WITH Geoffrey Segal, Director of Government Reform, Reason Foundation

GEOFFREY SEGAL is the director of government reform at the Reason Foundation, a nonprofit market-oriented think tank based in Los Angeles. He has a diversified background in policy research and analysis, focusing on public-private partnerships, competition, government efficiency, government spending and waste, transparency, accountability and government performance. He recently served as an advisor to Florida Governor Jeb Bush's Center for Efficient Government. Located primarily in Washington D.C., he is working with the Government Efficiency and Financial Planning group inside the Office of Management and Budget. Segal has worked closely with legislators in 20 states to reduce government spending, improve government performance and enhance accountability in government programs. He has testified to the United States Senate and numerous state legislatures and agencies. He is editor of Reason's annual *Privatization Report* and a contributing editor to *Budget & Tax News*. He holds a B.A. in Political Science from Arizona State University and a Masters of Public Policy from Pepperdine University. He was interviewed October 27, 2005, following his speech to a Frontier Centre luncheon.

Frontier Centre: You have described the contracting out of government services as a rapidly growing phenomenon. Is it still?

Geoffrey Segal: Well, rapidly is a very subjective term and it really is relative to past experience. When we look specifically at the United States, we see a couple of fundamental things developing and the first is that governments at every level are taking more of a comprehensive approach to introducing competition and utilizing the private sector rather than simply go for a single initiative at a time. We are seeing more and more in developing these comprehensive programs where they are introducing competition across large swaths of traditional government services. Overall over the last few years with continuing budget challenges, we have continued to see contracting on the rise. Again, rapidly may not be the best word to describe it, but it certainly is increasing.

FC: Do you have a percentage figure? Are there any cities that are focusing on this area of public policy?

GS: There are a number of cities, traditional cities that pop to your mind like Indianapolis and Phoenix. A small city just outside of Atlanta called Sandy Springs is contracting out about 80% of their municipal services. The problem with getting good data is there is no central repository of information and frankly, with about 75 or 80 thousand cities, towns and counties in the United States, there is no way to collect that data.

FC: Why does contracting and privatization save money?

GS: The two primary factors are, one, that competition always produces better results—we have seen that in industry after industry, and competition does drive down prices—and the second factor is just that the incentives are different. The private sector has better incentives to focus on the bottom line and deliver results, which generally are cost savings.

FC: Do you have any ballpark figures? What are the typical savings?

GS: Typical savings usually are in the range of 15 to 30 percent. The federal government's average savings are slightly over 28 percent. Depending on circumstances, you do see as high as 50 and as low as 5 percent.

FC: Are there examples where contracting has ended up costing more money?

GS: That's a tricky question, because the answer is yes and no. The answer is yes when cost was completely taken out of the equation, in the sense of, "We contracted to dramatically increase the scope of a service," so you are not comparing apples to apples. In those cases, if you looked at per unit cost, the cost was higher. However, when you traditionally think of "When we contracted out a service, did it cost more?" I cannot think of an example of that taking place.

FC: Let's talk a about Milwaukee, which is a city that has some similarities with Winnipeg, population-wise and being an older, slow-growth city. They have contracted out the operation of their water plant. What is the context there? Have they saved any money?

GS: Yes. They are saving money and the quality of their water has improved as well.

FC: How much are they saving?

GS: I do not know the specific number.

FC: A few years ago, we brought in the mayor of Indianapolis, as well as the leader of the municipal workers' union. They also mentioned that the water facilities had been contracted. Do you have information on that?

GS: Yes.

FC: Why did they do it?

GS: They did their sewer system. Indianapolis is actually the classic example of taking a comprehensive approach to introducing competition into a number of services. No only did they do wastewater, they recently did water; their road maintenance and pothole repair has been done. They have done a number of initiatives; all have saved money and all have improved the service. You are talking double-digit percentage savings.

FC: Your presentation here was titled, "If you could save 225 million dollars, would you?" How did you arrive at this figure for Winnipeg for saving money from contracting out water and wastewater?

GS: Winnipeg is considering investing well over $900 million, actually close to a billion at last count; even just taking a basic 25 percent savings puts you north of $225 million, based on those figures. It is essentially a number that is derived out of the typical savings that we see in other cases and seeing how much money is being spent on the initiative. That is where the $225 million comes from.

FC: How could politicians retain control of a vital service like water if management resides with a non-government entity?

GS: Two very powerful tools. The first is the contract itself, actually. I believe it fundamentally increases their power and their control. They are able to demand specific performance and have something to point against in the sense of rewarding good performance and/or penalizing the failure to perform. The second is the government remains the regulatory body that oversees the water companies, sets the standards and ultimately measures the water quality as well.

FC: Once a company has a contract, how much competition can you expect at renewal time? Would not the existing provider have an inside track?

GS: The water services industry is a very competitive market. There has been some consolidation over the last few years, but it remains highly competitive. Usually there are four or five companies that will bid on almost every project, and the general rule of thumb is that, once you get three, you have a good competition.

FC: Most people here can't conceive a commercial water utility, yet you cite German, French and English companies that have a long track record in providing water services. Can you elaborate?

GS: European cities have been contracting for water for centuries. In fact, the three largest water companies in the world are French, British and German respectively. London and Paris have had private water services since the 1850s.

