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Privatization in Massachusetts: An Evaluation of the 1993 Privatization Law ("The Pacheco Law")

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Introduction

In 1993 Massachusetts passed a law requiring state agencies (excepting some specifically exempted organizations) to concretely establish a cost savings to taxpayers prior to contracting out any service previously provided through in-house labor. This law, the first of its kind, essentially mandated that good management practices had to accompany privatization. The law required subject agencies to submit contracting plans to an independent audit, conducted by the Office of the State Auditor (OSA). Furthermore, the Privatization Law (Chapter 296 of the Acts of 1993, sometimes also called the Pacheco Law or the Pacheco-Menard Law) required that a cost comparison, that would accurately establish the savings taxpayers could expect to derive from any such contracting out action, accompany any proposal to outsource work currently done by state employees. The privatization solution to which this law was responding was born of a time when state budgets were being squeezed by simultaneous economic downturn and Federal reductions in fund transfers. A similar economic climate today may account for the renewed focus on privatization and points to the need for the Privatization Law to continue to bring rational order to privatization efforts.

> *The privatization law has created an atmosphere where state agencies are forced to think like private firms as opposed to assuming that a private provider working under contract will automatically solve any problem at a lower cost. It compels state agencies to think through the pitfalls that lie ahead and prods them to be sure they are making the highest and best use of scarce resources in difficult fiscal times.*

Privatization, as it emerged in the early 1980s, held out the promise that taxpayers could have their cake and eat it. That is to say that by substituting private service providers for public employees, it would be possible to have high quality public services and lower costs and presumably lower taxes. This view, rooted in a libertarian ideology that distrusts government in general and views public employees in particular as inefficient, turns to a simplified model of a competitive market to justify the approach. But government is neither simply “good” nor “bad” and public employees do not go to work everyday to do a bad job. The vast majority of them are hardworking citizens dedicated to promoting the common good through their public service. Moreover the contracting out that would substitute for public service is itself not free from inefficiency and corruption. However in the 1980s and early 1990s the attraction of this simple solution was very powerful. Since then as difficult and costly experiences with privatization have accumulated both domestically and internationally a more balanced view has emerged. It holds that privatization is sometimes a good thing and sometimes not. But regardless of which

way a service is delivered its effectiveness depends upon good public management. Even the World Bank, an early and ardent proponent of privatization has begun to change its stance. It now argues that more important than the way the service is delivered is the managerial quality of the public agency responsible for its delivery.[1] The Massachusetts Privatization Law was an early exemplar of how to achieve this balance in public contracting.

In an era when public managers are looking with a more critical eye at privatization, the Massachusetts Privatization Law stands as a first-in-the-nation attempt to legislate sensible contract decision making for public agencies. The law has effectively helped the state save over $1.2 million per year and, more importantly, to avoid at least $73 million in bad contracts.[2] The process set up by the law effectively provides state agencies with assistance in measuring the likely impact of contracting decisions and helps them to ground privatization in reality.

This report clearly demonstrates that the Massachusetts Privatization Law is effective. The Law enables agencies that have a compelling, cost-saving way to effectively contract out a public service without sacrificing quality to do so.

Since 1993, various subject agencies and organizations have attempted to contract out 8 separate services.[3] Of these, the OSA approved six applications and two were rejected based on either a failing to adequately comply with the Privatization Law, or a failure to adequately establish true cost savings to the taxpayers. A review of the cases demonstrates that winning approval for contracting out a service is not a matter of institutional size, ability to hire consultants, or contracting experience. Rather the Privatization Law process simply rewards good management and good management processes. Operations as large as the Massachusetts Highway Department and as small as Holyoke Community College have successfully negotiated the required process and have contracted out services with a subsequent financial benefit to state taxpayers. A review of the various proposals submitted to the OSA demonstrates that the process works; it creates an atmosphere that encourages good management. The process does not discourage good contracting decisions, but avoids bad ones. It compels public managers to enter into a dialogue with an independent and competent public auditor to justify change in the name of either cost savings and/or improved services.

This report reviews the Privatization Law and its consequences. Four of the cases reviewed by the OSA are examined in-depth (two approved and two denied cases). These case studies and the general review of the impacts of the law are used to determine the efficacy of the law as it stands, and to derive recommendations for improvements to the current review system.

This report clearly demonstrates that the Massachusetts Privatization Law is effective. The Law enables agencies that have a compelling, cost-saving way to effectively contract out a public service without sacrificing quality to do so. The Law avoids being too cumbersome for smaller agencies to handle. Agencies can successfully complete the review process without outside legal or accounting assistance. The Privatization Law is effective because it forces state agencies to carefully consider the fiscal and service impacts of contracting decisions, just as any private firm would do. Taxpayers are spared the cost and service burden of privatization experiments, and agencies that have not carefully examined the impacts of a potential contracting solution are discouraged from doing so without first examining the finer detail.

It is easy to understand why managers in the public and private sectors can become excited over new ideas. Often the fight to implement change then pushes managers to oversell the value or cost savings associated with these ideas. The Privatization Law provides a needed counter balance. It gives subject agencies a workable process through which to ground their concepts and ideas in fact, and to ensure that a simple basic, "back of the envelope" calculation is not substituted for a careful managerial and financial analysis. The privatization law has created an atmosphere where state agencies are forced to think like private firms as opposed to assuming that a private provider working under contract will automatically solve any problem at a lower cost. It compels state agencies to think through the pitfalls that lie ahead and prods them to be sure they are making the highest and best use of scarce resources in difficult fiscal times. It avoids the squandering of public funds on untested ideas that has plagued privatization efforts in so many other places. Massachusetts voters and legislators should be proud of their ground-breaking law.

Issues Shaping the Current Debate

The term privatization has several different and highly case specific meanings. One of the most common meanings refers to an expanded reliance on outside contractors to supply all or part of public services. Contracting, regardless of whether it is public or private involves creating complex ongoing relationships between two parties that often have very different goals and missions. In the case of the multiyear contracts, which typify much of public sector contracting, the process is further complicated because there are a large number of factors that only reveal themselves in the fullness of time. Many times these factors, which can transform what initially seemed like a good idea into a nightmare, can be anticipated and avoided by a more through evaluation and questioning from a neutral third party.

The long-term nature of public contracts means that these contracts sit in the realm of what economists call "incomplete contracting."[4] It is a realm in which the information that the two parties (agency and contractor) have is typically unequal and in which the interests of contractors and the interests of the agency can greatly diverge. In these instances it is important that decision makers have analytic tools that allow them to go beyond price and look at the larger transactions costs of the new relationship. Transactions costs economics suggests that in contracting situations in which the parties have different knowledge bases and understandings about the product in question and there is future uncertainty because of the length of time of the relationship, the best decisions that either can make are problematic. Moreover contractors acting (properly) on their self interest in situations in which the instructions are not clear cut often make decisions that favor their interests over those of the state. These problems are especially prominent in cases where service outcomes are ambiguous such as care for the mentally ill or developmentally disabled. In these cases the transactions costs of supervising and maintaining an ongoing relationship with an outside contractor become significant.[5] That, by itself, is not a reason to not consider a contract, but it is reason to engage in a rigorous analysis that factors in the transactions as well as the direct contract costs before any decision is made. It is that analysis that the Privatization Law requires.

Whether services are contracted or directly supplied the only way to ensure that taxpayers get value for the money spent is to ensure that public mangers are required to engage in a process that sets out all the pertinent knowable facts at the outset. That is the larger lesson the entire world is now learning from the many failed attempts at privatization and deregulation that have been underway over the past two decades. The harsh and costly lessons that the citizens of nations like Argentina[6] are learning the hard way from their total embrace of privatization and deregulation should teach us that while there is a place for privatization and deregulation in the public sector there is also an equally, if not more important place for rigorous public oversight and sound regulation.

The Massachusetts Privatization Law was enacted in a political climate that encouraged frequent and poorly-considered privatizations.

The Massachusetts Privatization Law was enacted in a political climate that encouraged frequent and poorly-considered privatizations. These privatizations were enacted quickly and, "without legislative approval or oversight by the newly elected Weld administration."[7] Though it was often claimed that extensive savings were achieved through these almost random forays into privatization, cost data was never adequately tracked prior to privatization to do a credible job of comparing the public and private costs. Furthermore, significant questions regarding service quality were raised. Concerns that the state was privatizing away core services,

losing competencies in its core service provision areas, and possibly wasting taxpayer money led to the 1993 passage of the Privatization Law.

> *Independent outside auditors taking a more measured look at the MassHighway privatization judged it a money-losing venture. According to the Massachusetts House Post Audit and Oversight Bureau the first year's report showed that although the contractor complied with its contractual obligations, its administration of highway maintenance was of low quality and cost about $1.1 million more than the pre-privatization work. A review by the OSA also concluded that the state lost money. The OSA put the loss at $1.4 million.*

The type pf problem that arose before the passage of that law can be illustrated by recalling one of Governor Weld's first hasty privatizations in the Massachusetts Highway Department (MassHighway). The pro-privatization atmosphere of the early Weld period was such that it was assumed, as opposed to determined, that the private sector could do it better. Governor Weld began the push to privatize MassHighway in 1992. Because some of the types of services that MassHighway performed (such as pothole filling and grass cutting) were widely available through small private contractors, this seemed at first glance to be a case where a competitive market of small suppliers did in fact exist. The problem was that highway maintenance is not simply a matter of stringing a bunch of simple tasks together. Rather it is a complex problem in managing these tasks and timing them. So when MassHighway let the project for bid, it was not the small landscape firms and paving contractors who came forward. Instead it was the very large and very well connected state highway construction firms who customarily divvy up all the state contract construction work who bid on the contract. Moreover, because they were being asked to do something they never did before, manage a regional highway maintenance operation, their bids ranged widely from a low of $3.7 million to a high of $8.1 million. The Weld Administration took the lowest bid and declared the project a success.

However independent outside auditors taking a more measured look at it, judged it a money-losing venture. According to the Massachusetts House Post Audit and Oversight Bureau the first year's report showed that although the contractor complied with its contractual obligations, its administration of highway maintenance was of low quality and cost about $1.1 million more than the pre-privatization work.[8] A review by the OSA also concluded that the state lost money. The OSA put the loss at $1.4 million.[9] To counter this bad publicity, the Weld Administration asked their privatization consultants Coopers & Lybrand to prepare another evaluation. The C&L "assessment," unsurprisingly concluded that, not only did the state not lose money but that it actually saved $2.5 million. [10] Although it is impossible to know the exact truth after the fact, my own assessment of the various analyses is that the state probably did lose money. The word "probably" is the

operative problem. It is impossible to know what happened because there was no careful cost analysis done by the Commonwealth before the fact. Moreover the contract did not adequately specify performance expectations. While the contract called for collecting litter and mowing the medians, it did not specify the order. Thus when the House auditors went to inspect the completed work they found mowed litter. Despite the protestations of the Weld Administration the best that can be said for the effort is that it was not a clear success. However at worst, it may have been a costly failure.[11] It was because of experiences such as these that the Legislature enacted the Privatization Law. The new law required measured and deliberative reason in an environment in which public money was being rapidly thrown at a series of untested privatization schemes.

