Reason Foundation
April 2012

Annual Privatization Report 2011: State Government Privatization

By Leonard Gilroy and Lisa Snell
Edited by Leonard Gilroy and Harris Kenny

Reason Foundation

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Annual Privatization Report 2011: State Government Privatization Update

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This is an excerpt from Reason's *Annual Privatization Report,* which is available online at http://reason.org/apr2011

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Part 1

State Budget Outlook

State governments continue to face fiscal pressures amid an uncertain economic recovery, according to several reports on states' fiscal health in 2011. While the fiscal picture is beginning to improve as revenues rebound, overall state revenues remain below their FY 2008 pre-recession high.

An October 2011 report by the Nelson A. Rockefeller Institute of Government at the State University of New York found a significant improvement in state revenue collection, with states seeing an 8.4% revenue increase over the 2011 fiscal year, representing six straight quarters of growth and the strongest year-over-year gains since 2005.[1] However, the researchers noted that the recent growth in state revenues might be short-lived, given the ongoing weakness in the national and international economy.

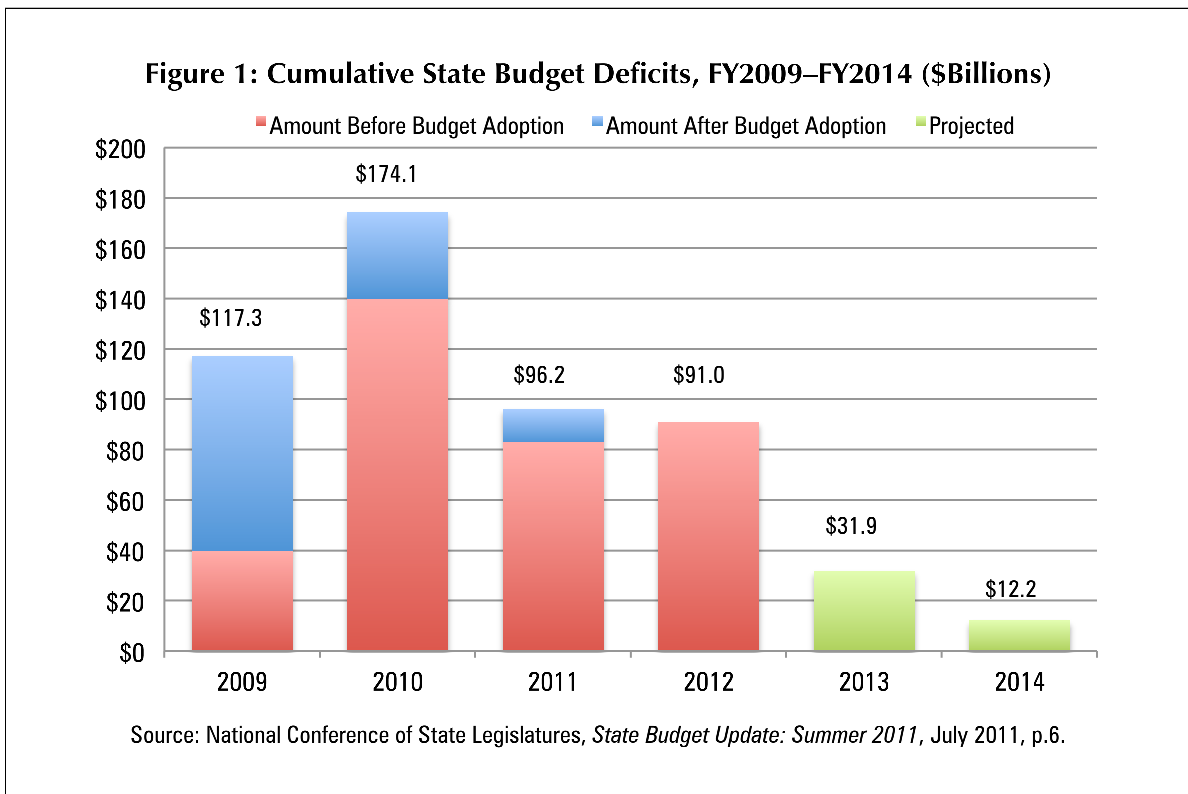
The National Conference of State Legislatures' (NCSL) *State Budget Update: Summer 2011* struck a similar tone, finding that state budgets are slowly recovering but still face uncertainty amid a sluggish economic recovery.[2] While state revenues are projected to continue increasing at a slower pace in FY 2012, the NCSL report suggests that states still face significant financial challenges, including the fragile economic recovery, health care cost inflation rising faster than state revenue growth, and numerous competing budget priorities and trade-offs. FY 2012 marked the fourth consecutive year of large-scale aggregate state budget deficits, according to the report, though the total size of state deficits has been on a decline since hitting a peak of $174.1 billion in FY 2010.

