Outsourcing Outrages:
Why Wisconsin Must Continue to Require Cost-Benefit Analysis When Considering Privatization Proposals

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State leaders have proposed to end the existing requirement for proposals that privatize public functions to show cost-benefit advantages and report on results for Department of Transportation projects over $25,000. Privatization in other states has sometimes saved the public money, but has often led to huge losses and other problems. Politicians may be enticed by the short-term cash offered by privatization, but citizens of Wisconsin deserve to know that there will not be larger long-term losses.

Background

A proposal put forward recently by Wisconsin legislators would strike requirements that prevent waste and abuse when the Department of Transportation spends significant public dollars on outside contractors. The change would end requirements that contracting agencies must, for instance, have a clearly determined scope, must show why they are not utilizing already existing in-house services if they are available, and must justify the reasons if the agency would not use competitive bidding to assure best value.

Cautionary lessons from states

Governments cannot afford to enter privatization deals without rigorous analysis because experience shows ill-considered privatization can be extremely costly. Consider the following examples:

Parking system privatization –

- The City of Chicago hastily privatized its parking system, leaving city Aldermen with little opportunity to even read the 75-year agreement before the vote. The city received $1.2 billion in upfront cash, promised to fund long-term endowments to aid the city but which were spent down in a few short years. Meanwhile, parking rates skyrocketed, increasing four-fold in some areas and required during longer hours when parking was previously free of charge. City residents became outraged as tickets were issued on many meters that failed to work or with inaccurate signage.

The city will also often be forced to pay "compensation" to the private meter operator when streets are closed for repairs, parades or festivals. An Inspector General report subsequently ascertained that Chicago received almost a billion less than it should have in the deal.
- In Washington D.C., an auditor's report showed that from the years 1999 to 2005, under contractor ACS, costs for maintenance and operation of the city's leased parking system were 33.4 percent higher and resulted in $8.8 million additional spending of taxpayer funds than if services had remained in-house. ACS also improperly fined patrons $159,975 when they parked at broken meters. Overall meter complaints increased over 900 percent. Moreover, ACS inappropriately billed the city for $644,952 in penalties that the city did not owe them for temporary meter closures.

Decision making and administration of who receives human service benefits – Both Indiana and Texas ended up cancelling their contracts after huge losses and service problems.
- Texas found problems arose quickly with their deal with Accenture, such as high call center wait times, technical issues, insufficiently trained contractor staff, delays in application processing, and improper benefit denials. Texas cancelled the contract in 2007, but suffered large losses and legal fees scrambling to reconstruct the functions in-house. The state was fined millions by the federal government for failing to comply with timeliness standards.
- Indiana paid $5.25 million in legal fees in the course of cancelling its contract with IBM. It cancelled a ten-year contract with the IBM-led consortium after less than a third of the term, justifying the move because of inferior quality of service. Governor Daniels brought the privatized functions back in-house after losses that some estimate may have reached $500 million to the taxpayers of Indiana.

Building leasebacks –
- Facing a short-term budget crunch, the state of Arizona leased its Supreme Court building and about a dozen other high-profile buildings, with agreements to pay about $1.2 billion over the next 20 years renting these same buildings back from their new owners. It is not known how the long-term cost for taxpayers will compare to costs without the privatization.
- California initially proposed a similar arrangement to lease 24 state buildings. Thankfully, due to a thorough study by the Legislative Analyst's Office, it was revealed that the deal would end up losing the public treasury hundreds of millions of dollars over the 30 year lease period. A separate study by Beacon Economics found similar results. The state of California decided to cancel the lease proposal before finalizing the deal.

Juvenile detention – Sometimes privatization can create perverse incentives.
- In Luzerne County, Pennsylvania an owner and developer of for-profit juvenile detention centers admitted to paying $2.8 million to Judge Mark Ciavarella in cash kickbacks between 2003 and 2008 for sending children to incarceration in their facilities. Long-term sentences were sometimes handed down for minor crimes or

outbursts at parents. The following year a state supreme court voided the thousands of sentences that had been issued. The public has since saved millions in reduced institutionalization costs.

