In the Public Interest? Safeguarding New Jersey's Public Investments

A Response to the New Jersey Privatization Task Force Report

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Executive Summary

The New Jersey Privatization Task Force, led by former Congressman Richard Zimmer, issued its report to the governor on May 31, 2010. The report proposed a variety of privatization projects that it predicted would result in $210 million in savings; however, it provided few details about how these projects would actually achieve this level of savings. Only a small number, if any, of the Task Force's proposals will meet its key standard of "achieving efficiency through private sector competition." While the Task Force's report argues that successful privatization can be achieved only through a combination of best practices for project analysis, vendor selection, and contracting and performance monitoring and oversight, the Task Force fails to heed its own advice when making its privatization recommendations.

The Task Force's report presumes that privatization will inevitably produce costs savings. The current empirical research on privatization however, which was largely ignored by the Task Force, suggests otherwise. Recent rigorous and comprehensive evaluations of privatization projects do not find significant benefits from privatization. A variety of explanations have been advanced to explain the lack of returns to privatization, including: government, itself, through process improvement can achieve more significant cost savings; monitoring and contracting costs for privatization can be as high as 20%, often making privatization an uneconomical alternative; competitive bidding markets for government contracts often do not exist; and private contractors collude causing price differences to erode (Bel and Warner 2007).

Arising from poor service quality and insufficient savings arising from privatization, many privatization projects result in reverse contracting (in-sourcing), where government reclaims work formerly privatized. Reverse contracting is growing. A combination of increased government efficiency, reverse contracting, and market failures, has stalled the shift toward privatization in the United States. Government service delivery remains the dominant method for the provision of two-thirds of local public services.

Although the Task Force never considered the potential benefits, there are large potential cost savings for in-sourcing currently privately contracted work. Government has a substantial advantage in supplying its own professional work since it pays its professional employees considerably less than the private sector, giving it a substantial economic cost advantage in providing professional services, such as engineering, law, informational technology and accounting.

While the Task Force did recognize the importance of public employee involvement in a competitive contracting process, it failed to understand employee and union incentives that motivate incumbent at-risk employees through their union to collaborate with public managers to improve service processes. These collaborations often result in internal efficiencies greater than those achieved through privatization. The federal government now requires a public incumbent employee bid for all competitive contracting processes. Federal employees have won 90% of all of these competitions.

The Task Force's report fails to provide any methodology, accounting, or data sources for their savings estimates. According to our review, the Task Force oversells potential savings, while very little of its privatization savings can be attributed to increased efficiency. Rather we believe

whatever "savings" are achieved will come from a reduction in services, higher fees, fares, and user costs, and the substitution of bad jobs with low wages and few benefits for good jobs with decent wages and benefits.

New Jersey offers a multitude of negative examples of privatization, public corruption and politically motivated misallocations, including E-ZPass, EnCap, schools construction, motor vehicle inspections, tax collections, inmate health services and municipal utilities. While the Task Force believes it has learned the appropriate lessons, it demonstrates naivety by asserting that the problem can simply be resolved by creating a centralized state agency able to write clear contracts.

What the State needs is a comprehensive framework to evaluate projects for privatization and reverse privatization. This framework should cover all levels of government in the State, since State funds flow to county, municipal, school district, and special entity units. Over 80% of the State's budget passes through to other governmental units or private entities, which need to be brought under a unified effective framework of transparency, oversight, and enforcement.

New Jersey must be guided by a system with standards and rules for transparency, arms-length independent contracting, oversight, evaluation, and enforcement with clear lines of authority and accountability. Adequate budget resources and qualified staff are needed to implement these essential functions if New Jersey is to get value from government and provide a bulwark against public corruption. However, our initial research suggests that resources for state oversight are shrinking, and the State is presently incapable of overseeing its current vast array of contracts.

The state should make fair competitive bidding a cornerstone of its privatization policy. The standards listed below should be incorporated into the State's privatization activities but are either omitted from the Task Force report or are more weakly advanced than advocated here.

- The contracting process should require multiple competitive bids that provide detailed information about how the contractor plans to achieve efficiencies.
- The contracting agency must insure transparency, accountability standards, oversight procedures, and remedies for noncompliance sufficient to ensure that public services are not privatized unless there are cost savings to government agencies and taxpayers based on improved management efficiencies.
- The contract should not increase fees, fares or other charges to the public and should not reduce the quantity and quality of services or the qualifications or pay of employees.
- The contractor must comply with contracting, discrimination and conflict of interest laws.
- The contracting agency must certify the contract cost to be less than the cost of agency employees providing the services.
- Incumbent employees through their designated representative must be given an opportunity to competitively bid for work already contracted or proposed for contracting.
- All contract renewals should be subject to a reverse contracting review and possible bid.

The Task Force, guided by an ideology rather than practicality, has advanced a privatization program that if implemented will result in reduced services, higher fees, fares, and user costs, and the substitution of bad jobs for good ones. It will not achieve its advertized objective of saving costs through greater efficiency, and with the current diminished oversight capabilities it may result in the opposite – higher costs and inefficient service provision. As a result, less ideological future administrations will eventually reverse contract many of its proposed projects.

Introduction

The New Jersey Privatization Task Force, led by former Congressman Richard Zimmer, was created on March 11, 2010, when Governor Christie signed Executive Order 17, to undertake a comprehensive review of opportunities for privatization within state government and to identify impediments to privatization by May 31, 2010.

In its final report to the Governor, the Task Force provided few details about how its privatization projects plan to achieve a predicted $210 million in savings; to the extent possible we will highlight questions and concerns about these proposals. We estimate that very few, if any, of these proposals meet the standard of “achieving efficiency through private sector competition.”[1]

In its report to the Governor, the Task Force recommended institutionalizing its proposed privatization program in a new central privatization state agency. To fully implement a comprehensive privatization program the Task Force concluded the Governor must **establish a new centralized privatization entity to manage both privatization and related policies aimed at increasing government efficiency.**[2] The Task Force recommended that the entity should continually evaluate all agencies’ performance and implement and oversee privatization initiatives across state government.

According to the Task Force the principal determinant of success is political will, which begins with the Governor, who has prioritized **achieving efficiency through private sector competition**. For advocates of privatization, the main argument in favor of privatization is that market competition can achieve efficiencies unavailable to public entities, and thus market competition can improve service quality at lower costs.

This report will show, however, that many privatization projects fail to achieve these hoped for market efficiencies and, instead, may result in higher costs to the public; inferior services; lower labor standards for new employees; political spoils for politicians; and even public corruption. State and local governments already have an enormous range of contracts with private service providers that need more transparency with better oversight, evaluation, and enforcement processes.

Although the report talks about privatization’s enhanced efficiency, **the source of some of the Task Force’s proposed privatization savings will most certainly come from lower quality or reduced services, higher fares and fees charged to New Jersey citizens by private vendors, and the replacement of good jobs with bad jobs.** Is it in the public interest to achieve savings by degrading generations of public investments, reducing services or service quality, shifting costs on to the service consumer through new or higher fees, or cutting employee wages and benefits? The Task Force provides no standards for evaluating privatization initiatives beyond saving state dollars, avoiding public corruption, and promoting competition. **The fundamental problem with this approach is does not ensure quality services or government capability to govern and respond to citizens.**

[1] For the Task Force the term “privatization” refers to a broad array of initiatives that government can use to take advantage of the capabilities of the private sector to provide better value for taxpayers.

[2] The Task Force advocates that this privatization entity should also disseminate privatization best practices; conduct a regular inventory of all functions performed by state government to determine which activities can be privatized; maintain an inventory of surplus state properties and other underperforming assets that can be sold; design comprehensive, performance-based contracts for privatization vendors; develop protocols and procedures for contract monitors and assist the monitors in carrying out their responsibilities; track agency performance in implementing the privatization strategy; and report periodically on the results of the privatization program.

In the present economic environment with high unemployment, reduced tax revenues, and budget deficits, we are concerned that projects initiated under the banner of enhanced efficiency are in fact motivated instead by short term cost savings and quick revenue generation at the expense of the long-term well-being of the state and its citizens.

