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COMPETITIVE GOVERNMENT FOR A COMPETITIVE LOS ANGELES

by
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For the citizens of Los Angeles, public safety is the number one concern. Mayor Richard Riordan has promised to put 3,000 more police officers on L.A.'s dangerous streets. Yet Los Angeles faces a severe fiscal crisis and no easy answers to finding the $75,000 it costs for each additional Los Angeles police officer.

The Crime Bill will help, but not nearly as much as has been generally reported. Los Angeles is likely to receive only enough money from the Crime Bill to pay for between 250-500 officers. However, even this figure is misleading because the city will have to match the federal grant by 42 percent, according to Mike Thompson, Mayor Riordan's public safety assistant, meaning the city will be paying almost half the cost for each of the 250-500 additional officers. In short, it would be a mistake to think that Los Angeles can rely on the Crime Bill to pay for the Mayor's Public Safety Plan.

In addition to the need for more police, the city faces other pressing fiscal challenges including a looming $200-$300-million budget deficit for the next fiscal year; $70-$80 million annually in deferred street maintenance; and antiquated technology systems.

There are really only three ways to pay for more police, balance the budget, and pay for the deferred maintenance: raise taxes, cut services, or improve efficiency. Raising taxes is not an option, since it will only exacerbate the downward economic spiral of the city by driving out business. Cutting services is a possibility in some areas, but in a depressed community that has experienced several years of service reductions this is not an attractive option.

This means that Mayor Riordan will need to focus on another major plank of his campaign platform: increasing efficiency in city government. One way to do that is to embrace the competitive model of government that government operations around the country are embracing.

This review of city operations found that injecting competition into the seven city services listed below could result in annual cost savings of nearly $120 million (see Table 1), enough to pay for close to 1,600 additional police officers. (We do not apply savings from building maintenance/custodial for additional police officers. Instead, we recommend using the savings to enhance current service levels). This would go a long way towards meeting the financing requirements outlined in the Mayor's Public Safety Plan. To be a competitive city, Los Angeles needs a competitive government.

Table 1

Estimated Annual Cost Savings Through Injecting Competition into Los Angeles Government		
Service	Dollar Savings (Millions)	Percent Savings
Building Maintenance/ Custodial Services	$2.2	28%
Emergency Medical Services	30.7	53%
Golf Courses	3.5	N/A
Parking Enforcement	19.0	N/A
Trash Collection	42.0	27%
Workers' Compensation	22.4	24%
Zoo	0	0%
TOTAL	**$119.8**	**N/A**

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II.A NATIONAL TREND

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Vice President Al Gore's National Performance Review

Monopolies don't serve taxpayers very well. All across America, towns, cities, and states are discarding the historic model of government-as-monopolistic-service-provider and are embracing a competitive approach. Governments can no longer afford business as usual, and competition is a key way to dramatically improve government efficiency.

Joining the trend toward competitive government, Los Angeles could significantly reduce its operating costs, which would, for example, allow the city to significantly increase the number of police on the streets and/or help to balance next year's budget.

Around the country and around the world, governments are changing the way they operate. Rather than acting as monopolistic providers insulated from pressure to improve, governments are introducing market pressures and competition to public service delivery (see Table 2).

Since taking office in Spring 1989, Chicago Mayor Richard M. Daley has brought competition to about 40 services, ranging from water customer billing to drug and alcohol treatment. Savings from privatization total tens of millions of dollars annually. I see privatization as a way to accomplish three important goals, said Daley. Save money, improve services, and give the public greater control over the process of governing.

Indianapolis Mayor Stephen Goldsmith has developed the country's most comprehensive competition program. Since taking office in 1992, Mayor Stephen Goldsmith has moved nearly 60 services into the competitive marketplace, saving the city $28 million annually. Competition is the fundamental aspect of change for a city that is successful to stay successful, says Goldsmith.

In Indianapolis as in other cities, opening up services to competition does not always result in hiring a private firm. After being asked to compete, the Indianapolis Transportation Department streamlined its operations and won bids for pothole filling, crack sealing, and other street repair work, each time saving the city at least 25 percent from its previous costs.

Philadelphia Mayor Ed Rendell has found that public workers are capable of doing a good job, but in a monopolistic environment they lack the incentive to reduce costs or improve operations. Savings that weren't possible before suddenly materialize once you put a service out to bid, says Linda Morrison, the former director of Philadelphia's competitive-contracting program. Cost savings from privatization have averaged 40-50 percent in Philadelphia.

Why has competitive contracting proved so popular in other cities Because it works. Through privatization and competition, cities all over the country have been able to cut costs without reducing services. The potential savings from opening up city government to competition are dramatic. Joining this trend, Los Angeles could significantly reduce its operating costs, allowing the city to increase the number of police officers on the streets.

The success of cities such as Chicago, Indianapolis, and Philadelphia has prompted numerous other mayors to consider bringing competition to city government. New York City's Rudolf Giuliani, San Diego's Susan Golding, and Cleveland's Michael White are all embarking on wide-reaching privatization initiatives in their cities.

III.COMPETITION AND PUBLIC EMPLOYEES

Competition almost never means widespread layoffs for public employees. Municipal government can and should take steps to see that competition is introduced in a matter that is fair to public employees. Public employees can be allowed to bid for contracts, and if a private firm wins a contract it can be encouraged to hire displaced city workers.

Recognizing the worldwide shift to competitive government, some of the country's union leaders are beginning to see competition more as a challenge than a threat. I think there is room for dialogue, even about competition, says Gerald M. McEntee, head of AFSCME, the largest public-employees' union. If you're really going to go to the extent of seriously considering redesigning and reinventing government, competition can be part of that...

Steve Fantauzzo, Indianapolis' local AFSCME spokesman, says that all the union wants is a level playing field in the competitiveness process and points out the in-house units really have a built-in advantage over the private sector. They pay less for fuel, have no capital start-up costs, and don't have to make a profit or pay taxes. These advantages translate into the in-house units starting out with 28-percent lower costs. If we still can't compete, shame on us, says Fantauzzo.

IV.TRASH COLLECTION

As the third-largest item in the city's general fund, refuse service is an obvious potential candidate for competitive-contracting. A preliminary comparison of current city costs with those of adjacent areas with competitively contracted refuse service suggests that competitive contracting could generate large savings to Los Angeles taxpayers.

Based on contractor costs from other cities with similar demographics and service, competitive contracting of residential refuse collection could save the city over $40 million per year over the long run. The current fully allocated city cost per residential unit is approximately $21 per month. This is significantly higher than city rates in nearby jurisdications that use competitive contracting. In those jurisdictions, monthly residential rates for similar service range between $9 and $15 per unit.

Some significant savings may come from improved vehicle maintenance patterns. In other cities, not more than 5 percent of refuse vehicles are out-of-service at any given time, in contrast to a 30 percent rate for the city of Los Angeles.

The city may consider phasing in competitive contracting by bidding out only individual subsets of the city's total residential units at a time. Dividing the city into service districts of 40,000 or so households could enable large numbers of local firms to compete to provide service. Moreover, a gradual phase-in would minimize any impact on public-sector employment, since any workforce reductions could occur partly through natural retirement/attrition rates.

V.EMERGENCY MEDICAL SERVICES (EMS)

Los Angeles is among the highest-cost cities in the nation when it comes to EMS. Its total cost per patient transported is $476, compared with $160 per transport in some cities with high-performance systems. Although users are charged for EMS services, collections fall far short of what is billed. In Los Angeles the collection rate (adjusted for nonreimbursables) is 48 percent, compared to rates of 60-80 percent in high-performance cities. The net result is a high level of taxpayer subsidy in Los Angeles approximately $12 per capita. By contrast, high-performance cities such as Fort Wayne, Las Vegas, and Little Rock have per capita subsidies of less than $3 per year.

The principal features of high-performance EMS systems are three. First is a public-private partnership, in which the fire department provides first-response and the private sector provides all ambulance service. The second feature is a different organizational design, which features an all-paramedic-ambulance fleet, rather than a mixed Advanced and Basic Life Support (ALS/BLS) fleet. The third feature is stringent contractual provisions guaranteeing cost and service quality, especially response-time reliability.

Were Los Angeles to adopt these changes, the net taxpayer cost of EMS services (after subtracting revenues from user fees) would be reduced from today's $45.6 million to an estimated $14.9 million. This would be a net taxpayer savings of $30.7 million per year (see Table 3). The new system design, including flexible deployment of vehicles (by time of day and area) would also lead to significantly improved EMS performance.

Table 3

Potential Savings from EMS Privatization		
	Current	Projected
Total EMS Expenses	$57.6 M	$29.9 M
Collectibles	$25.1 M	$25.1 M
Collection Rate	48%	60%
Revenues	$12.0 M	$15.0 M
Net Taxpayer Cost	$45.6 M	$14.9 M
Savings	**$30.7 M per year**	

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VI. WORKERS' COMPENSATION

Los Angeles' Workers Compensation Administration, which is under internal investigation, is needlessly costly. The rate at which claims are filed (27 per 100 employees) is nearly double the national average of 15, and the city pays $2,169 per employee, compared with $830 nationally. And each workers' compensation caseworker handles an astounding 1,700 cases, compared to the industry standard of 250.

Many other governments have cut the costs of workers' compensation substantially by contracting with Third Party Administrators (TPAs). These firms have developed expertise in reducing the number of claims filed and in settling claims expeditiously and for less money. Among the jurisdictions successfully making use of TPAs for workers' compensation are Dallas, Houston, Philadelphia, and the Los Angeles County Metropolitan Transportation Authority (LACMTA).

Because TPAs offer a number of services not currently provided by the Workers' Compensation Division, the operating costs under privatization may actually increase somewhat. But the cost of claims, which is the large majority of total workers' compensation costs, should decline significantly, resulting in overall cost savings.

Based on the experience of other jurisdictions using TPAs, we estimate the annual savings from privatization to be in the vicinity of $22.4 million, principally from reducing the number and size of claims (see Table 4).

Table 4

Workers' Compensation Privatization Savings From Other Governments			
TPA	City/County	Medical Cost Savings	Disability Cost Savings
The Summit Group	Houston	41.6%	46.15%
Willis-Rollinson	Dallas	20.0%	Not Available
Hertz Claim Mgm't	Generic	30.8%	24.7%
Blue Cross & Claims Management TPA	Philadelphia	15.0%	10B15%

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In his April 20, 1994 budget address, Mayor Richard Riordan committed to privatizing the Western Parking Enforcement Area as a pilot project. At the present time, the city pays approximately $36 per hour for parking enforcement: approximately 47 percent higher contrasted to other cities, which pay an average of approximately $19 per hour through contracting (see Table 5).

Table 5

Parking Enforcement		
Municipality	Scope of Services	Cost per Hour*
City of Anaheim (contract)	Citation issuance only	$15.20
City of West Hollywood (contract)	Citation issuance, abandoned vehicle removal, response to complaint calls, peak-hour towing, booting	$19.23
Montgomery County (contract)	Citation issuance, abandoned vehicle removal, response to complaint calls, peak-hour towing, booting	$22.52
City of Los Angeles (in-house)	Citation issuance, abandoned vehicle removal, response to complaint calls, peak-hour towing, booting, special events	$35.94

* According to city officials, may not include all remaining unavoidable costs.

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Through privatization, the department is anticipating that expenditures will increase initially by $6 million for the administration and implementation of the contract, and revenues will increase by approximately $25 million resulting in a net revenue increase of $19 million for the city through both the privatization of the Western Division and expansion of other divisions through the reassignment of existing personnel. The pilot project in the Western Division will present a number of opportunities to the city, including: an addition of up to 110 additional parking officers through the private contractor; the ability to reallocate existing personnel to other divisions, thus increasing revenues; and overall reductions of operational costs.

While $19 million per year would be realized from this pilot project, combined citywide savings and revenue increases would be several times that sum if the program were replicated in the other parking enforcement areas.

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Under its current operations, the Los Angeles Zoo is owned by the city and jointly managed by the city and the Greater Los Angeles Zoo Association (GLAZA). Privatizing the zoo and consolidating operations under the direction of an independent nonprofit, such as GLAZA, is an alternative that should be explored. Privatizing the Los Angeles Zoo has the potential to reduce costs, increase donations, and improve zoo quality.

In recent years many cities have shifted operation of zoos from government to private agencies, moving to either a fully private or a public-private partnership model. The San Francisco Zoo, Zoo Atlanta, and the Stone and Franklin Park Zoos in Massachusetts have all gone to a nonprofit management model in order to enhance operations. Typically, privatization of zoos nationally has been spurred by a desire for a higher level of management capability and reductions in operational costs.

Taking the zoo from the control of the city would free management to eliminate duplication of efforts by GLAZA and the zoo. A privately run zoo would free management from bureaucratic red tape and provide incentives for efficient operation.

As a private nonprofit entity, the zoo would also be more likely to receive donations. The city could save money in the short-term through the possible elimination or reduction of tax-subsidies. Furthermore, the zoo could begin raising the funds necessary for capital-improvement projects.

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Currently, the city of Los Angeles owns and operates 12 municipal golf courses. Contracting for the management and operation of Los Angeles's 12 public golf courses has the potential to generate an additional $2.7 to $4.3 million annually (an average of $3.5 million). Many other cities and local governments, including Los Angeles County, have successfully privatized the management of public golf courses. Under privatized management, the city would still set green fees, and the additional revenue could be realized without dramatic increases in playing fees. A well-structured contract could guarantee the city a revenue increase and improve the condition of the courses. New York City has contracted out the management of 13 golf courses and has gone from losing $2 million a year to realizing a profit of $1.74 million in fiscal 1993. Numerous California cities have also benefited from privatization of their golf courses (see Table 6).

Table 6

Municipal Revenue Comparison					
Course Name	Government	Last Year Public	Revenue		
			Public Operation	Private Operation (1st Yr.)	1992B93 Fiscal Year
Arcadia Golf Course	Arcadia	FY/87	$25,000	$60,667	$112,319
El Dorado	Long Beach	FY/83	(68,918)	201,087	491,973
Fullerton Golf Course	Fullerton	FY/78	19,770	75,463	274,286
La Mirada Golf Course	LA County	FY/81	155,547	182,558	695,077
Los Verdes	LA County	FY/81	94,553	56,412	441,071
Mountain Meadow	LA County	FY/88	569,233	708,704	1,027,135
Rec Park 18	Long Beach	FY/83	126,249	201,087	609,954
Rec Park 9	Long Beach	FY/83	24,403	67,029	112,319

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In addition, experience with other cities indicates that more people are likely to enjoy privatized golf facilities, in part because of enhanced facilities through capital improvements. The city should explore privatizing management of its 12 golf courses.

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Privatizing building maintenance and custodial services in the North and South districts of the city at present service levels could potentially result in $2.24 million in savings for the city. In most cases, the city's current per-hour and per-square-foot costs are much higher than in the private sector.

In addition to high unit costs, for a number of years most city buildings in the North and South districts have not been adequately maintained. Present levels of maintenance and custodial services are inadequate and are resulting in significant deferred maintenance to city buildings.

The deferred maintenance will be felt in the future not only by Los Angeles city employees who have to work in deteriorating environments, but also by Los Angeles taxpayers who will be forced to invest more of their tax dollars in the additional capital expenditures required to replace poorly maintained facilities.

Other governments have experienced substantial quality improvements and cost savings from privatizing building maintenance and custodial work. Los Angeles County's costs are 51 percent lower than previous county operating costs. Philadelphia last year successfully contracted out custodial services at City Hall, resulting in a marked increase in the cleanliness of the facility. Philadelphia estimates cost savings of 20 percent, or approximately $344,000 from privatization. Like Philadelphia, Chicago experienced quality improvements and substantial cost savings ($5 million a year) from privatization of custodial services (see Table 7).

It is recommended that the city take advantage of the lower unit costs associated with contracting to significantly increase service levels in building maintenance services. (Concurrently, the city should explore facility consolidation, which would allow it to sell off some of its faciltities which are now proving too costly to maintain properly.)

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There are many other areas of Los Angeles government which the city should explore opening up to competitive forces to promote greater efficiency. The city's citizens and taxpayers deserve a government in which every activity is scrutinized. This entails adopting a comprehensive approach to introducing competition into city government. Evidence from other cities and our analysis of seven Los Angeles city services indicate that superior service and cost savings of 20-50 percent can be achieved through competition. The dozens of other prime candidates for competitive contracting include large ticket items such as fleet maintenance, information services, convention center management, power and water operations, and wastewater treatment facilities.

Savings and/or revenue increases through the sale, lease or contract management of parts or all of the city's water, power, and wastewater operations, for example, would likely amount to hundreds of millions of dollars annually. According to a recent report from a city advisory committee, restructuring the DWP Power System could result in efficiency savings and revenue increases in the range of $118 million. According to several major private water/wasterwater companies who have looked at L.A.'s wastewater facilities, Los Angeles could expect operating savings of at least 25 percent and up to 50 perent from privatizing its water and wastewater plants.

LAX is one of the city's most valuable assets, comparable only to the port and the municipal electricity/water utility in asset value. A study commissioned by the city and carried out by Babcock & Brown in 1992 estimated LAX's market value at around $2 billion. A 1993 Reason Foundation study, building on the city's study but making somewhat different assumptions, concluded that the sale of LAX would net the city $2.2 billion, while the net present value of a 30-year lease could be as much as $3.7 billion. Carefully designed asset sales and leases could be a potential major new revenue source for Los Angeles.

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The findings of this study, demonstrating potential annual cost savings of nearly $120 million from privatizing only seven city services, offers strong support for the notion that opening up city hall to competition can yield positive results for Los Angeles taxpayers. A competitive model of service delivery should be considered across the board for Los Angeles government, and wherever appropriate, implemented.

It is recommended that Mayor Riordan follow the successful examples of cities such as Philadelphia and Indianapolis and form a bipartisan blue-ribbon commission of leading Los Angeles business people to identify further competitive contracting opportunities and assist in building public support for bringing competition to Los Angeles government.

Governments throughout the countryCincluding in most of America's largest cities Care fundamentally changing the way they do business, and competition is a key component of this new governing philosophy. Explains Mayor Michael White of Cleveland, The world is marching forward and that world is lodged in a competitive environment...government cannot remain as a monopoly which constantly borrows against our childrens' future, a monopoly that doesn't know of new ways to deliver a product. As the 21st century approaches, Los Angeles can no longer afford a city government that clings to the status quo. Embracing competition in public service delivery is one key element to turning Los Angeles around.

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For the voters of Los Angeles, public safety is their number one concern. As a candidate, Mayor Riordan promised to put 3,000 more police officers on LA's dangerous streets. The City Council subsequently approved the Mayor's plan to reach this goal. Yet Los Angeles faces a severe fiscal crisis and no easy answers to finding the additional $75,000 it costs for each additional Los Angeles police officer.

This year's wage settlement with the police union which resulted in substantial pay increases for current officers will cost the city an additional $100 million a year beginning in the 1996B97 fiscal year, according to Los Angeles Councilwoman Jackie Goldberg. This will make the task of finding more money to fund the additional officers outlined in the Mayor's Public Safety Plan even more difficult. (In fact, City Councilmen Marvin Braude and Zev Yaroslavsky believe the police contract will force the mayor to scale back his goal of putting 3,000 officers on the street in 1994). So far, no credible plans to pay for additional police have been advanced.

The city cannot count on the recently passed Crime Bill for salvation. The bill will pay for at most 250-500 additional officers for Los Angeles, but to receive these federal funds, the city will have to put up 42 percent of the cost for each officer.

One way to help pay for the Mayor's Public Safety Plan and meet other fiscal challenges such as a looming $200-$300 million budget deficit and $70-$80 million in deferred street maintenance is to increase efficiency in city government. The best way to do that is to embrace the competitive model of government that is being embraced by local governments around the country.

Competition: The Key to Better Public Services

Governments at all levels are discovering that bureaucratic reforms do not cure the problems that often plague government: a lack of innovation, disregard for customer needs, and escalating costs. Despite the best efforts of city administrators and public workers, excess overhead and inefficiency result almost inevitably from monopoly. A central component of change is competition.

Change is difficult for governments. But for Los Angeles to be competitive in the 21st century, the city must have a municipal government that is in step with the times.

Rather than acting as monopolistic service providers insulated from pressure to improve, governments are introducing market pressures and competition to public service delivery. Joining this trend, Los Angeles could dramatically reduce its operating costs, allowing the city to significantly increase the number of police on the streets.

The main opponents of competition are public employees and their unions. Fearing job losses, these groups do not usually like the idea of having to compete, and they pressure their elected representatives to oppose competitive government.

The union opposition is understandable.

However, current circumstances mean that Los Angeles cannot afford not to change. In Cleveland, another city fighting back from economic decline, Mayor Michael White, a Democrat, is moving ahead with a program called Cleveland Competes. Despite strong opposition from public workers, a traditional Democratic constituency, White promises that he will not back down from plans to compete services. While we have 8,000 employees, there are 500,000 Clevelanders, and they pay for this, says the mayor. I think that somebody, somewhere ought to stand up for them, since they're paying the tab.

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The City of Los Angeles is in serious financial straits. In an attempt to balance its budget, Los Angeles has cut some costs over the last few years, but has done so primarily through the reduction of vital services, according to the Mayor's Tennenbaum Commission report. In addition, Los Angeles has been unable to meet its most pressing need, an increase in public safety.

Rather than cutting services or raising taxes, Los Angeles has the potential to reduce its looming budget deficit and raise the needed cash for more police by improving efficiency. A key way to do this is to embrace the competitive model of government proving successful in so many cities around the country.

Why has competitive contracting proved so popular in other cities Because it works. Through privatization and competition, cities all over the country have been able to cut costs without reducing services. The potential savings from opening up city government to competition are dramatic. This report, the result of six months of intensive study by a dozen researchers, finds savings of $119.8 million possible by introducing competition to just seven city services (see Table 1). That is enough to put nearly 1,600 additional police officers on the street.

As the 21st century approaches, Los Angeles can no longer afford a city government that clings to the status quo. Embracing competition in public service delivery is exactly what's needed to turn Los Angeles around.

Table 1

-2Savings estimates range from a high of $41.0 million to a low of $16.7 million. Current budget is $57.6 million.

3Based on estimated revenue increases.

4Based on projected revenue increases.

5Based on current per resident costs of $21/month vs. contracted per resident costs of $14B$16/month.

6Based on current program costs of $94 million ($86.4 million paid in benefits + $7.6 million in operating costs).

7Based on current operating costs of $13.2 million per year.

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As in other major U.S. cities, refuse collection and disposal service in Los Angeles represents a significant expense item of the city's general fund. A City Administrative Officer (CAO) report on refuse service costs, estimates FY93 solid-waste costs at $176 million, including refuse collection and disposal, recycling, and capital improvements associated with automated collection and landfill.

On several occasions over the past decade, Los Angeles city officials have explored the prospects of reducing refuse costs through privatization. However, to date the city continues directly to provide most residential refuse service, including both waste collection and disposal.

Elsewhere, over 50 percent of U.S. cities of varying sizes contract all or part of their refuse collection services, and the National Solid Wastes Management Association estimates that at least 50 percent of disposal capacity is privately owned and operated. A number of surveys and empirical studies have documented cost savings attributed to competitive contracting of refuse service in U.S. cities.

Privatization models for refuse collection service vary widely, but fall into five basic categories:

Single-district, winner-take-all, competitive contracting;

Multi-district, multi-winner, competitive contracting;

AEvergreen noncompetitive negotiated contracting;

AFree-for-all competition with no public involvement; and

Nonexclusive, licensed franchising.

In recent years, several cities have introduced a hybrid public-private competitive process, in which the city's refuse collection division bids on the contract against private firms.

Facing persistent budget pressures in the 1990s, the City of Los Angeles is again exploring cost-cutting options. As the third-largest item in the city's general fund, refuse service is an obvious potential candidate for competitive contracting. A preliminary comparison of current city costs with those of adjacent areas with competitively contracted refuse service suggests that competitive contracting could generate savings to Los Angeles taxpayers. Based on contractor costs from other cities with similar demographics and service, competitive contracting of residential refuse collection could save the city some $40 million per year over the long-run. The current fully allocated city cost per residential unit is approximately $21 per month. This is significantly higher than city rates in nearby jurisdictions that use competitive contracting. In those jurisdictions, monthly residential rates range between $9 and $15 per unit.

The city may consider `phasing in' competitive contracting by bidding out only individual subsets of the city's total residential units at a time to retain a portion of the service in-house. Such a phased implementation would generate lower initial yearly cost savings. Over the longer term, however, total annual savings of over $40 million could be realized if the city were eventually to expose all six residential refuse collection districts to competition.

The following report outlines the issues and costs involved in a program of competitive contracting and provides brief information on other cities that have contracted out their refuse collection services. The study does not examine prospects for privatizing disposal facilities through asset sales or through operation contracts. For this report, disposal facilities are assumed to remain under their current ownership and operational status.

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The city's Bureau of Sanitation, a division of the Department of Public Works, oversees and operates the collection and disposal of residential household refuse in Los Angeles. Basic residential services include same-day, weekly collection and disposal of one 60-gallon container of refuse per unit, one 60-gallon container of yard trimmings (in appropriate neighborhoods), and an unlimited amount of recyclables. Residents also receive free of charge special services, including 24-hour-advance-notice collection and disposal of bulky items, white goods, and bulky brush; same-day on-call collection and disposal of dead animals; weekend cleanups for community events; collection and disposal of household hazardous waste; collection from Parks and Recreation facilities; and collection from city Housing Authority units.

The Bureau is also responsible for activities ancillary to residential collection and disposal, primarily the design, planning, and operation of disposal facilities. Most commercial refuse collection within city boundaries is currently provided by private firms on a contract basis with individual businesses. Though not within the scope of this report, the Bureau is also responsible for the design, management, and operation of wastewater and stormwater facilities.

Currently, city collection crews provide refuse-collection service to 720,000 single-family homes and apartments of up to four (4) units. (The city also collects trash from larger apartments in which residents place individual cnas on the curb.) This total is divided into five roughly unit-equivalent geographic districts and the Harbor Section, which is an adjunct to the South Central District. The districts divided themselves by scheduled pickup day, resulting in collection from a total of approximately 144,000 units per day. By August 1, 1994, the city also offered curbside recycling service to 600,000 households. A map of the six districts is attached as Appendix I.

To provide refuse collection service, the Bureau employs nearly 800 truck operators, maintenance laborers, and supervisors, with vehicles dispatched from a central yard located in each district. Approximately 525 crews are dispatched each day for collection. Of this total, approximately 120 are recycling crews, 55 are yard-trimming crews, 320 are refuse crews, and 8 are dead-animal crews. Of the 525 crews dispatched per day, approximately 35 crews are two-person crews. There are also 15 bulky item/white goods two-person crews fielded each day. City officials report that routes average 450B650 units served per day.

To improve the speed and efficiency with which crews collect refuse, the city is in the process of implementing an automated collection program, whereby the collection of all refuse and yard trimming will be performed by vehicles equipped with a mechanical arm that picks up the container, empties refuse into the truck, and replaces the container curbside (the collection of recyclables was not included in conversion plans). Conversion of collection to automated service involves the purchase and/or conversion of nearly the entire fleet of trucks, as well as the purchase of new 60-gallon containers suitable to be picked up by the new/converted vehicles.

As of mid-1994, approximately 550,000 homes had begun receiving automated service, with a plan to achieve full automation by the summer of 1995. Nonautomated vehicles in the current fleet consist of front- and rear-loading vehicles (recycling crews also utilize side-loading vehicles). Much of the equipment and refuse containers are paid for from the Sanitation Equipment Charge on every collection recipient's Department of Water and Power bill. This charge, originally set at $2 per month per single family residence rose to $6 per single family residence per month in 1993, but was lowered to $4.50 per unit per single family residence in 1994 in order to fund the conversion to the automated collection program. These charges do not represent the full costs of refuse service to individual residences.

The city requires that 70 percent of its collection vehicles, approximately 623 out of a total fleet of 890, be available for service each day. Thus, at any given time as much as 30 percent of the city's refuse fleet may be out-of-service.