Figure 1 illustrates historical and projected state budget deficits from FY 2009 through FY 2014. According to the NCSL report, states closed approximately $478 billion in aggregate budget deficits between FY 2009 and FY 2012, and they still face an estimated $44 billion in deficits in FY 2013 and FY 2014. The report finds that:

- States closed a cumulative $96.2 billion deficit in their FY 2011 budgets, compared to $174.1 billion in the previous fiscal year. FY 2011 general fund revenues increased 6.1% above FY 2010 levels. State FY 2011 general fund spending increased 4.6% over FY 2010 expenditures, and 39 states reported year-over-year increases in FY 2011 spending. Four states reported year-over-year spending increases exceeding 10%, with the largest in Florida (13.3%), Massachusetts (12%), Tennessee (10.6%) and Nevada (10.4%). Still, 11 states and Puerto Rico reported lower year-over-year spending in FY 2011.

- Entering FY 2012, 38 states and Puerto Rico confronted aggregate deficits of at least $91 billion during the enactment of their FY 2012 budgets. A total of 21 states reported FY 2012 deficits exceeding 10% of their general fund budgets, with the highest found in Alabama (33.7%), Nevada (31%) and California (28%).
- Additional budget deficits may materialize in some states, given tenuous economic and fiscal conditions. For example, the report found that FY 2012 general fund revenues are projected to increase 1.9% over FY 2011, while FY 2012 state spending is projected to increase at a higher rate of 2.7%, suggesting that states will continue to face ongoing budgetary pressures.
- The size of state deficits and the number of states experiencing them are expected to decline in FY 2013 and FY 2014. A total of 29 states have projected deficits for FY 2013, with early estimates of a total cumulative deficit of $31.9 billion. Nine states have taken steps to close those deficits already, while another 11 states still face FY 2013 deficits totaling over $15 billion. Nine states currently project budget deficits in FY 2014 of $12.2 billion.

Figure 1: Cumulative State Budget Deficits, FY2009–FY2014 ($Billions)



Source: National Conference of State Legislatures, *State Budget Update: Summer 2011*, July 2011, p.6.

The NCSL report concludes that, "Much uncertainty continues to surround the trajectory of economic recovery, however, which threatens spending and revenue assumptions underlying these gap estimates."[3] Despite the uncertainty, state fiscal directors appear to be seeing light at the end of the tunnel. NCSL released the results of a survey of state fiscal directors in December 2011 that found that 35 states and Puerto Rico reported strong revenue growth or performance in the first several months of FY 2012.[4] Fiscal directors in 30 states described their overall fiscal outlook as either "positive" or "cautiously optimistic" in FY 2012, while officials in the remaining 20 states

and Puerto Rico were "concerned" about their fiscal outlook. Notably, the report found that no state official was "pessimistic" about his or her state's FY 2012 fiscal outlook.