The law continues to be relevant because it encourages careful consideration of privatization. The framework established under the law creates a process for agencies to follow and a dialogue with the OSA that grounds management decisions in the facts of costs and benefits. The Law does not prohibit contracting out. The law is not too onerous for small agencies to successfully privatize services. At its essence the law requires an agency to fully research and consider the cost and service impacts of contracting out services currently performed in-house prior to making a contracting decision. This is good for Massachusetts, its citizens, taxpayers, and state employees. It ensures that services are not contracted out at a loss. It ensures that service standards are at least maintained, if not improved. The law requires that agencies develop a credible case and a solid management plan for contracting out services. This is the type of behavior one would expect to see in the private sector. Firms carefully consider the impact of contracting out decisions. It is their fiduciary responsibility to their stockholders. Sometimes firms contract-out, sometimes they continue to perform work in-house. But successful firms always consider the relative costs and benefits of doing so prior to making such a decision. Massachusetts' Privatization Law provides an important avenue for state agencies to perform due diligence prior to making a contracting decision.

The Massachusetts State Privatization Law

The law itself lays out a process for evaluating the cost impact of proposed privatizations and provides a framework that ensures this evaluation is fair and accurate. The law ensures good governance by declaring allowable only those privatizations that will clearly save taxpayer money while continuing to provide comparable service The law excludes several types of contracts from review, including those valued under $100,000, those previously approved through the Privatization Law process (rebids), and those consisting solely of legal, management consulting, planning, engineering or design services. Furthermore, the law only

applies to cases where an agency proposes to use "private contractors to provide public services formerly provided by state employees."[12]

Following these exceptions, the Privatization Law lays out seven requirements that subject agencies must meet in order to legally privatize a function that falls within the purview of the law. First, (1) the agency must prepare a statement describing the service or function to be privatized. This statement must include the specific quantity of work required and quality standards to be met. The agency then issues a request for proposals from contractors to meet these requirements.

The law then requires (2) that bidding contractors (respondents to the RFP) pay employee wages at least equal to the entry level of those paid to current state employees, including at least a portion of health insurance costs for coverage similar to that which the state offers employees that work more than 20 hours per week. Third (3), the law requires contractors to offer available positions to qualified employees being displaced by the privatization who "satisfy the hiring criteria of the contractor."

Fourth (4), the privatizing agency must prepare a written estimate detailing the costs the agency would face if the service in question were performed in the most cost-efficient manner. Fifth (5), current employees must be allowed to submit their own bid for providing the service in question. Sixth (6), the privatizing agency must analyze the winning bid (lowest cost bidder) and provide to the OSA data detailing the bid price, and costs associated with the transition to contract provision. Decreases in income tax revenue must also be included, if the contracting agency plans to use out-of-state employees.

Since 1993 the OSA has reviewed proposals for the privatization of eight separate state services. Of these, six were approved and two denied.

Finally (7), The Agency must certify that the quality of the services to be received through a contract will both meet the agency's needs and will at least meet the level of in-house provision.

Once these requirements are met, the OSA has 30 days to conduct a review and to determine whether the requirements have been adequately met, and whether the privatization in question will indeed save taxpayer money. If the agency has met their obligations under the law, and the privatization is a cost saving measure, the winning bid is allowed.

Privatization Cases Under the Privatization Law

Since 1993 the OSA has reviewed proposals for the privatization of eight separate state services. Of these, six were approved and two denied. The majority of these cases were reviewed in 1996. Since that time two applications have been reviewed. One was denied and one approved. The table below lists all eight cases, their dates of review and whether they were approved or denied.

Cases Review by the OSA 1993-2002

	Date	Case	Approved /Rejected
1	1/96	Department of Employment and Training – Storage and Retrieval of Records	Approved
2	6/96	MBTA - Real Estate and Property Management	Approved
3	8/96	Massachusetts Highway Department – Highway Maintenance in Central and Western Massachusetts	Approved
4	9/96	Holyoke Community College - Food Services	Approved
5	12/96	MBTA – Bus Shelter Maintenance	Rejected
6	12/96	Massachusetts Highway Department – Highway Maintenance in Worcester County	Approved
7	6/97	MBTA – Operation and Maintenance of Bus Routes Originating in Quincy and Charlestown	Rejected
8	6/00	U. Mass – University Store	Approved

This record demonstrates a 75% success rate for applying agencies, though it should be noted that some cases were initially denied for failing to adequately meet the requirements spelled out in the law, and were subsequently approved upon resubmission.

As each case reviewed and approved by the OSA must include cost comparisons, it is possible to generate an estimate of the cost savings generated through the application of the Privatization Law. The table below lists the estimated savings associated with each approved privatization.

OSA Determined Savings Generated by Approved Cases Under the Privatization Law

Case	Savings per Year
Department of Employment and Training – Storage and Retrieval of Records	$ 88,000
MBTA - Real Estate and Property Management	$ 41,000
Holyoke Community College - Food Services	$ 55,000
Massachusetts Highway Department – Highway Maintenance in Worcester County	$ 830,000
U. Mass – University Store	$ 260,000
Total	**$ 1, 274,000**

As the table above demonstrates, the Privatization Law has enabled over $1.2 million in annual savings. This figure represents the value of good contracting to the taxpayers of Massachusetts. However, it does not highlight the value of bad contracts avoided. The requirements of the Privatization Law have also not prohibited smaller institutions, like Holyoke Community College from complying. However, it is extremely likely, given the pace of privatization prior to the enactment of the law, that it has prohibited many poorly thought through privatizations from occurring. The net effect of the Privatization law is that it provides subject agencies with an avenue through which to perform a solid assessment of the value of contracting prior to entering into an agreement, and it establishes a dialogue between the OSA and those agencies, which can be used to proactively manage those costs.

Assessment of the Impacts of the Current Law and Case Studies

Overview

In this section I review four of the eight proposals evaluated by the OSA under the Privatization Law. The purpose of this review is to understand exactly how the law works in practice. These reviews also highlight how the law has provided a general guideline to state agencies, discouraging bad privatizations in general.

The four proposals considered here are the approved Holyoke Community College Food Services privatization, the approved MBTA Real Estate and Property Management privatization, the denied MBTA Bus Shelter Maintenance privatization and the denied MBTA Bus Route Operation and Maintenance privatization. In each case both the proposal and the OSA's determination are reviewed. If applicable, cost

savings associated with each privatization are listed. The two denied cases are examined to determine why they were unsuccessful, and to examine how each case might have been improved. The two denied cases were chosen because they are the only cases reviewed by the OSA to have been denied. The Holyoke and MBTA Real Estate and Property Management cases were selected because they represent two agencies of different sizes and resource levels.

Each case study highlights the exactness of the process used by the OSA to reach a determination of cost savings. It is clear that the successful subject agencies did their homework in terms of both present costs and contracting alternatives. Agencies that found genuine cost savings to be derived through privatization while maintaining consistent service were allowed to privatize. The two cases where the privatization was disallowed provide insight into the more complex operations of the review process.

The Privatization Law has enabled over $1.2 million in annual savings.

The most important finding from all four cases is that they highlight the dynamic dialogue that took place between the subject agencies and the OSA. The greatest strength of the Privatization Law is the way in which it compels outside review of the subject agency's management. It is clear, for example, in the MBTA Route Privatization case reviewed below, that the management of the MBTA fell in love with an interesting idea based on "back-of-the-envelope" calculations. The dialogue between the MBTA and the OSA set up by the law grounded that idea in the facts and ultimately avoided enormous unnecessary costs to the taxpayers of the Commonwealth.

Case Study 1: Holyoke Community College Food Services

Introduction

In 1996, Holyoke Community College released a request for proposals to privatize its food services operation. The college is a two-year public community college located in Holyoke, Massachusetts. In 1996, the college had approximately 3,500 students attending day classes and 2,000 attending evening and Saturday classes. Approximately, 1,000 students were enrolled during the summer. At the time the RFP was released, the school employed 360 full-time faculty and staff, supplemented with part-time employees. The college is a commuter school, and does not have dormitories. Dining services were staffed with state employees, and the service was run in conjunction with the School's Hospitality Management

Program. Students would work in the school's cafeteria as part of their curriculum, and costs were assigned to the program when appropriate. Food services at the college consisted of a dining area in the Campus Center and a separate café on-campus open during class hours. The service also provided catering services on demand for different special events.[13]

This case indicates that small governmental entities such as Holyoke Community College are able to comply with the Privatization Law in privatizing operations for cost savings.

Holyoke College made the decision to privatize food services because the service was consistently losing money. In fiscal year 1994, the service lost $56,333. In 1995, the service lost $178,311 and in 1996 the last fiscal year before the RFP was released, the service lost $119,661.[14]

The RFP asked potential contractors to maintain the current year round operation, hours, and the quality of the program. In addition, it was stated that preference would be given to bidders who would be willing to work cooperatively with the Hospitality Management Program but there was no requirement that the program be integrated with the department as in the past.[15] The RFP was released without notifying the OSA but prospective bidders were asked to consider that the privatization law could apply. The College's Dining Services Proposal Review Committee reviewed three bids. Two of the bids were from private firms, and the third was an in-house bid submitted by the director of dining services. Fame School and College, Inc. (FAME) was chosen over both Grace Food Service Associates, Inc (GRACE) and the in-house proposal. In the recommendation section of the committee's memorandum to the College's Vice President for Administration and Finance it was stated that FAME was chosen, "based on the guaranteed financial return to the College in their proposal." It was then written that this recommendation was, "based on the underlying assumption that the Pacheco Bill will apply; should Pacheco be judged not to apply, the committee's preference would then be Grace Food Service Associates, Inc."[16] The memo indicates that the committee was more comfortable with the Grace proposal because of their "extensive community college experience."[17] The memo also included an evaluation matrix that indicated the level of financial return estimated or promised to the college. The Fame proposal guaranteed an 8% commission or $35,000, and the GRACE proposal guaranteed a 2% commission or $9,000. The in-house proposal did not offer a guarantee to the college but projected a $30,898 return to the college.[18]

Privatization Proposal

As was noted, the college released the RFP without notifying the OSA, contending that the proposed outsourcing was not subject to the privatization law.[19] AFSCME Council 93 objected to the release of the RFP on the grounds that it violated the privatization law, and requested an inquiry from the OSA.[20] On July 11th, Holyoke College officials submitted a proposal for privatization of campus food services to the OSA but it was deemed incomplete on the grounds that it did not indicate the designated bidder's compliance with certain state and federal statutes and because the proposal was not signed by the College President or the State Secretary of Administration and Finance.[21] A subsequent August 23rd proposal was judged complete by the OSA and review of the proposal began on August 26, 1996.[22]

In its proposal to the OSA, the college estimated that the winning bid by FAME School and College Inc. would yield net revenues of $37,650 while efficient operation by the school would yield a net loss to the school of $32,944.

Auditor's Determination

On September 26, 1996 the OSA determined that Holyoke Community College had complied with the privatization law in awarding a contract for management of food services activities.[23] The determination letter outlines the college's compliance with the statutory provisions of the law including wage rates, health insurance requirements, food service quality, and the hiring of qualified agency employees. In terms of cost impact, the OSA determined that the estimated cost of the work performed under contract would be less than the estimated cost of the work performed with state employees. Specifically, privatization of food services was found to yield net revenues of $29,880 while continued operation by the college would result in the loss of $25,314.[24] The total savings generated by the privatization was then estimated as $55,194, the sum of the estimated revenue from privatization and the loss avoided from continued in-house operation of dining services. This figure differed from the total savings figure of $70,594 submitted by the college as part of the proposal because the OSA made five cost adjustments. Two adjustments were made to the in-house cost estimate and three were made to the privatization contract. The cost comparison table below shows the cost and revenue figures submitted by the college and the adjustments made by the OSA. Total costs for the in-house operation include direct and indirect costs while total costs for the private operation equal Holyoke College's costs for contracting food services, including contract administration, transition costs, and unemployment insurance. Total revenue for the in-house operation includes all sales while revenue for the contract operation is the projected contract price to the school (8% of sales or $35,000).