For the disposal of residential refuse, the Bureau utilizes a combination of the Lopez Canyon landfill, private landfills, and transfer stations. Bureau crews transport refuse directly to city-owned Lopez Canyon; Bradley West, a privately owned landfill; and Calabasas landfill, owned by the County of Los Angeles. Two transfer stations utilized by collection crews are owned by BLT Enterprises and operated by BFI and BKK, respectively.

Through the curbside recycling program that served 600,000 households by August 1994, the city began generating some revenues through sale of recyclables. In FY93, the city sold 42,740 tons of paper; 17,485 tons of commingled materials (metals, glass, and plastics); and an additional 3,966 tons of mixed waste (paper and other recyclables), for a total of over 64,000 tons. On average, the city received approximately $9.43 per ton for paper; $19.30 for commingled materials; and $5 per ton for the mixed waste. Total recyclable revenues totaled $760,328.

According to the Los Angeles City Administrative Officer (CAO) and Bureau officials, employees responsible for residential refuse collection and disposal are compensated through wages, city contributions to pension plans, health insurance benefits, including medical, dental, and optical plans, vacation time, and 12 sick days at 100 percent of salary, with the possibility of 10 more at reduced pay levels. Pension rights vest after five years, but base standard of 30 years of service at age 55 is required to receive full city retirement benefits. To determine the percentage of salary to be received at retirement, the number of years of service is multiplied by 2.16. The city currently contributes $280 per month for refuse collection and disposal employees' health benefits, and 17 percent of employees' salaries yearly into the pension/retirement fund.

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A.General Information

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City budget appropriations for the Bureau for FY94 were $161,446,827. Of that amount, $80,343,147 is directly attributable to the costs of refuse collection and disposal. An additional $77,076,494 is in the Sewer Fund budget, for a total of $238,523,321. The breakdown in expenditures is as folows:

Maintenance & Operation of Flood Control Facilities:$2,409,835

Maintenance & Operation of Wastewater Facilities:$150,927,326

General Admin. & Misc. Other:$4,843,013

Refuse Collection & Disposal: $80,343,147

Total:$238,523,321

Including all related costs such as pension/retirement funds, health benefits, water/electricity costs, land costs, general overhead, and so on, the total expenditure for collection and disposal is $177,190,045, an approximate cost per household per month of $20.51 (see Tables 1 and 2).

Salaries currently comprise the highest direct budget costs to the Bureau to provide collection and disposal, totaling $41.8 million; expenses for solid waste disposal make up the next largest item at $30.4 million.

In addition to these costs, however, the City Department of General Services pays for another significant refuse collection cost: the maintenance and upkeep of Bureau sanitation trucks. This expense is estimated to be over $30 million per year. Daily truck-maintenance reports show that trucks are frequently kept out of service for several days, and many break down repeatedly. According to the Sanitation Bureau, some of the maintenance problems may result from the fact that many older trucks have been kept beyond annual replacement schedules as the Bureau awaits their replacement with automated trucks. Although automated trucks tend to have a higher frequency of problems due to the large number of moving parts, Bureau reports show that a large number of front-loaders are experiencing habitual problems as well. This difficulty in keeping 70 percent of trucks available for service each day has resulted in one division's average of approximately 100 delays per month due to unavailability of trucks for the period June 1993BFebruary 1994, resulting in an average of approximately 250 delay-hours per month for the division during the time period.

Table 2

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1.General Comments

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For purposes of understanding the potential cost savings (if any) from competitive contracting, the following figures represent only those costs that would be potentially affected by contracting. That is, the costs outlined here are those that would be fully or partly eliminated from the city's budget under a competitive contracting arrangement.

From the city's perspective, these costs would be replaced with a contract fee (and new contract monitoring and enforcement costs). The contractor would, of course, experience costs for salaries, equipment, and so on. These contractor costs would form part of the basis for the fee that the contractor bid in the contracting process. In terms of potential cost savings to the city, the critical issue is whether the contractor's costs (as represented through the total contract fee) plus any contract administration costs to the city exceed or fall below the city's total direct and indirect costs for in-house service provision.

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How to handle capital costs for purposes of comparison with alternative service delivery methods poses special problems when using cost figures for a single year. Most budgets report either actual capital outlays incurred in a given year, or report the depreciation/amortization expense incurred in a particular reporting period, plus any interest paid on borrowed funds to finance a capital asset. Other financial reports include the actual debt serviceCprincipal plus interest payments on borrowed monies. These methods can all be appropriate for generating financial statements. However, they are not appropriate for an economic analysis of capital costs, for a variety of reasons. We have chosen to use a cost-of-capital methodology.

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The refuse collection salary figure represents salaries of all nonexecutive positions associated with the provision of refuse collection, including all positions at each of the six sanitation yards, the refuse collection training and safety division, warehouse and container division, monitoring and enforcement division, and administrative services division.

To arrive at this figure, the approximate midpoint of the salary range for each class of worker in the refuse collection division is multiplied by the total number of authorized positions for each class in the division, from the Bureau of Sanitation's organizational table (see Table 3). The breakdown by yard/division is as follows:

Table 3

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This figure is an estimate provided by Bureau officials, and results from the fact that crews earn time-and-a-half when they must work on Saturdays following a holiday weekend.

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This figure represents a conservative adjustment of an estimate given by Bureau of Sanitation officials of $3.50 per household per month, which was multiplied by the number of units served (720,000) and then annualized.

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As the Bureau implements its automated collection program, it must purchase a certain number of new automated trucks. In FY92, the city budgeted bureau capital expenditures at over $30,000,000 for purchase and conversion of trucks; in FY93, the city budgeted bureau capital expenditures for purchase and conversion of trucks at $35,000,000. As the bureau has thus far replaced only two-thirds of the fleet necessary to serve residential units on an automated basis, it is reasonable to assume an amount of $35,000,000 for the final phase of automated plan implementation.

Assuming that approximately two-thirds of the truck expenditures will be for new trucks, rather than conversion of old vehicles (due to the advanced age of the existing fleet), the total capital expenditure figure for new trucks is $23,450,000. Interest on the purchase was calculated on the basis of an imputed 7 percent yearly simple interest rate (reflecting a cost approach based on the opportunity cost of capital) for each of the seven years of the truck's useful life (as indicated by the bureau's stated seven-year replacement cycle), then principal and interest are amortized over the useful life.

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Truck conversion is also an integral part of the automated collection program. The Bureau has undertaken the conversion of a portion of its existing fleet to perform automated collection. Those trucks most likely to be converted are younger than average, to take advantage of their remaining useful life. The remaining $11,550,000 of capital expenditures available after the purchase of trucks are assumed to be for the conversion of existing trucks. As in the purchase of new trucks, interest on the conversion is calculated at a 7 percent yearly simple interest rate; principal and interest are then amortized over four years rather than seven (as the trucks are assumed to have been in use for several years already, but are not so old as to make conversion economically inefficient).

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In addition to the purchase of new trucks, the Bureau must also provide containers suitable for automated pickup. In 1990, the city issued certificates of participation (COPs) to pay for the first batch of automated containers; it is likely to do so again to fund containers for the roughly 170,000 units which have not yet been converted to automated service. The approximate total capital cost of the containers is conservatively estimated to be $11,220,000, at two containers per household multiplied by the 170,000 units to receive them, multiplied by the most recent bid price per container of $33. As with the trucks, interest was calculated at a 7-percent yearly simple interest rate and amortized over the containers' five-year useful life. A 5-percent per year replacement cost is then added to take into account bin theft and damage.

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This figure represents the total cost to the city to dispose of household refuse collected by its crews. Table 4 outlines the fees associated with disposal at the various sites as of July 1993.

Table 4

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* $15.38 rather than $13.92 due to personal communication with Courtney Timberlake upon writing this report. If we were to use

$13.92, the monthly disposal cost per household would be $20.44.

Source: Department of Public Works, Bureau of Sanitation, Solid Waste Program Status Report (July 1993). It should be noted that these reported July 1993 disposal fees may have changed by 1994.

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This figure is from Bureau officials; primarily for consulting services related to the closing of Lopez Canyon, negotiated on a year-to-year basis.

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From a Bureau report; contract to begin in the summer of 1994.

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This figure is derived by estimating the approximate value per square foot of land used for the yards and amortizing over a 30-year useful life of the land at 7 percent annually, totaling the opportunity cost of retaining the land for yard space rather than selling it at current market value. As the Bureau has been unable to provide estimates on the value of land upon which the yards are located, numbers have been used from a 1988 study of the city's refuse collection costs to estimate the approximate value of the land. Table 5 outlines the cost schedule of yard land.

Table 5

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Source: Reason Foundation, Savings A.S.A.P., Analysis of the City and County of Los Angeles, (Los Angeles, L.A. Taxpayers Association, 1988).

Assuming the Bureau were to sell the land at the low end of the range, the $29,186,934 is amortized in the same way as for trucks and containers, over a 30-year useful life.

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In 1991, the city approved an interim five-year $96-million budget to develop Lopez Canyon Area C as additional landfill space to replace the city's Lopez Canyon Areas A and B at use permit expiration. The plan has proceeded on schedule, with two years remaining to completion. Using the opportunity cost of capital computation methodology outlined above, 7 percent yearly interest is computed on the $96-million commitment, multiplied by the land's 30 years of useful life, added to the original principal, and divided by 30 to obtain a yearly cost estimate. Note that according to the Sanitation Bureau, the landfill won't actually last 30 years. (The permit expires in 1996, but permits are not a reflection of actual capacity or potential landfill lifespan, which are a function of the size of the landfill and the daily amount of trash deposited). A shorter lifespan for Lopez Canyon Area C would result in increased annual costs, using the methodology applied here. We have chosen to use the longer lifespan to generate very conservative, rather than overstated, annual cost estimates.

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1.Pensions/Retirement - $6,497,595

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The amount of pension funds to be saved by contracting is based upon a two-step process. First, we take the portion of salaries to be avoided in a division as a result of competitive contracting. Second, this is calculated as a percentage of the total amount allocated for salaries within the Bureau. This percentage is then applied to the total amount allocated to the Bureau for pension/retirement costs ($24,894,999). For the refuse collection division, the percentage is approximately 25 percent; for refuse disposal, the percentage is approximately 1.1 percent. (All numbers come from the City of Los Angeles FY93 budget).

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The amount of indirect costs paid out of other budgets for various services is determined by calculating the amount of unallocated division overhead as a percentage of total Bureau unallocated overhead (as with pensions/retirement costs, all figures come from the City of Los Angeles FY93 budget) and applying each percentage to the total unallocated overhead for each service. For the refuse collection division, the percentage is 27 percent; for the disposal division, the percentage is 8.9 percent.

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In considering costs to the city under a competitive contracting arrangement, more than simply the price charged per unit of collection must be reviewed. The actual cost of contracting a service is equal to:

Total Contracting Cost/Year = Contractor Cost + Administration Cost + Conversion Costs (Amortized) - New Revenue

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Based on prices from 14 other cities which have contracted out refuse collection, as well as industry estimates, a price of $9 to $15 per household per month for pickup and disposal of refuse, recyclables, bulky items, white goods and yard trimmings is a range within which collection services could reasonably fall (see Table 6).

As a baseline for analysis, a detailed examination of contractor costs for two cities in the Los Angeles Metropolitan Area was undertaken. Because some of the information examined is proprietary, the two cities have not been identified by name.

City A has between 75,000 and 100,000 residents, with an average density of 10,000 residents per square mile. The contractor serves nearly 18,000 households, providing weekly manual pick-up of unlimited numbers of containers; periodic bulky-item pick-up; and unlimited green waste collection (within specified guidelines). Five trucks serve approximately 3,600 households over five days, for an average pick-up per crew of 700 to 720 households.

Table 6

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Notes: Contract charges should not be misconstrued to reflect actual service costs. However, private contractor per household charges will at a minimum cover total service costs, unless the public sector is providing some additional service subsidy to the hauler. The cities cited above do not subsidize trash service.

The contractor's financial records show total annual costs of $2,010,435 to serve nearly 18,000 households. This sum translates into costs of just over $113 per household per year, or $9.44 per household per month. This amount includes total service costs as described above and incorporates the costs of disposal, which average around $16 per ton for trash and $7 to $8 per ton for greenwaste. Labor costs make up about 33 percent of total direct operating costs.

The private hauler reported operating a minimum of 95 percent of trucks at all times, in contrast to figures for the City of Los Angeles of 70 percent. The hauler has two shifts of maintenance personnel, ensuring a 16-hour supply of labor to fix any problems which might occur. This is consistent with reports by other private haulers providing residential refuse service under contract to cities in the Los Angeles area. These haulers report that not more than 5 percent of vehicles are out-of-service at any given time, in contrast to the 30-percent rate of the City of Los Angeles. As one hauler stated, The trucks are critical to my success, so I have a very high stake in maintaining them in top shape. In addition, the haulers are not subject to stringent city procurement policies and are thus able to standardize their fleet and allow maintenance workers to obtain complete familiarity with a product line, resulting in lower maintenance costs.

A second city in the Los Angeles area showed costs of $12.99 per household per week to collect trash and recyclables in a fully automated program. Under that program each resident is provided with two 90-gallon containers: one for trash and the other to collect 70 recycling items. Trash pick-up occurs weekly; recyclables are collected every other week. Note that the $12.99-per-household cost includes franchise fees and other taxes, as well as the hauler's profits. Under this fully automated program, the private contractor serves 900 to 1,000 households per truck per day.

Other cities in the Los Angeles area report contract costs ranging between $9 and $15 per ton, giving at least a tentative benchmark against which to compare costs for the City of Los Angeles. Actual contract fees for the City of Los Angeles can only be determined by actually putting the service out to bid.

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Administration costs may be estimated to be between 2 and 4 percent of total contractor costs, as outlined by a U.S. Office of Management and Budget circular discussing the calculation of private contract costs. This 2- to 4- percent administration cost includes costs for contract monitoring and oversight to ensure accountability of the private haulers. Most current refuse collection contracts set service standards and mechanisms to hold private haulers accountable for service quality. Many of these contracts require that the private hauler handle all citizen complaints and make thorough quarterly, bi-annual, or annual reports to the contracting city regarding complaint levels. These cities often provide a back-up public-sector phone number for citizens to call in the event that the private hauler fails to remedy the offending action. Cities that pay haulers for household refuse service often have provisions for withholding payment if citizen complaints exceed specified levels. In those areas where haulers bill citizens directly, it is typically the individual households that hold haulers accountable by withholding payment for service deemed inadequate by the household.

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During any move toward competitive contracting, cities can face substantial costs. For example, if a city has existing unexpired leases, the city will continue to incur expenses for those leases unless equipment or land can be transferred to the contractor. In addition, existing specialized equipment owned by a city will need to be sold or mothballed, again sometimes resulting in costs (although equipment sales or subleasing of space can also result in new sources of revenue).

For the City of Los Angeles, lease conversion costs would be minimal since the Bureau currently does not lease any of its facilities and has only the small lease for extra East Valley yard space in its future leasing plans. However, existing city-owned land and equipment would either need to be sold or transferred to other uses where feasible. In at least some instances, cities have sold existing equipment to the winning bidder as part of the competitive contracting process.

Some conversion costs may be offset by any new revenues gained by the city, such as fees paid by a contractor to dispose of refuse at city-owned landfills or various taxes paid by the contractor into city coffers, including, for example, franchise fees.

For illustrative purposes, assuming that contract and administration costs are at the high end of the ranges reported here, the cost to contract trash collection is:

Total contracting cost/yr. =

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Ù(admin. cost 4% * cost/household/mo. * total # households * 12) +

Úconversion costs (estimated at $30,000)

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For a hypothetical contracting in the City of Los Angeles of trash collection excluding new revenues, this comes to:

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However this figure likely overstates net costs of trash collection since Los Angeles, like most other cities, would probably charge contractors a franchise fee. Such fees range between an average of 5 percent to 7 percent. Assuming a 5-percent franchise fee, revenue to the city would be almost $6.5 million.

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Subtracting franchise fees from the total cost to contract trash collection yields a net annual cost of $128,334,000, or $14.85 per household per month.

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Savings equal:

Current City Costs - Contracting Costs = Savings

Low-End Savings (Household charges at $15 per month) $177,190,045 - $134,814,000 = $42,376,045

Mid-Range Savings (Household charges at $12 per month) $177,190,045 - $107,857,200 = $69,332,845

Total estimated potential savings if the city fully contracted waste collection services could exceed $40 million. In addition to these savings, a 5-percent franchise fee charged to the contractor(s) could generate an additional $6.48 million, assuming a per-household monthly charge of $15. Note that this figure would be lower if the household charge under contracting were at the lower end of ranges currently applied in some Southern California cities.

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A.Public-Employee Concerns

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Perhaps the most important transition issue concerns the fate of current city employees affected by any move toward competitive contracting of refuse service. Given current public employment turnover rates in the City of Los Angeles, the possibility of working within the natural rate of attrition appears feasible. The Bureau's attrition rate is currently approximately four employees per month, or 48 per year. Dividing the total number of units served by the Bureau (720,000) by the total number of authorized positions for refuse collection and disposal (1,182) results in an allocation of 1 employee for roughly every 609 units served. Attrition of 48 employees without replacement would theoretically result in a loss of service to 29,238 units (48 employees x 609 units/employee). If the city phased in competitive contracting on an annual basis in districts of approximately 40,000 households, this transition could be accomplished with no reductions on the existing labor force, other than through natural attrition rates. Since Mayor Riordan is on record saying no lay-offs will occur due to privatization, this approach would be consistent with that stance.

Concerns have also been voiced regarding the potential negative impact of contracting on the city's minority population. Roughly 80 percent of refuse collection and disposal employees are minorities. Thus, refuse service layoffs could affect a large number of minorities. However, this problem would be overcome if: 1) the winning contractor were required to offer employment to current Bureau employees through some sort of preferential hiring clause in the contract; or 2) the Bureau were permitted to compete in the bidding process and actually submit a low bid to continue collection and disposal, as the service would simply be retained in-house at a lower cost. In addition, working within the natural rate of Bureau attrition would also render the point moot.

It is worth noting that the city's affirmative-action requirement already shapes hiring decisions for outside firms wishing to bid on a service. For private firms (as well as the Bureau), the nature of refuse collection is decidedly gender-divided: crews are almost exclusively male, forcing a requisite increase in female hiring in other areas to achieve the city's minimum goals. All firms that enter nonconstruction contracts with the city for services within the County of Los Angeles must submit as part of their bids a written affirmative-action plan setting forth minimum goals for minority and female utilization (currently 21 percent for each) by the contractor in each occupational category as outlined by the city. According to the schedule of affirmative-action requirements, the goals are not to be construed as quotas, but should indicate the extent to which the contractor or the subcontractor, in good faith, shall make an effort to utilize minorities and females in each occupational category provided the opportunities arise and qualified persons are available to fill vacancies.

In addition to the affirmative-action requirement, firms are required to certify the existence of a formal child- care policy, with possibilities for satisfying the requirement ranging from paid parental leave to provision of a full-scale day-care center. Particularly important is the fact that firms with such a policy in place receive preferential hiring treatment.

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A number of privatization studies have underscored the importance of viable competition as critical to successful privatizations that result in cost savings. Thus, it is important to examine the potential for competition in Los Angeles. In part, the number of potential bidders on a refuse contract will depend on how the bidding process is designed. Bidding out all 720,000 Los Angeles residences in a single process, with a single winning contractor, would eliminate all but a few major national firms from the bidding process. However, if the city were divided into a number of smaller districts of 35,000 to 40,000 households each, competition in Los Angeles would be robust. At least a dozen local firms have the capability to bid on contracts of this size; in addition, at least a half-dozen regional and national firms could potentially bid on such contracts. In short, absence of competent bidders should not be a constraint on privatization of refuse service in the City of Los Angeles.

Experience in other Los Angeles-area cities confirms that competition in the refuse industry is robust. For example, the City of Manahattan Beach, which just recently rebid its collection and ancillary services, was able to choose from two of the largest haulers nationwide, two medium-sized haulers, and one small local hauler to provide service. A medium-sized firm won the contract, suggesting that large haulers will not necessarily win most of the contracts, thereby putting smaller haulers out of business. In another local example of competitive contracting, one of the nation's largest haulers, BFI, is currently under contract for 32,000 units in the Firestone district of Los Angeles County, providing manual collection of refuse, recyclables and greenwaste at a cost of $7.50B$8.00 per household per month.

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A growing body of academic literature confirms that use of competitive processes in service delivery can yield cost savings, improved service quality, or both. While early studies showed private contracting per se could produce cost savings, more recent studies show the importance of competition (in the public and private sectors) in generating savings.

A number of studies examining trash-collection systems show savings from contracted service. The most comprehensive of theseCfunded by the U.S. government and conducted in the mid-1970s by a team of researchers at Columbia UniversityCshowed savings of 29 to 37 percent in cities with populations over 50,000. Private subscription systems in which households contract directly with private haulers proved more costly than any other system type (competitive contracting, franchising, or public provision of service).

These findings were confirmed in a 1984 study of 20 California cities. That study, by Barbara Stevens (who also worked on the earlier nationwide study), found savings ranging from 28 to 42 percent. The Stevens study found that seven of ten contract cities surveyed had lower per-ton costs than any of the cities with municipal service. The average cost for municipal service was $33.96 per ton; the average cost for cities with contracted collection service was $22.25 per ton.

More dramatic cost savings were found in a 1982 survey of 120 Canadian cities. There, University of Victoria Professor James McDavid found costs in the public sector averaged 50.9 percent higher than for contracted service.

Unlike a number of other studies with ambiguous findings regarding cost savings, the nationwide Columbia University study and the Stevens study controlled for such characteristics as route density, frequency and location of service, waste quantity collected, and service quality.

More recent studies have begun to refine these comparisons, looking at the effects of competition (rather than simply ownership arrangements) on costs. These studies begin to point to the critical importance of competition in generating cost savings.

A 1986 survey of 300 local governments in Great Britain that used competitive contracting showed cost savings averaging 20 percent for a variety of municipal services. Not all private contracting yields cost savings. However, one analyst, comparing public and private refuse collection, shows that competitive tendering (contracting) reduces the range of costs per unit of output or service by failing to award contracts to high-cost providers. The author concludes that the clear implication from this analysis is that competition does not make all operators equally efficient, but reduces the range of observed inefficiency. (see Figure 1)

Use of competitive-bidding procedures in which in-house (municipal) agencies compete for service with other private providers can produce benefits even when the public sector wins the bid. At least three positive outcomes from introducing competition may result. First, the process necessitates that public agencies develop clear data about their own costs and service-delivery choices. Second, preparation of service specifications for the bidding process requires clear consideration of desired service levels (a weighing of trade-offs between costs and different service levels, for example). Third, the competitive process can separate the provision of a service from the purchaser (the local government). This result holds true whether the service is won by an in-house or private-sector provider, and heightens accountability.

What accounts for reported cost savings under conditions of competition The Stevens 20-city study in California identifies a number of practices that contributed to cost savings when competitive contracting of trash collection is used. Stevens summarizes these factors, noting that private contractors tend to:

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Aoffer equivalent salaries but fewer benefits;

Amatch skill levels with job requirements, using employees with the lowest skill levels necessary to adequately perform a task;

Ause part-time labor when appropriate;

Arequire that managers be responsible for equipment and labor availability;

Aallow first-line supervisors to have hiring and firing authority;

Ause incentive-pay systems; and

Ause less labor-intensive means of providing a given service.

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Other factors that contribute to lower costs include lower absentee rates (7.9 percent vs. 13.4 percent), less vehicle downtime (6.2 percent vs. 16.2 percent), and more use of standardized, single-brand vehicles. Information comparing vehicle maintenance schedules of publicly owned with privately owned refuse collection vehicles is unavailable. However, a 1989 Federal Reserve Bank study of public versus private buses drew conclusions potentially relevant to refuse-collection service. That study found that maintenance spending per mile by contractors that provide bus service average 77 cents; the public sector spent on average 53 cents per mile. These maintenance expenditures translated directly into longer vehicle life in the private sector. Operators of buses made between 1971B75 and sold in 1987B88 received on average $1,648 in the public sector and $7,500 in the private sector. Fully 80 percent of all vehicles owned by private-sector bus companies were still operative after 15 years of service; in the public sector 60 percent were still operable.

Since collecting more tons of waste per workday can increase productivity, larger-capacity vehicles and flexibility to structure routes efficiently can also play an important role in lowering costs. For example, routes with fewer left turns and more nonpeak-traffic travel time can reduce route-service times. Since as much as 50 percent of route time is spent driving from stop to stop (and 50 percent on loading of trash), efficiencies in route structuring can significantly reduce costs. In addition to greater route efficiencies, several studies comparing public and private refuse collection systems found that the private sector, on average, used larger trucks.

Cost savings, while important for local governments, cannot overshadow service quality. In fact, critics of competitive contracting often worry that it will result in poorer service. The Columbia University and Stevens studies both attempted to include service-quality comparisons in their assessments of public versus competitively contracted trash collection. In a ranking from 1 to 100 (from best to worst), municipalities and private contractors received similar scores in the Stevens study (34.4 for municipalities; 38.2 for contractors).

A fundamental problem with examining quality of service is determining just what that means. The Stevens study examined a variety of performance characteristics, including amount of spillage, noise levels, yard damage, number of missed stops, rudeness of haulers, amount of waste left uncollected, frequency of improper placement of cans (lids left off, cans not left upright).

Satisfactory quality need not mean top-of-the-line service. Rather, a more appropriate concept of quality is service that consistently meets the stated purpose. For example, not all automobiles need all the attributes of a Rolls Royce to be considered satisfactory quality. In solid waste service, this can be a central issue. Public-sector systems more frequently provide twice-per-week pick-up and backyard service than do private contractors. This higher public-sector level-of-service may, however, represent more than the household would prefer were they paying full service costs.

Under competitively contracted service, the public sector need not relinquish decisions about service requirements to the private contractor. Such requirements can be made explicit in bid documents.

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While numerous variations exist, five basic models for privatization of refuse collection service exist. These include:

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xMulti-district, multi-winner, competitive contracting model. Boston and Seattle both have multi-districts, with separate bidding for each district, and limits on the number of districts a single bidder can win. New Orleans has multi-district bidding, with no restriction on the number of districts a single bidder can win. Phoenix has multi-districts in which both the public and private sectors bid to provide service, and places limits on the number of districts to be served by the private sector.

xAEvergreen noncompetitive negotiated contracting model. A number of cities, including, for example, Orange County, simply renegotiate existing private contracts periodically, with no competitive bidding process.

xAFree-for-all competition with no public involvement model. This arrangement is primarily restricted to rural, or unincorporated areas. Citizens subscribe directly with haulers for service.

xNonexclusive, licensed franchising model. This arrangement is sometimes used for commercial refuse collection service: haulers contract directly with local commercial entities to provide waste service, but cities require that haulers obtain a franchise to offer local service.

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Each of the competitive contracting models can incorporate a hybrid, public-private competition element in which the public sector actually participates in the bidding process and may win the contract to provide all or portions of a city's refuse collection service.

There is no one-best-way to undertake competitive contracting. Ultimately, the appropriate choice is a function of local political, economic, demographic, and other factors. The following discussion presents a brief outline of successful competitive-contracting models in several large U.S. cities.

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The City of Phoenix has achieved national prominence as a result of its numerous successful competitive- contracting initiatives. Its curbside refuse collection service program has saved the city almost $21 million over 14 years, during which time the number of household units collected increased from approximately 61,000 to 285,000. In the late 1970s, Public Works Director Ron Jensen issued a request-for-bids (RFB) for collection services in one of the city's five districts, declaring that the city would bid on the district, as well. Though the city lost the district at that time, it ultimately won it back. At the outset, the competitive process prompted the city carefully to examine its costs and exactly where costs could be cut in the provision of collection services. As a result, city officials decided to gradually put all five districts out to bid. This `phased implementation' plan allowed the city to retain some in-house service for emergencies. The contracts specify that winning contractors must give hiring preference to displaced city workers, allaying the fears of union members.

