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PRIVATIZATION AND PUBLIC EMPLOYEES: GUIDELINES FOR FAIR TREATMENT

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EXECUTIVE SUMMARY

Introducing competition into the delivery of public services, as through competitive contracting, can help stretch scarce tax dollars, often saving 20-50 percent. Politically, however, privatization can be extremely difficult, since public employees often view privatization as a threat to their livelihood.

The cooperation of public workers is essential to a successful privatization program, and public officials should communicate a commitment to fair treatment for current employees. Fortunately, privatization need not be a hardship for public workers. There are a number of techniques available to officials to insulate workers almost entirely from the potential of job loss, including:

·working within the rate of attrition;
·having contractors hire displaced workers; and
·offering early retirement incentives.

Other strategies exist to ease the transition to a competitive environment. For example, public departments should not only be encouraged to compete against private contractors but should also be offered guidance to help make them competitive.

Gaining the cooperation of public-sector managers is also important, since they frequently fear a loss of control and diminished authority. It is possible to restructure managerial incentives to promote good decision making. If some of the benefits of productivity gains accrue to their departments, public managers are more likely to take advantage of cost-effective approaches to service provision such as competitive contracting.

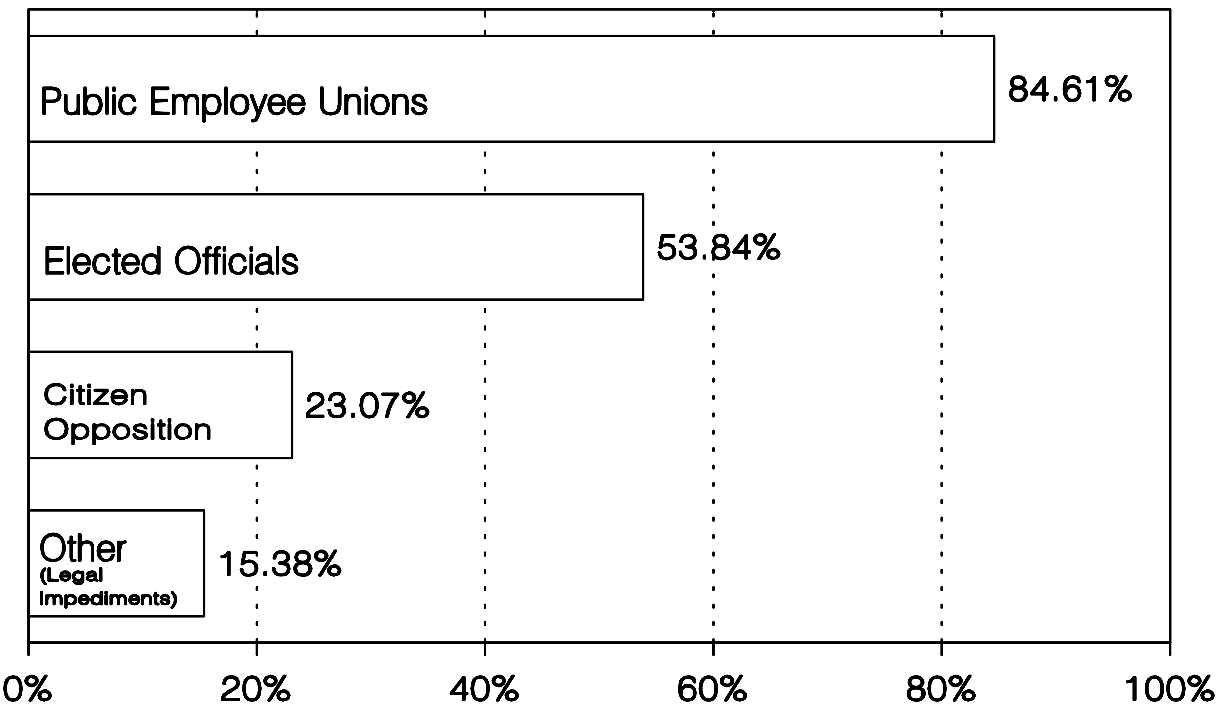
Structuring privatizations so that employees are treated fairly can make possible changes that ultimately benefit citizens and taxpayers. Though often difficult to introduce, the ultimate goal of privatization—quality services at lower costs—is popular with voters.

I.INTRODUCTION

Privatization is a political process. Despite evidence of sizable cost savings, public officials often face strong opposition to privatization and competitive contracting.[i] The greatest political opposition comes from public employees and their unions (see Figure 1).[ii] Experience in the United States and overseas has demonstrated that making privatization attractive for impacted workers is vital to achieving the political support needed to implement privatization.

The best way to reduce opposition is to communicate to workers a commitment to fair treatment. Keeping employees informed can reduce antagonism and avoid the morale problems often associated with organizational change.

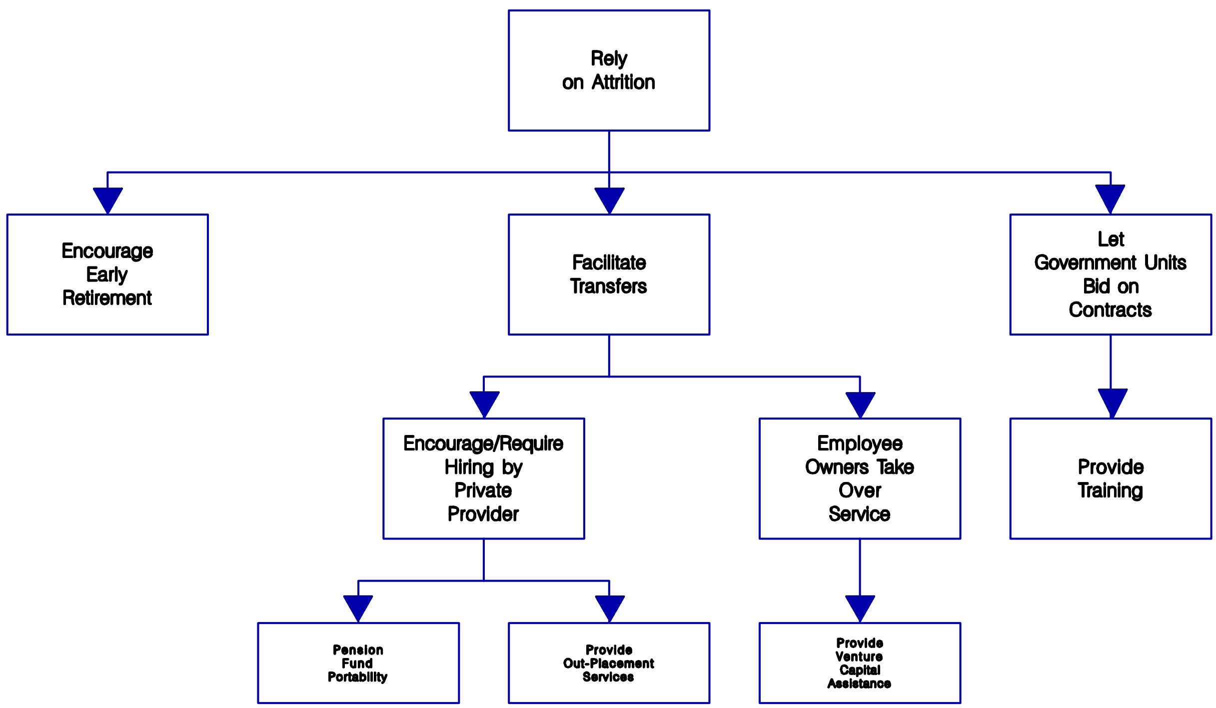
Figure 1
Obstacles to Privatization



SOURCE: 1992 Reason Foundation Survey of the 24 Largest Cities in the U.S.

