

The United States' Experience with Outsourcing, Privatization and Public-Private Partnerships

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Although the principles and practices of implementing public-private partnerships are quite similar around the world, the United States has a unique history and culture of developing working relationships between the public and private sectors in the provision of public services and infrastructure. From the earliest of colonial times to the present, the U.S. private sector has always had an active and sometimes leading role in building what we now consider public goods and services.

The earliest major roads in the 18th century were private toll roads. Most all of the country's first urban water supplies were built and maintained by privately owned water companies, some of which are still in business today. The great expansion westward in the US in the late 19th century was driven by a major public-private partnership between the federal government and the private railroads. The government provided the right-of-way and related development property while the railroads used private capital to build the rail facilities and rolling stock. Urban transit was primarily a private venture, with bus and rail transit companies providing service under exclusive franchises from local governments. The electrical sector was founded as a private initiative and is essentially still a private industry publicly regulated by each of the 50 state governments. Many other examples abound – in education, social welfare, transportation, utilities and elsewhere – of what we now consider to be the public realm that were begun under private, non-governmental or public-private partnership auspices.

A major shift in U.S. policy occurred during the Great Depression of the 1930's when private providers went bankrupt and were taken over by governments that needed to maintain those vital services. The federal government adopted an activist role in spurring the economy through public works and public payrolls. Vast initiatives, like the Tennessee Valley Authority, as well as hundreds of small local projects effectively claimed the development of infrastructure as a government job. The command-control mentality during World War II effectively cemented the government's role as the provider of preference for the public sector, so that in the 50's and beyond, when it came time to redevelop the nation's transportation and environmental control infrastructure, the solutions were new government programs, like the Interstate highway program, the Clean Water Act program for sewage treatment and the Airports and Airways Development Act program. During those decades, governments at all levels expanded their size, scope and level of control.

Development of the U.S. Model

The modern era of public-private partnerships began during the Reagan Administration of the 1980's. President Reagan took an ideological cue from Britain's Prime Minister Thatcher and made the discussion of privatization a legitimate part of public policy decision making. Although

few actual public-private partnership initiatives took hold during his administration, the stage was set by his vision of down-sized government, the dedication of the managers he brought into government service, and his economic policies that effectively starved governments of the funds they would need to maintain or expand programs.

At the state and local levels, governments were also facing challenges that tested their abilities to provide services themselves. Taxpayer revolts, starting in California, created a wave of attempts to limit the size and reach of governments. While the ability of government to perform was being constrained, demands for services still increased, due in part to unfounded mandates handed down from the federal government, and from the continual pressure from citizens to look to government to improve service quality and quantity. Sometimes, this economic squeeze led local governments to convert services from being paid for by general taxes, to having them supported by fees from the actual users. Self-sufficient service provision provides a good foundation for public-private partnerships.

That confluence of policy and economic prerogatives created a fertile environment for the development of public-private partnerships, which began to flourish, albeit not without the fierce resistance of government employee unions. Since that time, governments at all levels in the U.S. have seen the benefits of incorporating private sector resources into their kit of tools for providing services to their citizens. Even the switch of national government to the Democrats in 1992 didn't derail public-private partnerships, as the centrist Clinton Administration read the public mood (as the Blair Labor government did in Britain) and didn't unwind the momentum gained by public-private partnerships in the previous dozen years. Even Clinton's program for the reform of the federal government, the National Performance Review, had a strong place for public-private partnerships in its structure.

With the ascendancy of the new Bush Administration, whose ideology and economic policies return with force to those of the Reagan '80's, there will be a renewed interest in public-private partnerships of all kinds, and a greater reliance on the private sector in the future. The administration has already announced its intention to reduce the federal workforce by 600,000 through outsourcing and other forms of public-private partnerships. Practicality and this federal resolve will force all levels of government to clear the way for more involvement of the private sector in the delivery of public infrastructure and services.

