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Publication Date

2001

WHY ARE MUNICIPAL SERVICES RARELY PRIVATIZED? CAUSES AND CURES

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Introduction

In spite of an extensive literature, which argues that contracting out municipal services can reduce their cost and provides some empirical validation, governments have taken relatively few steps in this direction (Hirsch 1991). For example, in the City of Los Angeles with a population in 1998 of 3.14 million people, only \$95 million out of its budget of \$3.8 billion (excluding capital improvements) or 2.5 percent was contracted out. Table 1 presents the major contracted out city items and their magnitudes. Los Angeles County, which is the largest county government in the United States, contracted out 2.63 percent of its budget in 1998-99, up from 1.2 percent in 1987-88. Table 2 presents the major contracted out county items and their magnitudes in the 1998-99 budget. Thus, particularly in comparison with industry, there is relatively little outsourcing by municipal governments, apparently even if such an undertaking promises to be cost-effective.

This chapter will argue that a municipal government service to be contracted out must meet the necessary condition of having a relatively low level of accountability. Otherwise the service is unlikely to lend itself to being contracted out, regardless of cost advantages. While few municipal services have high accountability levels, recent U.S. Supreme Court decisions have raised somewhat the number of services requiring a higher level of accountability and thereby have reduced the potential scope of contracting out by governments. Nevertheless, when accountability concerns stand in the way of privatization, it might prove possible to contract out select services with little or no accountability concerns which serve as inputs into the ultimate (output) service. For example, while a high accountability level might prevent privatizing the courts such inputs as custodial, transport, and bookkeeping services might be readily privatized.

Even if a municipal service meets the accountability criterion and contracting out promises to reduce costs, powerful opposition from special interests, particularly organized labor, can stand in the way of government taking this step. With the leadership of public sector unions declaring "privatization 'public enemy No. 1'" "and allocating in 1998 tens of millions of dollars to fight it, they have further raised the political cost to elected municipal officials (Burkins 1998).

In relation to organized labor's opposition to contracting out municipal services, various initiatives that increase a service's transparency by providing information on their quantities and qualities, the process by which they are produced and its cost as well as the resulting tax burden,

**Table 1. Major Areas of 1998-99 Los Angeles City Budget Contracted Out
(Greater than \$1 million) Excluding Capital Improvements**

Public works Design and Construction Management	\$27,500,000
Los Angeles Conservation and Visitor's Bureau	14,534,000
Processing Parking Citations	10,066,000
Los Angeles Bridges Program to eliminate or reduce gang behavior	9,235,000
Workers' Compensation Third Party Administrators-Fire and Police	6,530,000
Building Maintenance	4,500,000
Street Resurfacing	4,491,000
Custodial	4,338,000
Graffiti Removal	3,280,000
Household Hazardous Waste Mobile Collection Program	2,299,000
Information Technology – Programming and project management services	2,000,000
Tree Trimming	1,900,000
Worker's Compensation Claims Management Computer System	1,260,000
Arrestee Transportation	1,125,000
Security Services	1,000,000
Stormwater Public Education	<u>1,000,000</u>
Total	\$95,058,000

Source: Los Angeles City Chief Administrative Office.

Table 2. Major Areas of 1998-99 Los Angeles County Budget Contracted Out (Greater than \$1 million), Excluding Capital Improvements

Internal Services	\$89,386,347
Probation	33,200,866
Sheriff	29,230,079
Community and Senior Services	17,893,704
Community Development Commission	15,510,000
Fire	10,926,500
Registrar-Recorder/County Clerk	10,111,635
District Attorney	8,237,877
Treasurer and Tax Collector	6,434,601
Parks and Recreation	3,778,000
Human Resources	3,226,900
Beaches and Harbor	3,031,000
Auditor-Controller	2,981,000
Museum of Natural History	2,455,627
Public Library	2,246,392
Superior Court	2,032,260
Chief Administrative Officer	1,519,000
Arts Commission	1,270,000
Agricultural Commissioner/Weights and Measures	1,147,106
Assessor	<u>1,029,000</u>
Total	\$249,885,000

Source: Los Angeles County Chief Administration Office.

can counteract labor's opposition. The transparency of these aspects of a municipal service can be heightened by providing service users, i.e., the electorate, with cogent, readily accessible information. In the presence of such transparency, voters might decide to support elected officials in overcoming unions' opposition to cost-effective contracting out.

