PRIVATIZATION OF STATE SERVICES IN MASSACHUSETTS: POLITICS, POLICY, AND AN EXPERIMENT THAT WASN'T

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Privatization of government services, or the use of the private sector to attain public goals, took center stage in the "reinventing government" era of the early 1990s as federal, state, and local government attempted to reform service delivery and lower cost. Perhaps nowhere was privatization pursued more eagerly and with more fanfare than in the Commonwealth of Massachusetts, under the leadership of Republican Governor William Weld. If privatization were to succeed this was to be the arena.

But the enthusiasm of the gubneratorial privatization initiative was met by an equally strong cynicism spread throughout the Democratically controlled state legislature and within organized labor. The resulting clash of interests, filtered through the political system, highlighted weaknesses in the privatization approach and ultimately produced a rational policy for making privatization decisions. Other governments could benefit from a review of the Massachusetts privatization experience, and the purpose of this report is to provide that analysis.

Privatization

"Privatization" of government services has many different meanings. After noting that the word itself first appeared in the dictionary only in 1983, Savas (1987: 3) defines it as "... the act of reducing the role of government, or increasing the role of the private sector, in an activity or in the ownership of assets." Butler's definition (1991: 17) makes the most sense here: "Privatization is the shifting of a function, either in whole or in part, from the public sector to the private sector."

While the concept of privatization is broad, we know it better in its various forms, including the use of vouchers, load-shedding, asset sales, and contracting out. The focus of this paper is contracting out -- private sector provision of services that had previously been provided by public employees. Contracting out is nothing new in state government, having been used by government in the United States for over two hundred years (Kettl, 1993).

The goal of privatization as contracting out is usually reduced cost, and often greater flexibility. The argument usually suggests:

-- government bureaucracy is inefficient, and is not driven by the threat of competition, thus raising cost and lowering performance, reducing efficiency;

-- competition among private firms for government business lower costs;

-- civil service and public employee union contracts limit flexibility and ability to reward performance, and to punish those who don't perform, or reassign personnel;

-- privatization eliminates corruption.

Critics of privatization posit:

-- government workers have expertise;

-- government exists to promote goals beyond low cost;

-- the need to lower bids may lead to reduced service;

-- government loses direct control, becoming dependent on private providers;

-- "legal corruption," in the form of campaign contributions, occurs.

There are several conditions that are generally thought to be prerequisite to privatization through contracting out to be a viable alternative to government provision. Most agree that perhaps most importantly there needs to be a competitive marketplace, that is, a significant number of bidders to ensure competition, and to provide back up should the chosen provider fail. Moving from a government monopoly to a private sector monopoly is not necessarily an improvement. The good or service to be provided also must be able to be clearly defined, preferably with measures of performance available. There should be provision for government monitoring of the contractee's performance. Finally, some would argue that there should be minimal risk to the public and government should services be interrupted.

Savas points out four major forces behind privatization efforts, an analysis very relevant to the Massachusetts experience. Privatization, he says, can be driven by pragmatic concerns (more cost-effective government); commercial concerns (to promote business); populist concerns (to increase public choice); and/or ideological concerns (the goal is to have less government). For Governor Weld of Massachusetts, a self-described libertarian Republican, the ideological motivation appeared strongest, often clothed in pragmatic rhetoric.

Indeed, what makes Massachusetts such an interesting case study is that Weld, a Republican elected in a state with a huge Democratic majority, came into office with a predisposition to privatization. Advised by David Osbourne during his campaign, Reinventing Government (1989) would become "assigned reading" for his staff, and in his inaugural addressed he promised to have government "steer, but not row." Privatization would become not just another administrative procedure, but an agenda, a crusade.

The Politics of Privatization in Massachusetts

As for many states, privatization is not new to Massachusetts. Historically there have been swings back and forth between public and private provision of services in the Commonwealth (Massachusetts Senate, 1993). Overuse or abuse by one sector often led to increased reliance on the other. Massachusetts' 18th and 19th century experience with the financial failures of several private turnpikes led the Commonwealth to build more public roads. Social services, traditionally handled by philanthropic organizations, became state responsibilities when growing immigration and urbanization at the turn of the century overwhelmed private providers. As in many states, contracting out for most construction projects has been done for a long time, dating back to the 19th century.

More recently, the first significant shift toward returning social services to the private sector came in the late '60s and early '70s. Fueled in part by Frederick Wiseman's film on state mental institutions, Massachusetts began to contract out certain human service programs, including mental health and youth services. The feeling was that large institutions had failed, that there was a need to get out from under civil service requirements in order to allow some program experimentation, and that putting people in community settings might work better (Dukakis, 1994). In addition, before he left office former Governor Michael Dukakis had, for simple cost cutting reasons, privatized certain transportation functions, including the cleaning of the Massachusetts Bay Transit Authority stations and grass cutting along highways.

The more recent privatization movement in Massachusetts provided a seemingly exponential leap. Politics appeared in many forms including:

-- <u>partisan</u>: a Republican governor fighting for more efficient (and generally less) government, a Democratic legislature resisting his efforts;

-- <u>institutional</u>: a governor seeking more control over the administration of state policy, with a legislature eager to maintain its budget and oversight functions; (Rosenthal, 1981);

-- interest group: an odd alliance of taxpayers organizations, active in Massachusetts since Proposition 2 1/2, and non-profit providers, eager for more business, squaring off against public employees and their unions.