Cost Comparison	**In-House Operation**	**Privatized Operation/Performance Costs**
Total Costs	$568, 944	$2,350
Total Revenue	$536,000	$40,000
Net Profit	$(32,944)	$37,650
Audit Adjustments	$(7,630)	$7,770
Adjusted Cost Net Profit	$(25,314)	$29,880
Total Savings		**$55,194**

Conclusion

Initially, Holyoke Community College attempted to contract out the operation of food services to an outside vendor without a review by the OSA. It is unclear exactly why the college wanted to avoid the process but it does not appear that there was a protracted fight over the issue. Holyoke College submitted its proposal to the OSA a little over two months after the OSA began its inquiry into Holyoke's RFP. In internal memos included with the college's proposal, it is revealed that the Grace Food bid would have been chosen if the Privatization Law did not apply, even though the bid guaranteed $26,000 less than the winning Grace proposal and a 2% commission on revenues compared with 8% in the FAME proposal. In this case, it is clear that the privatization law had an effect throughout the entire RFP process, requiring the college to ensure compliance with the law in its bidding process and influencing the selection of the FAME proposal because the bid guaranteed the most cost savings over in-house operation.

In approving the college's choice of FAME, the OSA verified compliance with all aspects of the privatization law. The OSA evaluated financial figures submitted ensuring that only avoided costs were included in evaluating the loss expected from continued in-house operation of food services, and that all of the costs of contracting were included in estimating net revenues from the college's privatization proposal. Accordingly, the OSA made five adjustments to the financial figures submitted by the college in calculating a total estimated savings of $55,194 in privatizing food services compared with continued in-house operation of the function.

This case indicates that small governmental entities such as Holyoke Community College are able to comply with the Privatization Law in privatizing operations for cost savings. Additionally, there is no evidence that the college relied on outside expertise to navigate the OSA's process in complying with all aspects of the law. In this case, the law did not create a barrier, but rather guided the choice of a contractor that would maintain quality standards and employee benefits while saving the

greatest amount of money as compared with continued in-house operation of food service provision. Holyoke CC was able to use the guidance provided by the OSA to comply with the law and make a good management decision.

Case Study 2: Massachusetts Bay Transit Authority Real Estate Department

Introduction

On December 18, 1995, the Massachusetts Bay Transit Authority (MBTA) issued a request for proposals to privatize their property management and real estate development functions. At that time the MBTA sent notification, and a copy of the RFP to the OSA, signaling the intent of the agency to outsource its Real Estate Department's major functions.[25]

In this case, the OSA determined there could be savings of $206,257 as a result of the privatization and the proposal was approved. In the absence of the OSA's review, though, an inappropriate accounting methodology could translate into a privatization that costs additional money compared with continued government provision.

The MBTA operates the fourth largest mass transportation system in the country with operations concentrated in the Boston Metropolitan Area. The agency's service area has a population of approximately 2.6 million in an area of 1,038 square miles, spread among 175 municipalities in two states. The agency operates 155 bus routes, 3 rapid transit lines, 5 streetcar routes, 4 trackless trolley lines, a commuter boat, paratransit services, and 13 commuter rail routes.[26]

The primary mission of the MBTA is the provision of mass transportation, but the Authority has considerable real estate holdings related to its transit services. For example, it owns right-of-ways maintained for its commuter rail operations, and space within transit stations. At the time of submission to the OSA, the Authority was the fourth largest landholder in Massachusetts, with total holdings estimated at 4,000 parcels.[27] The Authority's Real Estate Department (RED) managed real estate holdings with responsibilities including the leasing of concessions, sale of surplus property, and initiation of joint development projects proximate to major transit stations.[28] These functions and responsibilities were undertaken with 27 staff divided into four groups: development, disposition, facilities management, and acquisition. Additionally, the department received substantial support from the legal department with five full-time attorneys assigned to real estate issues, and the Revenue Collection Department with one employee dedicated to real estate accounts receivable and collections.[29]

The Decision to Privatize

As previously stated, the MBTA is one of the largest landowners in the commonwealth but the primary mission of the Authority is transit provision. Concern that real estate assets were not being maximized to support this core mission precipitated the hiring of Kenneth Leventhal & Company to undertake a management study in 1993. The report recommended strategies to reassert the importance of the Real Estate Department within the Authority's mission through organizational, operational, and systems improvements. For example, the report recommended setting increased annual revenue goals for the department and the creation of a separate data management system for leases as opposed to using 20-year old tenant ledger information technology.[30] As a follow-up in November 1995, the Audit Department of the MBTA hired E&Y Kenneth Leventhal Real Estate Group to audit the 20 year-old tenant ledger managed by the MBTA's Department of Revenue. This ledger is composed of 862 entries cataloging the Authority's leases. The study found that the tenant ledger was not being managed to maximize lease revenues.[31] Eighty-three percent of the leases were found to be under performing, 580 tenants were found to be operating without a lease, and rents were not adjusted after 1980 on over 300 leases.[32]

According to the Authority's submission to the OSA, the findings of these two reports confirmed suspicions that the Real Estate Department was not performing well, and also served as a basis to justify the outsourcing of real estate management. In a management study included as part of the MBTA's official submission to the OSA it is stated with reference to the tenant ledger review, "in light of these findings, and others detailed in the appendices, the perception that the property management and development functions would be handled much more efficiently and effectively by an outside contractor was confirmed". Further, it stated that, "the results clearly show that the department has been performing at unacceptable levels at some considerable cost to the Authority."[33]

The RFP and Selection Process

The RFP asked prospective bidders to provide services in two main areas: real estate asset management and formulation of strategies to plan, finance, and construct 5,000 parking spaces over the subsequent five years. The latter aspect of the RFP was to help fulfill the MBTA's commitment to construct 20,000 parking spaces by 1999 as part of mitigation for Boston's Central Artery roadway project. The designated contractor would essentially perform the functions of the Real Estate Department, with the exception of new property acquisition, which would continue to be performed in-house by the Authority.[34] Accordingly, the RFP implies that the six

employees and legal support currently working in the acquisition division of the department would be retained. Other legal support dedicated to other divisions of the department, and support from the revenue department would be outsourced as part of the contract.[35] The department would also maintain management and oversight functions to act as liaison to the Authority's Board of Directors and operating divisions.[36] The initial contract would be bid out for five years, with plans to subsequently re-bid every three years.[37]

The RFP noted that in fiscal year 1995, the Authority collected $4.0 million in lease income, and $1.6 million in property sales for a total of $5.6 million in net revenues. For FY 1996, it was estimated that the authority would collect a total of about $6.5 million in net revenue.[38] Total personnel costs in fiscal year 1995 totaled $1,203,121.[39] Clearly, though it was implicit in this offering that the authority believed revenues were not being maximized.

There were four responses to the RFP, with three submitted by private consortiums and one union response. All four were numerically ranked using bid criteria developed by the MBTA. There were however two evaluation forms: one for the private firms, and one for the unions. In its submission to the OSA, the MBTA stated that a separate evaluation form was made for the union response because, "the union response was, at their discretion, not required to address the disadvantaged business enterprise requirements or the design, financing, management of construction, and operation of the parking garage." It is further stated that the points allocated in these categories were spread over the other evaluation categories.[40]

The MBTA selected a consortium of companies called Transit Realty Associates LLC. This consortium consisted of two teams of companies to provide both real estate services functions and parking garage design, construction, and management functions respectively. The team scored 82.3 points out of 100 and offered a fixed fee price of $6.730 million that was reduced to $6.178 million during contract negotiations.[41] In addition, it was agreed that there would be additional money paid on a performance basis dependent on property sales. The second place team, Codman Corporate Services Inc, had the lowest fixed fee price, $6.702 million and scored 74.1 out of 100 points. The third place team, EDTAM, Co., LLC. Scored 69 out of 100 points and bid the highest price for the contract, $8.286 million dollars. The Union bid finished fourth among the bids with a score of 31.1 out of 100 points. The Union submitted a bid of $2.483 million for salaries only. In the submission to the OSA, the MBTA claims that the union made this bid based on eliminating staff from the department but did not anticipate laying off employees from the Authority. Therefore it is stated that since there would be no layoffs, "there are no anticipated cost savings to the Authority," and total cost was re-calculated to be $10.154 million.[42]

There was no detailed rationale in the submittal to the OSA regarding the selection of Transit Realty over the other bidders. Transit Realty did submit a higher initial bid than the second place finisher, but this initial figure was lowered below the Codman bid in contract negotiations. The winning team also initially included commissions on the sale of properties in the bid, but this was changed to performance bonuses in contract negotiations.[43] Performance bonuses and commissions were included within the MBTA RFP[44]. There is a detailed rationale on why the union bid was not chosen. In the executive summary of the submission to the OSA it is stated of the union bid: "The proposal is so lacking in detail that it could almost be deemed non-responsive.[45] In general, the MBTA did not accept that the union bid would help avoid costs and the bid excluded a response to the parking space development aspect of the RFP.[46]

Privatization Proposal

On April 24th, 1996, the MBTA submitted its privatization proposal to the OSA. On April 29th, 1996, the OSA conditionally began is 30 business day review of the proposal as the initial proposal was deficient in several areas.[47] The MBTA disputed the time taken in the review period, and attempted but then held off of awarding the contract before the OSA had rendered an opinion.[48]

The proposal itself included nine parts including the proposed contract, cost forms, summary of bids received, and a management study. The RFP included privatizing existing functions of the Real Estate Department and new functions as recommended in its management study such as changes to lease management and property inventory procedures. Therefore, the MBTA presented in its cost forms existing in-house costs and costs of additional services to document the avoidable costs of additional functions and changes recommended in the management study. There were, however, no costs related to the parking garage program included because the program was to be funded from Authority revenues or from project-specific funding.[49]

Throughout the OSA's review period, Local 453 of the Office & Professional Employees International Union corresponded with both OSA and the MBTA regarding alleged deficiencies in the submission. These alleged deficiencies included using un-adjusted 1992 wage rates and claiming savings for the elimination of positions that were vacant.[50] Both these issues were addressed in the OSA's adjustment of the MBTA's cost forms in reviewing the privatization proposal.

