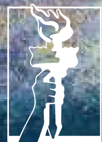
Focus on State and Local Privatization



Privatization Watch

Celebrating 32 Years of Privatization and Government Reform

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Getting the Government OUT of the Business of Business...5

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Privatization Watch

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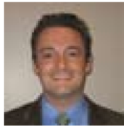

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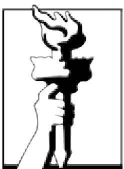

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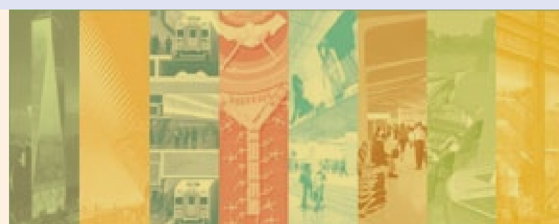
Letter from the Editor

In August, Reason Foundation released its *Annual Privatization Report 2008,* detailing the latest on privatization and government reform at all levels of government and across a broad range of policy areas. This issue of *Privatization Watch* will give you a sampling of the many topics covered in *APR 2008* on the state and local privatization front, such as Utah's revamped privatization board, state contracting in Florida, Chicago's landmark infrastructure privatization initiatives and an update on Georgia's growing contract cities movement. I would invite you to visit reason.org/apr2008 to access full-length versions of these and other *APR 2008* articles.

In addition, this issue features an article by Georgia's State Property Officer Steve Stancil on transforming the management of state real estate assets, as well as an interview with two of Utah's privatization leaders, State Senator Howard Stephenson and State Representative Craig Frank, on their efforts to apply the "Yellow Pages Test" to state government. The examples offered by these and other leaders profiled within demonstrate that privatization and competition are alive and well in state government and that privatization remains a powerful, proven policy tool to "right-size" government and deliver the best value for taxpayers.



Annual Privatization Report 2008

Edited by Leonard C. Gilroy

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Privatization Briefs

Improved Outlook for Pennsylvania Turnpike Lease

In September 2008, the Federal Highway Administration (FHWA) rejected the Pennsylvania Turnpike Commission's (PTC) second application to toll Interstate 80, ruling that it does not meet requirements for approval under the Interstate System Reconstruction and Rehabilitation Pilot Program law. The FHWA ruling effectively strikes out a key component of Act 44, the Commonwealth's 2007 transportation funding bill.

Act 44 created a fifty-year lease arrangement with the PTC to pay the state Department of Transportation upwards of $1 billion annually in a "public-public," non-competed toll concession for the Pennsylvania Turnpike and the currently untolled I-80. Without the I-80 tolling component, Act 44 would provide only $450 million to the state each year, far short of the $1.7 billion identified by the Pennsylvania Transportation Funding and Reform Commission in 2006 as necessary to maintain the state's current transportation infrastructure.

With the FHWA rejection of I-80 tolls, Commonwealth lawmakers are now likely to revisit Governor Ed Rendell's proposal to lease the Turnpike to Spanish toll road operator Abertis and the U.S.-based Citi Infrastructure Investors in a $12.8 billion, 75-year concession. The investor-operator team was selected by Rendell in May 2008 and, if approved by the legislature, would be the largest toll road concession in U.S. history, dwarfing the $3.8 billion lease of the Indiana Toll Road in 2006. According to figures released by the Harrisburg-based Commonwealth Foundation in August, the $12.8 billion Turnpike lease payment would yield $50.1 billion for the state over the next fifty years, compared to $22.5 billion for Act 44 without I-80 tolling (or $450 million annually).

For a Turnpike lease to move forward, the General Assembly would need to take action shortly after reconvening in September, as Abertis/Citi have stated that their offer will expire later this fall.

Colorado Offers Innovation Incentives

In April, Colorado Governor Bill Ritter signed into law a bill (HB1363) that provides financial incentives for private prisons to develop innovative security programs and provide education. While no specific incentives are outlined in the

legislation, the new flexibility will allow the General Assembly to consider setting new rates for prisoners in private facilities. Previously there was no flexibility in negotiating adjustments to existing contracts, so there was no incentive for private firms to outperform their agreements.

Given the state's rising prison population, Colorado is increasingly turning to private prisons to provide beds for its inmates. Roughly 22 percent of the state's prisoners are held in private facilities and that number could rise to 40 percent in the next few years, according to state Department of Corrections Executive Director Ari Zavaras.

Atlanta to Privatize Parking Ticket and Meter Collections

In April 2008, the city of Atlanta accepted bids from companies interested in running the city's parking ticket and meter collection operation, an activity now performed by the city's Public Works Department. The privatization initiative comes as Mayor Shirley Franklin's administration struggles with the challenge of closing a projected $140 million budget gap in the FY 2008-09 fiscal year. City officials estimate that Atlanta is currently spending $1.3 million annually on parking enforcement annually (including the costs for the system's 26 employees), while it collects roughly $3 million from parking fines and meter fares. Officials are also open to exploring ideas from the winning bidder on how to expand the parking program. At press time, no details were available on the contract structure. Any contract would require City Council approval before proceeding to implementation.