IT systems **–**While private contractors typically work as tech consultants or suppliers, the experience of contracting operation of whole information technology systems has often created big problems as government entities realize their needs have evolved or they would like to adapt for new opportunities.

- Virginia contracted for 10 years with Northrop Grumman to modernize and consolidate its information technology system. After many performance problems and complaints, the state found itself with little options but to pay more to finish the job, revising the contract and paying an additional $100 million. New York City signed a $63 million contract privatizing the city's timekeeping system, which has been a source of controversy as costs have ballooned to over $700 million. The city's deputy mayor, Stephen Goldsmith, once known as the "prince of privatization" for his outsourcing efforts as mayor of Indianapolis, this year decided he could save $41 million by bringing the city's wireless network and data center back in-house.
- In Wisconsin a 2001 legislative audit also revealed that taxpayers had been overpaying for private computer consultants, with some equivalent contractors receiving twice the hourly compensation as paid in-house.

Engineering **–**

- Here in Wisconsin, an audit report from the Legislative Audit Bureau found the department of transportation had spent $1.2 million on contracting work that would have been performed more cheaply in-house. Consulting payments by the department rose from 8 percent in 1988 to 63 percent in 2008, far more than in surrounding states.

Finally, one indication that privatization often fails is the large number of government entities that end up subsequently reversing privatizing. Professor Mildred Warner of Cornell University finds that in any given year local governments may be equally likely to bring services back in house as they are to privatize. According to a 2007 survey by the International City/County Management Association the most common reasons for reversing privatization are problems with service quality (61 percent) and lack of cost savings (52 percent). Such moves can be difficult and expensive because in-house capacity may need to be rebuilt from scratch.

The need for rigorous analysis is particularly important in the face of current budget shortfalls. State officials will be strongly tempted to embrace short-term budget gimmicks with long-term costs that exceed upfront savings. A report released last month by New York's Comptroller on "public-private partnerships" ("P3"s) found that both the City of Chicago and the State of Indiana used "one-shot" payments from privatization for short-term budget relief without addressing long-term budget health. He warned that, "P3 agreements are sometimes used for short-term fiscal relief, which provides a short-term cash benefit while pushing costs to the future." More pointedly he added, "some asset maximization proposals are little more than new ways to perpetuate unsound financing practices, such as using new debt to pay for current expenses."

Cost-benefit analysis must be done properly

Cost benefit analysis must include a broad array of considerations. For instance, if governments privatize public functions, they will incur new costs to monitor and enforce agreements. They may face additional costs to litigate agreements, or pay change order, cost overruns and contractual penalties. If a new private operator stops providing health care benefits, for instance, then coverage is likely to be shouldered by public assistance.

Not all costs will be possible to quantify, but additional considerations should nonetheless be documented and considered as part of the privatization decision. For instance, if the state loses in-house capacity to perform a particular function, then if the decision is made to bring the function back in-house in the future, there will be significant additional transition costs to cultivate new staff and other internal capacity. And while clearly spelled out private responsibilities and benchmarks encourage greater accountability, longer and more specific contracts can also reduce public flexibility to address evolving needs and technologies that were not anticipated by the original contract. In assessing public risks, analysis should consider whether private contractors have taken out insurance or established escrow accounts to protect the public against unanticipated costs and disruption in case a contractor becomes insolvent.

Cost-benefit analysis itself requires time and money. Existing rules in Wisconsin currently exempt contracts of less than $25,000 from this due diligence requirement. It may be prudent to establish other thresholds requiring greater and lesser levels of analysis according to the size of contracts or the value of leased public assets. Greater analysis is necessary for proposals to newly privatize functions, rather than simply to renew private contracts. Contracts below dollar thresholds should also be subject to random audits so as to avoid an oversight-free zone that might encourage waste and abuse.

Given the enormous long-term costs that can result from misguided privatization, the basic safeguard of cost-benefit analysis must be maintained. An ounce of prevention is worth the ton of cure that must be paid when privatization goes badly.

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