Contracting Out Government Services: Privatization at the Millenium

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Abstract: Utilization of the private sector in producing services is an important element in the movement toward reforming government. The aim is to contain costs, increase productivity, or improve quality. There are choices as to the type of privatization to be employed. Contracting out that involves retaining ownership and overall control but employs a private sector operator, is the dominant form. Although there is strong evidence of the benefits of privatization, several important factors must be present for optimization. In particular, the bidding process must be competitive and the contract must be carefully structured. As the airline security case illustrates, low bid contracting without careful specification of service quality can lead to poor service. How extensively a city can employ contracting out is being tested by the city of Centennial, Colorado. Although not a panacea for all fiscal and government performance problems, contracting out, if properly managed, can be a strong force for delivery of greater efficiency and effectiveness.

Keywords: privatization, contracting out, reforming government, efficiency, government services

A key and continuing issue in government reform is the option of utilizing the private sector in producing services. Offered as a method to improve public services, privatization can contain costs and increase productivity. Critics, however, contend that privatization can raise a variety of problems if the process is not well managed.

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As government agencies experiment with various forms of privatization, its limitations may be exposed but its possibilities can be revealed. Two case studies are explored that show limitations of privatization efforts and the possible future direction of this reform option.

Privatization, “any process aimed at shifting functions and responsibilities, in whole or in part, from the government to the private sector”[1] is not a new concept in the United States. Governments have long used the private sector. However, the use of private operators in supplying services was very restricted. Their role was limited to providing a few in-house functions and a very limited number of direct services. The limited use by governments of private producers was evidenced by the fact that the word, “privatization,” did not make the dictionary until the early 1980s.

Spurred by the emergence of “reinventing,” the acceleration of privatization efforts began in the mid-1980’s with the growth of privatization in many service categories. The greater utilization of the private sector continued throughout the 1990s.

Privatization could take various forms even though, as we shall see, contracting out is the dominant form. A classification of those techniques provides some prospective for examining the nature of the privatization movement.

PRIVATIZATION CHOICES

Two functions are involved in rendering services to citizens: making provision for output and producing the service. Making provision basically involves the financing of the output. Road construction is an example of this distinction as the government can pay to have a road built and maintained (make provision) but has a choice as to the construction and maintenance of the roadway (e.g., produce in-house or hire a private contractor).

Using these two variables: making provision and production, we can classify privatization processes as shown in Table 1.

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EXPLORING THE CHOICES

1. **Load (service) shedding**  
The most complete form of privatization occurs where the government simply disassociates itself from providing the service and turns financing and production entirely over to the private sector—i.e., service shedding (or simply allowing the service to disappear). Examples would be the government eliminating existing recreation programs or not building a new sports stadium.

Even if the current government operation involves public ownership of buildings or equipment, those assets may be retained in the government inventory or converted to other uses. An example would be a trash collection service that is eliminated but the trash trucks are kept in the government inventory, often to be held in reserve in case the privatization effort is aborted and public trash collection is resumed in the future.

2. **Asset sales**  
In many cases where there are existing assets owned by government, those assets may be sold to private buyers. The assets may be sold to a bidder who would then use them to operate the previously publicly operated service such as trash collection or a golf course. In other cases, the government may just sell the assets to any buyer with no restrictions on their use. The assets may have other uses, in the case of an office-type building, or there may be no bidder who intends to continue the discontinued service. In the case where there may be a private provider, the private firm may use its own assets.

3. **Franchising**  
A modified form of load shedding involves franchising—i.e., a special privilege granted to a private operator. The service is turned over to the private sector but the government chooses the private operator or operators. For example, a local government may decide to load shed trash collection but chooses to franchise the existing trash collection routes to one or more private collectors. The government also may exercise some operational control over the franchisee such as setting quality standards for effluent discharges in the case of waste treatment plants.

Where infrastructure-type operations are involved, especially in the case of new (highway) or expanded (waste treatment) operations, there are at least two variants of franchising: design-build-transfer-operate (BTO) and design-build-operate-transfer (BOT). In the BTO case, the government agency can utilize a turnkey model in which the private operator designs, constructs, and transfers ownership upon completion to the government but operates the facility. This model has been used in wastewater treatment.