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Utah Strengthens State Privatization Board

By Leonard Gilroy

Nearly two decades ago, the Utah State Legislature established the Privatization Policy Board (PPB). Its mission is to evaluate and make recommendations to state agencies concerning effective privatization of government services and to address concerns regarding unfair government competition with the private sector.

But with its membership heavily tilted towards public sector representation, the lack of clearly defined duties in its statutory mandate, and no dedicated staff, the PPB's efforts thus far have been piecemeal at best. Only two successful privatization initiatives have been completed to date: contracting with Staples for procurement of the state's office supplies and contracting with Xerox to provide state printing services.

In the 2008 legislative session, two privatization champions in the Utah legislature—Senator Howard Stephenson and Representative Craig Frank—sponsored bills designed to give the Privatization Policy Board powerful new tools to advance privatization, and in the process elevate Utah to the upper echelon of state privatization leaders. Rep. Frank's House Bill 75 expands the membership of the PPB to include more private sector members and requires:

- The PPB to develop a biannual inventory of "inherently governmental" and "commercial" activities and services performed by state agencies;
- The PPB to develop an accounting method to facilitate accurate cost comparisons between public sector and private sector service providers;
- The PPB to investigate citizen complaints of unfair government competition with a private enterprise; and
- The governor's office to examine at least three potential services or activities for potential privatization every two fiscal years.

Senate Bill 45, sponsored by Sen. Stephenson, goes even further by requiring Utah cities and counties of the first and second class—which includes the majority of Utah's local governments—to submit biannual government activity inventories to the PPB, similar to those that will be prepared at the state level.

In all, the revamped PPB will offer Utah taxpayers and policymakers new tools to understand what their governments are doing, and the government activity inventories will help allow agencies to concentrate on their core functions of providing "inherently governmental" services while partnering with the private sector for "commercial" activities. Applying competition to non-core activities could free up valuable resources for agencies to complete their missions and provide the greatest value to taxpayers.

Getting Government Out of the Business of Business: Legislators bring the 'Yellow Pages Test' to Utah government

Interview with Utah State Senator Howard Stephenson & Utah State Representative Craig Frank

Reason's Director of Government Reform Leonard Gilroy sat down with Sen. Stephenson and Rep. Frank on May 12, 2008—the same day that Utah Governor Jon Huntsman, Jr. signed House Bill 75 and Senate Bill 45 into law (see "Utah Strengthens State Privatization Board," previous page)—to discuss the revamping of the state's Privatization Policy Board (PPB) and what they envision moving forward with implementation.

Gilroy: Today, Governor Huntsman signed into law two privatization bills you sponsored. Can you explain the genesis and evolution of these bills?

Stephenson: The Utah Taxpayers Association has for the last eight or 10 years been pursuing privatization legislation in the Utah legislature with very little success. [...] It's just been baffling that a state that's the reddest of the red states would have such difficulty in understanding that free markets are the best way to provide services. Somehow we like the idea that free markets bring us the highest quality of food anywhere in the world at low prices, that we get quality cars and appliances, you name it...the free market works just great. But when it comes to the education of our children, socialism is good enough. When it comes to golf courses, socialism is preferable. When it comes to fitness centers, socialism is great.

So we've been struggling with that and trying to focus legislators' minds on the value of having free markets determine what people want and how they're willing to pay for those things. And this year we finally had a task force created—the Government Competition and Privatization Subcommittee, which is actually a subcommittee of two legislative committees—that was charged with studying how to get to privatization in Utah. And Rep. Frank and I co-chaired that committee. We came up with legislation that was the two bills you just mentioned. We didn't get the bills passed in their original form, we had to make some compromises, but we're really pleased with the outcome.

Frank: Government by its very nature is inefficient in its approach to providing services, and you can flip through the

Yellow Pages and find companies that are providing exactly the same service or good that the government is providing. And so there was a feeling that we should be spinning off or divesting ourselves of these activities that are better performed and provided by the private sector.

Today, you have government competing with business, and putting business out of business. It's my belief that government shouldn't be in the business of business. For example, you've got some of our local governments that are providing rec centers, pools, and other facilities that are going head-to-head with local, private gyms, and we've got examples of where a couple of those were put out of business in our state because government was competing with them at that level.

And we also have a couple of excellent examples of the benefits of competition. Such as when Xerox came in with an RFP after it was found that they could provide state copying services. According to our Chief Procurement Officer, we're saving nearly a half million dollars a year by privatizing state printing operations. We're also saving nearly a half-million dollars a year with Staples providing inventory for our state offices. Instead of having closets full of paper clips, Post-It notes, pencils, and paper—they'll deliver that. So we cut down the cost of carrying inventory also, which is a big deal for a small state like ours running on a shoestring, basically.

These are two great examples of things that have happened over a 20-year period as a result of the PPB's work, but if you look at that as a reasonable businessman you recognize that two activities over a 20-year period probably could be stepped

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Chicago Raises the Bar on Asset Privatization

By Leonard Gilroy

Chicago Mayor Richard Daley continues to raise the bar on municipal privatization. After the blockbuster $1.8 billion lease of the Chicago Skyway in 2005 and the $563 million lease of four underground parking garages downtown—in addition to the dozens of other city services and functions privatized over his 19-year term—Daley is now moving to privatize several additional big-ticket city assets.