FC: Where would a typical company find those savings if one were to take over the Winnipeg facility?

GS: They are going to introduce new technology and they are going to automate as much as possible. The companies have better purchasing power and over time they may use fewer employees, in the sense of getting the same job done with fewer folks. Perhaps the biggest reason is just the incentive to keep an eye on the bottom line, be efficient and root out waste, which will deliver the savings and enough room for their profit.

FC: What if a private company that delivers the service goes bankrupt?

GS: In the water industry, it has never happened. I suppose there is always the hypothetical that it could. Typically, companies are required to post a performance bond or post some insurance, in the sense that there would be money available for operations. Again, given the competitiveness of the environment and of the water industry the other competitors would love to step in and take over operations. Even if a provider goes bankrupt, the pipes are still in the ground, and the operators (the employees) are still there. It is possible and it has happened where the city could just take the service back over.

FC: How does the safety record of outsourced facilities compare with those directly owned and managed?

GS: I assume you mean owned and managed by the public sector. In the U.S., the privately operated facilities have a lower rate of EPA violations in terms of not meeting water standards and quality standards.

FC: What about the safety records? Do workers benefit from a safer workplace when it is contracted?

GS: I don't know about safety. A benefit of competition or of contracting out is reducing the government's workers' compensation claims and the risk that is inherent by having more government employees. This risk would be shifted to the contractor.

FC: You claim that many municipalities contract out water and wastewater services to improve their quality. How does that work?

GS: They sign a performance-based contract that outlines the expectations and standards that are to be provided. Should the contractor not meet those standards, penalties and the withholding of payment and the like take place. The contract and the mechanisms determine the ultimate performance that is required and what is met.

FC: In Canada, the opponents of contracting out water services cite horror stories like Walkerton, Ontario, where residents got sick and died, as the main reason to fear such policies. Yet Walkerton was a public-sector facility; it was government officials who fell down on the job. Is such demagoguery common?

GS: It is. The twisting of facts, stories and half-truths are always going to take place, yes.

FC: Our understanding is that the employees typically benefit in these arrangements because they have a bigger career track. Why is it that the unions in particular don't like this policy?

GS: It threatens their base. Typically the employees who go to work for a private contractor end their membership with the union. Although there is nothing that prohibits them from unionizing with the private contractor, even for a short time period it is a direct attack on their influence and power, as the public employee union derives its power from the number of its members. If you are taking 200, 300, or 500 off their membership list, their power and influence goes down.

FC: Why did the union in Indianapolis buy into the privatization there?

GS: They saw it as an opportunity. Mayor Goldsmith was open and forthright. He gave them an opportunity to compete; they did win a number of competitions and kept the service in-house. From a broader policy perspective, public employees usually are the first one to be criticized for poor service—maybe just a step ahead of elected officials—but they are beaten up in the media and there's a very low public perception of the quality of work they do to begin with. If I were a union member, I would embrace the opportunity to get in an open, fair competition because this is my one chance to prove that my colleagues and I were doing a good job, providing a good service and that we deserve to stick around because we did win a competition. I would embrace a competition unless I knew there was waste, unless I knew that there was no chance to win because we were grossly inefficient, and as a taxpayer and a citizen, I would think I would want to make services better for citizens.

FC: How much job loss can a local bureaucracy expect with outsourcing? Are there ways to mitigate this?

GS: Again, the contract mechanism does allow you some opportunities but it's really just a matter of strategic thinking. In the U.S. history, fewer than 5 or 6 percent of employees are negatively impacted. A couple of tools are a requirement that the contracting agency hire anybody they need from the existing pool, and secondly taking care of any other reductions in the workforce with attrition and the general rate of retirement. You know you have open positions throughout other places in government where you could shift people. You really could mitigate it to where it has absolutely no impact on employees outside of some people having to go work in other agencies. The big bulk of them will start getting their cheques from a private provider instead of the government.

FC: You have observed that nine out of ten municipalities that contract out water services renewed those arrangements as they expired. How does that satisfaction level compare with that for direct, in-house delivery?

GS: There is no way to compare with direct in-house delivery if it has never been competed; there is usually not another option given. What the 90-plus percent renewal rate suggests is that the municipalities are happy with the service that is being provided and all of the fears and horror stories were unwarranted to begin with.

FC: A couple of years ago there was a catastrophic spill in Winnipeg and 437 million litres of raw sewage was dumped into the Red River. In retrospect, it turns out that there was no fine levied on the city by the federal government. What would have happened had that facility been managed or operated by the private sector?

GS: There certainly would have been a fine levied that would have covered the cost of the cleanup and then some. There would have likely been a significant change in management and/or structure. To steal a phrase from Texas, "Heads would have rolled like tumbleweeds across the desert." People would have lost their jobs, you would have seen changes in administration and potentially, if the spill was serious enough and the violation serious enough, that the company itself could have lost its contract.

Frontier Centre for Public Policy is an independent public policy think tank whose mission is to explore options for the future by undertaking research and education that supports economic growth and opportunity. You can contact the Centre at: Suite 25 – Lombard Concourse, One Lombard Place • Winnipeg, Manitoba CANADA R3B 0X3 •Tel: (204) 957-1567 Fax: (204) 957-1570 • E-mail: newideas@fcpp.org • www.fcpp.org