BOT is a more complete form of privatization since the private sector may continue to own the facility, often subject to government regulation, on a long-term basis. After a number of years, however, the private firm may transfer ownership to the public sector. This model has been used for toll roads, solid waste facilities, and water systems.\(^2\)
4. **Vouchers, grants, and subsidies**
   The most market-oriented mode of privatization in which the public sector continues to make provision (i.e., pays) is the use of vouchers or grants/subsidies. In the voucher form, the government provides the user a check to pay the bill for the privately produced service. If there are competing suppliers, the user is afforded choice. Examples at the federal level include: food stamps, Medicare, and housing vouchers; and at the state and local levels: Medicaid, mental health, job training, and other social services.

   Instead of allowing the consumer to pay for the service from a producer of his or her choice with a government check, the government may directly provide a grant or subsidy to a private producer. In this case, the user may have less choice as the subsidy or grant may go to one or only a handful of producers. Government subsidies have been given to universities, hospitals, other health-related facilities, art museums and other organizations that offer cultural services, and to a wide variety of community service organizations.

5. **Public-private partnerships**
   A mixed technique of service provision/production is that of a public-private partnership. Under this relationship, the government fashions a contractual arrangement with its private sector partners. Infrastructure projects illustrate this approach such as in the BTO model where each partner has carefully defined responsibilities. Also, a government agency may work with a private social service organization to address a particular social problem. An example would be needle exchange or publicity efforts to reduce the incidence of HIV infection in which the government’s role is to furnish the needles and provide educational materials while the private organization operates the program.

6. **Volunteer activities**
   Under the umbrella of government provision and/or operation of some programs, citizen volunteers may be utilized. A service may be organized and funded by a government agency that enlists volunteers to provide all or a part of the services offered either directly under government supervision or through a non-profit service group. Examples of programs utilizing volunteers include neighborhood crime watches, tutoring programs in schools, and delivery of food in a “Meals on Wheels”-type operation.

7. **Contracting in**
   Although some of the above techniques are not widely used, contracting in is an even rarer option. In this case, the private sector is the provider but the government is the producer. An example is where a private group or company hires, at its own expense, public police personnel to secure a sporting event or patrol a shopping mall. In most cases, however, the public operation was established under public provision and these additional services rendered to the private sector are incidental to the primary mission.

8. **Contracting out (outsourcing)**
   Rather than employing some form of load shedding, most governments have preferred contracting as the method to shift operations to the private
sector. In this model, the government entity retains ownership and overall control but employs the private vendor to actually render the service. Except for activities involving infrastructure or voucher/subsidy systems, contracting out is the way practically all privatization is now being implemented. Everything from in-house support services to direct taxpayer services falls under the contracting out umbrella. Much of the analysis of this article is in the context of utilizing contracting out as the mode of privatization.

9. Managed competition/competitive contracting

One variant of contracting out is that of managed competition or competitive contracting. Government departments or agencies currently producing the service (or capable of producing the service) can bid on contracts. The entire service may be contracted out to private vendors or kept in-house if the agency bid is superior to the best bid of the private competitors. Where feasible, part of the service may be outsourced and the remainder of the service may be retained in-house. An example of the splitting technique is in trash collection or in bus transport where there is a geographical dimension to service, or in solid waste operations where there are vertical processing steps such as collection and disposal.

DOMINANCE OF CONTRACTING OUT

Overall, in 1993, 78% of state agencies used contracting out as the primary privatization device. The pattern at the local level also reflects this pattern.

If a government agency chooses to privatize, why would it most likely use the contracting out option? The answer appears to be that the choice of contracting out reflects a variety of practical and political considerations.

Practical Factors

Often, government officials wish to retain substantial control over service production while seeking the lower costs or improved performance promised by private sector producers. The major alternative to contracting out a service is to allow the private sector to have complete, or almost complete, control over the service. In the extreme case of load shedding, the public agency relinquishes provision as well as production. In the case of vouchers, subsidies, and even franchises the degree of public control is much less, as funding is the principal function of the government. By comparison, contracting out typically allows much greater involvement in the design and oversight of production by the public agency.

In the case of poor performance by the private producer, contracting out offers a degree of reversibility not available with other forms of privatization. Especially if the public agency retains some equipment and management expertise in the service area, it is not too difficult to resume public production
if the private operation proves to be unsatisfactory or if the private operator goes out of business. This option to resume public operations is especially important if there are no other private producers on the horizon.

