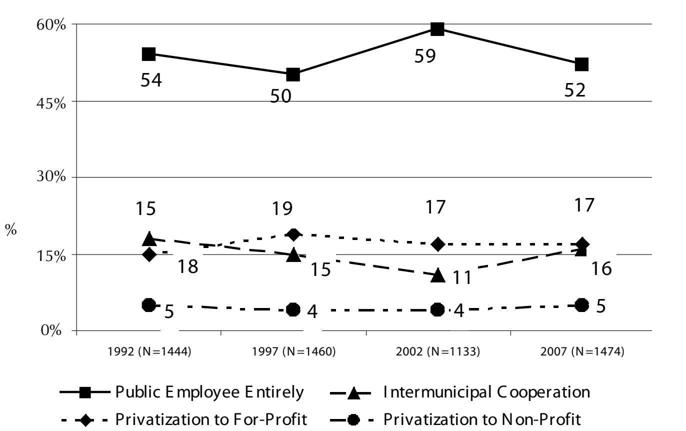
One obvious place to start is examining what other local governments are doing. The International City-County Management Association (ICMA) conducts a survey of alternate service delivery by local governments every five years, measuring service delivery for 67 local services across more than 1,000 municipalities nationwide. The 2007 survey shows that public delivery comprises, at 52 percent on average, the most common form of service delivery across all local governments (see Figure 1).[5] For-profit privatization at 17 percent and intergovernmental contracting at 16 percent are the most common alternatives to public delivery. Non-profit privatization is next at 5 percent, with other forms of alternative delivery collectively accounting for less than 2 percent of service delivery, on average.

Trends in levels of privatization and contracting—both for-profit and non-profit—have remained relatively steady over the last two decades (though the 2007 survey would not capture the likely uptick in local government privatization in the wake of the 2008–2009 recession and subsequent proliferation of state and local fiscal crises).

Table 1 shows the percentages of surveyed local governments using privatization across a range of public services. Among the most frequently privatized local government services are waste collection (residential and commercial), waste disposal, vehicle fleet management, hospitals, vehicle towing, electric utilities, drug programs and emergency medical services.

Those services are just a start; one privatization expert at the City University of New York identified over 200 city and county services that have been contracted out to private firms (including for-profit and non-profit).[5] Some of the most prevalent areas of local government privatization include:

Figure 1: Local Privatization Trends in the United States



Source: Warner and Hefetz, *Trends in Public and Contracted Government Services: 2002-2007.*

Table 1: Use of Alternative Service Delivery Forms by Metro Status

	% Use 2007			% Point Change 2002-2007		
Service	Metro	Suburb	Rural	Metro	Suburb	Rural
For-Profit Contracting						
Res. Waste Collection	29.0%	57.3%	39.3%	-4.6%	10.4%	10.0%
Comm. Waste Collection	39.2%	63.8%	52.7%	-2.1%	14.5%	18.9%
Waste Disposal	35.3%	51.9%	30.4%	-1.7%	8.0%	0.8%
Hazardous Materials	32.4%	29.1%	36.5%	-10.1%	-9.0%	2.5%
Airport	17.1%	14.7%	9.0%	-6.2%	-15.8%	-5.3%
Electric Utility	42.6%	56.7%	36.8%	26.0%	16.4%	19.6%
Vehicle Towing	57.1%	68.4%	65.4%	-22.3%	-13.1%	-9.3%
Daycare	39.0%	53.8%	64.9%	1.1%	13.8%	33.1%
Child Welfare	8.7%	10.9%	8.9%	-6.1%	-2.4%	4.6%
Transit Services	24.4%	17.7%	13.3%	-0.4%	-3.4%	-0.7%
Job Training	9.2%	7.4%	2.6%	-5.2%	-3.0%	-5.6%
Welfare Eligibility	1.0%	3.0%	0.8%	-1.3%	1.7%	-2.5%
Hospitals	35.3%	38.6%	43.2%	24.2%	8.6%	11.6%
Insect Control	14.8%	24.6%	19.3%	1.7%	3.5%	8.9%
Drug Programs	23.6%	17.0%	22.0%	1.1%	-1.7%	10.1%
Emergency Medical	16.1%	16.6%	18.3%	1.4%	3.9%	8.0%
Museums	3.0%	4.3%	4.1%	-0.8%	-0.4%	-0.8%
Fleet Management	23.6%	28.6%	22.3%	-15.3%	-11.2%	-8.4%

Source: International County and City Management Association, Alternative Service Delivery Surveys, 2002, 2007; Washington DC. Service average is the percentage based on number answering each question where the denominator varies with each service. This is consistent with ICMA's reporting method in the *Municipal Yearbook*.