While Daley's push to privatize Midway Airport has certainly generated the most attention, Chicago has several other precedent-setting privatization initiatives in the works. First, in February 2008 the city and the Chicago Park District jointly solicited qualifications from private bidders interested in a long-term lease of the city's parking meter system—one of the largest in the United States with 35,000 parking meters generating roughly $20 million per year. Chicago's would be the first major public parking meter operation in the nation to be privatized under a long-term concession.

The concession agreement for the parking meter system is anticipated to be 50 years in length and will grant the operator the right to maintain and operate the meters in exchange for an upfront payment to the city. The city will retain parking enforcement authority and the right to set parking fees. Industry observers expect the bid process to be similar to those for the Skyway, the parking garages and Midway Airport.

Chicago officials will need to resolve several legal issues related to the project, including: the city's obligation not to create competing parking spaces; city maintenance of existing roads and access routes; the city's and Park District's liability for failure to enforce tolls or to increase rates; how to address major project risks (i.e., would revenues be affected if the City pursues congestion pricing in the future?); and how to address changes in parking meter technology.

In early 2008, spiraling costs forced Chicago to cancel an ambitious plan to build a transit station in downtown's "Block 37" and develop express train service from the new station to both O'Hare and Midway airports. The Chicago Transit Authority (CTA) had already spent $250 million on the project, but rapid construction cost inflation, poor site conditions, and larger-than-expected utility relocations left CTA with little to show for their efforts—just an almost-completed shell of a station.

To rescue the project, CTA President Ron Huberman recently announced plans to partner with a private sector team to complete the build-out of the transit station and develop and operate the airport express train service. The city of Chicago is working with the CTA to develop a request for proposals for the project. Meanwhile, the CTA will spend an additional $45.6 million to complete the shell of the station and construct the underground lines to connect with existing rail lines. Work on both is expected to be completed by 2009.

According to Huberman, "[t]he CTA is committed to developing a premier service that will enhance Chicago's standing as a world-class city. Tapping into private sector expertise at this stage allows us to leverage our existing investment in this project, creates an opportunity for outside investment, and can bring in partners who have experience building and managing premium services."

Seven firms have expressed interest in pursuing long-term leases of the city's three material recycling and recovery facilities, which are currently operated under a five-year, $78.8 million contract held by Allied Waste Transportation. Mayor Daley has indicated that upfront proceeds from the lease could be used to finance a costly expansion of the city's curbside recycling program. The current contract with Allied Waste Transportation was signed in July 2006 and included a provision that it could be canceled with 60 days notice if the lease plan moves to completion.

Georgia Contract Cities Movement Continues to Advance

By Leonard Gilroy and Anthony Randazzo

In December 2005, Sandy Springs became Georgia's first new contract city, launching a wave of city incorporation in suburban Atlanta involving largely privatized local government. The city of nearly 90,000 was originally created with just four government employees (before starting their own police and fire departments, as required under Georgia's constitution). All other non-public-safety-related functions—such as public works, planning and zoning, and parks and recreation—were contracted out to one vendor providing comprehensive city services. Sandy Springs maintains ownership of city assets, controls its budget, and sets service performance standards, while the contractor is responsible for all operations, services, and staffing.

In its third year of cityhood, Sandy Springs' officials reported a budget surplus of over $9 million. Mayor Eva Galambos and some on the city council suggested cutting property tax rates to offer some relief to homeowners hit by rising assessment values and using the surplus to cover the reduced tax revenues. However, a majority of the city council agreed that the surplus should be targeted towards a backlog of city improvements, such as road resurfacing projects, new sidewalks and parks, or a permanent police headquarters.

Following in the footsteps of Sandy Springs, two new cities—Johns Creek and Milton—were formed on December 1, 2006 using similar contract models (and the same contractor) as Sandy Springs. In December 2007, the small community of Chattahoochee Hill Country became the fourth new contract city in Georgia. All four contract cities were formally unincorporated communities within Fulton County, and each required specific state legislation authorizing a public vote on incorporation. With the incorporation of the four new cities, the population of unincorporated Fulton County now stands at just 40,000 people, less than half the population of Sandy Springs itself.

In March 2008, Georgia Governor Sonny Perdue signed Senate Bill 82, allowing residents of the north DeKalb County community of Dunwoody—Sandy Springs' neighbor to the east—to decide if they wanted to incorporate. Dunwoody residents went to the polls July 15th, and voted overwhelmingly—84 percent saying "yes"—for incorporation, becoming DeKalb County's first new city since 1937. The city of approximately 37,000 will hold its first elections September 16 and begin officially operating December 1, 2008.

A group of task forces has already been tasked with recommending how the new municipal government should operate its police, zoning, planning, ordinances, parks and recreation, and other aspects of cityhood. The task forces will provide a series of options this fall, which will then be debated by candidates for city council and mayor.

One additional community in Fulton County—South Fulton—received legislative approval in 2007 for an incorporation vote, but was defeated at the polls by an overwhelming 85-15 percent margin. The proposed city would have encompassed all of the remaining unincorporated land in Fulton County and made it one of the few counties in the country entirely composed of municipalities.