The Task Force's report argues that successful privatization will be achieved only through a combination of best practices for project analysis, vendor selection, contracting and performance monitoring and oversight. We agree. Accordingly, the Task Force advocates adopting a series of ideal best practice policies; however, it should be noted that while most of these best practices are well-known, they rarely are used in making privatization decisions.[3] Why? There are many motivations driving privatization decisions beyond efficiency: chief among them is ideology. As we will see the Task Force fails to heed its own advice when it makes its privatization recommendations.[4]

Literature Review: What is the Evidence of Privatization's Success or Failure?

Historically, the academic debate on privatization has been highly ideological (Warner and Bel 2007), relying primarily on case studies with proponents finding cost saving efficiencies (Eggers and O'Leary 1995; Savas 2000) and detractors reporting cost overruns, corruption, erosion in wages, and the elimination of citizen voice (Hebdon 1995; Sclar 2000; Starr 1988). **The Task Force's report presumes that privatization will inevitably produce costs savings. The current empirical research on privatization however, which was largely ignored by the Task Force, suggests otherwise**. The record of empirical research does indicate that there may have been substantial savings arising from privatization in the 1970s and 1980s. For example, the Reason Foundation's research summary table (derived from John Hilke's book *Competition in Government Financed Services*, published by Quorum Books in 1992) cited by the Task Force is based on studies from this period. Literature reviews evaluating privatization projects from this period by Domberger and Rimmer (1994) and Domberger and Jensen (1997) also concluded that privatization was linked to cost savings.

[3] To guide privatization efforts the Task Force recommends that the new entity and agencies base decisions on accurate, activity-based costs, and a uniform cost accounting model; ensure that only qualified bidders in sufficient numbers participate; award contracts based on predetermined, merit-based criteria, and following a documented scoring process,; use qualified and unbiased evaluators to rank and judge proposals; require successful vendors to have a strong balance sheet; vet subcontractors and downstream contracts; build specific metrics, goals and outcomes into contracts; enforce contract terms and impose prescribed penalties for failure to perform; conduct open, competitive rebidding upon contract expiration; and require rigorous and vigilant monitoring of each contract on a real time basis to maintain the accountability of the vendor and ensure that contractual terms are enforced. Monitoring must be independent and transparent from the beginning of the contract and inserted into every facet of the project. The cost of the monitoring also should be included in each privatization proposal and taken into account in the required cost-benefit analysis. In addition, government officials must be free from conflicts of interest, and as much information as possible about each project, including contracts and other documentation, should be posted on the Internet.

[4] The Task Force's recommended best practice standards are commendable, but are unlikely to be undertaken since the State does not have the information and accounting systems to implement these practices. Nonetheless, these best practices should be required and the state should make the necessary investments to achieve them before any significant privatization is undertaken. The increased costs for the accounting and information system upgrades should be born by the private contractors in their contracts.

More rigorous and comprehensive evaluations of privatization projects undertaken since 1990, however, do not find significant benefits from privatization.[5] Meta-analyses in more recent studies, such as those conducted by Boyne (1998) and Hodge (2000), emphasize that the evidence is mixed and a systematic relation between private production of public services and cost savings cannot be demonstrated. More recent studies of privatization of public services are less likely to find cost savings from privatization, possibly because the projects that were going to yield the most benefit were already privatized. In other words, the low-hanging fruit may have already been picked for privatization. On average, local governments have privatized one-third of their public services (Warner and Bel 2007).

The research literature increasingly questions the benefits of privatization. For example, Bel and Warner (2006) review all econometric studies of costs for waste collection and efficiency for water distribution from 1965 to the present and find the majority of studies report no difference in costs and efficiency or productivity between public and private production. Similarly, Zullo (2007) detects no immediate or long-term economic benefit from contracted bus services.

Studies from the early 1980s reported savings from contracting urban bus operations; however, Leland and Smirnova (2009) replicating that research find **privately owned and managed transit systems are no longer more efficient or effective than government owned agencies**. They conclude this occurred for several reasons, which may apply more broadly to privatization. First, without any serious competition, private transit services remain a monopoly and operate under the same conditions as public providers. Second, private firms may have higher transaction costs in their financing and business activities that outweigh any initial cost savings. Third, over time, the pressure from the public may have intensified and private providers may have had to adapt to public demands requiring them to operate with similar constraints as public providers. This would also explain the rapid decrease in the sheer number of private providers. If service provision is no longer profitable, then many private companies simply have left the market. The Task Force's mass transit privatization proposal follows this familiar formula, and is unlikely to lead to significant public savings in the long run. It may, however, yield short-term cash for the state, monopoly profits for the Academy Bus services, the most likely private bidder for NJ Transit's profitable bus lines, and higher fares for commuters with no efficiency gains.

More generally, **a variety of explanations have been advanced to explain the diminishing returns to privatization**:

1. **Government, itself, uses a range of tools to achieve cost savings.** Public managers have become more sophisticated in the use of these tools, which not only include privatization of services to for-profit and non-profit organizations, but also mixed private-public undertakings, intergovernmental cooperation, private-public competitive bidding, process improvement, incentive compensation plans for public employees, benchmarking, and reverse contracting (in-sourcing).
2. **The monitoring and contracting costs for privatization can be as high as 20%,** often making privatization an uneconomical alternative.
3. **Competitive bidding markets for government contracts often do not exist.** Few contractors have the capability to undertake many government services being contracted. Most governments do not face a competitive market of alternative suppliers. Market

[5] This discussion benefits enormously from the work of Mildred Warner and her colleagues.

competition also erodes due to incumbency – contracts are typically renewed as other providers exit the market.

4. **Research has shown private contractors collude and price differences erode despite government regulation to ensure competition and price policies to ensure cost efficiencies (Bel and Warner 2007).**

Scholars have concluded that privatization and market failures can lead to reductions in service quality and lack of cost savings.[6] These failures are the primary reasons for "reverse privatization" (Hefetz and Warner 2004, 2007), which occurs when contracted work is brought back into the governmental entity from for-profit providers, non-profit providers, or other governmental units. Mildred Warner, 2008, the leading academic analyst of privatization, reports data from a 2002 International City/County Management Association (ICMA) survey of local governments which shows that **poor service quality and insufficient savings were the leading causes for reverse contracting**.

Table 1: Reasons for Returning Work to the Public Sector (Reverse Privatization)

Service quality was not satisfactory	72.7%
The cost savings were insufficient	51.0%
Local government efficiency improved	35.9%
There were problems monitoring the contract	20.4%
There was strong political support to bring back the service delivery	21.6%
There were problems with the contract specifications	15.1%

ICMA Survey of Alternative Service Delivery 2002, N=245 U.S. Municipalities who answered the question, "Why did you bring services back in house within the last five years?"

Source: Reproduced from Warner 2008

Warner and Hebdon (2001) find that **reverse privatization, or contracting back in previously contracted services, is a logical consequence of privatization**. Change in government management capability, monitoring difficulties, and principal-agent problems are most important in explaining contracting back-in.[7] Professional government managers often find that the best value is obtained by the public entity (Hefetz and Warner 2004, 2007). In many of the cases, internal process improvements undertaken by labor management cooperation are associated with contracting back-in (Hefetz and Warner 2004).[8] Contracting back-in may reflect market success where competition increases the efficiency of the public entity when confronted with privatization and job losses (Lavery 1999). In other cases it reflects the failure of markets to meet desired outcomes or failure of government to adequately manage and monitor contracts (Sclar 2000). This process of reverse contracting is growing in the United States (Hefetz and Warner 2007).

[6] Market failure is said to occur when a market left to itself does not allocate resources efficiently.

[7] Principal-agent problems arise when somebody (the principal, in this case government) hires somebody else (the agent, in this case the contractor) to carry out a task and the interests of the agent conflict with the interests of the principal.

[8] Process improvements are often linked to new technology upgrades, but not always. They seek to identify root causes in a process and to use this knowledge to reduce variation, remove activities that contribute no value to the service produced, and improve customer satisfaction. A team examines all of the factors affecting the process: the materials used in the process, the methods and machines used to transform the materials/service, and the people who perform the work. Activity based process improvement focuses on eliminating or reducing cost drivers in processes.

