Privatization

BACKGROUND

State and local governments across the country are struggling with the public's demand for better public services for less money. One response is to privatize government functions—that is, to transfer provision of certain services from the public sector to the private. There are four general types of privatization: outsourcing, asset sale, commercialization, and vouchers.

- Under *outsourcing* the government entity remains fully responsible for providing the service and maintains control over management decisions, but a nongovernment entity carries out the function or performs the service. This is the most common privatization method and includes contracting out, granting franchises to private firms, and using volunteers to deliver public services.
- An *asset sale* involves transferring ownership of a government asset to a private party. The government rarely has a role in overseeing or managing the private company.
- *Commercialization* occurs when a government stops providing a given service; residents may do without the service or contract with a private company to continue receiving it. Commercialization occurs most often at the local level.
- *Vouchers* are government-financed subsidies given to people to use in purchasing specific goods or services on the open market, from either the private or public sector.

GLOSSARY

Privatize
Transfer the provision of a government service from the public sector to the private.

In the last few years, Michigan state government has engaged in several privatization efforts. In 1992 the governor issued an executive order creating the Michigan Public-Private Partnership Commission and charged it with analyzing ways in which state services can be provided more efficiently by "introducing competition into the public sector." The commission encouraged the various departments to review each activity and every program in state government to find candidates for potential privatization. Although the commission no longer is active, a recent report by the Senate Fiscal Agency concludes that department participation in the commission's efforts varied widely and that most activities privatized under the commission's auspices did not result in cost savings to the state. The commission's main accomplishment was to increase public and policymakers' awareness of privatization as a practical alternative.

In 1995 the State of Michigan engaged in one of the largest asset sales in the nation. After years of political debate and court challenges, the state sold the Michigan Accident Fund, the largest workers' compensation insurer in the state. The Accident Fund was established in 1912 as part of the Michigan Treasury Department, under the regulation of the insurance commissioner, but over the years its administration shifted to a private board of directors. After many court challenges concerning the Fund's private/public status, in 1989 the Michigan Supreme Court determined that the Fund was a state agency. Within a few years, policymakers began the process of selling the Fund through competitive bid. Blue Cross and Blue Shield of Michigan ultimately won the bid, paying the state $255 million.

Another emerging privatization area is highway maintenance. The Michigan Department of Transportation (MDOT) traditionally has contracted with private companies to construct state roads, but until recently, the department maintained existing highways. In 1992 the department initiated a test of privatized highway maintenance. The Wayne County Road Commission won the first contract, to maintain a 27-mile strip of I-94 in metropolitan Detroit. Maintenance for a second stretch of highway—20 miles in the Lansing area—was bid in early 1994, but the process was open only to private contractors (local and county road commissions were excluded).

In 1997 the state partially privatized liquor distribution. Before, state government had bought, warehoused, and distributed distilled spirits to regional outlets. Recent legislation, among its other provisions, privatized the Michigan Liquor Control Commission's merchandising and warehousing functions; the state subsequently sold its three main warehouses and 63 regional outlets and entered into contracts with private companies to perform these functions. Since the liquor privatization effort is less than a year old, it is too early to assess its effect on state revenue or consumers.

Local governments in Michigan also use privatization as a way to increase efficiency in delivering services. Government functions that have been at least partially privatized in many areas include garbage collection, delinquent tax collection, certain police protection activities, street lighting maintenance, tree trimming, snow removal, parking structure operation and maintenance, and even cemetery operation.

Privatization can affect local government even when a service continues to be performed by public employees. For example, to help to balance the city's budget, the mayor of Flint solicited bids from five private companies to take over garbage collection. The low bid was nearly $2 million under current expenditures. In response, the city department responsible for garbage collection, in concert with the employees' union, offered to reduce collection costs by approximately $1.4 million. As a result of the agreed-upon cost savings, the work was kept in the public sector and the city employees kept their jobs.

DISCUSSION

Privatization proponents argue that nearly all state and local government functions can be privatized. They maintain that having a government monopoly provide services leads to high costs, reduced quality, and stagnation (lack of innovation and flexibility). Proponents cite numerous examples whereby state and local governments have enjoyed savings after a service has been bid out to the private sector. Proponents acknowledge that privatization sometimes leads to abuse, but they argue that improving the contracting process and better monitoring can eliminate most problems.

Some privatization supporters contend that what is most important is not whether the work is *performed* by private or public employees but that *provision* of the service is open to competition. Simply replacing a public monopoly with a private one does not increase efficiency. Similarly, work done by the public sector can be as productive as that by the private sector, as long as competition between the two has been encouraged.

The most common arguments against privatization are that it can lead to collusion, corruption, and taxpayers' money being wasted. The president of the American Federation of State, County, and Municipal Employees, the union representing many government workers, recently wrote:

> Contracting out for government services often results in higher costs, poorer quality of service, increased opportunities for corruption, and the loss of government flexibility and accountability. In addition, women and minorities are disproportionately harmed because they, more so than white male workers, rely on public employment as a means of advancement. The economy of communities also suffers as relatively good jobs with benefits become low-wage, no-benefit jobs provided by companies, who may not even be located in the area.

Privatization opponents also point to instances in which costs have gone up when a service was performed by a private company. For example, preliminary analysis by the Senate Fiscal Agency shows that the maintenance costs charged by a private company maintaining the 20 miles of Lansing highway are averaging 96 percent and 80 percent more than the average cost of maintenance performed by the MDOT and county road commissions, respectively. However, transportation department officials contend that the accounting is misleading because some department costs are carried in other budget areas. They also argue that this was only a test and doesn't fully reflect savings that could be achieved by privatization on a large scale.

Other state privatization efforts also have run into problems. The Department of Natural Resources had to spend $500,000 to buy out the contract of a private company that had been hired to upgrade the state's park-reservation system but did not perform up to standards. The Department of Corrections entered into a $41 million contract with a private vendor that failed to make the required payments to health care providers; the vendor—United Correctional Managed Care—eventually was taken over by another private firm that now is delivering the service.

While some efforts at privatization have been problematic, it is clear that governments at all levels see it as a tool that can be used to help control costs and improve services.

See also Corrections; Health Care Costs and Managed Care; K–12 Schooling Alternatives; Medicare and Medicaid; Mental Health Funding and Services; Road Funding; University Funding.

FOR ADDITIONAL INFORMATION

American Federation of State, County,
and Municipal Employees
1625 L Street, N.W.
Washington, DC 20036
(202) 452-4800
(202) 293-8166 FAX
www.afscme.org

Mackinac Center for Public Policy
140 West Main Street
P.O. Box 568
Midland, Michigan 48640
(517) 631-0900
(517) 631-0964 FAX
www.mackinac.org

Senate Fiscal Agency
P.O. Box 30036
Lansing, MI 48909
(517) 373-2768
(517) 373-1986 FAX
www.state.mi.us/sfa