If ever we needed more proof of the inability to maintain the politics-administration dichotomy, one need only look here. Could privatization, the policy improvement, be pushed for partisan or self-interest reasons? Of course it could. Could it, even if an improvement, be opposed for partisan or self-interest reasons? Of course. But the in some ways surprising result is that better policy was the result of this clash between partisan, institutional, and interest group opponents. Politics worked.

The Weld Administration

The policy theme that would come to most characterize the Weld Administration’s approach to state government was privatization, highly promoted and garnering Weld much nationwide attention. Weld's victory in a predominantly Democratic state was a shock, producing the first Republican governor since 1974. Having held no previous elected office, Weld beat the party endorsed candidate in the primary, and squeaked out a 52%-48% victory over Boston University President John Silber (who also beat the party endorsed candidate in the Democratic primary) only after Silber committed several gaffes in the final two weeks of the campaign.

Weld was thus somewhat of an unknown commodity, fiscally conservative, a self-described "filthy supply-sider," and a social moderate/liberal bordering on libertarian. During the campaign, he espoused the traditional conservative position of "reducing big government," a theme more salient than usual in Massachusetts in the context of the Commonwealth's fiscal problems of 1988-89 (Wallin 1995). While he never explicitly promoted privatization during the campaign, according to one campaign worker the idea had been firmly implanted in Weld's mind through discussions with Reinventing Government's David Osborne and John Donohue of the Kennedy School. Privatization, Weld promised, would improve the quality of service while greatly lowering costs.

While ideologically appealing and offering the potential for efficiency gains, privatization also made great political sense once Weld was in office. From an institutional perspective it was a way to gain more control as chief executive over a bureaucracy which had grown under Democratic administrations, much like Richard Nixon's earlier efforts at consolidation in the federal executive branch (see Nathan 1975). Further, it could be justified as part of the chief executive's duty to do what's in the “best interest” of the broader citizenry of the entire state -- efficiency, not its components (organized labor and service recipients). From a partisan perspective, privatization fit the anti-big government, anti-public employee, and especially anti-public employee union position of most Republicans. And from an <u>electoral</u> and <u>interest group</u> (reelection) perspective, privatization would punish those who had opposed the governor (in particular public employees and their unions), while allowing him to cast a wider private sector campaign contribution net, gathering in those in the private sector who would benefit from increased state contracting.

The responsibility for spearheading the privatization initiative fell to the governor's most trusted aide and Chief Secretary, John Moffitt -- the man who had turned around the gubernatorial campaign. The position of Special Research Officer, initially created many years ago to perform background checks on potential gubernatorial appointments, was now to be charged with the researching of privatization issues. One staff member explained that many of the initial privatization ideas came from conservative "think tanks," including the Pioneer Institute locally, and the Reason Foundation, Heritage Foundation, and Cato Institute nationally. On July 25, 1991, the Weld Administration convened a "Privatization Summit" for all cabinet secretaries, with participants including academics and administrators from other states who had been involved with privatization.

With some privatization initiatives already under way in agencies, the Secretary of Administration and Finance promoted a <u>decentralized</u> targeting of programs for privatization by sending out a memo to all Cabinet Secretaries and agency heads asking for new initiatives, and offering criteria for their selection. Ideas were discussed at cabinet meetings. The first Weld Administration privatizations began that same July, six months into the Governor's first term.

As evidence of the governor's "rush to privatize," the initial charge to the agencies calling for privatization initiatives offered only these simple, easy-to-meet criteria for selecting privatization projects:

> -- the service involved must be one you can define distinctly in an RFP;
> -- the privatized function must have measurable performance standards;
> -- there must be more than one vendor able to perform the service, or you lose the benefits of competition.[1]

Note that the instructions were not very detailed, nor more importantly were the criteria demanding. The requirement that there "must be more than one vendor," for example, is obviously not a very rigorous guarantee of competition.

[1] Internal memo from Department of Administration and Finance,

The memo did go on to list a "number of conditions and criteria which might dictate against contracting out," which reads more like a preemptive stike against negative publicity than a guide for management. These included:

- -- when other privatization strategies are deemed to be more effective;
- -- when services cannot be effectively measure as to cost, quality, process, and outcomes;
- -- when done in conjunction with services cuts;
- -- when privatization is explicitly forbidden by existing collective bargaining agreements, or when costs outweigh benefits;
- -- for so-called "core" functions of government, e.g. policy making, enforcement functions;
- -- when public ends (i.e., equity, access, anti-discrimination) are ill-served by private provision;
- -- when services are not readily available from the private sector;
- -- where legal barriers exist.

The lack of specificity and the desire to minimize the fear of initially tying privatization to service cuts suggested politics was more important than policy.

Commonwealth of Massachusetts, p. 2.

In May of 1992, when Moffitt left the Weld Administration for the private sector, the locus of privatization shifted to the Executive Office of Administration and Finance (A & F), the governor's budget office, where there was a new position created titled "Director of Privatization." A more detailed guide to privatization was drafted by January of 1993, and a final guide, including a "privatization checklist" for agencies, published in November of 1993 (discussed below).

The initial privatizations that were completed are found it Table 1. By the November 1993 report the Weld Administration claimed to have saved Massachusetts' taxpayers $273 million, about 2% of the annual budget, a number subject to much dispute and which aroused considerable debate (Commonwealth 1993a). A few of the initiatives are worthy of discussion.