As evidence of the city's success at reducing costs sufficiently to compete with the private sector, Phoenix eventually won back all five of its districts. Currently, the city serves four of the five, having just lost the fifth to a contractor who significantly underbid the city.

The city's twice-weekly, automated curbside collection plan costs approximately $3.75 per household per month; the plan includes all household refuse, organic wastes such as yard trimmings, and recyclables for those residents not participating in the city recycling plan.

All bidders are required to submit a $100,000 surety bond, with winning firms required to furnish a performance bond in the amount of $2,500,000.

Features of the contracts include contractor monitoring of noncollection complaints, with a schedule of charges to be applied should the contractor fail to remedy the noncollection. The only permissible exception to twice-weekly collection is for city holidays; residents whose collection falls on such a day shall only receive collection once that week. The contracts also require specific medical benefits to be available to contractor employees, and that the contractor submit an affidavit regarding its affirmative action plan. In the event any dispute between the city and the contractor cannot be settled, and the dispute involves $50,000 or less in money damages, the parties are to submit the complaint to binding arbitration.

As Public Works Director Ron Jensen stated, All local conditions [must] be fully evaluated before a privatization effort can be truly successful....It is management's job to seek out all alternatives to service delivery for our government agencies.

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One of the most recent successful examples of household refuse-collection contracting has occurred in the City of Indianapolis. In just a few months, the city has been able to cut its costs significantly while also improving the level of service.

In late 1993, the city put to bid its curbside refuse collection services provided to approximately 319,000 single- and multi-family residences. The scope of the services included the curbside manual collection of household waste and yard waste, with collection of recyclables on both a subscription and nonsubscription basis, allowing for flexibility in implementing the waste-reduction portion of the city's 20-Year Solid Waste Management Plan. The contract for services was to run for thirteen months, preventing the city from being locked into an unsatisfactory contract in the initial stages and permitting maximum flexibility.

The city was already divided into eleven districts, a result of previous private contracting of commercial refuse- collection services. One district is reserved for the city Department of Public Works (DPW), in order to retain some of the service in-house. To allay union members' fears of layoffs, the DPW was permitted to bid on the remaining ten districts, and preferential hiring by a winning private contractor was a feature of the bid requirements. Firms were to submit bids for contract terms of three and five years. No performance bond was required on the bids, as Indiana state statutes do not require a bond for contracts valued at over $300,000. To allow for maximum competition, no firm, including the DPW, could be awarded more than three of the ten districts. In all, five different firms (including the DPW) were assigned to serve the eleven districts, at an average total monthly price for the three distinct services of $8.54 per household per month, with a high price of $10.09 per household per month (in a district won by a local hauler) to a low price of $6.97 per household per month (the DPW's price in its three bid-won districts). Five of the seven private-hauler contracts were for a five-year term, resulting in cost savings over the three-year contracts.

Contract features designed to monitor the contractors include a schedule of liquidated damages for a breach of contract, for example, failure to collect refuse on time, as well as accumulation in excess of a fixed number of legitimate complaints. If material breaches of the contract terms are not remedied within three days, the city is authorized to assume the responsibilities of the contractor. In addition, the city has the right to terminate the contract upon written notice at any time, should funding for the contract be insufficient as a result of fewer appropriations or any other reason.

Prior to and during the initial transition period, the city made every attempt to inform residents of the features of the new service by mass mailing detailing the new district hauler and the day of the week scheduled for pickup. In addition, the city set up a three-month temporary hotline for residents to call with any questions. Initially, the hotline received 2,000 calls per day, gradually tapering off.

Ultimately, should a contractor fail to live up to the terms of the contract and be terminated, the fact that the city has kept a portion of the service in-house has served to affirm to residents and city officials alike that the city would be able to keep collecting the trash if necessary.

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As an example of the wide variety of services available in the Southern California region, the City of Manhattan Beach contracting program for its 12,000 residential units serves to highlight the potential for unique facets within the bidding process and the potential for creativity in contract structure.

Historically, the city had always contracted for its refuse collection services, including recyclables and yard trimmings; thus, there is no in-house unit with which to compare costs. This did not mean, however, that the city was uninterested in reducing its costs. In early 1993, the City Council's cost-cutting efforts led to a decision to re-bid refuse collection services. In the process, the city decided to attempt to negotiate a price with the current refuse collection contractor, since there had been no service problems under the previous contract. Over the next several months, however, the city soured on the idea of the negotiated bid process due to outside circumstances. In August, the Council voted to open the bidding to all. This was not to be an ordinary request-for-bids, however. In developing the request, the city opted to issue a request-for-proposals (RFP) instead. In doing so, the city asked contractors to describe their process for waste disposal, thus absolving the city of most of the liability for Superfund cleanup should an accident occur.

In addition to avoiding Superfund liability, the city was able to use the bid process to obtain an even better deal for itself. After all proposals were in, the city actually revealed the proposals publicly, for all bidding firms to review. At the same time, the city said, [H]ere is your chance to make your proposal betterCgo ahead and see what you can do. Firms were allowed to revise their proposals based on what other firms had offered, thus allowing for improvement in the city's ultimate deal.

Firms were asked to bid on the provision of weekly curbside refuse, recyclables and green waste collection, ancillary collection services such as bulky goods and Christmas tree collection, administrative costs such as recycling promotion and education programs, California state reports, waste characterization sort and analysis, etc., and two rate-increase structures, one based on consumer price index(CPI) and no adjustment for landfill tip fee increases, or a fixed 5 percent annual increase, with a maximum annual increase of 7 percent.

Ultimately, the firm under the current contract won the bidding war. Though the firm offered only the second-lowest total price for single-family residential service, it eliminated the cap on indemnification from CERCLA (Superfund) liability, offering unlimited access to its assets; offered collection of greenwaste with the regular refuse, with sorting at the firm's transfer station, thus reducing both the cost per household and the number of trucks on city streets; and the lowest rate increase structure with the firm receiving 70 percent of its rate increase based on the CPI and 30 percent based on increases in landfill fees, with a maximum possible increase of 4.5 percent. The final cost per household per month was $12.12; the highest of the five bids still came in at $16.64 per household per month for the numerous services provided. Savings from the previous contract are estimated to be approximately $1 million for the city's 12,000 units.

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The City of New Orleans has been contracting its refuse collection services for nearly 20 years. In 1976, the Department of Sanitation produced a cost study on the potential privatization of the East New Orleans district. City officials were, essentially, almost forced to accept privatization as an option: at the time, the vehicle fleet was aging, truck maintenance was expensive, and the city had virtually no funds to allocate for capital expenditures to update the fleet. The trucks had aged rather quickly, due to the particularly long drive to the landfill from East New Orleans. The city chose to contract its refuse collection service, rather than attempt to squeeze funds from the budget for massive capital expenditures.

Initially, the union outcry over the program was significant. To defuse the protests, the city included a preferential hiring clause in the RFB, which was ultimately accepted. In addition, the city also factored in the rate of attrition, as well as a number of layoffs scheduled as part of a citywide plan regardless of the contracting initiative. Though the unions were less than happy with the layoffs, the fact that the winning contractor would give right-of-first-refusal to displaced workers was sufficient to quell most union concerns.

Once the initial program was in place and running successfully, the move was made toward privatizing all five of the city's districts, ultimately encompassing approximately 180,000 single-family homes, multiple-unit apartments of up to ten units, and small businesses (for example, companies working out of the equivalent of a single-family home). Mike Lewis of the New Orleans Department of Sanitation claims that collection is as good or better before privatization...it saved us millions of dollars in capital expenditures and provided us with quality service.

Terms of the most recently rebid contract, in September 1993 for the city's 15,000-unit Algiers district, include twice-per-week curbside collection of refuse, collection of exceptionally large quantities of waste and bulky items on the second collection day, and on-call pickup and disposal of dead animals, for a total of $3.99 per household per month over five years, or approximately $3,340,000. The RFB requested bids on various combinations of services, including a twice-weekly refuse collection and once-weekly curbside recycling plan, a once-weekly refuse collection, once-weekly curbside recycling and once-weekly composting pickup; none of the options received a bid of more than $7.24 per household per month. However, only the two largest haulers nationwide bid on the contract, perhaps indicating the dearth of local haulers in New Orleans capable of serving the city's large districts. In fact, the city has permitted the same firm to win the right to provide residential and small commercial service to all five of the city's districts.

In addition to the above services, the winning contractor is also required to provide, maintain, and service containers placed at the Algiers district yard for resident drop-off recyclables, if the curbside collection of recyclables is not chosen as the winning option.

To pay for the service, the city has historically had a fee on the books; currently, the figure is $10 per billable water meter, resulting in revenues of about $17 million to $18 million. This pays for the costs of the contract, the costs of administering the contract, and other programs within the Department of Sanitation.

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The city cannot know for certain whether competitive contracting will yield savings nor what the scope of those savings might be without actually putting service out to bid. However, short of taking that step, the city can undertake a detailed examination of its own internal service costs and compare them to costs in nearby cities that use competitive contracting for refuse service and identify potential target areas for improving efficiencies.

As this report has discussed, internal cost analysis is no simple matter. Budget-based accounting does not identify total costs associated with delivery of any particular service. Thus, the city must develop some sort of activity-based costing of services, in which all costs associated with the delivery of a particular service are identified and allocated to that service to determine total costs. There is no single methodology with which to undertake such costing of services.

This report attempts a first-cut effort at identifying all costs associated with refuse service, setting forth the assumptions and methodologies for cost determination. While there is some room for adjustment of these costs, the authors believe the data and assumptions represent a reasonable and fair characterization of city costs to provide refuse collection and disposal service.

Using these costs, and contrasting city costs to costs in two neighboring communities with competitive contracting and similar service levels, shows that the City of Los Angeles should expect savings from competitive contracting. The scope of those savings would depend on the actual contract process developed. However, if the city's entire residential service were competitively contracted (whether through private-sector only or public-private competition), this report estimates that the city could save over $40 million.

These savings are likely achievable even though the city has embarked on a major city-wide automation program that uses single-person crews. Several factors explain the potential for significant savings.

First, available data suggest that the city makes inefficient use of its refuse vehicles, owning more vehicles than necessary to service existing residential accounts if the city maintained in-service ratios comparable to those in the private sector.

Second, even with automated service, the city does not appear to achieve productivity rates comparable to those in the private sector. The city reports that crews serve 450 to 650 households per day; the lower figure may be more presentative of actual service. By contrast, private haulers operating under similar demographic conditions and with similar service profiles tend to serve at a minimum 700 households per day, even with manual service. Those that offer automated service appear to be achieving service rates of over 900 households per day.

Wage rates appear to be comparable between the public and private sectors, though benefits appear to be more generous in the public sector.

Private-sector wages and benefit packages vary across firms. However, in Southern California, an average driver of a residential compactor truck earns approximately $400 to $500 per week. A number of haulers base their pay schedules on route-hours, so that pay may be set at $10 per hour for 40 route-hours, for a total of $400. Drivers may actually only work 38 hours, yet they will still be paid on the basis of 40 route hours. A second crew helper may earn $300 to $400 per week, again based on route hours that may exceed actual hours worked. These wage rates translate into hourly wages for drivers of anywhere from $8.35 per hour for new employees to $10.85 per hour with the average salary being approximately $10.00 per hour. For helpers the average range is between $7 and $8 per hour. Mechanics in the Southern California area for the trash industry earn between $9 and $12 per hour.

In addition to wages, most Southern California residential haulers offer various benefits. For example, one surveyed hauler offers full health insurance coverage to drivers and their families with no employee co-pay requirement. Helpers receive full health-care coverage also, but these employees pay extra for family coverage. Two other haulers surveyed offer 100-percent health-care coverage for employees but health care for family members is not included.

The same hauler provides annual bonuses that average around $1,500 per driver and $500 per helper. The firm also pays the equivalent of 10 to 12 percent per year of employees' wages into a profit-sharing retirement account. A second firm offers a 401K plan into which the company will pay 5 percent of employees' salaries. One hauler mentioned that they also provide interest-free loans (up to the equivalent of three weeks of salary) to employees.

Private providers in the Los Angeles area appear to be able to provide service at costs lower than that of the City of Los Angeles even though they pay taxes, franchise fees, and generate internal profits. City of Los Angeles statements say that residential fees are lower than prevailing private-sector fees are highly misleading and bear no relationship to city service costs. The city fees are politically set fees that do not cover total service costs. Current city fees are set at $4.50 per month for single-family dwellings. The remainder of costs are covered through general fund outlays. The relevant cost comparison is, thus, not fees charged by the public sector, but actual service costs.

It should also be noted that taxes and franchise fees paid by private haulers into local government coffers are actually a credit to cities.

Given the preliminary review of city and private-sector costs offered in this report, it is estimated that the City of Los Angeles could, in the long-run, potentially save over $40 million if it were to contract its refuse-collection services in their entirety to private firms.

Even if the city were to choose to contract only one of its districts and retain the remainder in-house, the city would likely save some $7.5 million per year. These figures do not include some difficult-to-estimate figures, such as foregone taxes, which are a cost to the city and could potentially increase the amount of savings, if added to the computation.

There is no technical requirement that the city competitively contract the six districts in their entirety. Other cities, such as Indianapolis, specifically provided for retention of a portion of the service in-house. This process has helped to minimize disruption among the city's workforce and retain service in-house, allowing an objective program assessment on the part of both the city and the winning contractors. Regardless of whether the public or private sector wins the contract, it is likely to be an enlightening experience since, done properly, it could require the city to consider all the costs of refuse collection, including opportunity costs, and not just immediate budgetary costs. This sort of cost discipline is a prerequisite to any attempt to lower city service costs.

Currently, the city faces policy impediments to competitive contracting. Specifically, the city recently entered into a four-year agreement with the union representing refuse-collection operators. This agreement limits the city's ability to privatize city operations. That contract expires in 1996, but allows for up to 10 percent of city services to be privatized. As of mid-1994, there were no active efforts to put any of the refuse collection out to bid.

APPENDIX I: Recycling/Automated Master Implementation Schedules

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The cost and quality of the Los Angeles Emergency Medical System (EMS) system fail to measure up to modern high-performance standards of many other large cities. Differences in EMS system design are the key to different levels of performance. A public/private partnership between the fire department and the private sector, in which the fire department provides first-response and the private sector provides ambulance service, is one key component of high-performance EMS. The second is the use of a flexible production strategy, using a single fleet of advanced life support (ALS) vehicles for all ambulance service, rather than a mixed fleet of ALS and BLS vehicles. The third component is performance-based contractual provisions holding the ambulance provider accountable for high levels of service. Upgrading the Los Angeles EMS system in this way should result in a higher level of service for consumers, reduced rates of accident- and injury-related morbidity and mortality, and significant cost savings estimated at $30.7 million per year.

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A.Los Angeles EMS

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Los Angeles' EMS program was established by ordinance to provide emergency first aid at the scene of an accident or illness, and transportation to the nearest emergency medical facility. An integral part of EMS is the establishment and operation of the emergency call, or 911 system. In Los Angeles, Operations Control Dispatch (OCD) channels calls for medical aid to specially trained personnel who triage demands based on pre-established protocols. Appropriate units are dispatched for treatment and, when necessary, transportation. Other key areas of EMS include training, billing, collection, and accounts receivable management. For purposes of fire suppression and EMS, the city is divided into three districts, each of which has five or six battalions. Each battalion is approximately one-sixteenth of the city.

The 1993/94 budget for the City of Los Angeles appropriates $57.6 million to EMS, and anticipates $14 million in revenues from these activities (see Table 1). Involving the full-time participation of 466 Fire Department personnel, 99 percent of whom serve in the field, the cost per transport to the city is $476 ($360 when receipts have been subtracted).

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EMS provision has historically been the domain of local fire departments and hospitals. With the Vietnam War, however, came the increased recognition of the benefits of sophisticated prehospital care. A seminal study by the National Research Council reinforced these findings and led to the National Highway Safety Act of 1966, which provided funds for ambulances, training and communication. As a result, a number of small private ambulance service companies were established to handle the burgeoning emergency transport market.

By the 1970s, however, private companies had gained a reputation for inconsistent quality, due primarily to bad system design. Aided by federal subsidies (Federal Emergency Medical Services Acts of 1973 and 1976), municipalities once again became dominant providers of EMS. During the 1980s, however, as federal monies began to dry up and cities began to experience fiscal crises, many began to question whether these services might be provided more efficiently by the private sector. These sentiments were reinforced by dramatic changes in the industry by way of acquisition/consolidation, increased technological sophistication, better contracts and increased accountability (see Appendix I).

In Los Angeles, as well as in the majority of nonrural communities, the fire department is designated the first responder to 911 emergencies. Ambulances, which are typically dispatched as second responders, provide additional support and transport to a hospital, if needed. In public/private systems, some or all of the transport component is provided by private ambulance companies. While EMS systems vary from location to location, for the most part they can be categorized by the provider types in Table 2.

Table 2

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* Check one option in each column. Checks shown indicate most efficient configuration.**

** Options for provision of the other 10 components not shown.

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While many cities depend exclusively on their fire departments for all aspects of emergency first aid and transport, this alternative is rarely efficient or cost-effective. While fires occur unexpectedly, there are both geographic and temporal patterns associated with injury and accident volume. In fact, there is a fairly predictable 400-percent fluctuation in demand during the course of a week. Thus, while it might make sense for the purpose of fire suppression to spread stations out equally over the city and to have the same number of personnel staffing these stations around the clock (constant manning or staffing), it does not make sense for the purposes of ambulance services.

Fire departments, however, tend to approach EMS and fire suppression functions in the same fashion. Because resources are housed in existing structures, major innovations in geographic deployment are difficult. While more responsive staffing may seem to be a logical solution, there is tremendous resistance to change, in part, because current practices have arisen out of 300 years of tradition. By failing to match resources with demand, however, public provision of EMS can both squander money and jeopardize public safety.

An additional area of inefficiency in many municipal EMS systems which also endangers patients is access. Because callers are not equipped to assess their own emergency care needs, they often dial 911 for nonemergencies or call a nonemergency provider when they need more immediate or intensive treatment. Many private systems, however, eliminate these problems because all ambulance requests, regardless of whether the caller has dialed 911 or a seven-digit number, terminate at a single dispatch center. These calls are received by paramedics who, rather than screen calls to determine if a response is necessary and who or what type of unit should respond, follow a protocol which results in an emergency ambulance, staffed by at least one paramedic, being sent to every call (priority dispatch).

The demand for increasingly high levels of pre-hospital care, along with significant involvement of third party payers and accompanying insurance-related concerns, is moving EMS from the public safety to the public health realm. While a fire department does an unparalleled job in the former arena (including first response and basic life support), the complexities of the latter suggest that there may be benefits to transferring EMS to health care providers. This need becomes especially apparent in light of decreasing resources and municipal budget crises.

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Publications of the National Association of EMS Physicians, the American College of Emergency Physicians, and the American Ambulance Association recognize 12 functional components of an EMS system. The performance of two such componentsfirst response and ambulance services has been shown in clinical studies to directly alter survival chances for some patients. The experiences of numerous local governments reveal that different methods of organizing delivery of these services i.e., differences in EMS system design produce dramatic differences in clinical performance, economic efficiency, and cost to local taxpayers. In fact, an inverse relationship has been found between local tax subsidy and quality of care, i.e., the higher a system's level of subsidy, the worse its overall quality. This chapter stresses the importance of sound EMS system design, with special emphasis on opportunities for simultaneously improving the quality and economic efficiency of the system's ambulance service component.

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The cost and quality of the ambulance service component of the Los Angeles EMS system are typical of those experienced by other urban systems of comparable design. However, when compared with urban EMS systems of more recent design i.e., high performance systems designed to deliver above-average service at below-average cost the ambulance component of the Los Angeles system does not measure up well. The Los Angeles system is significantly more expensive, in both cost per patient transport ($476) and annual per capita local tax subsidy ($12.50).

It is important to understand that the only effect of ambulance service subsidy is a reduction of user fees to below-cost levels. That is, the higher the amount of subsidy, the lower the user fee required to balance the budget. At zero subsidy, user-fee charges must cover the full cost of service, including bad debt and the portion of bills which certain providers (e.g., Medicare) will not reimburse. Based on current costs and collection rates, were the subsidy reduced to zero, ambulance service user fees sufficient to fund the ambulance service component of the Los Angeles system would average $992 per patient transport. This amount is several times the levels required to fund the ambulance service component of high-performance systems providing superior service in other urban areas, often without local tax subsidy.

But in spite of the city's generous taxpayer funding of ambulance services, the resulting clinical quality and response time reliability are inferior to those found in systems operating at substantially lower cost and subsidy levels. In fact, the current quality of city-funded ambulance service would constitute a major default of contract standards in many high-performance systems. The profound inability of the Los Angeles system to efficiently convert dollars into service stems directly from defects in the EMS system design. One of the EMS industry's oldest designs, the Los Angeles EMS system was implemented long before superior designs were conceived and tested. Based on conservative extrapolation from the financial track records of urban high performance systems, net annual taxpayer savings of over $30 million should be possible, with simultaneous improvement of clinical performance and response-time reliability.

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Every EMS system generating high levels of clinical and economic performance exhibits three key system design characteristics. These are:

Firefighter First Response Teamed with Private Ambulance Service. High performance EMS is not the result of either privatizing or socializing the EMS system. Rather, high performance systems assign to the fire department that EMS component which experience has shown can be provided most efficiently by fire departments: first response. Simultaneously, the architects of high performance systems assign to a qualified private firm that EMS component which experience has shown can be provided most efficiently by the private sector: ambulance service. Thus, the benefits of high performance EMS are achieved by effectively blending the best capabilities of the fire service industry with the best capabilities of the private ambulance industry.

This public-private partnership does not represent a duplication of effort. In many cases, a fire truck with an emergency medical technician (EMT)-trained firefighter and a defibrilator can reach the scene within three minutes or less at low cost, taking immediate life-saving action. More extensive medical treatment and transport to hospital (if needed) requires specialized equipment and personnel, which cost significantly more and can usually be provided more economically by the private sector (for the reasons discussed below).

Flexible Production Strategy. In the early 1970s, the federal government embraced and promoted the concept of the specialized production strategy i.e., the notion that money could be saved with an acceptable risk to the public by specializing ambulance fleets according to clinical capability. The idea was to use telephone call screening and on-scene patient hand-offs so that a limited number of paramedic ambulances would be sufficient to handle life-threatening emergencies. Less-capable (and less-expensive) crews would thus handle nonlife-threatening emergencies, and nonemergency calls to private seven-dispatch numbers would be handled by still other fleets under separate dispatch control.

The specialized production strategy was conceived without a clear understanding of the temporal and geographic patterns of demand for ambulance service, and thus failed universally to generate the predicted efficiencies. Today, every urban ambulance service capable of delivering high-quality paramedic care within eight minutes or less to 90 percent or more of life-threatening emergencies, with annual local tax subsidy of less than $4 per capita, has abandoned the specialized production strategy in favor of the flexible production strategy.

The flexible production strategyCusing a single ambulance fleet of all-Advanced Life Support (paramedic) vehicles safely achieves levels of productivity double and even triple those common in specialized systems. It makes use of a single fleet of precision-deployed (by time and area) paramedic ambulances, each capable of meeting any customer's medical transportation needs without resorting to telephone call-screening, refusals to transport, rejection of hospitals of choice, or patient hand-offs to less-capable crews.

Higher productivity, reduced overhead costs, better economies of scale, stronger disaster response and overload capability, opportunity for precision deployment of all ambulance units, and funding of fixed operating costs from nonemergency and interfacility transport work . . . these and other factors combine to create and sustain the overwhelming performance advantage of the flexible production strategy over the specialized production strategy which now prevails in the Los Angeles EMS system.

Performance-Based Commitment and Enforcement. The third characteristic shared by communities enjoying the benefits of high-performance ambulance services is a clear and certain knowledge that the private providerCnot the local taxpayerCwill suffer the financial consequences of any failure to predict or control costs. Equally important is the certainty that chronic failure to deliver the promised quality of service and response- time reliability, equally among all neighborhoods of the community, and to every patient regardless of ability to pay, will result in replacement of the defaulting firm by a better-qualified organization (and not by increased funding to attempt to correct the problem).

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The kind of public-private partnership described above involves contracting with the private sector for the entire ambulance component of the EMS system, using a flexible production system. This approach contrasts sharply with the contracting-out proposal currently being considered by LAFD and the Fire Commission. Under the LAFD proposal, the fire department would continue to provide the ALS component with the private sector providing nonemergency BLS call response (in addition to routine transport). If approved as currently proposed, private providers would bid for exclusive operating areas (EOAs), which would consist of one or more battalions. The goal of this program, as stated in the proposal, is reducing the impact of nonemergency medical responses on Department resources. Estimated first year net cost savings are approximately $6.3 million.

Thus, LAFD proposes to retain the present specialized production system. The underlying economic logic behind the specialized production arrangement is that since only a small percentage of patients require ALS services, it is possible to save money by using less expensive units both to serve less seriously ill or injured patients and for routine transfer work. At the same time, the more clinically sophisticated ALS units are reserved for more demanding cases.

In contrast, under flexible production strategies, every ambulance unit is equipped and staffed at the ALS (paramedic) level, and ALS units are sent to every request for serviceCboth emergency and nonemergency. By making every unit capable of handling every type of request for service, a higher level of peak-load emergency production capacity can be funded and maintained. In addition, because every unit is also used for less serious, nonemergency work, the surplus production capacity that would otherwise be wasted during off-peak periods is used for productive work.

As long-time EMS system design consultant Jack Stout explains, In a specialized system, because you are maintaining two fleets, half will be alternatively over- or under-utilized. During peak demand, ALS units will be overworked while the BLS are not being used. During off-peak hours the reverse will occur.

Furthermore, the collection rate from nonemergency work is much higher than that of emergency workCsometimes nearly double. In this regard, even if the charges for emergency runs are higher, the dollars collected from emergency and nonemergency runs might be the same, with the costs associated with the latter much lower. A private provider that uses the generalized production strategy can subsidize the higher-cost calls with the lower-cost calls. However, a city that contracts with a provider only for nonemergency calls is likely to see critical resources being drained out of the system.

Numerous applications of flexible production in a number of medium and large cities have led industry experts to believe that it produces superior economic performanceCat any level of clinical and response time reliability. Therefore, the flexible production approach is what is recommeded for Los Angeles in this report. In addition, all systems discussed below as best practices examples operate under this strategy.

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While the EMS industry itself is complicated, there is one fairly straightforward performance measure: response times. While exact definitions vary, the term usually refers to the total elapsed time between the moment a verifiable address is obtained in the communications center and the moment the first responding [unit] arrives at scene....

Usually, reporting is done on a fractile basis, meaning that a city will dictate that a certain fraction of response times be within a given interval. For example, the city of San Diego requires a response time of 10 minutes or less for 93 percent of all paramedic calls dispatched. Las Vegas has a response time requirement of eight minutes or less for 90 percent of all calls. (Penalties are assessed for violations.) Los Angeles strives for the same standard. Sometimes more stringent requirements are placed on calls that require ALS than on those which are less urgent, requiring only BLS. For example, for nonlife-threatening calls which could become life-threatening, San Diego requires a maximum response time of 15 minutes. It is important to note that pursuit of a desirable fractile distribution requires a very different plan of geographic and temporal deployment than does that of a low average response time. (The latter measure could mask very slow response times and is far less sensitive.)

While performance times indicate whether a provider is meeting a minimum level of service delivery, two additional measures, the total system cost per unit hour and the unit hour utilization ratio (U:UH ratio), are used for determining the efficiency of the EMS provider. While these concepts are rarely calculated by municipal providers, they have been called the essential missing link between the operating budget and the cost per patient served, and provide a basis for determining what total system costs should be.