Last, the National Governors Association (NGA) and the National Association of State Budget Officers (NASBO) issued their biannual state fiscal survey in June 2011, noting "somewhat improved" state fiscal conditions relative to those experienced in 2009 and 2010. Among the findings in the NGA/NASBO survey:[5]

- FY 2011 general fund expenditures ($651.5 billion) increased 5.2% from FY 2010 ($619.3 billion), and governors' recommended FY 2012 increased 2.6% over FY 2011 levels to $668.6 billion. Despite the uptick in state spending in FY 2011 and FY 2012, the projected FY 2012 spending level remains $18.7 billion less than the $687.3 billion peak seen in FY 2008.
- For FY 2012, governors in only 10 states recommended lower general fund expenditures than in FY 2011, with the remaining 40 proposing higher general fund spending.
- States saw their second consecutive year of increased tax receipts after several years of decline from their 2008 highs. Estimated FY 2011 sales, personal income and corporate income tax collections ($504.7 billion) were 6.4% higher than those in FY 2010. For FY 2012, states are projecting a 3.9% increase in tax receipts to $524.4 billion, a level that remains 3.1% lower than the 2008 highs.
- Tax, fee and other revenue increases proposed in governors' FY 2012 recommended budgets are expected to generate an additional $13.8 billion in revenue, up from $9 billion in FY 2011. However, a significant share of this increase can be attributed to three states (Connecticut, Minnesota and California). In FY 2012, a total of 12 states recommended net tax and fee increases while another 12 recommended net decreases. The previous fiscal year, 24 states enacted net tax and fee increases of $6.2 billion, while six states saw net decreases.
- Ending account balances and the amounts in budget stabilization (e.g., "rainy day") funds remain far short of their FY 2006 peak of $69 billion, or 11.5% of general fund expenditures. Balances saw a slight increase in FY 2011 to $31.9 billion (4.9% of general fund expenditures) over their FY 2010 level of $31.5 billion. Governors have proposed increasing overall balances to $32.6 billion in FY 2012.
- However these estimates mask a more nuanced picture, as two states (Texas and Alaska) accounted for over 48% of total state balance levels in fiscal 2011, and balances in the remaining 48 states accounted for only 2.7% of general fund expenditures in FY 2011 and 2.5% in FY 2012. In FY 2011, 11 states had balance levels below 1%, and 19 states had balance levels between 1% and 5%, with similar numbers projected for FY 2012. The report notes that such low reserve balances in many states may "[impede their ability] to respond to […] unanticipated budget gaps that appear towards the end of the fiscal year."[6]

Looking ahead, the report suggests that despite improving fiscal conditions, "[t]he reduction of [federal stimulus funds] for states, when combined with a slow recovery in state revenue collections, will continue the tight resource environment for states in fiscal 2012."[7]

Part 2

Christie Administration Expands Privatization Portfolio in New Jersey

New Jersey Gov. Chris Christie's administration continued to expand its portfolio of privatization initiatives in its second year of office as part of its broader government streamlining and reform agenda.

The administration's push to lower the costs of state government through private competition began in earnest in 2010 with the creation of the New Jersey Privatization Task Force, an advisory body that issued over 40 privatization recommendations in a May 2010 report. These recommendations, if fully implemented, were estimated to realize cost savings and/or other benefits totaling over $210 million on an ongoing, annualized basis. Since then, the Christie administration has begun to advance some of the Task Force's recommendations along with other opportunities identified by the administration (see Reason Foundation's *Annual Privatization Report 2010* for an overview of the administration's 2010 initiatives and the Task Force report.)

Major current and recent privatization initiatives advanced in New Jersey include:

Highway Maintenance: In September 2011, the Department of the Treasury issued a request for proposals (RFP #12-X-22209) from private firms interested in providing privatized highway maintenance services for the Department of Transportation in a pilot program advancing one of the Privatization Task Force's recommendations. Under the initiative, the state could hire up to three firms under a three-year contract to provide a full range of highway maintenance services—including pothole repair, landscaping, snow removal and emergency response—in three regions of the state to compare the relative costs of public and private sector provision. According to the request for proposals:

> *In 2010, the governor's privatization task force issued a report that recommended NJDOT explore the idea of privatizing highway maintenance work. That recommendation has resulted in the specification contained herein. In order to fairly compare the cost of performing the work using state forces vs. contract forces, this specification was written to allow NJDOT to insert a contractor's crew seamlessly in place of a DOT crew, performing the same functions with the same management flexibility that currently exists with state*

DOT crews. Such a contract will allow a level comparison between outsourced vs. in-house work.