Privatization need not be catastrophic for current workers; much anxiety can be avoided simply by expressing a firm committment to deal justly with employees. Most privatizations occur with few or no layoffs (see Appendix B for data regarding the impact of privatization on employment status and wages). And a variety of techniques are available to public officials that reduce the negative impact for current workers (see Figure 2) and assist employees in making the transition to a competitive environment with minimum disruption.

Figure 2
Steps to Prevent/Minimize Public Employee Lay-offs



SOURCE: Reason Foundation

Nonetheless, it is unlikely that any approach will greatly diminish the strong opposition of public employee union leadership to privatization. (See Appendix A for information concerning union opposition to privatization.) The strategies outlined in this paper, however, can significantly decrease the resistance to privatization among public workers.

By making privatization as attractive as possible to workers and managers, public officials can ensure that sound privatization proposals will not be undermined by political opposition.

II.MINIMIZING DISPLACEMENT OF PUBLIC EMPLOYEES

Governments exist to serve citizens, not public employees. Nonetheless, current employees should be treated as fairly as possible when governments rightsize. Public managers should make every reasonable effort to see that current employees do not needlessly take the brunt of a privatization. Most governments that have extensive privatization programs also have programs to minimize public employee job loss (see Table 1). Techniques that can attenuate the impact on current workers include:

·working within the rate of natural attrition;
·encouraging or requiring first consideration by contractors;
·offering early retirement incentives; and
·allowing public departments to bid for contracts.

Table 1

PRIVATIZATION POLICIES ADOPTED BY 28 LOCAL GOVERNMENTS

Labor Policy for Affected Workers	Percentage
No lay-off policy/guaranteed other government jobs	29%
Right of first refusal w/contractor	35%
Informal policy/work with individual workers	6%
Retraining	6%
No employment policy	24%

SOURCE: *Privatization and Public Employees: The Impact of City and County Contracting Out on Government Workers*, NCEP, May 1988.

A.Working Within the Attrition Rate

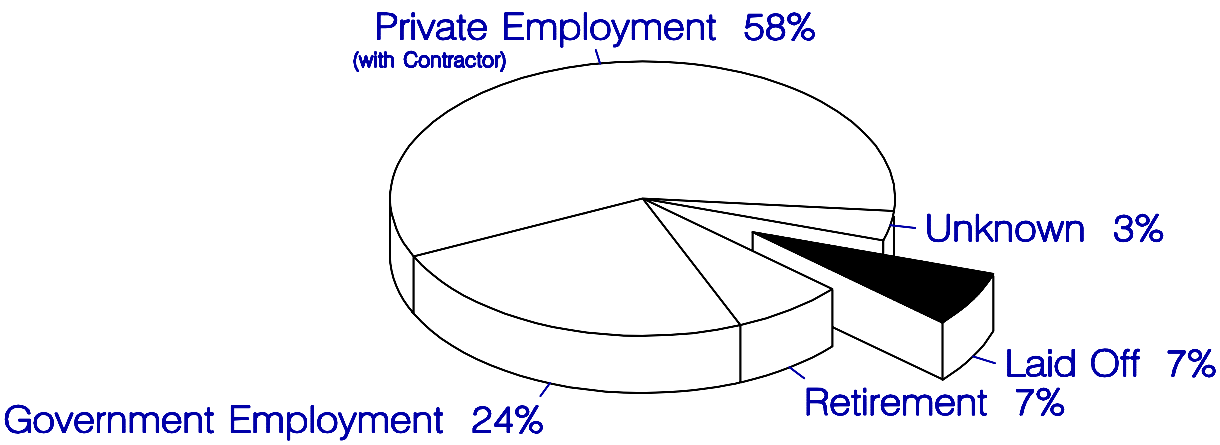
Perhaps the easiest method to reduce the negative impact on public employees is to schedule the privatization of functions within the normal rate of attrition. Workers on a given function targeted for privatization are simply shifted to other government work, avoiding any need for layoffs.

An extensive privatization effort can be accomplished without unduly impacting the current public workforce. The strong resistance to privatization results partly from the mistaken notion that privatization entails massive layoffs. A major national study has confirmed that privatization seldom results in widespread layoffs. In 1989 the National Commission on Employment Policy (NCEP), a research arm of the U.S. Labor Department, released a pioneering study titled “The Long-Term Employment Implications of Privatization.” The study reviewed the effect on public employees in 34 city and county privatizations during the 1980s.

Figure 3

Employment Status of Affected Government Workers

Total Number of Affected Workers: 2,213



SOURCE: The Long-Term Employment Implications of Privatization, NCEP, March 1989.

The study examined a wide range of privatizations involving 2,213 government workers, finding that only 7 percent of all impacted workers were laid off (see Figure 3). The study concluded that "In the majority of cases, cities and counties have done a commendable job of protecting the jobs of public employees."[iii]

Government officials typically make a strong effort to provide for current public workers even when embarking on extensive privatization programs. Between 1982 and 1986, for example, Los Angeles County privatized functions that affected 1,300 workers, yet only 36 permanent employees were laid off due to the contracting out program.[iv] (See Table 2).

Table 2

SUMMARY OF JOB DISPLACEMENT RESULTING FROM LOS ANGELES COUNTY CONTRACTING 1982–1986

Classification	Number	Percent of Affected Workers
Employees placed with county	1061	80%
Employees who left county service voluntarily	96	7%
Employees placed with contractor	128	10%
Employees laid off	36	3%
Total affected employees	1321	

SOURCE: *Privatization and Public Employees: The Impact of City and County Contracting Out on Government Workers*, NCEP, May 1988.

San Diego also introduced large-scale privatization gradually to avoid layoffs. Beginning in 1979, San Diego began to increase its use of competitive contracting for transit services. San Diego currently engages in more competitive contracting for bus service than any city in the country of comparable size, with 60 percent of its bus routes served by six private providers, and 22 percent of all passengers carried by the private sector.[v] Despite the large shift from public to private, increasing the amount of contracted service by about 3 percent per year—well within the normal turnover rate—enabled San Diego to achieve its bus privatization without layoffs of public employees.[vi]

B.First Consideration by Private Contractors

A common strategy to reduce current employee impact involves encouraging or requiring a contractor to offer first consideration for employment openings to all qualified public workers. Private contractors are usually quite happy to have access to an experienced labor pool. In adopting this policy, however, government officials should be careful not to constrain contractors with burdensome mandates.

Public officials should avoid restrictions that mandate wage or benefit levels for contractors. Requiring private providers to match public-sector wages and benefits in perpetuity can reduce the potential cost savings from privatization. Contractors should be allowed maximum flexibility to perform the given function in the most cost-effective fashion possible. In many cases this will result in the job being performed by fewer workers. Also tending to diminish the attractiveness of contracting out are state and local laws and civil service regulations that prohibit contractors performing public functions from paying their employees less than what government workers receive for the same work—a form of prevailing-wage legislation.

Public officials should consider other, less burdensome approaches to ensure that current workers are given fair treatment, such as:

1)Require contractors to guarantee public employees jobs at their current compensation, but allow all future employees to be hired at market wages. Though this can reduce short-term savings, it may be worthwhile to enable a privatization that would have otherwise been politically impossible.

2)Encourage the contractor to offer employment to current public employees at market rates. Most contractors are happy to offer qualified experienced workers a position with their company.

In 1984, Hamilton County, Tennessee contracted out a medium-security detention center to Corrections Corporation of America (CCA). Of the 60 affected county employees, 58 were hired by CCA, one left the area, and one remained with the county government. All of the workers who went to work for CCA received a pay increase and enjoyed comparable fringe benefits, though the pension benefits were lower than those offered by the county[vii].