**Political Factors**

The loss of control over the nature and level of service (or no service at all) with load shedding encourages public officials to rely upon contracting out to privatize services. Politically, a major loss of control opens elected officials to criticism by disgruntled citizen-consumers. The blame cannot easily be deflected, nor is it easy to make changes.

Moreover, the economic rent that often entices public provision, if not production, of services slips away with load shedding. Even with contracting out, favors for constituents are still possible to garner. Contract features may be designed to give substantial benefits to selected consumers. Even after the contract is let, public officials may be able to gain concessions for certain voters since contract renewal is on the horizon.

Contractors themselves may be encouraged to share some contract benefits with elected officials, even barring illegal forms of favors. Campaign contributions and the aforementioned favors for selected constituents may not be uncommon events.

The use of competitive contracting by some cities has also softened the political resistance to change. Offering the public agency and its workers a chance to compete for the contract to supply services is a way to show effort to contain costs while retaining the possibility of public production. Some critics of competitive contracting argue that by clever manipulation of costs, especially misallocation of overhead costs; the public agency can be given an edge and thus can win the contract. Additionally, checking the public bid winner for subsequent cost overruns can be ignored or downplayed since sanctions might be difficult to impose and the exposure of the higher costs could be politically damaging to elected officials.

**RESULTS OF PRIVATIZATION EFFORTS**

The primary aim of the movement toward using the private sector was to effect cost savings without reducing the quality of services. Direct contracting out or competitive contracting with government workers are both aimed at containing costs. In the case of some services, more emphasis was placed on improving the quality of service without escalating costs. The latter examples often involved producing human services such as job training or drug rehabilitation or infrastructure operations such as water and waste treatment in the face of tightening federal environmental quality regulations.
Cost Containment

The primary aim of contracting out was to reduce operating costs without sacrificing the quality of the service. In the vast majority of cases the results appear to be favorable. As one of the chief researchers of privatization has put it: “Savings from competitive contracting of public services—the most thoroughly studied form of privatization—average roughly 25 to 30 percent.”[3] A recent example of the potential of cost savings by contracting services to private producers is seen in the case of Oakland County, Michigan. Recent private contracts covered serving civil court papers, providing hospital services at the county medical facility, fixing body damages to vehicles, direct supply of office supplies to county departments, and providing dental care to low-income adults. Between 1993 and 2000 these savings were estimated to be $9 million.[4]

Public-Private Competition

Cutting costs is also the purpose of outsourcing such services as solid waste collection, road maintenance, and park maintenance. The idea is to inject competition for the government agency producing the service. Where used, contracting out here usually takes the form of bidding for work previously the sole responsibility of a public agency producer.

The emerging competition typically results in lower costs and more efficient service. When spurred by outside competition, the public agency often reduces its costs and gains a share of the work. Phoenix, Indianapolis, and Charlotte have made extensive use of managed competition.

Contracting out, or its threat, also can have the effect of weakening the power of public unions. Former Governor Whitman (New Jersey) and former Mayor Giuliani (New York City) used the threat of privatization in negotiating with turnpike workers, sanitation workers, school custodians and school bus drivers, all of whom “agreed to major modifications in their work rules to stave off private competition.”[5]

Results: Quality Enhancement

Although cost restraint or reduction (without compromising quality) is a major objective of contracting and the record suggests impressive results, achieving high quality is an important objective in producing some services. These services often are classified as “soft services” since they are involved with helping consumers (or “clients”) directly. Such services include education, job training, drug rehabilitation, and prisoner services. Assessing the performance of these services is very difficult since defining and measuring “output” is an imprecise art.
The evidence of performance in the “soft services” is not clear-cut. In the few documented studies available, the quality of service was either improved or not significantly different than when publicly produced. For example, in the social service area where non-profit suppliers are relied upon to produce most of the contracted for services, the performance record appears to be mixed.\[6\]

**PRIVATIZATION IN OPERATION**

As indicated above, in the vast majority of privatization cases, contracting the operation of the service to a private supplier (or suppliers) has been the preferred method. The government provider typically solicits bids from private suppliers and awards the contract or contracts based on price and/or quality of service to be supplied. Occasionally contract awards are made without bids, usually in the case of professional services such as engineers, lawyers, architects, and social service organizations. In most instances the contractor is a for profit enterprise but, in some cases, non-profit agencies are used, especially in the human or social service area.\[7\]

**Objectives of Privatization**

Privatization, especially the predominant contracting out option, has been utilized as a management tool as well as a device to realign the public-private sector mix. The managerial objectives include cutting costs, improving the quality of services produced, or both. Most frequently, the primary aim has been to cut costs in order to relieve budgetary pressures rather than to improve services, especially since assessing the quality of output of many government services can be a complex and time consuming activity. Privatizing was aimed also at increasing the flexibility of government operations such that expansion, contraction, or complete elimination of specific services could be accomplished with fewer obstacles and with greater speed.\[8\]

The major thrust toward privatization in the United States seems to be motivated by practical managerial considerations. Nevertheless the movement toward the greater use of the private sector taps into the philosophical point of view of a reduced role for government in a market system.