Auditor's Determination

On June 10th, 1996, the OSA issued a determination concluding that the MBTA complied with Massachusetts' privatization law, Chapter 296 of the Acts of 1993 in awarding a privatization contract for the management of its real estate activities. The determination details the MBTA's compliance with statutory requirements of the law including wage rates, health insurance requirements, service quality, and the hiring of qualified agency employees. By approving the MBTA's proposal, the OSA determined that the estimated cost of work performed under contract by Transit Realty would be less than the estimated cost of work performed with state employees. Privatization of most real estate functions of the MBTA was determined to cost $8,526,886 in performance costs representing a cost savings of $206,257 compared with the estimated cost of continuing to perform the work in-house with state employees.[51] This cost savings breaks down to an estimated annual savings of $41,251 over the five-year life of the contract. This total savings figure is significantly less than the figure provided by the MBTA because of ten adjustments made by the OSA. The MBTA, in its proposal, claimed saving and gain to the authority of $7,583,460. This figure includes a $5,184,000 revenue enhancement for expected lease revenue.[52] The OSA, however, subtracted this projected revenue enhancement, from the performance costs of the privatization contract. With regard to this adjustment, the OSA stated, "there is no acceptable or demonstrated reason why MBTA management cannot increase revenues by holding itself to the same standard of performance expected from the contractor and by using the same updated tenant that will be used by the contractor."[53]

Cost Comparison	**In-House Operation**	**Privatized Operation/Performance Costs**
Total Costs	$10,154,208	$7,754,740
Total Revenue	Not identified	$5,184,000[54]
Net Profit	N/A	N/A
Audit Adjustments	($1,421,065)	$5,956,146
Adjusted Cost	$8,733,143	$8,526,886
Total Savings		**$206,257/$41,251 per year**

Accounting Methodology

The OSA's cost savings figure represents a difference of over $7 million dollars compared with the MBTA estimate, indicating differences in accounting methodology, and possibly managerial philosophy. The largest audit adjustment concerned a projection by the MBTA that revenue collections would increase by over $5 million if the contract was awarded to Transit Realty and recommendations from the two management studies were implemented. In assigning increased revenues to the privatized operation with the improvements recommended in the management study and not assigning increased revenues to the in-house operation, the MBTA is essentially arguing that recommendations cannot be implemented by state employees. In contrast, by subtracting increased revenues from the proposed privatized operation of real estate services, the OSA is arguing that there is no demonstrated reason why the MBTA cannot improve in-house revenue enhancing performance as recommended by its own management studies. This significant audit adjustment could simply represent a difference in philosophy about the effectiveness of public employees between the MBTA and OSA. Regardless, it indicates different accounting methodologies were employed, with the MBTA projecting that private operation would allow for improved performance and the OSA strictly calculating avoidable and performance costs. The end result, an approved privatization proposal, is the same but the approved cost figures follow the OSA's methodology and the savings projected are much more modest. The significant cost difference is indicative of how different accounting methodology can significantly change calculations of cost savings with respect to privatizations. In this case, the OSA determined there could be savings of $206,257 as a result of the privatization and the proposal was approved. In the absence of the OSA's review, though, an inappropriate accounting methodology could translate into a privatization that costs additional money compared with continued government provision.

Conclusion

In December 1995, the Massachusetts Bay Transportation Authority issued an RFP for operation of its real estate functions, as well as planning and construction of 5,000 parking spaces in central Boston. The MBTA sought this privatization to improve the management and financial return of its extensive real estate assets. The release of the RFP followed two independent management studies of the Authority's management of its real estate assets in 1993 and 1995. The 1993 study concluded that real estate assets were not being maximized for many reasons including lack of appropriate management systems. The follow-up 1995 study focused on

management of the Authority's tenant ledger and the results indicated that the Authority was unable to implement recommendations made in the 1993 study.

The MBTA's submission to the OSA included detail on the reasons for privatization and a management study, summary of bids received, bid evaluation criteria, and cost forms. The selected team, Transit Realty, did not have the lowest initial bid but was deemed to have the best qualifications to fulfill the scope of services in the RFP. The union bid scored the fewest points of the four bidders. On this subject, MBTA stated that it was difficult to compare the union and private bidders because the union bid, at its request, was evaluated with different criteria. The union bid was judged to lack detail, and avoidable costs to the department. For example, the union proposed to eliminate staff from the department, but not from the agency as no layoffs were included in the proposal.

Unlike the approved Holyoke College food services privatization case, the MBTA notified the OSA of its intent to outsource functions when the RFP was released. There was not, in this case, any apparent disagreement over the OSA's jurisdiction to review the proposed contract for privatization. The only friction concerned the timing of the OSA's review, with the MBTA arguing in letters to the OSA that the time of the review period was excessive. Still, the review took just over a month from initial submission, and under six months from release of the RFP. The OSA approved the MBTA's proposed contract with Transit Realty on July 10th, 1996. In its cost forms, the Authority claimed that outsourcing real estate functions to Transit Realty would save $2.4 million and enhance revenues by $5.18 million for a total savings of $7.58 million. Ten audit adjustments were made in evaluating these cost forms. Notably, the OSA would not allow the MBTA to count estimated increased lease revenue of over 5 million dollars through more efficient management of the tenant ledger by Transit Realty. The OSA did accept the Authority's assertion that the parking garage development program not be evaluated for compliance with the privatization law because it would be funded from other sources. After the ten audit adjustments, the OSA determined that the proposed contract could be expected to save $206,257 over the life of the 5-year contract and this privatization proposal was approved.

Case Study 3: MBTA Bus Shelter Maintenance

Introduction

> *The Weld Administration viewed this as an ideal case with which to undermine a law that was bothersome to them.*

In 1995, the Massachusetts Bay Transportation Authority (MBTA) began exploring possibilities for increasing revenue by including advertising on bus shelters. Accordingly, the marketing department carried out research on bus shelter advertising programs in New York, Toronto, and San Francisco and determined that these cities had success with contracting out the service to specialized advertising and marketing companies. Additionally, it was determined early on by the MBTA that it is frequent industry practice for the advertising contractor to also undertake cleaning, repairing, and replacement of shelters hosting advertising. This is because the advertising company has a vested interest in ensuring that it can secure an attractive environment for advertisers.[55]

Initially, the MBTA either did not realize that contracting out for bus shelter advertising and maintenance would be subject to the Privatization Law, or hoped to avoid the process, but after being notified by the OSA, the RFP process was delayed. Before releasing an RFP in January 1996, the MBTA had 198 bus shelters located throughout 68 of the 78 municipalities served by the MBTA. Twenty-seven of the shelters were glass and sheet metal while the remaining were constructed with lexan and sheet metal. These shelters were maintained by 2 full-time employees with support from one sheet metal worker. On average, these workers cleaned six shelters per day, thus each shelter was normally cleaned once every two months. Included in the cleaning regimen was washing and disinfecting of shelters as well as graffiti removal.[56]

RFP and Selection Proposal

The January 1996 RFP had two-phases: pre-qualification and the actual proposal submission. As previously stated, the RFP was not initially crafted to allow for compliance and review with respect to the privatization law. After agreement with the OSA that the contract would be subject to the privatization law, an addendum to the RFP was added that required compliance with the requirements of the law. The union was then notified, and the deadline for submission was extended from

February 14 to March 1, 1996 for private bidders, and to March 8 for a union response.[57]

In addition to requiring compliance with all provisions of the privatization law, the RFP was comprised of three parts: the advertising function, the cleaning, maintenance, and installation of bus shelter function, and other performance indicators. The advertising function consisted of all steps necessary to upgrade or replace existing shelters to include advertising. This function also included obtaining all local permits necessary for the upgraded or replaced shelters. Additionally, the contractor was asked to draft an advertising strategy to maximize revenues. The cleaning, maintenance, and installation function included daily, twice monthly, and as needed maintenance services that exceeded the current level of service. Finally, the other performance indicators section included performance benchmarks related to two objectives of the contract; increasing revenue and improving cleanliness of bus shelters.[58] Performance indicators were required to allow the MBTA the ability to sever the contract if benchmarks were not met.

As previously stated, the bid process had two phases. Three private vendors, TDI, Inc., Park Transit Displays, Inc., and Outdoor Systems submitted pre-qualification bids. All were accepted but only Outdoor System and a union group called the Union Consortium submitted actual bids for advertising and bus shelter maintenance services.

The Outdoor Systems Advertising Group bid proposed to clean and maintain shelters at a rate of 18 shelters per day, exceeding specifications in the RFP scope of work. At this rate, shelters would be cleaned once every two weeks as opposed to once every two months as was the standard in house at the time the RFP was released. The cost of maintenance over 5 years totaled $665,000, however, there would be no cost to the MBTA for these services as the centerpiece of the contract would be for Outdoor Systems to pay the Authority a minimum of $2.1 million per year for advertising rights to bus shelters. Additionally, Outdoor Systems would replace about half of the 198 existing bus shelters and provide several hundred new shelters without any cost to the transit authority. Outdoor Systems proposed to pay extra in advertising revenue for each replaced and new shelter installed.[59]

The Union Consortium Bid addressed the cleaning and maintenance functions of the RFP but did not offer to provide advertising revenue to the Authority. The union bid a price of $1,232,065.63 covering labor costs for maintaining and repairing the bus shelters over the five-year contract term. According to the Authority's proposal submitted to the OSA, this price did not include other costs such as materials and supplies, depreciation, maintenance, and insurance. After including these costs, the union's bid was adjusted by the MBTA to $1,633,314. The union also recommended that certain changes be made to the bus shelter program in order to facilitate more

efficient maintenance but after review by the Authority it was determined that these recommendations, which included replacing glass with lexan material, were inconsistent with the ability to provide advertising services.[60]

Unsurprisingly, the Authority chose to select Outdoor Systems for maintenance of its bus shelters stating, "the cost of contracting with Outdoor Systems, without consideration of the lack of inclusion of materials and supplies or other direct costs by the unions, is $597,220 less than the Unions' bid."[61] Further, the Authority also believed that the union's bid exceeded current in-house costs. This, however, was most likely not a determining fact in the ultimate decision to select Outdoor Systems. Although unstated in the Authority's evaluation of bids, the union consortium did not address the real purpose of the RFP – increasing revenue through advertising on bus shelters.

Privatization Proposal

In July 1996, the MBTA submitted its first proposal to privatize bus shelter advertising and maintenance. This proposal was rejected on August 15th, 1996 because, "The Office of the State Auditor determined that the MBTA had not met the requirements of the Privatization Statute in that the contractor's maintenance cost estimate was incomplete, unauditable, and could not be documented."[62] Additionally, Outdoor System's compliance with certain regulatory statutes could not be documented.

On November 12, 1996, the MBTA formally submitted its second privatization proposal to the OSA and two days later on November 14, 1996 the OSA began a formal review of the proposal.[63] The MBTA immediately disputed the OSA's review period in a letter to the OSA, arguing that the review should take 30 calendar days, not 30 business days as stipulated by the OSA.[64] This second proposal's ten parts included the written statement of services, proposed contract, cost forms, supporting documentation, and a management study. It also attempted to respond to the shortcomings of the first proposal by including more detailed cost comparisons between present in-house maintenance, and future maintenance costs under the proposed privatization.

The cost forms indicated that in-house costs for the cleaning and maintaining of bus shelters would total $1,177,867 over the proposed five-year life of the contract, while Outdoor System's cost would be $634,846 but would in fact cost nothing to the Authority. In the Summary of Bids received section, it is explained that Outdoor Systems is able to maintain shelters at a lower cost than the Authority because they would use a more efficient method of cleaning and utilize staff that are proficient in

all needed tasks so that fewer employees are necessary to undertake cleaning and maintenance.[65] The in-house cost comparisons did not account for the number of shelters increasing as planned by the chosen contractor, Outdoor Systems. The MBTA estimated that contract performance costs would result in net revenues of $2,063,557, leading to a total cost savings of $3,241,424.[66]

The major argument of the proposal submitted to the OSA was that the plan would allow the MBTA to realize significant guaranteed revenue, and the possibility for additional revenue through the planned installation of additional advertising space on new or replaced shelters to be installed by the contractor. It presented the cleaning and maintenance of bus shelters as an additional benefit of contracting out advertising that would improve performance over in-house provision of the service at no cost to the Authority.

Auditor's Determination

On December 11, 1996, the Office of the Auditor issued a determination objecting to the awarding of a contract to Outdoor Systems that would involve maintenance of bus shelters. The determination denied the MBTA's request on the grounds that it had not met two of the requirements of the Privatization Law. In rejecting on the grounds that basic requirements were not met, the OSA did not provide cost comparisons between continued in-house provision of cleaning and maintenance, and privatization of the function in conjunction with contracting out advertising on bus shelters. The determination indicated the OSA's readiness to accept a contract without shelter maintenance.