The first involved the closure of state hospitals and mental health facilities, with subsequent contracting out for patient care. Early in 1991 the governor appointed a commission on hospital consolidation, which reported "[t]he Commonwealth's inpatient facilities system, which was built to accommodate over 35,000 individuals at its peak, today cares for 6,200 clients" (Governor's Special Commission 1991:i). The commission recommended the closure of nine state hospitals, and two other mental health facilities. While there was strong protest, especially from patients and their families, and one long hunger strike by a patient that garnered media attention, eight hospitals and the two other facilities were closed. These closures, with attributed savings of $143 million (mostly due to capital avoidance costs) account for half the monetary success of Weld privatization initiatives (Table 1). The validity of this boast is therefore somewhat suspect.

Overall, consolidation of the Health and Human Service facilities accounted for $203 million in savings when including $60 million in operating costs. It is also important to note that another goal of the closures, besides the potential for direct savings and better care, was maximization of federal reimbursements. For example, the commission report noted "although not reimbursable by Medicaid in a psychiatric institution ... treatment for mental illness ... is reimbursable when carried out in a general hospital..." (Commonwealth 1991:36). This makes it difficult to determine if the primary motive for the privatization was really better and more efficient delivery of services, or merely cost-shifting. From an economic perspective cost-shifting is not cost-saving.

The privatization of prison health care – Weld's first -- was presented as very successful, one of the most cost-effective privatizations of service delivery, although also not without controversy at its inception, and serious administrative problems later. The Weld administration noted that in 1991 Massachusetts had the highest per inmate costs for prison health care in the nation, allegedly due to a reported lack of cost controls, weak central accountability, lax controls of malpractice claims, and few standards for evaluation. The Weld Administration claimed that between its privatization in January of 1992 and November 1993 costs went from $4300 per inmate to $2600, with half of the facilities receiving accreditation for the first time (Commonwealth 1993b). Yet several inmates unexpectedly died while under the care of the newly privatized prison health care services. Critics suggest that at least in one case the desire to keep costs down prevented aggressive treatment (McNamara 1992). Ignored in the Weld promotional campaign was the fact that the firm eventually lost its contract in April of 1994, charged with changing records and encouraging fraud to assure accreditation.

The single largest early **project** involved the privatization of the entire maintenance function of a district office of the Massachusetts Highway Department. In September 1992, the state contracted with a private company for highway maintenance and drawbridge operation for the County of Essex. The Administration and Finance Report (1993b) notes that before privatization maintenance was spotty, the ratio of foremen to laborers was 1:2.15, and overtime costs were high. After privatization, savings were claimed to be $2 million in operating costs, $1 million in reallocated equipment, and $1.5 million in reallocated personnel. Both the performance and cost saving boasts were soon to be challenged by the state legislature and Auditor’s Office as noted below.

The Weld Administration was not shy about publicizing its alleged success. The executive summary of the Administration and Finance Report on privatization claimed in addition to the tax savings noted above the implementation of rigorous reviews and cost comparison analyses; increases in quantity, timeliness, and quality of services; public employee involvement; bipartisan support; a large number of bidders; and minimal job losses to state employees. There was no documentation. Meanwhile as early as July of 1994 the Attorney General’s Office charged four contractors with violating prevailing wage laws.

Interest Group Opposition

The strongest interest group opposition to Governor Weld's privatization efforts naturally came from public employees and their unions. In particular Council 93 of the American Federation of State, County and Municipal Employees (AFSCME) consistently countered the Weld Administration’s alleged advantages of privatization.

Among AFSCME's charges was the argument that privatization's cost savings were inflated by omissions such as failing to include increased training costs and lower productivity due to employee turnover. The union also emphasized the decrease in government accountability and control that occurs, including the potential bankruptcy of a private provider, and the tendency of privatized services to be controlled by a small number of companies, which could lead to price collusion. In addition the union charged that privatization under Weld was another word for patronage, citing alleged favoritism in the awarding of contracts to politically connected individuals or firms. They placed particular emphasis on the fact that Weld's chief campaign fundraiser had been a private consultant for several firms doing business with the Commonwealth. The head of one union characterized privatization as "Republican patronage."

Some troubling testimony on the privatization process came from Local 285 of the Service Employees International Union (SEIU). They reported that for the Essex County highway maintenance privatization, they, the union representing the existing workers, had the low bid of $2.9 million compared to the winning bid of $3.7 million (Council 93, AFSCME, et. al.). Their bid was thrown out on a technicality. In addition, they note that the state further <u>stacked the deck against them in future bidding by selling off or reallocating capital equipment, thus forcing any new bid to include the cost of acquiring new equipment</u>. Not surprisingly their interpretation was that the Weld

Administration wanted to guarantee the success of privatization by erecting barriers to future public employee union competitiveness. While the potential loss of jobs or reduced wages and elimination of health care benefits may motivate union opposition to privatization, these charges are disturbing.

Advocates for the mentally ill were also vocal in their criticism of privatization, including the Alliance for the Mentally Ill of Massachusetts and the Partnership for Quality Care. In response to the state hospital closings these groups noted that stays in private hospitals generally cost twice as much as state run facilities. They further expressed concern that patients were moved from their local communities, where support systems exist, and argued that most private hospitals had in the past avoided accepting difficult-to-treat, long term Department of Mental Health patients. Given this history, advocates worried about what options such patients would have if they were turned away from these facilities.