Importance of Reverse Contracting

Using survey data on 628 governments in the 1990s, Hefetz and Warner (2004) report 93 percent contracted out at least one service, while 81 percent of these governments contracted back-in at least one service. Almost three-quarters of governments engaged in both new contracting out and contracting back-in. These findings challenge the adequacy of a singular focus on contracting out. On average, most governments both contract out and contract back-in services. The Task Force does not provide any framework for examining the cost savings and service improvements through reverse contracting, although these benefits may be larger than those arising from privatization.

Since the presumption of the Task Force is that privatization almost always results in savings, they were, therefore, apparently blind to potential advantages for in-sourcing current privately contracted work. For example, government has a substantial advantage in supplying its own professional work. New Jersey state and local governments pay their professional employees considerably less than the private sector, giving it a substantial economic advantage in providing professional services, such as engineering. Because the state and local governments enjoy this substantial total employee compensation advantage in providing professional services (see Table 2), we question whether the public is presently getting best value by using outside private firms for professional services.

Table 2: Private and Public Annual Wages and Compensation Compared by Education Level

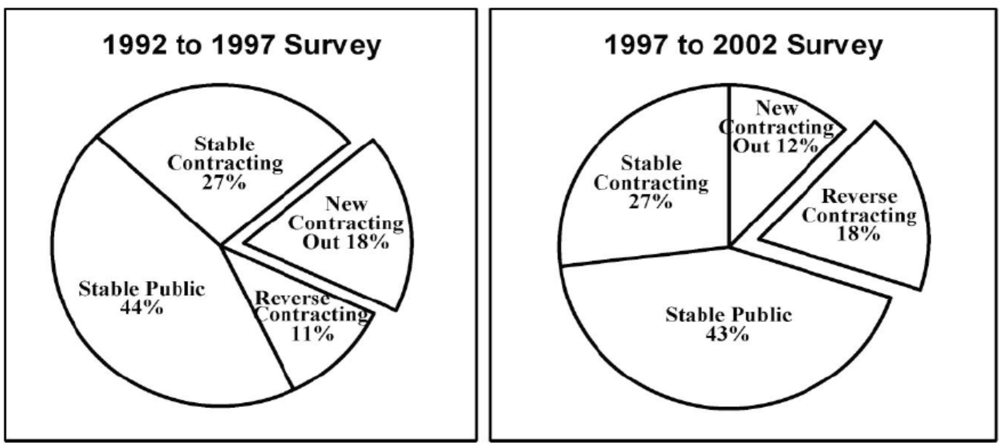
Annual Wages by Education	All Private	State and Local Government		Public/ all Private
Average Wages	$61,252	$56,694		-8%
Wages by Education				
Less than high school	$25,238	$41,000		38%
High School	$39,818	$44,050		10%
Some College	$49,539	$47,567		-4%
Associates	$50,793	$50,916		0%
Bachelors	$80,911	$56,641		-43%
Professional Degree	$153,553	$79,330		-94%
Masters	$97,333	$69,171		-41%
Doctorate	$110,696	$109,482		-1%
Average Compensation	$93,478	$77,325		-17%
Total Compensation by Education				
Less than high school	$36,961	$55,747		51%
High School	$59,761	$59,855		0%
Some College	$72,011	$64,589		-10%
Associates	$75,056	$69,500		-7%
Bachelors	$118,947	$77,463		-35%
Professional Degree	$234,091	$108,402		-54%
Masters	$143,393	$94,687		-34%
Doctorate	$145,050	$147,173		1%

Source: Keefe 2010

One can imagine reverse contracting (in-sourcing) some professional work, for example, engineering and legal services that might result in better value for the public. Privatization contracts in New Jersey have often been linked to business contributions to political candidates and political parties. While the New Jersey Pay-to-Play legislation has been considerably successful in limiting that practice at the state level, it is still widespread at the county and local levels of government. Both levels of government are the recipients of enormous amounts of state funding. (See Appendix C for a discussion of Pay-to-Play reforms and the present sources of business contributions to New Jersey political candidates).

There are numerous difficulties in the privatization process, including the specification of contracts that lead to reverse privatization. Significant technical and auditing costs are associated with monitoring contracts, which are seldom taken into account in the privatization literature (Prager, 1994). Monitoring costs may be as much as 20 percent of the total costs of contracting out (Warner and Hebdon 2001). At the municipal level of government, reverse privatization was most common in service areas where privatization was high (public works, transportation, health and human services, and parks and recreation). The reverse privatization reflects the difficulties in monitoring quality of services that are hard to specify, and the difficulty in structuring competition between and among private suppliers to ensure efficiency and, thus, relying on competition from the government to gain efficiency (Warner and Hebdon 2001).

Figure 1: Dynamics for Government Service Delivery and the Growth of Reverse Contracting



Author analysis based on data from the International City/ County Management Association, Profile of Alternative Service Delivery Approaches, Survey Data 1992, 1997, 2002 Washington, DC. Paired samples, 1992-1997= 628 municipalities, 1997-2002=480 U.S. municipalities

Source: Mildred Warner 2008

Figure 1 above reflects the increasing reliance on reverse privatization and the limits of privatization in the provision of government services. Privatization has proven to be unstable, and has not delivered the promised cost savings. The real challenge for government is to promote process improvement. This requires an internal focus within government and careful attention to management (Warner 2008). The process of outsourcing and then reverse contracting involves substantial, and we argue unnecessary, costs to the public and disruptions to the employment of public employees.

Growth in Privatization Has Stalled

As a result of increased government efficiency, reverse contracting, and market failures, the shift toward privatization has stalled; government service delivery remains the dominant method in the provision of two-thirds of local public services in the United States. The 2007 ICMA survey shows:

- Direct public delivery is still the most common form of service delivery at 52% of all service delivery across all local governments on average.
- Intergovernmental contracting at 16% and for-profit privatization at 17% are the most common alternatives to direct public delivery.
- Non-profit delivery at 5% is next, and franchises, subsidies, and volunteers collectively account for less than 2% of service delivery.
- Compared with 2002, the levels of for-profit privatization and non-profit contracting are flat, and intergovernmental contracting rose from 11% to 16% of service delivery.
- Direct public delivery fell from 59% in 2002 to 52% in 2007, but this fall was offset by an increase in intergovernmental delivery.

Averaged across all governments and all services, the trends in local government service delivery are relatively unchanged. (From *Trends in Public and Contracted Government Services: 2002-2007* by Mildred E. Warner and Amir Hefetz, Reason Foundation).

Public verses Private Competitive Bidding with Standards

Many privatization advocates in the United States recognize that competitive bidding between public and private providers can ensure competitive pricing (Reason Foundation, 1997). Competitive contracting by the employees in a public agency is required by many governments as part of the privatization decision process. Competitive contracting is common in the United Kingdom, New Zealand, and Australia and is used to ensure "contestability" in numerous limited competitive market situations (Boyne 1998; Martin 1999; Osborne and Plastrick 1997; Young 1992). Competitive bidding has become standard in some cities, such as Phoenix, Indianapolis, and Charlotte (Martin 1999). In competitive bidding, incumbent at-risk employees through their union and in collaboration with public managers are given the freedom to redesign work processes that often results in internal efficiencies greater than those achieved through privatization (Applebaum and Batt 1994; Ballard and Warner 2000; Martin 1999).

The federal government now requires a public incumbent employee bid for a competitive contracting process. Federal employees won 90% of all competitions conducted under the regulations in the Office of Management and Budget. When allowed to make improvements and compete, public sector employees have done well. More importantly, these results demonstrate that the public sector is not inferior to the private sector when there is head-to-head competition (Dannin 2006). Coupled with other reforms, for example, one which allows departments to reinvest savings into improved technology, competitive bidding can further efficiency gains and reduce two major sources of public-sector inefficiency: outdated technology and rigid organizational management systems (Warner and Hefetz 2001).