Increasing a municipal service's transparency and that of its production process has been facilitated to an amazing extent by the all-encompassing cyberspace revolution. As a consequence, information on services can become available to service users virtually instantaneously and at almost zero marginal cost.

Following these introductory remarks, the two major obstacles to cost-effective contracting out – high accountability requirements and union opposition – will be examined. Strategies to manage these two impediments will be developed, before specific initiatives will be presented.

The Accountability Factor

Accountability involves the responsibility of ensuring that an activity, for example, a municipal service is performed according to the quality standards expected by and promised to society, and, if it is not, authorities will be held accountable for not having properly discharged this duty. Thus, those who are accountable must ensure that promises are fulfilled and, in case of failure, they must make good on their promises in a responsible manner or face appropriate consequences.

Accountability is not costless. The cost is the price paid to assure that the service's quality requirement is met. These costs have two main components – resources used to provide a service of the promised quality, i.e., of producing the service and monitoring its quality, and societal losses incurred when the service falls short of the promised quality level, i.e., resources used in remedial undertakings necessary to make society whole.

It is mainly the magnitude of the potential societal losses that occur when the promised quality is not delivered which determines the two cost elements. The more highly valued by society a service is, i.e., the larger the resource input and losses if standards are not met, the higher the accountability costs. As long as government proves more accountable than private firms, i.e., incurs lower accountability costs, the less likely that the service will be contracted out, *ceteris paribus*.

Accountability can be analyzed with the aid of the theory of incomplete contracts (Shleifer 1998). The theory emphasizes the extent to which the end-product and its quality can be precisely described and its delivery enforced. Much hinges on incorporating or not incorporating the social value of quality into the contract.

The accountability level of public services varies along a wide spectrum; a service's position is determined in a democracy by the society's values as well as by political and legal

consideration. An important determinant of the accountability level relates to whether the service involves a ministerial function, one that relates to an operational-level day-to-day decision, or a discretionary function. In relation to the latter no hard and fast rule exists as to the course of conduct that one must not take. Consequently, a ministerial function allows establishment of a rather precise level of accountability, while a discretionary function does so less.

The power to legislate is endowed with a high level of accountability. Thus, legislating by city councils or county boards of supervisors and judging by local courts involves a high level of accountability. So does zoning. Additionally, there is concern about accountability when discrimination on the basis of race, gender, religion, national origin or age is a serious possibility. For example, Liebman fears that contracting out might allow “government to avoid accountability for its action,” permit “an excessive amount of separation and segregation: economic, racial, or religious,” and lead to the practicing of “inadmissible favoritism toward particular political or religious groups, classes, or persons (Liebman 1975).

In cases where society has decided that specific laws must be administered with particular care and specified outcomes must be assured, governments in the eyes of some have advantages over private corporations. As Justice Traynor of the California Supreme Court wrote in 1953, “public officials, who are ‘paid by the state to administer the law’ and whose acts are ‘reviewed by the judiciary’, are likely to act more responsibly than will private firms,” (State board of Dry Cleaners v. Thrift D-Lux Cleaners, 1953). This greater responsibility of public employees is reinforced when public officials take an oath of office. Not only are public officials thus reminded that society expects them to act responsibly, but legal action, if needed, is easier to bring. And more severe penalties are assured for transgressions.

Perhaps a somewhat lower level of accountability, but still a high one, relates to the incarceration of prisoners and their guarding. The U.S. Supreme Court addressed the question of whether prison guards warrant immunity if sued by prisoners claiming that they were unlawfully subjected to the deprivation of a right assured by the Constitution of the United States. The Court in Procunier v. Navarette in 1978 had extended qualified immunity to state prison guards. By doing so, it acknowledged that such immunity furthers the public good by promoting principled and fearless exercise of discretionary governmental authority. The Court in 1992 in Wyatt v. Cole expressed concern that a private company is subject to competitive market pressures and its correctional officers “are not principally motivated by a desire to further the interest of the public at large. Rather, as employees of a private corporation seeking to maximize profits...[they] act, at least in part, out of a desire to maintain the profitability of the corporation for whom they labor, thereby assuring their own job security.”