Specifically, the OSA determined that the MBTA had not met the requirements of Section 54(7) (iii) and Section 54(7)(iv) of the privatization law. Section 54(7)(iii) requires that "the agency must certify and demonstrate that the proposed contract cost will be less than the estimated cost of keeping the service in-house, taking into account all comparable types of costs." In rejecting the proposal partly on this basis, The OSA was essentially saying that the MBTA had provided a proposal for maintenance that could not be compared to present operations in that the chosen contractor planned to increase the number of shelters. The OSA wrote; "based on the presentation of costs estimated by both the MBTA and the proposed outside contractor, it is clear that both costs may be based on a significant variance in the number of shelters that are the subject of this proposal." Further, "because this substantial variance remains unreconciled it cannot be demonstrated or determined that the contracting out of the service will result in any cost savings." Section 54(7)(iii) concerns certification that a designated bidder has complied with all relevant federal or state statutes. On this section the OSA wrote that; "the MBTA has

not provided sufficient, competent evidence of the proposed contractor's compliance with certain significant relevant regulatory statutes, namely certification of good standing from the state and federal tax collection agencies."[67]

It should be noted that in disapproving this privatization, the OSA reversed a draft approval determination that was circulated to the MBTA. This draft approval outlined the MBTA's compliance with all sections of the privatization law. With respect to cost comparison, the OSA adjusted the amount to be paid to the MBTA for advertising out of the performance costs, claiming that the MBTA did not demonstrate why only the private contractor, and not the MBTA could realize revenue from bus shelter advertising. After subtracting this revenue source from the package along with other audit adjustments, the OSA determined that the contract would save $23,967 per year or $119,833 over the five-year life of the contract.[68] The draft approval was reversed once the OSA determined that the MBTA had been using conflicting estimates of the number of bus shelters to be maintained when evaluating Outdoor Systems' and the union's proposals.

Court Challenge

There is no administrative process through which to appeal the OSA's decision. However there was and is nothing in the law to prevent the MBTA from re-submitting its proposal to conform to the OSA's implementation of the law's requirements. Rather than preparing a third proposal, the MBTA instead elected to challenge the constitutionality of the privatization law, and decisions made under that law in court. The court challenge that ensued in this case must be viewed in the context of the politically charged atmosphere within the Weld Administration. The Executive Office of Transportation and Construction, the super agency that oversees the MBTA as well as MassHighways, was a particular administration focal point for the creation of privatization initiatives. The uncritical acceptance of the notion that public contracting could cure virtually all the problems of government was strong among the senior management of that high level agency at that time. Thus the MBTA's executive staff was working under the notion that with sufficient contracting it could eventually transform into what they termed a "virtual" agency or a department that did nothing but manage contractors. At the same time that the bus shelter privatization proposal was preceding a more ambitious proposal to begin the eventual privatization of the entire MBTA bus system was also just getting underway. That more ambitious project was to begin with the proposal to privatize bus routes in Quincy and Charleston, reviewed below. In June 1997 the OSA rejected that bus privatization proposal on the straightforward grounds that it would cost more than present operations. In the context of these rejections, and the larger ideological mission that the Weld Administration set for itself, the OSA was, as far

as they were concerned, not a public watchdog but an obstacle to a political agenda. The agenda was to massively transform public service in the Commonwealth by putting as much of the public work as it could out to bid.

On February 16, 2000, the Massachusetts Supreme Judicial Court ruled against the MBTA, and in favor of the OSA in two areas. The court ruled with respect to the constitutionality of the law, that the MBTA did not have standing to challenge the law because it is a state statute. Although the court did not grant the MBTA standing, it also made a specific determination on the bus shelter proposal concluding that, "there was ample evidence that the MBTA did not clearly establish that its "in-house" and "contract" cost estimates were based on the same number of bus shelters". In conclusion the court stated, "the Auditor's objections, therefore, were reasonable and followed the statutory mandate that he independently review the contract."[69]

Conclusion

This case was more complex than the others in that issues of revenue enhancement became conflated with issues of service cost to the detriment of both. The problem here was that, for the MBTA, politics came to trump good public management. Despite the claims of potential savings and more importantly revenue enhancement, the OSA rejected the MBTA's second proposal. They did so because the legal mandate under which they operated required them to compare direct service cost issues for the task that was to be privatized apart from revenue issues which as we saw in the real estate case they regarded as separate. Indeed the 2000 decision of the Supreme Judicial Court upheld this interpretation of the law. They rejected the proposal for privatization of bus shelter maintenance and repair because they found that the proposal did not accurately compare the cost of in-house operations with the contract proposal costs because the proposer intended to increase the number of shelters to be maintained and because of conflicting estimates of the actual number of shelters to be maintained. Additionally, the OSA found that insufficient evidence was provided on Outdoor System's compliance with federal and state statutes related to tax payment.

The heart of the MBTA's disagreement with the decision was that from their point of view contractor maintenance costs were irrelevant to the substantive issue here. The substantive issue for the MBTA was that it was not a matter of privatizing the maintenance function as much as it was a chance to enter into a new profitable relationship and bring in needed revenue. Outdoor System's essentially proposed to "throw in" shelter maintenance along with substantial payments to the MBTA in

exchange for the right to sell advertising on existing shelters and expand the number of shelters to expand the number of salable advertising venues.

The problem here was neither the law nor the OSA's application of the law. The problem was that, because the MBTA made a determination to use this case to undermine the law, all fruitful communication to resolve the problem broke down. To a large extent that was intentional because the Weld Administration viewed this as an ideal case with which to undermine a law that was bothersome to them. The tragic part of this from a public point of view is that the proposal had the potential to bring in substantial new revenue and involved outsourcing advertising on bus shelters. The MBTA could have separated the issue. It could have retained its own cleaners and collected more revenue from its contractor. But it never chose to even explore the option for two reasons. First it never seriously entertained the possibility that its employees might want to work with management to make this work. Secondly it cared more about the principal of executive privilege to contract at will than it did about the specific situation at hand.

Case Study 4: Bus Service Delivery Privatization

Introduction

> *This case shows how the Privatization Law protects the interests of the public and forces public sector managers to clearly think through contracting decisions prior to committing the public to risk and liability.*

Possibly the most well known Privatization Law review case is that of the twice-litigated Massachusetts Bay Transit Authority's (MBTA) proposal to privatize the operation and maintenance of Charlestown/Fellsway and Quincy bus fixed bus routes. In a case that was widely reported on in the press, the OSA twice turned down the MBTA's request to authorize the contracting out of these services, because the MBTA failed to adequately demonstrate a positive cost savings associated with this proposal. This case is instructive in that, despite reliance on both legal counsel and outside consultants, the MBTA was unable to comply with the Privatization Law requirements, and demonstrate a fiscal benefit to the plan. Furthermore, the case, and the legal proceedings that followed from it, showed that the MBTA had not done an adequate job pricing its anticipated cost savings in terms of avoidable costs. This is important, because, had the privatization been allowed, the public would have been left holding a significant liability. For these reasons, the MBTA route privatization case demonstrates the ultimate efficacy of the law – it forces agencies to fairly forecast the ultimate impact of contracting decisions on the public,

which is the ultimate owner of state assets and systems. This case shows how the Privatization Law protects the interests of the public and forces public sector managers to clearly think through contracting decisions prior to committing the public to risk and liability.

The MBTA's plan would have incurred an extra $73 million if the privatization had been allowed.

Following an audit and operational review in mid 1993, a consulting firm[70] recommended that the MBTA move quickly (by Spring 1994) to privatize or contract out a significant portion of the fixed bus routes then operated by the authority.[71] According to the COMSIS report, such action was the only way to stabilize what was then viewed as the MBTA's increasingly perilous financial situation.[72] The consultant highlighted two significant cost issues that seemed to make a strong case for such a contracting decision. First, the consultant observed that in FY 1991, the MBTA had an overall bus operating cost of about $95 per revenue hour, a cost level second at that time only to Seattle's.[73] Second, the consultant noted that the MBTA was then paying private contractors to operate marginal routes at about $46 per revenue hour.[74] The consultant's report used these two accurate facts to imply that by contracting out, the MBTA could save as much as fifty to sixty percent on routes it chose to privatize.[75] This suggested a savings of close to $30 million per year on the Charlestown/Fellsway and Quincy routes, though the report itself did not place a dollar figure on the savings, promising only that "the MBTA can achieve significant savings"[76] through such a privatization.

Clearly the suggestion of an opportunity to significantly reduce costs deserves careful consideration. MBTA was clearly correct in pursuing these savings and further examining the likely impact of such a privatization. However, it is also clear that the COMSIS cost assessment was, at best, lacking in finer detail. A review of the COMSIS proposal demonstrates that the net cost impact of such a privatization would not be a $30 million savings. In fact, the net impact of the COMSIS proposal was likely to be a cost increase – exactly the kind of poor privatization decision that the Privatization Law was designed to guard against.

This case study will review the COMSIS cost assessment. It will demonstrate how that assessment failed to recognize ongoing cost liabilities. The MBTA privatization application will be reviewed, as well as the OSA's objections. This case study will conclude with the likely cost impact of the privatization, had it been allowed, along with a summary discussing the value of the case as a demonstration of the efficacy of the Privatization law.

Privatization Proposal

In May of 1997 the MBTA submitted a revised application for the contracting out of two "bundles" of fixed route bus service operation and maintenance that had previously been operated by MBTA employees. The MBTA's August 15,1996 RFP had solicited bids for any of the five bundles, based on the existing facilities in Albany/Cabot, Bartlett, Charlestown/Fellsway, Lynn, and Quincy.[77] Though the document record does not clarify the reasons why, MBTA selected ATC/Vancom as vendor to operate and maintain the Charlestown/Quincy routes and ATE/Ryder for the Quincy bundle. No privatization of the other bundles was applied for at that time.[78] In the RFP, the MBTA explicitly recognized the applicability of the Privatization Law, and attached the state privatization guidelines, highlighting the re-employment provisions, the data requirements, and the performance measurement requirements.[79] The OSA's final determination declined the privatization due to a failure to establish cost savings.

Prior to the OSA's negative determination of June 1997, the MBTA had previously submitted a rejected application.[80] In the MBTA's submission, it was estimated that the privatization of the Charlestown/Fellsway routes and maintenance associated with those routes would save $17,542,608 and that the privatization of the Quincy bundle would save $9,165,347.[81]

MBTA Submission	Charlestown	Quincy
In House Costs	$261,217,706	$71,275,253
Contract Costs	$243,675,098	$62,109,906
Savings	$17,542,608	$9,165,347

Once rejected by the OSA for deficiencies, the MBTA reworked its application and resubmitted on May 23, 1997.[82] In the second submission, the MBTA acknowledged some of the OSA's objections to the first submission, clarified some of the facts as requested by the OSA, and reduced its savings estimates by over $2.7 million for the Charlestown/Fellsway bundle and by almost $1 million for the Quincy bundle. The MBTA's submission estimated a savings of over $23 million through the privatization of both bundles. However, the OSA's analysis indicated that between deficiencies in the MBTA's second submission and the understatement of the value of concessions by the primary union, the privatization would actually end up costing money. The OSA's determination is reviewed below.

Auditor's Determination

> *The OSA determined that the liability cost, "by itself, would more than exhaust the total savings claimed for the two proposals, without even considering other significant findings. The OSA's estimation of the cost of this liability was that it was greater than $47 million.*

The OSA rejected the MBTA's second submission because it failed to adequately establish a cost savings through contracting out. Furthermore, the OSA determined that the MBTA would actually lose money on the contracts between the contract price and the unavoidable costs associated with the privatization.[83] First, the OSA determined that the MBTA's proposals were dependent upon "unreasonable cost savings." The MBTA's proposed contracts included a requirement that the contractors would use a heavy maintenance facility owned by the MBTA in Everett for the first two years of the contract in exchange for a fee. The MBTA labeled this the 'vehicle maintenance plan.' However, the MBTA included the revenue from this agreement over the five year life of the contract. The MBTA did not demonstrate how it would reduce the costs then associated with the to-be-privatized bundles at the Everett facility after two years.[84] The MBTA's second submission did not address this issue.

