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FACTS & ISSUES

League of Women Voters® of Houston Education Fund

PRIVATIZATION

What is privatization?

Privatization is the process of transferring property from public ownership to private ownership and/or transferring the management of a service or activity from the government to the private sector. Most common is privatization of management through contract, franchising, and open competition.

In "Perils and Pitfalls of Privatization," Lawrence W. Reed suggests that until the late 1970s, there was no word "privatization" in the dictionary. It was made part of the jargon when Margaret Thatcher became the first world leader to make it the centerpiece of economic policy. It was not until the 1980s that it became popular in the United States, when expensive government services and the agencies that delivered those services became increasingly unpopular with the taxpaying public.

What are essential government services?

The Preamble to the US Constitution is suggestive:

- *Form a more perfect union* - overcoming the chaos and confusion of the Articles of Confederation
- *Establish justice* - courts and correctional institutions
- *Ensure domestic tranquility* - police and fire
- *Provide for the common defense* - army, navy, marines, air force
- *Promote the general welfare* - education, postal service, health care (the so-called "elastic clause")
- *Secure the blessings of liberty* - representative democracy

The body of the Constitution gives some details, including taxing authority, to pay for these and other services deemed "essential" for the public good. All of these areas are, of course, open to interpretation. No "essential service" is immune from the idea of privatization.

As the definition of "essential" or perhaps "desirable" has grown, opposition to increased taxes has grown, the economy has slumped and tax revenues have declined. Some pundits describe the current situation as people wanting more than they are willing to pay for. To address the gap between money and services, governments from local to federal have turned to privatization as a solution.

Our challenge as citizens is to determine when privatization is appropriate and how to evaluate its effectiveness.



FACTS & ISSUES: Privatization

Why do it?

Governments turn to privatization for a number of reasons:

- *Save money* - Private enterprise can deliver services at lower cost because it is not constrained by civil service laws or union contracts.
- *Transfer risk* - The private company takes the risk that the project or service will cost more or take longer than when the agreement was made, e.g., change orders, material shortages, or weather delays in construction.
- *Increase revenue* - Sale or lease of public assets can be seen as a new revenue source.
- *Increase level of expertise* - Private companies may have more experienced personnel than the public sector.
- *Expand flexibility* - The private entity bears the burden of expanding and contracting the number of workers to deliver projects on time.
- *Speed the process of bringing a new asset on line* - Lack of time and resources in a public entity may make it more attractive to contract out the service for a timely completion date.

Why not do it?

Citizens and legislatures ask several questions when considering privatizing an asset or service.

- Can the private sector operate or manage the service more efficiently than public employees?
- What will be the effect on public employees?
- Will the cost of the service to the public increase?
- How will the public interest be protected?
- What level of transparency is desirable?
- How is the value of the asset/service to be determined?

What sorts of assets/services are privatized?

- Toll roads and bridges
- Utilities
- Correctional institutions
- Waste management
- Airports
- Transit
- Educational services
- Medical services
- Support services

How does that work?

Complete privatization is relatively rare. More common is privatization of the **operation** of a publicly owned asset, such as a sports arena or concert venue. The private company manages and



FACTS & ISSUES: Privatization

maintains the facility, collects revenue through ticket sales and user fees, and pays the public owner a fee. In **outsourcing for services**, the private company is under contract to the government entity and is paid with taxes or fees collected by the government. Consulting services, such as architecture and engineering, are typically contracted out at all levels of government. A long-term lease is another method of privatization, often used in the construction and management of toll roads and other infrastructure projects. Weighing the cost/benefit results in these cases is difficult, given the length of the terms of such a lease. In fact, a report by the LWVUS task force has determined that “there is no definitive way to evaluate whether or not a privatization initiative is a success or a failure.” It often depends on the point of view.

There are, however, certain “best practices” in evaluating a privatization decision. The conditions for a successful privatization include:

- The services are in growing and competitive markets.
- Information associated with the delivery of the service is abundant and public accountability (transparency) is not a limiting issue.
- The service involves transactions that are not irrevocable.
- Externalities that can impact the profitability of a service are limited.
- Service efficiency can be achieved in ways that are not contrary to the public interest.

