Government Outsourcing: A Practical Guide for State and Local Governments

The Report of an Expert Panel

January 2014

School of Public and Environmental Affairs at Indiana University

SCHOOL OF PUBLIC AND
ENVIRONMENTAL AFFAIRS
INDIANA UNIVERSITY

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INTRODUCTION

This report is the initiative of John D. Graham, Ph.D., Dean of the Indiana University School of Public and Environmental Affairs (IU-SPEA), and members of the Dean's Advisory Council, who convened a panel of experts to explore key issues concerning government outsourcing and public private partnerships (P3s or PPPs).

In developing this report, we attempted to avoid the ideologically charged aspects of government outsourcing and PPPs and instead set out to prepare a document that would serve as a resource for practitioners, policymakers, and community leaders considering significant outsourcing initiatives. The international panel of experts assembled for this project started neither from the point of view that government outsourcing and PPPs are inherently suspect nor from the position that private delivery systems always produce greater efficiency and effectiveness compared to the public sector. Instead, we recognize that the motivations for outsourcing, the choice of functions and services to outsource in whole or in part, the manner in which contracts are structured, and how relationships are managed usually determine whether the public derives value from outsourcing.

At the outset we grappled with lack of common definitions concerning outsourcing. Terms like "outsourcing," "privatization," "contracting out," "asset management," and "public private partnerships" are often used interchangeably in a way that creates confusion. For the purposes of this report, we concentrate on government outsourcing of substantial public functions and services (such as the processing of Medicaid applications or a component of a larger public function like information technology services) and for public infrastructure (like a bridge or toll road). To illustrate, the State of Indiana's Family and Social Service Administration's (FSSA) contract with IBM to modernize the agency's processing of Medicaid, Food Stamp and Temporary Assistance for Needy Families (TANF) applications in 2007 was an outsourcing initiative that involved substantial services. The City of Chicago's lease of the Skyway, a 7.8-mile toll facility linking the Dan Ryan Expressway to the Indiana Toll Road to Skyway Concession Company, LLC in 2005 is an example of an equally complex initiative that involves infrastructure. The latter case is also sometimes referred to as "asset privatization." The lease temporarily transfers assets to private parties, but rights and responsibilities to the asset revert back to the government at the end of the lease term.

Despite these differences, government outsourcing initiatives have some important features in common: They involve complex decisions at many stages as to how to best promote the public interest, including determining initial feasibility, designing sophisticated agreements, assessing performance, and resolving technical and managerial problems. These decisions have political, managerial, financial, and legal dimensions. Perhaps most importantly, they all involve consequential shifts of duties from the government to the private sector and require significant coordination efforts.

Objective and Approach

Our objective with this report is to enhance the value that can be generated from government outsourcing initiatives—including lower costs, higher performance, and greater responsiveness—and improve efforts to analyze, design, and implement such initiatives. Choices at each stage of the outsourcing process affect the extent to which the public gets the value it desires. The international panel of experts—composed of leading academics, practitioners, and political officials and staffed by SPEA faculty and research assistants—worked together for a year and a half to ascertain the latest knowledge and lessons from research and experience. Panelists were selected on the basis of their knowledge of the research and literature and for their practical knowledge of contracting, privatization, and outsourcing. The expertise of the group is broad, covering outsourcing at all levels of government, both in the U.S. and abroad. We did our best to reveal our values and views about the merits of government outsourcing, to critically challenge each other, and to base our recommendations on sound evidence.

Before the panel was convened, we developed a list of several prominent outsourcing cases that covered a range of activities and involved different government jurisdictions. We documented the facts of these cases and attempted to answer several key questions: How did the initiative come about? Was it successful? What were the points of contention? What were the challenges? From the literature we also prepared a list of key points for discussion by the panel. The panel met on two different occasions to pull out important lessons from these cases, from other experiences, and from the literature to assist with the production of this report.

Why Now

We are witnessing a renewed interest in government outsourcing with noticeable differences in the choice of partners as well as in the size and scope of projects from prior years. For most of the 1990s, we witnessed an increase in government outsourcing, especially at the state and local levels. The Council of State Governments reported increases in the amount and variety of outsourcing activities in about 60 percent of the states from 1993 to 1997[1]. Similarly, research from the International City/County Management Association indicated a general increase in government outsourcing among American local governments during most of the 1990s[2]. By the end of the 1990s and during the following decade, growth in local government outsourcing tapered off, particularly contracting with for-profit and non-profit firms, although the frequency of intergovernmental contracting continues to rise[3]. According to the Council of State Governments, outsourcing activities increased in only 13 of the states from 1998 to 2002[4]. However, in 2011, they released a new study that showed 200,000 active, formal agreements for human services. In 2012, the Reason Foundation reports outsourcing activity in most states with services ranging from port operations to highway maintenance to data center management.

