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Technical Bulletins: Should Your City Consider Privatization? (2011)

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SHOULD YOUR CITY CONSIDER PRIVATIZATION?

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INTRODUCTION

Many cities have come to see privatization as a means of saving money and improving the quality of the services they provide to the public. As municipal costs continue to escalate, with the attendant pressure on the budget, the trend toward privatization – or "outsourcing" as it has recently become known – is likely to continue. Examples from West Tennessee include:

- The governing board of a county-city library has recently contracted with a private-sector firm to provide the management for its library operations in an effort to cope with mounting budgetary constraints.
- Following a long-standing personnel problem and financial difficulties, a municipality recently advertised for proposals to operate its water and sewer utilities. Following an analysis of the bids it received, the city decided against outsourcing these operations.
- A suburban community, having no civic center of its own, has made contributions to the local YMCA, thus providing recreational opportunities to local citizens via the private sector. The program is substantially cheaper than the cost of building, staffing, and maintaining city-owned facilities for the same purpose.

Privatization can be defined simply as an effort to introduce market economics into the provision of programs and services that have traditionally been supplied solely by the government. More than merely hiring a private sector contractor to perform an occasional service (periodic street repairs, for example), we refer to privatization as the long-term provision of ongoing, everyday municipal services (for instance, the delivery of water and sewer services).

By outsourcing part or all of any given public service, the local government hopes to harness the price-regulating forces of the free market, namely:

- **Competition.** Contracts that are offered by municipalities to private firms and individuals can be put up for bid with the job awarded to the lowest (and best qualified) bidder. Such competition among service providers serves to lower costs.
- **Economies of Scale.** Particularly for smaller cities, contracting out for the provision of local services enables cities to take advantage of the contractor's leverage in a larger marketplace. Supplies and materials can often be purchased less expensively by contractors who are better able to obtain volume discounts, and the cost of labor can be "shared" with the contractor's other customers.
- **Specialization.** The nature of municipal programs often requires city employees to perform a wide variety of functions that are not directly related to their primary function (for example, water treatment plant employees who must also cut the grass at the facility). It is wasteful for such employees to be used in this manner. Certain duties can sometimes be performed less expensively by a private contractor whose business is narrowly specialized.

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Privatization is not the answer to every municipality's budget problems. Some public programs more easily lend themselves to contracting out than others. But cities would do well to periodically review the programs and services they provide, including internal programs in which the city itself is the sole beneficiary, and to consider the potential for cost savings that might result from privatization.

SOME OF YOUR CITY'S OPERATIONS ARE (PROBABLY) ALREADY PRIVATIZED

Outsourcing government services is not a new development. Most cities already contract with private sector firms for a wide variety of such services. They include:

- **Privatized Street Repairs.** On an occasional, short-term basis, many cities have traditionally contracted with private-sector contractors to rebuild or re-pave streets. Traditionally, cities seek bids for such work and award a contract to the lowest bidder.
- **Privatized Solid Waste Collection and Disposal.** According to one source, about half the cities in America do not own garbage trucks or employ sanitation workers. Instead, they have privatized solid waste collection by contracting with private sector companies for this service. And even fewer cities own landfills, opting instead to dispose of their community's solid wastes in a facility serving a broad region (whether privately or publicly owned).
- **Vehicle Repair and Towing.** While some cities own and operate garages where a city-employed mechanic can perform minor maintenance on city vehicles, many municipalities have found it cost effective to contract with a privately owned business for oil changes and other maintenance, as well as major repairs to city vehicles. Towing services are usually contracted out to a private sector firm, as well.
- **Building and Grounds Maintenance.** It is common for offices in many city halls to be cleaned by employees of private firms with which the city has contracted. Similarly, the grass in city-owned parks and cemeteries is as often as not mowed by contracted employees.
- **Utility Billing Services.** Many Tennessee municipalities have contracts with private firms to calculate, print, and mail monthly water and sewer bills, thus eliminating the need to hire additional office staff and to purchase specialized computers and printers.
- **Professional Services.** Particularly in small communities, it is unusual for the city government to employ a full-time city attorney, auditor, engineer, etc. Instead, these duties are privatized with contracts reviewed periodically and put up for bid, competitive quotes, or proposals. Tennessee law does not mandate a competitive bidding process for certain professional services, but cities have learned the value of shopping around when hiring outside expertise.

There are many more examples of privatization in city government: data processing, drug testing, tree trimming, special events security, printing and advertising services, animal control, and job training, to name but a few. It is important to note that in none of these instances does privatization require the city to forfeit ownership of the programs it delivers to itself and its citizens. The difference, however, is that a city need not employ large numbers of people, own high-priced, specialized equipment, and occupy large facilities to provide basic services to the community.