**Conditions Required for Success**

In order to achieve the objectives set forth in a privatization initiative, certain environmental factors must be present. These factors include: political support, managerial/political leadership, and a supportive private market structure. Overcoming the bias toward the status quo protected by the stakeholders
who receive monopoly rent is essential. A strong case must be made for change; the case must speak to the benefits to be received with a provision/production arrangement in comparison to the costs that may have to be incurred. Legislative and voter support offers the opportunity to move in the privatization direction and to allow the new structure a fair chance to demonstrate its advantages.

The full support of political leaders, especially in the executive branch, greatly enhances the chances of success. Not only is this support required for approval of change, but also enthusiastic and careful backing of the effort often is compelled to sustain it. Well-prepared and ardent political leaders often are needed to overcome the inertia of the status quo.

To achieve the required objectives requires more than political support and strong leadership. To achieve the maximum benefits of privatization, the private sector should be structured such that alternative suppliers exist to compete in providing the service in the case of load shedding, can compete for contracts in the case of contracting out or franchising, or can supply services in the case of vouchers. Without competition, privatization might simply consist of a private monopoly substituting for a government monopoly.

**Cautions and Pitfalls**

Several cautions must be exercised and pitfalls protected against when contracting out. Where there is little competition in the private sector prior to privatization, a viable bidding process may not take place such that the savings anticipated or the quality improvement desired may not take place; private monopoly may simply replace public monopoly. Even where there is competition and bidding is spirited, the contract must be carefully drafted and monitored. Especially in service categories where output is ill defined and relevant costs are hard to measure, vague contracts may lead to less than optimal results and enforcement may not be effectively practiced.

Also, a reasonable contract period may be required for the vendor to demonstrate results, especially for social services where desirable outcomes may take years to achieve. During the length of this long contract, the government may not be able to rebid even if performance is marginal.

Undesirable outcomes could also occur during the contract period or at the time of rebidding. The private supplier may not perform according to the contract owing to strikes, other work stoppages, and business cessation or bankruptcy. The contracting government agency must be prepared to find an alternative supplier or to resume operations itself. Where large capital investments in plant and equipment are necessary for operations, the government must be wary of disinvesting itself of back up equipment in case it has to resume operations.

Maintaining operations is a particularly vital issue when infrastructure is involved; the public sector must have contingency plans to take over. Essential
services such as waste water treatment, airport operations, and water treatment must not be interrupted.

In monitoring and at the rebidding phase there is also the danger that the provider and beneficiary coalition may subvert the public interest. The experience of contracting out social services in Michigan illustrates the problem. In quick order, the evaluation of services and the interpretation of the “needs” of client beneficiaries became heavily influenced by providers. “For their part, self-interested bureaucrats and legislators cannot fail to see the opportunities for developing mutually beneficial relationships with contractors.”[9]

Abuse of the public trust and favoritism in awarding contracts to political friends is always a possibility. Public officials who let contracts may wind up working for the contractor. A case in point was the recent Fairfax County, Virginia, episode where the Fairfax County Park Authority selected a company to build golf facilities at two parks. Shortly after the contract was let, a board member of the Authority quit and went to work for the contractor as a “$500 per day consultant.”[10] Large contracts may even be let without competitive bidding. For example, the Washington, DC school board hired a firm to handle a $21 million contract to operate school cafeterias without competitive bids.[11]

Reliance on bidder competition and aggressive public watchdog activities are essential to avoid the undue influence of suppliers on the contracting process. “Sweetheart” contracts, guaranteed contract renewal, and collusion among bidders are always a threat to undermine the potential advantages of privatization.