In recent years, toll roads, parking meters, and human services have emerged as the latest trend. A recent report by the Reason Foundation notes, "just a few short years ago, few would have predicted that parking assets would be the next hot trend in municipal privatization"[5]. The report goes on to discuss the lease of parking meters in Indianapolis, Indiana, Pittsburgh, Pennsylvania, and Chicago, Illinois, as well as the privatization of the zoo in Dallas, Texas, the library system in Riverside County, California, and emergency 911 services in Orlando, Florida. With the prolonged economic downturn and the turbulence of financial markets since 2008, many state and local governments are looking closely at outsourcing initiatives to ease their own fiscal distress. These deals can look enticing, especially when they include significant upfront payments to government. Yet, while some deals achieve their objectives, others are neither lucrative nor efficient, and most are much more challenging to implement than initially anticipated. Given this renewed interest in outsourcing, the time is ripe to assess what we have learned from the research and from past experiences.

We wanted to produce a set of recommendations we all agreed were sound and useful to practitioners and policymakers. At the same time, we believe it is no longer fruitful to engage in debates that situate the public sector against the private sector, although we do not discount the importance of deliberating on whether it is appropriate and/or feasible to outsource certain functions. Government has rightly moved from a time of "assumed service provision by government" to a time when "excellence in service delivery matters." We have moved from general discussions on performance to a search for more evidence-based determinations of how performance can be improved and effectively measured, especially when it comes to the practice of government outsourcing. We also recognize that public officials are increasingly relying on networks and collaborative activities in order to capitalize on the respective strengths of the public and private sectors with the aim of improving the performance and legitimacy of government.

Although our panel generally agreed on the recommendations provided in this report, we did differ with regard to our enthusiasm toward private production. Several of the panelists are quite confident that competitive outsourcing will produce significant value in terms of gains in efficiency and effectiveness if done correctly. For instance, one panelist has experienced well-run competitions with as many as double-digit bidders generating savings of over 20 percent compared to the current service delivery arrangement. Panelists pointed to a number of other important objectives that can be achieved through outsourcing, for example:

- Outsourcing of government functions can be a source of new ideas about how to perform work more efficiently and effectively using knowledge and resources that are in short supply in the public sector.

- Outsourcing can make research and development (R & D) feasible when government does not have the financial or human capacity to invest in innovation.

- Outsourcing can bring about fundamental change in organization structure and culture that can facilitate improvements in performance.

- Outsourcing of infrastructure can be structured to provide funding necessary to modernize equipment and roads.

- Outsourcing can free up government agencies to focus on strategy, planning, and core functions they perform best.

- Outsourcing can mitigate the long-term structural challenges faced by governments with regard to health care and retirement benefits.

Other panelists, however, have a more guarded view about outsourcing and point to challenges and constraints that make it difficult for many state and local governments to create the right conditions and marshal the necessary resources to make outsourcing work. Among the warnings raised by some of the panelists were the following:

- Research indicates that the anticipated cost savings from competition, fewer managerial constraints, and financial incentives often fail to materialize in practice, particularly when outsourcing initiatives are not designed and managed effectively. The difference between political expectations and empirical results can be significant.

- Although two-three bidders is the minimum recommended number, national surveys find that in most local government markets, the average number of alternative providers is often less than that. Thin markets undermine the potential for cost savings and force officials to spend resources cultivating providers.

- Policymakers do not always consider the broader range of contracting modalities that includes in-house provision, outsourcing with for-profit and non-profit firms, intergovernmental contracting, and other mixed and hybrid inter-organizational arrangements.

- Contract management requires a high degree of skill and expertise and is more costly than is often believed. Governments need to carefully project the costs of these activities and the challenges they pose when making outsourcing decisions.

- Research indicates state and local governments increasingly rely on insourcing or "contracting back in" when outsourcing fails, even though insourcing itself requires careful planning, sufficient technical know-how and skillful management to be successful.