In 1997, in Richardson v. McKnight the Court ruled on a federal constitutional tort action against two prison guards. A prisoner claimed that they had injured him by placing on him extremely tight physical restraints. The Court held that the fact that private prison guards perform the same work as their state-employed counterparts does not automatically mean that the same immunity protects the private guards. In rejecting a functional approach, the Court emphasized the importance of government direction and supervision. It concluded that that rationale behind qualified immunity “is less likely present...when a private company subject to

competitive market pressures operates a prison” (Richardson v. McKnight 1997). Although the prison guards union in California is politically influential, this rationale may explain the reluctance in the state to privatize the corrections system.

There can be little doubt that the denial of qualified immunity to workers carrying out government functions, while in the employ of a private firm, raises the firm’s cost. Not only will it cost to meet accountability norms, but also to cure lapses in accountability when suits ensue. These costs can be approximated by insurance premiums. Thus when private firms who are providing a service are denied immunity accorded to governments, a cost advantage accrues to in-house production which, however, might be counterbalanced if the firms are more efficient.

In some instances, legislation has been enacted which determines that a service, even though its level of accountability is very low, cannot be contracted out. For example, California’s “Civil Service Mandate” forbids private contracts for work that the state, through its civil service, can perform “adequately and competently” (Cal. Const). In 1997 the California Supreme Court reaffirmed this position. It ruled that the State of California can contract out only in the rare instances when it can show that private companies can do the work more cheaply, that state employees lack the ability, or that an emergency exists and public safety is at stake, (Professional Engineers in California Government v. Department of Transportation 1997).

In summary, there always have been accountability concerns that stand in the way of municipal governments contracting out services, but recent court decisions and legislative action have extended these concerns.

Combating Accountability Impediments

When governments are concerned about high levels of accountability that are associated with certain (output) services, they can often contract out select inputs used to produce these output services, and yet associated with low accountability.

It is easy to distinguish between municipal output services and input services. Such output services as municipal courts and police benefit constituents directly and enter into the public’s final evaluation of a government’s performance. Input services, in turn, enter into the production function of output services and are not valued directly by the public in and of themselves. The public seldom knows about such inputs as custodial services, which are used, for example, by the courts and police. Likewise voters know little about the maintenance of the city’s fleet of cars and trucks, though this service is an important input into police services and arrestee transportation.

Police departments are a good example of the significance of input services. While sworn officers tend to perform the functions that raise the greatest accountability problems, significant portions of police departments’ budgets are devoted to other activities. For example, in the police department of U.C.L.A., compensation of sworn officers accounts for about 60 percent of the department’s compensation expenditures and about half of its budget. The City of Los Angeles in 1998-99 entered into contracts with private firms in the amount of \$10.1 million for

processing of parking tickets, \$6.5 million for Worker's Compensation administration, and \$1.1 million for arrestee transportation (City of Los Angeles). Los Angeles County in 1998-99 had Probation, Sheriff, District Attorney, and Superior Court contracts for \$33.2, \$29.2, \$8.2 and \$2.0 million, respectively, for input services.

Initiatives to contract out select input services, are often facilitated by the fact that these are much less unionized than are many output services. Note that, for example, in 1987 among municipal employees the unionization rates were 67.4 percent for firemen, 59.3 percent for police, and 53.3 percent for sanitation workers (United States Department of Commerce 1991). In the City of Los Angeles, such services are covered by union contracts.

Organized Labor's Opposition

Historically, municipal unions have powerfully, and often effectively, fought efforts to privatize services that they had been accustomed to see performed by their members. The reason is clear in that contracting out reduces their membership and weakens their bargaining power. Unions' arguments against contracting out have emphasized the potential for corruption, lack of accountability, government flexibility, and high social costs (McEntee 1987). Since accountability has already been discussed, we therefore will focus on their high social cost assertion.

The social cost argument has two major dimensions. One relates to the fact that costs of private firms are often below those of government mainly because of lower labor cost, much of which results from lower wages and limited or no health insurance and retirement benefits. Good examples are sanitation and janitorial services. Consequently, health services and retirement burdens may be passed on to government and society at large. Thus, simple cost comparisons, they claim, are misleading since the total cost to taxpayers must include these burdens. The second dimension relates to social mobility of the underclass, especially minorities and new immigrants. For them public employment is a major means for entering the labor force and progressing upward on the employment ladder. During the 2000 MTA strike, profiles of bus drivers in the popular press emphasized how MTA pay had lifted drivers into the middle class.