3)Incorporate a contractor's offer to current employees into the contract award decision. In Los Angeles County, bonus points are awarded to bidders who provide public employee accommodation plans. This approach allows flexibility in the packages that contractors can offer, yet allows treatment of current employees to be given consideration in choosing a contractor.

C.Early Retirement Incentives

Given that privatization often entails a reduction in the overall labor force, another strategy for avoiding layoffs is enticing public workers to voluntarily leave government employment by offering them early retirement incentives. Such programs can be cost-effective if they enable governments to adopt otherwise politically unattainable cost-saving privatization measures, but early retirement programs are in no sense guaranteed to save money.

During fiscal years 1991 and 1992, however, 18 states and hundreds of localities adopted early retirement programs. In many states, the vacated positions were slated to be refilled. In Pennsylvania, for example, 6,700 workers took advantage of early retirement, reducing the state payroll by between $30 million-$40 million. But the state admits that up to 85 percent of the positions could eventually be refilled.[viii] Refilling these positions negates potential cost savings. “You achieve savings to the extent that you are able to permanently reduce the size of the workforce,” says William Whitbeck, director of Michigan's Office of the State Employer.[ix] Furthermore, many pension plans call for an increased contribution by government to cover health care costs, and thus overall savings due to early retirement may be greatly reduced by these increased pension costs. In essence, future taxpayers will be paying for current savings.

Nonetheless, in cases when the vacated slots are left unfilled, early retirement programs can generally save money by reducing the government payroll.

In **Massachusetts**, for instance, Governor William Weld embarked on an aggressive privatization program soon after taking office in January of 1991. Within two years, his administration privatized maintenance of some state highways, turned public skating rinks and zoos over to private management, closed several state mental health facilities and placed patients in private community-based care, and contracted for food and health services in state prisons.

This privatization program resulted in transferring many positions from the public sector to the private sector, thereby diminishing the number of state employees. In the first 21 months of his administration, the number of state employees under the governor's budgetary control was reduced from 49,750 to 42,864, a 13.8 percent decrease.[x] To accomplish such a reduction with a minimum of layoffs, in April of 1992 Weld signed an “Early Retirement Bill,” under which 3,568 Massachusetts state employees took advantage of incentives to retire ahead of schedule. The Massachusetts Executive Office for Finance and Administration estimates the net payroll savings due to the early retirement plan at $16 million for fiscal year 1993 and $29 million for fiscal year 1994. These figures may be misleading, however, since they fail to account for the costs of contracting with private firms to perform work previously done by state employees. The Massachusetts early retirement program, however, helped keep layoffs to a minimum.[xi] By avoiding layoffs, early retirement plans are popular with employees. When San Francisco offered an early retirement incentive, nearly a third of all eligible employees took advantage of it. As with any company reducing its payroll, governmental downsizings are often marked by low morale, worker anxiety, and low productivity. An early retirement program can accomplish the desired downsizing by offering enticements rather than layoffs, thus avoiding such morale problems.

D.Letting Public Departments Bid on Contracts

Because it reduces opposition to privatization, allowing public employee units to compete for contracts makes good political sense. It also makes good economic sense. Cost savings from privatization arise from the efficient operating practices that a competitive market promotes. The difference is not one of public versus private, but of monopoly versus competition. Experience shows that when faced with competition, public departments can greatly improve their operating efficiency.

There is no reason why a motivated public department cannot provide cost-effective service. Comparing the full cost of in-house and contracted service provision can be difficult, however; cost analysis should be conducted by an impartial third party using accepted accounting procedures.[xii]

In **Indianapolis**, local public employee unions were geared to battle new Mayor Stephen Goldsmith in 1992 after he repeatedly pledged during the election campaign to increase privatization. The expected confrontation never materialized, however, because Goldsmith switched the emphasis from privatization to competition shortly after taking office.

Indianapolis currently has among the most comprehensive competition programs of any city in America. Since January 1992, when Mayor Goldsmith assumed office, more than 150 competition opportunities have been identified and over 40 government services have already been shifted into the marketplace. This competitive process has resulted in substantial cost savings. A private firm is now doing the city's microfilming for about 61 percent less than previous in-house costs. Printing expenses are approximately 47 percent lower, and privatizing sewer bill collections has generated $1.8 million in savings.[xiii]

Introducing competition has often resulted in privatization, though not always. After being asked to compete for future work, Department of Transportation workers discovered that they could fill potholes with a crew of four workers instead of eight, and needed only one truck instead of two. The crew also asked the mayor to relieve them of unnecessary management overhead costs. In the end, the city crew submitted a bid thousands of dollars under the closest private company, saving the city 25 percent from its previous costs.[xiv]

Steve Fantauzzo, the local AFSCME spokesman, says that all the union wants is a level playing field in the competitiveness process and admits the in-house units really have a built-in advantage over the private sector.[xv] They pay less for fuel, have no capital start-up costs, and don't have to make a profit or pay taxes. Skip Stitt, who directs the Indianapolis competitiveness program, estimates that these advantages translate into the in-house units starting out with as much as 25 percent lower costs.[xvi] "If we still can't compete, shame on us," says Fantauzzo.

Phoenix sanitation workers have demonstrated the same sort of entrepreneurial spirit. In 1978, the City Council announced that garbage collection would be open to competitive contracting. Initially, private trash haulers were able to win a majority of the contracts by underbidding the public works department. The public works department took several years before it learned enough to be competitive and began winning contracts. But competition brought about changes. A new accounting system was brought into track costs, new trucks purchased to reduce crew size, and a suggestion program implemented offering up to $2,000 for cost-saving ideas. Workers also suggested changes to the routes to increase efficiency. By the early 1980s, municipal workers were winning contracts and saving taxpayers money—a total of $25 million since the program began, according to Public Works Director Ron Jensen.[xvii]

Milwaukee is also using competition to encourage city support units, such as computer services and vehicle rental, to lower costs and become more competitive. Called the Internal Service Improvement Project (ISIP), it allows city departments to purchase six different internal services from private firms if they can get a better deal than they are getting from the city agencies. The competition has spurred the internal units to make dramatic changes and operate more like businesses. The building maintenance division, for instance, is doing customer surveys and beginning to come in with lower bids than private firms.[xviii]

III.STRUCTURING THE TRANSITION

For public employees that go to work for private contractors and for public departments that bid for contracts, the government can and should take steps to ease their transition into a competitive market. The change from a protected monopoly to a competitive environment can be accomplished more smoothly if public officials take steps to assist public workers.

A.Training Assistance

One strategy to enhance the chances of successful bidding by public departments is to train the managers and workers in productivity, cost-saving strategies, and customer service. Workers and managers may require new skills to excel in a competitive environment. Training can provide them with the tools needed to make the transition as painlessly as possible, and increase the awareness of the need for continuous improvement and productive efficiency.

Coral Springs, Florida, for example, is offering training for their employees to excel in a competitive market. Having decided to competitively contract for vehicle maintenance, Coral Springs wants to give public workers every opportunity to effectively compete. “We're asking our employees to go head-to-head against the competition,” said Assistant City Manager Mike Levenson, “so we are giving our employees an opportunity to bid, and we are working with our employees in structuring that bid.” According to Levinson, Coral Springs is committed to offering public workers a fair shot at winning: “We just didn't say, `You have to bid.' We offered all the support they needed to structure their bid, to come up with their business plan, and put the bid package together. We're helping them develop unit costs and unit revenues so they can better understand the economics of the service that they have historically provided.”[xix]

For those employees who are displaced by privatization, the government can dedicate a percentage of the privatization cost savings to training employees in new skills and enhancing present skills in order to make them more attractive for the private sector. Los Angeles County sets aside 5 percent of cost savings from privatization for retraining dislodged employees.[xx] Rather than creating a separate government training program, vouchers could be given to employees to use at private training centers in order to acquire new skills or upgrade existing ones.