The Benefits of Public-Private Partnerships

In a 1998 survey by the U.S. Council of State Governments, respondents were asked the reasons they used public-private partnerships over the past 5 years. The results were as follows:

- Cost savings 40.9%
- Lack of in-house personnel and expertise 32.5%
- Lack of State support of political leadership 30.8%
- Flexibility and less red tape 23.8%
- Speedy implementation 21.4%
- Increased innovations 20.4%
- High quality of service 18.5%
- Other 10.6%

These results are similar to many other surveys that point to the same advantages for public-private partnerships. Overwhelmingly, the most frequent use of partnerships is to save costs. The U.S. experience with outsourcing of public services routinely results in 10-20% savings over the traditional delivery system. In some cases, savings as high as 40% have been achieved. Conversely, more and higher quality services can be provided at the same cost as before or less. In the State survey, cost savings are also the result of other reasons given, especially “flexibility and lack of red tape”, and “speedy implementation.” Public bodies have found that they can use private resources and expertise to save precious funds through faster facility design and construction, as well as cheaper operations.

But cost is never the only reason to use public-private partnerships. The second-highest reason cited in the survey is the access to specialized expertise and proprietary technology. As generalists, governments cannot afford to provide or maintain such know-how in-house, especially in the area of information and communication technology. The laboratory of the competitive private sector accelerates change to a rate that cannot be matched in the public sector.

Even in other more traditional areas, like environmental control systems, the private sector develops advanced techniques that are better left to their proprietary owner to operate, even if the new technology is installed by the public sector on its own. This is related to another key benefit of partnerships: the sharing of risks with the private sector. In developing complex projects, the private sector can guarantee fixed or maximum prices for construction and eventual operation of systems, relieving the government of its open-ended financial risk in those areas. A private provider can also guarantee the effectiveness and efficiency of the technology it installs, giving public agencies access to such technologies without innovation or performance risk. In some cases, as with concessions, the private provider can even relieve the government of market risk or rate/pricing risk. In most cases, all the risks in a partnership can be distributed among the parties by having the party best equipped to handle each of them take on that responsibility.

Lastly, use of the private sector can help governments to address sensitive political and labor issues. In the State survey referenced above, the third highest reason for public-private partnerships was to accomplish objectives when the political leadership couldn't directly take on an issue. With the flexibility and efficiency of private developers and operators, the public can sometimes enlist the private sector to handle more easily problems such as downsizing, coordination of political entities, regionalization, implementation of difficult policies and cross border relationships.

In the United States, as elsewhere, the criticism of privatization as a way to cut public payrolls and slash wages has been a rallying issue for partnership opponents. Overwhelmingly, however, private operations in the U.S. have not meant massive layoffs. Most operating contracts call for downsizing only through attrition, and the assumption of the public payroll at salaries and benefits that are comparable to those that existed in the public sector before the takeover. Many private providers have union represented employees in their operations, and in many cases, union members and the unions themselves have fared better than with the public employer. In many cases, grievance filings have been all but eliminated, attesting in part to the greater flexibility of private employers.

Types of Public-Private Partnerships

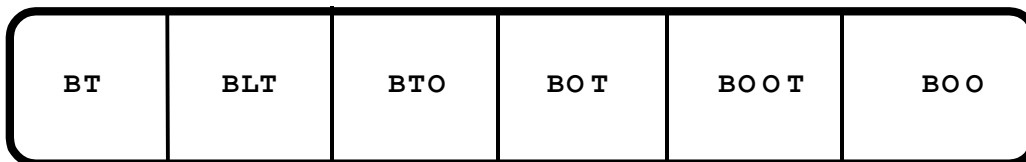
In the U.S. public-private partnerships rarely mean privatization, in many cases because assets were never nationalized to begin with. Instead, partnership refers to an entire spectrum of relationships where private sector resources are used in the delivery of services or facilities for public use. The private sector may be called upon to provide one or more of the following functions:

- Project initiation and planning;
- Design;
- Financing;
- Construction;
- Ownership;
- Operation; and
- Revenue collection.