The Task Force did recognize the importance of public employee involvement in a competitive contracting process. They received testimony from former Indianapolis Mayor Stephen Goldsmith, a fiscally conservative republican, who undertook in 1992 an innovative approach to privatization. He engaged the City's main union, AFSCME, to allow the union represented employees to retain their work if they could do it for less than competitive contractors. His pioneering initiative resulted in most Indianapolis union workers retaining their jobs while the city greatly improved the quality of its service delivery and reduced the costs of those services.

What the Task Force fails to grasp is what is necessary in order to engage public employees and their representatives in "productivity bargaining."[9] As in any employment situation, employees' desire to maintain and secure their jobs often becomes the chief motivation in their willingness to engage in productivity bargaining and process redesign. For example, the Task Force recommends that the New Jersey Employer-Employee Relations Act be amended to permit public sector employers to outsource services to private vendors without the need to negotiate the impact of these actions. If public sector political executives cannot manage "effects" bargaining, which merely requires negotiations over the effects of changes on employees and not the decision to implement the change, they will never be able to mount a more sophisticated productivity bargaining framework.[10]

Furthermore, the Task Force recommends elimination of the Displaced Workers Pool (DWP), which allows workers who are laid off or displaced due to privatization, outsourcing, or closure of facilities to remain employed by the state for up to four months. These state employees continue to receive their full salary, health, and all other contractual benefits, and continue to accrue seniority; however, they do not receive severance pay and do not bump other employees if they are unable to find another position with the state.[11] Without any consideration of the costs and benefits for the State, the Task Force recommends that the State should oppose extension of current labor contract language regarding the Displaced Workers Pool (DWP). Instead of engaging public employees and their collective bargaining agents as Indianapolis' Goldsmith did, the Task Force builds opposition to its proposals from the incumbent employees and their elected representatives.

Finally, in their discussion of impediments to privatization, the Task Force reveals a basic misunderstanding about the nature of public sector employment. They correctly observe that civil service replaced the spoils system by protecting public employees from politically motivated management actions, but today they claim it frustrates good management. What they fail to acknowledge is that it still protects workers from their politically appointed executives, who would often prefer to use their work time for political rather than public purposes. What the Task Force incorrectly asserts is that several decades ago a parallel system of collective bargaining emerged to protect employees, rendering the civil service system largely redundant. The Task Force misrepresents the relationship between the two systems. For the most part, even though there are tensions between the two, the two systems complement each other. The greatest problem that public managers encounter with civil service is the difficulty in dismissing poorly performing employees, which can be easily fixed with an incremental approach to civil service reform. It would make sense to move all discipline and dismissal cases, wherever possible, into the collectively

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[9] Productivity bargaining is the process of reaching an agreement through collective bargaining whereby the employees of an organization agree to changes which are intended to improve productivity in return for an increase in pay or other benefits or, in the case of privatization, in return for maintaining the work in the public sector.

[10] Effects bargaining does not require the employer in these negotiations to reach any agreement with the union over the effects of the changes on employees, but to negotiate in good faith to minimize the negative effects of the change.

[11] Bumping is an expensive and lengthy civil service process to politically insulate and protect tenured employees from layoffs or job eliminations, which allows senior workers to claim positions of less senior employees, unleashing a downward chain of employee job movements.

bargained grievance-arbitration system and out of the cumbersome civil service hearing procedure, where a single well established "just cause" standard could be applied to all disciplinary and dismissal cases. This would greatly improve public managers' ability to take corrective action up to and including dismissals. The relatively few cases of public corruption involving public employees (as opposed to elected officials), however, should be an indicator of the civil service's success. Given the history of public corruption in New Jersey, it would seem unwise to dismantle civil service.

Zimmer Task Force's Proposed Savings Not Based on Enhanced Efficiency

While the Task Force proposes $210 million in privatization savings, their report fails to provide any methodology, accounting, or data sources for their estimates. Consequently, it is impossible to conduct an independent evaluation of whether these proposals are achievable. The proposal also fails to consider reverse contracting of professional services, where the state enjoys a substantial competitive advantage over the private sector contractors.

The short time the Task Force had to complete its work did not permit "the exhaustive vetting and cost-benefit analysis that it recommends in this Report for all privatization initiatives." The Task Force was unable to calculate precise savings for most of its proposals and failed to make any calculations for many of its other proposals. This lack of precision, according to the Task Force, arises because the full savings are unknown until the end of a full-fledged competitive bidding process, but it also occurs because New Jersey state government agencies have difficulty calculating with precision the full cost of the functions currently performed at the state level. **The State lacks the management accounting systems that would permit either these calculations or the implementation of an activity-based cost improvement program.** Nonetheless, the Task Force provided savings estimates for a number of privatization initiatives.

According to our review, based on reading the Task Force's privatization project summaries and our background research, very little of privatization savings can be attributed to increased efficiency. Instead, some savings may result from deliberately cutting services, for example, motor vehicle safety and environmental inspections. In addition, to make private bus service attractive or state park concessions profitable the commission believe fees and prices should be uncapped, meaning the public will be paying higher prices for the privatized services (see Table 3). Other savings, however, will come from layoffs of long serving public employees and their replacement by significantly lower-waged private sector workers who will likely have fewer benefits, including health benefits, and will experience much higher turnover. What we did not calculate are the increased costs of unemployment benefits and other social services as many public workers join the ranks of the unemployed. Older workers are presently experiencing the longest periods of unemployment in this labor market. In general today there is more long term unemployment of all workers than any period since the Great Depression.

Table 3: Assessment of Zimmer Task Force Privatization Proposals Most Likely to Reduce Services or Raise Fees, Fares, or Costs of Services

Zimmer Task Force Privatization Proposal	Less Services	Higher Fees for Services
State Parks Concessions		X
Golf Course Management & Maintenance		X
NJ Transit Bus Routes	X	X
NJ Transit Parking Facilities		X
Trenton War Memorial		X
Interstate Rest Areas		X
Emergency Service Patrol	X	X
Employee Parking		X
Pre•K Reforms	X	
Special Education	X	
Passenger Motor Vehicle Inspections	X	X
Housing & Uniform Construction Code Enforcement		X
Public Colleges Auxiliary Services		X
Highway Maintenance Contracts	X	
Toll Collection	X	

Source: Keefe 2010

Rather than review each proposal here, we will focus on the two most troubling projects: privatization of New Jersey Transit (NJ Transit) bus operations and the full privatization of the Motor Vehicle Service. The privatization of NJ Transit bus operations will inevitably result in further service reductions on unprofitable routes and increased fares to ensure the profitability of the private contractor. There is not a competitive market for urban bus services. The most likely private provider is the Academy Bus Company, the largest privately owned and operated transportation company in the country. As indicated in the above discussion of the research literature, private bus services are not more efficient than public providers. Therefore, we need to ask what is the motivation behind the privatization of bus services? And, will higher fares be used to pay franchise fees to the state?[12] Before making any privatization decisions the state needs to undertake a more balanced assessment of NJ Transit Bus Service operations.

Motor Vehicle Inspections were privatized during the Whitman administration (see Appendix B). Testing, license and registration applications and renewal, and administration of Motor Vehicle Services were reverse privatized by the McGreavey administration since the private contractor could not provide adequate services. Recently, safety inspections services have been eliminated by the Christie administration and five inspections centers have been closed, resulting in a significant reduction in both public services and public safety. The Task Force would take the next step and drive all Motor Vehicle Services to private vendors. Inspections will be fraught with a basic conflict of interest problem. For-profit inspections mean that the person inspecting a vehicle has an incentive to find problems in order to fix them for a profit. Alternately, it may also allow collusion between the for-profit inspector and the owner of an unsafe or polluting vehicle to pass the

[12] Franchise fees are paid to government for exclusive access to route by a provider – a tax on fare paying riders.

inspection. This shift may result in dramatic cost increases for the driving public and increases in profits for repair shops, which may explain why their trade association enthusiastically welcomed this proposal. Many of the other Task Force proposals are fraught with these kinds of problems. They profess an unquestioned belief in market efficiency and competition, even when the private market solution rests on a monopoly provider or a blatant conflict of interests.