B.Human Resource Strategies

As governments move to competitive contracting and providing public managers with more workforce flexibility, human resource departments will need to evolve. Rather than simply reacting to the changes in government and processing paperwork, human resource departments will need to become employee advocates—assisting employees with career paths and identifying new career opportunities within and out of government.

Human resource departments will have to take a more active role in the city's long-term planning process and should be included from the beginning when devising privatization processes.[xxi] They will have to be able to look over the horizon and, working with the managers responsible for delivering services, assess which services are likely to still be delivered by government units five and ten years from now, and which ones are likely to be contracted out.

If circumstances require a reduction in force that includes layoffs even in a single department, the entire organization can be affected. The morale of all workers, not just those in the affected department, is likely to deteriorate due to workers' concern for their livelihood.[xxii]

In addition, many public employees work under policies that link job security with seniority. This means that rather than laying off the least productive workers, it is the youngest—and lowest paid—workers who bear the brunt of layoffs.

Associated with this is the disruptive phenomenon known as "bumping," whereby those employees with seniority are allowed to bump less senior employees in similar classifications from other departments. This can set up a domino effect that ripples through an organization, since a single layoff can result in a large number of employees changing jobs.

One strategy used by the city of Phoenix to avoid such disruptions involves the use of temporary employees. According to Public Works Director Ron Jensen, on contracts which impact a large number of workers, such as trash collection, Phoenix takes advantage of the time between the award of the contract and the beginning of the contract, usually between 6 to 12 months, to prepare for the change. Other city departments are put on a hiring freeze, and as positions become available they are filled by workers from the function to be taken over by the private firm. These workers, in turn, are replaced by temporary hires, who are fully aware of the contingent nature of their positions. In some cases, the private contractor is invited to take part in the hiring process, since in many cases the contractor will hire these employees when they assume the function. But since these temporary employees have no expectations or guarantee of long-term employment, they act to insulate the organization from the effect of the transition to private service provision.[xxiii]

C.Pension Fund Portability

Public officials must also address the question of what to do about pension benefits. Retirement benefits represent a large percentage of public employees' benefit packages in most jurisdictions. The prospect of having to forfeit their pension benefits will induce many public employees to strongly resist privatization. To overcome this problem, state and local governments should promote pension portability. The federal government revised its pension program in the late 1980s to allow benefits to be more portable. Public employees, for instance, could be allowed to carry over their established pension credit to the private contractor's pension program or could rollover their vested pension credit into an Individual Retirement Account (IRA).[xxiv] Another possibility is to give displaced public employees annuities, worth their invested credit, that could be cashed out upon retirement.

In cases where the private contractor does not have a comparable pension plan or has no pension plan at all, public employees joining the private firm could be given stock as part of the benefits package.

IV.STRUCTURAL INCENTIVES FOR EFFICIENCY AND PRIVATIZATION

In many instances, incentives for public-sector managers do not promote the efficient allocation of resources. Thus, public managers fail to adopt innovative and cost-saving approaches such as competitive contracting. In fact, there are strong structural disincentives for public managers to streamline their departments.

For public managers, salary and prestige are often proportional to the size of their budget, and the number of workers they oversee; thus, managers are in effect rewarded for “growing” their departments. Rather than rewarding managers based on departmental efficiency, public managers' salaries traditionally have been based on the inputs under their control. Bigger staffs and budgets mean bigger salaries.

Government managers are also rarely rewarded for successfully fulfilling their department's mission. Paradoxically, managers who oversee departments that are failing to perform are often rewarded with greater resources. Furthermore, public-sector managers who economize and accomplish their duties while spending less than budgeted are often subjected to a humiliating “triple whammy”: They lose the money they didn't spend this year, they have their budget reduced by the same amount next year, and they are reproached for having requested more money than needed. The result is that very few public managers come in under budget, choosing instead to make unnecessary purchases at the end of the fiscal cycle. A Park and Recreation official in Indianapolis, for example, purchased more than 40 tons of the chalk used in lining softball fields rather than return unused money to the general fund.[xxv] Public managers have little incentive to reduce spending since managers and their departments will not benefit from any of the cost savings realized.

A.Performance Budgeting

Governments are developing management strategies that combat this phenomenon by changing the incentive structures. Sunnyvale, Calif., for example, has pioneered a performance-based budgeting system among the most sophisticated in the nation. Under Sunnyvale's Planning and Management System (PAMS), managers are rewarded according to how well they achieve certain objectives, and their salaries are raised or lowered based on performance.

The results have been generally positive. Between 1985 and 1990 the average cost of delivering service dropped 20 percent. Sunnyvale even rebated $1 million to its property taxpayers one year. Originally introduced in the city's public safety department, it was so successful that the City Council extended the approach to all city functions.[xxvi] In a 1990 comparison with other cities of its size, Sunnyvale found that it accomplished most functions with 35 to 45 percent fewer employees and that Sunnyvale employees tended to be better paid. On a per-capita basis, Sunnyvale's taxes were lower than any community in the sample.[xxvii]

B.Intracapital Funds

Another strategy to promote efficiency lies in allowing public-sector managers to retain a portion of any unused budgeted funds and apply them to capital projects or further development activities, such as training. In the private sector such an approach is known as “intra-capital” funds, and it provides tangible incentives for productivity enhancement and efficient use of resources. To be meaningful, such a program must be careful to avoid front-end over-budgeting.

In the mid-1980s Dade County, Florida instituted a program whereby departments that show surpluses within their budgets are permitted to carry a part of the savings into the next fiscal year over and above the estimated budget. Dade County's Office of Management and Budget estimated that $11 million in funds had been made available to eight county departments in this way.[xxviii]

C.Gain Sharing

In addition to providing managerial incentives for privatization, governments may want to consider sharing part of the savings from implementing privatization with department employees.[xxix]

One option is to set up a public employee stock-ownership plan (PESOP). With a PESOP, each time the department secures a privatization savings for its intracapital fund, a certain percentage of this savings would be issued as stock to the employees.[xxx] Like private-sector 401k plans, for each share of stock the employee purchases, the government contributes a certain number of shares.

Another gain sharing program which may be uniquely suited for privatizing government services and agencies is called the Scanlon Plan.[xxxi] The Scanlon Plan is a form of profit sharing in which workers are given a share of the savings generated through productivity gains. Workers are encouraged to develop better ways to accomplishing given tasks because they share in the benefits of having greater output per unit cost of labor. Employee involvement is very high in this approach; it contains a suggestion program and committee participation. Moreover, bonuses—which can be very large depending on results—are given for productivity improvements.

Yet another form of reward that provides incentives for efficient operation is a suggestion system. Some public workers are reluctant to offer suggestions that could increase productivity because of the potential for reducing the need for labor. But combined with a competitive environment, a suggestion system that pays cash for cost saving ideas—such as the one used in Phoenix—can be an effective tool for streamlining.

V.PRIVATIZATION VIA EMPLOYEE OWNERSHIP: Transforming Public Workers into Entrepreneurs

Another technique for easing the transition from public to private employment is to structure a privatization to offer workers an ownership interest in the privatized enterprise. The term employee ownership embraces a number of strategies that result in stock being owned by employees. Such arrangements are typically structured through Employee Stock Ownership Plans (ESOPs), which give workers a stake in performance.