The difference in the rates of public and private sector unionization has a powerful effect on the extent of contracting out by municipal governments (Hirsch 1995). Still, municipal unions typically oppose contracting out to private firms which are unionized, since different unions and leaders are involved. In addition, wages in governments are less subject to competitive pressures than is the case in the private sector, so private sector union wages may be less than public. A given amount of labor pressure may yield greater expected "rents" when applied to governments than to private firms. Moreover, since the unionization rate is much higher in the public than in the private sector, unions can impose heavy political costs on elected officials, thereby threatening their reelection. In 1999, the public unionization rate (members only) in the State of California was 50% compared with only 10% in the private sector (Hirsch and Macpherson 2000).

Mitigating Labor Opposition by Heightening Service Transparency

Government can take a number of initiatives for the purpose of managing union's opposition to contracting out services. One promising approach is to raise the interest of the electorate in being served well and efficiently by their government. Public officials would thus want to provide voters with cogent information on a service's quantity, quality, its production process, cost, and tax burden, and do so in a manner that they will act on it at election time. The task of officials, thus, is to develop an information system that induces voters to be (1) well informed about how well and efficiently their government serves them and (2) inclined to act on the information and vote.

Raising transparency is not costless to government, nor is the acquisition of information to voters and their action on it. Acquisition by voters of information, which raises a service's transparency level, involves two major classes of costs. One is the time spent in learning about how much service and of what quality, by what production process, and at what cost and tax burden is provided, and the implication of service changes. The second relates to the productivity of time spent in learning about the service. This acquisition cost depends on how much contact voters have with a given service and the availability of readily understandable details about the service's provision and its cost.

The cost to government of providing information and to voters of accessing it has significantly been reduced by the cyberspace revolution. Most major levels of government in California now have web sites. As a consequence, raising the transparency of municipal services and making them less opaque can become a powerful tool in enlisting the constituents' help in overcoming union opposition to contracting out. Moreover, as will be argued in a later section, availability of cogent information can raise voter turnout.

We will next present a decision framework followed by some initiatives municipal governments might take to mitigate labor's opposition.

An Interactive Decision Framework

In the presence of union opposition, three major decision makers play an interactive role in deciding on the transparency of services and their production as a means to advance the contracting out process.

- Voters, who can benefit from a service's transparency, decide how much effort and time to invest in being informed about a service and in making use of this information. It is assumed that they support or disapprove of public officials on the basis of their performance that ultimately benefits voters. They can vote more intelligently if they have appropriate, readily available information. The greater a service's transparency, the better public officials' chances to gain the electorate's general support for efficient production decisions and also for their reelection, including contracting out, even in the light of union opposition. Voters in supporting contracting out must trade off their expected benefits against their effort and time cost to cast their ballot.

- Organized labor leaders who decide how much pressure to exert on government, recognize that the greater their pressure, the greater the willingness of voters to learn about the service and vote accordingly. In response, to the extent voters are informed about the service's major characteristics, i.e., its transparency, and cast an informed vote, organized labor will select its level of resistance to privatization. Thus, the investment of labor in resisting privatization will be affected by government's investment in making a service and its production transparent, by its estimate of voters making use of the service's transparency, and their gains or losses when services are contracted out. Unions in opposing contracting out must trade off the gains to their members if services are not contracted out against their cost of opposing it, including the loss of goodwill of voters and public officials.
- Government, which decides how much to invest in making the service and its production sufficiently transparent so voters might realize benefits that will accrue to them from privatizing a service. In deciding whether to contract out a service, municipal governments must consider the seriousness of labor's opposition in terms of the political cost labor can impose on elected officials and the extent to which this opposition alerts and antagonizes the electorate, as well as the extent to which contracting out would reduce service costs. Municipal officials in deciding to contract out a service must trade off the benefits from lower costs against the losses associated with organized labor's reelection opposition and possible labor upheaval. Within this framework, municipal officials can seek to decide whether or not to raise the level of transparency and if so, by how much, and thereby help voters to be better informed about a service and its production process.

Transparency Raising Initiatives

As was mentioned earlier, in order to influence the electorate to take a more active interest in how efficiently municipalities provide services and to consider the merits of contracting them out, heightening their transparency can help government overcome labor's opposition. Toward this end, two mutually reinforcing classes of initiatives are available. One seeks to make available to voters reliable, cogent information in a readily accessible form so they might use it and act on it. A second initiative seeks to organize municipal governments so that voters incur relatively low costs, in terms of effort and time, of acquiring information.

