NATIONAL LEAGUE of CITIES | MUNICIPAL ACTION GUIDE

by Stephanie Rozsa and Caitlin Geary

Privatizing Municipal Services

In a world of constrained resources, local governments of all sizes and metro types are exploring new ways to reduce costs and infuse innovation. One method, privatization – the provision of goods or services to the public by private businesses under contract by the public sector — is increasingly looked to as a viable option. Privatization is grounded in the belief that market competition can be a more efficient and cost effective way to provide services. Today, facing recessionary deficits and shrinking municipal workforces, privatization is gaining popularity. In fact, many local governments are using privatization to turn the crisis into an opportunity by restructuring government management, modernizing delivery systems and raising new revenues in order to better serve residents and support long-term growth.

> The average American city currently works with private partners to perform 23 out of 65 basic municipal services.
>
> –National Council of Public-Private Partnerships

TYPES OF PRIVATIZATION

Privatization allows flexibility in deciding how much to involve the private sector in the design, building, operation, financing and ownership of public facilities and services. Here are the most common[1] types:

Contracting Out (Outsourcing) – Municipalities purchase or contract for services or functions, which may or may not have been previously performed by public sector employees.

Public-Private Partnership – Municipalities enter into a joint venture with one or more private companies to collaborate on any or all of the planning, funding and operation of a project.

Competitive Contract Bidding – Municipal departments or offices can bid for a city contract against private-sector companies.

Asset Sales/Lease – Municipalities sell or lease city assets to the private sector. Such assets might include land, buildings, utilities or other property.

Vouchers – Vouchers are coupons with monetary value that can purchase services in the private marketplace.

Government Corporations – This involves the establishment of a quasi-government agency, subject to overall regulation, but that functions more as a private business. These are more common at the federal level, like the postal service, but can occur at the local level through entities like municipal enterprises and special or public authorities.

Volunteer Partnerships – These are instances in which a function is mostly conducted by volunteers, but in which the municipality provides some degree of funding, guidance, and perhaps staffing.

Complete Privatization – A complete transfer of a function to a private entity.

1 Stone, Mary N., Perspectives on Privatization by Municipal Governments, National League of Cities, Washington, D.C., 1997, pg. 3.

POTENTIAL BENEFITS

Unlike other funding methods, privatization allows communities the flexibility to locally determine their own growth and development. While privatization's record of success is not guaranteed, here are some considerations that will increase the likelihood of success.[2 3 4]

> "The role of local government is to represent, identify, defend and express the public interest, and the services it provides should be determined locally."
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> – Dr. Michael Pagano, College of Urban Planning and Public Affairs, University of Illinois at Chicago

Cost Savings. As citizen demand for services increases and government revenue decreases, the private sector also offers additional advantages that benefit the bottom line, including market competition; access to an agile talent pool; purchasing power; flexible resource deployment; service improvement without an increase in tax rates or user fees; significant tax benefits that can reduce net costs; and the creation of economies of scale. An economy of scale is especially important for cities too small to have sufficient staff expertise or command market power in purchasing. According to the National Center on Public Private Partnerships, governments often realize cost savings of 20 to 50 percent when the private sector is involved in service provision.

Private Sector Proficiencies. The public sector can draw on the vast knowledge of the private sector, including workplace efficiencies that reduce demands on a shrinking city workforce. In addition to abundant technical and financial expertise, the private sector usually boasts superior access to newer technologies and far more diverse funding sources. Such a partnership also introduces innovative management practices and flexible operating procedures into the public sector and allows both parties to share the construction, operations, management and financial risks.

Red Tape Reduction. Operating in the private sector often involves less bureaucracy, which leads to expeditious project completion. And as municipalities confront tax and spending limitations, outside funding offers flexibility to increasingly constrained municipal budgets.

POTENTIAL DOWNSIDES

While privatization can be an effective management and service delivery tool, it remains a complicated and controversial process. Municipal leaders should consider the following:

Conflicts of Interest. When a profit-focused private company provides public services, a conflict of interest may be created if the company attempts to cut corners or exercise policy-making authority. This issue can be addressed by bundling services, contract clarity and effective contract enforcement.

Decreased Control. Once a public asset is transferred to the private sector, municipal control and oversight is automatically reduced. And while risk is shared between sectors, it is also increased by adding a new partner into a process normally initiated by a single sector.

Citizen Dissatisfaction. If the voting public regards the private sector or the particular private partner negatively, enthusiasm for even the most well-planned partnership can be dampened. Disgruntled citizens can also jeopardize a project in progress if their concerns are ignored.

Imprecise Performance Measurement. Accurate quantitative measures tell the story of a contractor's cost and performance efficiencies. Such measures, however, are difficult for cities to produce accurately and consistently, as service indicators and cost-benefit evaluations are often not standardized.

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2 Kemp, Roger, *Privatization: The Provision of Public Services by the Private Sector,* McFarland and Company, Jefferson, North Carolina, 1991.

3 Fryklund, Inge et. al., *Municipal Service Delivery: Thinking Through the Privatization Option. A Guide for Local Elected Officials,* National League of Cities and the Center for the Study of Ethics in the Professions, Illinois Institute of Technology, Washington, D.C., 1997.