The cost per unit hour is the total production cost during a given accounting period divided by the total number of unit hours produced during that same accounting period. The result tells how well resources are being utilized. In Los Angeles, according to Chief William Bamattre, Commander of the Planning Section, two to three of the department's 65 rescue ambulances are out of rotation for training purposes while another two to three are out of service for repairs. Thus, if 60 paramedic ambulances are staffed each day and ready to respond, the unit hours produced for the day equal 60 X 24 or 1,440. The unit hour cost, thus, would be the total budget divided by 365, divided by 1,440, or roughly $110 (see Table 3).

At a recent LAFD budget hearing, however, it was revealed that at any given time, 12 ambulances are out of service for repairs. In this scenario, the unit hours produced each day would total only 1,224, with the resulting unit hour cost approximately $129. In the EMS industry, excessive costs per unit hour can result from top-heavy administration, above-market wages, poor economies of scale, overtime pay from ineffective staffing procedures, bad management and poor system design.

In general, more clinically sophisticated unit hours cost more to produce than less clinically sophisticated unit hours. However, even in systems using the most expensive vehicles and on-board equipment, and technologically advanced computer and communications equipment, the amortized costs of these production factors comprise only about 20 percent of operating costs. Labor, on the other hand, should account for 65 percent of unit hour costs, with overhead and administration, maintenance and fuels, supplies, medical quality control, costs of billings and other miscellaneous costs making up the balance.

Table 3

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In high performance systems where the best use is made of financial resources available, total system costs per ALS unit hour typically range from about $45 in very large systems where fixed costs are spread over a large production volume to around $90 per unit hour in smaller EMS systems. By the calculations shown above, LAFD's high unit hour costs, which range from $110 to $129, suggest that there are more effective ways to translate resources into performance.

While it is important to control unit hour costs, the effectiveness with which the unit hours are used is an even more critical consideration. The U:UH ratio is the total number of patient transports during any accounting period divided by the total number of unit hours produced during that same period. Put more simply, it is the time required for a unit to answer a call (including transporting the patient) and then be ready for the next call. Thus, a U:UH ratio of 0.5 means that an ambulance can accomplish the above tasks in two hours (1 divided by 0.5 = 2).

The U:UH ratio has been called the most widely accepted indicator of effective scheduling, deployment, redeployment and dispatching practices in the ambulance industry. Higher ratios mean lower costs per patient served. While LAFD's estimated range of U:UH ratiosC0.23 to .27 based on the above unit hour calculationsCwould be considered reasonable for a municipal provider, several industry consultants as well as high ranking personnel from other fire departments commented that the proportion of requests that result in transportsCapproximately 35 percentCis alarmingly low. If the percentage were higher, the U:UH ratio would be even lower.

This measure is influenced by two competing influences. First, as response time requirements become increasingly stringent, the provider is forced to maintain and support increasing levels of surplus production capacity to handle demand pattern fluctuations. These factors lower the U:UH ratio, increasing the cost per patient served. For example, with an eight minute, 90 percent requirement, Kansas City's EMS system achieves a 0.39 U:UH ratio. However, with a less stringent standardCeleven minutes for 90 percent of callsCthe ratio would be 0.50. Furthermore, every .01 change in Kansas City's U:UH ratio results in a $170,000 difference in the bottom line. Similarly, as the number of available ambulances in Los Angeles increases, the U:UH ratio decreases.

Conversely, new and innovative staffing and deployment techniques minimize the level of surplus production capacity that must be maintained. In accomplishing this goal, these factors raise the U:UH ratio while enabling the provider to meet or exceed response time standards established by the community.

One such innovation is peak-load staffing. The 24-hour (constant) staffing practice used by many fire departments (including LAFD) is, in the words of Donald J. Jones, vice president of Strategic Business Development at MedTrans, an extraordinarily inefficient way of delivering service. Because of the large (and predictable) demand fluctuations for EMS, optimizing resource usage along these patterns, instead of constant-manning, could reduce the numbers of hours paid for by 25 percent and improve response time. For Los Angeles, where labor accounts for approximately $30 million of the EMS budget, these savings alone could be in the neighborhood of $7.5 million per year.

In addition to response time reliability (usually required by statute, ordinance or contract) and staffing, the major factors affecting the U:UH ratio are geographic density of demand for service, size and shape of service area, road systems and traffic flow, and level of expertise in system management. The highest overall U:UH ratios achieved in urban settings range from about 0.30 in more-difficult-to-serve communities to as high as 0.45 in easier-to-serve communities. The two highest-productivity systems in the country are in Las Vegas, which boasts a 0.50 U:UH ratio (or one patient per two hours on duty), and Pinellas County, Florida, which achieves U:UH levels between 0.50-0.60 (the latter responding to 95 percent of all calls in 4.5 to 5 minutes!)

Urban systems using traditional staffing, deployment and dispatching techniques can expect levels of productivity that are from three to five times lower. A few years ago, San Diego operated under the specialized production strategy, while Fort Worth, TX had an all-ALS fleet. The cities contracted with the same provider and had similar EMS demand profiles. Because San Diego's response requirement was less stringent (11 minutes for 90 percent of calls as opposed to Fort Worth's eight minute requirement) and the city was more densely populated, one would have expected it to have a higher U:UH ratio. However, its productivity level was 0.23 compared to Fort Worth's 0.37. This difference has been attributed solely to Fort Worth's use of the generalized production strategy.

Finally, whether economies of scale can be (and are being) realized influences the U:UH ratio as well as unit- hour costs. The minimum population base to support a reasonably efficient EMS system is approximately 200,000 people, more if there are multiple providers and if specialized production is used. The maximum service area for achieving economies of scale is thought to be 1.2 million. In 1988, the cost per unit hour of efficient providers serving populations of one million or more was approximately 35 percent less than that of equally efficient firms serving populations one quarter to one half that size.

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In the 1988 report, Savings A.S.A.P.: Alternative Service-Delivery Assessment Project, the Reason Foundation and the University of Miami Law & Economics Center estimated that contracting out of ambulance service in Los Angeles could result in savings of between 28 percent and 40 percent. Brenda Staffan, director of marketing/communications for the American Ambulance Association, confirmed that this range is in accordance with savings achieved by other cities. Applied to the current budget of $57.6 million, the range of savings would be $16 million to $23 million, with the resulting overall budget falling to between $34.5 million and $41.3 million.

A more detailed formula for determining the range of costs of an EMS system employs the U:UH ratios discussed above. To find out how many unit hours a provider will need to produce, one divides the number of transports per year by the high and low U:UH ratios. For Los Angeles' 121,000 transports, the unit hours required should be not more than 403,333 and not less than 268,889 unit hours annually (121,000 divided by 0.30 and 0.45 respectively).

Next, one determines the minimum and maximum total system costs of producing the required range of unit hours by multiplying the least optimistic unit hour production estimate by the least optimistic unit hour cost estimate (403,333 UH/yr. x $90/UH) and the most optimistic unit hour production estimate by the most optimistic unit-hour cost estimate (268,889 UH/yr. x $45/UH). Thus, based on the range of current unit-hour costs and the current productivity levels of reasonably efficient companies delivering quality ALS service with good response time reliability, the total annual cost of unit hour production should not be more than $36.3 million or less than $12.1 million.

The third step is adding in the cost of first-responder service. With medically trained EMS dispatchers and well-designed priority dispatching protocols, first responder service can be limited to between 40 percent and 50 percent of all emergency requests. This component of EMS can run as low as $27 (marginal cost per patient), including fuel, training, medical equipment, vehicle maintenance and depreciation. For the call volume in Los Angeles, the total cost of providing first responder services (for 50 percent of all calls) would be approximately $4,752,000 (176,000 x $27). Adding this figure to the above range, the total system cost per year, including marginal cost of first responder services, should not be more than $41,052,000 or less than $16,852,000. Thus, even at the high end, contracting out EMS could save the city more than $16 million annually; with the lowest likely private-sector cost, the savings would approach $41 million (Appendix II).

For further analysis, we will use the mid-range cost figure of $28,902,000. Dividing this figure (without subtracting revenues) by the total transport volume of 121,000 per year, the average cost per transport to the city would be $239Ccompared with the current cost (without subtracting revenues) of $476. Thus, efficiency gains from alternative service delivery would reduce the current cost per transport by nearly 50 percent.

The fact that the current price is higher than these estimated costs under contracting out does not mean the system would break even. With Los Angeles' current 48 percent collection rateCan average of $2.08 would have to be billed for each dollar collected. Thus, in order to generate sufficient revenue to cover these costs by means of fee-for-service billings, the retail pricing structure must include an adjustment to account for losses for uncollectibles. The resulting average price per transport would be in the neighborhood of $498. With a tax subsidy, however, average prices could be reduced by $2.08 ($1.72) for each $121,000 of local tax support (Appendix III).

However, the assumption that the collection rate under contracting out would remain at 48 percent needs to be questioned. The private sector has a generally superior record in collections to the public sector (except in some cases when the public sector contracts out the billing function). Table 4 provides comparative data on the cities discussed in the following section as best-practices examples of private EMS provision. As can be seen, their collection rates (here defined as revenues divided by collectibles, the same as LAFD's definition) range from 62 percent to 85 percent. It seems reasonable to project that a Los Angeles EMS system revised along these lines should achieve at least a 60-percent collection rate. Hence, the prices shown in Appendix III for the 60 percent rate are more representative of the contracted-out case than those based on a 48 percent rate.

Table 4

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We can summarize the cost implications of contracting out ambulance service as shown in the accompanying box. Contracting would dramatically lower the cost of EMS ambulance services in Los Angeles, from $57.6 million at present to an estimated $29.9 million. Because of the higher collection rate, it would increase revenues from the present $12 million to an estimated $15 million. Hence, the net taxpayer cost (expenses minus revenues) would drop from today's $45.6 million to just $14.9 million. This would mean a savings of two-thirds of the present cost, saving $30.7 million per year (see Table 5).

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Of the largest 200 cities in the United States, 50 have contracted out elements of their EMS systems. Of these, 25 percent of the cities have put transport exclusively in the hands of the private sector, while 17 percent divide this component between the fire department and private companies. Many counties have contracted out EMS as well. Los Angeles County turns to the private sector for BLS transport, granting five-year contracts (with opportunities for one year extensions up to five years) for 11 different exclusive operating areas. Other cities and counties which contract out in California include Santa Barbara, San Diego, San Jose and Oakland.

For several reasons, it is not a fruitful exercise to compare overall EMS budgets from different cities. First of all, one might not be comparing like items because of vast differences in system designs. In addition, different municipalities classify items in different ways. For example, when asked San Diego's total EMS budget, the contract administrator quoted the line item in the budget, which was $412,225. This figure included only the salary of the contract administrator ($52,000), ambulance purchase and communications equipment ($313,000) and administrative overhead ($47,225). When asked if further costs were involved, the city official conferred with others and came back with $859,000, which included equipment and training for EMTs and paramedics plus medic service to outlying areas. Fire department personnel, even though they provide first responder service, were not factored in because they would be there anyway. (The total fire department budget for San Diego is $68.9 million.)

In addition, for a variety of reasons, fire departments are often unable to provide estimates of cost savings due to privatization. For example, Los Angeles County and San Diego both said they had not previously been in the business of ambulance provisionCthus, there was no basis for a before-after comparison. In addition, because contracting out is a process that takes place over time, there are no clean before and after points. Early estimates are confounded by phased-in implementation, while estimates years later might be measuring a system whose demands have increased. Finally, because some EMS budgets, like San Diego's, do not include all fire department personnel who are involved, the amount in savings will mean different things to different cities.

According to The Fourth Party, an independent consulting organization serving the paramedic and ambulance industries, LAFD's unit costs (of $476 using AAA recommended calculations) are high compared with those municipalities that have contracted out all transports. They note a number of cities that have contracted at which boast high performance EMS systems [that] provide full-cost paramedic ambulance services for less than $160 total cost per patient transported.

Because of LAFD's high costs, it is virtually certain that the fees charged for transportCan average of $393 per ALS transport (base price = $338) and an average $180 per BLS transport (base price = $147)Cwill fall short of covering costs (see Table 6). (These figures, however, provided by the CAO, differ from LAFD's estimates of $350B$375 for ALS and $125B$155 for BLS.) The deficit is ensured by the city's low collection rates. According to the City Administrative Office, LAFD's collection rate is 48 percent, which places it in the middle of the industry-wide range of 40B60 percent. While the city is not in the ambulance business to turn a profit, these factors make the provision of EMS a very costly service. As a point of comparison, San Diego's RFP quotes a collection rate of 57.35 percent.

Table 6

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Source: Los Angeles City Administrative Office

For the 1993/94 fiscal year, Los Angeles' net revenues for EMS are projected at $14 million, which works out to only $115 per transport. Because this figure is a small fraction of costsCALS or BLSCtaxpayers will pay a subsidy of approximately $12.50 per person ($57.6 million minus $14 million divided by 3.5 million people. Without subtracting the revenue, the subsidy works out to $16.50 per person.) The average subsidy for metropolitan areas is somewhere between $6 and $8 per person. Other cities that have successfully contracted out at little cost to the taxpayer are Kansas City, Las Vegas, Syracuse, Fort Wayne and Little Rock, whose subsidies per capita per year are less than $3, and Fort Worth and San Diego, whose subsidies are less than $6 (see Figure 1).

In some cities, ambulance services can be provided to customers on a subscription basis. These programs, like auto-club emergency road service programs, protect residents from out-of-pocket costs at the time of use, in exchange for an annual fee. Such a payment method has advantages and disadvantages. While members receive whatever ambulance services they need for a relatively modest cost, nonsubscribers, who are often those individuals who can least afford it, are charged the full fee.

There are a number of licensed private ambulance companies in Los Angeles currently providing general transport (for individuals who require medical supervision en route to health care facilities). This type of call accounts for approximately 30 percent of the industry nationwide and includes the following categories: inter-hospital transport, critical care transport and elderly or handicapped transport. The Los Angeles telephone directory lists some dozen private providers. Some of the largest companies providing such service are Goodhew, Mauran and Schaeffer, which participated in the pilot project which serves as the basis for the city's current contracting-out plans for nonemergency BLS transport. In addition, many reputable private providers are currently providing BLS service for unincorporated areas.

Furthermore, with the recent industry trend toward consolidation in the ambulance industry, some of the largest providers are serving multiple cities, both regionally and nationally. For example, American Medical Response provides emergency response and general ambulance service in nine states. CareLine serves Southern California; LifeFleet, Southern California, the South and Northwest; Chaulk Ambulance, the Northeast; Rural/Metro in the Southeast and West; and Mercy Ambulance, the Midwest and South. Laidlaw, recently entered the EMS arena with its purchase of National Medical Transport Network (MedTrans), a large private consolidator. Thus, competition for Los Angeles's considerable market for EMS would most likely not be limited to local firms.

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Figure 1

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V.EXPERIENCE IN OTHER CITIES

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The best examples of EMS contracting out, as explained above, are public/private partnerships in which the city fire department provides first-responder services and a single private ambulance contractor is responsible for all transports using an all-ALS fleet. This cost-effective arrangement combines the organizational stability, reliability and community support of the fire department with the innovations and efficiencies of the private sector.

Such systems can be found in Las Vegas, Pinellas County (Florida), Kansas City, Syracuse and Fort Worth. These systems provide consistently high levels of service without excessively high user fees and with very low (or no) taxpayer subsidy. Some of the common features associated with their efficiency and effectiveness include the following:

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APriority dispatch by paramedics replaces call-screening;

AThe all-ALS fleet (working in concert with the fire department first-responders) eliminates the risks of sending the wrong unit;

AProviders are held to strict standards of response time reliability;

APeak-load staffing replaces 24-hour shifts; and

ASystem status management (moving resources according to demand) replaces static deployment.

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While some features of San Diego's EMS system vary slightly from the above examples (for example, the city has implemented municipal medical service for hard-to-reach areas), it also provides outstanding levels of service at little taxpayer cost. It is the largest city to have an exclusive contract for the provision of ambulance transport.

While most of the systems mentioned above are operated as exclusive franchises, others, including Pinellas County and Fort Worth employ a particularly innovative design called the public utility model (PUM). Under this arrangement, a separate quasi-governmental authority owns the infrastructure, supervises the contract and performs billing and collection services. (In San Diego the provider uses city-owned vehicles, while in Las Vegas, the provider supplies vehicles and other equipment.) Similar to an airport authority, this entity, managed by a paid executive director and governed by a board of directors, pays the ambulance provider a monthly management fee.

The public utility model is thought to align the needs of the public most closely with the interests of the contractor. Because of the payment arrangement, the contractor does not need to be concerned with billings and patients' ability to pay, but rather, can focus on meeting performance and other contractual requirements in the most cost-effective way possible. (The management fee, as it is not linked directly to billings or volume, thwarts any motive on the part of the provider to induce demand or give unnecessary treatments.) The more economically the contractor provides service (without sacrificing quality), the greater its financial reward.

The efficiencies in PUM systems often improve over time as the provider incorporates unique and increasingly advanced techniques. Last year, SunStar, which provides emergency and nonemergency medical first response and transport to the 900,000 residents of Pinellas County (plus one to two million tourists at any given time), returned a profit of $8 million to the County. This system, the largest exclusive contract in the country, is also noteworthy in that it boasts a response time between four and five minutes for 95 percent of all calls. Their total budget for the 1992/93 fiscal year was $43 million, there were 166,000 emergency responses and 104,000 transports. According to Barry M. Mogil, Director of EMS for Pinellas County Fire Department, the fee-for-service component (transport) subsidizes the fire department's first response, and exception care is provided to all calls.

Because of the geographic size and population of Los Angeles, however, it would not be economically optimal for the city to grant an exclusive contract to a single provider as in the above examples. Rather, the city should be divided into at least two zones, with exclusive contracts for each zone. A single communications center would suffice.

Not all contracting-out experiences have been positive. However, an understanding of what can go wrong and what to avoid is a valuable component in any procurement process. At the most basic level, it is critical to have a well-crafted Request for Proposals. Jerry Overton of the Richmond Ambulance

Authority is currently faced with the challenge of administering an RFP that is riddled with inconsistencies. The lessonCas with any privatization effortCis that the cleaner and more straightforward this document, the fewer problems that will arise.

Another potential problem is that of a contractor going bankrupt. This predicament has especially dire repercussions when the provider involved has been awarded an exclusive contract, and especially in a field such as EMS where public safety is involved. One city in which such a scenario occurred was Eugene, Oregon. In order to mitigate such outcomes, cities need to address the issue in detail in their RFPs, using such security measures as pre-qualification of bidders, performance bonds, government-owned accounts receivable, and conditional or three-way leases. Another problem occurred in Tulsa, again, under an exclusive franchise model, where a provider virtually blackmailed the city into paying an additional subsidy under threat of shutdown. These scenarios have led some cities to switch from the franchise model to a PUM.

While many concerns have arisen over massive layoffs of fire department personnel, experiences in other cities have shown that this scenario need not occur. Rather, because existing private providers will have to hire additional staff to meet demand, there are usually ample opportunities for employment of existing EMS personnel with the private firm(s), where wages are at least equal and often higher. The latter is possible due to higher personnel standards and greater efficiencies which are converted into compensation. Because of the high turnover rate in fire departments and the small percentage of paramedics relative to fire suppression personnel, those who do not apply for work with the private sector can usually be absorbed through attrition and promotion. EMS Consultant Jack Stout estimates that in Dallas, which is contemplating a spectrum of privatization alternatives, the personnel turnover would take approximately 18B19 months.

Nevertheless, the prospect of contracting out encounters strong opposition from fire department personnel. While the demand for fire suppression is declining, the costs associated with it have increasedCat a time when cities are facing financial crises. EMS is a highly visible service which enables fire departments to maintain high funding levels in light of the above trends. In addition, fire unions view EMS as a source for extra money (tech pay) for personnel, since each additional task performed results in additional pay. Finally, fire fighters enjoy doing EMS work. Not only is this aspect of their jobs both exciting and rewarding, but it also alleviates the inevitable periods of boredom that are associated with waiting for fire- suppression opportunities.

Additional concerns have been encountered in the area of antitrust laws. Dan Smiley, chief deputy director of the California Ambulance Authority, notes that all the exclusive contract models, which are associated with the highest levels of efficiency, are regulated monopolies, with the variations revolving around the degree of regulation and the number of safeguards. The primary disadvantage associated with these models is the elimination of consumer choice among competing providers of routine transport. In most instances, however, the loss of competition within the market is offset by cost savings from the competitive bidding process.

From a legal standpoint, as long as there is such a process, antitrust laws are not violated. This viewpoint was argued and upheld in the United States Court of Appeals, Ninth Circuit. Mercy-Peninsula Ambulance, a private ambulance company, brought an antitrust action against the County of San Mateo, challenging the county's grant of exclusive contracts to other private providers for paramedic services. The court held that the contract, after competitive bidding, was subject to state action immunity from antitrust liability (California Health & Safety Code, 1797-1799.110, 1798.200(j); Sherman Antitrust Act, 1 et seq., 15 U.S.C.A., 1 et seq.).

Because EMS is inherently so complex, redesigning the system along the lines recommended here must be undertaken with care. Because many other large urban areas have already taken this step, Los Angeles does not have to re-invent the wheel. One of the best ways to profit from their experience is for the city to make use of a comprehensive new guide to contracting for EMS ambulance services and system design, published in 1994 by the American Ambulance Association. This comprehensive 154-page manual thoroughly reviews the issues discussed in this chapter, and includes a checklist for EMS bidding and contracting. It is an essential resource for cities contemplating a shift to the flexible production approach recommended here.

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The choice of a specific EMS model is a tremendously complicated process, based on political and economic considerations, and is beyond the scope of this study. The advantages to contracting out, however, can be considerable. Better spatial and temporal deployment and more efficient staffing offered by the private sector lead not only to superior cost-containment and cost savings, but also to higher levels of service. Safeguards can be implemented to ensure continuity, and the private sector provider not only has financial incentives to provide service efficiently, but also faces the threat of replacement in the event of inadequate performance.

While there is resistance on the part of fire department personnel, experiences in other cities have shown that layoffs are not inevitable and that city paramedics who so desire can find employment with the private provider(s), where wages are commensurate or higher. Antitrust concerns can be eliminated through a competitive bidding process, which will also ensure that the most qualified provider is selected. Finally, there is no evidence of contractors refusing to provide service to low- income areas or of inferior service for such communities.

While many of the possible alternatives for privatization of ambulance service are still being tested, a number of cities that have fully privatized systems provide consistently high levels of service at low taxpayer cost. In many instances, these systems have replaced costly, inefficient systems that posed a threat to public safety. While all evidence indicates that LAFD is currently providing high levels of pre-hospital care, the costs of this service in light of scarce resourcesCcombined with the ongoing shift of EMS from the public safety to the public health realmCsuggest that contracting out (at higher levels than currently under consideration) should be fully investigated. The cost savings to the taxpayers of Los Angeles can be expected to be at least $16 million per year, and as much as $41 million per year.

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APPENDIX I: Ambulance Industry Trends

Acquisition/Consolidation: The private sector of the ambulance services industry is consolidating rapidly with regional and national firms establishing networks of providers by acquiring local private ambulance providers. By combining several smaller operators in a given market, larger providers can realize significant operating and financial synergies in areas such as asset utilization, reimbursement and purchasing. In addition, it becomes more economically feasible to invest in new technologies, such as satellite-based tracking systems as the population base of the service area increases. Since investing in such technology requires significant capital commitments, larger companies should have an advantage as they will be more capable of securing the required financing. The net result is that they will be in a position to offer higher quality of service at a lower overall cost to the community.

Technological Sophistication: During the past decade, EMS 911 systems have become increasingly complex and technologically sophisticated. Advances in both dispatching systems and medical equipment have improved significantly the quality of care that ambulance providers are able to deliver. However, as the level of sophistication increases, so do the required managerial expertise and capital investment. Because of the perception that it is better positioned to attract such resources, the private sector has had a superior record of keeping up with and implementing new technologies. This advantage has enabled the private sector to run efficient operations and to achieve the quality demanded by municipalitiesCat a lower overall cost to taxpayers.

Development of Better Contracts: The initial absence of standardized contracts between municipalities and the private 911 emergency response sector resulted in inconsistent levels of service from private ambulance providers. The development of comprehensive standard contracts, however, has given better protections to municipalities, enabling them to monitor private providers' performance closely, giving them greater confidence in the private sector and leading to a greater willingness on their part to privatize EMS.

Accountability: Closely linked with the development of better contracts is the enhanced ability of municipalities to hold providers accountable. Aided by the development of more sophisticated computer systems, the provider bears the burden of demonstrating compliance with contracted objective performance standards.

Source: Montgomery Securities report on Ambulance Industry

APPENDIX II: Derivation of Cost Savings

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+121,000/.30 = 268,889 (low)

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ÙMultiply least (most) optimistic unit hour production estimate by the least (most) optimistic unit hour cost estimate to determine minimum (maximum) total system costs of producing required range of unit hours

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+268,889 UH/yr. x $45/UH = $12 million

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ÚAdd cost of first responder service (50% of all emergency requests multiplied by marginal cost per first response)

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ÛTotal cost, high estimate: $41,052,000

Total cost, low estimate: $16,752,000

Current cost: $57,600,000

Ü Cost savings using upper-range value: $16 million annually

Cost savings using lower-range value: $41 million annually

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APPENDIX III: Tax SubsidiesCPrice Schedule

A. Zero Subsidy Pricing Level

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$29,902,000/121,000 = $239 = cost/transport

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+$239/.60 = $398 with 60% collection rate

B. $2.00 Subsidy Per Capita

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$21,902,000/121,000 = $181 = cost/transport

+$181/.48 = $377 with 48% collection rate

$181/.60 = $302 with 60% collection rate

C. $4.00 Subsidy Per Capita

-

$14,902,000/121,000 = $123 = cost/transport

+$123/.48 = $257 with 48% collection rate

$123/.60 - $205 with 60% collection rate

D. $6.00 Subsidy Per Capita

-

$7,902,000/121,000 = $65 = cost/transport

+$65/.48 = $135 with 48% collection rate

$65/.60 = $108 with 60% collection rate

E. Current System Configuration

$57,600,000/121,000 = $476.03 = cost/transport

+$476/.48 = $991.67 with current 48% collection rate

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Two types of costs are considered in evaluating the City of Los Angeles' workers' compensation program: 1) The compensation benefits paid to city employees; and 2) the operating cost of administering workers' compensation claims. The City of Los Angeles currently pays out roughly $86.4 million in workers' compensation benefits to its city employees, and incurs an estimated $7.6 million for the cost of operation. If workers' compensation administration is contracted out, the city can expect to save approximately $22.4 million in the first year of change. A detailed analysis is provided in this chapter which includes a larger savings range.

The city should not expect to save in the area of administration. Third Party Administrators (TPAs) normally provide an array of additional services which means a slight increase in operating costs. Although these expanded services may increase operating costs, this increase is outweighed by the substantial savings in compensation expenditures. Savings in compensation expenditures are primarily achieved by reducing the number of new and pending claims.

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A.Workers' Compensation in the City of Los Angeles

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Workers' Compensation Administration in the City of Los Angeles is causing financial problems to an already financially strapped city government. The Los Angeles system currently ranks among the highest in the nation in both claims submitted and costs. The system has also been the subject of recent allegations of mismanagement and fraud. According to a June 7, 1994 article in the Los Angeles Times, individuals in the Workers' Compensation Division are under both internal and criminal investigation for possible fraud and theft.

Moreover, a mayoral risk management task force also highlighted some important statistics which point toward a need for a major overhaul in the way the city manages its workers' compensation system. In a review of the system, it has been found that:

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ÙThe city pays $2,169 per employee for workers compensation as compared to $830 nationally.

ÚMany municipal employees make more while on disability than when they come to work.

ÛWorkers compensation administrators are grossly overburdened. They each handle an average of 1,700 cases compared to the industry standard of 250 cases.

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Despite these and other findings over the past two years from extensive studies of the Workers Compensation system, and despite some organizational changes, the major problems remain unresolved.

In November and December 1993, separate studies identified significant problems in both staffing and administration which are resulting in millions of dollars lost within the system. Over the past five years, workers' compensation payouts have increased by more than 80 percent.