- Accounting, financial and legal services;
- Administrative human resource functions (e.g., payroll services, recruitment/hiring, training, benefits administration, records management, etc.);

- Core IT infrastructure and network, Web and data processing;
- Risk management (claims processing, loss prevention, etc.);
- Planning, building and permitting services;
- Printing and graphic design services;
- Road maintenance;
- Building/facilities financing, operations and maintenance;
- Park operations and maintenance;
- Zoo operations and maintenance;
- Stadium and convention center management;
- Library services;
- Mental health services and facilities;
- Animal shelter operations and management;
- School construction (including financing), maintenance and non-instructional services;
- Revenue-generating assets (garages, parking meters, etc.), and
- Water and wastewater system operation and management.

This is only a partial list. But more importantly, the question of "what can local governments privatize" is in many ways the wrong question to ask, as privatization is a policy tool that can and should be considered in almost every instance of public service delivery.

What may surprise many local policymakers in Fresno is the extent to which other communities have embraced privatization, extending the boundaries far beyond what's seen in most jurisdictions. For example, since 2005, six new cities have incorporated in the Atlanta region, Georgia as "contract cities," and many of them have opted to contract out virtually all of their non-safety related government services to private firms, dramatically reducing costs and improving services along the way.

Sandy Springs, Georgia—a community of nearly 100,000 residents—was the first to incorporate as an independent city in 2005 and established a model for the new contract cities that followed. Instead of creating a new municipal bureaucracy, Sandy Springs opted to contract out for nearly all government services, except for police and fire services. Originally created with just four government employees, the city's successful launch was facilitated by a contract with CH2M-Hill OMI to oversee and manage day-to-day municipal operations, and the contract value was just over half of what the new city had formerly been charged through taxes by Fulton County before incorporation. The city maintains ownership of assets and maintains budget control by setting priorities and service levels. Meanwhile the contractor is responsible for staffing and all operations and services. According to Sandy Springs Mayor Eva Galambos, the city's experience "has been exemplary. We are thrilled with the way the contractors are performing. The speed with which public works problems are addressed is remarkable."

Beyond Sandy Springs, city officials in recently incorporated Central, Louisiana (population 27,000) hired a contractor in 2008 to deliver a full range of municipal services—including public works, planning and zoning, code enforcement and administrative functions—as part of a three-year, $10.5 million contract. After rebidding the contract in 2011, Central granted a new 5-year, $15 million contract to The Institute for Building Technology and Safety (IBTS), a Virginia-based nonprofit, to continue handling the outsourced city operations. "We're sold on privatization. It works for us. It's so much more efficient," Central Chief Administrative Officer David Barrow told *The Advocate* in September 2012, "In government, public works employees can be civil service employees and you can't fire them if they are not doing their job. If someone is not doing their job, we can go to IBTS and they take care of it."[7]

Sandy Springs and other contract cities demonstrate something very powerful from a public administration standpoint: there's hardly anything that local governments do that can't be privatized, so there's no reason policymakers shouldn't think big on privatization.