In addition to the questionable savings related to the vehicle maintenance plan, the OSA questioned a cost savings of over $1 million in non-revenue vehicle repair associated with the contracts. However, the MBTA presented no plan for the reduction of non-revenue vehicles or their repair. The issue at stake is whether the costs of supporting those vehicles would truly be avoided by the MBTA, or merely shifted to another accounting unit. The statute clear demands that the subject agency truly reduce costs and not just shift them around.

Similarly, the MBTA's submissions failed to address the issues of "nonscheduled service" and performance payments, both of which were included in the proposed contracts.[85] The MBTA submissions included non-scheduled and emergency service costs that could potentially exceed $29.2 million for the two bundles, however the cost of in-house provision of these services was never factored in. More seriously, the MBTA failed to include incentive payments, detailed in the contracts into the cost of contracting out. These payments could have potentially cost the MBTA $4.3 million, "in the event contractors [met] some of the performance standards that are currently achieved by MBTA employees."[86]

The MBTA also included an estimated savings on pension costs of about $20.4 million should the 729 "nonvested" employees affected by the privatization be displaced. Likewise, the MBTA included savings related to vacation accrual that they would save should the affected employees be let go. The OSA took issue with both of these. The MBTA presented no plan for avoiding the costs of the pensions, as it was not legally clear that the employees in questions would be deemed to have left of their own volition. The vacation savings cited by the MBTA included accrual already earned by the affected employees.[87]

Of greatest cost concern, however, is the issue of "13(c)" liability. It was not clear, at time of submission, the extent to which the MBTA would have been liable for displaced worker severance pay as required by federal statute. The MBTA did not include these potentially substantial costs in its estimates despite a lack of resolution on the issue. At the time of the second submission, the MBTA and the affected union were attempting to seek arbitrated resolution to the issue. The OSA determined that the liability cost, "by itself, would more than exhaust the total savings claimed for the two proposals, without even considering other significant findings [by the OSA]."[88] The OSA's estimation of the cost of this liability was that it was greater than $47 million.

In addition to problems with the cost comparisons in the MBTA's two submissions, there was also concern that the two contractors would not be able to meet quality of service levels as this went unaddressed in the MBTA's submission. That is, it was unclear that the contractors could provide service that was as good as the MBTA was capable of providing in-house. In response to OSA concerns, the MBTA did develop a short set of performance targets, however these were not included in the proposed contracts.[89] In addition, the MBTA made no effort to determine the level of performance achievable in-house, instead it relied on existing performance levels. This violated both the spirit and letter of the statute which was intended to cause the subject agency to carefully consider operational performance, improvement opportunities, and costs prior to contracting.

During the process of making its applications, the labor unions volunteered concessions and other cost savings opportunities worth $21 million, but the MBTA failed to include these in its estimates.[90] The MBTA failed to adequately establish the cost savings that would derive from contracting out, and failed to consider in-house improvements achievable. The OSA's two reviews both correctly denied the application of the MBTA to privatize the two service bundles in question.

Conclusion

Given the OSA's objections and the labor concessions, it is clear that had the proposed privatization been allowed (if, for example, there were no Privatization Law), the MBTA's contracting decision would have resulted in a loss to the taxpayers of Massachusetts. As the table below demonstrates, the Labor concessions alone would have negated any cost savings associated with privatization

Cost Comparison	In-House Operation	Private Operation
Total Costs	$332,492,959	$305,785,004
Net Savings (Loss)	($26,707,955)	$26,707,955
Adjusted Costs with Concessions	$304,578,665	$305,785,004
Adjusted Cost Net Savings (Loss)	**$1,206,339**	**($1,206,339)**

Furthermore, the OSA identified several cost factors missing from the MBTA's assessment. Excluding those costs identified, but not specified by the OSA (vehicle maintenance plan, non-revenue vehicle maintenance, emergency service, vacation time, and fuel costs), the MBTA's plan would have incurred an extra $73 million if the privatization had been allowed. As a result of the labor concessions and the additional non-avoidable costs, the privatization would have cost taxpayers $73,206,339, as described in the table below.

Cost Comparison	In-House Operation	Private Operation
Total Costs	$332,492,959	$305,785,004
Net Savings (Loss)	($26,707,955)	$26,707,955
Adjusted Costs with Concessions	$304,578,665	$305,785,004
Non Avoidable Costs		
Performance Payments		$4,300,000
Pension Costs		$20,400,000
13 (c) Liability		$47,300,000
Subtotal	$304,578,665	$377,785,004
Adjusted Cost Net Savings (Loss)	**$73,206,339**	**($73,206,339)**

It is clear, then, that this particular privatization was not adequately thought through. It is equally clear that without the Privatization Law, it would have been carried out nonetheless.

Following this case through from COMSIS report to the final MBTA submission and OSA determination, it is clear that several of the flaws related to the initial concept were carried through to the contracting decision. Costs, and particularly savings were not considered carefully enough. Furthermore, issues of cost avoidance and of adequate service were insufficiently examined. The Privatization Law exists to ensure that that subject agencies make good management decisions related to privatization, and in this case the law was successful.

Conclusion to the Case Studies

The review of the cases assessed by the OSA under the Privatization Law and particularly those cases reviewed in-depth here highlight the efficacy of the statute. The Privatization Law has helped Massachusetts effectively avoid poorly thought through privatizations. Privatizations performed under the assumption that the private sector can deliver higher quality at a lower price are not allowed. Only carefully considered contracting decisions, including a thorough cost analysis and clear establishment of service and quality standards, are permitted. The process used by the OSA is clear, and while it requires specific measures, it is not so complicated that smaller agencies are unable to comply with it. Furthermore, the law's lower limit of $100,000 avoids superfluous applications and tedious assessment for smaller contracting decisions. The Privatization Law therefore effectively protects Massachusetts' taxpayers from bad privatization decisions, while allowing them to enjoy the benefits of good contracting.

Previous Studies of the Privatization Law

Despite the highlighted efficacy of the statute, the Privatization Law has not been without its critics. The predominant critic has been the pro-privatization think tank, the Pioneer Institute.[91] At the same time, the law has received significant positive review.[92] The aim of this section is to briefly review the major criticisms of the Privatization Law with reference to the case study findings covered above.

The Pioneer report mixes its criticisms of the Privatization Law together with its complaints about the process that the OSA employs to review applications. However, several major themes emerge:

1. Privatization is generally good and should not be discouraged.
2. Avoidable cost accounting is generally bad, and full cost accounting should be used to determine cost savings associated with privatization.
3. Transitional costs (costs of moving to contracted provision) should not be considered as they over-emphasis short term costs at the expense of long term gains.
4. Contract monitoring costs are over emphasized as they de-emphasize the benefit of performance monitoring to service quality.
5. Allowing employee bids or concessions is unfair.

The Pioneer report spends the bulk of its time arguing the first, and then the second point. As long time privatization advocates, Pioneer presumes that privatization is a good thing and should not be discouraged. In their study the law is held to, "present both statutory and political roadblocks to efficient government operations," and has provisions that "essentially slam the door on many opportunities that have been shown to improve services and save money in other places."[93] The law is held to disregard all potential privatization benefits, other than reduced costs. The institute claims that, "well-designed contracts allow agencies to improve quality, accommodate peak demand, speed project delivery and meet deadlines, gain access to expertise, improve efficiency, spur innovation, and manage risk more effectively."[94]

Privatization is Generally Good?

We have no way of knowing how many agencies have contemplated privatizations, researched them, and rejected them because they could not meet cost or service level requirements. Is this a bad result of the law?

Both the review of the impact of the law (above) and the case studies (also above), paint a different picture of the Privatization Law. The Law does not 'block efficient government operations,' rather it provides clear guidance to agencies to help them make successful contracts. The law certainly does not prohibit privatizations; 75% of applications have been successful. Rather the law forces agencies to consider the impact of contracting out before making a decision. This is not a bad thing. It can only be through careful consideration of costs and service levels that an agency can expect to achieve all the positive benefits that Pioneer suggests can be the fruit of 'well-designed contracts'. The 'privatization is a generally good idea' argument is

somewhat superfluous here. The authors of the Pioneer report bitterly complain that the Privatization Law focuses on cost, making it the only point of contention in OSA reviews, and ignoring issues of improved performance achievable through contracting.[95] It is true that the law focuses on costs – an agency may not privatize unless it can save money by doing so – but it also places a significant emphasis on performance.

Pioneer does not advance any argument to explain why it is that contractors can improve service when subject agencies cannot. In the end, this is the fundamental problem with the 'privatization is a generally good idea' argument. Proponents cannot explain how it is that private firms can bring such great improvements in cost effectiveness and service levels, but fail to meet the Privatization Law's standards. The standards are clear, the cost of a five year contract, including the cost of implementing, monitoring, and maintaining that contract must be less than the in-house costs to provide the same service. Service levels to be provided by the contractor must be at least to the level that the subject agency can provide in-house. Finally, the privatization must be in the public interest, a clause that has never been used by the OSA as grounds for rejecting an application. If the private sector is able to do the job that Pioneer suggests – if it is better, faster, smarter – meeting these goals should not be difficult. And indeed, most agencies that submit applications for privatization are successful.

Pioneer sees the fact that eight services privatizations have been attempted since the law went into effect as a negative consequence of the Privatization Law. This would make sense if the OSA routinely rejected applications. The pass rate, however, belies this assumption. What would be a more logical conclusion, is that the requirements of the law, being what they are, have demonstrated to managers that they must carefully consider privatization opportunities. We have no way of knowing how many agencies have contemplated privatizations, researched them, and rejected them because they could not meet cost or service level requirements. Is this a bad result of the law? Of course not. This is how we want our public service managers to behave. We want them to research major contracting decisions prior to radically altering service delivery mechanisms. We want them to make complete assessments of the likely cost impacts of those decisions. What Pioneer labels as a failure of the current law is actually a success – subject agencies are not pursuing losing propositions and are only seeking to privatize where it makes sense.

Avoidable Cost Accounting

That the Reason Foundation, a pro-privatization, libertarian think tank accepts the logic of using avoidable cost accounting for making contracting decisions serves to highlight the tenuousness of Pioneer's position.

The second major complaint of the Pioneer Institute is that the Privatization Law requires subject agencies to consider cost avoidance when addressing the benefits of a potential contract. That is, how much will the agency actually save if a service is privatized?

Avoidable cost accounting is a widely accepted methodology for understanding savings to be derived from a contracting decision. Quite simply, when a firm, or agency, contracts out a service, not all of the costs associated with in-house production necessarily disappear. Buildings or capital equipment may continue to be owned and depreciated, contractor performance needs to be watched and evaluated, and pensions and benefits for displaced workers may need to be paid. Avoidable cost accounting methodology helps decision makers understand the net effect of contracting out – what will actually be saved.

Accordingly, the Privatization Law requires that each privatization proposal prove a projected cost savings compared with continued provision of the service by the public sector. It is, however, much easier to define the goal of cost savings than it is to calculate, as assumptions always need to be made in order to create a realistic comparative cost model.[96] The realities of government service provision mean that savings from a privatization are not simply a matter of subtracting costs of the service to be privatized, and then adding any fee to be paid by the private sector operator. There is a continued governmental responsibility that varies with the particular service being privatized. This continued responsibility typically includes contract management, and other required areas of support to the contractor such as providing emergency back up, and administrative support. In short, it can be expected that the government would continue to bear overhead costs after a particular service is privatized. If lay-offs and productive transfer of workers are not possible, then labor costs often cannot be saved. If cost savings from a privatization is the goal, than a nuanced, individually tailored approach is appropriate.