Format

We wanted to write a report that was both streamlined and detailed, as well as one that combined big ideas with more specific best practice pointers and caveats. We accomplished this by providing various kinds of information in the report. First we provide nine main recommendations in narrative form. Second, we offer a short vignette following each recommendation; these are case-based examples that illustrate one or more of the key points in the recommendation. The report concludes with a bibliography, organized by topic. In keeping with our objective to present a balanced guide to outsourcing, the bibliography reflects a range of theoretical perspectives. It points to sources of evidence-based knowledge useful for policymakers and practitioners to help them achieve excellence in service delivery.

Public officials owe it to their taxpayers to produce the most public value per dollar spent. In every transaction, every day these officials need to drive fair bargains for those in their communities—whether the bargaining is with their own employees or with private firms. Every transaction brings with it complexity, including estimating the price of service delivery; measuring service levels; selecting the most competent provider; managing personnel; ensuring equity, fairness, and transparency; solving technical problems; improving inter-organizational coordination; and ensuring public organizations and their service delivery agents are held accountable. In democratic societies that promote values beyond economy and efficiency—we also expect responsiveness, fairness, and equity—calculating the costs and benefits of outsourcing are especially complex.

Stephen Goldsmith
Ed Rendell
Sergio Fernandez

RECOMMENDATIONS

In this section, we provide a series of nine recommendations for improving the practice of government outsourcing and PPPs. Each recommendation is accompanied by a short vignette illustrating one or more of the key points in the recommendation.

Recommendation #1. Determine initial motivations for outsourcing.

There are many different reasons to consider outsourcing, for example, to achieve cost savings, to improve performance, to increase political responsiveness, and to reduce governments' ongoing and future financial obligations. The outsourcing of infrastructure or asset privatization is often considered as a means to raise funds otherwise not available to modernize equipment or roads. Outsourcing can facilitate achievement of objectives in a strategic plan that otherwise could not be accomplished. For example, research and development (R & D) may be a priority, but government may not have the financial or human capacity to invest in it. Outsourcing can shift some of the high-fixed investments associated with R & D, technology acquisition and infrastructure development. Likewise, outsourcing can allow an agency to focus more on its core mission and less on peripheral activities. It can also help bring about fundamental organizational change in structure and culture. Sometimes the reason for outsourcing is ideological; outsourcing proponents tend to believe that the private sector should be considered for all services except inherently governmental and critical functions or when a market failure has occurred. Many critics argue the opposite and assume that the default should be government provision. Either way, the initial motivations for outsourcing need to be explicit and acknowledged within policy debates.

The outsourcing decision is itself complex. In the majority of instances, governments cite motivations for outsourcing ranging from cost savings to accessing specialized expertise, increasing flexibility, immediate access to current technology, and implementing high quality services quickly. But technical feasibility, costs, and benefits cannot be properly assessed—making outcomes difficult to achieve—without clarity of purpose. An informed outsourcing decision requires a broad skill set, which will depend in large part on the initial rationale and scope for the project. Moreover, when motivations are clear and transparent and can be defined in terms of objective measures of success, one can also more easily determine if any decisionmakers or advisers have a conflict of interest and whether the optimal policies and structures are in place to ensure the independence, probity, and objectivity of the outsourcing decision. In short, the manner in which we judge success or failure of large-scale outsourcing initiatives will depend to a large degree on the initial motivations.

- *Vignette: Fleet Maintenance Outsourcing*[6]

  States and local governments across the country have successfully outsourced fleet maintenance services. The Commonwealth of Virginia's Department of General Services (DGS) achieved approximately 25 percent in annual savings through a managed competition process. In subsequent years, the department contracted out the acquisition and implementation of a maintenance information management system, VMCC (Vehicle Maintenance Control Center) that later reduced preventative maintenance costs by 16 percent.

  In 1992, the City of Indianapolis undertook a comprehensive managed competition program, Indianapolis Fleet Services (IFS), which is widely regarded as one of the most successful managed competitions for local government in the country. During the competition, a team of city employees competed against three of the largest private-sector vehicle maintenance providers for the award. As a result, the city realized approximately $4.2 million in cost savings over a two-year period, saw an estimated cost savings of 21 percent over traditional government-provided services, and had a 66-percent reduction in workers compensation claims between 1994 and 1997.

  The City of San Diego, California consolidated all fleet operations for municipal operations in 2008. This move combined the "motive equipment" assigned to the Police Department, Fire-Rescue Department, and Equipment Division into a new Fleet Services Division. The Fleet Services Division provides all aspects of fleet management services including acquisition, fitting, maintenance and repair, parts and fuel, body repair, painting, metal fabrication and disposal services. In 2012, the city conducted a managed competition after previously outsourcing the service. This competition resulted in an "insourcing" of services where the city awarded the services contract to a team of city staff assembled for the purpose of proposing to provide the service. The award resulted in a complete restructuring of the staffing structure for the department (ultimately eliminated 92 of 249 positions), realizing savings for taxpayers.