RECENT LOCAL GOVERNMENT PRIVATIZATION HIGHLIGHTS

While privatization has long been a steady trend at the local level, some new and interesting examples have emerged in the wake of the 2008 economic recession, which exacerbated municipal fiscal challenges faced in many parts of the country. Recent highlights in local government privatization include:

Chicago, Illinois: In March 2012, former Obama administration Chief of Staff and current Chicago Mayor Rahm Emanuel announced the creation of the Chicago Infrastructure Trust (CIT), a public infrastructure bank designed to raise capital from the private sector to deliver a range of public infrastructure projects. Under Emanuel's plan, private investors in public infrastructure projects will be repaid through user fee revenues, a share of city cost savings (for energy efficiency-related building retrofits, for example) or other repayment mechanisms. The Emanuel administration plans to raise $8 billion from private investors for the trust to improve city streets, parks, water and wastewater, schools, commuter rail and much more.[8] The city has already received interest from several financial institutions—including Macquarie Infrastructure and Real Assets, Ullico, Citibank and JPMorgan—and in January 2013 the city issued a request for qualifications calling on potential financial partners to lay out the terms and conditions they would require to finance Retrofit Chicago, the first of the new trust's planned initiatives.

Emanuel has also successfully used competition to lower recycling costs in Chicago by outsourcing recycling collection in parts of the city to create a head-to-head competition with city workers, which has forced them to become more efficient. In April 2012, Emanuel announced that the city had saved $2.2 million in recycling service costs during just the first six months of competitive bidding and that private competition had forced the city's crews to lower their own costs by 35 percent.[9] Because of this success, Emanuel plans to expand competitive bidding to other city services, including tree-trimming services for the 20,000 trees lining Chicago parkways.[10]

New York City, New York: In August 2012, New York City Mayor Michael Bloomberg announced the award of the first local government "social impact bond" contract, which aims to reduce recidivism among young adults released from the Rikers Island correctional facility. Goldman Sachs is financing an evidence-based intervention program for four years through a $9.6 million loan to the local nonprofit MDRC, which is contracting with the city to oversee implementation of the program. MDRC will manage the nonprofit service providers Osborne Association and Friends of Island, which will deliver the intervention.

The city's Department of Correction will make payments to MDRC based on outcomes and cost savings achieved in reducing recidivism levels. If the program reduces the recidivism rate of the target population by 10 percent, Goldman Sachs would break even on its original investment of $9.6 million. If the program reduces recidivism by more than 11 percent, the city will pay MDRC on a capped, sliding scale that rises as recidivism rates fall, and Goldman Sachs could earn a return on its investment up to a maximum of $2.1 million if recidivism rates fall more than 20 percent. At that maximum level, the city would net over $20 million in long-term savings, nearly ten times the return that would be paid to Goldman Sachs. If the program does not meet its recidivism reduction targets, the city pays nothing.[11]

In October 2012, Fresno became the second U.S. municipality to launch a similar pay-for-success, "social impact bond" program aimed at reducing incidents of asthma caused by indoor air pollution.

Additionally, in April 2012 New York City's Department of Environmental Protection (DEP) signed a contract with Veolia Water to deliver an optimization program for the city's public water and wastewater services, which serve 9 million customers. In this first stage of the project, Veolia will prepare a strategy to improve the system's performance and lower operating costs, and once completed, the city will decide whether to partner with Veolia or another firm to implement the optimization. Officials are targeting annual cost savings in the region of $100–$200 million, and the city's private partners will be compensated on the basis of savings that are achieved and documented.[12]

Jacksonville, Florida: Soon after taking office in July 2011, Jacksonville, Florida Mayor Alvin Brown established the city's first Office of Public-Private Partnerships (PPPs) as a means to leverage greater returns from public resources by cultivating new funding sources for city initiatives, forging new partnerships with the private and nonprofit sectors, and optimizing the use of public assets and city-owned real estate. In less than two years, the PPP office has already generated some significant results, including tapping approximately $7 million in direct private sector donations and grants, and approximately $2 million in identified cost savings opportunities through efficiency and competition initiatives. Examples of planned or completed competition initiatives include the outsourcing of vehicle fleet parts (both inventory and parts management), privatization of the city's vegetable oil conversion facility, privatization of the city's surplus auction, and the development of a real property inventory and divestiture program.[13]

Indianapolis, Indiana: In August 2010, Indianapolis Mayor Greg Ballard announced the winning bidder for a 50-year concession (lease) of nearly 3,700 city parking meters. Under the concession, ParkIndy—a team composed of Xerox-subsidiary Affiliated Computer Services (ACS) and its local partners Denison Global Parking and Evens Time—have taken over responsibility for meter system operations, maintenance and capital investment, in exchange paying the city $20 million up front and an estimated $300–600 million share of ongoing revenues over the 50-year lease term. All city revenues generated from the parking meter concession are dedicated to street, sidewalk and other infrastructure improvements in the neighborhoods surrounding the leased meters.