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FACTORS LEADING TO PRIVATIZATION

The most significant factor in the trend toward privatization is financial. The rising costs of public programs coupled with increasing citizen resistance to tax and rate hikes have led municipal officials to ask an obvious question: Is there anybody out there who can do the job for less money? Under the circumstances, the advocates of privatization have had little difficulty getting the attention of governing bodies looking for some relief.

Economics, however, is not the only reason cities are considering outsourcing of programs. Other factors include:

- **Performance improvement.** When repeated efforts to improve the quality of a local service have failed, the governing body may conclude that the problem is systemic. In such cases, privatization of some or all of the program may be seen as a means of operating programs more effectively.
- **Specialization and complexity.** Particularly in response to technology, cities may sometimes decide to contract with private sector firms for the delivery of highly specialized or complex services. Most cities, for example, own computers and operate a variety of software programs from bookkeeping to utility billing. But relatively few cities employ the technicians and programmers needed to keep these computers and programs operating. Instead, cities usually enter into contracts with private sector firms for these services as they are needed.
- **Adverse labor relations.** Some cities have considered outsourcing public programs as a response to such personnel-related issues as high turnover, collective bargaining difficulties, or repetitive disciplinary problems. Contracting allows public managers to focus more on service delivery and less on employee issues.
- **Avoiding or reducing unfunded liabilities.** Cities may pursue privatization in response to escalating costs associated with employee pensions and health insurance benefits, which can demand resources for years into the future.

REQUIREMENTS FOR SUCCESSFUL PRIVATIZATION

What types of government programs tend to be privatized successfully?

Practically any governmental program can be performed by the private sector, but those having the following qualities tend to be the most successful:

- **Easily defined scope of work.** Successful contracting requires that the desired work can be easily described in the city's solicitation for bids and in the resulting contract. A vague or ambiguous description of the desired work increases the chances for disappointing results.
- **Availability of an ample supply of contractors.** The argument for privatization is rooted in the competition of the marketplace. Services lacking a sufficient number of bidders will not usually be more cost effective than those performed in the traditional manner by government employees. Conversely, a government service that operates in direct competition with private-sector business should be a candidate for privatization.
- **Easily measured and easily monitored work outputs.** Successful contracting requires that a municipality can effectively measure the quantity of the work performed by the contractor.

Such measurements are essential if the municipality wants to assure that privatization is achieving the desired cost savings.

- **Ability to share program control.** The program selected for privatization should be one for which tight, hands-on control by the city is not necessary. As a rule, any work performed by a city department that is not central to that department's basic mission might be successfully privatized.
- **High tolerance for occasional errors.** The program is not so crucial to the well-being or safety of the community that a single error might have catastrophic consequences. In such cases, tight, hands-on control is needed and outsourcing may not be desirable.
- **Political acceptability.** The savings to be realized from privatization may be offset by lawsuits, labor slowdowns or strikes, and other protests. For this reason, it is best to avoid privatizing services that the public demands be provided by direct municipal involvement – and for which it is willing to pay higher costs.

THE PITFALLS OF PRIVATIZATION

Privatization is not a cure for every municipal ailment. Along with its benefits, privatization is accompanied by its own unique problems, some of them quite serious. Any effort to implement the privatization of a municipal program should include steps to assure that such problems do not offset the anticipated benefits.

- **The incentive to cut corners.** Private sector contractors are in business to earn a profit – a reasonable and legal goal in most instances. However, the drive to realize profits will sometimes lead contractors to decrease service quality to the maximum extent allowed by their contract with the municipality. Cities that have privatized their operations must implement performance measures to assure that service quality is better than that provided by traditional methods.
- **Failure to consider attendant costs of privatization.** The cost of a privatized operation always exceeds the amount specified in the city's contract with the private-sector provider. Any realistic analysis of a privatization proposal must take into account such additional costs as bid preparation and advertising, contract administration, performance monitoring, etc. Otherwise, it is entirely possible that the total cost of a privatized service may exceed the cost of in-house operation even though the contractor's fee is less.
- **Corruption and privatization.** There are sufficient examples of government contractors who, in the effort to secure public contracts, have corrupted the political process. Elected and appointed officials must be aware that contractors may offer bribes and other kickbacks in an attempt to influence the selection decision. Alternately, contractors may attempt to have their competitors disqualified from the bidding process. It is also possible that, once hired by the city, the private contractor will acquire political power in direct proportion to the number of people it employs. Sometimes, a private contractor may attempt to use these employees as a "voting bloc" to influence the decisions of public bodies.
- **Surprises.** The effort to submit the lowest bid may lead some contractors to "low ball" their bids. Once the contract has been awarded to them, they may seek amendments that result in higher than expected costs to the city.