The contract would include a variety of performance standards, including requirements that the vendor remove hazardous road kill and debris immediately upon notification, repair potholes within 48 business hours, and arrive on the location of emergencies within two hours. Bidder responses were due in mid-November 2011.

State Parks: In November 2011, Gov. Christie announced the release of a parks sustainability plan designed to improve the financial self-sufficiency of the state parks system and improve visitor services by partnering with private for-profit and nonprofit entities to expand revenue-producing amenities (e.g., food, boating) in the parks. Under the plan, the New Jersey Department of Environmental Protection (NJDEP) will continue to own, manage and operate the parks, and park entrance fees will increase (though some amenity-related fees may increase). In the near term, the plan aims to increase non-tax resources to $15 million by 2015 through an initial round of partnerships at some of the state's largest parks, and in the longer term, the plan seeks to raise about two-thirds of the annual operating budget for the park system from alternate funding sources, reducing reliance on budgeted funds. Currently, the parks system generates just $8 million in fees and concessions, or 21% of the total $39 million parks operating cost.

The state has already begun taking steps to implement the plan. In March 2011, NJDEP announced a five-year concession contract with Linx Golf Management and H&L Golf Course Maintenance Co. to take over operations and management of the 18-hole Spring Meadow Golf Course in Monmouth County. Later in August, NJDEP issued a request for proposals for the private management and operation of two additional state-owned, 18-hole public courses. NJDEP also issued a request for proposals in September 2011 for the private operation and management of food service, catering and events services at Liberty State Park in Jersey City.

For more details on the parks sustainability plan and the procurements described above, see Part 11 ("Interest in State Parks Privatization on the Rise") of this report.

Manual Toll Collection: The Christie administration is using privatization to achieve its goal of driving down the costs of manual toll collection on state-run toll highways operated by the New Jersey Turnpike Authority (NJTA) and South Jersey Transportation Authority (SJTA).

In November 2011, the SJTA's board unanimously approved the privatization of manual toll collection on the Atlantic City Expressway, a move estimated to save the agency over $1 million per year. Four firms responded to an August 2011 request for proposals to provide toll collection services on the Expressway, and SJTA selected the Virginia-based Faneuil, Inc. as the winning bidder. The agency had selected the same firm in a similar procurement the previous year, but that privatization was ultimately dropped after SJTA officials negotiated a one-year package of concessions with the existing public sector toll collectors that lowered their pay scale.

The SJTA sees the privatization as a step toward the agency's ultimate goal of eliminating manual toll collection altogether in favor of a transition to all-electronic tolling. In a November 2011 interview with the *Press of Atlantic City*, SJTA Executive Director Bart Mueller noted that, "[t]he toll collector is going the way of the elevator operator […] This is the last step before we move to all-electronic tolling, hopefully within 24 months."[8]

State Transportation Commissioner and NJTA Chairman James Simpson told state officials earlier in the year that the larger tolling agency—which operates the New Jersey Turnpike and Garden State Parkway—plans to move in a similar direction toward all-electronic tolling in the future. According to Simpson's figures, it costs NJTA $100 million annually to collect $290 million in cash toll revenue; by contrast, it costs the agency $53 million per year to collect $670 million in electronic toll revenue.[9] "Manual toll collection is simply way too expensive. In the future, all electronic tolling technology, which is being implemented by tolling agencies around the country, will one day be implemented on the Authority's roadways thereby replacing all of our toll collectors," Simpson said.[10]