Additionally, some state legislators and many residents of the new privately run cities have called for splitting off a new county, Milton, from Fulton County. The original Milton County merged with Fulton County in 1932, and the new county would include the cities of Sandy Springs, Milton, Johns Creek, Alpharetta, Roswell, and Mountain Park.

"Fulton County is too big to be responsive," Sandy Springs City Councilman Rusty Paul told the *Atlanta Journal-Constitution* in March. "You need a county big enough to get significant projects done, but still small enough to deliver personal services." However, legal issues loom large for the Milton County proposal. The Georgia state constitution caps the number of counties at 159, so a constitutional amendment would be required to move the idea forward.

Florida's Council on Efficient Government Reviews Controversial Outsourcing Initiatives

By Leonard Gilroy and Anthony Randazzo

In February 2007, Florida Governor Charlie Crist charged the state Council on Efficient Government (CEG) with the task of reviewing three large, controversial state outsourcing projects: MyFlorida-MarketPlace (MFMP), People First, and Project Aspire. The CEG released their findings in January 2008.

Starting in early 2000, the state began an effort to upgrade and modernize its core operational software and IT infrastructure, specifically its accounting, cash management, procurement and human resources functions. At that point, these systems ran on five separate tools. By late 2000, several initiatives began to address portions of the upgrade plan, though CEG notes that they were implemented separately without a cohesive integration plan for how each system would interact with one another. The end result was three separate projects: MyFloridaMarketPlace for procurement functions, People First for human resource functions, and Project Aspire for accounting and financials. All three programs required significant modifications with a number of custom enhancements and all have had significant development, implementation, and performance-related issues.

CEG Findings on MyFloridaMarketPlace

The state signed the $108 million MFMP contract with Accenture in October 2002, and extended three additional years to a total of $114 million. MFMP created an Internet-based system that allows buyers access to electronic purchase orders, invoicing of goods and services, electronic vendor registration, e-quotes and electronic bidding/sourcing. This significantly cut paperwork and expedited transaction times. Vendors can receive information on upcoming bids from all participating agencies and electronically receive purchase orders. MFMP also serves as a performance reporting tool for state buyers on vendor performance in providing products and services.

The state Department of Management Services (DMS) combined the use of strategic sourcing's best practices with

MFMP to develop solicitations maximizing value for the state. To date, the DMS reports $71 million in savings through six state term contracts.

Overall, the system "improved accountability for the expenditure of state funds and provided better insight into its purchasing patterns." Vendors began registering online in April 2003, and the first state buyers began using the system in July 2003. Today, 29 state agencies, over 13,000 state users and 90,000 vendors use MFMP. An August 2007 customer survey found that vendor and agency satisfaction with the system was 91 percent. The program is self-funded and supported by a 1 percent transaction fee and did not displace any full time equivalent government staff positions.

CEG Findings on People First

The purpose of People First was to outsource human resource, payroll administration, staffing, and benefits functions, while streamlining and automating the state's human resource functions by consolidating the seven different IT systems into one. The state saved $80 million from the cost avoidance of rebuilding its own systems, reduced HR-related workforce by 70 percent, and gained other efficiencies through the elimination of duplicative services between agencies.

In 2002, DMS entered into a seven-year contract (2002-2009) with Convergys Customer Management Group, Inc. valued at $278.6 million. The contract term was subsequently amended to extend through 2011, increasing the total contract value to $350 million. Since 2005, the People First project

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Time for a New Lease on Government Facilities in Georgia

Commentary By Steve Stancil

Since its creation in 2003, the Commission for a New Georgia has brought fresh eyes and ideas to ways government can manage assets and operations to increase efficiency, reduce and avoid costs and improve service. Its recommendations have saved millions of dollars on a wide range of government functions, including facility, real estate and construction management.

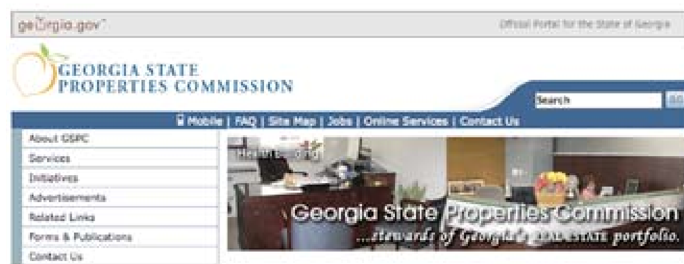
The Commission, an independent council of top-level executives from all parts of Georgia, which acts as a "real-world consultant" to state government on management and performance, launched 22 fast-track task forces. The implemented recommendations started with the establishment of a State Property Officer to manage the state's real estate assets and to coordinate and identify efficiencies within the operations of the Georgia State Financing and Investment Commission, the Georgia Building Authority and State Properties Commission.

A *State Construction Manual* was developed and implemented to ensure $1 billion in construction projects remain on time, on budget and within quality standards. The first comprehensive inventory of all buildings, land and leases is completed; divestiture of surplus properties has generated $36 million in proceeds and the consolidation and renegotiation of leases have reduced future state expenditures by an estimated $10 million.