Need for a Comprehensive Assessment of Private and Public Sector Work and Contracts

New Jersey needs a comprehensive, transparent methodology for assessing when it makes sense for government to provide services and when it reflects good judgment for the private sector to provide public services. Some services are inherently public, for example, police, while others may be performed either by government or private sector firms under governmental oversight. Developing and administering a transparent methodology is more complex than the Task Force would have us believe and not easily centralized in one agency, since it affects virtually every agency and governmental unit. We also think that the framework must govern all governmental units in the state, not merely the State. **Over 80% of the State's budget passes through to other governmental units or private entities, which need to be brought under a unified effective framework of transparency, oversight, and enforcement.**

Both state and local governments already engage is substantial private contracting. The State reports for 2009 that it had $3.4 billion in contracts with 4,073 vendors (NJ Financial Reporting as of June 1, 2010). Other governmental units had many more contracts that need to be made more transparent. The total number of governmental units in New Jersey makes clean contracting and oversight an enormous task. Aside from state government, New Jersey is comprised of 1,383 governmental units, with 21 county governments, 566 municipal and township governments, 606 public school systems, and 247 special independent units, such as the Turnpike Authority. In addition, there are various governmental units that have certain characteristics of governments but are classified as subordinate agencies of the state or local governments, for example, housing authorities or the New Jersey Sports and Exposition Authority. Each of these units does and may enter into private sector contracts to accomplish their respective missions. The complexity of these relationships and the difficulty of providing adequate oversight have created a highly controversial legacy of public corruption in New Jersey.

A comprehensive assessment process for privatization should focus on efficiency gains in the delivery of services. The important standards listed below are either omitted from the Task Force report or are more weakly advanced than advocated here:

- The contracting process should require multiple competitive bids that provide detailed information about how the contractor plans to achieve efficiencies.
- The contracting agency must insure transparency, accountability standards, oversight procedures, and remedies for noncompliance sufficient to ensure that public services are not privatized unless there are cost savings to government agencies and taxpayers based on improved management efficiencies.
- The contract should not increase fees, fares or other charges to the public and should not reduce the quantity and quality of services or the qualifications or pay of employees.
- The contractor must comply with contracting, discrimination, and conflict of interest laws.
- The contracting agency must certify the contract cost to be less than the cost of agency employees providing the services.

- Incumbent employees through their designated representative must be given an opportunity to competitively bid for work already contracted or proposed for contracting.
- All contract renewals should be subject to a reverse contracting review.

Does New Jersey Have Adequate Oversight Over Existing Contracts?

The Task Force reports on a series of cases that are claimed to be successes. Unfortunately, their presentation provides little evidence, few metrics, and very little information about cost savings. On the other hand, New Jersey offers a multitude of negative examples of outsourcing. The Task Force invited the State Inspector General, the State Comptroller, and the Executive Director of the State Commission of Investigation (SCI) to its first public hearing to testify about the failed privatization efforts investigated by their offices. They told the Task Force about the lessons they learned from failures in the privatizations involving E-ZPass, EnCap, schools construction, motor vehicle inspections, tax collections, inmate health services and municipal utilities (see Appendix A for other recent failures). According to the Task Force, these failures have much in common:

> *"they were poorly conceived at the start, goals were not clearly articulated, due diligence was superficial, contractors were inexperienced or undercapitalized and government oversight was lax or nonexistent. In extreme cases, government officials had clear conflicts of interest and engaged in official misconduct. These failures have led to the enactment of significant, albeit piecemeal and incomplete, statutes to avoid future reoccurrences."*

In response to these failures, the state strengthened its conflicts of interest law and mandated ethics training for all state government employees. The Task Force concludes that "although the new laws resulting from failures of past privatization initiatives form a good foundation to ensure the success of future privatization initiatives, New Jersey does not have a comprehensive system for managing the privatization process." Their solution to the management problem is a centralized privatization agency. We believe that what is needed is a more comprehensive system with standards and rules for transparency, arms-length independent contracting, oversight, evaluation, and enforcement with clear lines of authority and accountability. Adequate budget resources and qualified staff are needed to implement these essential functions if New Jersey is to get value from government and provide a bulwark against public corruption. **However, our initial research suggests that resources for state oversight are shrinking.**

The Office of the State Comptroller is an independent office that audits government finances, reviews the performance of government programs, and examines government contracts.[13] During FY 2009, approximately $8.2 million was appropriated to the Office of which $5.3 million was actually expended. Out of this $5.3 million, $3.5 million was spent on salaries and wages to support a staff of 53.[14] For FY 2010, $8.1 million was appropriated ($4.2 million for salaries and wages) to support a staff of 57. The Governor's budget for FY 2011 proposed continuing this level of support for salaries and wages to support a staff of 59;[15] however, **the approved appropriations bill cut the**

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[13] State of New Jersey Office of the State Comptroller. 2010. "About the State Comptroller's Office." http://www.state.nj.us/comptroller/about/ (accessed October 2, 2010).

[14] New Jersey Office of Management and Budget. 2009. *State of New Jersey Budget: Fiscal Year 2009 – 2010.* http://www.state.nj.us/treasury/omb/publications/10budget/pdf/front.pdf (accessed October 2, 2010).

[15] New Jersey Office of Management and Budget. 2010. *State of New Jersey Budget: Fiscal Year 2010 – 2011.* http://www.nj.gov/treasury/omb/publications/11budget/pdf/front.pdf (accessed October 2, 2010).

salary and wage appropriation in half to $2.2 million. Although no job cut figures are publicly available, it must be assumed that significant cuts were made to address this decrease in funding.[16]

The Office of the State Auditor supports the State Auditor, a constitutional officer appointed by the legislature, required "to conduct post-audits of all transactions and accounts kept by or for all departments, offices and agencies of the state government."[17] As part of these audits, the Office independently verifies all assets, liabilities, revenues, and expenditures. These audits result in the development of reports that address compliance, internal management, and efficiency issues.[18] In addition to the required post-audits, the State Auditor is authorized to conduct performance review audits "of any program of any accounting agency, any independent authority, or any public entity or grantee that receives state funds" at his discretion and/or at the direction of the Legislature.[19] Since FY 2000, the Office of Legislative Services (OLS), which houses the Office of the State Auditor, has received an annual appropriation of approximately $31.3 million (in 2010 dollars). The OLS saw relatively stable annual allocations in inflation adjusted terms between FY 2000 and FY 2009.[20] It is unclear exactly what percentage of this allocation was used to fund the Office of the State Auditor. However, the fact that the Office of the State Auditor expanded its staff during this time period (from 84 to 97 employees) indicates that it did not experience significant declines in funding.[21]

The Governor's budget for FY 2011 proposed an allocation of approximately $29 million for the OLS.[22] **If approved at that amount, this would be the smallest budget in inflation adjusted terms the OLS has seen in the past ten years.**[23] Because the approved appropriation for the Legislature was approximately $3.9 million more than what was recommended in the Governor's budget, it is possible that the OLS received some of this increased allocation.[24] However, it is unclear how this additional funding was distributed throughout the Legislature and what, if any, portion was allocated to the OLS and the Office of the State Auditor.