Like SJTA, the NJTA initiated a procurement to solicit private bids for manual toll collection on the agency's tollways in early 2011, but in late April the agency abandoned privatization after negotiating significant concessions from two toll collector unions in a two-year agreement that included significant salary cuts and lower operational costs than bidders had proposed. According to the *Press of Atlantic City*, the concessions are expected to generate approximately $35 million in cost savings over the two-year agreement, after which the NJTA plans to transition to either private operation or all-electronic tolling.[11]

State-Run Horse Racing Facilities: The Christie administration has made significant progress toward its goal of putting the horse racing industry on a self-sustaining path without taxpayer and casino subsidies, selecting private sector operators for the Meadowlands Racetrack and Monmouth Park. On June 1, 2011, both racetracks were turned over to private sector operators that, under the terms of agreements in principle, assumed the costs to operate those facilities and took over responsibility for all simulcast wagering at the racetracks and the operation and future development of off-track wagering facilities. The New Jersey Sports & Exposition Authority (NJSEA) had previously operated the two facilities, which were losing an estimated $6–10 million per year each.

In December 2010, Gov. Christie announced an agreement with the Standardbred Breeders and Owners Association (SBOA) and partner Jeff Gural, a New York developer and racetrack operator, to take over operations of the Meadowlands Racetrack in a $1 per year, five-year lease. Under the agreement, there will be no ongoing subsidies for purses or racing operations. Gural also plans to invest more than $90 million in a new grandstand and an off-track wagering facility in Bayonne.

In April 2011, the NJSEA selected New York developer and casino owner Morris Bailey as the winning bidder for a five-year lease of Monmouth Park under similar terms. Under the agreement, Bailey also took over operations of the off-track wagering facility in Woodbridge and will work with Gural on the development of future wagering facilities.

At press time, formal leases had not been executed and were pending regulatory approval, but since June the private operators have already been working under memoranda of understanding with the state to operate the facilities until leases are finalized. Changes in state law have also been necessary to facilitate the transfer. For example, Gov. Christie signed legislation (A-3710) in August 2011 authorizing the operational takeover of horse racing from NJSEA by the private sector operators and authorizing the joint management of Monmouth Park and the Meadowlands Racetrack for a one-year transitional period.

"There are many beneficiaries," Gov. Christie said of the privatization in a May 2011 press release. "We're saving a New Jersey tradition with the continuation of live horse racing at the Meadowlands and Monmouth Park; we are saving and creating jobs; and we are helping to preserve New Jersey farmland and a way of life for many people, from horse farm owners and employees, to jockeys to racing enthusiasts."

New Jersey Lottery: In early 2011, the New Jersey Department of the Treasury contracted with a consultant to assess the financial performance of the New Jersey Lottery and assess the desirability of privatizing its management.[12] At press time, the results of this evaluation were not yet available. A 2010 transition report recommended that the incoming administration consider privatizing lottery operations. According to the report, "The Lottery would benefit from privatization with operations conducted by private management contracted by the State to manage, staff, and operate the administration of the Lottery. […] The committee believes a significant increase in gross and net revenues to the State will result from privatization."[13]

Vehicle Fleet Ownership, Operation and Maintenance: Seeking to lower the state's vehicle fleet costs, the New Jersey Department of the Treasury issued a request for information (RFI) in 2011 soliciting private vendor responses on potential options and strategies for the ownership and maintenance of the state's Central Motor Pool and Department of Transportation passenger vehicle fleets, totaling approximately 6,500 vehicles. The Department of Transportation operates 12 maintenance facilities throughout the state to service its 450-vehicle passenger fleet (in addition to trucks and other equipment), while over 6,000 other passenger vehicles are serviced and repaired by the Central Motor Pool in its eight statewide facilities. The state specifically requested vendor feedback on a range of options that include leasing vehicles instead of purchasing them, selling existing fleet vehicles and having a private company own the vehicles that compose the state's passenger fleet, and outsourcing all or some vehicle maintenance and repair. At press time, the agency was evaluating RFI responses received at the end of October 2011, and the responses are likely to inform a future fleet services procurement.