The following report details how privatization can enhance both the quality of administration and potentially save the City of Los Angeles millions of dollars within a short period of time.

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The City of Los Angeles is currently self-insured for workers' compensation. Compensation benefits for work-related injuries experienced by city employees are paid out by the city as opposed to a private insurance company. All workers' compensation claims are handled through the Personnel Department's Workers Compensation Claims Division. The Division is separated into the following six specialized units:

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AThe Civilian Unit performs the same functions as the Sworn Unit. However, the unit handles the workers' compensation claims of those who are not sworn employees of the police and fire departments. The unit consists of 25 employees ranging from a Principal Workers' Compensation Analyst to Clerk Typists.

AThe Awards Section processes payment of temporary and permanent disability benefits after the Civilian and Sworn Units approve payment of benefits. It also processes payment of awards issued by the Workers' Compensation Appeals Board. The section is staffed by three employees, a Management Analyst, Accounting Clerk II and Accounting Clerk I.

AThe Payment Section approves and processes payment of vendor bills for medical services, field investigations, medical legal expenses and all other service providers. The section is staffed by nineteen employees including an Accounting Records Supervisor as well as Accounting Clerks and Clerk Typists.

AThe Vocational Rehabilitation Unit determines eligibility of city employees for vocational rehabilitation benefits within the California Labor Code. The unit processes payments of vocational rehabilitation benefits and controls the vocational rehabilitation process. The unit consists of nine employees ranging from Senior Personnel Analyst I to Accounting Clerk Typist.

AThe File Room Unit maintains the file room, processes file requests, delivers files to staff and oversees off-site storage of closed files. The unit is staffed by two Clerk Typists.

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The Workers' Compensation Claim Division has a total of 71 employees (83 are authorized). In addition, three employees report directly to the Division Chief and perform specialized functions: the Senior Clerk Typist, the Senior Workers' Compensation Analyst and the Senior Systems Analyst. Currently, not all positions are filled.

The City Attorney's Office also has a division assigned to workers' compensation claims. Eleven attorneys and 15 support staff receive applications from city employees who encounter problems with their compensation claims. The City Attorney's Workers' Compensation staff is mainly responsible for investigations and litigation of all dispute settlements.

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The following costs were provided by the city's Personnel Department and reflect workers' compensation payouts only (see Table 1).

Table 1

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The trend experienced in recent years has been a double-digit rise in workers' compensation expenditures annually, with a total increase of 80 percent in a five-year period.

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Claims frequency in California is the fourth highest among states, and is 25-percent higher than the national average. The City of Los Angeles receives approximately 10,000 new claims each year of which 40 percent are medical only and 60 percent are indemnity (same ratio for open claims). In 1989, a management audit by the City Administrative Officer reported open claims at 22,000. The number has now increased to 39,000. With 12,000 to 15,000 open claims eligible for closure, the 20 active analysts handle between 1,200 and 1,350 claims apiece. The unmanageable number of claims results in delayed actions on claims subjecting the city to penalties for violating the Labor Code. According to a report issued by Personnel's Workers' Compensation Division, given present staffing and organization, there is no reasonable expectation that the city will ever be able tocomply with all the requirements of the law. A private Third Party Administrator has been hired to try to close a portion of the cases.

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The escalation of workers' compensation costs for the City of Los Angeles has resulted in several evaluations of the in-house program. Two reports in particular have focussed on the structure and performance of the Workers' Compensation Division.

A study conducted by Warren, McVeigh & Griffin (Dec. 8, 1993) outlines the following problems and makes the following recommendations:

Organizational Problem: The Workers' Compensation Division is organized into highly specialized units, resulting in a lack of accountability, control and teamwork.

Recommendation: Reorganize in a manner that will lead to greater teamwork and provide clear lines of responsibility for the final completion of specific tasks.

Staffing Problem: The Division is not adequately staffed to properly administer an estimated current open inventory of approximately 20,000 indemnity claims. Technical staff is poorly trained and not qualified to perform duties of a Workers' Compensation Analyst.

Recommendation: Hire qualified staff, implement training programs, require personnel certification and restaff.

A second report involves the findings of the City of Los Angeles' Risk Management Subcommittee. Among the report's findings were the following:

Problems: Lack of accountability, indications of fraud, inadequate staffing and training, no organized Back-to-Work programs, no culture of risk management, poor information flow, fraud, questionable reporting structure, high number of open claims, and late reporting.

Recommendations: Departmental accountability for litigation, focus on fraud, train staff, establish goals to reduce claim frequency and severity, create investigation unit, modify payment structure, contract out for closure of old claims, contract out where possible and refine the RFP process.

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The General Manager of the Personnel Department has proposed a plan to improve the organization and performance of the Workers' Compensation Claim Division. For the Fiscal Year 1993B94, the budget for the Personnel Department's workers' compensation expenditures was $75 million (the actual cost was $71 million). For the Fiscal Year 1994B95, the proposed budget will be $66 million. Personnel's budget accounts for medical costs, indemnity costs (disability payments), vocational rehabilitation costs (retraining employees), and user assessment fees (to fund state activity fraud investigations). Injured On Duty (IOD) Salary Continuation payments, totaling $22 million last year, are paid by respective department salary accounts, and therefore, are not part of the budget discussed above. The plan is summarized in the Appendix.

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The only costs discussed thus far have involved workers' compensation payouts which are calculated annually. Operating costs, however, are not as readily available, primarily because they are often spread out among various departments and include hidden costs often overlooked and difficult to calculate. The operating cost of workers' compensation refers to costs such as payroll, fringe benefits, overhead, copy services and all other costs incurred in relation to the administration of workers' compensation claims.

The analysis of operating costs outlined below has been calculated with the assistance of staff members in both the Personnel Department and the City Attorney's Office. The intent is not to affirm complete accuracy, but rather to offer an estimate of full operating costt. All cost figures in Table 2 below represent annual amounts.

Table 2

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The above cost analysis has been provided as a base comparison to determine whether the city will experience cost savings if workers' compensation administration is contracted out. An important piece of cost information unattainable from the City Attorney's Office pertains to litigation costs. Since the number of litigated claims cannot be determined, a per-claim litigation cost cannot be calculated. Third Party Administrators offer legal services as part of their comprehensive program, saving their clients a substantial amount in litigation expenditures. Specific percentages in this area will be given below.

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In cities where workers' compensation administration is contracted out, programs have taken different shapes and forms. Typically, two major factors shape the overall program: 1) The nature of the in-house system (including costs, internal structure and problem areas); and 2) the Third Party Administrator's (TPAs) ability to be innovative and effective in reducing costs while enhancing the quality of service.

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Calculating potential cost savings for workers' compensation through contracting is difficult due to the complex nature of the program and its expenditures. For example, using operating cost per claim as a unit of analysis is problematic because it does not take into account the city's pending claims nor does it distinguish between claim types (medical-only claims require less time and work than indemnity claims). However, in order to provide at least a preliminary comparison, operating cost per claim was chosen as the unit of analysis. The following cost comparison has been calculated using limited cost information provided by the City of Los Angeles, other cities and their respective TPA's, and local TPA's.

Table 3

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2Averaged over three years.

3Averaged over five years.

4Projected amount given introduction of new services.

5Information not comparable to methodology used.

A successful workers' compensation program will control claims frequency which may actually increase the net operating cost per claim. According to the Mayor's Risk Management Task Force report, the city had 76 percent more claims than the other 27 governments studied and the city pays out 49 percent more for each claim than other government employers. Since operating costs are spread out among fewer claims, the amount per claim becomes inflated. This is evident in contacts with multiple-year options. Once in the fourth year, TPAs experience a rise in per-claim operating costs due to effective reductions in claims frequency.

Third Party Administrators offer a variety of additional services often not provided in-house. Thus, the cost of operation may be higher for TPAs than for internal administrators. A proper cost comparison will take into account these services and compare the cost of expanding the program in-house to the total cost of TPA services. The City of Philadelphia conducted this type of cost comparison and calculated a 30-percent savings in operating cost if the city contracted out the service. Furthermore, TPAs operating costs usually show incremental increases over the years of a contract due to salary increases, continuing benefits and inflation adjustments.

The comparison of operating costs does not produce consistent evidence in support of either substantial savings or losses to the City of Los Angeles if workers' compensation administration is contracted out. For example, the City of Dallas shows a low cost per claim, yet it is explained by their high percentage of medical-only claims which require less time and work. On the other hand, Houston's contractor, the Summit Group, shows a high cost per claim, which is explained by the large and diverse services they provide.

Nevertheless, TPAs interviewed agree that substantial savings are experienced in compensation expenditures due to an investment in better management, efficient systems and innovative services. Though this investment may result in slightly increased operating costs, more importantly, it results in substantial decreases in compensation payouts.

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B.Initial Cost Assessment

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TPAs evaluate pertinent in-house information to determine their own service charges. This information involves claims frequency and existing number of open claims. TPAs then determine the number of employees needed, their respective payroll and overhead costs along with a profit margin. This becomes the claims handling cost (comparable to the city's operating cost discussed above). Although the operating cost is important in characterizing in-house programs, savings in this area do not always occur. Generally, the bulk of savings is experienced in compensation payouts due to the effectiveness of administration and the implementation of efficient systems by a Third Party Administrator. The information needed to determine potential cost savings in compensation payouts includes, in addition to the information mentioned above, a breakdown of medical only/indemnity claims, a history of compensation payouts, a calculation of future payouts and the TPAs own resources and historical experience.

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Workers' Compensation administration public service is contracted out with the prospect of lowering costs and increasing the settlement and processing of claims. The TPAs interviewed for this study attest to having the resources and technology to administer the workers' compensation program more efficiently. In terms of staffing and caseloads, TPAs hire qualified claim adjusters and each is given a manageable number of claims, usually between 150 and 200. Another important component to improving efficiency is automation. The utilization of computer systems has facilitated injury reporting, data imputing, data transferring, cost analysis and file tracking.

-

Innovative and effective services are put into place by Third Party AdministratorsCoften in coordination with in-house personnelCto reduce compensation expenditures. This has been the key to cost savings in many of the cases reviewed for this study. These services/programs include: fraud investigation units, cost containment strategies (e.g. medical-bill reviews), injury-prevention workshops, medical-treatment reviews, and alternate job training programs (back-to-work programs). Successful workers' compensation programs have been those with a comprehensive approach in terms of offering innovative services and programs.

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The city can expect the majority of cost savings to come from reducing compensation expenditures (payouts). This area has various cost components including medical-only costs, temporary disability payments (includes salary continuations for lost time), permanent disability payments and rehabilitation costs (see Table 4). The strategy of any TPA is to intervene by targeting one or more of these cost components.

The methodology used to calculate potential savings for the City of Los Angeles involves an application of percentage savings experienced by other cities and the County of Los Angeles to the current city costs.

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Information made available from other cities currently contracting out workers' compensation administration include Philadelphia, Houston and Dallas. The City of Philadelphia has an innovative workers' compensation program which is coordinated by the Blue Cross and in-house personnel. The City of Houston has held a contract with The Summit Group for the past three years. On January 13, 1994, the City of Houston issued an RFP for continuation of TPA services. Proposals are currently under review. The City of Dallas contracted its workers' compensation administration in July of 1990 to Willis-Rollinson. As previously detailed locally, the County of Los Angeles contracts out its workers' compensation administration with Hertz Claim Management and Noetics.

Cost savings resultCat least in partCfrom the expertise of the Third Party Administrator's staff. For example, The Stockman Group and Hertz Claim Management reported substantial savings of up to 23 percent in legal fees due to the expertise and effectiveness of their own staff in controlling the number of cases litigated. This savings is manifested in both the medical and disability cost savings percentages. The savings percentages above are also the result of other efforts introduced by TPAs, e.g. fraud investigation units, back-to-work programs, medical bill audits, injury prevention seminars, and similar services.

Given the extreme savings range of 15 to 41.6 percent for medical costs, the City of Los Angeles could likely expect to save anywhere between $6,525,000 and $18,096,000 in medical costs by contracting out. However, a more realistic amount can be calculated by using the average savings of 26.5 percent which translates into a savings of $11,527,500. This average savings is supported by the percentages quoted by local TPAs.

In terms of disability payments, the spread of cost savings is even greater. With a range of 10 to 46 percent savings, the city can expect to save between $4,030,000 and $18,538,000. Again, we used the average of 27.1 percent which translates into a savings of $10,921,300.

To obtain a more accurate picture of cost savings, it is important to contact local Third Party Administrators. If the service is contracted out, it will probably be contracted to a local TPA. Due to time limitations, only two TPAs were contacted, Hertz Claim Management and The Stockman Group.

Hertz Claim Management (HCM) representatives offered insightful information regarding their claims-handling operation. HCM is one of the Third Party Administrators for the County of Los Angeles and is now involved in a pilot program for the City of Los Angeles (Workers' Compensation). HCM is a well established firm with offices all across the state. Presently, HCM handles workers' compensation claims and other claims (e.g. civil liability) for large and small firms, public or private.

HCM operates on a computerized network. The computerized system offers improvements in injury reporting, data imputing, data transferring, cost analysis and file tracking, and therefore, saves time and money. HCM provides an array of special services and programs that ultimately translate into cost savings for clients. Their strategy begins with expert analysts handling no more than 175 claims apiece. Once claims are controlledCwhich usually takes one to two yearsCHertz Claim Management uses the extra time and resources to shift priorities.

Besides the County, other clients include Bank of America and the Metropolitan Transportation Authority (MTA). Impressive results experienced by the MTA illustrate the ability of TPAs to effectively save their clients money while increasing the quality of service. Between 1988 and 1993, HCM reduced the MTA's new claims by 30.26 percent and their pending claims by 51.66 percent (closure of claims has remained nearly 100 percent). Compensation expenditures have been reduced by 46.57 percent, from $69 million to $37 million. Additionally, an average of 35 percent of total claim closures have been closed without payment. By contrast, the City of Los Angeles has experienced average annual increases of 12.6 percent over a five-year period.

The Stockman Group, also familiar with Los Angeles city numbers, quoted a potential 25-percent decrease in workers' compensation payouts for the City of Los Angeles. A representative for The

Stockman Group outlined their cost per claim quite differently than the analysis conducted above. The Stockman Group's unit of analysis (which includes both operating and compensation costs) is calculated using cost per claim per $100 payroll.

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A.City of Philadelphia

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The City of Philadelphia recently contracted with Blue Cross and a professional claims management firm to handle its workers' compensation claims. The winning bid was not yet available for review, and thus information was obtained from the Request for Proposal and the Economic Analysis.

The Philadelphia program has three important components working together to provide quality service and reduce costs:

Professional Claims Management has the responsibility for all claims processing, investigation, evaluation and management services relating to employee injuries on the job (providing legal support for compensation hearings is the responsibility of the city).

Single Care Provider. A single provider will manage a network of primary physicians, acute care facilities, specialist physicians and rehabilitative therapists under a capitated fee (i.e., maximum price) arrangement. The new single provider will be responsible for paying all out-of-network and workers' compensation medical care costs within its capitated fee (anticipated savings of 15 percent).

In-house Staff. A small Employee Disability Programs Unit will manage the contract and provide program coordination and oversight functions. The Law Department's Workers' Compensation unit will continue to provide legal support.

Benefits of the proposed approach include convenient access, stringent quality of care standards, phone-in injury reporting, expert occupational assessments (speedy return to work) and retraining for alternated employments.

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For the past three years, The Summit Group has handled workers' compensation claims for the City of Houston. Thus far, the City of Houston has experienced a 41.6 percent decrease in medical costs as well as a 46.15 percent decrease in disability payments. Lost time from work has been cut by 48.1 percent (from 62,265 to 32,341 lost days). In their proposal for renewal of services, The Summit Group projects further reductions in lost time by 20 percent, further reductions in medical costs by 15 percent, and detailed reporting to improve programs.

Summit working with The City's Workers' Compensation Program established a Claims Reporting System (CRS) to end compliance problems. The CRS program decreases the amount of paperwork which formerly flowed across the busy desk of the Compensation Director. The Houston-based operation allows information to begin flowing immediately and avoids bureaucratic delays. In pilot programs, CRS is being used to fast track injured city employees to the attention of vocational nurses. These nurses are informed of all injuries to department personnel, but only become involved with those injured employees matching a specific protocol. This allows the department to become involved in the process of getting an employee back to work from the beginning.

In terms of medical-only claims, the Summit philosophy is quality communication and early intervention. Every city worker who currently reports a medical-only injury receives two calls. The first checks up on the accuracy of the report to CRS. This call expresses the city's concern and determines if any lost-time problems may be expected. The second call tracks the first and insures that the worker is sticking to his own plan. The emphasis on communication and early intervention results in a decrease in bottom-line dollars.

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The information obtained from the City of Dallas is less descriptive in terms of best practices. The documents made available by the city included cost information and the contract for administration between the city and Willis-Rollinson. The contract specifies: Contractor's services (in detail), allocated loss expense and compensation, payment, accounting records/files/reports, workers' compensation payment account, and other pertinent specifications.

In terms of payment, the city pays the contractor a sum not to exceed $3,883,310 for claims, claim adjustments, and administrative services, paid on a monthly basis upon receipt and approval of invoices (in accordance with contractor bid). In relation to the compensation payment account, the city makes available funds for the payment of benefits or services to or for injured or diseased employees. The funds are furnished by the city and are accessed through a Zero Balance Account maintained at the City Treasurer's depository bank. The contractor is authorized to settle and issue a check for any claim with a combined reserve of less than $5,000. Those exceeding $5,000 need Director approval.

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A.Third Party Administrators (TPAs)

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Both public and private entities turn to Third Party Administrators for professional help in handling their workers' compensation claims. However, the decision to contract out is often controversial. Many issues arise including the displacement of employees and the stability of the TPA. The TPAs interviewed were familiar with the concerns and had previously responded to such concerns. In relation to displaced employees, Third Party Administrators have hired displaced employees in the past. These employees are evaluated and hired based upon their qualifications.

In terms of stability and dependability within the industry as a whole, the County of Los Angeles' experience sheds some light on this issue. The County of Los Angeles contracted out workers' compensation administration in 1986 to four separate TPAs. Two of the four contractors decided to discontinue their services with the County. The experience was frustrating both for the public employees involved and for the two remaining TPAs. Currently, the two remaining TPAs each handle 50 percent of the County's claims. Established firms in the claims management industry seem to have the resources to assume the responsibilities of those who may discontinue their services.

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A contract between the public entity/client and the TPA can include built-in performance guarantees such as an 80-percent closure of pending claims or a 20-percent reduction in compensation expenditures. In response to Request for Proposals, Third Party Administrators provide a range, if not an exact percentage, of potential savings. In addition, the contract should include payment arrangements for claims handling as well as an agreement on the accessibility of city funds for compensation expenditures. The TPA should be required to submit applicable invoices and/or paperwork for review by the city. Special services to be rendered by the TPA, e.g. injury prevention, should also be specified in the contract.

One conclusion that may be drawn from LA County's experience is that four TPAs may be too many. It took a lot of time and effort for county staff to coordinate with four TPAs as well as monitor each contract. Two Third Party Administrators may be a more manageable number. Moreover, before contracting with any TPA, their track record should be checked. Background information sheds light on the TPAs dependability, accountability, effectiveness and willingness to coordinate with in-house staff.

APPENDIX I: Cost Allocation Plan

Indirect Costs Included In Rate Calculations

Fringe Benefits Rate - Includes the costs of:

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AHealth Subsidy

AEmployee Assistance

ALife Insurance

AMedicare

APensions

ARetirement

ASocial Security

AUnemployment Insurance

AUnion-Sponsored Insurance

AUnused Sick/Vacation Payout

AWorkers Compensation (includes medical expenses and salary replacements paid by the Personnel Department)

-

Central Services Rate - Includes the costs of:

-

ABuilding Use Allowance (City-Owned)

ACommunications Lease (Phone Bill)

AComputer Assets Depreciation

AEquipment Use Allowance

AGas (Utilities Expense)

AGeneral City Purposes

AInsurance Payments on Bond Financed Bldgs. & Equipment

ALiability Claims

AMall Garage Use Allowance (Employee Water and Electricity Vehicle Depreciation Parking)

APetroleum Products (fuel/oil)

-

Specific Costs of Other Departments

-

ACity Attorney

ACity Clerk

ACity Council

ACity Employees' Retirement (CERS) and Office Pensions

ACity Ethics Commission

AController

AEmployee Relations Board

AEnvironmental Affairs

AGeneral Services

AInformation Services

AManagement Employee Services

AMayor

APersonnel Department

APublic Works

APublic Works Board

ATreasurer

-

Department Administration Rate

(Typically includes the costs of the following administrative functions within each department)

Salaries of:

-

ABudget Staff

ADepartment Management (Gen. Mgr. & Asst. Gen. Mgrs.)

-

APayroll Staff

APersonnel Staff

AInventory Staff

AStores Staff

ASystems Staff (if serving the whole department, not a special project)

-

Expenses which:

-

AAre not in line operations expenses

AAre not directly charged to a grant program

ABenefit the department as a whole

-

APPENDIX II: Methodology for Calculating Other Costs

City Attorney's Office Workers' Compensation Staff

The City Attorney's Office has a total of 693 employees, 361 of which are attorneys. The services under consideration are utilized, in some cases by all employees, and in other cases by the attorneys only. Since the number of employees working exclusively on workers' compensation claims is known, the following percentages were calculated:

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Ù3.0 percent of the City Attorney's Office attorneys handle workers' compensation claims (11 of 361)

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The above percentages were used to separate the Workers' Compensation Division costs from the totals obtained from the City Attorney's Business Office.

Photocopies (used by all):$168,939.29 X .0375 = $6,335 = WC Staff Total

EXCELLO Copy Service:$225,000.48 X .75 = $168,750 = WC Staff Total

(WC Div 75% of cost-known)

Depositions (attorneys):$696,980.08 X .03 = $20,909 = WC Staff Total

Snyder Heathcote (attorneys):$111,656.00 X .03 = $3,350 = WC Staff Total

Depo Services

Mileage Reimbursement (attorneys):$6,371 = Known Total

Messenger Service (used by all):$91,058.67 X .0375 = $3,415 = WC Staff Total

APPENDIX III

Control Temporary Disability (IOD) Payments - Limit pre-injury take-home pay coupled with more aggressive management of medical treatment and evaluation during the early stages of a claim.

Risk Management Consultant - Engage a consultant to assist in determining necessary changes to improve the quality, efficiency and effectiveness of the program and to achieve all cost reductions possible.

Return to Work Program - Redesign the city's return-to-work program to allow for expedited return to productive city employment in some capacity.

Coordination of Effort With City Attorney's Office - Work with management level staff of the City Attorney's Office to develop consistent and cooperative policies related to claim handling and litigation.

Fraud Control - An 800 fraud hotline has been requested for the 1994B95 budget to enable city employees and citizens to anonymously report abuse and fraud. The Fraud Control Program will require an educational campaign to eradicate fraud in the system.

Decrease Medical Treatment Costs - The Personnel Department will explore the concept of 24-hour care with its health insurance providers to determine the feasibility of their providing medical evaluation and treatment for industrial injuries to city employees as part of health insurance coverage. At least a 15-percent savings in medical payments is expected, or approximately $9.6 million, in compensation expenditures. To further reduce costs, workers and their physicians will be encouraged to use the city pharmacy.

Increase the Awareness of and Accountability for Workers' Compensation Expenditures on the Part of Department Managers - The Personnel Department will provide other department managers information that will clearly illustrate the nature and frequency of injuries, lost time, temporary disability payments (including IOD), permanent disability awards and settlements, medical payments, return-to-work efforts and other pertinent information. It will be recommended that the Mayor direct department managers to develop programs that will ultimately improve the performance of individual departments.

Initial Investment/Third Party Contracting - Immediate contracts are planned to cover three critical areas: Closure of approximately 12,000 open claims, partial contracting of current inventory (to reduce the workload of current staff), and risk management expert advice to the General Manager. The Personnel Department recognizes that present caseloads need to be managed aggressively before other plans can be implemented.

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In his April 20, 1994 budget address, Mayor Richard Riordan invited the city council to join him in a comparison of the costs of public vs. private parking ticket enforcement. The Department of Transportation (DOT), which oversees parking enforcement, has prepared a Request for Proposal (RFP) to contract out the area, one of five parking enforcement divisions in the city. The following is an analysis of this RFP and other cities experiences with the privatization of parking enforcement.

Privatizing parking services in the Western Division should enable the city to begin an incremental reduction of costs associated with this function. At the present time, the city pays approximately $36 per hour for parking enforcement: approximately 47 percent higher compared to other cities which pay an average of approximately $19 per hour through contracting.

Estimates by city staff indicate that privatizing the Western Division for the DOT will reduce the hourly costs from their current budget of $35.94 to approximately $31.45. This is a total cost reduction of 12.5 percent. The department's actual estimated costs to contract the function are $20.00B$22.50, however according to DOT figures, city overhead and unavoidable costs require the addition of $11.45 per hour to each contract position.

Under the current budget, the city's expenditures for the Western Division equal approximately $8 million, with revenues of approximately $16.3 million. Through privatization, the Department is anticipating that expenditures will increase initially by $6 million for administration and implementation of the contract, but revenues will increase by approximately $25 million. This yields an estimated $19 million in net revenues to the city.

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Under the DOT, the city manages five separate divisions, each providing a full range of parking enforcement and management services. The principal objectives and responsibilities of each division are:

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AAbandoned Vehicle Removal;

AResponse to Complaint Calls;

ASpecial Event Support;

APeak-Hour Towing;

ATraffic Control; and

ABooting (habitual violators).

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The current budget for parking enforcement salaries and direct expenses is $23.7 million with other parking enforcement budget items totaling $20.9 million. The total cost of the program for the city is $44.6 million.

The City of Los Angeles' cost per unit for parking enforcement is an hourly rate of approximately $35.94 per hour which includes: salaries (traffic officer and supervisor); uniform allowances; vehicles; clerical support; benefits; central services; and department administration costs (including share of salaries and benefits).

The avoidable cost portion of the hourly rate is $24.49 and is composed of the following:

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AUniform allowances;

AVehicles;

AClerical support; and

ABenefits.

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According to DOT estimates, unavoidable costs total $11.45 per hour and include:

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ADepartment administration costs including share of administrative and support-staff salaries and benefits.

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An important consideration in reviewing the costs incurred by the Department is the city's cost allocation rate which represents a total of 107.1 percent of salaries. This rate is calculated as follows:

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ACentral Services 48.11 percent

ADepartment Administration 21.71 percent

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Request for Proposal

Under the current Request for Proposal, the city has proposed a pilot program to contract the operations for the Western Division of the Bureau. This division currently operates with approximately 100 officers and a $8-million expense budget.

The draft RFP dated March 9, 1994, provides the following overview of parking enforcement:

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In the RFP, the following criterion are listed for contract compliance and can provide a basis for comparing the quality of city performance versus the quality of contractor performance:

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ACitation issuance by violation category

AVehicle impounds

AAbandoned vehicle removals

AComplaint calls and responses

AHours devoted to traffic control

-

APersonnel complaints

ACitizen citation complaints

ACitation cancellations by area

-

AChambers of Commerce

AHomeowner groups

-

The principal financial advantage to the city (according to their estimates) from bringing in a contractor for parking enforcement is a $25-million increase in revenues. The $25-million revenue increase should result from more efficient ticket collection and the redeployment of existing Western Division Personnel to other areas of the city.

Cost Savings in West Hollywood

The City of West Hollywood achieved a reduction of 28 percent in operating costs, saving $300,000 when it contracted with JL Services. Their prior contract with the LA County Sheriff was for $1.1 million; their contract with JL Services is $800,000. Budget revenues for fiscal 1994 were $4.3 millionCactual revenues are estimated at $4.8 million.

The pilot project in the Western Division will present a number of opportunities to the city, including:

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AAbility to reallocate existing personnel to other divisions, thus increasing revenues; and

AOverall reduction of operating costs in lieu of hiring city personnel and overhead.