Finally, the Partnership for Quality Care notes that in mental health care, **continuity** of care is both extremely important and efficient (see Kettl 1993a). The history and relationship that has developed between a patient and doctor or counselor is not easily replaced. This problem is confounded by privatization's incentive to keep costs low, which drives down salaries, producing greater rates of staff turnover, further exacerbating the negative effects of discontinuity of care. These concerns were given credence by reports of a dramatic post privatization increase in the number of suicides and deaths among those under the care of the Department of Mental Health (Bass 1995). The number of deaths in the Massachusetts Mental Health System soared 79% between 1990-1994, while injuries more than doubled between 1993-1994.

One interesting sideshow of the Weld Administration’s privatization program was its ability to produce an important split in the human service advocate community. Previous to privatization social service providers and social service advocates were often joined in their opposition to many of the Republican governor's initiatives. Privatization, which can bring more business to the providers, broke the coalition. While difficult to prove as an intended strategy of the Weld Administration, they clearly were pleased with the result as it weakened the opposition to privatization.

State Legislative Opposition and Regulation

Most of the powerful countervailing action on privatization came from the Democratically controlled state legislature, specifically from the House Post Audit and Oversight Committee (and its Research Bureau), and in a Senate initiated privatization regulation bill carried by Senator Mark Pacheco.

The Post Audit Committee issued many early reports on privatization in carrying out its role of legislative oversight. The most damning is its December 17, 1993, report entitled "Privatization Savings: Where's the Beef?" The report challenged the validity of $268 million of the $273 million in cost savings claimed by the Weld Administration's privatization efforts (See Exhibit 4). For example, it accurately pointed out that, as noted above, $143 million of the $273 million is derived from capital avoidance costs due to closing state hospitals and mental health facilities. This number represents <u>projected</u> capital expenditure requirements that the Weld Administration <u>claims</u> would have been necessary to meet federal certification requirements.

The Audit Bureau also noted that “repeated visual and photographic inspections of the Essex Highway Maintenance project,” the largest privatization project, did not support the claims of continued equivalent service at a savings of $1.9 million. It further charged that the <u>Administration would not provide information on the level of service before privatization took place, prohibiting adequate cost-service comparisons</u>. This inability to compare and thus properly evaluate was <u>worsened by a consolidation of Department of Public Works districts during the post-privatization period.</u> These appear to have been strategic moves on the part of the Weld Administration to make meaningful evaluation difficult.

Overall, the Bureau criticized the Weld Administration privatization efforts for lack of planning, inappropriate oversight, deficient management, and shoddy accounting in terms of savings figures. It did suggest that in at least two cases privatization initiatives could have worked to the benefit of taxpayers had proper drafting and management requirements been built into the contracts.

The report also charges that there was no uniformity of records provided by the Administration under subpoena, and no uniform calculation process followed to arrive at savings estimates. Costs that should be included did not appear, including the cost of employees who spent all or most of their time working on privatization, the printing costs for promotional materials, and the costs of consultants hired to promote privatization. Many of these findings are disturbing, and raised questions about the legitimacy of both the Weld privatization process and its reporting. The administration produced no evidence to counter these charges.

While the Post Audit Committee and Bureau was doing its work, a bill regulating privatization was working its way through the Massachusetts Senate. The Chair of the Senate Administration Committee, Mark Pacheco, was first drawn to the privatization issue by attempts during both the Dukakis and Weld

Administrations to close several of the state schools and hospitals in his district. Most disturbing to Pacheco was the Weld Administration plan to close the Dever School earlier than had been announced, with reports that patients and parents of patients had been harassed into consenting to the removal if their children from the facility. Additional closings were slated for Lakeville State Hospital and Glavin State Hospital.

While Pacheco was politically motivated by the loss of jobs of voters in his district, he had major policy concerns about the Weld privatization program, including:

-- the transition of patients from state schools and hospitals to community settings, where lower levels of service would be available;

-- the qualifications of the new care givers did not match those of state employees; and

-- the exclusion of the costs of unemployment, health insurance, and retraining programs for displaced state workers in the privatization decision.

Pacheco also found flaws in the privatization process itself, concluding that the Weld Administration <u>was exercising little or no oversight</u> on privatization efforts and that the entire process was moving too quickly. Before there was any evaluation of one program, the next was begun. There apparently was little tracking of or concern for what happened to the clients of these facilities after they were closed; many were alleged to have ended up homeless. While there were treatment successes in many of the community residences, it seemed to him the process was politically driven, part of an ideological and political campaign (Pacheco 1994).

While a member of the House Pacheco had introduced a bill to regulate privatization as early as June of 1992. In March of 1993 he carried S.1257 to the Senate, an act to regulate privatization (an "anti-privatization bill" according to Weld) which required an in-house management study to determine the most efficient manner for delivering services before any decision to "privatize" a service could occur. S. 1514, the redrafted version, added a controversial element: that a service was to be privatized only if there was to be documented savings of 10% with no decrease in the level of services. While this provision was inserted to compensate for low bidders who might subsequently increase their costs once awarded the contract, the Weld Administration accused the legislature of stacking the deck against privatization. Pacheco felt that since Weld was claiming savings of 40-50%, the 10% threshold should not be difficult. The bill also required that health insurance be provided to employees of the contractor/vendor. Finally, it not surprisingly gave Pacheco's committee on State Administration, along with the House and

Senate Ways and Means Committees, some discretionary power over privatization, requiring the Secretary of Administration and Finance to submit a report justifying privatization before any contracts were let.