Because each of these governments had a clear vision and understanding of the desired outcomes for the competitions—primarily to save money while maintaining or improving the quality of service—they were able to create the right conditions for promoting competition and were in position to monitor progress and assess the effectiveness of outsourcing.

Recommendation #2. Thoroughly assess the feasibility, potential costs, and potential benefits of the outsourcing initiative.

Once the motivations for outsourcing are clear, feasibility must be fully assessed. Statutes and regulations, tax policies, existing labor contracts, and intergovernmental agreements may all have implications for assessing feasibility of the outsourcing project as well as the costs and benefits derived from it. Stakeholder interests must also be understood and assessed. Those who will champion the outsourcing initiative and those who are likely to oppose it should also be acknowledged. Giving voice to a range of stakeholders can help to mitigate future opposition.

Often alternative solutions are not obvious. The full range of service delivery options should be considered, including delivery in-house, provision by other governmental units, contracts to non-profits, contracts to for-profits, and/or provision by hybrid arrangements.

To compare alternatives, decisionmakers must have complete and reliable cost, benefit, and performance data for all functions and services targeted for outsourcing. A cost analysis of required services can be performed to determine what such services should cost the government entity. This "should cost," based on independent government estimates and fully loaded to capture all related expenses, is a critical tool in assessing cost proposals to determine if prices offered by vendors are reasonable and realistic.

It is also important to have an understanding of the services offered by potential providers, and of the underlying concept, technology, and financial cornerstones of their proposals. Comparisons between internal and external options should involve full consideration of likely transaction costs, including the costs of gathering data, negotiating contracts, properly monitoring performance, coordinating ongoing efforts, settling disputes as they arise, and amending and renewing contracts. The long-term effects of different options on performance, innovation, and employee morale must not be overlooked. Finally, the market for the service must be understood well. What is the current structure of the market and how will outsourcing alter the market? Efficiencies are unlikely to be achieved where there is an existing monopoly.

- *Vignette: An Electronic Toll Road System for the German Federal Government*[7]

  In 2002, the German federal government signed a contract with a private consortium in which the consortium agreed to develop and install a satellite-based electronic toll road system by which road tolls for trucks using the German highways were to be calculated, monitored, and collected. The start date for the system was originally planned for August 31, 2003. The consortium failed to meet this date because the development of the system took much longer than all involved parties had originally expected. This was due to various reasons, including overly optimistic commitments by the consortium, insufficient feasibility checks by the government, and public and political pressure to stick with the original implementation schedule. The toll system finally became operational in January 2005 with a reduced set of functionalities and did not reach complete configuration until January 2006.

  In 2005, the German federal government started legal proceedings against the consortium, claiming contractual penalties and lost toll profits in a total amount of approximately €5 billion. The consortium raised counter claims for payment of retained fees in the amount of approximately €1 billion. The legal proceedings are still ongoing. Based on the available information, it seems that if the federal government and the consortium had conducted a more detailed feasibility analysis, including the actual state of development of the system prototypes, they would have discovered that it was unrealistic to comply with the very ambitious timeframe that the government required the consortium to meet. By conducting a much more thorough analysis, the parties could have avoided the material, commercial, and reputational damages caused by the long delay and the corresponding legal disputes.

Recommendation #3. Scope and plan the outsourcing project early on in the process.

The second and third recommendations are closely related, since an adequate assessment of costs requires full understanding of the scope of the project. The more that decisionmakers are clear about the goals and expected outcomes, the better they can plan major processes, tasks, and milestones, as well as identify associated costs. Proper scoping and planning is also important to attracting the right suppliers and setting reasonable expectations. Importantly, ample time must be allowed to accurately describe the service or function, especially when no precedent exists.

The timing for scoping and planning is important. Planners should try to seek advice from potential providers (e.g., at a pre-solicitation public meeting where all interested vendors are welcome) and other technical experts before drafting the solicitation document. The earlier this occurs in the process, the better. Officials are encouraged to develop Most Important Requirements (MIRs), which reinforce the goal of maintaining competition and serve as guiding principles for the entire source selection process. A useful practice is to publish requests-for-information (RFIs), which can provide the government with good understanding of the capabilities of the supplier community. When adequate planning and scoping occurs before the solicitation, a more diverse group of stakeholders is likely to weigh in, including possible vendors, public employees, elected officials, citizens, and consultants. The wider the range of input, the greater the likelihood that any potential issues and problems will surface early and can be dealt with before the solicitation document is issued. Planners should also set up information systems to facilitate frequent and systematic feedback, for example, by scheduling public forums and designing web sites to send comments and responses.