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The average cost per hour for contracted parking enforcement in the two public agencies listed above that provide a level of service comparable to that contemplated by the City of Los Angeles is $20.88. The city's current cost per hour of $35.94 is 72 percent higher than this average. Since Anaheim contracts only their citation issuance function, they are not included in this average (see Table 1).

Table 1

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* According to city officials, may not include all remaining unavoidable costs.

The city, based on its RFP, is projecting that it can contract parking enforcement functions for the Western Division for between $20.00 and $22.50 per hour. If unavoidable costs remain at their current hourly level of $11.45, the resulting total cost would range from $31.45 to $33.95. Given the city's own assumptions, the resulting savings over current operations would be between $1.99 and $4.49 per hourCa reduction of more than 12 percent in operating expenses.

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One key to the apparent success of private parking enforcement providers appears to be the private sector's willingness to invest in technology. Municipal agencies are often reluctant to invest in capital equipment that would allow them to improve their productivity and efficiency. For example, the use of hand-held computers can eliminate the need for hand-written citations, and can significantly automate a majority of routine record keeping and data processing. Such technology may not only improve field operations, but can similarly improve the efficiency of clerical functions by eliminating the need for manual entry of citations, expedite claims processing, and automate citation issuance.

According to Enforcement Technologies of Irvine, their experience with over 100 governments both nationally and internationally have resulted in the following:

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ARevenue increased by 15B20 percent;

ACollection time decreased by 30B40 percent;

AData entry eliminated by 65B95 percent;

AScofflaw identification increased by 37 percent; and

ACost of payback of investment by 3B12 months.

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In a review of the agencies contacted for this report, each reported that the private sectors ability to innovate and infuse technology into the parking enforcement function dramatically increased revenues and productivity.

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Parking enforcement is a growing area in the field of privatization. Currently a number of cities contract their parking enforcement services in the United States. Examples (and length of contract) are: Anaheim (approximately 10 years); West Hollywood (3 years since release of L.A. Co. Sheriffs Dept.); Montgomery County, Md. (7 years); and Baltimore County, Md. (2 months). Other cities in Southern California considering contracting their parking enforcement functions include: Pasadena, Glendale, Fullerton, and Newport Beach.

Opportunities for privatization include citation issuance and processing, vehicle removal, towing, and the overall management of the parking control officers. There are currently a number of contractors that perform parking enforcement services. JL Services is the contractor for West Hollywood, Baltimore County, and Montgomery County. Pedus International is a security services contractor that provides the City of Anaheim with parking enforcement and is considering bidding on other parking enforcement contracts. Public Services was the contractor for Montgomery County from 1988 to 1993. The security firm Bonafide Security Services was Anaheim's previous contractor. JL Services is the only known company with multiple contracts for parking enforcement within Southern California.

Both contractors that were interviewed for this study indicated a willingness to bid on a multitude of parking enforcement contracts in Southern California and elsewhere. While there is only one contractor currently providing this service in multiple cities, there are one or more firms with a single contract looking to hire an additional 75 officers. The department has previously requested additional officers, however due to budget and hiring freezes, they have been unable to fill their staffing requests.

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The following municipalities in Table 2 all contract some portion(s) of their parking enforcement functions. Each indicated positive overall experiences with privatization. The following contracts represent municipality-wide privatization of the service with little or no transition period.

Table 2

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The pilot program in parking enforcement should yield approximately $19 million to the city. Assuming the privatization of the Western Division is successful, this could serve as a model for privatization of the city's other divisions.

If contracting proves successful for the city, other divisions should be opened to competition on a staggered basis. For example, the city should consider either the Valley or Hollywood divisions because both fall in the middle in terms of ticket production, while the Western Division already generates the most tickets per officer. Through privatization, the city has the potential of reducing its costs by approximately 48 percent in comparison to other cities which have privatized the parking enforcement function. Based on the current budget of $23 million if implemented citywide, this could eventually result in a total cost reduction of $11.3 million annually.

Lastly, when examining the issue of increasing the city's parking enforcement capabilities by contracting out the Western division, city officials should bear in mind the trade-offs between increasing parking ticket revenues and the negative effects that increased enforcement may have on street-front businesses. Many Los Angeles business people worry that customers will avoid areas where parking enforcement is very tight. Explains Sandy Brown, a board member of the Westwood Village Association,

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Brown's reservations are not unwarranted. One reason malls have increased in popularity vis-a-vis street-front stores is that at malls parking is easier, usually free, and patrons don't have to worry about getting parking tickets. Overly aggresive parking enforcement is likely to induce more shoppers to abandon street stores for shopping malls. Moreover, each additional dollar that is collected by the city through tougher parking enforcement is a dollar that could have been spent in the private economy.

Overzealous ticket writing, however, need not be an inevitable result of privatization. In fact, if structured properly, privatizing parking enforcement could be a win-win situation for city government and Los Angeles's street-front stores.

In the Western division, for example, working with Westside businessesCwho, along with area shoppers should be viewed as the true customers of parking enforcementCstrategies can be developed to make parking enforcement more business friendly under a private contractor. Such strategies might include the following:

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AInstructing the parking enforcement operators to place warnings on windshields rather than writing tickets for parking meter violations for a certain number of hours each week.

AInstructing parking enforcement officers to be more courteous and flexible about issuing tickets.

AAffixing color-coded decals denoting maximum meter time limits to city meters in order to minimize motorists' confusion and frustration over parking tickets.

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The positive effect that these and other strategies would have on motorists' perceptions of the city as being attuned to their shopping needs would more than make up for any slightly lower parking revenues. It would also serve as a prime example of how injecting competition into government can spur not only efficiency increases but also innovation in service delivery.

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Since 1981, the Los Angeles Zoo has had an Operating Agreement with the Greater Los Angeles Zoo Association (GLAZA). Under its current operation, the zoo is owned and managed by the city, acting through its representative, the Zoo Director, who determines the ultimate course of any action. The Zoo Director runs the zoo and shall set the overall policies of the zoo, manage the zoo, report to the General Manager of the Department of Recreation and Parks, and be the arbiter of disputes between city staff at the zoo and GLAZA staff. This joint management arrangement may be creating various operational inefficiencies. Privatizing the zoo and consolidating operations under the direction of an independent nonprofit is an alternative that could reduce costs and provide other benefits such as enhanced fund-raising ability.

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The relationship between the zoo and GLAZA has a colorful history. Before 1992, a theoretical wall separated the two organizations. The President/CEO of GLAZA and his support staff were completely separate from the zoo director and his staff. Each group had its own separate division for education, marketing, administration, and publications.

Since the spring of 1992, after the hiring of Dr. Mark Goldstein and Dr. Susan Rice to lead the zoo and GLAZA, respectively, the zoo director's office has acted more concertedly with the GLAZA President/CEO's office. This was partially made possible by GLAZA allowing Dr. Goldstein to participate in the selection of the President/CEO. Dr. Goldstein was thus able to help choose his co-worker.

The fruit of this relationship was the Amended and Restated Operating Agreement between the City of Los Angeles and the Greater Los Angeles Zoo Association executed in November of 1992. Key provisions of the operating agreement include:

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AThe city and GLAZA will cooperate on all matters affecting the operations and reputation of the zoo. The zoo director is a nonvoting member of the GLAZA Board of Directors.

AThere shall be a unity of command on all matters affecting the zoo under this Agreement.

AAll funds raised by GLAZA...shall be used for zoo purposes approved by GLAZA and the zoo director.

AGLAZA is to give $5 for each individual membership and $7 for each family membership to the city to be placed in a separate zoo account.

A[O]n all matters affecting the zoo, the city, acting through its representative, the zoo director, shall determine the ultimate course of any action. The Zoo Director runs the zoo and shall set the overall policies of the zoo, report to the General Manager of the Department of Parks and Recreation, and be the arbiter of disputes between the city staff at the zoo and GLAZA staff.

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The shared organizational responsibilities of GLAZA and the city in the past has resulted in inefficient duplications and political disagreements that have interfered with effective zoo administration.

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The zoo budget supported by the Department of Recreation and Park's General Fund (1992/93) includes $8,155,431 in direct expenditures, and $4,846,000 in indirect costs for a total of $13,001,431. In fiscal 1993, the city received $5,008,567 in revenue for the zoo, including $738,823 in direct transfers from GLAZA. The $7,992,864 difference is the city's direct financial support of the zoo. In addition, however, GLAZA generated $8,936,187 in revenue and had $8,742,793 in expenses over the same period. Included in GLAZA's expenses is $3,970,815 expended in areas directly supporting the zoo, such as public relations, contributions to world wide conservation programs, education programs and capital improvements. If GLAZA had not provided this support and if the city had chosen to incur these same expenses the city's financial support would have increased to $11,963,679.

Within the zoo's operations, a number of efficiencies could potentially be realized by the joining of GLAZA and zoo operations. This would be achieved by eliminating certain divisions that exist in both GLAZA and the zoo. Key examples are:

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AFinancial Management

APersonnel

ABudget

ALegal

AAdmissions

APayroll

AComputers

APhone Systems

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Certain cost savings might be achieved by eliminating duplication, augmenting or reducing certain functions that are performed by GLAZA and by the city at the zoo. However, these functions would have to be defined anew predicated on what alternative governance structure is suggested. Evidence from other zoos indicate that greater managerial efficiency and enhanced fund-raising ability could be achieved under a single, privatized management organization.

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There are a number of different arrangements by which zoos are owned and operated in the United States. Common examples are as follows:

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ÙGovernment owned but privately operated. In some cases, a government agency leases the land (sometimes at little or no cost) to a nonprofit agency that manages the zoo. The government agency may or may not contribute financially to the operation of the zoo.

ÚGovernment owned and jointly operated by the government body and a private society.

ÛOwned and operated by a government agency. An example of this is the L.A. Zoo.

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In recent years many jurisdictions have shifted operation of zoos from government to private agencies, moving to either a fully private or a public-private partnership model.

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Typically, privatization of U.S. zoos has been spurred by a desire for a higher level of management capability and reductions in operational costs. As is seen in other cities (See Case Studies), private entities have often saved zoos from closing due to financial shortfalls and lack of public support. Some key reasons why zoos have benefited from privatization include:

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ÙPrivate Fundraising. Nonprofit entities have enjoyed considerable success in raising revenue to assist in funding zoo operations. Individuals and corporations are more likely to donate money to private nonprofits rather than a government agency that receives tax revenues.

ÚMarketing. Because private operators are in the business they are often better prepared than government to market their product.

ÛQuality. In Atlanta and Massachusetts, the quality of exhibits and facilities for both the animals and the public were enhanced significantly after privatization. In Atlanta, the zoo went from worst class to first class after privatization. This is because a private zoo must both attract visitors and satisfy donors that it is a worthy cause. To attract visitors, the zoo must be clean, safe, and entertaining. To attract donors, a private zoo must be perceived as being well run. In addition, private donors are often interested in supporting a zoo's educational programs and efforts to aid rare and endangered species. Also, donors may withdraw support if admission prices are raised too high, since they will cease to consider the zoo a philanthropic endeavor.

ÜReduction of Public Subsidies. Although some zoos continue to receive a public tax subsidy, the bottom line results to the government and the public was a significant reduction in the costs to the taxpayer for zoo operations.

VI.KEY ISSUES RELATING TO THE LOS ANGELES ZOO

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Some key issues in considering privatization include the following:

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ÙCapital Improvements. Almost 30 years old, the zoo is showing signs of its age. A recent site analysis uncovered many problems with the zoo's facility. Areas needing review for improvement include the utility grid structure, maintenance facilities, and parking facilities. Donations to a privatized zoo could provide the capital needed to improve the zoo's physical plant.

VII.GLAZA

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When considering opportunities for privatizing the Los Angeles Zoo, GLAZA is the natural candidate to assume control, and responsibility, for zoo operations.

GLAZA was founded in 1966 as a source for visitor services, advice and as financial and political support for the zoo. GLAZA quickly established the world's first zoo docent program. Today, it is the world's largest such program. In 1993, 550 participants volunteered 80,000 hours of their time to the docent program. In 1992, GLAZA docents gave 4,383 tours of the zoo to 117,969 people (averaging about 27 people per tour). These docents served 37,931 children that year, all of whom were admitted to the zoo free of charge. GLAZA members also sit on the zoo director's advisory committees.

The financial support role of GLAZA is also taken seriously. Every year nearly half of their expenses are direct payments to the zoo. Fundraisers held for the zoo attract people from across the area and raise hundreds of thousands of dollars. GLAZA has also helped the zoo during the city-wide hiring freeze. As animals' lives may be at stake, a vacant position must often be filled with dispatch. The organization thus hires people as GLAZA employees but assigns them solely to the zoo's city employees. They report toCand are evaluated byCcity employees, but their pay check and benefits come from GLAZA. Today, about one-third of the Research Department and one-third of the Education Department are GLAZA-employed city workers.

Personnel Issues

Any transfer of management responsibility to a nonprofit must consider current city personnel at the zoo. Some city employees at the zoo fear losing their jobs and accrued benefits. By 1995, there will be 27 zoo employees who have been with the city for 25 years or more. In addition, 17 zoo workers employed by the city will be 55 years old or older by 1995, and there are 14 who will be 60 or older.

Complicating matters is the fact that current city workers and GLAZA employees working side by side have different wage and benefit structures. City employees have more generous vacation, sick leave, holiday, floating holiday, retirement, dependent care reimbursement, and Metrolink benefits than GLAZA employees. GLAZA employees have better life insurance and tax sheltered annuity plan benefits than city employees. Both groups have exactly the same long-term disability insurance, bereavement leave, and RTD benefits. Moreover, cooperation between the two groups has not always been ideal.

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A.Zoo Atlanta, Atlanta, Ga.,

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Jeff Swanigan, Deputy Director

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In the early 1980s, Zoo Atlanta was widely regarded as one of the worst zoos in the nation. Like many other cities facing financial troubles, Atlanta sought to lower expenditures. On December 5, 1985, the city privatized the zoo by giving authority to the Fulton County Recreation Authority, the same group that runs the Omni Arena (where the Atlanta Hawks play) and the county stadium (where the Atlanta Falcons play). That same day, the Recreation Authority contracted with Fulton County Zoo to run the zoo. The zoo's existing nonprofit fundraising, membership, and advisory support arm was the Atlanta Zoo Society. In 1991, seeking to eliminate duplication of many services (accounting, personnel, etc.), the Zoo Society and the Fulton County Zoo merged to form Zoo, Inc. (a.k.a. Zoo Atlanta).

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The lease is open ended, and Zoo Atlanta pays a nominal $1 per year in rent. The city's subsidy declined from $1.1 million in 1986 to zero by 1993 (the 1992 subsidy was $100,000). Fulton County backed a $16-million bond for capital improvements on behalf of the zoo. It is being paid back by the County (two-third) and the city (one-third). However, there is a stipulation that any zoo gate revenues generated over the 800,000-people level goes toward debt service of the bonds.

The option of personnel management went to Zoo Atlanta. The County workers had the option to stay or move to another agency. Those who chose to remain were reviewed for hiring by Zoo Atlanta. The pensions of those who remained were paid by Zoo Atlanta. All of the land, equipment, and facilities are owned by the city and leased to Zoo Atlanta. Further, Zoo Atlanta pays sales tax and pays for its utilities.

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AIn a span of ten years, we traveled from worst-class to first-class, according to Director Terry Maple. Says Maple, AWe've rebuilt half the zoo. Our membership has increased tenfold. By every standard it has become a world-class zoo.

Soon after privatization, Zoo Atlanta was reaccredited by the American Zoo and Aquarium

Association. This was an important step, as it allowed Zoo Atlanta to trade animals with other zoos. Gate prices for adults increased from $4.00 in 1985 to $7.75 in 1994. Attendance has increased dramatically: whereas the pre-privatization record was 350,000 in 1984, in 1989 there were 799,000 visitors. Memberships in the Friends of Zoo Atlanta grew from 3,000 in 1984 to 50,000 in 1992, one of the largest memberships of any American zoo. Family members are at an all-time high of 30,000. Employment at the zoo swelled to 105 in 1992 from 35 in 1984 and fundraising has increased many times over thanks to the zoo's nonprofit corporation, Atlanta/Fulton County Zoo, Inc.

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Sanders Lewallen, President and Chief Executive Officer

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1.Privatization History

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Throughout the 1980s, these two zoos were in need of help. As state entities, they relied on the state for almost all of their funding. Both had deteriorating physical plants, and by 1990 the Stone Zoo had closed and many feared that the Franklin Park Zoo was not far behind. Because an increase in zoo admission price had to be approved by both chambers of the legislature and signed by the Governor, the zoo had no gate fee, an important potential source of revenue. To address these problems, Governor William Weld appointed an 11-member zoo privatization board. The board established a nonprofit organization and gave control of both zoos to it.

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The Commonwealth Zoological Corporation was created in July of 1992 by the state to control both zoos. At first, the state provided subsidies, but the intent is to decrease these so that by 1996 or 1997 there will be no subsidy. The subsidy is small, however, relative to those in the past. In the 1980s, state support was as high as $6 million per year. This year, the state will provide the zoos with about $3 million. The Zoological Corp. was required to assume all of the zoos' debt.

A community group in Stoneham, Mass., the home of the Stone Zoo, pushed the State Legislature to privatize its zoo in order to keep it open. Their State Senator, Richard Tisei (R-3), introduced legislation to privatize both zoos in 1990. Current public employees were kept on, but as they retired, management was free to hire whomever they pleased.

The state gave all of the equipment and facilities to the zoos. The land itself is rented to the Commonwealth Zoological Corp. for a nominal fee. Utility charges are also paid for by the Zoological Corp.

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Within the first year after privatization, fundraising is up, the Stone Zoo was reopened, and employees were cut back from 130 to 78. Aside from the subsidy and including the debt, the Zoological Corp. has earned $1.6 million per yearCfour times more income than under state control. In 1990, under state control, Franklin Park Zoo attracted just 101,000 visitors and Stone Zoo was closed. In 1993, the two privatized zoos attracted a total of 324,000 visitors.

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Margaret Burks, Executive Director

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1.Privatization History

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In 1993, the San Francisco Zoo was going to lose its American Zoo and Aquarium Association accreditation. This would have been a blow to the zoo because it would prevent it from trading animals with other zoos, an activity that is usually a revenue generator and important for breeding. After much debate, the Park and Recreation Commission recommended privatization. The City Council and Mayor agreed and the San Francisco Zoological Society was given control of the zoo on January 1, 1994.

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The lease between the city and the Society runs for 99 years at $1 per year. It is renewable, though, every five years if either party wants to renegotiate any provisions. The zoo receives a $4-million subsidy, about 30 percent of its operating budget. The city used to contribute $4.5 million per year to run the zoo, so it is currently saving $500,000 per year.

For the first five years of the contract, any capital improvements must be funded by private donations. From then on, bonds voted on by the citizens of San Francisco as well as private donations will be used for upgrades. The Society can float bonds on its own accord without city approval.

Although equipment and facilities are included in the $1 fee, workers' salaries were not. Instead, they remain city employees with their salaries and benefits paid for by the city. Open jobs can be filled by the Society as they become available. The city subsidy is tied directly to these employees. For the first five years of the contract, $4-million per year will be given to the zoo to pay for the city employees= salaries and benefits. This $4-million sum will be provided ad infinitum, indexed only for the civil service gains of the city workers. The Society can spend freely only whatever money is left after the civil servants have been compensated.

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Because of the recent assumption of operations within the past few months, there are no results to report.

IX. WHAT TO AVOID (Other Zoos' Privatization Mistakes)

A few zoos are experiencing difficutl transitions to private operations. Two such zoos are the Memphis Zoological Garden & Aquarium and the Birmingham Zoo.

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The zoo has been trying for years to go private. The Memphis Zoological Society has made proposals to the Memphis Parks Board. The Parks Board has rejected the proposals, however, mainly over the issue of paying the zoo=s utilities: almost $1 million per year. After passing the reluctant Board, however, the proposal would face a more amenable City Council and Mayor. Because of this sticking-point, the proposal sits idle.

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The community of Birmingham is going through a transformation to build a new zoo to replace the existing city operated and supported zoo. Efforts are under way to establish a non-profit entity that will build and operate a new zoo, allowing the city to get out of the zoo business. Pending successful fundraising, a non-profit association intends to transfer the animals from the existing zoo to their planned new zoo at a new location to be annexed into the City of Birmingham.

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Today, a family of four can get into the Los Angeles Zoo for $23. Admission prices for many of the aforementioned zoos follows:

Table 1

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* Toddlers are admitted free.

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Privatizing the Los Angeles Zoo has the potential to reduce costs, increase donations, and improve zoo quality. This could benefit the citizens of Los Angeles through the elimination or reduction of the zoo's operating subsidy with a simultaneous enhancement of zoo facilities.

Giving the nonprofit GLAZA control and responsibility for all zoo operations should be explored. Taking the zoo from the control of the city would free management to eliminate duplication of efforts by GLAZA and the zoo, reducing the delay, cost, and outright resistance to implementing reforms and innovation in zoo operation. A privately run zoo would free management from a great deal of bureaucratic red tape and provide incentives for efficient operation.

As a private entity, the zoo would also be more likely to receive donations. The city could save money in the short-term through the possible elimination or reduction of tax-subsidies. Furthermore, the zoo could begin raising the funds necessary for capital improvement projects.

With less of a municipal subsidy, a private Los Angeles Zoo would have to find ways to reduce costs and enhance revenues. The potential for cost reductions is evident when considering the elimination of many of the duplicated services and the experiences of other zoos around the nation.

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Contracting municipal golf operations in the City of Los Angeles to the private sector has the potential to achieve revenue gains of between $2.7 million to $4.3 million annually (an average of 3.5 million). Through privatization, the city could also achieve the goals of improving the quality of facilities and programs, decreasing city financial obligations, initiating needed capital improvements, and maximizing the revenue potential of these assets. These goals could be realized without significant increases in costs to the public (green fees), and could also reduce the city's liability exposure.

Mayor Riordan has recently authorized the study of the privatization or contracting out of golf courses currently operated by the City of Los Angeles. The Mayor has publicly stated that he is encouraged by the potential for private operators to increase revenues to the city and improve golf facilities and services to the public. To date, the city has involved itself in a variety of meetings (both internal and external) to explore potential privatization opportunities for its golf operations.

Private-sector management of golf services is not a new concept within the City of Los Angeles. Presently, private operators are responsible for a significant portion of the services provided at city courses, including golf- cart rentals, pro-shop operations, golf-range operations, golf lessons, and food concessions.

The private sector also plays an important role in the capital development of these courses. Most design and capital improvements on the course are done through private contractors and private golf course architects.

The current operation of the City of Los Angeles' twelve golf courses falls under the jurisdiction of Department of Recreation and Parks. The Department's main duties include the overall management of the courses, collection of green and other fees, and course maintenance. The city's public golf courses grossed nearly $14 million in fiscal 1993, and achieved a profit of well over $3 million.

The 12 courses are grouped into three different regions: the Griffith Region, the Pacific Region, and the Valley Region. The courses that constitute the Griffith Region are Harding, Wilson, Los Feliz, and Roosevelt; the Pacific region has the Harbor, Penmar, and Rancho golf courses (Rancho has a 9-hole and an 18-hole course); and the Valley region, with the Hansen Dam, Encino, Balboa, and Woodley courses (a thirteenth course is a pitch-n-putt and is not included in any budget numbers).

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The privatization of golf services falls into eight main categories:

ØGolf Course Management;

ÙFood and Beverage;

ÚPro-shop;

ÛDriving Range;

ÜCart Rentals;

ÝLessons;

ÞStarter; and

ßMaintenance.

In a review of the city courses, Table 1 describes the services under city C operation and those under the direction of a private operator P.

Table 1

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The privatization of municipal golf facilities occurs when the city turns over the operation of the facility or a particular service to a private vendor who then operates the facility in a commercial manner. The city benefits through the receipt of rents (revenues) and the operation of the facility for public benefit and enjoyment.

Private vendors for golf operations range from large corporations to individual entrepreneurs. Specifically, we might categorize them into three groups:

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ÙRegional Enterprises. Typically small companies located exclusively within a specific geographic area.

ÚEntrepreneurial Enterprises. Golf Pros and smaller groups of individuals who either own or operate a specific facility. These operations might include existing employees purchasing the rights to operate the course.

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The services provided range from specialized operations (pro shop, driving range) to full scale management of entire facilities. Generally, the Entrepreneurial Enterprises dominate the more specialized operations, and the Management Companies offer more comprehensive services, controlling both the commercial operations (food and retail) as well as facility maintenance and development.

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The services provided through a private contractor include:

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ÙCommercial Operations. This includes all commercial enterprises of the facility including sales, rentals, and marketing.

ÚMaintenance. Through either hired employees or subcontractors, maintain all facilities, horticulture and major improvements on a course. This includes absorbing the costs for energy and water.

ÛCapital Improvements. This includes the design, contracting, purchase, and project management of all improvements and additions to facilities.

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The implementation of a contract comes in a variety of forms. The arrangements between the municipality and the contractor might include the following components:

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ÙContracts (such as with the County of Los Angeles) require the elected government board to regulate green fees charged for utilization of the course.

ÚContractors make all capital improvements on the course, using funds that they are contractually obligated to set aside for this purpose.

ÛPrivate contractors give right of first refusal for employment to current employees of the golf course.

ÜPrivate contractors allow the city to set the minimum maintenance requirements and playing standards for the facility.

ÝPrivate contractors will enhance community outreach by providing and advertising special programs for youth, seniors, the disadvantaged, and disabled golfers.

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A commonly asked question is how do private contractors make a profit Profit is most often achieved through the following means:

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ÙDecreased overhead costs in comparison to government;

ÚVolume purchasing of materials and supplies;

ÛBetter golf course management techniques;

ÜImproved conditions of the course;

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ÞReinvestment of revenues in capital improvements to help ensure that no large, unforeseen repairs have to be made in the future.

III.CALCULATIONS OF REVENUE ENHANCEMENT

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The budgets in Table 2 have been provided by the city's Recreation and Parks Department. This budget was a record of all revenues and expenditures from the fiscal year ended June 30, 1993. The primary categories of costs and revenues reflect Revenues (Green Fees, Concessions and other) and Expenditures (Personnel, Maintenance, and Capital). A deduction of 18.5 percent is made from the estimated revenues to reflect an estimated surcharge from green fees toward the Capital Improvement Program for each course.

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In a review of all budgets, city courses experienced total gross revenues of $13.8 million and expenditures of $10.5 million for a net profit of $3.3 million. The total number of rounds played in fiscal 1993 was 1,108,550, equating to an average profit of $2.95/round.

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Most municipalities privatize golf operations to increase revenues. Table 3 provides a comparison of the revenues received by cities following the privatization of the golf courses.

Table 3

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Of the eight examples cited, seven cities achieved revenue increases between 24 percent and 400 percent within the first year of private operation. For those courses which have been private for ten or more years, fiscal 1993 revenues average over 500 percent more than the base year. Contracting for the management of public courses has shown a proven ability to increase revenues in many cases. It does depend, however on the condition and management skills of the particular publicly operated facility.

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A primary benefit of private operation is the provision for capital improvements. In three cities (Detroit, Indianapolis, and New York), a key reason for seeking private operation of the courses was the need for capital improvements. In the April 11, 1994 Los Angeles Times, it was stated that City of Los Angeles golf course workers are scrambling to improve the courses on their own...maybe American Golf could fix the greens at Wilson where the crush of play has taken its toll, as has salt in reclaimed sewage water used by the city. For the City of Los Angeles, the improvements could be dramatic in comparison to current practice.

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An important concern of golfers is that privatization would result in much higher green fees. This not usually the case.

Under typical contracts, an elected board annually reviews and approves any fee increases regarding the public course. In a comparison of fees, the City of Los Angeles charges a rate of $15.00 on the weekdays and $19.50 on the weekends. This is in comparison to the County of Los Angeles, which charges a rate of $17.00 on weekdays and $21.00 on weekends with seniors always charged $8.50. This represents a difference of only 7 percent. It is important to note that the county has very high maintenance and capital-improvement requirements that help to sustain the improved quality and availability of the facilities.