Pioneer's complaint that avoidable cost accounting misrepresents potential cost savings is poorly argued, unsupported, and illogical. First, Pioneer argues that the value of privatization is that agency personnel can be redeployed elsewhere. Pioneer writes, "If [staff] are redeployed to other priorities, then there is a benefit from the privatization. This is true even if none of the support or overhead staff are removed . . ."[97] Pioneer's argument then, is that agencies should no longer include the cost of

staff that continue to work at the agency in question after a privatization if they do other work that was neither performed or paid for by the agency previously. How is this a cost savings? The agency in question is still paying for the staff and for the new contract. This is not good fiscal management. The example used by Pioneer to highlight this issue is that of the 1994 Department of Revenue proposal to privatize mail opening during the tax season. This proposal was approved.[98] Pioneer presents no evidence to indicate that this issue has actually interfered with a privatization. Second, the Pioneer report discusses "avoidance" of capital construction costs on future projects. The report implies that the Privatization law does not adequately account for these savings. However, Pioneer presents no evidence to demonstrate that this issue has prevented an otherwise good privatization.

Pioneer's argument about avoidable cost accounting is also poorly supported. Pioneer suggests that total cost accounting is a superior method for understanding savings to be derived from privatization. That is, agencies should examine what their costs are currently, what the contract cost will be, and subtract one from the other. This certainly holds the appeal of simplicity. Unfortunately this is also bad fiscal management. Clearly, any private sector firm, when making a contracting decision, would consider what their costs are now, *what their costs will be after contracting out*, and what the contract price will be. These ongoing costs include non-avoidable costs like continued staffing, capital equipment, rent, utilities, etc. and new contract monitoring costs. To support their assertion that agencies considering privatization should not be required to include these on-going and new costs in their decision, Pioneer cites a US EPA report.[99] However, these EPA reports are concerned not with accounting for the benefits of contracting decisions, but of understanding the environmental and other external costs of waste management systems. Full cost accounting definitely has a roll to play in fiscal management, just not in making privatization decisions. This is even recognized by the Reason Foundation, a sibling research institute to Pioneer.[100] That the Reason Foundation, a pro-privatization, libertarian think tank accepts the logic of using avoidable cost accounting for making contracting decisions serves to highlight the tenuousness of Pioneer's position. Pioneer's argument to the contrary goes unsupported.

Ultimately, Pioneer's argument that it is unfair or inaccurate for agencies that are considering privatization to calculate the total cost impact of that decision (current costs, contract costs, unavoided costs, and other new costs) is ultimately illogical, contrary to common practice and to good government recommendations. The taxpayers of Massachusetts deserve good fiscal management and the Privatization Law delivers this by mandating avoidable cost accounting.

Transition and Contract Administration Costs

Similarly, the Pioneer report makes nonsensical arguments about transitional costs and contract administration costs. Pioneer briefly suggests that the costs associated with moving into a privatization not be included in an agency's estimation of the value of a privatization. Likewise, the Pioneer report criticizes the inclusion of contract monitoring costs into the calculation. The first issue is not fleshed out in the Pioneer report, making it difficult to address. Pioneer does write that costs associated with displacing employees – retirement costs, accrued vacation payout, and other post-employment benefits – should not be counted as costs of privatization. As was seen in the case of the MBTA's route privatization proposal, these can be serious liabilities, and will cause costs out of the normal timing and scale the agency could otherwise anticipate. To ignore these would be a significant dereliction of good fiscal management.

Clearly, management of employees is good and necessary, but third party, or additional contract oversight is unnecessary. These costs are included in the privatization value calculation because they are necessary when contracting out. The "benefit" of monitoring contracts is factored in – in the price the contractor is charging for meeting service requirements.

More serious are Pioneer's criticisms of contract monitoring and administration costs. Pioneer makes two worrisome arguments with regard to these costs. First, they suggest that the benefit of contract administration should be factored into the cost analysis of the benefit of privatization. The benefit of contract monitoring is that agencies receive the services they pay for, at the service levels promised, and are not over billed. This is not necessary for in-house work because of the internal management systems already in place. Primarily, in-house service provision gains no profit through under provision. Clearly, management of employees is good and necessary, but third party, or additional contract oversight is unnecessary. These costs are included in the privatization value calculation because they are necessary when contracting out. The "benefit" of monitoring contracts is factored in – in the price the contractor is charging for meeting service requirements.

Pioneer goes on to argue that the system used to evaluate contract monitoring costs is unfair because some service areas interact with the public to a greater degree than others. Pioneer writes, "When customers immediately notice service problems and are motivated to complain, monitoring is fairly simple and less costly – the customers do most of the monitoring themselves."[101] It is Pioneer's contention then that services with a high degree of public interaction – bus service or food service, for example – require less monitoring then back office contracts like IT or support

services. This argument does not hold up under scrutiny. First, as Pioneer argues, contract monitoring is beneficial and important for good contracting and all services need to be monitored if they are contracted out. Second, monitoring involves both service levels and costs. The public cannot be asked to ensure that a service provider's billing is in order, not can they know if a bus operator is doing an adequate job of maintaining capital equipment. Service provision and effective delivery involves too many levels and areas of performance to ask the public to do the monitoring. This is not good fiscal management.

Employee Concessions

Finally, the Pioneer report takes issue with the fact that, as in the case of the MBTA Route Privatization proposal, the existing labor union may offer concessions, and that these must be factored into the privatization cost estimates. Good fiscal management, however, demands that agencies find the least costly method of delivering the required level of service. If a private firm that was considering contracting a service out determined part way through the process that it would be possible to reduce in-house costs and make in-house service delivery cheaper, that private firm would not refuse to consider the value of those costs reductions. Public agencies should be held to the same standard. This is the type of good management practice that the Privatization Law effectively delivers.

Summary

A review of the major criticisms of the Privatization Law suggests that critics continue to assume that privatization is a panacea for all public service delivery issues. These critics would like the Privatization Law to be overturned and to see no barriers to privatization. However, a review of their arguments demonstrates that they are illogical and unsupported. The Privatization Law does not prevent privatization, but it does require agencies considering contracting out to do a thorough review of the costs and benefits of doing so. The Law does not "slam the door" on privatization. The law does mandate good fiscal management helping Massachusetts to achieve affordable government.

Conclusions

The law has allowed over $1.2 million in annual savings and prevented at least $73 million in bad privatization decisions. More importantly, the Privatization Law has provided a framework with which agencies can accurately judge the likely cost impact of contracting concepts. The law has effectively delivered good management practice as relates to privatization to Massachusetts.

This study has aimed to examine the efficacy of the Massachusetts Privatization Law. A review of the law and its requirements, of the costing mechanisms used within the law, of the OSA's review procedures, and of the privatization cases heard by the OSA have demonstrated that the law creates an environment in which good management practice can flourish. Where contracting out services makes sense, the mechanisms used to enforce the law allow this to happen while making sure that the subject agencies clearly understand what they are getting into. Where agencies are under prepared for contracting out, or where the costs and benefits are unclear, the law forces them to carefully consider the outcomes of alternative service provision methods. The law has allowed over $1.2 million in annual savings and prevented at least $73 million in bad privatization decisions. More importantly, the Privatization Law has provided a framework with which agencies can accurately judge the likely cost impact of contracting concepts. The law has effectively delivered good management practice as relates to privatization to Massachusetts.

All this is not to say that the law is perfect or that it cannot be augmented or improved. The largest potential strength of the law has not always functioned perfectly, or even well. The Privatization law sets up a dialogue between the subject agency and the OSA. It is a great strength of the law that it inserts a third party that has the interests of the taxpayers of Massachusetts into the decision making process. The OSA's role, empowered by the statute has provided an external consultant with which subject agencies can think through the benefits of privatizations. Where this has functioned well, agencies have successfully put together valid justifications for privatizing, have clearly understood the impacts of their decision, and have saved money and maintained or improved service. Given the success of the Privatization Law, and its demonstrated ability to protect scarce public resources in tight fiscal environments, privatization law-like OSA review should be extended to rebids of existing contracts and possibly even to wholly new services. Such an extension of OSA oversight would allow the management and good contracting benefits of the law to further accrue in contracted service areas.

Massachusetts is well served by the Privatization Law. An innovative, first-in-the-nation law, it sets up a process by which reasoned decision making flourishes,

where costly mistakes can be avoided, and where contracting concepts are grounded in reality. The law works well. It is not unduly prohibitive. It allows a healthy dialogue between the contracting agency and a third party that represents the interests of the taxpayers. The law is not perfect. Expanded powers for the auditing agency could help improve the process. A depoliticized environment would also help, but this is likely outside the power of the law. In the final analysis, this is a law that not only benefits the taxpayers of Massachusetts, but that could benefit taxpayers across the country. Good government advocates should be studying the innovate work being done in Massachusetts and exporting it to other states.

Notes

[1] See World Development Report 2004: Making Services Work for Poor People (World Bank: Washington DC)
[2] These are the quantifiable savings based on those proposals that actually made it to the final stage of review – it is impossible know just how much taxpayer money has been saved by forcing decision makers to go through the process as some, or even many, may have determined on their own that the privatization was not justifiable.
[3] The OSA's records show that eleven different audits/determinations have been made under the law on these eight services, due to re-submittals by subject agencies.
[4] That is, it can be difficult for the contracting agency to know the quality of service provided. Also, there are temptations for the contracting firm to take advantage of the knowledge they gain by being close to work to the detriment of the contracting agency. Generally it is possible and even likely that contracting firms work to their self interest which may be exclusive from the interests of the contracting agency. The longer the term of contracts, the more likely these problems develop.
[5] See Williamson, Oliver E, "Transaction Cost Economics Meets Posnerian Law and Economics," Journal of Institutional and Theoretical Economics, 1993, 149(1), pgs. 99-118.
[6] Krauss, Clifford, "Economy's Dive Dazes Once Giddy Argentina," *New York Times*, International, Page A3, Sunday, September 30, 2001.
[7] The New England Institute for Public Policy, Privatization in Massachusetts 1991-2003: Is It Working?, April, 2003
[8] Commonwealth of Massachusetts, House Post Audit and Oversight Bureau. 1994. *Interim Report: Review of Essex County Privatization*. Boston, Massachusetts.
[9] Commonwealth of Massachusetts, Office of the State Auditor. 1995. Privatization of the Maintenance of Roads in Essex County, October 7, 1992 to October 6, 1993. Document no. 93-5015-3. Boston, Massachusetts.
[10] Coopers and Lybrand. 1996*. Independent Assessment of Massachusetts Highway Maintenance Privatization Program*. Prepared for the Executive Office of Transportation and Construction.
[11] See Sclar, Elliott D., You Don't Always Get What You Pay For: The Economics of Privatization, Cornell, University Press, Ithaca, NY, 2000, Page 29 for further detail.
[12] Massachusetts General Law Annotated, Part I, Title II, Chapter 7, (Privatization Law) §52 and 53
[13] Holyoke Community College, Submission to the Auditor, Proposal to Privatize Food Services Operations, Holyoke, MA, 1996, Page A-7.
[14] Holyoke Community College , Submission to the Auditor, Proposal to Privatize Food Services Operations , Holyoke, MA, Section D-7.
[15] Holyoke Community College, Submission to the Auditor, Proposal to Privatize Food Services Operations , Holyoke, MA, Section D-4, Page 1.
[16] Holyoke Community College, "Memo from Nancy B. Eddy to Hugh Robert: Final Report, Dining Services Proposal", Holyoke, MA, June 18, 1996, Page 3.
[17] ibid.
[18] Holyoke Community College "Memo from Nancy B. Eddy to Hugh Robert: Final Report, Dining Services Proposal", June 18, 1996.