Employee ownership in the private sector is a relatively new phenomenon in the United States. Prior to 1974, tax laws made employee ownership unattractive, therefore only 300 companies had ESOPs. By 1992, however, there were 10,000 American companies owned fully or partially by their combined 11.5 million employees through ESOPs.[xxxii]

While the use of ESOPs or other employee ownership programs as a mechanism for *privatizing public departments* is virtually unheard of in the United States, employee ownership played an important role in Britain's privatization program of the 1980s, especially in the area of bus services.

Transforming a public monopoly into a competitive, employee-owned private company has the potential to be an effective form of privatization. One of the common complaints from public employees when public departments compete for contracts with the private sector is that the public sector is at a competitive disadvantage. Private companies, it is pointed out, can operate more efficiently because they are unencumbered by arduous procurement procedures, hiring protocols, and other bureaucratic strictures. Employee ownership is one method of reducing these barriers to efficiency and unleashing the creative efficiency of public workers who are often stifled by bureaucratic controls.

Privatization through employee ownership also has the advantage of offering current workers an economic incentive to privatize, since stock offerings are often free or heavily discounted for workers. This can dramatically reduce workers' political opposition to privatization. Employee ownership also fosters support for privatization among the general public who see the benefits of privatization being widely disbursed.

A.Mechanisms For Employee Ownership

The private sector has used numerous methods for establishing employee ownership. The following techniques can and have been used in the public sector:

1.The ESOP

An ESOP is a defined-contribution employee benefit plan established as part of an overall benefits package. Generally, ESOP funds are invested in common or preferred stock and kept in trust until allocated to individual employees. By law, employees must be fully vested in an ESOP within five to seven years.

The ESOP is the most common mechanism for widespread employee ownership. ESOPs offer employees more control over the operating decisions of the company and give employees a real stake in performance.

ESOPs have proven successful in the private sector in increasing productivity. A study by the National Center for Employee Ownership found that companies where a majority of ownership resided with the employees grew at a faster rate than firms in general.[xxxiii] Other studies have found that employee ownership boosts productivity only when combined with employee control.[xxxiv]

There are several key advantages to the ESOP structure.

Employee Involvement. By gaining a vested stake in the performance of the company, employees will have greater incentives to increase their productivity. Surveys of employees at ESOP companies indicate a general satisfaction with the program and an increased commitment to productivity. (See Table 3).

KEY ESOP ADVANTAGES

1.Significant Employee Involvement and/or Control
2.Continuity of Ownership
3.Leveraging Ability
4.Tax Advantages

Table 3

EMPLOYEE OWNERSHIP AND WORK ATTITUDES AT PRIVATE-SECTOR ESOPs 1982–1986

Statement	Percent Agreeing
1.Owning stock in this company makes me more interested in the company's financial success.	84%
2.It is very important to me that this company has an employee stock ownership plan.	65%
3.Because of employee ownership, my work is more satisfying.	50%
4.I work harder on my job because I own company stock.	43%
5.Employees have more say in company decisions because they own stock.	28%

Based on survey of 2,804 employees at 37 private-sector ESOPs.

SOURCE: Corey Rose, Katherine J. Klein and Karen M. Young, *Employee Ownership in America,* (Lexington, Mass.: Lexington Books, 1986) p. 15.

Continuity. Before ESOPs were common, there was some concern that current employees would raid the assets of the firm for their short-term benefit. In actual practice, however, most ESOPs are structured so that an employee's shares must be kept, with few exceptions, until their departure from the company. Though individual employees change over time, there is an essentially stable ownership that benefits both current and future workers.

Leveraging Ability. Because it allows employee-owners to borrow using the assets of the company as collateral, an ESOP enables employees greater access to ownership than would otherwise be possible by buying stock out of current income through individual share purchases.

Tax Advantages. The United States tax code allows employee-owned companies to deduct the cost of providing ESOP benefits from corporate income tax. In the case of leveraged ESOPs, both the principal and the interest may be deducted.

2.Individual Share Purchases

Shares of stock are purchased individually by employees, often offered at a discount. This is the a common method of employee ownership and has been a component of almost all privatizations making use of employee ownership. Because such ownership is not concentrated, however, it does not generally have the same benefits as an ESOP program.

3.Employee Associations

These are formal or informal groups of employees, often organized as nonprofit associations, that purchase and manage employee-owned shares. Employee associations are a way for employees to leverage the ownership influence of their individual stock options. Like individual share purchasing, this is a common technique in privatizations, with associations often providing technical assistance to employee stock purchasers.

B.What Can Be Privatized Through Employee Ownership?

Particular local circumstances and the nature of the government enterprise or service determine whether privatization through transfer of ownership to current workers is viable.

1.The Monopoly Sector

This includes services that are essentially natural monopolies in which the government is currently the sole provider, such as many utilities, infrastructure, waterworks, and some communication systems. Privatization of these enterprises has been popular overseas. In many of these privatizations, employees have been offered a certain number of shares either for free or at some discounted value (see Table 4).

Table 4

EMPLOYEE DISCOUNTS IN INTERNATIONAL PRIVATIZATIONS	
Country	Stock Bonus Offer
Canada	Teleglobe employees offered a 10% discount on shares.
Canada	Canada Fishery Products gave 4% of stock free of charge to ESOP.
Nigeria	Employees offered 10% discount.
France	Matching shares on a one-to-one basis offered, but shares must be held at least one year.
Great Britain	British Telecom, British Gas, TSB, and British Airways offered "loyalty" bonus shares, usually 10% after 3 years.
Yugoslavia	Discounts of 30%–70%, depending on tenure.

SOURCE: *Privatization and Public Employees: The Impact of City and County Contracting Out on Government Workers*, NCEP, May 1988.

At first it may appear that by transferring some of the assets of ownership from the taxpayers at large to particular workers the government is "giving away the store." But the very act of privatizing a state-owned enterprise can greatly enhance its value, provided that it will now be forced to operate in a more competitive environment. The change in incentives from subsidized, protected monopoly to the market can prompt a more efficient utilization of existing capital, thereby dramatically enhancing its value.

In 1992, the World Bank released a study that considered the overall impact of privatization on 12 previously government-run enterprises, from a British airline to a Malaysian container port. The privatizations resulted in an average increase in overall wealth of about 26 percent of the firms' prior-year turnover. The study attributed some of these gains to a change in incentives which produced performance-based compensation.[xxxv] Because privatization often increases the value of an enterprise, it is worth it to "sweeten the pot" for employee owners to enable privatization to take place.

For example, taxpayers own the United States Post Office, but their ownership returns them no benefits. If, to gain postal employees' cooperation the government were to offer 10 percent of the Post Office to employees as part of an ESOP, both parties would benefit. Employees are offered an attractive bargain to make the switch from a protected environment to one in which other providers compete for postal patronage. Customers benefit by the service efficiencies and cost reductions that competition would generate. Taxpayers benefit because the privatized Post Office would be subject to corporate taxes. Taxpayer-owners would benefit because the remaining ownership shares would increase in value. In essence, owning 90 percent of a privatized Post Office that operates in a competetive market is better than owning 100 percent of a monopolistic Post Office.

2. Services for Which the Government is the Sole Buyer

There are some goods and services for which government is virtually the only customer: nuclear submarines, road maintenance and repair, and prison management, for example. In these areas, employee ownership can be an important aspect of a private company providing the service: for example, Corrections Corporation of America, the nation's largest private-corrections firm.

3.Competitive Goods and Services

Those goods and services that are sometimes produced by the government and yet are also bought and sold on the open market make excellent targets for employee-based privatization. Enterprises such as child-care centers, parking structures, civic auditoriums and stadiums, golf courses, letter and package delivery, printing, education, job training and placement agencies, etc., are all potentially profitable enterprises. Such concerns are especially attractive for employee buyouts because a well-run company can actually increase their market share if they are adept at serving customers cost-effectively. In these enterprises, the beneficial effects of competition, privatization, and employee ownership can greatly improve customer satisfaction and cost effectiveness.