Currently, all leases are for a single year. But the State Properties Commission is positioned to take the next step in lease renegotiations and, following a market-oriented approach to real estate transactions, enter into long-term lease agreements for select properties.

State Properties Commission inventories include approximately 1,850 leases totaling $254 million annually. Ten percent of these leases, or 170, account for 65 percent of the rent monies expended annually ($155,677,196 in fiscal 2007) and 82 percent of the space (11.5 million square feet). These large leases are where the greatest cost reduction will be found.

A shift to multi-year fixed term leases to leverage the state's real estate spending is good public policy for several reasons. A multi-year term gives the landlord an incentive to provide cost-effective lease rates and favorable terms by amortizing initial build-out costs over a longer period of time. These



leases are the industry standard in the commercial real estate market; if state government can enter into similar agreements, cost comparisons will be more transparent with other market transactions, allowing the State Properties Commission to competitively negotiate leases on the taxpayer's behalf.

In a 19-state survey for the State Properties Commission on best leasing practices by state government, 18 states have addressed the legitimate need to balance annual appropriation requirements with more economically favorable multi-year contractual agreements. But Georgia still takes a literal interpretation of its "full faith and credit" clause and adheres to a firm policy of one-year leases.

Best practices among the states indicate that multi-year leases are the new standard. State leases should not be handled as short-term space solutions because they are not. State agencies are looking for long-term occupancy, which benefits the stability of the agency and the community it serves. Long-term occupancy, with the leverage to enter into long-term leases, benefits the financial well-being of the state—therefore, the taxpayers—and is aligned with the state's mission to become the "best managed state in the nation."

The Commission for a New Georgia recommends leasing, wherever possible, instead of construction and ownership of non-special purpose facilities (specifically, administrative or office space). This sound guiding principle is greatly strengthened when long-term leases allow more competitive lease arrangements.

Deploying, managing and maintaining the state's $240 million leased portfolio is costly and time-consuming. As the transformation to a portfolio management culture matures, long-term leases instead of annual leases will improve flexibility, reduce rental rates, favor tenant improvements and provide real transparency and accountability for the service delivery process.

Steve Stancil, Georgia's State Property Officer, leads the Georgia Building Authority and State Properties Commission. This article was originally published by the Georgia Public Policy Foundation (www.gppf.org).

Florida Leading the Nation in Outsourcing

By Adrian T. Moore, Ph.D.

The Florida Council on Efficient Government's (CEG) 2007 annual report found a significant increase in state outsourcing projects since 2001. Prior to 2001, a total of 16 outsourced projects were reported by state agencies, but from 2001 to 2005, the state initiated an average of 25 projects annually. In all, the report identified 289 projects currently being outsourced, with a lifetime value of over $5.5 billion.

Today, five agencies—Department of Juvenile Justice, Department of Children and Families, Department of Corrections, Agency for Persons with Disabilities, and the Department of Management Services—account for 79 percent of the outsourced projects. Twelve agencies (36 percent) reported no outsourced projects. CEG also found that at least 40 percent of the outsourced projects identified by agencies provided services not previously untertaken by state employees.

While the increased outsourcing has been positive news for privatization advocates, the manner of the project pace was questioned by the CEG report. Agencies reported that they failed to do complete cost-benefit analyses for 92 percent of the outsourced projects. Further, 21 percent of agency-outsourced projects either do not have performance metrics or information on performance metrics in the current contract.

Florida State Outsourcing Projects by Year, 1995-2007

Year	Number of Projects Outsourced
1995	2
1996	0
1997	3
1998	6
1999	3
2000	2
2001	16
2002	15
2003	34
2004	32
2005	31
2006	85
2007	46
Total	275

Note: Outsourced projects are arranged by contract start date. Fourteen outsourced projects did not identify a start date. Source: State of Florida, Council on Efficient Government, 2007 Annual Report.

Competitive Bidding for Pharmacy Services in St. Louis County, MO

By David Stokes, Show-Me Institute

In 2003, the Saint Louis County (MO) Department of Health was having serious financial problems. The health department operated three clinics with a shared pharmacy which maintained standard government hours and provided prescription drugs to increasingly large numbers of Saint Louis County residents. In 2002, the county pharmacy filled 295,000 prescriptions at the three clinics, compared to 178,250 in 1997, an increase in demand that quickly stretched thin the department's budget and resources.

If financial stability was to return to the department, the cost increases had to be brought under control. In a bold move, the Saint Louis County Executive's office decided in the spring of 2003 to ask private companies to bid on providing pharmacy services to Saint Louis County citizens using the county's three health clinics. The results of this competitive bidding process and subsequent privatization effort have lowered costs for taxpayers and improved health care services for patients.

In February 2003, in an effort to control spiraling costs, Saint Louis County negotiated a contract with a local pharmacy company, RPh on the Go USA, Inc., to manage the county pharmacy at John C. Murphy Health Center. The contract was done on an emergency basis for a period of two months while Saint Louis County requested bids on providing pharmacy services to the three clinics. It received two proposals back. Walgreens, the nationwide pharmacy giant and LDI, a local pharmacy benefits firm that contracts with a network of independent pharmacies, both bid for the clinic pharmacy work. Saint Louis County selected Walgreens' bid of $5,923,000 per year to provide pharmacy services to residents needing assistance from the Department of Health clinics.