- *Vignette: The Chicago Parking Meter Lease*[8]

  In December 2008, the City of Chicago, Illinois, leased its system of 36,000 parking meters to a private company for 75 years in exchange for a payment of $1.16 billion. One of the advantages of privatizing parking meters is that a private system can increase rates to address underpriced parking space and reduce congestion. From announcement of the proposal by the mayor on December 2, to final approval by the City Council on December 5, there was not enough time to adequately review the proposal, much less for input by citizens and other experts. Most knowledgeable observers and Chicagoans believe the result was not good. Even though the bid emerged through an openly competitive process, the city sold the rights too cheap.

During the recession of 2008, the city sorely needed the infusion of cash, but the haste of the sale resulted in an underestimate of the actual value. The winning bid exceeded the city's expectations by 15 percent. However, the Chicago Inspector General's Office in 2009 found that if the city were to keep control of the parking meter system and operate it under the same terms as the private company, the system would be worth approximately $2.13 billion to the city over 75 years. Although one wonders whether the city could in fact operate the system as effectively and under the same terms as a private parking operator, it is apparent that the deal deprived taxpayers of future financial gains. Moreover, in a 21st century of peak oil and a re-emphasis on pedestrian scale cities, Chicago has given over rights to the lane next to the sidewalk to parking for 75 years. This prevents dedication of this public infrastructure for bike lanes, bus lanes, or expanded sidewalks. After a very rocky start, the operation of Chicago parking greatly improved, but poor execution of the transaction produced extraordinary friction between the vendor and City Hall and less than optimal results for Chicago.

Recommendation #4. Develop clear, specific, and effective contract requirements.

Contract requirements should reflect organizational goals and mission. To the extent possible, clearly and precisely describe key aspects of a project (inputs, processes, technologies, outputs and/or outcomes) that are essential to its success. Consider developing a summary contract term sheet with key contract principles and requirements to include in the solicitation documentation. Contract requirements should balance the needs for specificity, flexibility, and opportunities for mutual adjustment. When drafting contracting specifications, look for opportunities for operational efficiencies from the existing method of delivery. In addition, be sensitive to contract requirements that inadvertently encourage delays or indirectly transfer unnecessary costs to the government by shifting risks and uncertainties to the vendors that get priced back to taxpayers. Finally, the contract type (e.g., fixed-price, cost plus, and time and materials) should be determined with due consideration for such factors as service type, price, labor certainty, available suppliers, acceptable levels of risk, and the adequacy of structures in place for monitoring and accounting.

- *Vignette: Texas Modernizes its Eligibility and Enrollment Services Systems*[9]

Poorly designed contract requirements can create the wrong incentives that lead to poor performance. In 2005, the State of Texas Health and Human Services Commission (HHSC) awarded a five-year, $899-million contract to a consortium of private companies led by Accenture, LLP, to restructure the way clients apply for public benefits through the use of call centers, greater reliance on technology, and new partnerships with nonprofit organizations. Federal law requires states to use public employees to make final Food Stamp and Medicaid eligibility determinations, while allowing them to hire contractors to help clients fill out their applications and gather the information and documentation necessary for making final eligibility determination.

Under the terms of the contract, Accenture staff working in the call centers was responsible for the bulk of the information gathering and processing. During the first year of the contract, a variety of factors conspired to slow down the eligibility process and cause significant reductions in program enrollment. These included too few contractor staff at the call centers to collect and process information required for eligibility determination, inadequate HHSC staff to review the applications coming from the call centers and make eligibility determinations, and failure to plan for and coordinate involvement by nonprofit organizations in the eligibility determination process. Notably, the contract required the State to compensate the contractor for every interaction or "touch" (e.g., telephone conversation) it had with the client. This created an incentive for the contractor's staff to increase the number of individual requests for information from clients and to cause delays in referring cases to state employees authorized to determine eligibility. Consequently, many cases resulted in "procedural denials," i.e., clients being denied access to a program not because they are ineligible but for failure to complete the application in a timely fashion.

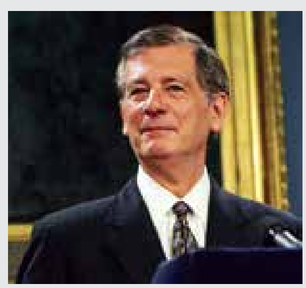
Recommendation #5. Encourage competition at different stages of the project.