C.What the Record Shows

A number of examples from overseas show how employee ownership can be used to enable privatizations. The examples in this country are much more rare, and some have not been successful.

Great Britain. Employee ownership has played an important role in the extensive privatization program that began under Margaret Thatcher. During the 1980s, 14 large state-owned enterprises were sold with special discounts and incentives offered to employees. During the same time there were also over 100 much smaller employee buy-outs and “buy-ins” that offered not only widespread employee ownership, but significant worker control.[xxxvi]

The 1988 British Local Government—which mandated that local governments open up six services to competition from the private sector—spurred at least 10 management buy-outs of public service units. The results to date have been mixed. Some of the firms have not only been successful holding on to local government contracts but also in gaining private-sector contracts.[xxxvii] Over 10 percent of the firms, however, have gone into receivorship while a number of the others were sold between two and four years after being started.[xxxviii]

Bus service in Britain has been an especially active area for both privatization and employee ownership. The 1985 Transport Act ordered the general deregulation of British bus services and the break-up of the National Bus Company into roughly 70 subsidiary concerns. According to the National Center for Employee Ownership, as of 1992, “approximately 30 percent of the private-sector bus market in Britain is made up of companies with significant and broad employee ownership."

In 1987, the Provincial Bus Company, a subsidiary of National Bus, was having problems. Having previously operated in an insulated monopolistic environment, the company was struggling in the face of increasing competition. Two potential buyers—a rival low-wage bus operator and a management team—were seeking to buy Provincial, and neither owner was seen as an attractive alternative for the workers. Provincial's employees, who had previously enjoyed stable public-sector positions, recognized that their future depended on the performance of the company and its ownership and decided to initiate an employee buyout.

Each employee contributed about one month's salary as a down payment, and the employees purchased the rest of the company (80 percent) through an ESOP. The aptly renamed People's Provincial Bus Company—today owned 100 percent by its 270 employees—has managed to maintain revenues despite a declining bus market and has successfully lowered operating costs, reduced absenteeism, and improved service. People's Provincial has won performance awards and served as a model for the privatization of other bus companies. Over 60 percent of the bus companies in Britain that operate with substantial employee ownership have used ESOPs to finance the purchase, often in combination with a management buyout.[xxxix]

The FED CO-OP Failure. The Fed Co-Op (Federal Employee Direct Corporate Ownership Opportunity Program) was an attempt in the mid-1980s to privatize the National Technical Information Service (NTIS). NTIS, employing 350 federal workers, is a centralized source of federal documents serving libraries and other users which are charged for this service.

In the mid-1980s, the Reagan administration attempted to privatize the NTIS through an ESOP. To avoid the need for congressional approval, the transaction was structured as a standard contract for services, with special conditions applying. Under the terms of the contract, the winning bidder would be required to form a wholly owned subsidiary of the government function, offering employment and stock in the parent company to all of the current workers. The employees would be immune to layoffs for six months and would be offered extensive outplacement assistance if terminated within the first year.

The NTIS, a government profit center, was thought to be ideal for realizing enhanced productivity through private-sector efficiency. The arrangement was structured so as to offer NTIS employees a financial incentive to accept the increased risk of private-sector employment. Nonetheless, the program never got off the ground.

The biggest barrier to implementation was not NTIS employees, but users of the service, mostly libraries, who were fearful that the change would mean a deterioration of service. The other major obstacle was political inertia.
In the absence of a strong driving force for change, the program simply dissipated. Advocates of the idea are still convinced that such a program could be successful. Federal tax law (1986 TEFRA) requires that a minimum of 50 employees be involved in any federal ESOP privatization, making it difficult to demonstrate the concept's viability on a small scale.

Transit Privatization through ESOPs in the United States

In 1989, Price Waterhouse released a report titled "Feasibility of Employee Ownership in the Transit Industry," which analyzed the issues involved with two hypothetical employee buyouts of transit. Using data from the Fort Wayne PTC and the Corpus Christi RTA, the report concluded that "the analysis suggests that under the right circumstances an employee buyout could work for Fort Wayne and Corpus Christi." The report cautions that the assumptions and conditions of the buyout are critical in estimating its likely success.

In terms of employee benefits, the Price Waterhouse report assumed that wages and benefits for existing workers would fall slightly, though in some cases the 10 year total compensation for average workers increases when the equity stake and profit-sharing components are considered.

In Michigan, the Isabella County transit system is in the process of structuring a privatization through an ESOP. The unionized workers appear to be amenable to the arrangement, but there are numerous political and legal difficulties associated with what could be the first domestic ESOP privatization.

D.Overcoming Obstacles to Employee Ownership Privatization

The lack of examples of employee buyouts of government enterprises in the United States and the failure of the Fed Co-Op program illustrate that there are serious obstacles to this privatization technique. Potential impediments include:

·up-front capital costs for equipment and supplies;
·lack of entreprenuerial and management expertise;
·possibility of employee-owned firm not winning initial or subsequent contracts;
·bankruptcy; and
·loss of tax-exempt debt.

Incentives for Overcoming Obstacles to Employee Ownership

These obstacles, while, in some cases formidable, are not insurmountable. Numerous techniques can be used to facilitate employee buyouts.

Transferring Capital Assets. A government can remove or ease the obstacle of large up-front capital and equipment costs, for instance, by transferring the capital assets of the government activity to the employee-owned business at no cost.[xl] The assets could also be transferred by lease, leveraged buy-out, or no-interest loans.

Because government accounting systems treat some assets as sunk costs, there may be no costs to such transfers in budgetary parlance. The chief drawback to this approach is that it may not provide a level playing field for private bidders who may view the transfer of capital assets as giving the in-house units an unfair advantage.

Venture-Capital Assistance. Another barrier to employee buyouts of government entities is that public employees may not have the full range of entrepreneurial and managerial proficiency necessary to make the transition to a private firm.[xli] To overcome this, employee-owned businesses could be provided with venture-capital assistance to help them during the transition. Such assistance can take the form of instruction on developing a business plan, preparing a bid, organizing the business, and garnering investment capital.

Government Policies that Promote Employee Buyouts

_Reduced price shares
_Reduced sale price
_Financial and legal start-up assistance
_Continued use of government facilities and assets
_Guarantee of initial contract for service
_Start-up loan
_Forgiveness of debt

The assistance would require no budgetary outlays. In return for its services, the venture-capital firm could be given an equity stake in the employee-owned firm.

Guarantee of Initial Contract. For services in which the government is the only customer, the future existence of the now-private employee-owned company depends entirely on the patronage of the customer-government. In such cases, the state may have to guarantee a contract for a certain period of time, with the understanding that future contracts will be competitively offered. Even in cases of services that are bought and sold on the open market, workers are likely to insist on such guarantees in order to participate in the buy-out.

Start-Up Loan. It may be advisable in some cases for the government to offer employees a loan, either in the form of cash or capital equipment, as an incentive and assistance in privatizing the function.

Forgiveness of Debt. Oftentimes, there is debt outstanding on capital equipment associated with a particular function. When public employees are taking that function into the private sector, there may be some question as to whether the outstanding debt for the capital equipment should be transferred to the private sector. Public officials can consider forgiving the privatized entity such debt as an incentive to privatize.

Tax-Exempt Status of Debt. The loss of tax-exempt status of any capital debt could have significant negative impacts on cash flow and the viability of the employee-owned concern. A new IRS ruling confirms, however, that in certain cases, federal tax-exempt bonds issued for public infrastructure may be retained if the asset is transferred to private ownership, subject to certain conditions assuring "fair play" for taxpayers. Such transfers can be difficult, however. Likewise, the status of tax-exempt municipal bonds should be assessed by officials when a public department goes private. If the public interest is still being served, it may make sense to continue tax-exempt status—but there are significant legal obstacles to such an arrangement.