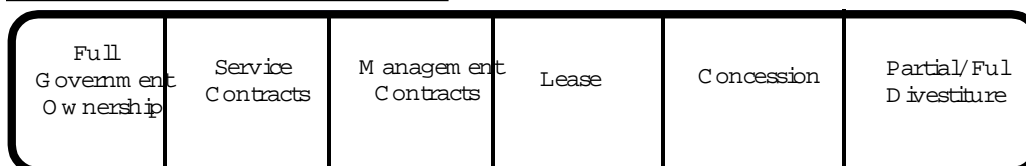
The nature of the partnership is really defined by the distribution of those roles in a service or project. The continuum goes from full public responsibility (standard public services) to full private responsibility (commercialization/privatization) as follows:



New Projects



Existing Services and Facilities



As depicted above, partnership alternatives can be divided into two categories, depending on the type of project: new projects; and existing facilities and services.

Partnerships for New Projects. In the U.S., the nomenclature of public-private partnerships is somewhat different than elsewhere. For convenience, both sets of terms will be used.

Build-Transfer or Turnkey (US)

The Build-Transfer (BT) option stands on the public end of the private participation spectrum. Build-Transfer or “turnkey” approaches involve the public sector “ordering” a project and the private sector delivering it on site. The private participant provides design, construction and construction financing, and the public agency in charge provides permanent financing and operations. BT projects also result when a public infrastructure project is either located near or would otherwise provide significant benefit to a privately owned property or company. In these

circumstances, by designing, building, and transferring an infrastructure facility to the public domain, the private sector can realize significant benefit while simultaneously creating real value for the public at large.

Build-Lease-Transfer (BLT)

This technique is similar to the BT option, except that the facility is conveyed to the public sector under a lease structure upon completion and acceptance of the facility. The lease financing is supplied by the private participant. When the lease is fully paid, the facility is transferred to the public sector at no additional cost. The public sector operates the facility during the term of the lease.

Build-Transfer-Operate or Design-Build-Operate (US)

In the Build-Transfer-Operate (BTO) model, the private sector designs and builds a facility or piece of infrastructure for the public sector, and usually provides the financing for it. Upon completion, the title for the new facility is then transferred to the government but the private sector contractor has the contractual obligation to operate the facility and recover its investment in the project over a set number of years. These terms are usually pre-negotiated. In the U.S., the method of design-build-operate (DBO) has become a most favored alternative, especially in the water and sewage treatment industries. The U.S. practice is to have the private sector design, build and operate the facility over the long term, while the public sector provides both the construction and permanent financing using tax-exempt financing, which is more cost effective than private financing. The existence of tax-exempt financing, and its availability to creditworthy state and local governments makes the U.S. unique in the world, and skews the selection of public-private partnership when contemplating new facilities.

Build-Operate-Transfer (BOT)

Under the Build-Operate-Transfer (BOT) model, the government turns over development and initial operation of what typically would be a public-sector project to the private sector. The private sector contractor or consortium of contractors finances the project, accomplishes the construction, and operates the new facility for some specified length of time after which it is expected to transfer ownership to the government, usually at no cost. The eventual transfer to the government occurs so it ultimately can retain control of the public service.

The BOT approach is often appealing to a host government because it allows that government the following options:

- The ability to minimize its capital costs while still implementing a project at a time when it would not be able to provide the requisite funds, and/or might seek to use its funds for other projects;
- The opportunity to take advantage of operational efficiencies regularly associated with private sector participation; and
- The chance to encourage outside investment and introduce new or improved technology.

This technique works as well for rehabilitation or expansion of an existing facility, when it is sometimes call Rehabilitate-Operate-Transfer (ROT).

Build-Own-Operate-Transfer (BOOT) or Build-Own-Operate (BOO)

When no operating contract binds the public and private partners, the project becomes more of a standard commercial venture, which is relatively rare in the U.S. In these cases, the developer is much more like an owner, and so the option would be called BOOT rather than BOT. The eventual no-cost transfer of the facility to the public sector would most likely be well after the economic life of the facility has expired, or at least not until the financing has been repaid.

The Build-Own-Operate (BOO) method involves the greatest degree of private sector participation in development of a new facility. Under this model the sponsoring consortium finances the project and operates the facilities as owner; it is not required to transfer the facilities back to the host government. These types of facilities are sometimes called “merchant” facilities because the owner’s risks are about the same as if it built and operated any other type of business, like a hotel. This type of arrangement works well when it can be anticipated that a strong and ongoing market will always exist for the service. In the U.S. this option has worked well with solid waste disposal facilities where the owner has several customers available even if the initial one - the public utility - discontinues using them.