Tulsa, Oklahoma: Tulsa Mayor Dewey Bartlett faced a major deficit upon taking office in late 2009 and immediately hired the global consulting firm KPMG to prepare a strategic operational review for the city. KPMG's report identified 298 competition opportunities alone, including asset maintenance, solid waste collection, building operations, traffic operations, road maintenance, recreation services, drainage maintenance and many more. Shortly thereafter, the mayor created an internal Management Review Office to oversee implementation of public/private competitions. In the first competition, city employees bid against private contractors for the delivery of building maintenance services (e.g., mechanical, electrical, plumbing and carpentry services) at city hall. The city employees won the competition while saving the city more than $900,000 over five years, enabling employees to retain their positions.[14]

In other privatization initiatives undertaken in Tulsa, the city sold its vacant city hall building for $1 million to a private hotel developer, and it has transferred the operation of both the city zoo and city animal shelter to local nonprofits, allowing the city to draw down its public subsidies to these facilities as the nonprofits increase private donations from philanthropic interests.

Bayonne, New Jersey: In August 2012, the city of Bayonne, New Jersey signed a 40-year concession with United Water and private equity firm Kohlberg Kravis Roberts for the operation and maintenance of its water and wastewater system that will lead to over $100 million in improvements like wireless metering, pipe replacement and reduced water loss through leakage. The city received $150 million up front in the transaction, allowing it to retire $130 million in Bayonne Municipal Authority Debt, freeing up funds for other city priorities.[15] The deal will also help the city avoid far higher future water rate increases than those approved in the concession.

MYTHS VS. FACTS ON PRIVATIZATION

Privatization is a complex subject, and one that is commonly misunderstood or misrepresented by those with an interest in maintaining the status quo, such as government employee unions. Three of the most prevalent myths include:

Myth: Privatization is partisan.

Fact: Privatization is not the domain of any one political party or ideology. In the U.S., privatization is used by leaders of both major political parties, and they have demonstrated that not only can politicians at all levels successfully privatize public services, but they can get re-elected after doing so. For example, former Indianapolis Mayor Stephen Goldsmith, a Republican, identified $400 million in savings and opened up over five dozen city services—including trash collection, pothole repair and wastewater services—to competitive bidding. Former Chicago Mayor Richard Daley, a Democrat, privatized more than 40 services and generated over $3 billion in privatization deals for the Chicago Skyway toll road, four downtown parking garages, and the city's downtown parking meter system. And when Democrat Ed Rendell, governor of Pennsylvania, was mayor of Philadelphia, he saved $275 million by privatizing 49 city services, including golf courses, print shops, parking garages and correctional facilities.

Myth: Privatization involves a loss of public control.

Fact: This myth involves a fundamental misunderstanding of the nature of privatization—that government loses control of an asset or service once it is privatized since the public sector is no longer providing that service. In well-structured privatization initiatives the government and taxpayers gain accountability. In fact, the legal foundation of a privatization initiative is a contract that spells out all of the responsibilities and performance expectations that the government partner will require of the contractor. No detail is too small for the contract. Any failure to meet the performance standards specified in the contract could expose the contractor to financial penalties, and in the worst-case scenario, termination of the contract.

So government never loses control—in fact, it can actually *gain more control* of outcomes—in well-crafted privatization arrangements. For example, state officials in Indiana have testified that they were able to require higher standards of performance from the concessionaire operating the Indiana Toll Road than the state itself could provide when it ran the road, precisely because they specified the standards they wanted in the contract and can now hold the concessionaire financially accountable for meeting them.

Myth: Privatization hurts public employees.