In late May of 1993 Senate Ways and Means Committee members submitted a more detailed and more sophisticated bill, S.1642, later to become S.1664, with a companion bill introduced in the House. The controversial 10% savings requirement was dropped. The bill (as amended in conference) included the previous requirements of written statements on costs and quality of service measures and health care benefits. Major additions included:

-- a five year limit on any contract (a sunset law);

-- regulation of all contracts over $100,000;

-- a guarantee for employees of contractors of the average private sector wage, or the state wage for similar services, whichever is lower;

-- a requirement that employers offer positions to qualified state employees;

-- a strong conflict of interest provision, prohibiting state employees involved in the contracting process from going to work for the vendor awarded the contract;

-- provisions for vendor compliance with affirmative action and equal opportunity laws;

-- oversight of the whole process by the State Auditor.

This latter office was in effect given a veto power over privatization.

The State Auditor in Massachusetts is an independently elected constitutional officer, charged with providing "the Governor, the Legislature, auditees, oversight agencies, and the general public ... independent evaluation of the various agencies, activities, and programs operated by the Commonwealth" (Commonwealth 1994:2). The position was then and is currently held by a Democrat and former member of the state legislature.

The final bill was passed by both houses of the legislature in November of 1993, and, quite naturally, was vetoed by the governor, mostly for the power it gave to the State Auditor. On December 16, 1993, the veto was overridden.

The Governor's Guidelines Revised

As the regulation of privatization bill was going through the legislative process, Weld's Office of Administration and Finance was developing a much more detailed set of guidelines for the privatization process, perhaps in an attempt to cut off the legislature's action, suggesting that the development of its initial guidelines had indeed been more driven by politics than good policy. The guidelines are found in the report "Privatization in Massachusetts: Getting Results."

In a section entitled "Evaluating Privatization Initiatives," the report listed and discussed the ideal conditions for privatization, greatly expanded from the original Administration and Finance memo, and including:

1. competitive marketplace -- the desire for multiple potential providers and a warning to avoid creation of monopolies.

2. potential for savings -- decreased costs without passing costs on to service recipients through fees, and the special applicability of privatization to seasonal work.

3. promise of enhanced quality or responsiveness -- promotion of increased quality, consumer satisfaction, or

responsiveness for the same cost.

4. satisfactory assurance of government control and accountability -- need to have services readily measurable in terms of quantity, quality, and desired performance, and government agency capacity to maintain oversight.

5. minimal risk -- including the likelihood of private failure, or reduction or stoppage of services if losses occur, and the consequences of such an occurrence.

6. no insurmountable legal, political, or practical barriers -- desire to avoid strong opposition, loss of public trust, or conflict with federal and state law.

7. minimal adverse employee impact -- including avoidance of conflict with collective bargaining agreements and maintaining diversity of work force.
(Commonwealth 1993b:4-6)

This was a strong and inclusive list of issues to be considered. In addition to the many new issues addressed obvious examples of improvement over the initial privatization charge to agencies include the need for "multiple bidders" under "competitive marketplace," and the category "potential for savings" which had surprisingly been missing from the original.

The Weld Administration report then offered a parallel seven point guide to "mitigating imperfect conditions" (also Exhibit 5). Some of the strategies included:

1. To preserve and promote competition -- permit in-house program managers and public employees to bid for the contract on a level playing field, contract with multiple vendors, and maintain an in-house capacity to perform the services;

2. To ensure the potential savings are realized and maximized -- build cost controls and containments incentives into contracts;

3. To ensure quality and responsiveness -- develop reliable measures of service quality, strengthen in-house monitoring capacity, and write contracts with periodic performance reporting;

4. To ensure accountability and control -- write detailed contract specifications, and require record keeping and periodic reports;

5. To reduce risk -- conduct pilot projects, phase in privatization slowly, and develop emergency contingency

plans in the case of termination of service;

6. To overcome legal and political barriers -- involve affected groups in the decision-making process, and sponsor remedial legislation;

7. To soften adverse impact on employees -- enable public employees to have an equal opportunity to bid for the work, and develop a personnel redeployment plan, including a requirement that private firms interview displaced employees, and have the state provide job placement and retraining to affected employees.

(Commonwealth 1993b:6-8)

Of particular note is the emphasis in both strategies 1 and 7 on involving and assisting existing public employees in the bid process. What a difference some healthy opposition makes.

The issue of comparing costs between privatized and in-house provision was also treated in some detail for the first time. Particularly interesting issues include the suggested determination of whether there are any "retained costs" due to the salaries of redeployed employees. The report suggested that if they are placed in another (already budgeted) slot, then the savings are real, whereas if they are placed in a position which otherwise would be kept vacant, the savings were to be considered illusory. It was further suggested that start up costs and capital investments be amortized over the life of the project, a fair perspective, and one traditionally followed in cost-benefit analysis (Commonwealth1993b:8-10).