Gains in efficiency are premised upon attracting competition and optimizing the supplier base. There are many ways that competition can be encouraged at the early stages of project planning as well as in the contract negotiation, specification, and implementation phases. Match the scope of the contract to the market and to supplier availability to attract the highest number of quality bidders. Avoid developing contract specifications that are too narrow and unnecessarily exclude potential providers from bidding. Consider using a mix of public, private, and non-profit providers to avoid "thinning the market" during the contract term. Limit the use of excessively long contract terms while providing opportunities for contract renewal based on performance. Release a draft solicitation document and request feedback from vendors during a reasonable period of time, revise the solicitation document using that feedback, and issue a final document. Finally, consider using indefinite delivery/indefinite quantity (IDIQ) contracts that foster an ongoing competitive environment by promoting competition for task orders that are part of a larger contract, motivating contractors to be innovative and deliver superior performance, and providing the government entity the leverage needed for changing requirements and workload.

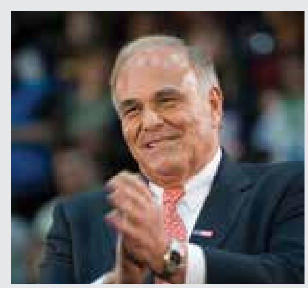
Policymakers should be engaged on an ongoing basis to reduce regulatory barriers associated with sustaining markets. They must also ensure that sufficient rules are in place to reduce the likelihood of collusion among suppliers and/or improprieties between procurement staff and bidders.

- *Vignette: Promoting Competition to Reduce Costs in Indianapolis and Philadelphia*[10]

Both Indianapolis and Philadelphia faced similar problems in 1992, mainly economic competition from their suburbs and deteriorating infrastructure. Finding solutions that promoted efficiency rather than tax increases appeared to be the only path to revival. Both Mayors Stephen Goldsmith (Indianapolis) and Ed Rendell (Philadelphia) began cost-saving initiatives, including identifying a range of functions where the private sector could do the job with equal effectiveness at a significantly reduced cost.



Goldsmith



Rendell

Goldsmith conducted over 80 managed competitions allowing city employees to bid against the private sector and in so doing saved over $400 million, producing successes for both his public sector union workers and private operators. Private operators, often by taking on the city's employees, produced what at the time were among the country's largest wastewater, airport, and IT government contracts.

Rendell outsourced 46 separate functions under the city's procurement statute. Competitive bids or proposals were solicited for each of these functions, and in almost every case, significantly lower costs were achieved. However, Rendell added a provision that established a rule that once the winning bid or proposal from the private sector had been selected, city workers and managers were allowed 30 days to put together their own proposal. If they matched or came close to the cost savings, city officials promised to retain the city workforce. Initially, the union refused to allow their workers to compete and filed a lawsuit again the city. In court, city officials established their right to outsource, and after a while the city employees and managers began working together to respond to the city's competitive solicitations. City employees also voluntarily agreed to allow the city to change a number of onerous work-related rules and procedures that had been dramatically driving up the cost of service delivery. Private sector firms competing for city services responded to these cost-saving measures by sharpening their pencils and reducing their prices even further. This provision to allow public employees to bid on contracts works best when the award process is transparent and relies on objective figures, otherwise private firms eventually will stop competing.

Recommendation #6. Select the "best" suppliers and partners.

There are several steps to selecting the "best" suppliers and partners. After optimizing the supplier base and prior to awarding the contract, there should be a rigorous and objective evaluation of potential suppliers and partners. Seek all relevant information about the reputation, capabilities, and past performance of potential suppliers. A method for evaluating responses and selecting the winner should be in place, including clearly identified and ranked or weighted evaluation criteria. Evaluation criteria should reflect such considerations as capability and approach, proposed service levels, price, the adequacy of the contractors' management team, and the contractors' past performance.

- *Vignette: Mornington Peninsula Shire Council*[11]

The Shire of Mornington Peninsula, in Victoria, Australia, has been a quiet international leader in improving public sector services. The Shire was originally encouraged to outsource following the Victorian Government's 1994 reforms, which required all councils to subject at least 50 percent of their budgets to competition. Among the various outsourcing initiatives undertaken by the Shire's Council were ten-year alliance contracts awarded for cleansing services, maintenance of park and roadsides, furniture and signs, and building maintenance in 2003.