The private sector often conceptually prefers the absence of a transfer component so it can maximize its return on investment. Thus, in a BOO the contractor is more committed to the investment than it would be with a transfer, particularly in cases when transfer occurs relatively quickly. For instance, it is likely to operate and maintain the facility most effectively. In essence, the facility is run like a pure commercial venture.

Partnerships in Existing Projects/Facilities. Public-private partnerships are also available for the operation, redevelopment and financing of existing services and systems as well as new ones. In the case of existing systems, the question of asset transfer and ownership becomes a significant variable in determining the appropriate partnership structure, as well as the responsibility for system financial performance.

Service Contract

The public sector retains the greatest degree of control over its services and facilities when the private sector participates through a service contract. In service contracting, or “contracting out,” the government contracts with private entities to supply functional responsibilities that the governmental previously performed, such as garbage pick up, billing and collection, janitorial services, etc. By allowing the private sector to compete for service contracts, the government introduces competition into a previously monopoly-driven area. The public can benefit from competition in reduced service delivery costs, improved service quality, and improved morale of public employees and managers.

In the U.S. existing government employees are often permitted to compete along with private firms for the right to a service contract in a method called “managed competition.” The existing employees submit a proposal the same as the private providers, and they are evaluated on the same basis. This method is fraught with difficulties and is often challenged by the private sector as inherently unfair, but it can be quite effective at achieving employee participation in the overall process.

Management Contract

Like the service contract option discussed above, in a management contract, a private partner operates a publicly owned facility under contract with the sponsoring government. A

management contract is broader than a service contract; the private operator is responsible for all aspects of operations and maintenance as opposed to only certain functions. Private operation of a facility can result in improved service and efficiency, but this option is still on the public end of the spectrum as the private sector does not have a financial stake in the facility or service, but rather is merely providing it. There are dozens of water and sewage treatment plants in the U.S. that are operated on this basis, as well as hundreds of services and facilities in all parts of the public sector, from education to sanitation to public works. Some U.S. cities outsource their entire public works functions to private service companies. This type of service provision is limited more by the availability of a competitive set of service providers than by the imagination and leadership of government leaders.

Lease

In a lease structure, the government grants a leasehold interest in some or all of the assets (usually the entire existing system) with the requirement that the private firm will operate and maintain them pursuant to a lease agreement. The private firm charges the utility an agreed-upon amount for providing the service. Investments in new or expanded facilities would still be the responsibility of the public owner of the assets, while the private lessee would be responsible for repairs and rehabilitation as needed of the leased property. Meter reading, revenue billing and collection may be contracted to the private firm, but rate setting and responsibility for overall financial results would still be the purview of the public owner. In some cases, incentive payment plans with the private lessee may be used to try to improve financial results. In the U.S. it is not unusual for convention centers, sports facilities and entertainment venues to be operated in this manner.

Concession

With a concession, the government grants to a private firm or consortium the exclusive rights to operate, maintain and manage the entire system for an extended period of time. The basic system is still owned by the public, but the private concessionaire owns all improvements and extensions. The operating requirements placed on the private firm are contained in a concession agreement that details all of the performance expectations that need to be met in order to maintain the concession in effect. The concessionaire sets the rates for the service under the regulatory requirements of the government. Unless neutral, informed regulation is provided, a concession arrangement will not work. For the rights to operate the system and reap the profits from such operations, the private firm may be required to pay an initial and/or annual concession fee to the government, and to commit to certain levels of investment over the course of the concession period. The concession yields total operational responsibility to the private consortium for the length of the concession without transferring or selling the assets. The U.S. electrical sector serves the public under these arrangements.

Partial/Full Divestiture

A partial or full divestiture involves sale of public infrastructure to the private sector. Because the actual asset is transferred and government permanently loses control, this option is on the extreme private end of the spectrum. Divestiture can be advantageous for governments with little or no funds to devote to improving failing infrastructure, because with a purchase the private sector assumes all financial responsibilities. In addition, in some situations the government may receive an additional economic benefit from the divestiture if the sale price of the divested asset exceeds the public debt on that asset. A sale agreement will generally have certain conditions, however, such that the government can ensure that various improvements

are made and the new owner continues to serve the citizens. Although few in number, there have been some divestitures made, such as the Conrail railroad and the U.S. Nuclear Enrichment Corporation.