Several critics of contracting out point to the history of widespread corruption when several large cities undertook contracting in the 19th century. Political favoritism, bribery, and the toleration of poor contractor performance were documented in New York City, Chicago, and Detroit. Adler traces the problem to that of the existence of personal incentives for the public servant who does the hiring. “The (private) entrepreneur is interested in performance and nothing else. The public servant may trade performance for a personal gain.”[12]

THE EFFECT OF POORLY CONSTRUCTED OR LOOSELY ENFORCED CONTRACTS: THE AIRLINE SECURITY CASE

Not all contracting out works well.[13] When contracting with government agencies, or with companies that government(s) permit to operate in a given market or industry, like the airline industry, low bid contracting can mean low levels of professional performance.[14] When it occurs in situations where safety, security, and health are concerned, governments are reminded by their citizens and by market forces that they have a duty to monitor and control unsafe, less than secure, and unhealthy practices. Such is the case with lax security, contracted with private security contractors like Argenbright which led, at least in part, to the September 11, 2001, terrorist attacks in New York City and Washington, DC.[15]
With thousands killed and injured, the World Trade Center buildings destroyed, the Pentagon damaged, the economy disrupted, the transportation system derailed, international relations in disarray, and our citizens victimized, accountability became a primary issue. At the federal level, the Department of Transportation and its secretary, Norm Minetta, found themselves in the spotlight. The FAA’s role in security screening and safety came under severe scrutiny. The traditional, inherent conflict of interest question regarding the FAA’s dual mandate: to enforce safety and promote the industry was raised yet again for review. 

State government became actively involved when the Massachusetts State Police ordered Argenbright Security Inc. to leave Logan International Airport in Boston after security lapses. Argenbright’s parent company is the British Securicor. An international company, it provides security services in the United States as well as in Europe.

At the local/regional level, we find airport authorities involved. These organizations have contracted security to Argenbright and others on a regular basis. The security lapses leading to September 11, and those discovered both before and after raise serious questions about accountability.

Governments in America and beyond, in Europe and Israel, for example, have allowed airline, and airport, and air passenger security to be handled by private firms. The U.S. model has been that the airlines manage the security, typically by subcontracting to security companies like Argenbright. This, in effect, is privatizing or contracting out security in the airline industry—i.e., both de facto and de jure privatization and contracting out, depending upon one’s analytical focus at the time. When it fails, as it did so demonstrably on September 11, and afterwards, the chain of accountability for safety, security, and health becomes activated in direct proportion to the real and perceived seriousness of the event(s).

In this case, Transportation Secretary Norm Minetta got involved immediately. The State Police in Massachusetts responded promptly. Denver’s Mayor Wellington Webb, as head of the Denver International Airport Authority, promptly got more active. Ken Meade, the Inspector General of the Department of Transportation suggested to the United States Senate Subcommittee on Governmental Affairs that we need: “…a single government entity with security as its primary and central focus, profession and mission.” We need: “uniform, more rigorous training and performance standards…..” Less than 10% of bags checked at airports are screened for bombs. Senators, like Max Clelland (D-GA), called the private security companies failures, e.g., 90 incidents of lax security in less than 2 weeks, about a month after September 11: a “national scandal” and a “travesty.”

Low bid contracting yields low quality performance. The Service Employees International Union reports screeners make an average salary of $6.00 per hour, compared to the federal minimum wage @ $5.15 per hour. This leads to high turnover of 193% a year at Denver International Airport,
and inadequate training. Undercover federal security testing resulted in up to 20% of dangerous objects slipping through security. Reports by the GAO and DOT have noted such security lapses over time.

Argenbright provides security for at least 54 U.S. airports and 26 European airports. It was recently fined over $1 million for having untrained employees, including a number with criminal backgrounds, working checkpoints at Philadelphia’s International Airport. The company also employs large numbers of foreign employees, many of whom are not proficient in English. Argenbright was the security company at Dulles International and Newark, N.J. airport as well as at Logan International in Boston, where the September 11 hijackings happened. It is notable, in the contracting and accountability context, that the United States is one of only a few countries not utilizing military and local police officers for airline security purposes. \[22\]

After September 11, both the National Guard and local police officers were used to enhance airport security.