The report went on to maintain that to be realistic cost comparisons should contain in-house conversion costs, including competitive procurement and contract development, as well as contract administration costs and contractor support (e.g. data processing, technical assistance, loaned facilities, equipment or staff). The failure to do this had been one of the early criticisms made by both employee unions and the state legislature. Indirect costs of both the state agency and private vendor such as employee payroll taxes and fringe benefits were to be included in the comparison, and the report also warned of the potential for overlooking such private sector costs as performance bonds, liability insurance, and legal fees (Commonwealth 1993b:10).

If cost estimates resulted in the likelihood that privatization was warranted the Weld guidelines next mandated the determination of service specifications and performance standards. The guidelines called for them to be "clear and specific," focused on desired outcomes vs. internal operations, quantifiable when possible, and realistic.

Finally, the report offered a "privatization checklist" to be followed by agencies, which the Administration touts as capturing the "best demonstrated practice" of its early privatization initiatives (A & F 1993:3). Included are sections dealing with

-- minority business participation

-- affirmative action

-- work force transition

-- quality assurance

-- public employee participation in bidding

-- conflict of interest provisions

-- cost comparison

-- implementation.

In sum, the report offered a comprehensive model for the privatization decision process, a dramatic improvement over its initial guidelines. Clearly the presence of good, strong partisan and institutional politics seemed to have improved the policy.

Assessment

The discussion of issues in the Weld Administration's November 1993 "Getting Results" report is comprehensive, with very important and detailed sections on the ideal conditions for privatization and a guide to mitigating imperfect conditions, including an emphasis on involving current public employees. The discussion of cost comparisons is similarly excellent. Finally, the "privatization checklist" presented agencies with a very practical roadmap to follow through the privatization process and its potential pitfalls. In sum, these principles may be worthy of emulation by other governments considering privatization.

But the Weld experience with privatization suggests a gap between the rhetoric and reality, and reinforces the potential for problems when privatization is overzealously pursued. In fact, the new guidelines were not applied for two years until the opposition arose. As interesting is the fact that after the implementation of the administration's privatization guidelines and adoption of the legislative check the Weld Administration stepped back from its privatization campaign, seeking only to expand on existing privatizations, or implementing ones under the $100,000 limit which would trigger the State Auditor review.

The spirit of many of the revised guidelines was clearly violated in the early privatizations, as documented by legislative reports. Public employees felt that they were not as involved as they should be, cost comparisons were not comprehensive, and performance data was not presented. Many of the fears of opponents of privatization in general, and those affected in Massachusetts, were realized.

Whether due to acts of omission or commission the rush to privatize produced policy mistakes. The most costly in both fiscal and human terms was the inability of the state to find homes for many of the mental health patients displaced due to the state hospital closings. While partially reimbursable by the federal government's Medicaid program, the cost to the state of maintaining many of these patients in private hospitals was considerably over budget, while reinforcing a medical orientation that may detract from community support objectives.

In retrospect some executive branch officials admit that they moved too fast, without proper evaluation of alternative care providers. Further, the state realized only half of the predicted savings from Medicaid reimbursement, as there were problems qualifying the homeless, illegal immigrants, and those who recently moved to the state.

Legitimacy concerns have been raised by instances of revolving door behavior (the individual who negotiated the prison health care privatization went to work for the provider), the extravagant expenses by some contractors (including the use of contract funds to buy luxury cars), and campaign contributions from vendors. While not illegal these and other instances cause concern for the taxpaying public.

Disturbing criticisms also relate to the manner in which privatization decisions were made, and the inability to document claimed savings and equal or better service. The legislature's Audit Bureau findings that the Administration followed no uniform cost calculation process, and, among other things, failed to include the costs of conducting privatization studies and promotion, are worrisome, as was the Administration's failure to provide data even when subpoenaed.

Even more disturbing (and instructive) are charges that whether intentionally or not, actions were taken that "stacked the deck" in favor of privatization, including

-- the inflation of expected savings;

-- the failure in some cases to adequately measure service levels and costs before privatization, which prohibits accurate comparison;

-- the reduction in resources for the highway maintenance project in the period before privatization, lowering performance, and thus increasing the likelihood of service improvement after privatization;

-- the redrawing or consolidation of district lines for highway maintenance to further hinder accurate pre- and post-privatization performance and cost;

-- the failure to explain bidding rules equally to all parties, and rejection of union bids on technicalities or judgment issues;

-- the selling off of state equipment to create high switching costs and thus increase the cost of future bids by state workers; and

-- the failure to include the costs of unemployment, health insurance, and/or retraining for displaced state workers;

-- the laying off of state hospital employees to increase the chance that the hospital would lose certification, and thus have its service provision privatized.

These actions make a mockery of the claim that privatization was to be a policy experiment.

While some of the individual privatizations were worthy, the process for determining and justifying them was not a consistent one. There was no uniform calculation process, and little effective documentation of service level and cost savings. The new Weld Administration guidelines responded to many of these criticisms, but whether they would have been developed in the absence of legislative opposition is an open question, and they have not been used much as Massachusetts has retreated from its great privatization experiment.

The great pronouncements of a privatization revolution never reflected the reality of the Massachusetts experience during Weld's time in office. Developments since are also interesting.

The Massachusetts Privatization Experience Since Legislative Regulation

In the 2½ years before the Pacheco law passed the Weld Administration let 36 contracts; in the years since 7 contracts have been submitted. Five were subsequently approved by the State Auditor, including

- -- maintenance of Highways in Worcester County (after initial rejection)

-- storage and retrieval of records for the Department of Employment and Training

-- food service operations at Holyoke Community College

-- mail opening services for the Department of Revenue

-- the real estate functions of the Massachusetts Bay Transit Authority (MBTA).