The results have been significant. Before the pharmacy service was contracted out in mid-2003, the pharmacy budget had increased 180 percent between 1997 and 2002. After the pharmacy service was contracted out, first to Walgreens and later to LDI, the pharmacy budget declined 16 percent from 2002 to 2007. Over the past 12 years, the overall pharmacy budget has increased 136 percent, with the bulk of that increase coming in 1999 and 2000. During that same period of time, the overall health department budget increased 55 percent. Clearly, the rampant spending growth in the pharmacy division before 2003 was having a significant effect on the budget throughout the health department, taking up resources that could have gone to many other worthwhile programs.

How have the private companies fared in meeting the needs of Saint Louis County residents after taking over pharmacy operations? When the initial contract was up for renewal in August 2004, the County Council held hearings to determine the effectiveness of the program before approving its renewal. Along with the fact that the program had saved money for Saint Louis County taxpayers, then-County Health Department Director Dr. Jacquelynn Meeks stated in the hearing, "Overall services have dramatically improved. Walgreens and Interlock are good partners and have provided good service and good value for the County." Dr. Meeks later said that there had been "[v]ery few complaints since Walgreens had been contracted with for pharmaceutical services." Mr. Mike Agostino of Walgreens also spoke at the hearing, stating that the key to the cost savings was "the focus on providing generic drugs." He added,

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"The clinics are better served with prescriptions than in the past," and "the prescriptions are better controlled and there is less waste."

Walgreens did not just provide the same services to Saint Louis County residents for less money. After contracting out the pharmacy, county residents had access to the numerous and convenient Walgreens locations instead of just one county-operated pharmacy. Most of those locations are open 24 hours—the old county pharmacy was not. Walgreens also instituted a 1-800 phone number for the clinics and patients and provided Saint Louis County with the ability to fill prescriptions in 13 languages. Those increased services and options are a major reason why the Saint Louis County Department of Health told the author that they have "no plans to change the program at this time." The Department has recognized and encouraged changes that are working for the people of Saint Louis County.

Walgreens maintained the contract with Saint Louis County until 2006. In early 2006, the contract was rebid and LDI won, with a low bid of $4,250,000. This bid was significantly lower than both Walgreens' 2003 bid of $5,923,000 and Walgreens' revised 2004 bid of $5,423,000.

Under LDI, savings have continued and so has good service. LDI uses a modern system of phone, mail and online ordering of prescription drugs for users of the county clinics. It has a network of pharmacies involved in the county program tserve the needs of county residents who want to fill their prescriptions in person. Walgreens also accepts the LDI prescription card, so now patients of the county health clinics have more options than ever in filling their prescriptions. Saint Louis County renewed the contract with LDI for 2007 and the ordinance authorizes further renewals for two more years, after which another bid process will be required.

In bipartisan fashion, county government brought significant cost savings, more options and better services for patients who use its pharmacy system. These improvements to citizen service and health care are the direct results of competitive bidding and privatization.

David Stokes is a policy analyst at the Saint Louis-based Show-Me Institute. Stokes's August 2007 Show-Me Institute study, Saint Louis County, Drugs and Competitive Bidding: A Privatization Success Story, *is available online at www.showmeinstitute.org/publication/id.74/pub_detail.asp*

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BRIEFS

West Virginia Privatizes Workers' Comp Insurance Program

The privatization of West Virginia's state-run workers' compensation insurance program was completed in July 2008. A 2005 bill signed by Governor Joseph Manchin transformed the state's Workers' Compensation Commission into a private insurance carrier, BrickStreet Insurance. Brickstreet was given a two-year virtual monopoly on workers' compensation insurance in West Virginia, which ended on July 1st when the market was opened to other competitors. West Virginia now joins most other states in allowing private insurers to offer workers' compensation insurance. Today, only Puerto Rico and four other states continue to operate state insurance monopolies. Brickstreet is currently exploring plans to expand its operation into other states.

State Insurance Commissioner Jane Cline told the *Charleston Daily Mail* in August that workers' compensation insurance rates have fallen an average of 30.3 percent since the privatization began, resulting in annual employer savings of more than $150 million. According to Cline, "[t]hat's $150 million that companies have to invest in improvements for employees or for infrastructure, for other capital improvements." Cline added that 75 companies have already written workers' compensation insurance in West Virginia since the introduction of market competition on July 1st.

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team has deployed 330 system modules and releases. Today, over 50 state agencies and entities, 132,120 active employees, 48,261 benefits-only employees and 47,809 retired employees use People First in some way.

DMS recently conducted the first survey of the People First system and found that 59 percent of the employees surveyed said that People First met or exceeded expectations. Overall, the service center received the best reviews with 70 percent of the respondents saying they were satisfied or extremely satisfied, and 82 percent saying staff were friendly.

One of the biggest challenges with People First is lack of standardization of business practices across agencies, requiring "excessive" customization to the off-the-shelf software (over 200 customized interfaces). Implementing a standardized, statewide business process "would alleviate some of the trouble of software customization and additional workload issues associated with the divergent business processes."