In addition, privatization works best for services that are limited in scope and complexity and when the contracting government agency has:

- Clearly defined goals and criteria
- Officials open to the idea of privatization
- Established privatization policies
- Conducted an open public review process
- Worked closely with affected employees and developed employee transition plans
- Reliable cost data to accurately compare public service costs to private service costs, and the pricing of public assets to the pricing of private assets
- A contract monitoring and management system
- Performance-based criteria against which the private contractor will be regularly evaluated

In all these instances the terms of the contract are extremely important in protecting the public interest and ensuring that its fiscal goals are met.

All levels of government employ privatization and the trend is growing, especially in a sluggish economy. Two case studies, one local and one at the state level, illustrate the process, the pitfalls, and the measures of success.



FACTS & ISSUES: Privatization

CASE STUDY - The Houston Zoo

According to Andy Icken, Director of Development in Mayor Parker's office, Houston's privatization is primarily outsourcing through contracts. The City retains ownership of assets and some level of control to assure accountability. For example, nearly all support services are contracted out, while libraries and parks are operated and maintained by the City.

The Houston Zoo was established in 1922 and under Parks Department management until 2002 when it was privatized by City Council vote. As Houston grew, so did the Zoo. During the 1990s several additions were completed and more were planned. To achieve the goals of the master plan and to maintain the larger facility, more funds were needed. A Zoo Task Force was established and it recommended to City Council that the Zoo be privatized. In July 2011 the change was approved and the Houston Zoo became a private organization with a 50-year lease and an operating agreement from the City of Houston. Deborah Cannon, the Zoo's Executive Director since 2004, says that the privatization of the Zoo is definitely a success story.

The Zoo was privatized by creating two entities, The Zoo Development Corporation (ZDC) and Houston Zoo Incorporated. The ZDC is a local government corporation that holds the lease with the city. The ZDC was created because a local corporation is necessary to issue bonds. It is essentially a corporation solely on paper with no assets and no employees. The ZDC has a two-page operating agreement with Houston Zoo Inc. on how the Zoo is to be governed.

Although the City owns all of the assets of Houston Zoo Inc., the Zoo has complete control over the operations. According to its incorporation, however, the City decides how much the Zoo can raise prices annually; and, if the Zoo were to lose its accreditation, the City would regain control over Zoo operations. The City also continues to provide operating support. The amount provided by the City in the year of privatization was \$7.2 million; in 2011 the City provided \$8.5 million, which accounts for roughly 27% of the Zoo's total income. As a zoo rated among the top 10 in the U.S., the Houston Zoo generates a positive cash flow (\$4.2 million) with an operating reserve of \$7 million.

At the time of the privatization employees of the Zoo who had served a minimum of 25 years were able to keep their pensions and the Zoo paid the city back. The rest of the staff was given a choice of either working for the city or the Zoo.

A 35-member board governs the Zoo, of which 7 members are appointed by the Mayor. The Board members serve three-year terms and may only serve two consecutive terms. The financial statements are audited annually and available for the public online. There are no scheduled Board meetings.

Since privatizing, the Zoo entrance fees have increased along with attendance. Although prices have increased, all Title I schools in Houston, all Lone Star Card holders and their families gain free admission. In addition, every Tuesday there is free admission. Last year approximately 250,000 people visited the Zoo for free.



FACTS & ISSUES: Privatization

National accreditation, conservation work, and free admission are just a few of the benefits privatization has allowed. According to Deborah Cannon, if not for privatization, Houston probably wouldn't have a zoo, and certainly not one ranked in the Top 10.