All of these were fairly minor privatizations.

The Office of the State Auditor has rejected two proposals, both involving the MBTA. One involved the contracting out of advertising and cleaning of its bus shelters; the other was the privatization the operation and maintenance of two bus routes. These were privatizations on a much larger scale.

Proponents of the Pacheco law contend that approval of five contracts provides <u>de</u> <u>facto</u> proof that the process does not prohibit privatization, while the rejection of the other two most likely prevented unwise policy.

The bus route case had the biggest stakes. The Auditor challenged the contract on the basic question of whether anticipated cost savings were real. For example, the Auditor pointed out that the 1997 proposal did not include pensions and benefits for displaced workers, something required by the Federal Transit Administration (up to six years of severance pay, for example). There were also disagreements over whether quality would be maintained. Indeed the Auditor found that the two proposed private contractors had “significant performance problems” in other cities. Further, the proposal assumed free rent from two MBTA facilities, and free support services such as maintenance, public safety, and emergency services. These should have appeared as costs. Finally, the proposal did not specify the wages that the contractors would pay, nor was there any provision for tort liability.

The case is more interesting in that once again it appears the Administration was trying to stack the deck against bidding by public employee unions. The Carmen maintain that they had the lowest bid, saving $30 million to the contractors’ $25 million. But the MBTA rejected it, as it was the result of a bundled bid for all 10 garages. The union maintained that the bid must be looked at as a package, and that it couldn’t be competitive for just one garage. The MBTA ruled that the bundled proposal was the same as “withdrawing the bid.”

An important sidelight was the potential affirmative action impact of the privatization. Forty-three percent of MBTA employees are people of color, and twenty-eight percent are women, all making a fairly good wage. And awarding the contracts also would have had an impact on the state pension system. If a large number of bus drivers had lost their jobs, they would no longer be contributing to the pension system, threatening the pension of other workers and retirees. Finally, there was also a fear that non-profitable routes would be dropped.

In a case of principle over the practical, the MBTA spent over $500,000 in legal fees (taxpayer funds) in an attempt to challenge the Pacheco law and consequent power of the State Auditor.

Eventually it was politics, not beauty, that killed the beast. Aware of the effect that organized labor had on the Weld campaign for US Senate in 1996 (“Privatization is a Weld scam”), acting governor Paul Cellucci signed a contract with the MBTA Carmen’s union in the midst of his campaign. It included generous cost-of-living increases, but more importantly a “commitment not to privatize or subcontract work presently performed by Local 589 members for the duration of the agreement” (five years). While some might conclude that this only suggests raw political power, one can also assume that if privatization of these routes was such a good policy idea it would have been possible to convince the electorate.

The proposal to privatize MBTA bus shelter was rejected by the Office of the State Auditor due to its general sloppiness. Once again it was not clear whether there would actually be a cost savings or not. The MBTA did take this case to court, and lost in September of 1998 when the Massachusetts Superior Court upheld the power of the Auditor. The case is now on appeal to the Massachusetts Supreme Judicial Court.

One of the few “positive” fallouts of privatization has been the ability of Governor Cellucci to raise campaign contributions. Contractors with the Massachusetts Highway Department contributed $67,720 to his gubneratorial bid while State Highway workers contributed $54,129, the most of any state agency’s employees. Middlesex Paving company, one of the contractors, had already been fined by the Commonwealth’s Ethics Commission in 1996 for illegally entertaining Highway Department employees at corporate Christmas parties.

Meanwhile there has been criticism of the Commonwealth for attempting to circumvent the privatization rules. Several privatizations have been implemented under the $100,000 threshold that would trigger review by the State Auditor. Further, there has been a “privatization creep” as some existing contractors have expanded their services, or subcontracted out responsibilities, which the Administration contends is not increased privatization.

There have been other developments related the some of the initial privatization “success stories” highlighted in the 1993 report “Getting Results.”

Charles River Hospital, once hailed at privatization’s “biggest success,” was charged with changing records and encouraging fraud to win accreditation. It lost its contract after the first year, the result of a rush to privatize. Advocates for patients naturally expressed concern for the effect of being moved on psychiatric patients, one of the concerns they had expressed pre-privatization. Financial woes had mounted so much that ATT had cut off long distance phone service three months before the contract was terminated.

Mental health advocates have charged that other privatizations have resulted in denial of needed care, inappropriately short hospital stays, over-reliance on medication, lesser trained staff, high staff turnover, loss of ability to track patients, and a reluctance to respond to request for information. Further there was been a cost shifting to the commonwealth’s “free care pool” for the cost of serving psychiatric patients the state used to treat. This pool provided $0 in 1990 for psychiatric patients but has grown to $4-5 million a year. It is estimated that hospitals spent $22 million in 1997 on these services, with obviously only a fraction recovered from the pool. Psychiatric diagnoses are now second only to heart disease. Advocates also criticize the impact on patients of hours waiting in emergency rooms waiting for beds. Some private hospitals have simply refused to admit more than the contracted number of patients, something state facilities would not have done.

As noted above, the low base salaries of human service workers results in lesser trained staff and high turnover. The Massachusetts state legislature has in the past several years created a supplemental pool to provide cost-of-living increases to these health care providers, in effect bailing out the private contractors who argue that their hands are tied by contracts and the desire to remain competitive.