[16] New Jersey Office of Legislative Services. 2010. "Appropriations Act FY 2011 Summary Totals." http://www.njleg.state.nj.us/legislativepub/budget_2011/fy11_scoring.pdf (accessed October 2, 2010).
[17] "New Jersey State Constitution 1947 (Updated through Amendments Adopted in November, 2008)." 2008. http://www.njleg.state.nj.us/lawsconstitution/constitution.asp (accessed October 16, 2010).
[18] New Jersey Office of Management and Budget. 2009. *State of New Jersey Budget: Fiscal Year 2009 – 2010.* http://www.state.nj.us/treasury/omb/publications/10budget/pdf/01.pdf (accessed October 2, 2010).
[19] New Jersey State Legislature. 2010. "New Jersey Permanent Statutes (Updated through P.L. 2010, ch. 80, and JR 3 of P.L. 2010)," Title 52.24. http://lis.njleg.state.nj.us/cgi-bin/om_isapi.dll?clientID=284324&depth=2&expandheadings=off&headingswithhits=on&infobase=statutes.nfo&softpage=TOC_Frame_Pg42 (accessed October 16, 2010).
[20] New Jersey Office of Management and Budget. State of New Jersey Budget, FY 1999-2000 through FY 2010-2011. http://www.state.nj.us/treasury/omb/publications/11budget/index.shtml (accessed October 16, 2010).
[21] New Jersey Office of the State Auditor. Annual Reports of the New Jersey Office of Legislative Services Office of the State Auditor, 1999 through 2009. (2000 Annual Report not available online.) http://www.njleg.state.nj.us/legislativepub/annual_auditor_calendaryear.asp (accessed October 16, 2010).
[22] New Jersey Office of Management and Budget. 2010. *State of New Jersey Budget: Fiscal Year 2010 – 2011.* http://www.nj.gov/treasury/omb/publications/11budget/pdf/front.pdf (accessed October 2, 2010).
[23] New Jersey Office of Management and Budget. State of New Jersey Budget, FY 1999-2000 through FY 2010-2011. http://www.state.nj.us/treasury/omb/publications/11budget/index.shtml (accessed October 16, 2010).
[24] New Jersey Office of Legislative Services. 2010. "Appropriations Act FY 2011 Summary Totals." http://www.njleg.state.nj.us/legislativepub/budget_2011/fy11_scoring.pdf (accessed October 2, 2010).

Conclusion: Safeguarding New Jersey's Public Interest

The Zimmer Task Force provided few details about how its privatization projects plan to achieve $210 million in savings. We estimate that very few, if any, of these proposals meet their key standard of "achieving efficiency through private sector competition." While the Task Force's report argues that successful privatization will be achieved only through a combination of best practices, the Task Force fails to heed its own advice when it makes its privatization recommendations.

The Task Force's report presumes that privatization inevitably produces costs savings. The current empirical research on privatization, which was largely ignored by the Task Force, suggests otherwise. Recent rigorous and comprehensive evaluations of privatization projects do not find significant benefits from privatization.

Reverse contracting, where government reclaims work formerly privatized, is growing as a result of poor service quality and insufficient savings arising from privatization. The Task Force never considered the potential benefits of reverse privatizing work. In New Jersey there are potential advantages for in-sourcing currently privately contracted work. Government has a substantial cost advantage in supplying its own professional work since it pays its professional employees considerably less than the private sector. At contract renewals, all privatized work should be subject to a reverse contracting review. This may be the only genuine opportunity for formulating a competitive bid.

The Task Force did recognize the importance of public employee involvement in a competitive contracting process; however, they fail to understand employee and union incentives that motivate incumbent at-risk employees through their union in collaboration with public managers to improve processes that increase efficiencies greater than those achieved through privatization. The federal government now requires a public incumbent employee bid for a competitive contracting process, and federal employees have won 90% of all competitions. New Jersey should make this a cornerstone of its privatization policy. As a result of increased government efficiency, reverse contracting, and market failures, the shift toward privatization has stalled; government service delivery remains the dominant method in the provision of two-thirds of local public services in the United States.

The Task Force's report fails to provide any methodology, accounting, or data sources for their savings estimates. According to our estimates, the Task Force oversells potential savings, while very little of its privatization savings can be attributed to increased efficiency. Rather we believe whatever "savings" are achieved will come from a reduction in services; higher fees, fares, and user costs; and the substitution of bad jobs with low wages and few benefits for good jobs with decent wages and benefits.

What the State needs is a comprehensive framework to evaluate projects for privatization and reverse privatization. This framework should cover all levels of government in the State, since the State funds flow to the county, municipal, and special entity units. Over 80% of the State's budget passes through to other governmental units or private entities, which need to be brought under a unified effective framework of transparency, oversight, and enforcement.

New Jersey offers a multitude of negative examples of privatization that involving public corruption and political misallocations, including E-ZPass, EnCap, schools construction, motor vehicle inspections, tax collections, inmate health services and municipal utilities. While the Task Force believes it has learned the appropriate lessons, it demonstrates a naivety when it believes that the problem can simply be resolved by creating a centralized state agency able to write clear contracts.

We believe what is required is a more comprehensive system with standards and rules for transparency, arms-length independent contracting, oversight, evaluation, and enforcement with clear lines of authority and accountability. Adequate budget resources and qualified staff are needed to implement these essential functions if New Jersey is to get value from government and provide a bulwark against public corruption. However, our initial research suggests that resources for State oversight are shrinking and the State is incapable of overseeing its current vast array of contracts.

The Zimmer Task Force, guided by an ideology of "the market is always more efficient," has advanced a privatization program that will result in reduced services; higher fees, fares, and costs; and the substitution of bad jobs for good ones. If the privatization program is implemented it will not achieve its advertized objective of saving costs through greater efficiency. In the long run these projects will cost taxpayers more, while providing fewer services and raising fees, fares, and user costs.

APPENDIX A: AN EXAMINATION OF PRIVATIZATION IN NEW JERSEY

Findings from Case Studies in Privatization

Finding 1: Privatization in New Jersey has not saved money.

The Clarion group analyzed food service contractors in ten New Jersey school districts and found that the private contractor overcharged the districts almost $320,000 in insurance costs. This amount could have been used to purchase more than 4,600 new elementary school math textbooks.[25]

In March 1998, New Jersey entered into a contract for the design, installation, operation and maintenance of a state electronic toll collection (ETC) system. The state based the contract on the idea that the system would be self sustaining, since revenues would be generated by fines related to E-ZPass violations and the commercial leasing of fiberoptic telecommunication cable. A June 2004 state audit states that by the end of 2003, nearly $575 million had been spent on E-ZPass, but total revenues were only around $100 million.[26] The audit furthers reveals that this huge undertaking was placed "into the hands of a few individuals with little accountability" and that important information was "veiled from public view."

Finding 2: Privatization in New Jersey has not improved quality.

The Camden County jails contracted with Aramark to provide food-related services. On February 17, 2009, the Courier Post reported that a county inspection uncovered unsanitary conditions, including rodent droppings, improper food storage, and plumbing problems.[27] According to the county's prepared statement, Aramark manages and operates the kitchen area. The inspectors found multiple serious health violations in areas that were under the private contractor's purview.

In 2004, New Jersey ended its contract with Maximus, which ran the State's children's health insurance program. The State received complaints that the company lost important paperwork and failed to process applications in a timely manner. A state audit revealed that the Division of Medical Assistance and Health Services received hundreds of reports regarding vendor errors and processing delays. In 2002, the State filed six complaints against Maximus to the Department of Treasury, Bureau of Contract Compliance for unsatisfactory performance and failure to meet contractual obligations.[28]

Finding 3: Privatization in New Jersey can hurt workers.

According to a report by Mary McCain of the Rutgers University Center for Women and Work, the reported cost savings for schools that contract out their school food services mainly derives from significant cuts in wages and benefits for food service workers. These cuts were found to be as much as $4.00 to $6.00 an hour, ensuring that these workers remain a part of the "working poor." Furthermore, there is no requirement that contracted workers be granted sick days, encouraging sick employees to come to work and exposing students to health risks.[29]

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[25] Tom MacDermott. "Hard to Swallow: Do Private Food Service Contractors Shortchange New Jersey Schools?" Clarion Group. 2009.

[26] State of New Jersey Commission of Investigation. E-ZPass: The Making of a Procurement Disaster. June 2004.

[27] Article accessed from http://www.privateci.org/new_jersey.htm. Originally from the Courier-Post on February 17, 2009.

[28] New Jersey State Legislature Office of Legislative Services, Office of the State Auditor Department of Human Services Division of Medical Assistance and Health Services. "Health Benefits Coordinator Contract for Medicaid Managed Care Programs July 1, 2000 to September 15, 2004." December 17, 2004.

[29] Mary McCain. "Service Students: A Survey of Contracted Food Service Work in New Jersey's K-12 Public Schools." Center for Women and Work, School of Management and Labor Relations Rutgers, the State University of New Jersey. 5/1/2009.