Fact: Privatization tends to encounter opposition from public employee unions who view it as a threat to their jobs and influence. Well-managed privatization initiatives need not put undue burden on public employees, however. Comprehensive examinations of privatization initiatives have found that they tend to result in few, if any, layoffs—those not retained by the new contractor usually either retire early or shift to other public sector positions—and that public employees can actually benefit in the long term when hired on by contractors, as private companies often present greater opportunities for upward career advancement, training and continuing education, and pay commensurate with performance, for example. Nevertheless, it is important that management communicate early and often with the public employee unions regarding privatization initiatives. In the event that city employee jobs are at risk, the city should develop a plan to manage public employee transitions.

Myth: Because it doesn't have to make a profit, the public sector always delivers services cheaper.

Fact: Absent competition, government bureaucracies will effectively be monopoly providers of government services, which tends to yield higher costs, less choice and less innovation in service delivery. Further, the continuing public sector reliance on defined-benefit pension systems and generous retiree health care benefits for retired government employees—both of which are massively underfunded in many jurisdictions at all levels of government—carry an indirect cost that is rarely considered in discussions of whether governments should "make" services themselves or "buy" them from private sector providers. By contrast, competition through privatization creates a "tension in the system" that works to drive down costs and spur innovation in service delivery.

A recent analysis from Austin, Texas supports this point. At the behest of the city council, staff from Austin's Financial Services Department prepared a report in October 2012 to assess whether the city would save money by bringing currently outsourced services back in-house. After reviewing 37 different outsourcing contracts, city staff concluded that bringing these contracts back in-house "would result in increased operating cost to the City, require significant investments in equipment, and, in many cases, result in diminished service provision as a result of reduced flexibility in the City's ability to adapt to situational operational fluctuations which is a major advantage to and rationale for utilizing contractors."[16]

Further, insourcing these contracts would incur major new costs for taxpayers, according to the report. It found that "transitioning to in-house provision of the services encompassed by the 37 analyzed contracts would require an additional $169 million over a five-year period and 687.5 full-time equivalent positions."[17] In the case of only one individual contract—the management of a youth entertainment complex—did city staff recommend a return to in-house provision to lower costs.

Myth: Privatization always saves money.

Fact: How a privatization process takes place is critical to its success or failure. Well-designed competitions that include rigorous monitoring of a contractor's performance outcomes tend to be successful in saving money and improving service quality. By contrast, it should come as no surprise that poorly designed procurements—or even a lack of due diligence in framing the competition to begin with—will tend to yield poor results, including a failure to achieve desired cost savings. Additionally, a lack of a robust pool of competitors for a particular type of service—whether the result of geography, the nature of the services sought, or other factors—can serve to limit the potential for cost savings.

In the end, cities should view the procurement process as an independent, third-party budget validation. The competition will generate information via outside bids that can be compared to current in-house costs. If policymakers believe that a significant opportunity exists through privatization to lower costs, then they can proceed to a final contract. Alternatively, if the bids received do not present the desired value proposition, then policymakers can opt to cancel the procurement and continue with the status quo.

BEST PRACTICES AND LESSONS LEARNED IN LOCAL GOVERNMENT PRIVATIZATION

As is the case in all types of contracting, privatization can be implemented well or can be implemented poorly. A successful privatization process will ensure transparency, accountability and the delivery of high-performance services through a strong, performance-based contract. By using best practices and lessons learned from the experiences of other governments, the likelihood of achieving those results is greatly enhanced. Some of these best practices include:

Rethink the status quo, and ask the "make or buy" question: Taking a page from management guru Peter Drucker, every "traditional" service or function should have to prove its worthiness and proper role and place within government. For any particular city service, it is helpful to start by asking fundamental questions about what role government should play, such as "if we weren't already delivering this service this way today, would we still choose to do it that way if we were setting it up tomorrow?" And for any service, policymakers should ask themselves whether, in an ideal world, they would "make" those services themselves in-house or whether they would opt to "buy" those services from private contractors.

Focus on building procurement and contract management expertise: Successful privatization initiatives require good contract negotiation, management and monitoring skills on the part of city managers. The more that local governments use privatization, the greater the degree to which the city manager's role will center on contract administration—monitoring and enforcing contracts to ensure that the contractor's performance lives up to his contractual obligations. Staff must be properly trained in contracting best practices and, in particular, how to build specific service standards into agreements and monitor provider performance, in order to avoid possible ambiguities, misunderstandings and disputes.