CASE STUDY State of Texas Health and Human Services Call Center

In 2003 outsourcing of the HHS Call Centers to determine eligibility for certain services to private entities was only one of many recommendations or attempts to privatize/outsource services by the State of Texas. In the mid to late 1990s, due to a lack of funds or the Legislature's failure to remove the cap from the sporting goods tax, there were proposals to sell off part of the Texas State Park system, which did not happen. More recently, in 2011, the remote Christmas Mountains were made a gift to the Texas State University System by the General Land Office after a proposal to sell them to a private entity was met with a great deal of opposition. As home to one of the world's largest prison systems, Texas also has the largest network of private, for profit prisons/state jails in the country. Though initially unsuccessful, commodities such as water have not been immune to privatization proposals. One private company tried to get a contract to ship water from far West Texas to metropolitan areas such as San Antonio, Dallas, and El Paso. The most recent legislative session considered, but did not pass, a proposal by the Governor's office to privatize health care within the State prison system.

In an interview, Albert Hawkins, former Executive Commissioner for the Health and Human Services Commission, recalled his opinion regarding the initial call center proposal in 2003 and what is happening at the present time:

"I always believed that referring to the initiative as a 'privatization' effort was not accurate. Clearly, there were some tasks 'outsourced' or contracted out that were formerly performed by state workers; but all policy and program decision-making responsibilities remained with the State. The call center operation is outsourced today and is a stable and efficient way of supporting the eligibility determination responsibilities of the State. The main call center is located in Midland and processes incoming mail with modern technology and fields thousands of calls from recipients regarding their cases or applications."

Hawkins further explains the important role that the Texas Integrated Eligibility Redesign System (TIERS) played, and is playing, in the whole system. TIERS was a huge IT project to replace an obsolete automation system that had been developed to support eligibility determination in the late 1970s. As of November 2011, TIERS was rolled out statewide, but at the time of the contract for call centers, it was still in the development/pilot stage. There were major technology/programming changes that had to be made to make it suitable for use in a more technologically modern environment such as call centers and other remote locations. There was widespread resistance to TIERS among the state eligibility workforce.

In his opinion, Mr. Hawkins believes the two overriding problems were (1) an overly broad and expansive scope in contracted responsibilities that did not match the competency of the vendor and (2) a highly compressed and aggressive timetable for implementation, both problems



FACTS & ISSUES: Privatization

stemming from legislative budget decisions in 2005 to cut the number of state eligibility workers in half in the second year of the biennium. The budget cuts led to the broad-scope contract to pick up functions that would have been performed by state staff and to the decision to accelerate implementation. Given budget constraints at the time, there did not seem to be an alternative, but Hawkins believes that hindsight proves it to have been a bad decision.

Overlooked, or perhaps not known, the contract was put in place as a pilot in Travis and Hays counties. A number of operational problems surfaced during the pilot and after about two months, it was suspended. Hawkins appealed to Legislative leaders in the spring of 2006 to restore the funding for fiscal year 2007, which they did. However, by then there had been significant attrition of experienced eligibility workers as the workload continued to grow. In addition, there were continuing effects of caseload growth due to Hurricane Katrina.

Once the state funding was restored, Hawkins refers to negotiating a “re-balancing” of duties between the State and the vendor, which better recognized the core competencies of both. However, the agency could not reach a price agreement with Accenture and there was a mutual agreement to terminate. The State then contracted with Maximus (which had been a major subcontractor all along) to assume the “re-balanced” responsibilities with Deloitte to program the changes needed to TIERS. And that is how it stands today. Maximus handles call center and incoming mail under a contract with HHSC; Deloitte maintains the TIERS system and eligibility offices are appropriately staffed and meeting timeliness and accuracy standards. Mr. Hawkins refers to the call center as an example of how outsourcing can be effective, “even if it didn’t start out that way.”

Privatization Task Force: Judy Hollinger, chair, Alice Mae Berthelson, Laura Blackburn, Peggy Hamric, Emily Means, Martha Murphree, Jan Wilbur.

Sources:

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LWVUS links: <http://www.lwv.org/content/federal-privatization-ryan-plan>;
<http://www.lwv.org/content/surveying-state-laws-addressing-privatization>;
<http://www.lwv.org/content/privatization-public-policy-debate>.



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