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The following revenue projections for city golf courses under privatization include contract terms similar to those of the privately run Los Angeles County courses. The first and most conservative scenario is based on the fiscal 93 budget provided by the city (see Table 4), and simply assumes the existing revenue projections for all revenue sources. The anticipated revenue to the city is calculated as 35 percent of the gross participant revenue (greens fees) with concession revenue remaining at its budgeted level. Since under privatization all expenses are the responsibility of the selected contractor, the only expense the city would incur are those relating to contract administration. Administrative expenses of $75,000 are included for each of the three regions, and are based on an estimate of salary and benefits for a recreation supervisor for the City of Los Angeles.

Table 4

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This analysis suggests that privatization of the city's golf courses would produce an increase of $2.75 million in net revenue over the fiscal 1993 budget. Further, this is accomplished under Scenario 1 with no increases in the number of rounds played or concession revenues.

The second scenario assumes an increase over the fiscal 1993 budget of 25 percent for Participant Revenue and 23 percent in Concession Revenue (see Table 5). These increases are similar to those Los Angeles County experienced upon contracting out management of their facilities. Estimates of contract administration expenses remain the same.

Table 5

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Experience from both Los Angeles County and other municipalities that have privatized their golf facilities suggests that both concession revenues and number of rounds of golf played increase under privatization. In Scenario 2, this assumption yields an increase in net revenue over the fiscal 93 budget of $4.3 million.

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A.Other Jurisdictions

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In assessing how well the City of Los Angeles' golf courses are currently performing and how they might do when contracted out, we examined other jurisdictions that are currently contracting out their golf services. Not all cities that consider privatization choose to contract, which may indicate that certain public courses would not benefit from privatization or that the idea lacked political support.

Anaheim, for instance, has recently decided to continue public management of two courses.

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According to officials in the City of Detroit, they are very satisfied with the privatization of four of their six golf courses. (The city continues to manage two courses.) Total revenues generated for the four courses for 1992 was $200,000, in comparison to a deficit of $500,000 the previous year, when they were run by the city.

According to Detroit's Director of Recreation and Parks Dan Krichbaum, It's been a win-win situation. The new management has improved the condition of the course and increased the number of rounds played, making capital improvements the city could not afford. Krichbaum added that the competition has also improved operations at two courses the city continues to manage.

A key reason Detroit decided to lease-out its courses was an inability to make needed capital improvements to the courses. The city reports that the condition of the courses has significantly improved since the private contractor took over. In addition, the general-public reaction to the privatization of the courses has been positive with the improved playing conditions and efficient management of the operations. The city also reported that no municipal workers lost employment due to the changes, having either been hired by the private contractor or transferred to other positions within the city.

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Indianapolis, much like Detroit, contracted their golf operations because the courses were in need of significant capital expenditures. City officials indicated that they encountered a number of bureaucratic roadblocks while trying to execute Capital Improvement Projects (CIP's) in the past.

Indianapolis differs from Detroit and most other cities in that it has contracted out the management of all 12 of its courses. These courses were all leased to various local golf pros within the last two years and have since realized $2 million in savings, according to a January 30 article in the Indianapolis Star. Indianapolis has been unique in that they have contracted-out all of their courses and have used individuals (golf pros) instead of larger companies. In addition, Indianapolis has tended to use only short-term (usually 3 year) agreements as opposed to other cites that chose longer-term agreements (an average of ten years); and has also not included a requirement that private operators perform Capital Improvement Projects (this is usually a standard part of any contract).

The city faced opposition from union members who were afraid of losing their jobs and from members of the public golfing community who were concerned that green fees would skyrocket. There were also some charges of mismanagement since the courses were taken over by private operators in 1993, stemming from when a few private operators did not follow state bidding laws when hiring contractors for contracts totaling in excess of $600,000 in course improvements.

Nevertheless, outcome measurements would demonstrate considerable success from privatization. Capital investment increased substantially, as has customer satisfaction. The golf courses were awful [before privatization], says Mayor Goldsmith. [Now] we have lots of different things happening on our courses. Some are priced one way, others another, some have more bunkers, some have carts, others have clubhouses where there was nothing before.... There is a lot more variety out there.

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For New York City, contracting out golf services has been a major success story. They have contracted out 13 golf courses, and have gone from losing $2 million a year, to realizing a profit of $1.74 million in fiscal 1993. While the majority of their courses have been contracted out to local entrepreneurs, they have five courses that are currently being run by American Golf. New York City officials are quick to emphasize the disarray and disrepair that the courses were in when run by the city. So, there were really two main reasons why the courses were contracted out: 1) because they were in such bad shape; and 2) because they were costing the city an incredible sum of money.

Privatization did have some initial resistance from club members at these courses, who were afraid they were going to lose their privileges. These problems have worked themselves out for the most part. Most of the employees were transferred to other departments or hired on by the private contractor. New York City attributes its success to their strong monitoring program.

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The situation in the County of Los Angeles is probably the most comparable to the City of Los Angeles. This is because they share almost all relevant demographic and geographic characteristics. The County currently contracts out sixteen of its nineteen courses. Of these sixteen courses, nine are leased to small firms or groups of individuals (mostly local golf pros) and the other seven to larger management firms.

The county started the contracting-out process as a way to try to increase revenue, and has been satisfied with the effort; they made a profit of over $9 million in fiscal 1993. An example of the County's success is the Mountain Meadow Course. Before the course was privatized in fiscal 1989, it was generating revenues of approximately $570,000. After the contract, city revenues increased to $708,000. As of fiscal 1993, Mountain Meadows generated revenues of $1 million, almost doubling the profit of the pre-contract year.

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Probably the most significant and helpful sources in designing a contracting-out program is observing practices in other cities. Some of the most common contracting practices and recommendations are as follows:

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AKeep an open dialogue with community groups and unions to avoid misunderstandings and potential problems (i.e., negative media coverage, protests).

AConsider having the in-house unit bid as well as a private contractor. Phoenix, Coral Gables, and Sacramento have implemented programs where city employees run the golf courses as if they were private entities.

AAvoid layoffs of any current employees whenever possible. This can be achieved in a combination of ways: 1) transfer employees to a different position within city government; 2) use attrition; and 3) contract with private operators who are more likely to hire on current employees.

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While the practices discussed above are all very important, the recommendations most often stressed by other cities was the importance of developing a well-written comprehensive Request For Proposal (RFP). The County of Los Angeles emphasized that developing very specific and all-inclusive work specifications was the single most important element in effectively contracting out golf operations. The RFP must be able to identify each activity that could occur in golf operations and define the specifications for the performance of those activities. The following are important provisions to consider in an RFP:

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AThe term of the contract that the city desires. Ten to fifteen years is a common range when capital expenditures are involved.

AA rental provision that guarantees the city a fixed rent payment for each month. The rent can either be a fixed amount or a fixed percentage of green fees (30B40 percent), and all concessions at various percentages, whichever is greater.

AA provision that makes it mandatory for the private contractor to perform capital improvement projects (CIPs) that are specified by the city. The city should also require that the funds to pay for the CIP's be a percentage of the green fees to be paid by the contractor to the city. For example if the contractor is to pay 40 percent in green fees for rent, 5 percent should be set aside for CIP's.

AA provision that the contractor has relevant golf course management experience. In addition, the contractor should be able to provide proof of their financial capability, including credit, financial statements and references. This is to ensure that the contractor provides the public service without interruption.

AA provision that the city is guaranteed rent from the private operator regardless of whether the contractor makes a profit.

AProvisions that give complete specifications and work programs for the improvements to be performed at and on the course, including grounds, equipment, and building maintenance.

AProvisions that detail how services will be offered, including special event days, tournaments, days and hours of operation, concession sales, pro-shop operations, marshaling of play, starting, training of employees, and golf clubs/organizations.

AProvisions that detail that the contractor is responsible for all costs, including utilities, phone bills, repairs, etc.

AProvisions outlining accounting and auditing practices.

AA provision stating that the right of first refusal for employment will be offered to city employees affected by contracting out.

AA provision stating that the operator must hold insurance and be bonded (generally performance bonds are $1,000,000).

AProvisions that outline the monitoring and performance requirements by the city to be used in the evaluation of the contractor.

AProvisions that give the city the right to terminate the contract if the contractor fails to meet certain standards or commits certain acts.

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The final key to a contracting program is the implementation of an effective contract monitoring system. This point was stressed by officials in Indianapolis, Los Angeles County, and New York City. Generally, monitoring includes making on-site visits to make sure that the operation and condition of the course meet specified standards. Indianapolis frequently conducts secret shopping on its courses and compares course ratings against each other and benchmark performance standards each month. There are also checks of accounting procedures to ensure that the city is receiving the correct amount of rent.

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Most failures observed in the contracting process have been a result of a city not following one or more of the practices or recommendations discussed in the previous section.

The following are practices to avoid and recommendations to follow:

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ACities should contact all groups and organizations that could be affected by the privatization of the specific service and explain the facts to diminish public opposition.

ACities should opt for experienced contractors.

ACities need to provide enough qualified staff and an effective monitoring system to effectively review the performance of the private contractor. Los Angeles County has had complaints of inadequate maintenance and management at some of its contracted golf courses. This is most likely a result of poor monitoring of the private contractor by the county. In addition, these courses are managed by smaller and less experienced firms.

VI.CONCLUSION

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The evidence from other cities shows that privatizing the management of Los Angeles' 12 municipal golf courses is an option that should be explored. Issuing Requests for Proposals will enable city officials to evaluate what benefits the city could expect to realize by using a private management firm. It is estimated that the city could increase revenues by $2.7 million to $4.3 million (an average of $3.5 million), while at the same time enhancing course quality, increasing the number of rounds played, and limiting increases in green fees. These numbers are, of course, estimates; the only way to know for sure is to open management to a competitive bidding process.

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Privatizing building maintenance and custodial services in the North and South districts of Los Angeles at present service levels could potentially result in $2.24 million, or 28 percent savings for the city. Present levels of maintenance and custodial services, however, are inadequate and are resulting in significant deferred maintenance to city buildings. We recommend the city take advantage of the cost savings and lower unit costs associated with contracting to significantly increase service levels in building maintenance and custodial services. Though this would mean cost savings from privatizing building maintenance and custodial services could not be applied to more police, it is simply not prudent for the city to continue its present policy of deferred maintenance.

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A.Description of Tasks

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Building Maintenance and Custodial Services are functions of the General Services Department in the city. Operations are divided into three districts. In this study, we only examine two, the North and South Districts, because the city is currently examining these districts for service contracting. In the North District, 308 buildings are serviced by maintenance and custodial personnel, while in the South District 251 buildings receive service.

Theoretically the Building Maintenance Division of General Services is supposed to provide three levels of service: 1) as-needed service; 2) yearly maintenance; and 3) minimal preventive maintenance. Due to severe staff shortages, however, in reality the only service the department currently provides is responding to calls of equipment breakdown and some mandatory preventive maintenance on city facilities (i.e., fire extinguishers, back flow devices). Major alterations and improvements are performed by the Construction Forces Division. The department currently receives over 40,000 service requests per year and 65 maintenance employees work in both the North and South Districts with positions ranging from supervisory, to skilled craftsman, to basic maintenance laborer. Typical services provided by the department include plumbing and air conditioning repairs, carpentry, painting and electrical work. In addition, the department participates in the set-up of some special events and legally mandated retrofitting projects. A recent attrition forecasting study by the General Services Department estimates that over the last three years the average rate of attrition in the Building Maintenance Division in the North and South Districts to be 6 percent.

The Custodial Services Division of General Services, employing 127 people in the North and South Districts, is supposed to provide service on a daily schedule, building-by-building basis. Again, the reality is much different. Most buildings are cleaned only twice a week according to department officials. Positions range from Chief Custodial Supervisor to Custodial Services Attendant. Typical tasks include cleaning floors, emptying trash and dusting. More involved cleaning tasks are conducted on either a weekly, biweekly, monthly, bimonthly, semiannual or annual basis. Attrition forecasting estimates 5.8 percent as the rate of attrition within the Custodial Services Division in the North and South Districts.

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The central problem with the city's building maintenance and custodial services is simple: for a number of years most city buildings in the North and South districts have not been adequately maintained. The infrastructure of the buildings is slowly deteriorating year after year, says Bert Hinkle, Construction General Superintendent II for the Department of General Services. According to Hinkle and other officials in charge of custodial and building maintenance for the city, most of the facilities in the outlying areas get little building maintenance work. With only a handful of painters, plumbers and electricians working in each district, the only maintenance done on the buildings is when something breaks down and the department receives a complaint. This is not the way it has always been done. Prior to the budget cutbacks of the last few years, preventive maintenance was performed on more city buildings. The only exception to the current policy of breakdown maintenance is the city's new central library and three other buildings downtown, where maintenance is now contracted out to the private sector. Contractors are present around the clock at these buildings doing preventive maintenance every day.

On the custodial side, buildings in the North and South districts are cleaned only twice a week (most privately owned buildings are cleaned at least five days a week). We are not providing a high level of custodial service. In fact, its pretty minimal, says Frank Martinez from the General Services department.

In short, as a way of balancing short-term budget deficits, the city has been employing the quick-fix of deferred maintenance. As any owner of a home or cars knows, such a strategy has undesirable long-term consequences. The inevitable result being a shortened life span for the facilities and equipment. According to General Services employees, this policy could cause any or all of the following results:

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ÙBroken-down electrical systems;ÜFire safety hazards; and

ÙFloors having to be replaced;ÝPoor air quality in buildings.

These effects will be felt in the future not only by Los Angeles city employees who have to work in generally unclean environments, but also by Los Angeles taxpayers who will be forced to invest more of their tax dollars in additional capital expenditures to replace poorly maintained facilities and equipment.

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This section provides a summary of the budgets for both Custodial and Building Maintenance operations. (For a more detailed comparison, see Appendix I.) The budget for Building Maintenance in the North District is currently $1,446,560; in the South District the current amount is $1,711,835. These budget totals cover both direct operating costs associated with the target service in each district and the indirect costs (or overhead) of providing the service. (See the Appendix for cost categories.)

The budget for Custodial Services in the North District is currently $1,919,427; and $2,951,090 in the South District. These amounts cover both direct operating costs associated with the target service and indirect costs. (See Appendix for these cost categories.)

Although the South District has fewer facilities than the North (251 to 308), its operating costs are higher for both building maintenance and custodial services. There are two possible explanations for this discrepancy. The first is that there are simply more employees in the South district than in the North (105 to 87, despite its lower number of buildings). Another possibility is that for both services, there is a greater number of high-volume, publicly used buildings in the South such as police stations and libraries that have heavier useCtherefore requiring more cleaning and repairCthan the fire departments, maintenance yards and administrative buildings which are also serviced in the two districts.

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In determining the cost savings the city could experience by contracting out these services, we examined the city's internal numbers for Fully Allocated Costs (direct and indirect cost categories are detailed in the description of the Department's budget in the Appendix), avoidable costs (the costs of providing maintenance and custodial services which would be removed if these services were contracted-out) and remaining, unavoidable costs if the service were contracted out. Avoidable costs covered portions of cost categories such as: 1) Operations; 2) District Support; 3) Related Personnel Costs; 4) Support from Other Divisions; 5) Vehicles; and 6) a percentage of Facilities Costs.

Remaining, unavoidable costs included overhead, personnel, and equipment costs that would not be eliminated through contracting as well as costs associated with contract administration. In determining potential cost savings from privatization, unavoidable costs were added to the contractor's price.

Per the city's draft request for proposal, all costs were estimated as covering five phases of implementation of the contracting process. Each phase would be of sufficient length to allow bidders to inspect the buildings in question (as specified in the draft Request for Proposals). The resulting comparisons are found in Tables 1B5.

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Several different units of measurement are typically used when reporting costs for building maintenance and custodial services. The most common measurement is cost per square foot. Numbers for the city's costs per square foot were calculated using the above fully allocated cost information and the number of square feet in each district. The number of square feet in the North district is 2,683,661 and 2,168,510 in the South District. As illustrated in Table 1, the city's Building Maintenance costs per square foot are $0.54 in the North District and $0.79 in the South District.

Table 1

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However in this case, cost per square foot is not a good measurement because private-sector cost per square foot rates are based on full-service maintenance, while current city costs are based only on breakdown maintenance.

A more accurate comparison of city costs and private-sector costs can be obtained by examining costs per hour for each breakdown work order completed. According to the General Services division, current city costs are $83.67 per hour in the North District and $103.41 per hour in the South district (see Table 2). The going rate for building maintenance in the private sector is approximately $44.00 per hour.

At current service levels, the city could potentially save approximately 47 percent in the North District and 57 percent in the South District by contracting out breakdown building maintenance services. This amounts to fully-allocated cost savings of $679,883 in the North District, and $975,746 in the South. But considering unavoidable city costsC18.4 percent of current costs in the North and 19 percent in the SouthCreduces the total cost savings by $595,210. This yields a total net cost savings from privatizing building maintenenace of $1.06 million.

The city could use these savings to purchase over 4,150 more man-hours of building maintenance work, and would allow the city to perform some preventive maintenance on its buildingsCsomething it is not doing currently. Moreover, according to industry experts, each man-hour the city buys from the private sector would likely be more productive than in-house man-hours because private companies do not employ burdensome procurement guidelinesClike the city.

Table 2

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For custodial services, cost per square foot can be used as the unit of measure.

City custodial costs per square foot are $0.72 in the North District and $1.36 in the South District (see Table 3), while the market rate is around $0.72 per square foot for nonunionized firms and $1.32 per square foot for unionized firms. By industry standards, at first glance, the city's cost numbers are fairly low. The city's cost figures, however, are deceiving because they are based on very minimal levels of service to facilities like libraries and maintenance tasks which require less cleaning than office buildings.

Table 3

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Therefore private-sector costs are in actuality likely to be much lower than the figures quoted above which are based on cleaning office buildings. However, without inspecting the maintenance yards and other city facilities, it was not possible for the private contractors to provide more precise cost estimates, which are likely to be lower than those cited here (see Table 4).

Market for Private Service Providers

In the private sector, there are over 100 providers for maintenance and custodial services in Southern California. Many of these firms are within the City of Los Angeles. If the city were to outsource its maintenance and custodial divisions, there would be an ample pool from which to pick private service providers.

Table 4

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* This number includes costs of contract administration, monitoring, and unavoidable city costs.

For custodial services, in the North District, we cannot estimate cost savings from contracting out. In the South District, the potential savings are $1.18 million by contracting with a nonunionized company. Even using these very conservative private-sector custodial service ratesCbased on cleaning office buildingsCsavings can still be obtained through contracting.

IV. EXPERIENCE IN OTHER JURISDICTIONS

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Los Angeles County began contracting maintenance and custodial services in 1980. Initially the county made some mistakes in the contracting process, such as considering only the bid, not taking into account quality of service when awarding contracts, and making no provisions to encourage contractors to hire displaced county employees. The county learned from its early mistakes and in the second round of contracts improved its contracting process.

Contracts are now typically five years in length, for example, and quality and low bid are both considered in awarding the contract. The county currently has 15B20 custodial contracts; each selected on the basis of its overall merit. Bids are now judged first on the demonstrated ability of the contractor to provide adequate service for the needs of the specific building(s) going to bid. Firms are judged by their financial ability and their supervisory abilities as well. After these factors have been considered, the actual amounts of the bids are examined. Performance bonds are not required of firms because it is felt that this would likely prevent minority firms from competing in the bidding process. Instead, 30B45 day cancellation clauses are written into the contracts to protect both the county and the contractors. Another noteworthy improvement in the contracting process is the clause for emergencies: Contractors must be available to provide emergency clean-up services whenever necessary. The county has allocated a 10 percent contingency in its budget for such occasions.

Los Angeles County has also improved provisions for potentially displaced employees when services become privatized. Custodial employees now have several options regarding employment: 1) They can choose to be retrained in other fields, and then transferred to other areas within county government where they have the potential for increasing their salaries. 2) They can choose early retirement. 3) They can go to work for the private-sector provider.

Currently, contractor costs are 51 percent lower than previous county operating costs. Before the second contract, the county's custodial and building maintenance costs were $3.79 per square foot. They are now only $1.85 per square foot. A custodial services cost analysis estimated a savings of $242,279 for the maintenance of 15 buildings (see Table 5).

Table 5

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Philadelphia last year successfully contracted out custodial services at City Hall, resulting in a marked increase in the cleanliness of the facility. A December 1992 city report estimates cost savings of 20 percent, or approximately $344,000 from privatization. Quality also improved significantly. A city study revealed that contractors consistently performed all of the required cleaning tasks, even difficult or periodic ones. Previously, city employees had in many cases only occasionally (and sometimes never) provided the same services.

Before we contracted out the maintenance at City Hall these floors were filthy, says David Cohen, chief of staff for Philadelphia Mayor Edward Rendell. These windows were filthy. This whole building was a nightmare.

Contracts in Philadelphia are currently one year in length with a one-year contract extension option. A performance bond is required of the contractor in the amount of 25 percent of the contract's first year's amount. There is, however, some debate over this provision. Some city officials believe this requirement may keep minority firms from having a fair chance at bidding. A cancellation clause is also included in the contracts.

Overall, Philadelphia's experience with contracting has been positive. One city official has stated that we remain convinced that the only way to reduce costs and ensure a consistent level of quality service is to privately contract for these services. It is also felt that apart from cost savings and increases in quality, the contracting-out process can directly benefit city management capabilities. The research, performance measurements, benchmarking and cost accounting associated with preparation for privatization provides the incentive for in-house reforms and increased efficiency.

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The City of Chicago has also experienced success in privatizing custodial services. Like Philadelphia, Chicago experienced both substantial cost savings and quality improvements. The cost per square foot of custodial services was reduced from $2.28, $2.57 and $2.79 respectively in the city's three largest buildings to $1.81 overall. This amounted to over $5 million in cost savings to the city. (All numbers account for increases in employees' salaries and cleaning materials and supplies).

The Custodial Department was one of the first major departments within the city to consider privatization as a means of curbing costs. The city turned to contracting in an effort to help solve problems in the administration and performance of custodial services. According to one city official, the city had lost control of its custodial staff. There were problems with absenteeism and substance abuse by custodial workers. In addition, the average custodial worker was 64 years old with a chronic history of medical problems. As a result, job performance and the cleanliness of city buildings was very low. Productivity was calculated at less than 10,000 square feet per day; the commercial industry's average productivity rate is three times this.

Chicago's first contract, a 2-year, $5-million dollar contract with two, one-year renewal options, was eventually extended twice to a total of four years. Initially, buildings were contracted out in phases: 16 buildings were privatized during the first year; 16 more buildings the second year; and 53 additional buildings the third year. The total of 85 buildings are organized into three groups: Contractors may bid on one or more of these groups of buildings.

Contractors must make biweekly reports to the city regarding their expenditures on salaries and supplies, as well as on the tasks completed. City staff have observed that private providers use quality checkpoints more effectively than city custodial staff. The result has been cleaner facilities and more efficient cleaning and monitoring techniques. The improvement in cleanliness has been so sharply marked that the city has received thank-you letters from residents and other staff members.

In an effort to not displace city employees, Chicago required in its custodial contract that the contractor hire displaced city workers for a trial period of 60 days. If at the end of this time their performance proved unsatisfactory, or other problems arose, the contractor was no longer obligated to retain these employees. This process allowed the city to provide a guarantee for its employees and let the contractor filter out any problem people. Initially, the labor unions made an effort to protest the privatization movement, however, management's rights to sub-contract (stipulated previously in the agreements with the unions) were upheld. Chicago's Deputy Commissioner Louis Bennet, has stated that privatization has proved a very positive experience for his city.

V.WHAT ARE THE BEST WAYS FOR LOS ANGELES TO CONTRACT CITY SERVICES

First, the city should explore facility consolidation which would allow it to sell off some of its facilities which are now proving too costly to maintain properly. The city simply owns too many facilitiesCmany of which are underutilized according to General Services staffCin remote areas of the city. Facility consolidation would help make maintaining city buildings a more manageable task.

Los Angeles can also learn from other cities' models of competitive contracting. A crucial area to consider when structuring an effective contract is monitoring. First, the contracts should stipulate that any complaints by tenants be taken directly by the contractor. This will minimize the costs to the contract administration staff in the General Services Department. Second, the quality of services provided must be measured. This may be done by the contract administrator or remaining supervisory staff members. Periodic spot checking can keep city staff apprised of quality levels and will keep the contractor alerted to the needs of the city. A rating structure, similar to the one in place for the Custodial Services Division, could be used. Third, the contractor should submit periodic reports to the city which detail the costs and services provided. This will aid in the city's cost accounting and assure that the target services are being provided.

The city may also want to consider phased implementation of the privatization process, which has proven successful in Chicago and L.A. County. Structuring the transition in phases would allow time for the city's administrative staff to become acquainted with new procedures and mitigate some of the effects experienced by maintenance and custodial employees, especially when paired with forecasted attrition rates. Private providers will also have more time to calculate accurate price quotes, and contracts can be modified as lessons are learned.

Contracting out does not mean that the city will no longer be able to meet its affirmative action goals. In fact, if the process is structured so that firms may bid on individual or small groups of buildings, or in phases when particular types of buildings are being considered, minorities will likely be better off overall under privatization because minority-owned firms will have a good chance at delivering public services. In addition, if performance bonds are kept reasonable, minority businesses will not be kept out of the bidding process. The concern that if the city does not have control over the hiring process, then minority individuals and women will not be properly represented in the custodial and maintenance labor pools is misguided. A Bureau of Labor Statistics report shows that in the Los Angeles region, a large percentage of workers employed by private firms are either nonwhite or female. The reported averages for 1993 state that 37.6 percent of all custodial and maintenance workers are Hispanic or African-American men; an additional 30.7 percent are women. These figures suggest that if the city were to contract out these services, it is likely that women and minorities would be well- represented in the staffs of private contractors.

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Contracting out the Building Maintenance and Custodial Divisions of the General Services Department is a viable cost-reducing option for Los Angeles. Privatization has been successfully implemented in other large municipal agencies as exemplified above. The potential cost savings and service enhancements in the contracting of the services outlined above are one strong reason to outsource these services. Another is that there are many qualified providers in the Los Angeles region. Market competition will help keep bids low and affordable for the city.

Furthermore, these divisions are especially well-suited for privatization because they will have little impact on current public employees. As mentioned earlier, attrition forecasts for both divisions indicate that by the time any contract could be implemented, given the length of the bidding and public hearing processesCmany current employees will already have retired. In addition, absorbing any remaining employees into other departments would probably prevent the necessity of laying off any employees. These two factors should limit the political opposition against contracting these services. Judging by the experiences of Philadelphia, Chicago and L.A. County, the city can expect noticeable improvements in the quality of service it receives from private providers.

APPENDIX I: Cost Categories for Building Maintenance

Direct Cost

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District Support Costs Senior Craft Personnel, Supervisors, Superintendents, Clerical Support

Related Personnel Costs Medical/Dental Benefits, Retirement Plan, Workers' Compensation

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Indirect Costs

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Division Overhead Building Services Administration

Department Overhead Executive, Personnel, Management Information Services, Accounting, Finance Services

Outside Department Costs Information Services, Controller Services, City Administrative Office Services, Treasurer's Services, Personnel Services

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APPENDIX II: Cost Categories for Custodial Services

Direct Costs

Operations. Salaries, Overtime, Materials/Supplies, Contractual Services, Replacement Equipment, Replacement Tools, Uniforms

District Support Costs. Senior Custodial Attendant, Custodial Supervisor, Chief Custodian/Contract Administrator, Clerical Support

Related Personnel Costs. Fringe Benefits: Medical, Dental, Retirement, Workers' Compensation

Indirect Costs

Other Divisions. Materials Management, Communications Services

Vehicle Costs. Maintenance, Replacement, Fuel, Mileage Paid

Facilities. Custodial Services, Security Services, Water and Electricity

Division Overhead. Administration of Custodial Services

Department Overhead. Executive, Personnel, Management Information Services, Accounting, Finance

Outside Department Costs. Information Services, Controller, City Administrative Office, Treasurer, Personnel

APPENDIX III: Positions and Public/Private Salary-Range Information

The Building Maintenance Division currently employs 65 individuals in both the North and South Districts. These positions range from supervisory to maintenance worker in the areas of construction/maintenance, plumbing, electrical repair, carpentry, lock replacement, painting, and air conditioning. The salaries of these individuals range from $29.89 per hour for the top supervisory position of Building Maintenance Supervisor, to $10.19 per hour for Maintenance Helper.