The largest project, the Massachusetts Highway Maintenance contracts, has also seen continued controversy. First, as noted above, contractors made generous contributions to the political campaign of Governor Paul Cellucci. A report by the State Auditor found that the state in effect <u>lost</u> $1.4 million on one of the contracts, for Essex County. Meanwhile the Highway Department has found other ways to prop up the contracts. A toll-free call program for drivers to report trash on the highways rings in the offices of the Highway Department, which then dispatches <u>state</u> workers to clean it up. This is work that should be performed by the relevant contractor. This has been characterized by privatization opponents as a “whatever it takes” approach by the Administration. The Highway Department also paid Coopers $1 million to document their success.

There is one positive note. Public employee unions have in many instances moved from resistance to cooperation. To land highway maintenance contracts, for example, the union agreed to move from 3 to 2 man trucks, and to not fill positions when they come open. At the local level they have worked well with the increasingly financially sound providers of water and sewer service.

Perhaps most telling, however, is the fact that the executive branch has not promoted its successes as much as it did in the early “unregulated” days. One must assume that this is because those successes are rare. Greatly heralded at birth, Massachusetts privatization has become somewhat of an orphan in life.

Summary and Conclusions

The Massachusetts experience with privatization highlights the pitfalls of a zealous rush to privatize. There are important lessons for all considering such policy.

The Pacheco law to regulate privatization in Massachusetts presents important policy considerations relating to the decision to privatize, and the nature of its development reminds us of certain principles that relate to the privatization process.

Policy Considerations

The first consideration is the benefit of an independent check on the privatization decision, at least those of any magnitude. Partisan or institutional incentives may lead to a rush to privatize (or misinformed opposition to it) with mistakes potentially made. Better policy is likely to result from decision making which includes several perspectives in a clear, delineated process, and is potentially best served by an “independent” check by an office with little to gain politically by the ultimate decision. The removal of the state legislature in Massachusetts from any umpire role was probably a wise decision. The conflict of interest regulation in the Pacheco law is an important addition to privatization policy and needs an objective administrator. Further, the involvement of such a “third party” is likely to reduce suspicion about “stacked decks” among state workers and their unions, and thus promote legitimacy, and potentially cooperation.

Second, it is important to encourage and assist bidding by state workers; after all, if existing state workers can match or lower outside bids, transition costs are eliminated and the need for further privatizations may be lessened as other state employees reconsider the existing system and weigh their options. Privatization should promote competition, not involve political punishment. Indeed in Massachusetts state workers have in several cases changed their work rules and lowered their cost to the state to avoid privatization, including a 25% cut by some transit workers (Palmer 1993). As one Massachusetts chapter of AFSCME has offered, “if laws need to be changed, let’s change them.” One of the least studied effects of privatization is its motivational effect on current state workers.

Finally, it is important to treat privatization, as we should any new policy, as an experiment. Cost and performance must be carefully measured before privatization so that a proper evaluation of privatization’s effects can be made. Like all governmental policies, privatization should be easily reversible. The independent check on the privatization decision by the State Auditor may help prevent attempts to stack the deck in its favor, which obviously can contaminate results, while the sunset provision enacted by the Massachusetts legislature is important to guarantee that the evaluation occurs. And while proof of savings and performance may, as in many programs, be difficult, legitimacy and accountability argue that it be attempted. As Kettl has suggested, efficiency and lower cost must be balanced by effectiveness, retained in house capacity, responsiveness, and trust in government (1993b:17-20).

Politics and Privatization Policy

It is sometimes hard to find an arena in which a meaningful clash of interests, filtered through the political system, allows a policy to be developed to its fullest potential. The privatization agenda of Governor William Weld of Massachusetts, resisted by a Democratic legislature traditionally kind to public employee unions, provides us one such arena. "Politics as usual" in this case produced better policy.

The difficulty in sometimes determining or agreeing on cost savings estimates means that the <u>process</u> for making decisions becomes very important. The less you can prove the more input, negotiation and bargaining you need. The tendency of a proponent or opponent to try to stack the deck likewise argues for a sound, well-defined, and inclusive process. The Weld Administration's refusing the low bid of the public employees for highway maintenance, and subsequent sale of equipment, are examples of proponent stacking. Some evidence of "revolving door" behavior warns us of the bad old days of patronage and kickbacks. Massachusetts has fairly strong campaign finance laws to prevent "legal kickbacks;" not all states do. The need to regulate is clear.

What is further clear is the advantage of having some independent or bipartisan oversight. The inherent difficulty in measuring performance in most government services, and documenting cost savings from a change of service provider, are strong arguments for careful consideration of privatization initiatives. This is especially true when privatization becomes a crusade.

The difficult question for other states may be how to institutionalize that skepticism and oversight which grew out of the political climate and divided government of Massachusetts, and where to place the "check." In Massachusetts there were many institutional candidates considered for the role of "referee," including Attorney General, State Inspector General, and State Auditor. In some states a bipartisan, or non-partisan commission, might work best. Some "double security" as to the rights of public employees, service providers, service recipients, and taxpayers is warranted, however. The mechanism may need to conform to the political culture and institutions of each state. But there must be a mechanism to inject objectivity into what might otherwise be a politically motivated agenda.

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