CEG Findings on Project Aspire

Project Aspire was intended to replace Florida's quarter-century-old legacy accounting and cash management systems with a streamlined accounting system capable of serving 36 state agencies with different core missions. After dealing with a lengthy bid protest, the state Department of Financial Services (DFS) chose to award a fixed-price, $68 million contract to Bearing Point for six years from August 2003 through October 2009. The project was a massive, complex undertaking, requiring an evaluation of existing processes, policies, procedures, shadow systems, state and federal compliance, workforce transformation, technical requirements, cash management, investment opportunities and an assortment of additional areas.

In May 2007, the state's chief financial officer suspended work on Project Aspire in its testing phase. It was unfinished, over budget, and past its originally scheduled completion date. At the time of suspension, the vendor had already left the project, the application was still not fully developed, and $89 million out of the $100 million budgeted had already been dispersed to various vendors ($59.4 million of which was paid to Bearing Point). At the time of the project suspension the proposed system had not been implemented at any agency. After the project was halted, staff documented and preserved existing work products that had been developed. The state will retain ownership of the hardware and PeopleSoft software for possible resumption at a later date.

A major challenge has been the lack of standardization of business rules among state agencies and the resistance to change to a uniform process. The state did not incorporate third party advice to change existing internal business processes and not over-customize the best of breed software selected—there were 250 customizations on Project Aspire alone. Bearing Point reports that the changes requested by the state were significant in number, which consistently delayed the project. As a result, vendor project teams collaboratively reassessed the project and developed a more conservative strategy for project implementation that increased costs. The revised strategy "cost a significantly larger amount of money and elongated the schedule."

Key Lessons Identified

Looking at the experience with all three outsourcing projects, the CEG identified several lessons learned to guide future outsourcing and major internal reorganizations:

- Successful solutions require the designation of an *executive sponsor* with enforcement and conformance authority. A strong sponsor advocates for the project over its life cycle and builds stakeholder buy-in during conceptualization.
- Projects should not be rushed to the implementation phase before important *planning* is completed.
- The state can reduce risk and enhance manageability by discouraging large-scale projects and *encouraging incremental, phased-in approaches.*
- A reliable *multiyear funding model* must be created to enable proper execution of the project life cycle and reduce risks to the state associated with unforeseen changes to the funding model.
- *Engage stakeholders* early in the planning process and obtain their input prior to project implementation.
- Government must have the ability to *restructure business processes* to incorporate efficiencies that new technology offers and avoid encumbering the new system with legacy processes. The three projects each ran counter to industry best practices by over-customizing vendor systems, increasing costs and rendering the new systems sub-optimal.
- *Continuity of management* on projects to maintain vision and mission success is essential. Numerous leadership changes in the projects reviewed led to lost momentum.

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up considerably. It probably isn't as aggressive as we should be approaching this issue of privatization. We need to have the Board provide two or three solid privatization recommendations to the governor every year or two and then have him seriously consider them and have him work them into his budget recommendations. This is what HB 75 does.

Gilroy: What did you aim to tackle in the two bills?

Frank: We really wanted to create a more functional, equitable PPB. Not only that, we wanted the newly overhauled board to feel as though they had some bona fide authority, to make significant recommendations to the governor. We wanted the board to be balanced and functional.

After carefully reviewing the existing statute, we came to the realization that this current PPB doesn't possess some of the significant tools necessary to craft considerable policy to make a difference in helping divest the state of some of the non-essential services it is currently providing. We gave it some powerful new tools, such as a comprehensive inventory of "essential" and "non-essential" government services and a set of generally accepted accounting principles that will help facilitate accurate, apples-to-apples government and private sector activity cost comparisons.

Stephenson: The two bills have two approaches. SB 45 is a focus on local government, and HB 75 is a focus on the state and the PPB, giving a greater balance to the weight of the private sector as opposed to government representation. Until now, the Board has been highly weighted in the favor of bureaucrats and unions. So we were able to change that and get the balance back with the private vs. the public sector. It still is a balanced committee though, so hopefully that will bring about a good result.

Gilroy: Is it the balance of the Privatization Policy Board that's been the major obstacle to accomplishing more privatization? Is that why we've only seen two large state privatization initiatives coming out of the Board over its first two decades?

Frank: The composition of the PPB has been a major factor in pushing forward—or, in this case, not pushing forward—worthwhile measures. Bureaucrats don't typically look for ways to get themselves replaced. In my experience, inefficiency in government equals job security. Where the PPB was previously skewed toward the bureaucracy 67 percent, with the passage of HB 75, we have nearly a 50/50 split.

Gilroy: HB 75 goes beyond just the composition of the Privatization Policy Board and the requirement for regular activity inventories. Can you describe some of the other elements of the new law?

Frank: For starters, HB 75 requires the PPB to develop balanced, equitable accounting methods. Because government traditionally provides competitive services on the taxpayer's dime, it will be necessary to evaluate government-provided activities competing with the private sector on a more equitable basis to ensure that we're accurately capturing costs. Government regularly subsidizes facilities, employees, and cross-departmental resources when competing with private sector businesses. The line-item accounting principles established in HB 75 will help to level the playing field—no more playing favorites. We'll be able to do apples-to-apples cost comparisons.