A rigorous screening and evaluation process was used for these alliance contracts that included consideration of multiple weighted evaluation criteria to assess and compare the quality offered by bidders. Scores were made against all service objectives such as integrated approach, quality relationship, asset renewal, community engagement, safety, quality management, innovation, and social procurement (covering local employment objectives), and these were assigned a weight of 30 percent. The methodology proposed by each bidder was assessed and weighted at 25 percent. As well, the resources brought to the task by each of the bidders was rated and weighted at 45 percent, including the qualifications and experience of bidders (20 percent of the resources component), and the plant and equipment brought to the task by each (25 percent of the resources component). All scores were determined by members of an evaluation panel who were well informed by comprehensive documentation from the Council's own service coordinators on all aspects of bids (including, for instance, the adequacy of the contractors' management team, their thoughts on the contractors approach, and the firms' past performance). Discussions were also held amongst panel members to resolve outlier ratings. The overall assessment of "value for money" combined the various weighted assessments of quality described above (as the numerator) against the bid price (as the denominator), and the winning bidder was selected. Throughout this process, an independent Probity Auditor was also employed, reporting directly to the Council.

Recommendation #7. Spend adequate time negotiating and crafting the contract document.

Once partners and suppliers are selected, the final terms of the contract must be negotiated and specified. Policies should be in place to ensure probity of negotiations. Assess the government's capacity to gather relevant information, negotiate the contract terms, and adequately specify the contract. If government does not have the right skill sets on hand, consider bringing in outside consultants to augment the expertise of procurement staff. Identifying and complying with all the relevant procurement requirements takes time. Contracts should establish clear expectations, roles, and responsibilities. Review the appropriate contract term with due consideration for level of partners' investments, performance expectations, risk tolerance, prior performance, and cost associated with timing of renegotiation. Plan for an assessment of performance at the end of a contract term and make contract renewals contingent upon satisfactory performance. Finally, identify and plan for challenges during transition between providers when designing contract terms.

- *Vignette: The Devil is in the Details (or Lack of Details)*[12]

Revenues for many infrastructure projects are very unpredictable. Consider the privatization of a state toll road. Increases in gas prices, increases in unemployment, and changes in housing patterns are just a few of the reasons for why toll revenues fluctuate. Why do investors remain interested in these projects if revenues are so unpredictable? The risk associated with uncertainty increases with longer-term contracts, yet most infrastructure contracts are longer than the useful life of the infrastructure. As it turns out, the devil is in the contract details, and sometimes the lack of details.

The investors in the Indiana Toll Road depreciate the asset on an accelerated schedule, but only if the contract term exceeds the useful life of the infrastructure. As far as one can tell from the contract documents and from publicly available information, discussions of tax benefits in the form of accelerated depreciation were not part of the Indiana Toll Road negotiations. The contract is also silent as to their existence. On the other hand, the contract explicitly requires the government to reimburse the Toll Road Operator for lost revenues associated with emergencies. In accordance with the contract terms, in 2008 the state reimbursed the operator $447,000 for waiving tolls during a flood evacuation. If the state controlled the toll road, there would have been no such payout. This begs the question: Are such tradeoffs fully understood and known by the public and by the public's representatives who approve these contracts?

Likewise, many infrastructure privatization agreements include non-compete clauses. For example, the original PPP arrangement associated with the Express Lanes in California's Route SR-91 forbade the government from performing repairs or upkeep on non-toll lanes. As another example, a Colorado contract for the E-470 Toll Road requires the city to lower the speed limit and install extra traffic signals on roads adjacent to E-470. And, the Pocahontas Parkway agreement in Virginia requires officials to "exercise all discretionary authority . . . to prevent . . . competitive transportation facilities." Is there a sound reason for such non-compete provisions? On balance, the public may still be getting the best deal possible. However, we cannot know the true value of a deal without all of the details and a full understanding of costs and benefits. Market economics tells us that buyers and sellers achieve the best outcomes when both sides know and can weigh all of the risks and rewards. Such disclosures are a necessary foundation for sound negotiations and for crafting a contract that truly serves the public. More importantly, they are the foundation for an accountable, transparent, and responsive government.

Recommendation #8. Assess contract performance both during and at the end of the contract.