The Custodial Services Division currently has 127 employees in both districts. Positions in this division range from supervisory to Custodial Services Attendant. The salaries for these employees range from $14.25 per hour for the position of Chief Custodial Supervisor to $7.86 for the lowest level Custodial Attendant. The Bureau of Labor Statistics quotes the average wage for California local government level janitors as $10.76 per hour, excluding benefits.

Ten firms were surveyed by telephone in this study of private-sector comparablesCfive from each division. This survey revealed that few private-sector providers in the Southern California area hire unionized staff members. In addition, few firms surveyed offered their employees any benefits packages other than occasional incentive programs. The average wage for custodial workers was $5.15 per hour, while the average wage for maintenance workers was about $16.00 per hour. The Bureau of Labor Statistics quotes the average private- sector wage for custodial workers as $6.49 per hour, while the average hourly wage for private-sector maintenance workers was $18.88 per hour. These numbers are probably higher because they are drawn from statewide data.

APPENDIX IV: Performance Measures

Quality assurance in the Building Maintenance Division requires: 1) first level supervisors reviewing the work tickets and the hours spent on specific jobs; 2) supervisory spot review of specific jobs; and 3) legally mandated periodic review and maintenance of equipment (e.g. backflow devices, fire extinguishers). The Custodial Services Division has a formal quality-control program involving regular inspections, completion of inspection forms, reporting of repair needs, etc. A quality control inspector visits facilities weekly or monthly (depending on frequency of service) and grades the quality of cleanliness of each major category by element (floors, walls, etc.). The total rating score per category reflects total cleanliness for given areasCi.e., (office area, restroom, corridors, etc.). Each area element is rated Good, Satisfactory, or Unsatisfactory.

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In addition to the subject areas explored in depth in the previous sections, there are many other areas in which a competitive approach could benefit the City of Los Angeles (see Table 2 on page 117). The citizens and taxpayers of Los Angeles deserve a government in which every activity is scrutinized. If a competitive structure can enhance efficiency, it should be implemented.

A competitive model of service provision should be considered across the board, and wherever approriate, implemented. Evidence from other cities and from the analysis just presented indicates that superior service and cost savings of 20B50 percent can be achieved through competition. Following are several other areas in which privatization should be considered (see Table 3 on page 120).

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The Los Angeles Department of Airports owns and operates four airports: Los Angeles International (LAX), Ontario, Palmdale, and Van Nuys. While all are potential candidates for some form of privatization, the major fiscal impact would come from privatizing LAX.

LAX is one of the city's most valuable assets, comparable only to the port and the municipal electricity/water utility in asset value. A study commissioned by the city and carried out by Babcock & Brown in 1992 estimated LAX's market value at around $2 billion. A 1993 Reason Foundation study, building on the city's study but making somewhat different assumptions, concluded that the sale of LAX would net the city $2.2 billion, while the net present value of a 30-year lease could be as much as $3.7 billion (see Table 1).

Table 1

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1 Revised Babcock & Brown2 Public/Private Partnership

Source: Reason Foundation

There are several advantages to a lease rather than a sale of LAX. First, it would probably yield a greater total net gain to the city, as noted above. Second, it is likely to be more politically feasible, raising fewer concerns about loss of control on the part of the public, the city council, the airlines, and the Federal Aviation Administration (which makes airport grants to LAX). Third, the legal case for a long-term lease appears to be stronger than for a sale, given that at least four U.S. airports are currently leased to private, for-profit firms with the approval of the FAA.

Some would like the city itself to operate the airport as a for-profit business and use the net profits for general-fund purposes (such as expanding the police force). There are two problems with this alternative. First, the city is likely to be less successful as an entrepreneur than a professional airport firm would be. There are large risks in converting a bureaucracy to a commercial corporate culture and making investments in new facilities and services intended to produce a commercial rate of return. Those risks are more prudently borne by the private sector rather than by the taxpayers.

Second, it is illegal under federal airport-grants law for a municipal airport owner-operator to take any airport profits off the airport. As a condition of receiving and using federal grants, the municipality must devote all airport revenues to airport purposes. Congress's aviation subcommittees strengthened these revenue diversion provisions during the first half of 1994, so it is unrealistic to expect that Los Angeles will be able to get this law changed in the opposite direction.

By contrast, when an airport company enters into a long-term lease of an airport, it is legitimate and legal for it to pay the owner (the municipality) for the use of the land (which represents the city's direct investment in the airport). This lease payment is an operating expense to the airport company, analogous to wages and salaries, utilities, and other expenses. All monies paid out as airport operating expenses are spent by their recipients off the airport. Hence, a lease payment is not revenue diversion.

Around the world, 54 countries are involved in some form of airport privatization, usually involving either the sale of the airport or some form of long-term lease or franchise agreement. Among the countries embarked on this course are Argentina, Australia, Austria, Denmark, Germany, Greece, Italy, Mexico, and the United Kingdom.

In the United States, airport privatization has been proposed in a number of cities, including Atlanta, Baltimore, New York, Rochester, and Syracuse. Early in 1994 Indianapolis issued a request for strategies to the private sector; it received eight serious responses, including U.S. airport operators Johnson Controls World Services (Atlantic City International) and Lockheed Air Terminal (Albany, Burbank) plus overseas operators BAA (London's three main airports) and Aeroports de Paris (the two Paris airports). Indianapolis is now considering issuing an RFP to lease its airport.

The Airport Commission should follow the example of Indianapolis and request informal proposals from the private sector for a long-term lease of LAX. If the results indicate serious interest, with potential annual lease payments in the vicinity of $100 million or more, it should then develop a formal competitive process under which formal lease proposals would be sought.

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A.Summary

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Next to LAX, the biggest savings and/or revenue increases that could potentially be realized by the city from privatization/competition lie in the Department of Water and Power. Savings and/or revenue increases through the sale, lease or contract management of parts or all of the city's water and/or power operations are likely to total hundreds of millions of dollars annually.

The Mayor's Special Advisory Committee on Fiscal Adminstration report (termed the Tennenbaum report) found substantial inefficiencies in DWP's power operations compared to 57 investor-owned utilities. According to the report, restructuring the DWP Power System could result in efficiency savings and revenue increases in the range of $118 million. A separate audit commissioned by the city council found that operating expenses could be reduced by over $200 million if the operations were restructured. The poor showing of the power system compared to the investor-owned utilities would seem to make it a prime candidate for privatization.

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The Tennenbaum report recommendations are based on a benchmark study conducted by Arthur Andersen which compared the city's power system operations with 57 investor-owned electric utilities. According to the benchmark study, DWP's industrial rates, distribution expenses, administrative expenses, and accounts receivable days are all significantly higher than for the other utilities in the benchmark group.

Among the conclusions produced by the Arthur Andersen benchmark study were the following:

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ADWP's distribution expenses per customer are well above the benchmark group ($114.11 per customer versus benchmark median of $68.69). The DWP's expenses would be $50 million less if its distribution expenses were at the benchmark median.

ADWP's administrative expenses are also above the benchmark group. If these expenses were at the benchmark median, it would save $30 million a year.

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Getting any large organization to radically change its operations to achieve savings of this magnitude can be a very difficult processCfor a public-sector-operated enterprise it can be nearly impossible. Experience around the country suggests that if such fundamental restructuring and reengineering is to be achieved in a public-sector department, it is likely to occur only through competition. The private power industry now produces 51,300 MW of power in the United States. Another 74,000 MW of private power are under construction or in developmentCthis represents half of all new planned power capacity. We recommend the city begin exploring the sale, lease, or contract management of its power system.

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Privatization also appears to offer large potential savings opportunities for managing the city's wastewater facilities. Indianapolis's recent privatization of its two advanced wastewater treatment facilities will result in savings of $68 million over 5 years. According to several major private water/wasterwater companies who have looked at DWP, Los Angeles could expect operating savings of at least 25 percent and up to 50 perent from privatizating wastewater plants.

Water and wastewater are among the fastest-growing areas of privatization in the United States. Last year alone, dozens of cities privatized water/wastewater operations and management (O&M) or began taking steps to do so.

The most dramatic example last year ocurred in Indianapolis where the city awarded a five-year, $87-million contract to the White River Environmental Partnership to operate two of its adanced wastewater treatment plants. The contract is enabling the city to cut its annual operating budget by 44 percent. Moreover, according to the local AFSCME spokespersons, municipal employees hired by White River are getting a better pay/benefit/incentive package than they were getting previously working for the city.

Many other cities have recently privatized or are in the process of privatizing their water and wastewater operations. In April 1993, Newark, N.J. signed a three-year contract with Professional Services Group, Inc. to manage the city's 80-mgd Pequannock Water Treatment Plant, which serves 500,000 people. The contract will save the city $1 million annually.

The City of Laramie, Wyo. found that privatization was the least costly and most expedient method for upgrading the city's $13-million wastewater treatment plant. According to the report commissioned by the city council, privatization will reduce total project costs and O&M costs by 10 percent and accelerate project delivery. The Miami (Ohio) Conservancy District is also privatizing its wastewater treatment facility. Wheelabrator EOS has offered $7 million to the district in a 20-year contract to operate the district's facility.

The troubled Santa Margarita Water District in Orange County has received a $300-million buyout offer from California-American Water Company. The company has also offered to hire all current District employees. privatizing the water system would put it on local property tax rolls, paying $3 million per year. The water district serves 80,000 people, with a planned expansion to 180,000.

Privatization of water supply and treatment systems both in this country and abroad, has demonstrated the following benefits:

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Substantial inefficiencies have been documented in the city's water and wastewater operations. Contracting out the management of the plants would allow the city to utilize the expertise of major international operators and is likely to result in substantial cost savings.

IV. CONVENTION CENTER MANAGEMENT

Based upon the experiences of other cities, we recommend that the City of Los Angeles explore the possibility of contracting out the management of its Convention Center.

Convention center management is a growing area of privatization. The rise of privatization mirrors the increase of convention centers themselves; in 1991, there were more than 330 centers in the country, a 50 percent increase since 1980.

Reasons for privatizing convention centers are simple. Private organizations are often better equipped to develop comprehensive marketing and sales programs to promote the facilities. They are also better at managing such private services as concessions, food service, retail operations, and booking of entertainment and trade organizations.

The privatization of convention center management is in many ways an ideal option for an industry that requires a unique responsiveness to the demands of the customer. Customer service is critical in order to garner repeat customers and acquire new ones. The Los Angeles Convention Center (LACC) already contracts out a number of services, including telecommunications, systems and equipment maintenance, and custodial services. For FY 1994, funds were budgeted for 57 contracts with a value of just over $2 million.

Numerous cities in the country have recently contracted out for convention center management, with a good deal of success. The privatization of the Cook Convention Center in Memphis, Tennessee is one example. In 1992, the City of Memphis/County of Shelby contracted with a private manager, Spectacor Management Group (SMG), in order to reduce the center's annual operating deficit of $1.78 million per year.

Under the terms of the three-year contract, SMG took over complete operation of the facility, including day to day operations, up-keep and maintenance, and booking. The Convention Center Board retained overall policy control: it has the authority to approve the contractor's budget, marketing plan, booking policy, affirmative action plan and policy manual.

The first budget submitted by SMG, for FY94, showed a reduction of $220,000 from the originally approved budget for the time period. The proposed budget for FY 1995 will reduce the original operating deficit of $1.78 million to $1.25 millionCa $500,000 savings. SMG officials attribute a large portion of the savings to restructuring the food and beverage system. Under the city's management, the concession system was open to all caterers, and the center provided a portion of the concessions as well. SMG competitively bid out concession services to an exclusive provider, saving $250,000 per year.

The transition of the Memphis Cook Convention Center to private management also resulted in very little, if any, disruption to former employees. SMG offered positions to 27 of the convention center's 32 full-time employees. Those not retained found employment in other county departments.

Many other cities have had positive experiences with contracting out convention center management. The city of Arlington, Texas contracted with a non-profit corporation in October, 1992 and in the first three months of the fiscal year following privatization, the Convention Bureau had booked 11,000 rooms, compared to 6,000 for the same period the previous year. The City of Riverside, California also privatized its convention center, in 1991, and realized savings of $400,000 in the first year alone.

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Because it requires specialized knowledge and because technology is the rapidly changing, information services offers the city of Los Angeles another good privatization opportunity.

Under the direction of the Department of General Services, the city currently has a data management function that provides development and evaluation services on technological applications such as hardware and software throughout the city. Such services range from payroll and court processing to advanced development of specialized software and departmental systems.

Although the city processes literally millions of documents annually, the existing management of information would best be described as a fragmented compilation of departmental and interdepartmental operations. With the advancement of the Information Superhighway, the city will soon realize the limitations of its existing program due to an inability to invest (due to budget reductions and a lack of expertise) in the required capital and technology that are necessary to meet future demands.

Over the course of the past decade, there has been a nationwide private-sector trend toward outsourcing information systemsCdata processing, office automation systems, telecommunications, bill and payroll processing,etc. In 1990, American companies spent $7.2 billion on outsourcing computer information services. By 1995, that number is expected to grow to over $15 billion according to Input, the Mountain View, Calif.-based computer market research firm.

Although outsourcing, or contracting out an organization's entire computer operations, hasn't yet progressed as far in the public sector as the private sector, there has been a considerable increase in information services privatization activity in state and local governments. Services such as payroll and financial management, ticket and court records processing, traffic controls, and municipal records management are contracted out. Companies such as EDS, Martin Marrieta, and CMSI have begun the transition from corporate accounts into managing municipal systems. Banks and other institutions are quickly becoming important service providers by reducing the need for municipal processing of such records as payroll and municipal checks. A 1992 survey by Apogee Research revealed a 20 percent increase in privatization in this area in just three years.

Within both government and corporate America, outsourcing technology needs has provided both technological and financial benefits. Governments turning to the private sector for information services are finding outsourcing offers a number of benefits. These include:

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Most examples of contracting out information services generally fall into one of three categories: bill collection and processing, reengineering and applications development, and general data processing needs.

The computer information area most commonly contracted out to private firms is bill collection and processing. Medicaid processing is contracted out by at least 18 states. EDS, for instance, handles 350,000 claim items per day from 70,000 providers for California's Medi-Cal (California's version of Medicaid) program. Prior to EDS taking over the program in 1988 there was a 22-day backlog of unopened claims and claims processing was so slow that a group of hospitals sued the state for millions in unpaid claims. Now claims are processed in six days, and there is no backlog.

A second opportunity for privatizing Los Angeles's information systems is in the application of new technology for reengineering work processes. Installing document-imaging technology, for example, eliminates the need to store millions of paper files. The City of Dallas expects to realize significant space savings and handle court document requests with 10 fewer employees a year through document imaging, for a yearly savings of $250,000.

Lastly, the City of Los Angeles should explore hiring a private firm to operate all its general data processing or computer maintenance. The Illinois Department of Central Management Services began contracting with IBM in 1987 to handle computer maintenance for all state agencies. By reducing paperwork and administration costs and persuading IBM to give a 10 percent annual discount off maintenance fees, the state has saved about $12 million since 1987.

Local governments such as the counties of Orange and Los Angeles, and the cities of Long Beach and Orange have contracted with private firms for the maintenance and upgrading of internal systems. Advantages to this type of service include reduced cost of equipment purchase and maintenance (because the systems are leased from the private company), and the enhancement of software and hardware.

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With a budget of about $40 million, fleet maintenance is another service area where the City of Los Angeles may be able to experience significant cost savings and quality improvements by opening it up to competition. A 1990 survey by the Mercer Group found fleet maintenance to be one of the key areas in which governments used privatization.

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Governments are increasingly turning to the private sector to maintain their vehicle fleets for many reasons. Among these are the following:

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Governments are finding that these deficiencies can often be effectively alleviated by privatizing the fleet maintenance operation. Experiences from Phoenix, Des Moines, and the County of Los Angeles demonstrate that privatization, when properly implemented, can result in substantial first-year cost savings and even greater savings in subsequent years.

By contracting out, governments can often purchase higher-skilled fleet maintenance expertise because some contractors have national recruitment departments that have little trouble supplying top-notch labor in any location. Another benefit is that the right contractor can supply urgently needed capital equipment to the government on a rental or capital-lease basis and can train employees in the correct use of such equipment.

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Fleet maintenance can be divided into two kinds of services: target and non-target services. With target services, the contractor can plan, program, and forecast manpower and operational requirements in order to provide an established level of service. Target services include preventive maintenance, corrective maintenance, inventory management, motor pool operation, road service, and towing. Several supplementary tasks are also provided, such as fuel pump repair, fuel ordering, and courier service.

Non-target services are hard to define, because they cover all services which are not included in the target services. The result is that the contractor actually does not have much control over expenditures of the non-target services because they are difficult to plan and forecast. This can sometimes lead to disagreement between the contractor and clients. Examples of non-target services include accident repair, vehicle abuse, unexpected work load due to emergency situations such as snow, flood, or other natural disasters, fuel pump repairs, underground storage tank work, and capital expenditures.

In order to guard against potential disagreements between the contractor and contractee relating to the costs of non-target services, the contract should specify some emergency mechanisms and procedures, such as on-call crew, special time schedule arrangement for emergency services, and cost estimation criteria. Another way to resolve the dispute on the costs of non-target services is to design different alternatives for service charges. The most popular choices are averaged fixed price and fee-for-service. Both of them have advantages and disadvantages depending on different contexts of the dispute.

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In reaction to an audit that determined the contract had cost taxpayers $1 million more than expected, in March 1991, the Board of Supervisors terminated Los Angeles County's largest private contractCthe five-year, $65-million contract with Holmes & Narver Services to maintain and repair the county's 6,500 vehicle fleet. (Modified contracts with three other private firms were soon signed, however).

Los Angeles County's fleet maintenance contracts have saved the county approximately $14.7 million. The problems encountered with the Holmes & Narver contract were largely the result of inaccurate records the county had kept of the status of its fleet maintenance prior to privatization. The termination of the contract is not an indicator of the failure of contracting out, but a lesson to government in the need for more accurate pre-contracting information, better-written RFPs, and incentives and performance standards for the contractor to provide the highest quality service.

The major lessons from the Los Angeles County experience can be broken down into several categories: contract strategy and development; management information systems; and internal contract monitoring operations.

Contracting strategy and development:

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In order to avoid the kind of post-contract disagreements like those that occurred in Los Angeles County, the Fleet Maintenance Contract should at least specify four core factors: range and variety of maintenance, time schedule of maintenance, cost estimation, and criteria for quality monitoring.

Management and Information Systems

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Internal Contract Monitoring

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The Mayor's Special Advisory Committee on Fiscal Management, in its Tennenbaum Report, published its findings in February 1994 on the city's current system of acquisition and disposition of assets. The report found the city's decentralized procedures for processing real estate transactions to be inefficient, overly cumbersome and time-consuming, with political intervention a factor which often delays transactions, costs money, and makes effective decision making difficult.

The report made a compelling case that in order to realize important financial benefits from its assets, the city needs a more efficient and more proactive approach to asset management. A more proactive approach to managing its assets would include aggressively exploring options for the sale or lease of various assets such as vacant land, underutilized buildings, facilities, and infrastructure assets such as the airport, water plants, and power system.

Carefully designed asset sales and leases could be a potential major new revenue source for city hall. The City of Anaheim, for example, earns over $19 million a year from leasing its stadium, golf course, and Anaheim Convention Center to private companies.

Table 2

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Table 3

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INTRODUCTION

There are significant political and psychological barriers to injecting competition into public services.

Some opponents call private service providers privateers and view privatization as an attempt to decimate the public workforce.

In Los Angeles, public employee unions and some city councilmembers have voiced strong objections to privatization. The following quote from City Councilman Mark Ridley-Thomas is typical of the concerns expressed by those who oppose opening up government to competition from the private sector:

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While understandable, most of the objections raised about privatization are not supported by the considerable body of evidence that has been accumulated on the subject over the past fifteen years. In the following section we attempt to answer the most frequently voiced objections to privatization.* In addition, the section will outline a number of precautions that can be undertaken to ensure successful privatization.

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One of the principal reasons public employees are hostile to privatization is the perception that they will lose their jobs as a result of it.

Response: Few public employees are ever laid off as the result of privatization.

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 laid off. Over half of the workers (58 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 1). The study concluded that in the majority of cases, cities and counties have done a commendable job of protecting the jobs of public employees.1

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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.2 Of the 6 percent of displaced employees, half obtained jobs with the private contractor.

Recent large-scale privatization initiatives have demonstrated similar results. The City of Indianapolis has privatized dozens of services over the course of the past two-and-a-half years, yet no public union workers have been laid off.

It also must be recognized that privatization is not a zero-sum equation: though the number of public jobs may decrease, jobs are also created in the private sector from privatization. Since launching its comprehensive competition program, for example, Indianapolis has experienced its most-rapid private-sector job growth in decades.

Nevertheless, there are a number of techniques available to officials to insulate present workers from the potential of involuntary job loss, including:-

working within the rate of attrition;offering early retirement incentives; and having contractors hire displaced workers; Ûallowing public departments to bid on the contracts.

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, with staff reductions occurring only as employees retire.

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.3 (See Table 2).

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.

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

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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.

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Critics argue that because minorities constitute a disproportionate share of many government workforces, they are more adversely affected by privatization than whites. Writes Mark Ridley-Thomas:

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Response: In general, public employee job loss from privatization does not fall unevenly on minorities and women.

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.5 The study found that African-Americans are potentially 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.6 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.

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Some critics of contracting out have argued that the private sector is able to provide services more cost-effectively than city crews only because they pay rock bottom wages and provide almost no benefits to their workers. Writes Councilwoman Jackie Goldberg in the Los Angeles Times:

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Response: The evidence on the public sector/private sector pay disparity is mixed, yet this issue should have little relevance on whether or not to privatize.

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, 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.

As will be apparent from the following studies, however, the evidence is mixed regarding whether a large disparity in pay and benefits exists in the public and private sector for comparable work.

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.8

In some service areas, wages and benefits do seem to be 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.9 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.10

A 1992 report of the American Legislative Exchange Council (ALEC) authored by Wendell Cox and Samuel Brunelli also concluded that wages and benefits are higher in the public sector than in the private marketplace for comparable work. The study found that total compensation packages were significantly higher for public employees 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 $4,031.11 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.12

On the other side of the debate, several studies have documented either lower or comparable wages for public- sector workers compared to private. 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.13

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.14

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 California cities that contract for services with 10 cities that perform the same services in-house15 (see Table 3).

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 minimalC contractors paid an average of $551 per month versus municipal governments, which paid an average of $524 per month in benefits (see Table 4).16

It is not the purpose here, however, to try to settle the public/private wage debate. From the taxpayer's perspective all that really matters is that they are receiving the highest quality services at the lowest possible price. Exposing public-sector pay to competitive pressures by moving public services into the marketplace provides a benchmark for determining what the market rate of pay should be for public employees.

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Councilwoman Ruth Galanter has called for full public disclosure of all discussions regarding privatization of city services and city assets. Says Galanter:

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Response: Privatization should be conducted in an open, competitive environment.

The bid award process should be transparent and announced at an open, public meeting that is widely publicized. Awarding the contract is an important element of the bidding process. Ideally, a team of officials reviews the bid, even though it may be perfectly clear who is the low bidder. The team usually has representatives from the legal, finance, purchasing and contracting departments. This group certifies that the bid meets all specifications; meets all requirements (including bonds); is from a responsible bidder (i.e., an experienced and financially stable concern); and is the best (usually lowest) bidder.

The single most important technique for preventing contracting abuse is to promote competition between service providers. Competition encourages bidders to lower their bids through concern that a competitor will bid lower. Furthermore, in a competitive process unsuccessful contractors are quick to raise legal objections, thus discouraging sweetheart deals and other forms of collusion between contractors and public officials. Competitive rebidding of contracts ensures that ineffective contractors who may have developed cozy relationships with public officials are replaced by new firms if they fail to provide quality services.

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Some councilmembers are rightly concerned with ensuring that the quality of the city's services doesn't decline when privatization is introduced. Writes Mark Ridley-Thomas:

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Response: Surveys indicate that quality generally increases when competition is introduced.

In a 1992 Survey on State Government Privatization conducted by Apogee Research and sponsored by the National Association of State Comptrollers, Higher Quality Services was ranked near the top of the Advantages of Privatization. Only Capital Cost Savings and Operating Cost Savings were ranked higher. In a 1980 survey of 89 municipalities, 63 percent of public officials reported that contracting out resulted in better services.19 A 1993 50-state survey by the Council of State Governments (CSG) also found high quality service to be one most-often cited reasons by public officials for privatizing a service.

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Loss of control is perceived as one of the foremost implementation problems with privatization.

Response: Loss of control is also one of the easiest objections to privatization to resolve.

Indianapolis Mayor Stephen Goldsmith believes the loss of control issue is a red herring. In May 1994 he addressed this issue when speaking to a group of public-sector officials. Said the mayor:

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Experience around the country bears out Mayor Goldsmith's position. Governments canCand regularly doCuse numerous methods to ensure that control over the quality of service is retained when contracting out. These are:

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If a government wants to maintain a certain level of control over selected facilities, operations or services, this factor should be weighted heavily when establishing the criteria to qualify and evaluate the privatization opportunities.

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Government officials should also indicate in the RFP the extent and nature of the control they wish to retain over contracted service provision.

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If the required level of control by the government is marketable and negotiations begin with the selected private company(s), the government needs to develop specific performance standards to which the private company(s) will be held in the evaluation of their work.

Performance standards address issues such as:

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ATimeliness of Service and Repairs;

AActual Versus Expected Savings; and

AAvailability/Access to Government.

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A potential problem with developing performance standards is to specify performance requirements that are so detailed that they obviate the entire purpose of contracting out. By overspecifying, governments can also kill the interest of private companies in participating in privatization projects or public/private partnerships.

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Governments should develop and document performance standards and other requirements as if there will be a problem or dispute in the future with the private company selected for each privatization. Governments can specify a rate schedule to cover the cost of government intervention if the private company fails to perform to the documented standards.

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Governments can also demand bid bonds and performance bonds. The objective of the bid bond is to create an incentive for private companies to close an agreement. In other words, if the shortlisted, or selected private company(s) declines the award, it must forfeit the amount of the bid bond. The performance bond goes into action when private companies default in some manner during the term of the contract. Governments should be careful not to set the size of the performance bond too high, because it inhibits the participation of small companies and could serve as a catalyst for higher consumer costs. The size of the bond should be determined in advance to cover only the cost incurred by government to correct the situation or structure a contract with another company.

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In order for governments to detect a less-than-adequate performance by a private contractor, they will need to establish a system of monitoring and maintaining accurate records. Governments can use a variety of methods to monitor the performance of a contractor. These methods include:

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ASurprise On-site Inspections;

AUser Surveys;

AComplaint Monitoring; and

APeriodic Cost Comparisons.

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Unless governments retain at least oversight control, and manage the privatization contract, there will always be the danger of losing the advantages of competition.

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Privatization has been a volatile issue in Los Angeles, with highly charged rhetoric emanating from both sides of the debate. Much of the rhetoric, unfortunately, is based more on emotions and misperceptions rather than on an objective examination of the issues involved in contracting out services. Rather than reflexively opposing any discussion of competition and privatization, a more balanced approach for privatization skeptics would be to evaluate each competitive bidding project on its individual merit.

Keeping an open mind to introducing competition into city services will help to ensure that Los Angeles's elected officials fulfill the obligation they have to taxpayers to not waste their hard-earned tax dollars.

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