The first class of transparency raising initiatives available to municipal governments provides voters with information about the service's quantity and quality, its production process and cost, as well as the voter's tax burden as they are presently provided in-house and what they are likely to be if contracted out. In addition, some comparable data for earlier years and similar jurisdictions might be provided. In order to counteract labor's opposition, the information must be in user-friendly form, and thus readily accessible and likely to be used at the polls.

Thus, for a rational citizen to participate in an election requires cogent, readily accessible information and that by voting for a particular program or candidate he can expect a net benefit. Providing the electorate with appropriate information and do so in a readily accessible form is, therefore, a necessary condition for participating in an election to contract out a service, while net benefits are a sufficient condition. Transparency together with information accessibility can be a powerful instrument for enhancing the efficiency in the provision of public services.

In practical terms, Regional Data Banks could be established which collect information for comparable jurisdictions. It would include data on the quantity and quality of services, how they are provided, at what cost and with what tax implications. Emphasis would be on whether governments rely on in-house production or contracting out. Such banks can have the legitimacy and trust to produce reliable information for municipalities, and could be related to State government or regional bodies, such as the Southern California Association of Governments. Perhaps at first a few such banks could be launched on an experimental basis, financed jointly by all three levels of government. If the experiment proves a success, state grants to support such Regional Data Banks in a more permanent manner might be possible.

Municipal governments could arrange and package the information produced by data banks in user-friendly form, particularly on their web sites. It could include comparative quantity, quality, cost and tax data over time and across comparable jurisdictions. Also, estimates of the expected effects of contracting out a service could be presented as well as those of other service delivery changes. In this manner, voters could form an opinion about likely net benefits accruing to them should a service be contracted out.

The second class of initiatives could reorganize the government structure or tax system for the purpose of easing voters' burden to access, interpret, and ultimately use relevant tax information. In practical terms, this means delivery of a service by a single-purpose governmental unit or a service's separate financing. In the first instance, for example, a separate, single service district could be created, not unlike existing school, junior college, sanitation, library, mosquito control, and cemetery districts. The creation of such agencies can annually provide voters information about the taxes paid for a service when produced either in-house or contracted out. A clearly identifiable set of officials can also be held responsible for a service's quality and cost, as well as taxes.

Even if a single-purpose service district is not set up, voters can gain helpful tax information if separate financing of a service is introduced. When the tax is broken out of the government's consolidated budget, voters can learn from their property tax bills how much they pay for a particular service, whether produced in-house or contracted out. In this endeavor, breaking down property taxes as mill rates could provide helpful information (Buchanan 1960).

Matters are even easier if a service is financed by user fees. When a service is billed on a monthly or bimonthly basis, voters instantly learn their costs of obtaining the service. They may become concerned about high or rising fees and become supportive of such changes as contracting out the service.

Concluding Summary

In a period when there is great emphasis on improving government productivity, a variety of initiatives have been taken toward this end. The private sector has relied on downsizing, cyberspace developments, part-time employment and outsourcing. In many instances great success has been achieved. The public and particularly the municipal sector has been less

innovative, in part because it is highly labor-intensive, but also because it runs into strong opposition when making changes.

This chapter has addressed some of the obstacles faced by California's state and local governments when trying to contract out services. It goes without saying that in many instances in-house production is no less productive and costly than contracting out. But when there is opposition, governments must overcome two powerful impediments – accountability and opposition by organized labor. Where accountability demands in-house production, as is the case in court, legislative, zoning, and to some extent, police services, contracting out significant inputs is still a possibility. It can be cost-effective.

A strong presence of unionization among municipal workers can make their determined opposition very costly to elected officials. When contracting out promises significant cost and efficiency gains, officials can effectively seek the assistance of the electorate. By providing voters cogent, readily accessible information on the magnitude of the cost and tax savings expected to result from contracting out a service, the heightened service transparency can effectively lead the electorate to counteract the desires of special interest groups and serve as a countervailing force.

Certain government structures and financing systems, which inform voters about their tax burdens and their changes over time, can further counteract union pressures. But it should be stated emphatically that this paper is not directed against organized labor. Its analysis, particularly with respect to indirect social burdens, can be used by California's municipal governments to make better-informed contracting-out decisions. Sometimes public officials, by making services more transparent and raising the question of contracting out service, can heighten competition for the service provision.

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