Establish a centralized procurement unit: Governments should maintain an expert team of procurement and competition officials to guide individual departments in developing their privatization initiatives. This central unit will help to break down the "silos" that departments sometimes operate within and identify city-wide or enterprise-wide competition opportunities that might not otherwise be considered.

Apply the "Yellow Pages Test" through regular commercial activity inventories: Local government managers should regularly scour all government agencies, services and activities and classify each as either "inherently governmental" (i.e., services that should only be performed by public employees) or "commercial" (i.e., services offered by private sector vendors) in nature. This famous "Yellow Pages Test" helps government concentrate on delivering core, "inherently governmental" services while partnering with the private sector for commercial activities. In other words, undertaking a commercial activities inventory helps identify those areas in which government is engaged in the business of business, effectively competing against private sector business and undermining free enterprise and economic development.

The results of commercial activity inventories can be illuminating, especially with regard to the extent to which some governments compete against private enterprise to provide services. For example, Virginia's first commercial activity inventory in 1999 identified 205 commercial activities being performed by over 38,000 state employees, accounting for nearly *half* of all state workers.

Establish guidelines for cost comparisons: Local governments should establish formal guidelines for cost comparisons to make sure that all costs are included in the "unit cost" of providing a service, so that an "apples-to-apples" comparison of competing bidders may be made. This is especially important in situations in which public employees may bid against private sector firms to provide a given service, as the public and private sectors operate under different accounting and financial reporting rules.

Use a business case evaluation process to document the rationale for privatization and serve as an implementation roadmap: Smart privatization should be based on an impartial, apples-to-apples business case analysis that compares the status quo of in-house service delivery to what may be available in the private sector, across a range of cost, quality, performance and other key factors. It should be based on the fully loaded, current costs of in-house government service delivery and current performance benchmarks.

Utilize performance-based contracting: It is crucial that local governments identify good performance measures to compare competing bids fairly and to evaluate provider performance accurately after the contract is awarded. Performance-based contracts should be used as much as possible to place the emphasis on obtaining the results the city wants achieved, rather than focusing merely on inputs and trying to dictate precisely how the service should be performed. Performance standards should be included in contracts and tied to compensation through financial incentives.

Utilize "best value" contracting: The lowest bid for a contract may not be the best bid in terms of overall value for taxpayer money. Initiatives that are considered best practices for government procurement and service contracting utilize "best value" techniques where, rather than purchasing based on cost or "lowest bid" alone, governments choose the best mix of quality, cost and other factors in selecting a service vendor. Many privatization failures are linked to a low-cost selection where the allure of increased cost savings negatively impacted service quality.

Ensure contractor accountability through rigorous monitoring and performance evaluation: Regular monitoring and performance evaluations are essential to ensure accountability, transparency, and that the local government's management and the service provider are on the same page. This can help address any problems that might arise early, before they become major setbacks.

Communicate early and often: Any shift in the form of public service delivery can impact on—or cause concern among—city residents, so it is important for policymakers to outline the pros and cons of privatization to the public to ensure transparency and accountability. A clear communications and public relations strategy should be a key component of any privatization initiative, as it is crucial for getting the public's buy-in. Strategies should include a commitment to an open, transparent privatization process; outreach to the media, local policy bloggers and taxpayer advocacy groups; close communication with government employees and the unions that represent them; and a schedule of public meetings with key stakeholders and the public at large.

CONCLUSION

As they continue to explore ways to navigate current budget challenges and better prepare themselves for unforeseen future fiscal headwinds, Fresno policymakers should ask fundamental questions about how their city government operates and whether there is a better way. The experiences of the thousands of other local governments around the country—and indeed, around the world—that have embraced privatization demonstrate that there is indeed another more entrepreneurial and pragmatic way to govern. When implemented with care, due diligence and a focus on maximizing competition, privatization is an approach that puts results, performance and outcomes first and can deliver high-quality public services at a lower cost.

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RELATED REASON RESEARCH

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ENDNOTES

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