Other Forms of Partnership. Besides the traditional spectrum of partnerships, there have been other ways in which private sector resources have been incorporated into government programs. For example, vouchers have been successfully used in the food stamp program, where private grocers provide eligible families with foodstuffs and get payment from the federal government in reimbursement for the stamps that the families use for the purchases. Similar voucher programs have been used in subsidized housing and are now being experimented with in education. Outsourcing to NGO's has a long and proud tradition in the U.S., where church groups and non-denominational organizations provide social welfare, health, shelter, education, training and other services at the behest of government.

Lastly, de-regulation and commercialization round out the partnership picture. In the airline, natural gas and now the electrical utility industries, deregulation has led to more free market provision of services – with mixed results to date. In new and fast-breaking areas, like information services and e-government, new commercialized service is being explored. For example, government may make its databases and information (non-private) available to private firms to sell or manage, with the government getting a royalty; or the government may operate the information service but pay for it through commercial advertising.

Some Other Examples of U.S. Public-Private Partnerships

Toll Roads. Going back to original practices, some states, notably California and Virginia, are implementing private toll roads where the private investment is supported by toll revenues. In some cases, like Orlando, Florida, the public toll road authority has contracted out tollbooth operations to a private firm. Other road agencies now contract out road maintenance.

Water/Wastewater. Beyond the outsourcing of individual plant operations, water and wastewater utilities are looking at contracting out the entire operations of their systems. Cities such as Atlanta, Milwaukee and Indianapolis have already contracted out their systems on a long-term basis to private firms. New treatment and bio-solids management facilities are being developed using DBO (BTO) technique, including those in Seattle, Atlanta and Phoenix.

Prisons. Privately owned prisons, detention centers and rehabilitation facilities have been built based upon long-term contracts with local governments and the federal government to house their inmates at those facilities. Some are even partial merchant plants offering the facility on a market basis to governments. These programs have worked most successfully with low and medium security facilities.

Infrastructure Sales and Leasebacks. Although relatively rare in the U.S., there have been some privatizations of facilities. State-owned Stewart Airport in New York State has been leased to a private consortium under a long-term lease. In Franklin, Ohio, a water treatment system was sold privately. Similarly, a small water system in Pennsylvania was put out to bid by a local authority and sold to a private water firm. Most examples of this sort are small, non-controversial and usually special cases.

Comprehensive Programs. Some states, such as Michigan, Texas, Virginia and New Jersey, and some cities, like Philadelphia, Indianapolis, Los Angeles and Charlotte, North Carolina, have undertaken thorough reviews of all of their functions in order to select those that could be

performed better through a public-private partnership. These governments have developed tools and techniques to evaluate and determine the cost, performance and quality of hundreds of services delivered by both in-house resources and through potential partnerships. Many have converted eligible functions into management contracts or other forms of partnership.

A-76. The federal government has a comprehensive managed competition program based on Management Circular A-76, under which government functions are evaluated as to whether they are best performed by in-house government workers or outsourced to private firms. One such function that has been so privatized is the investigation and background checking of potential government employees. The A-76 program is under constant scrutiny and is now being overhauled by the Bush Administration as part of its effort to privatize more government functions,

Defense Department. Even the U.S. Defense Department is looking to partnerships so that it can focus more of its attention on its core mission and less on support functions. For example, the armed services are now looking to the private sector to provide housing units for service people and their families with payments made by voucher or other form of guaranteed revenue. All defense bases are also under mandate to privatize their utilities – electricity, natural gas, telecommunications, water and sewage treatment – by selling off those utilities to private providers

Summary

Within the enabling legislation of the federal and state governments, only the imagination and courage of government leaders limits the types of arrangements that can be made. It is hoped that this exploration of the U.S. experience can serve to generate some effective and creative thought in Mauritius as it embarks on its own initiative to use private sector resources to provide its citizens with more, better and more cost-effective services and infrastructure.

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