After Argenbright failed to detect a security breach involving a high-profile passenger with numerous knives and other weapons at Chicago’s O’Hare International Airport after September 11, Senate Majority Leader Tom Daschle (D-SD), wanted Argenbright fired, noting: “I think it’s a horrendous record and one that is inexcusable given our circumstances right now.” Denver Mayor Webb’s spokesman said he thought Daschle’s comments indicated “growing frustration for the lack of federal oversight, … federal training standards” for all the country, across the board. \[23\]

The United States Senate passed a bill authorizing a professional public sector airport security force by a vote of 100 to 0. Shortly thereafter, the House, with President Bush’s support, passed a private sector oriented bill by 286 to 139. \[24\] On Monday, November 19, 2001, President George W. Bush signed a compromise piece of legislation, a law that leaned toward the Senate bill, authorizing federal takeover of airport security. It is designed to implement rigid new staffing requirements and purchase million dollar machines for luggage screening. The compromise legislation eventually will allow airports an option to return to private screeners. Four hundred and fourteen commercial airports will replace and train 28,000 private sector screeners with federal employees. Up to 5 airports will be permitted to apply for a government supervised pilot program to use privately contracted screeners. \[25\]

A new ticket tax, not to exceed $2.50 each way, or $5.00 total, will help pay for the added security. A new federal Transportation Security Agency will be formed to implement dozens of security enhancing measures designed to improve air security and boost air passenger confidence to bolster an airline (and tourism) industry in crisis. \[26\]

The new Transportation Security Administration will recruit, investigate, train, and deploy 28,000 new workers to over 400 U.S. airports. It has one year to get new federal managers, supervisors, and screeners on the job. The most significant change has to do with the shift in accountability for security
and its past implementation by way of contracting: “...bill will shift airport security from the airlines, which have traditionally contracted out the task to the federal government, which will implement strict new requirements.”[27]

**EXPLORING THE LIMITS OF CONTRACTING SERVICES: THE CENTENNIAL CASE**

Centennial, Colorado is a city born at the millennium...of old “no taxation without representation” roots...but designed to be a prototype for the more privatized, contract based, virtual cities of the 21st century. The 104,000 suburban citizens of Centennial, a 3 mile by 16 mile strip extending primarily east and west across the southern boundary of metropolitan Denver voted, in 2000, to incorporate by 77% of the votes cast, to be taxed at 1.5% (½ the rate of surrounding communities), and later to accept a low mill levy for property taxes at 4.982, overcoming some restrictions of a state taxpayers bill of rights law.[28] The alternative would have been to continue to watch and become victimized by Greenwood Village, a small upscale community to the north which continued to aggressively annex the lucrative commercial properties along the transportation corridors, leaving the unincorporated county areas inhabited by what were to become “Centennial residents” without an adequate tax base.

Centennial overcame legal, economic, and other public policy hurdles along the way, including victories in the Colorado State Legislature and Colorado Supreme Court. The legislature and Supreme Court sided with the citizens who argued for incorporation rights to claim taxes for mandatory services, as opposed to Greenwood Village’s attempts to pool and skim the dollars of the residents of unincorporated Arapahoe County by way of annexation. John Brackney, an Arapahoe County Commissioner with Randy Pye, who became the Centennial Mayor, and Brian Voght, who heads up the South Metro Denver Chamber of Commerce, led the management and organization of the voters that ended in incorporation. According to Don Borut, Director of the National League of Cities: “In the United States, we take for granted that local governments have the right to incorporate, raise revenues, and decide what their priorities are. Most other countries don’t have that right.”[29]

Centennial is the essence of a privatization oriented contract city.[30] With the largest population of any city to incorporate since WWII of 104,000, Centennial plans to employ not more than 2 dozen employees. Typical cities of this size employ between 500 and 1,000 employees. Working in a bank’s donated basement space, there are no plans to build a city hall. The goal is to have a contract city with a large private sector presence. Some call it a reluctant city, one that was founded only to preserve the tax base for fundamental required services. Mayor Randy Pye likes to think of this city as a “virtual city.” In another virtual context, internet connections to further enhance citizen participation are proving to be more expensive than originally planned.[31]
The international dimension of this emerging contract city presented a sobering challenge to the Arapahoe County Government recently when Centennial contracted with URS Corporation to do all the planning, building and zoning work that had traditionally been done by the County’s Development Services and Infrastructure Management Department. This creates a loss of $1.8 million in the department’s budget, and represents a quarter of its work. URS, the international private corporation got the contract on the belief that it could best adapt to changes in the economy. URS is headquartered in San Francisco and has offices in 30 countries, and two offices in the metropolitan area. The new city council also believes the private firm will do a better job implementing its policies.