APPENDIX B: CASE STUDY ON PRIVATIZATION IN NEW JERSEY

DMV Emissions Inspection Contract

Amid threats from the United States Environmental Protection Agency (EPA) that it would withhold nearly $1 billion in federal transportation aid if New Jersey did not implement a tougher vehicle emissions testing program to comply with the Federal Clean Air Act, New Jersey contracted out the development and administration of a new emissions test to California-based Parsons Infrastructure & Technology Group in 1998.[30] The $392 million contract, under which Parsons took over the motor vehicle inspection stations previously operated by state employees, spurred political controversy as concerns emerged about cost estimates, bidding practices, contract oversight, and political influence.[31]

<u>Contract Concerns</u>

Although the Whitman administration said the contract would save the state $35 million over seven years,[32] union representatives disputed this claim by citing a Department of Transportation (DOT) report that showed inspection costs would be lower under a state-run system. State Treasury officials contended that the cost discrepancies were due to the DOT leaving out certain costs in its estimates.[33] However, investigations would later show that the state did not adequately consider developing and administering the emissions system itself. Instead, in its rush to meet the EPA deadline, the state was quick to accept Parsons' 1998 bid even though it was the sole bidder and had no experience operating a system of this size.[34] Investigations into the contract later found that other contractors had refused to bid because they saw flaws in the state's plan that they feared would result in long waits at inspection stations. These predictions came true in December of 1999 when Parsons began administering the new test.[35]

Political influence was also cited as a factor in the state's decision to award the contract to Parsons. While initial criticisms stemmed from the fact that Parsons awarded subcontracts to a number of politically connected New Jersey companies, the main indication that political ties may have influenced the outcome of the bidding process is the State Commission on Investigation's finding that politically connected consultants arranged meetings between Parsons and high-ranking state

Contract Timeline

December 12, 1997 – The EPA gave New Jersey two years to begin implementing tougher vehicle emissions testing.

July 6, 1998 – The Whitman administration announced plans to award a contract to Parsons Infrastructure & Technology Group to develop and administer a new vehicle emissions testing system.

August 3, 1998 – State Treasurer James DiEleuterio Jr. announced he would delay awarding the emissions testing system contract until lawmakers' concerns were addressed.

August 7, 1998 – A seven-year, $392 million contract was awarded to Parsons. At the same time, the Communications Workers of America, which represented supervisors working at the inspection stations, filed a lawsuit to block the contract because Parsons did not inform the state of lawsuits pending against the company.

September 21, 1998 – State employees protested against the Parsons contract.

December 13, 1999 – Parsons began to administer the new emissions tests at the state inspection stations. The new system was plagued with problems and caused long waits at inspection stations.

[30] Preston, Jennifer. 1998. "Taking a Deep Breath Before Debate on Emissions." *New York Times*, July 26.
[31] "Treasurer Defends Privatizing of Inspections." 1998. *New York Times*, August 6.
[32] Ibid.
[33] Couloumbis, Angela. 1998. "Whitman Seeking Answers on Auto Emissions Pact." *The Philadelphia Inquirer*, August 5.
[34] Peterson, Iver. 2001. "State Rushed Emissions Test System into Use, Witnesses Say." *New York Times*, July 11.
[35] Kocieniewski, David. 2000. "Errors Emerge as Exhaust Test is Introduced in New Jersey." *New York Times*, January 7.

officials to discuss the request for proposals (RFP) shortly before it was published.[36]

While the state was quick to overlook flaws in the Parsons contract early on, it was forced to address contract issues when Parsons began administering the new test and drivers experienced very long waits at inspection stations due to equipment failures and staffing shortages.[37] To deal with these excessive wait times, many of the inspection stations reverted back to the old emissions test while Parsons hired additional staff and increased training. In the meantime, the state withheld payments to Parsons and Governor Whitman ordered the attorney general to investigate whether Parsons or state employees had concealed the full extent of anticipated implementation problems.[38]

In June of 2000, the Attorney General's Office issued the findings of its investigation into the Parsons contract. The report said that state employees and officials had received and ignored warnings from state subcontractor Sierra Research that the emissions testing system was not ready for implementation. Sierra Research had warned that the testing system would likely have problems in cold temperatures and anger drivers by causing long waits.[39] These problems were realized when the system was implemented, resulting in the long waits discussed above.

The attorney general's investigation was not the only investigation into this contract. In March of 2002, the State Commission of Investigation issued a report that called the contract a "mammoth boondoggle" that suffered from serious mismanagement and political influence. The Commission projected that the state would pay Parsons approximately $590 million over the period of the contract, including $200 million in cost overruns. In contrast, the report estimated that it would have cost the state only $339 million to run the new system itself. During its investigation, the Commission found serious flaws in the Whitman administration's cost analysis, bid specifications, and contract oversight. In specific, the Commission found that the state's cost analysis had been flawed because it relied on Parsons' estimate of how much a state-run system would cost rather than the in-house DOT cost estimate.[40]

Additionally, in May of 2002 Governor McGreevey announced that a state audit of the Parsons contract found that there were substantial grounds for contract termination as Parsons had repeatedly failed to

Contract Timeline

January 6, 2000 – The EPA authorized New Jersey to use the old, faster emissions test when test line wait times exceeded 45 minutes until June 30, 2000.

January 21, 2000 – After learning that a state subcontractor, Sierra Research, had written memos warning that there would be problems with the new emissions testing system, Governor Whitman ordered the attorney general to investigate whether the full extent of anticipated problems was concealed.

January 25, 2000 – The State Commission on Investigation announced plans to investigate the Parsons contract.

January 27, 2000 – Governor Whitman announced plans to administer the old emissions test at about half of the centralized inspection stations and offer rebates to help drivers cover the costs of having the tougher inspection done at a private garage.

June 2, 2000 – The state informed the EPA that the new emissions test would not be ready for implementation at all of the state-operated inspection stations by the June 30th deadline and asked for another month to prepare for the switch.

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[36] State of New Jersey Commission of Investigation. 2002. *N.J. Enhanced Motor Vehicle Inspection Contract*. http://www.state.nj.us/sci/pdf/mvinspect.pdf (accessed September 24, 2010).
[37] Kocieniewski, David. 2000. "Errors Emerge as Exhaust Test is Introduced in New Jersey." *New York Times*, January 7.
[38] Kiely, Eugene. 2000. "State Withholds Money from Auto-Testing Firm." *The Philadelphia Inquirer*, February 11.
[39] Kiely, Eugene. 2000. "Inspection Report Issued." *The Philadelphia Inquirer*, June 10.
[40] State of New Jersey Commission of Investigation. 2002. *N.J. Enhanced Motor Vehicle Inspection Contract*. http://www.state.nj.us/sci/pdf/mvinspect.pdf (accessed September 24, 2010).

meet contract deadlines and performance standards.[41] Using these findings, Governor McGreevey negotiated an agreement with Parsons that included $85 million in cost reductions in exchange for a two year contract extension.[42]

While the state was working on its investigations, the inspection stations began to run more smoothly. As indicated by several surveys of motorist satisfaction, New Jersey drivers were generally satisfied with the motor vehicle inspection system by the mid 2000s.[43] After considering motorist satisfaction and weighing a number of options presented in a report prepared by MACTEC Engineering and Consulting Inc., the State decided to continue using contractors to run the inspection stations and issued another RFP for the enhanced motor vehicle inspection/maintenance system in June of 2007.[44] Parsons was awarded another five-year contract to continue to operate the central inspection centers. The current contract began in May of 2008 and will expire in May of 2013.[45]

Impact on State Employees

Although state employees initially protested the privatization of the state's emission inspection system because it would result in the loss of union jobs, the union that represents the inspectors (SEIU 518) was able to negotiate a satisfactory collective bargaining agreement with Parsons. In fact, the inspectors saw improvements in working conditions (e.g., lower injury rates) under Parsons' management. For this reason, when the possibility of the state taking back operation of the centralized inspection stations was discussed in 2005, SEIU 518 supported the continuation of the Parsons contract.[46]

Contract Timeline

June 9, 2000 – The Attorney General's Office issued its report on the Parsons contract, finding that warnings that the test would not function properly were ignored by state officials.