4 National League of Cities, *Legislating For Results: Motivating Contractors and Grantees to High Levels of Performance,* Washington, D.C., 2008.

ACTION STEPS

Listed below are recommended action steps gleaned from successful case studies.[5] [6] These general recommendations should be tailored to site- and project-specific requirements.

ASSESSMENT

- Define the needs and objectives to be accomplished by the project, and confirm the availability of resources to support the project through its full life cycle.
- Perform a feasibility study, which will evaluate the potential impact of the project. If an employee cannot perform the task, hire an outside consultant with a thorough understanding of the tax laws.
- Determine the current and future costs and savings through a pricing study or financial risk analysis. Clarify the financial standing of the public and private partners in terms of available capital and access to borrowing.
- Determine the amount of stakeholder support for the project. Encourage cross-agency and union collaboration so all affected stakeholders can lend insight and become invested in the project.
- Analyze political risk, build the coalitions necessary to support the change, and communicate clearly and frequently with the public.
- Seek assistance from the state's privatization board, commission, or council, if available.
- Examine existing labor contracts and statutory, regulatory and tax laws. Make modifications as necessary.
- Evaluate proposals using several criteria: contractor capacity, experience and reputation; net cost and cost per unit; and demands on city resources. Aim to have at least three bidders.

NEGOTIATION

- Hire an expert to negotiate a sound legal contract. The expert may come from your city's legal and purchasing departments or an outside organization.
- Clearly detail all expectations, performance indicators, obligations, communication guidelines, risk-sharing guidelines, incentives for superlative performance and penalties for nonperformance. Have measures in place for removing the contractor for consistent nonperformance.
- Maximize contractor incentives. One method is to bundle one or more phases of the project, which include the design, construction, service provision and long-term maintenance. Another method is quarterly incentives.
- Determine the appropriate contract term period, and anticipate a contract renegotiation process for additional or modified responsibilities, fees or payments. Include an exit strategy that details measures for the transference of the service back to the public sector, if applicable.
- Minimize disruptions in service continuity by making the transition as fluid as possible.

OVERSIGHT

- Assign a municipal department familiar with or responsible for the service to perform daily contract management.
- Establish regular on-site inspections and reporting by that department or an outside party. This should include quality control reviews.
- Hire a third party to perform formal financial and operational annual audits to track compliance with all contractual provisions, performance standards and all funds collected or expended.
- Hold council hearings if major contract breeches or complaints are filed.

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5 Fryklund, Inge et. al., *Municipal Service Delivery: Thinking Through the Privatization Option. A Guide for Local Elected Officials,* National League of Cities and the Center for the Study of Ethics in the Professions, Illinois Institute of Technology, Washington, D.C., 1997.

6 National League of Cities, *Legislating For Results: Motivating Contractors and Grantees to High Levels of Performance,* Washington, D.C., 2008.

- Maintain open lines of communication with the public about the new service. Provide a forum for community input and complaints. Include overall satisfaction levels as part of the contractor's evaluation.

EXAMPLES

PUBLIC-PRIVATE PARTNERSHIP: BALTIMORE

The City of Baltimore recently initiated a five-year joint venture with Ports America Chesapeake to update the Seagirt Marine Terminal. At $106 million, the investment was too expensive for the city to finance alone. The modifications will allow for cargo to be received and mobilized more efficiently. The project will create 3,000 construction jobs and 2,700 direct, indirect, or induced jobs over the course of the next three years and will generate nearly $16 million in new taxes for the state. In addition, Ports America agreed to pay more than $100 million to the state of Maryland for road, bridge and tunnel modernization.

COMPLETE PRIVATIZATION: SANDY SPRINGS, GEORGIA

Following its incorporation in 2005, the City of Sandy Springs opted to contract out all government services except public safety instead of creating a new municipal bureaucracy. This model saved its citizens upwards of 30 percent in taxes in the first year alone over the rate they paid to the county before incorporation. Inspired by this model, three neighboring communities have since incorporated using the same model and contractor, and a fourth recently incorporated and is contracting out bundles of services rather than hiring one operator.

COMPETITIVE BIDDING: PHOENIX

Between 1979 and 1994, Phoenix institutionalized competition by inviting private sectors to bid alongside city agencies for contracts. For example, the city geographically divided itself into three sectors for waste collection purposes and put each sector out to bid on a rotating schedule, and for which firms can serve no more than one of the three sectors. To secure the integrity of that process, the city's bid is prepared by an independent auditor and submitted under the same conditions as private bids. During that period, Phoenix awarded 56 contracts in 13 municipal services by this process, with 34 contracts going to private contractors and 22 remaining with the city agencies, saving $30 million.

ABOUT THIS PUBLICATION

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The National League of Cities is the nation's oldest and largest organization devoted to strengthening and promoting cities as centers of opportunity, leadership, and governance. NLC is a resource and advocate for more than 1,600 member cities and the 49 state municipal leagues, representing 19,000 cities and towns and more than 218 million Americans.

Through its **Center for Research and Innovation**, NLC provides research and analysis on key topics and trends important to cities, creative solutions to improve the quality of life in communities, inspiration and ideas for local officials to use in tackling tough issues and opportunities for city leaders to connect with peers, share experiences and learn about innovative approaches in cities.