Correctional Food Services Pilot Project: In November 2011, the New Jersey Department of the Treasury issued a request for proposals on behalf of the state Department of Corrections for a pilot project to provide correctional food service operations and management at Bayside State Prison and two satellite locations. Bidder responses are due in January 2012.

Child Support Payment/Receipt Processing: In October 2011, the New Jersey Department of the Treasury issued a request for proposals on behalf of the state Department of Human Services to solicit bids on a project that would develop, implement and transition the state from a partially privatized State Disbursement Unit (SDU)—a federally mandated, centralized location for the receipt and disbursement of child support—to a fully privatized SDU. The project is intended to complement and integrate with the state's new Web-based automated child support enforcement system, New Jersey Kids Deserve Support, which was designed to streamline business practices. New Jersey's current SDU services are partially privatized, covering receipt, payment processing, debit card maintenance, banking and limited customer services associated with those functions. The proposed privatization would incorporate additional services currently provided by various state agencies, including manual paper check and electronic disbursements, full banking disbursement operations, reconciliation, receipt adjustments and check voids/re-issues and other customer services. Bids are due in December 2011.

Montclair State University Housing PPP: In August 2011, Montclair State University announced the completion of The Heights, a new, state-of-the-art residential complex that is the first public-private partnership (PPP) completed under the 2010 New Jersey Economic Stimulus Act. The new $211 million complex was financed by tax-exempt bonds issued by Provident Resources Group—the owner-operator that developed, operates and maintains the complex under a long-term lease—under the auspices of the state's Economic Development Authority. “The State of New Jersey has not invested any direct capital funding in higher educational facilities in more than 25 years,” University President Susan Cole noted in an August press release. “Therefore, in order to grow and develop as a competitive university, we have had to find creative and cost-effective solutions to build new facilities and make capital improvements to existing structures.”

The title to the facility will transfer to the university in 40 years, unless bonds are paid off early, and until that transfer the operator is responsible for collecting rents and managing and maintaining the property in top condition. The new housing complex—which accommodates approximately 2,000 students and includes a 24,000-square-foot dining area—was built by the Alabama-based Capstone Development Corporation and the New Jersey-based Terminal Construction Corporation and opened in September 2011.

New Jersey Network: The privatization of the New Jersey Network—transitioning the 40-year-old, state-run broadcasting network to private, independent management—was completed in July 2011 when New York PBS affiliate WNET-TV launched its successor, NJTV. The Christie administration selected WNET the previous month to take over the state-run network as part of its initiative to end decades of taxpayer subsidies to public television broadcasting in the state while preserving New Jersey-specific programming. The new NJTV will blend stronger overall programming with enhanced state-centric programming, including a nightly news broadcast, live broadcasts of significant New Jersey political events, a new state-centered public affairs program and more.

"In the end, WNET presented the strongest, most complete plan that met my priorities for this process, most importantly the ability to deliver Jersey-centric programming, including a nightly news program, for the citizens of the Garden State and without the burden of taxpayer subsidy," Gov. Christie noted in a June press release. "With the myriad resources and extraordinary track record of WNET, New Jerseyans can be confident that public broadcasting in New Jersey will not only continue, but also has a bright and dynamic future with a strong operational plan to enhance New Jersey programming."

In addition, the Christie administration announced that all of New Jersey Network's radio licenses will be acquired outright, with station WHYY acquiring five licenses and New York Public Radio acquiring four others.

NJ Transit Parking: Plans to privatize parking at 81 New Jersey Transit (NJ Transit) train stations failed to materialize this summer, but officials hope to get back on track this fall, according to a July 2011 article in the *New York Post*. A NJ Transit spokeswoman told the *Post* the delay boils down to the fact that "The (RFP) process is taking more time than first anticipated. There are more complexities."[14] Specifically, NJ Transit does not control all the parking spaces in all its train station lots, with local townships controlling approximately 35% of the spaces in most of the facilities.