There's also the governor's biannual review. Using the basic premise that government shouldn't be in the business of business, the PPB will make at least three recommendations every two years to the governor for potential program divestiture.

And because Utah has a part-time legislature, it was necessary—if we were to make this inventory truly workable—to give the PPB additional full-time staff resources. So, a high-level analyst was budgeted for the PPB, as well as [one for] the Governor's Office of Planning and Budget. These two analysts will assure an accurate, detailed inventory and accounting system as defined in the new statute. Once the "bones" of the system have been established, the analysts will maintain and strengthen the newly constructed system.

Gilroy: What do you see as the value of the inventory, of categorizing all of government's activities and services as

being either "inherently governmental" or "commercial in nature"?

Frank: The value? Getting government out of the business of business. Government repeatedly breaches its constitutional mandate to stay out of the private sector. Perhaps government is just unaware as to how to go about backing itself out of some of the activities it's gotten itself into over the years. These bills (HB 75 & SB 45) ask state and local governments to step back and ask themselves a very simple question: "*Can the good or service we are providing be better or more efficiently provided by someone we can find in the Yellow Pages?*"

With this periodic query and heightened awareness (and a little fiscal constraint), governments will find themselves focusing on their "core" activities and responsibilities. Before deciding to provide or expand a service better suited to the private sector, government should be routinely asking itself: "*What is the proper role of government in regard to this activity?*"

By creating a line-by-line, department-by-department, division-by-division inventory of activities, we are asking state divisions and departments to actually look at non-essential services. Some of them have found that there are non-essential services, and they have taken steps within their own departments to outsource or privatize them. We've seen some success there even without HB 75. But what HB 75 does allow for is a mandate, for department heads to actually look at their day-by-day, budget line-by-budget line activities and determine whether or not those are core governmental or a proper role of government.

Gilroy: What were some of the challenges you faced advancing the bills to passage? What lessons learned would you pass along to legislators in other states who may be interested in replicating the Utah model?

Frank: Addressing the concerns of a number of division and department directors helped to smooth out the process. Many of the state's departments felt their statutory missions would be compromised by HB 75. Department directors, upon careful review of the bill, saw the wisdom in periodic review of their activities. HB 75 did nothing more or less than provide them with additional tools to create greater efficiencies under their watch.

Reason Foundation's several testimonies in front of standing committees were critical to the successful passage of this bill. Statistics introduced regarding many of the concepts included in this bill were indispensable for many legislators to feel comfortable with moving forward.

Bipartisan support was secured early on in the process. Several members of the minority saw the value of this bill and became advocates for the passage of HB 75. How can you argue for inefficiency?!

Gilroy: Looking into future, what do you expect to see from the revamped Privatization Policy Board?

Stephenson: I think that legislators, having seen these inventories, may want to give greater teeth to the law to have the PPB actually set in motion processes for converting to privatization. I think it's the transparency that will drive improvement. If things are hidden in a black box, people are not likely to even think of privatizing a service. But when it's in the light of day, I think that public officials will start to think twice about moving toward government ownership of new services and will also have an opportunity to consider cost-cutting measures for existing services.

Frank: The vision here is this: let's let government do what it does best, and let the private sector do the rest. It all comes down to less taxes; less burden on our individuals and families; less government intrusion into our lives. Every time we say "less," we increase freedom. If we don't do these things, we do just the opposite—take away someone's freedom. Because I'm part of the process, I know that for a fact. So let's create more freedom for individuals, families, and business owners and let's create smaller, more efficient government.

The Honorable Howard A. Stephenson (R) represents District 11 in the Utah State Senate and has served in the Utah legislature since 1993. The Honorable Craig A. Frank (R) represents District 57 in the Utah House of Representatives and has served in the legislature since 2003. The full text of this interview is available in Reason Foundation's Innovators in Action 2008, available online at reason.org/innovators2008.pdf.

Who, What, Where

Reason Studies

Innovators in Action 2008, September 2008, Edited by Leonard Gilroy, reason.org/innovators2008

Annual Privatization Report 2008, August 2008, Edited by Leonard Gilroy, reason.org/apr2008

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Privatizing University Housing, January 2007, Policy Study 356, By Leonard C. Gilroy, Laura J. Davis, Sarah F. Anzia and Geoffrey F. Segal

Upcoming Conferences

Infocast North American Port & Intermodal Finance & Investment Summit, October 20-22, 2008, St. Regis Hotel, Houston, TX

National Council for Public-Private Partnerships, 2008 Annual Meeting & Awards Banquet, November 13-14, 2008, The Westin Indianapolis, Indianapolis, Indiana

Reason Foundation, Reason Goes Hollywood, November 14-15, 2008, Hollywood Roosevelt Hotel, Hollywood, California

American Legislative Exchange Council, States & Nation Policy Summit, December 4-6, 2008, Marriott Wardman Park Hotel, Washington, DC

International Bridge, Tunnel and Turnpike Association, Transportation Finance Summit, December 7-9, 2008, Fairmont Hotel, Washington, DC

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