The next possible contract loss for Arapahoe County could involve public works for Centennial. This would be worth $14 million per year. Beyond that, the Arapahoe County Sheriff’s services could be reviewed. During the interim transition period, county services were utilized. Mayor Pye has made it clear, however, that private sector contracting is the way of the future for Centennial, especially if county “bureaucracy” appears to be hindering optimal performance for his citizens in his new virtual contract city.

CONCLUSION: THE FUTURE PATH OF PRIVATIZATION

The recent decades’ spurt of privatization activities by American governments represent a trend that is likely to be irreversible. To achieve the full benefits of hiring private sector producers, however, requires more creative public management both to design and to enforce contracts. Instead of operating as direct service producers, government agencies will take on the more complex role of overseer and coordinator for service producers, both profit and non-profit, that does not fit into the traditional hierarchical mold.

Since the mid-1980s the combination of fiscal constraints on governments and the growing popularity of the “smaller government” philosophy weakened opposition to privatization and encouraged the use of the privatizing option. Efficiency considerations moved to a position of greater prominence in the privatization debate, especially since the preponderance of evidence suggests that competently designed privatizing almost always leads to lower unit cost, improved product quality, or both. Also, the ability of private developers to raise funds and take risks more efficiently than the public sector in the case of infrastructure projects also seems clear.

In the face of the twin forces of budget pressure and the unpopularity of service cuts, public decision-makers became more sympathetic toward experimenting with privatization initiatives. Once in place, the privatization efforts usually demonstrated their cost advantage. Success then generated momentum for more extensive privatization initiatives.

Another force for greater use of the private sector was the “anti-big government” point of view of some voting groups. This philosophical position
may reflect an expected favorable distribution consequence of change or may be altruistic in its concern about the long-run effects on political/economic freedom of an encroaching government.

Countering the forces that push elected officials to move more rapidly toward privatization is the status quo coalition. Existing stakeholders attempt to hold onto their share of monopoly rents and attempt to erect obstacles to change. Change almost always threatens to cause redistribution of benefits and/or costs of government action.

Which set of forces is stronger will determine the particular course privatization will follow for state and local governments. Of course in our highly decentralized federal system of government particular states or local government may deviate from the trend and can influence other governments and may even impact on the trend itself by engaging in innovative experimentation.

Contracting out production is a less threatening option and has a greater probability of being used than other more drastic forms of privatization. The best chance of privatizing is when the number of public employees affected is small, specialized services are involved, output can be clearly defined and measured, several potential private suppliers exist or entry of others is easy, and the service beneficiaries are numerous.

However, where there is a large and entrenched pro-status quo group of stakeholders, where outcomes are not easily measured, and where significant externalities are believed to exist, breaking the mold will be very difficult. Examples would be in education and criminal justice functions.

Unless the process of contracting is effectively managed, contracting initiatives may be threatened. Clearly the airline security case was a major management misstep. The federal government left almost all of the control of security to the airline companies. The airlines wrote the contracts, hired the contractors, and paid for the service. The federal government agency provided minimal oversight. Seeking their short-run best interests, airlines focused on competitive bidding for the security contracts and awarded the bid to the lowest bidder. Little attention was paid to the quality of the service and the level of security.

Since scant attention was paid to direct security considerations by the direct contractors, the airlines, and the government overseer, contractors focused on achieving low costs by using low wage employees and not carefully monitoring passenger scrutiny. When disaster hit the county in September, 2001, the Congressional reaction was to blame the private security companies and to eventually remove the private contractors and replace them with direct government production, even though the underlying problem was the private contract’s emphasis on a secondary element of performance rather than on the primary mission of inspection.

If the pitfalls of private contracting can be avoided, if government management can be advanced in dealing with oversight and coordination requirements, and if cost savings are present in most areas of contracting, there will be opportunities for much more extensive use of private contractors in most
functional areas of government direct production of services. Theoretically, government could transfer the production of all but a handful of services (some elements of law enforcement and a limited number of regulatory activities) to the private sector. The Colorado case is an experiment in how far local governments can go in achieving a “virtual city.”

Clearly, the public sector could emerge primarily as the director rather than the producer of services. The interplay of many factors will determine the ultimate reach of the privatization movement. Although not a panacea for all the fiscal and government performance problems facing our country, if properly managed, contracting out can be a strong force for delivering greater efficiency and effectiveness to the American economy.

REFERENCES