Last fall, NJ Transit issued a request for qualifications (RFQ) for a 30- to 50-year concession for some of its commuter parking facilities throughout the state. The proposed concession program—known as System Parking Amenity and Capacity Enhancement Strategy (SPACES)—aims to expand parking capacity and enhance services at up to three-quarters of the approximately 48,000 spaces controlled by NJ Transit statewide. The agency received statements of qualification from 10 bidder teams in November 2010, and the following month the agency narrowed the list down to seven qualified concessionaires eligible to bid when the agency issues a formal request for proposals.

Part 3

Jindal Continues Louisiana Privatization Push

In the last year of his first term in office, Louisiana Gov. Bobby Jindal continued to advance privatization as a central component of his broad government reform agenda. And with his re-election to a second term in November 2011, privatization is likely to continue to play a major role in the Pelican State's streamlining efforts for the next several years.

The Commission on Streamlining Government (CSG), which held its final meeting in November 2011, proposed several of the largest privatization initiatives advanced to date. CSG was a two-year commission created by Jindal and the state legislature in the spring of 2009 to recommend reforms to reduce the cost of government through downsizing, streamlining and privatization. According to media reports, commissioners received a progress report that estimated that 62 of the commission's 238 proposals had been implemented, with 62 others not acted on yet and the rest underway; ongoing savings to date from CSG recommendations put into place to date exceed $750 million.[15]

In December 2009, the CSG had issued a report to the governor and legislature outlining 238 recommendations estimated to save over $1 billion through privatization, streamlining, consolidation and elimination of government activities. Regarding privatization alone, the CSG recommended over a dozen privatization initiatives estimated to save the state at least $88 million, including ongoing initiatives to outsource the administration of state employee group medical benefits and transition the state's Medicaid program into a privately delivered managed care system (see discussion below).

The state's streamlining efforts continued to yield dividends in 2011. In May, credit rating agencies Standard & Poor and Fitch both upgraded the state's credit rating, citing the state's strong fiscal management, strong employment levels and sustainable levels of public debt. The upgrades are the sixth and seventh under Jindal's first term and come at a time when many other states have faced downgrades.

In 2011, the Jindal administration made progress on some of its key privatization initiatives, though some met with significant resistance from the state legislature and public employees. For example:

Medicaid Privatization: In July 2011, the Louisiana Department of Health and Hospitals announced the selection of five healthcare insurers that will provide state-subsidized policies to over 800,000 state Medicaid patients under the largest single privatization initiative advanced to date under Jindal's watch. Under the plan, the state will transition away from its current fee-for-service model—where the state pays healthcare providers directly for services delivered to Medicaid recipients—and place recipients into "coordinated care networks," where the state will pay the private insurers to cover Medicaid patients, and the insurers will manage patient benefits and reimburse providers for services rendered.

According to the administration, the current fee-for-service system creates a patchwork of fragmented, uncoordinated care that poorly serves patients and drives up the costs of service delivery. The new privatization program—known as "Bayou Health"—is designed to coordinate care among physicians, hospitals and other healthcare providers to save an estimated $135 million per year out of the state's $6.7 billion Medicaid budget. At full implementation, approximately two-thirds of the state's 1.2 million Medicaid recipients will be served through the coordinated care networks, with approximately 400,000 recipients remaining in the current fee-for-service program.

Under the Bayou Health program, the five private networks will operate on a statewide basis under three-year contracts. Three of the networks—Amerigroup Louisiana Inc., Amerihealth Mercy of Louisiana Inc., and Louisiana Healthcare Connections Inc.—will be paid a monthly, prepaid fee by the state for each of its Medicaid enrollees, and the firms will manage benefits, approve services and pay providers. Two other firms—Community Health Solutions of America Inc. and UnitedHealth of Louisiana Inc.—will operate a "shared savings" model, a managed fee-for-service model in which the firm shares in the savings generated by improving health outcomes and reducing costs, while continuing to pay providers on a fee-for-service basis.