- **Employee resistance.** The announcement of a decision to contract out any program provided directly by city employees will be unsettling to those employees. Any city considering outsourcing its services must anticipate strong, organized resistance to the proposal. Unless satisfactorily addressed by the city administration, a privatization effort can result in lawsuits, collective bargaining actions, and other labor issues that are detrimental to the municipality.
- **Loss of interdepartmental cooperation.** The incentive of a private contractor to assist the city with unrelated emergencies is usually missing. Limited by the scope of their contract with the city, privatized employees cannot be ordered by the city administration to assist other agencies to meet the occasional emergency.
- **Interference in the development of the contract.** Municipalities should resist the offers of contractors to provide "free assistance" when writing bid specifications or outsourcing contracts. Invariably, such contracts reflect the contractor's best interests, not the city's. The city attorney should be charged with writing all contracts for privatizing municipal programs.
- **Failure to manage the contract.** Once an agreement is signed with a private sector contractor, the municipality cannot merely assume that the program or service is being run properly. Successful outsourcing requires that cities demand accountability from the contractor in the form of detailed, regular reports and statistics, narrative explanations of special problems and opportunities, and frequent contacts and meetings. For its part, the contractor should be eager to help the city understand the successes and failures of the privatized operation.
- **Dependence and contract renewal.** Once hired, the city government is largely dependent on the private sector contractor for delivery of the service. This creates special problems for the city should the contractor go out of business before the end of the contract. Similarly, at contract renewal time, the city may find that the pool of available contractors has shrunk since the date of the original contract. In such instances, where competition has been reduced and privatization is no longer such a good buy, the city may have no reasonable (i.e., cost effective) alternatives. Simply stated, it is difficult for a city to return to traditional service delivery once it has outsourced any particular program. The decision to privatize, therefore, should be seen as permanent.

SCOPE OF THE CONTRACTED SERVICES

Contracting out is not an all-or-nothing proposition. Cities can evaluate their municipal services and decide to outsource some or all of the program.

Outsourcing the Entire Operation – Or Just Some of It

Over the past 30 years, considerable attention has been paid to governmental operations that were turned over entirely to the private sector. In such instances, the contractor provides all labor, equipment, materials and management needed to provide the service. The local government simply administers the contract and monitors the performance of the contractor. The most obvious municipal service in this category is solid waste collection where all equipment, materials, and labor needed to collect solid waste is provided by a private sector firm on the basis of a contract with the city. Other municipal programs that might be considered for complete outsourcing include:

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- Animal control;
- Operation of animal shelters;
- Street sweeping;
- Tree trimming;
- Cemetery maintenance;
- Emergency medical services;
- Vehicle towing;
- Recreational programs;
- Job training programs;
- Operation of libraries, museums, community centers;
- Water/wastewater facilities;
- Electricity and natural gas utilities;
- Traffic sign/signal maintenance; and
- Street light maintenance.

Note that in none of these instances does privatization mean that the municipality must give up ownership of the facilities or the program. But in each, a private sector firm may be able to deliver the requisite service to the public more efficiently than traditional methods of service delivery.

Short of turning an entire program over to the private sector, however, cities can consider contracting out specific parts of their municipal operations.

Internal Support Services
Within any municipal department, the most likely targets for outsourcing are the duties and services that are not central to the department's mission. In this category are services in which the municipality, rather than the public, is the beneficiary. Contracting out for these services frees up administrators and employees to focus more on their mission, and, perhaps, save a little money. Examples of internal support services that could be contracted out include:

- Janitorial services;
- Computer maintenance and programming services;
- Data processing;
- Building maintenance;
- Bookkeeping;
- Meter reading;
- Tree trimming;
- Landscaping and mowing;
- Administration of employee benefit programs;
- Employee recruitment and testing;
- Mapping services;
- Engineering;
- Legal services;
- Payroll services;
- Secretarial services; and
- Public relations.

Operational Services
In some cities, contracts are signed with private sector firms to staff and operate the municipal water and wastewater plants, municipally owned golf courses, and similar programs. In such instances, the municipality may continue to provide administrative services in the traditional way, while a private contractor provides technical expertise and labor.

Seasonal Programs
Seasonal programs are prime candidates for privatization as cities can avoid owning specialized equipment and hiring specialized skills for tasks that are performed for relatively short periods during the year. Snow and ice removal programs, lawn mowing services (including nuisance abatement), and outdoor park and recreation programs might be provided more affordably by private contractors.

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Help with the Contracting Decision

Tennessee municipalities wishing to explore the possibilities and pitfalls associated with privatization should contact their MTAS municipal management consultant for a review and analysis of their programs. In most instances, the management consultant can advise cities of other municipalities where privatization of a particular program occurred and can share the lessons learned from such a decision. Additionally, the consultant can assist Tennessee cities to determine if the criteria exist for successful implementation of privatization.

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