VI.CONCLUSION

Privatization is a proven cost-effective technique for delivering public services.[xlii] Nevertheless, due to political resistence from public employees and their unions, many state and local governments fail to pursue privatization opportunities. The result: taxpayers are forced to pay more for services than would be neccessary in a more competitive market.

This need not occur. By developing a comprehensive employee adjustment and incentive program prior to pursuing privatization, the negative impact for current employees can be substantially reduced, thus reducing their resistance to privatization.

Layoffs can be minimized by using attrition, giving incentives for early retirement, and encouraging or requiring contractors to give first consideration to displaced public employees when hiring workers. Departments can be encouraged to privatize by basing managers' salaries on improved service performance, and by letting employees keep a certain percentage of the savings generated from privatization.

Resistence to privatization can also be diminished by giving public employees a fair chance to compete against private companies for contracts or even encouraging and assisting in-house units to privatize their service through an employee buy-out.

By employing a combination of these and other strategies, governments can realize the cost savings and efficiency gains from privatization and competition without adversely affecting the interests and morale of the public workforce.

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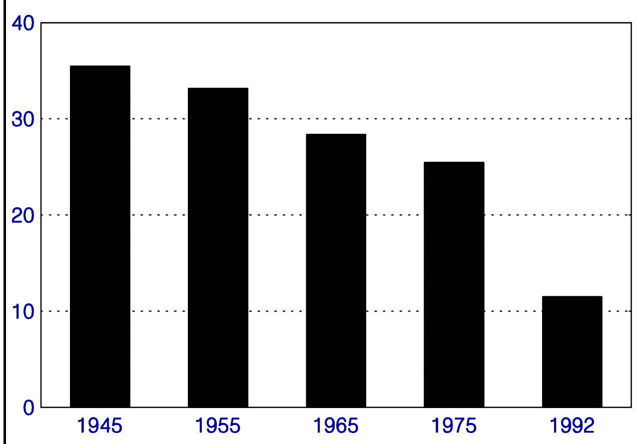
APPENDIX A

Union Opposition/Public-Sector Dependence

Since the middle of this century, union membership as a fraction of the total U.S. workforce has declined significantly (see Figure 4). The one bright spot for unions has been the growth of government employment. By 1992, only 11.5 percent of the private-sector U.S. workforce belonged to unions, while 43 percent of the 18 million government workers in America were represented by unions. Between 1973 and 1983, membership in the American Federation of State, County, and Municipal Employees (AFSCME) swelled by over 380,000 members, a 66 percent increase. In 1960, only one out of every twenty union members was employed by the government; by 1986, that fraction had risen to one in three.[xliii] Public workers currently account for 40 percent of all the unionized workers in the country.[xliv]

Figure 4
Percentage of U.S. Workforce Unionized



SOURCE: U.S. Dept. of Labor, Bureau of Labor Statistics, Washington D.C.

This trend has resulted in unions having a strong interest in maintaining high levels of direct government service provision, and many unions have undertaken extensive advertising and political campaigns opposing privatization. In 1992 and 1993, public employee unions took out full-page newspaper ads attacking privatization in New York and Detroit. In Philadelphia, the local AFSCME unit waged a $500,000 anti-privatization radio and television campaign. In response to an administration proposal by Governor Engler to examine privatization opportunities across the full range of state services in the state of Michigan, the state public employee unions produced a 200-page book assailing privatization and held an anti-privatization rally attended by over 1000 workers.

Strong union and worker opposition to privatization can derail proposed privatizations. In 1988, after successfully contracting out garbage collection to private, unionized contractors, New Orleans tried to contract out its emergency medical services. This time, bitter employee opposition scuttled the initiative. Fierce union opposition also ended Philadelphia Mayor Wilson Goode's attempt to contract out garbage collection in 1988.

APPENDIX B

The Impact of Privatization on Public Employees

One of the major reasons public employees are hostile to privatization is the perception that they will lose their jobs as a result. Though this fear is certainly understandable it is hardly justified.

Job Loss. The most-comprehensive evaluation of the effect of privatization on government workers was conducted in 1989 by the National Commission on Employment Policy (NCEP), a research arm of the U.S. Labor Department. The study, titled "The Long-Term Employment Implications of Privatization," examined 34 privatized city and county services in a variety of jurisdictions around the country. The report found that of the 2,213 government workers affected over a five-year period by the privatizations, only 7 percent were layed off. Over half of the workers (56 percent) went to work for the private contractor; 24 percent of the workers were transferred to other government jobs; and 7 percent of workers retired (see Figure 3).

These findings are similar to those of other studies examining job displacement from privatization. A 1985 General Accounting Office (GAO) study found that of the 9,650 defense employees affected by contracting out, 94 percent were placed in other government jobs or retired voluntarily from their positions.[xlv] Of the 6 percent of displaced employees, 3 percent obtained jobs with the private contractor.

It also must be recognized that privatization is not a zero-sum equation: though public jobs may decrease—jobs are also created in the private sector from privatization. In many cases, the public employees are the ones moving into these private-sector jobs.

Public Assistance to Displaced Workers. Public employee unions have argued that the unemployment assistance paid by government for displaced employees nullify the cost savings from privatization.[xlvi] The available evidence, however, suggests this is rarely the case. In only three out of ten cases examined in the NCEP study did the city or county pay out any public assistance benefits.

The 1985 GAO study found the costs of giving layed-off workers unemployment-related services totalled only about one percent of the overall savings achieved through contracting.[xlvii]

Effect of Privatization on Minorities. Another concern often raised regarding privatization is that it hurts minorities. Critics argue that because minorities constitute a disproportionate share of many government workforces, they are more adversely affected by privatization than whites.

The most comprehensive study of this issue was a 1985 study conducted by the Washington, D.C.-based Joint Center for Political Studies for the U.S. Department of Housing and Urban Development.[xlviii] The study found that African-Americans are more vulnerable than whites to unfavorable consequences from privatization because they are twice as likely to work for the government.

The study also found, however, that public employee job loss from privatization does not fall unevenly on minorities. According to the study, "The proportion of minorities employed in the municipal workforce remained relatively stable." Moreover, according to the study, employment opportunities for minorities with the private contractors were equal to those with government departments. "In services where minorities were heavily employed by city departments, they were also heavily employed by alternative providers."

Lastly, the study found that Hispanics were impacted less than whites or blacks from privatization because they are not highly represented in the public-sector workforce.

Privatization also provides minorities with entrepreneurial opportunities that public employment cannot bring them. Surveys of city and state-level privatization have found that up to 80 percent of all government contracts go to small businesses.[xlix] Especially in service areas that generally do not require large up-front capital costs, privatization thus can offer substantial business opportunities for startup minority-owned firms. Says Indianapolis Mayor Stephen Goldsmith, "In my view, there is no more exciting minority- and women-business opportunity than privatization. This is a wonderful way to increase the diversity of participation in my city."

Wages and Benefits. Another major concern public employees have with privatization is that the cost savings generated from using private contractors result in lower wages and benefits. While this concern is sometimes justified, the evidence is mixed.