The prior recommendations provided some prerequisites for performance monitoring and assessment. Policies should be in place upfront to insulate performance evaluations and contract disagreements from undue political influence. The contract should clearly identify milestones, expectations for service levels, output measures, and standards. Monitoring performance should be considered an iterative and dynamic process, where learning, change, and innovation can occur. Especially with high-value procurements, a periodic project review should be implemented where both parties can discuss challenges with execution as well as identify additional cost savings that could be achieved through a collaborative approach. Optimize monitoring with technology, by making it frequent and by relying on multiple sources of feedback. Leverage information technology to facilitate data collection and evaluation. Obtain feedback from contractors' managers and employees, as well as from citizens, consultants, and community groups. Collect performance data that is meaningful to decisionmakers and can be acted upon to improve performance. Share performance information with internal managers, external stakeholders, and contractor staff and their principals. Finally, take advantage of less adversarial approaches to resolving disputes and handling performance issues, like mediation or arbitration.

- *Vignette: Sandy Springs' Public-Private Partnership for Government Services*[13]

Operating as a public-private partnership (PPP), with nearly half of city staff employed by private companies, the City of Sandy Springs follows a non-traditional model of local government. As part of the procurement and ultimate transition, the City crafted contracts that are driven by monitoring and managing of contractor performance. Department directors are empowered as the "on-site lead," and any other contractual matters are resolved through one project executive for each contractor, alleviating the inherent issues associated with seeking input or approval from numerous levels of supervision.

Contractors are required to submit a detailed quarterly report to the City Manager's Office, which is reviewed and consolidated into one larger report, sorted by department. Anomalies are analyzed, and management works with the appropriate department head to adjust activities and workload where needed. In early January of each year, contractors submit a detailed semi-annual report to the City Manager's Office that is used as the basis of the Mid-Year Review that is presented to the City Council.

Each week, the City Manager and the two Assistant City Managers are in continual contact with departmental personnel (department directors, unit managers, and line workers) to manage performance and productivity. In addition, feedback is provided by Sandy Springs' residents on a daily basis. The city's Call Center receives an average of 2,300 calls per week with questions, comments, and reports of concern to residents. Issues are discussed in the weekly senior staff meeting, with more immediate concerns handled as they occur. Focus groups of residents (homeowners and apartment dwellers) and businesses are also used to assess whether or not the city and its contractors are meeting the needs of the community.

Recommendation #9. Minimize service disruptions and other difficulties associated with transitioning at the end of the contract.

In addition to designing the contract with end-of-contract challenges in mind, other planning can facilitate smooth transitions. Planning for contract transition cannot wait until 12 months before the end of the performance period. Successful transitions are addressed in the original proposal submission and updated throughout the contract period. Governments must anticipate capacity issues and costs if they must resume activity, for example, by ensuring access to and transfer of all relevant information, materials, and technologies. The contracting entity is cautioned to carefully craft and review contract clauses that may affect transition, including rights to documents, successors in interest, and any proprietary rights to knowledge and equipment. Government officials should ensure that the initial contract includes provisions regarding government ownership of all data and intellectual property related to the project. Particular attention must be given to penalty, early termination, and buy-back clauses that commit the government to a long-term relationship. If the government decides at some point that a better approach makes sense (e.g., switching suppliers or insourcing), it needs to have an unfettered hand to undertake such a change. It is also important that contracting officers maintain contact information for alternative suppliers and key employees should the need arise to prematurely terminate a contract.

- *Vignette: Kansas Child Welfare System and its Transitions between Service Providers*[14]

  Contract transitions can be particularly difficult for vulnerable populations. In the State of Kansas, which has outsourced child welfare case management and support services, periodic contract transitions translate into disruptions for multiple organizations in the support network. These include the family court system and the judges who have ultimate authority over all child welfare cases, the individual support organizations (mental health, etc.) serving each child, and the state agency responsible for contract oversight. Perhaps most importantly, contract transitions have direct impacts on the child-clients and their foster and biological families; these children have already experienced traumatic transition to a new family.

  New contracts often terminate established relationships with the individual case managers who coordinate the tailored support system for each child. Competition among the organizations that have won the new contracts, and those that are terminating may interfere with the sharing of information that could reduce these disruptions. Under the new contract, previous primary contractors may become sub-contractors for specific services, and vice-versa. At the same time, as new contracts take effect, caseworkers and others may move among organizations to meet evolving staffing needs. Judges may find themselves interacting with new caseworkers and other staff who are not always “up to speed” on the child-client, in part because of the proprietary nature of some of the case management systems, or due to hurried staffing adjustments. The competitive nature of these contracts, combined with the vulnerability of the child-client, indicate the need for aggressive transition plans that include clear expectations about preparation, and particularly about customized transition support for the child-clients and their families.

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Motivations for Government Outsourcing

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