June 16, 2000 – A group of 200 private garages that spent $50,000 each to purchase equipment for the enhanced emissions tests sued the state for forcing them to administer the enhanced emissions test while letting Parsons administer the old test.

July 10 – July 12, 2001 – The State Commission on Investigations held public hearings on the Parsons contract.

January 24, 2002 – Governor McGreevey launched an audit of the Parsons contract.

March 13, 2002 – The State Commission on Investigation issued its report on the Parson's contract. The report said the contract wasted $250 million compared to the cost of a state-run system.

May 6, 2002 – Governor McGreevey's office released a state audit of the Parsons contract that concluded there were substantial grounds for termination. McGreevey said he would cancel the contract if Parsons did not agree to substantial concessions.

[41] Kocieniewski, David. 2002. "McGreevey Threatens to End Deal with Car Emissions Tester." *The New York Times*, May 7.

[42] Kocieniewski, David. 2002. "In About-Face, McGreevey Extends Car-Test Contract." *The New York Times*, November 28.

[43] MACTEC Federal Programs, Inc. 2007. *Final Report for Evaluation, Consultation, and Procurement Services for the New Jersey Motor Vehicle Inspection System*. http://www.state.nj.us/mvc/pdf/About/MACTEC_FinalReport.pdf (accessed September 10, 2010).

[44] New Jersey Department of the Treasury, Division of Purchase and Property. 2007. "Request for Proposal 08-X-39078." http://www.state.nj.us/treasury/purchase/noa/contracts/t1628_08-x-39078.shtml#documen2 (accessed September 10, 2010).

[45] New Jersey Department of Treasury, Division of Purchase and Property. n.d. "Notice of Award Term Contract(s): T-1628 Enhanced Motor Vehicle Inspection/Maintenance System." http://www.state.nj.us/treasury/purchase/noa/ contracts/t1628_08-x-39078.shtml (accessed September 24, 2010).

[46] MACTEC Federal Programs, Inc. 2007. *Final Report for Evaluation, Consultation, and Procurement Services for the New Jersey Motor Vehicle Inspection System*. Contract No. A62116. http://www.state.nj.us/mvc/pdf/About/MACTEC_ FinalReport.pdf (accessed September 10, 2010).

Lessons Learned

The Parsons contract provides valuable lessons on the potential pitfalls associated with privatization contracts. Using the lessons learned from this experience, the state can rework its contracting process to avoid making the same mistakes again. In particular, the Parsons contract underlines the need for a standard cost accounting method, clear bid specifications, and an official process for considering employee cost estimates.

First, discrepancies in cost estimates caused confusion in the contracting process as DOT and contractor estimates of the cost of a state-run emissions testing system differed due to differences in the costs included. This confusion could have been avoided if the state had more clearly outlined the costs that must be included in all contract-related cost estimates.

Second, the bid specifications outlined in the RFP were flawed due to technical ambiguity, unrealistic implementation timelines, and a general lack of clarity.[47] To avoid similar mistakes in the future, the state should require each bid for a privatization contract to include a scope-of-work provision that clearly specifies each service or deliverable to be provided, including a description of each deliverable or activity that is quantifiable, measurable, and verifiable. Furthermore, prior to awarding a privatization contract, the involved agency should be required to outline specific performance standards, a projected timeframe for contract implementation, and a specific and feasible contingency plan addressing contractor nonperformance.

Third, the state did not appropriately consider the possibility of allowing state employees to create and administer the new emissions testing system. In overlooking this option, the state missed the opportunity to achieve cost savings without contracting out the emissions testing system. In fact, the State Commission of Investigation found that the state could have saved $250 million by running the system itself.[48] To address this issue, the state should permit public employees to submit an alternative cost estimate for consideration prior to the awarding of any privatization contract. Furthermore, the involved agency should be required to provide its employees with the resources necessary to prepare and submit such a cost estimate.

Adopting the policies recommended above will result in the application of an increased level of scrutiny when future privatization contracts are proposed to avoid encountering the same problems again.

Contract Timeline

November 28, 2002 – The McGreevey administration announced an agreement to extend the Parsons contract by two years in exchange for $85 million in cost reductions.

June 2005 – The state contracted with MACTEC Engineering and Consulting Inc. to research potential options for improving the inspection program going forward.

January 3, 2007 – MACTEC issued its final report. Although it does not provide direct recommendations, it includes a wealth of information that can be used by State decision makers.

June 5, 2007 – The state issued a request for proposals for the enhanced motor vehicle inspection/ maintenance system.

May 6, 2008 – New contract period began for another five-year contract with Parsons to continue operating the central inspection stations.

[47] State of New Jersey Commission of Investigation. 2002. *N.J. Enhanced Motor Vehicle Inspection Contract*. http://www.state.nj.us/sci/pdf/mvinspect.pdf (accessed September 24, 2010).
[48] Ibid.

APPENDIX C: CASE STUDY ON PRIVATIZATION IN NEW JERSEY

A Mainly Positive Example – Pay to Play Reform – Raises Some Questions

New Jersey was once plagued by a quasi-corrupt pay to play system, where government contractors were expected to contribute to politicians and political parties for elections in return for government contracts. Pay to Play regulations were enacted to clean up government in New Jersey. The legislation limits the amount of contributions state contractors can make in state elections if they want to remain contractors, and requires that their contributions be reported to the New Jersey Election Law Enforcement Commission. Currently, there are reform efforts underway to extend the pay to play model legislation to local government. These local units are more weakly regulated and can award contracts in a euphemistic "fair and open" process.

Since Pay to Play regulations were enacted four years ago campaign donations from business entities with public contracts have declined by 29 percent. Nonetheless, in 2009, 1,820 companies with government contracts at the state, county, and municipal level contributed $10.8 million, according to the New Jersey Election Enforcement Commission (see Table A1). Engineering firms that are private contractors are the largest business contributors to local elections. Only three non-engineering firms were in the top 20 of contributors in 2009. Engineering firms provide a variety of services to government some statutorily required to be supplied by an independent non-governmental entity.

Table A1: The Top 20 Election Contributors Among Public Contracting Firms 2009

Largest Contributors NJ State and Local Elections	Contribution_Amount	Busniess
Grand	$10,826,415	
T&M Associates	$503,200	Engineers
Remington & Vernick Engineers	$353,725	Engineers
Pennoni Associates Inc.	$207,479	Engineers
Parker McCay PA	$207,030	Engineers
Maser Consulting P.A.	$192,890	Engineers
Birdsall Services Group	$191,850	Engineers
Richard A. Alaimo Associates	$185,600	Engineers
Thomas Biga	$180,640	St Barnabas
Capehart Scatchard P.A.	$154,317	Engineers
David J. Samuel	$145,920	Engineers
Verizon Good Government Club - New Jersey	$133,500	Telecom
Federici and Akin, P.A., Consulting Engineers	$131,800	Engineers
Waters, McPherson, McNeill, P.C.	$118,490	Engineers
Environmental Resolutions, Inc.	$116,900	Engineers
Neglia Engineering Associates	$115,000	Engineers
Bach Associates, PC	$112,275	Engineers
John J Stevani	$101,150	Engineers
Acacia Financial Group, Inc.	$99,390	Finance
Gregory R Valesi	$95,400	Engineers

Source: NJ ELEC Election Law Enforcement Commission Disclosure 2009

Nonetheless, government pays its professional employees considerably less than the private sector, giving it a substantial economic advantage in providing professional services, such as engineering. Because the state and local governments enjoy a substantial employee compensation advantage in providing professional services (see Table 2 above), we need to question whether that public is getting best value by using outside private firms. One can imagine reverse contracting (in-sourcing) some professional work, for example, engineering and legal services that might result in less campaign contributions for the politicians and political parties, but better value for the public. The presumption of the Task Force, however, is that privatization almost always results in savings, and therefore, they were apparently blind to potential advantages for in-sourcing privately supplied work.