A 1981 study in the *Journal of Labor Research* found that compared to similarly engaged private-sector workers, total compensation for public employees was 29 percent higher at the federal level, 13 percent higher for state employees, and 10 percent higher at the local level.[l]

These findings are supported by a 1992 report of the American Legislative Exchange Council (ALEC) authored by Wendell Cox and Samuel Brunelli, which found that total compensation packages were significantly higher than for their private-sector counterparts and that the "wage premium" enjoyed by public employees increased sharply during the 1980s. From 1980 to 1990, for instance, average annual compensation increases for state and local public employees amounted to $4,031.[li] This equals $6.32 for every $1.00 increase in private employee compensation during the same time period, according to a study. This amounts to $47.3 billion more than if public employee compensation had only increased at the same rate as in the private sector.[lii]

A 1993 study by the Economic Policy Institute (EPI), "The Truth About Public Employees: Underpaid or Overpaid?" disputed the findings of Cox and Brunelli, claiming they had failed to adjust for education and experience. The EPI study concluded that state governments "on average compensate their employees at a level comparable to similar private employees" while local government compensation packages "remain 4 to 5 percent below that of comparable private-sector employees."[liii]

The EPI study rejected the claim that privatization savings could be generated through savings in wages. "Given the rough equality between private and public compensation, substantial savings could not be realized by simply using private employees with the characteristics of public employees.... Our results also suggest that only modest direct savings exist on wages and benefits, by turning all public tasks over to private firms."[liv]

An extensive, cross-sectional study of municipal services performed by Barbara Stevens in 1984 for the Department of Housing and Urban Development (HUD) compared 8 services in 10 California cities that contract for services with ten cities that perform the same services in-house.[lv] (See Table 5).

Table 5

COMPARISON OF WAGES BETWEEN LOCAL GOVERNMENT AND PRIVATE CONTRACTORS, FOR EIGHT SERVICES

	Average Monthly Wage for Laborers		
Service	Contractor	Municipal Agency	Percent Difference
Payroll	$2,083	$2,375	+12%
Asphalt Overlay	$2,421	$1,532	-58%
Refuse Collection	$1,237	$1,418	+13%
Street Cleaning	$1,576	$1,612	+2%
Janitorial	$881	$1,234	+29%
Traffic Signal Maintenance	$1,500	$1,721	+13%
Street Tree Trimming	$1,390	$1,475	+6%
Turf Management	$956	$1,237	+23%

SOURCE: Barbara Stevens, *Delivering Municipal Services Efficiently: A Comparision of Municipal and Private Service Delivery*, U.S. Department of Housing and Urban Development, Washington, D.C., 1984.

The survey found that although the private contractor's salaries were lower than the public sector in all but one service, in only two services was the difference significant. Moreover, for asphalt overlay private contractors' wages were much higher than in the public sector. For fringe benefits, Stevens found the difference between contractors and municipal employees to be minimal—contractors paid an average of $551 per month versus municipal governments, which paid an average of $524 per month in benefits.[lvi]

In the 1989 NCEP study, private contractors' wages were significantly lower in only 4 of the 28 cases studied. The study concluded there was “no significant pattern of lower wages paid by private firms” and that there were more cases when wages increased than fell after privatization[lvii] (see Table 6). Fringe benefits were a different matter, however. City and county governments had higher benefits than private contractors in 48 percent of the cases. Private-sector benefit packages were said to be better in only 16 percent of the cases, while benefits were reported to be about equal 34 percent of the time (see Table 7). The disparity most often cited between public- and private-sector benefits was in the area of retirement.

Whether public-sector salaries and benefits are much higher than in the private sector depends in part on the service in question. Social and health services wages often are higher in the private sector than in public employment. According to Charles J. Keloe, Director of the Department of Youth and Family Services for the state of Virginia, "Since state salaries are not competitive with those in the private sector, privatization may become the only way to recruit an adequate health care staff."[lviii]

In other service areas, wages and benefits are routinely much higher in the public sector. A 1985 eight-city study found that health benefits for public-transit operators were 139 percent higher than those of private union bus drivers and 401 percent higher than nonunion drivers. In New York City, public transit workers are paid over twice that of their unionized private-sector counterparts.[lix] In Denver, approximately 38 percent of the cost savings from privatizing transit services resulted from lower bus operator wages and fringe benefits. The average cost of wages and benefits per revenue hour of service was $24.44 for the public operators and $14.20 for private contractors' drivers, a 42 percent difference.[lx]

Table 6

COMPARISON OF WAGES: PRIVATE CONTRACTORS

City/County	Contractor Salaries as Compared to City/County Salaries**
Arlington, VA (1)	+5%
Arlington, VA (2)	Same
Auburn, AL	+5%
Bay County, FL	+7%
Chandler, AR	-5 to -10%
Charlotte, NC (1)	-40%
Charlotte, NC (2)	+35%
Columbus, OH	-45%
Corsicana, TX	Same
Fort Dodge, IA	+8%
Gainesville, FL	+10%
Hamilton County, TN (1)	+5%
Hamilton County, TN (2)	+5%
Imperial Beach, CA	+20%
L.A. County, CA (1)	-11%
L.A. County, CA (2)	Same
Mt. Vernon, IL	Same
New Orleans, LA	+20%
Newton, MA	Same
Orange County, CA	Same
Peoria, IL	+5%
St. Charles, MO	Same
Santa Fe, NM	+5 to +10%
Sarasota, FL	-20%
South Lake Tahoe, CA	-15%
Tucson, AZ (1)	Same
Tucson, AZ (2)	-50%
Virginia Beach, VA	Same
Washington, D.C.	-20 to 0%
Wichita, KA (2)	-10%
Wichita, KA (3)	Same

*All 34 cases not included due to inability of some cities/counties to provide us with reliable data.

**A plus sign (+) indicates salaries were higher with contractor.

SOURCE: *The Long-Term Employment Implications of Privatization: Evidence from Selected U.S. Cities and Counties,* NCEP, March 1989.

Public sanitation workers also typically enjoy significantly higher wages and benefits than their counterparts in the private sector. In Detroit, the retirement contribution for public sanitation employees is 15.3 percent—double the average private-sector rate.[lxi] New York City public sanitation workers receive 18 paid vacation days after one year of employment compared to nine days, on average, in the private sector.

Table 7

COMPARISON OF FRINGE BENEFITS: PRIVATE CONTRACTOR VERSUS LOCAL GOVERNMENTS*

	Percentage of Cases Where Contractor Benefits Were Ranked (n=31):		
Type of Benefit	Better	Worse	Same
Health Insurance	36%	64%	
Sick Leave	25%	75%	
Retirement	7%	93%	
Holidays	27%	73%	
Employee Stock Ownership	100%*	0%	
Overall Benefit Package	16%	48%	35%

* Five contractors provided workers with ESOPs.

SOURCE: *The Long-Term Employment Implications of Privatization: Evidence from Selected U.S. Cities and Counties,* NCEP, March 1989.

There are many sources of cost savings other than wages. Private companies typically have much smaller overhead and administrative costs. The flexibility of private companies, in everything from hiring practices to procurement procedures, enables efficiencies that are unavailable to public departments. A profit-driven private firm has an incentive to remove anything that does not contribute to efficient performance—including "red tape."

For public employees that go to work for private contractors and for public departments that bid for contracts, the government can and should take steps to ease their transition into a competitive market. The change from a protected monopoly to a competitive environment can be difficult for workers, but it can be accomplished more smoothly if public officials take steps to assist public workers.

The dispute over public-employee compensation should have little bearing on the decision of whether or not to competitively contract. If public employees are being compensated at market wages, as the EPI study contends, then the transition from public to private employment in a competitive market is unlikely to result in a significant decrease in wages. Where it does exist, any excess compensation enjoyed by public-sector workers is gained at the expense of taxpayers. Rather than being a reason for not privatizing, any "compensation gap" is evidence that public workers are enjoying a pay premium gained through political leverage. Introducing competition to public services helps ensure that citizens receive fair value for their tax dollars.

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