[19] Holyoke Community College, " Letter from Nancy B. Eddy, to A. Joseph DeNucci, Auditor of the Commonwealth,", Hoyoke, MA, May 13, 1996.
[20] AFSCME Council 93, "Letter from George Masten and Peter P. Wright to A. Joseph DeNucci, Auditor of the Commonwealth,",Boston, MA, May 6, 1996.
[21] Auditor of the Commonwealth, "Letter from John W. Parsons to Curt C. Foster, Holyoke Community College", Boston, MA, July 15, 1996.
[22] Auditor of the Commonwealth, "Letter from John W. Parsons to Curt C. Foster, Holyoke Community College", Boston, MA, August 27, 1996.
[23] Auditor of the Commonwealth, State Auditor's Determination of Holyoke Community College's Proposal to Privatize Food Service Operations, Boston, MA, September 26, 1996.
[24]ibid, Page 4.
[25] MBTA, Submission to the Office of the State Auditor, Outsourcing of the Property Management and Real Estate Development, Boston, MA, April 9, 1996, Page 2-1.
[26] MBTA, www.mbta.com.
[27] MBTA, Submission to the Office of the State Auditor, Outsourcing of the Property Management and Real Estate Development, Page 10.
[28] MBTA, Submission to the Office of the State Auditor, Outsourcing of the Property Management and Real Estate Development, Page 8.
[29] ibid
[30] Kenneth Leventhal & Company, "Massachusetts Bay Transportation Authority Real Estate Function Organizational and Operations Diagnostic Review" Boston, MA, August 27, 1993, Page v.
[31] E& Y Kenneth Leventhal Real Estate Group, "MBTA Lease Verification", Boston, MA, January 1996.
[32] MBTA, Submission to the Office of the State Auditor, Outsourcing of the Property Management and Real Estate Development, 1996, Page 8-5.
[33] MBTA, Submission to the Office of the State Auditor, Outsourcing of the Property Management and Real Estate Development, Pages 8-5 and 8-6.
[34] MBTA, Request for Proposals: Property Management and Real Estate Development Functions, Boston, MA, 1996, Page 8.
[35] ibid, Page 22.
[36] ibid, Page 13.
[37] ibid, page 25.
[38] ibid, Page 14.
[39] MBTA, Submission to the Office of the State Auditor, Outsourcing of the Property Management and Real Estate Development, Exhibit 4-2A.
[40] MBTA, Submission to the Office of the State Auditor, Outsourcing of the Property Management and Real Estate Development, Page 7-1.
[41] The Privatization Law requires the contracting agency to solicit bids and then compare those bids to in house estimates which are then submitted to the OSA.
[42] MBTA, Submission to the Office of the State Auditor, Outsourcing of the Property Management and Real Estate Development, Page 6-2.
[43] MBTA, Submission to the Office of the State Auditor, Outsourcing of the Property Management and Real Estate Development, Page 6-1.
[44] MBTA, "Request for Proposals", page 29.
[45] MBTA, Submission to the Office of the State Auditor, Outsourcing of the Property Management and Real Estate Development, 1996.
[46] MBTA, Submission to the Office of the State Auditor, Outsourcing of the Property Management and Real Estate Development, Page 6-2.
[47] Auditor of the Commonwealth, "Letter to Patrick J. Moynihan, General Manager MBTA", Boston, MA, May 31, 1996.
[48] MBTA, "Letter to A. Joseph DeNucci: Real Estate Privatization", Boston, MA, May 30, 1996.
[49] MBTA, Submission to the Office of the State Auditor, Outsourcing of the Property Management and Real Estate Development, Page 4-1.
[50] Local 453 Office & Professional Employees International Union, "Memo to John Parsons: Real Estate Proposal", Boston, MA, May 7, 1996 and Local 453 Office & Professional Employees International Union, "Memo to John Parsons: Real Estate Proposal", Boston, MA, May 16, 1996

[51] Auditor of the Commonwealth, State Auditor's Determination of the Massachusetts Bay Transportation Authority's Proposal to Privatize Property Management and Real Estate Development Activities, Boston, MA, June 10, 1996, Page 4.
[52] MBTA, Submission to the Office of the State Auditor, Outsourcing of the Property Management and Real Estate Development, Page 4-3.
[53] Auditor of the Commonwealth, State Auditor's Determination of the Massachusetts Bay Transportation Authority's Proposal to Privatize Property Management and Real Estate Development Activities, Page 10.
[54] This figure represents estimated increased lease revenue compared with continued in house operation of real estate management.
[55] MBTA, Submission to the Office of the State Auditor, Contracting for Cleaning Maintenance and Installation Services of Bus Shelters Supported Entirely By the Sale of Advertising Rights, Boston, MA, November 12, 1996, Page i.
[56] MBTA, Submission to the Office of the State Auditor, Contracting for Cleaning Maintenance and Installation Services of Bus Shelters Supported Entirely By the Sale of Advertising Rights, Page 8-4.
[57] MBTA, "Letter from Dave Reynolds, Senior Buyer MBTA to Douglas Watts, Gannett Outdoor", Boston, MA, February 7, 1996.
[58] MBTA, Submission to the Office of the State Auditor, Contracting for Cleaning Maintenance and Installation Services of Bus Shelters Supported Entirely By the Sale of Advertising Rights, Page 2-2.
[59] MBTA, Submission to the Office of the State Auditor, Contracting for Cleaning Maintenance and Installation Services of Bus Shelters Supported Entirely By the Sale of Advertising Rights, Page 6-1.
[60] MBTA, Submission to the Office of the Auditor, Contracting for Cleaning Maintenance and Installation Services of Bus Shelters Supported Entirely By the Sale of Advertising Rights, Section 6.0 Summary of Bids Received, November 12, 1996, page 6-2.
[61] MBTA, Submission to the Office of the State Auditor, Contracting for Cleaning Maintenance and Installation Services of Bus Shelters Supported Entirely By the Sale of Advertising Rights, Section 6.0 Summary of Bids Received, page 6-2.
[62] Auditor of the Commonwealth, Privatization Reports, www.state.ma.us/sao/privpage.htm, Boston, MA.
[63] Auditor of the Commonwealth, "Letter from John W. Parsons, General Counsel to Lisa McCallum, MBTA Deputy Chief of Staff", Boston, MA, November 15, 1996.
[64] MBTA, "Letter from Lisa A. McCallum, Deputy Chief of Staff to John W. Parsons, Office of the State Auditor", Boston, MA, November 18, 1996.
[65] MBTA, Submission to the Office of the Auditor, Contracting for Cleaning Maintenance and Installation Services of Bus Shelters Supported Entirely by the Sale of Advertising Rights, Page 6-1.
[66] MBTA, Submission to the Office of the Auditor, Contracting for Cleaning Maintenance and Installation Services of Bus Shelters Supported Entirely By the Sale of Advertising Rights, Page 4-2.
[67] Office of the State Auditor, "Letter from A. Joseph DeNucci, Auditor of the Commonwealth to Patrick J. Moynihan, MBTA General Manager", Boston, MA, December 11, 1996.
[68] Auditor of the Commonwealth, DRAFT State Auditor's Determination of the Massachusetts Bay Transportation Authority's Proposal to Privatize Cleaning and Maintenance of Bus Shelters, Boston, MA, Date Unknown.
[69] Massachusetts Supreme Judicial Court Decision (SJC-08014), Feb. 2000.
[70] COMSIS Corporation in association with Howard/Stein-Hudson, Inc. and John T. Doolittle Associates, Inc., Henceforth "COMSIS".
[71]COMSIS, "Bus Service Delivery System, Final Report," July 1993
[72] COMSIS pg. ii
[73] COMSIS, based upon the U.S. Department of Transportation data labeled the "Section 15 Report". IN FY 1991, Seattle's system operated at a system-wide average of $111 per revenue hour.
[74] COMSIS pg iii
[75] COMSIS, pgs ii and II-7
[76] COMSIS pg VIII-1
[77] MBTA, "Request for Proposals for Operation and Maintenance of Fixed-Route Bus Service," August 15, 1996.
[78] See for example, "Letter from Winfield Homer and Thomas Roth to Jonathan Barnes, Esq., Director, Office of Labor Relations, MBTA," April 23, 1997
[79] MBTA, "RFP" Attachment 3

[80] Office of the State Auditor, "Letter from Joseph DeNucci to Patrick J. Moynihan, MBTA General Manager", Boston, MA, May 16,1997. Office of the State Auditor, "Letter from Joseph DeNucci to Patrick J. Moynihan, MBTA General Manager", Boston, MA, June 20, 1997
[81] MBTA, Submission to the Office of the Auditor, Contracting for Operation and Maintenance of Bus Routes from the Charlestown and Quincy Garages, April 18, 1997 (MBTA Submission I)
[82] MBTA, Submission to the Office of the Auditor, Contracting for Operation and Maintenance of Bus Routes from the Charlestown and Quincy Garages, May 23, 1997 (MBTA Submission II)
[83] Office of the State Auditor, "Letter from Joseph DeNucci to Patrick J. Moynihan, MBTA General Manager", Boston, MA, June 20, 1997, pg. 2
[84] Office of the State Auditor, "Letter from Joseph DeNucci to Patrick J. Moynihan, MBTA General Manager", Boston, MA, June 20, 1997, pg. 4
[85]Office of the State Auditor, "Letter from Joseph DeNucci to Patrick J. Moynihan, MBTA General Manager", Boston, MA, May 16, 1997, pg. 5 and Office of the State Auditor, "Letter from Joseph DeNucci to Patrick J. Moynihan, MBTA General Manager", Boston, MA, June 20, 1997, pg.7
[86] Office of the State Auditor, "Letter from Joseph DeNucci to Patrick J. Moynihan, MBTA General Manager", Boston, MA, June 20, 1997, pg. 7 *emphasis by OSA*
[87] Office of the State Auditor, "Letter from Joseph DeNucci to Patrick J. Moynihan, MBTA General Manager", Boston, MA, June 20, 1997
[88] Office of the State Auditor, "Letter from Joseph DeNucci to Patrick J. Moynihan, MBTA General Manager", Boston, MA, June 20, 1997, pg. 13
[89] The proposed contracts did include a single performance target – customer complaint levels.
[90] The Labor Bureau, Inc., "Initial Critical Analysis of the MBTA's Submission to the State Auditor Concerning the RFP for Operation and Maintenance of Fixed-Route Bus Service," April 1997
[91] Segal, *et al*
[92] In addition to academic discussion, (see for example New England Institute for Public Policy and Sclar, Elliott, You Don't Always Get What You Pay For: The Economics of Privatization.) several states have adopted laws that are similar to portions of MA's Privatization Law – California, Maryland, Michigan, and Vermont.
[93] Segal, *et al*, pg. ii
[94] ibid
[95] Segal, *et al*
[96]See discussion in Sclar, Elliott, You Don't Always Get What You Pay For: The Economics of Privatization, pg. 29.
[97] Segal, *et al*, pgs 15-16
[98] Note, this proposal was approved after the privatization had taken place. The estimated savings was $205,000 per year
[99] Pioneer cites US Environmental Protection Agency (EPA), "Questions and Answers About Full Cost Accounting (530-F-98-003)," 1998, pg. 1 and EPA, "Full Cost Accounting for Municipal Solid Waste Management: A Handbook (530-R-95-041)," 1997, pgs 28-29.
[100] Martin, Lawrence, How to Compare Costs Between In-House and Contracted Services, How to Guide #4.
[101] Segal, *et al*, pgs. 16-17