Eligible Medicaid recipients will choose from one of the five plans, which have a consistent set of core benefits and services while offering different packages of enhanced benefits to furnish a range of choices. Under the contracts, the amount, duration and scope of services provided by Bayou Health insurers cannot be less than those provided under the existing state Medicaid plan.

Recipients will transition to Bayou Health in three phases beginning in February 2011. Recipients will have a 45-day window to choose a plan, and those who do not select a plan will be assigned to one that includes their primary health care provider. Recipients will receive an insurance card for their plan and can receive care from any provider in their respective firm's provider network. State health officials have launched a statewide education campaign to inform Medicaid recipients on how to navigate the new system.

In November 2011, the federal Centers for Medicare and Medicaid Services (CMS) informed state officials that it had formally approved the Bayou Health program. Any changes to a state's Medicaid delivery system must be submitted to CMS and approved as an amendment to the state plan that outlines how the state operates Medicaid.

“Because Louisiana is one of only a few states not already coordinating recipients' care through these kinds of networks, we had the advantage of other states' experience to draw from in creating our [coordinated-care network] model,” Medicaid Deputy Director and Bayou Health Project Director Ruth Kennedy said in a July 2011 press release. “We studied Medicaid programs in more than two dozen states, looking at what worked and what didn't. Based on these 'lessons learned,' we were able to develop very detailed network requirements that allowed our evaluation team to select the best entities for Louisiana, ones that demonstrated they can deliver the health care improvements our recipients deserve.”

Despite the significant progress toward implementation, Bayou Health faced some challenges along the way in 2011. First, the process was slowed by legal challenges from several of the insurers whose bids were not selected among the five chosen by the state; all were ultimately resolved. Additionally, the state legislature enacted a bill (House Bill 207) that would have created an annual reporting requirement on program implementation and would have terminated the Medicaid privatization program at the end of 2014 if not renewed by the legislature. Proponents suggested that the law would afford legislators the opportunity to review the program at the end of the three-year contract, but opponents countered that it was a move to undermine the administration's contracting authority. Gov. Jindal ultimately vetoed the legislation.

State Public Employee Health Care PPO: The Jindal administration began taking steps to explore the potential privatization of a health insurance plan run by its Office of Group Benefits (OGB), which administers several health care plans for approximately 250,000 current and retired state employees and their dependents.

While some of OGB’s health insurance plans are already operated by private firms today, the administration is exploring the potential privatization of OGB’s preferred provider organization (PPO), which arranges for discounted care for over 60,000 policyholders in a network of physicians and hospitals. According to the administration’s 2012 budget proposal, privatization of PPO operations could save the state an estimated $10.1 million and reduce OGB staff by 149 positions, roughly half of the 300 current employees administering the program today. The administration also expects that a privatization could net the state over $150 million in a one-time upfront payment.

In May 2011, OGB issued a request for proposals seeking a financial advisor to explore the potential privatization of functions related to OGB's statutory mission and provide a market valuation of the OGB's book of business. In July, state Commissioner of Administration Paul Rainwater announced that Morgan Keegan & Co. was selected over bidders Goldman Sachs and UBS Investment Bank to advise the Jindal administration on a potential OGB privatization.

Earlier in the year, the administration contracted with a separate firm, Chafee and Associates, to establish the fair market value of OGB's operations. A Senate committee issued a legislative subpoena in June 2011 to get a copy of the report, which the Jindal administration had not previously released publicly, claiming that it fell within the scope and protections of the

deliberative process privilege. The report found that the market value of OBG operations was between $133 million and $217 million as of January 2011.

However, the proposed privatization garnered significant pushback from state public employees and some in the legislature who fear that policyholder premiums would increase under privatization and that benefits could be reduced. In August 2011, the state Legislative Auditor's Office issued a report suggesting that privatizing the administration of the PPO might result in higher insurance premiums to state employees under a private insurer because of an increase in marketing costs, premium taxes, necessary profit margin and reinsurance costs, which the report suggested could be points for negotiation with the potential vendor. The auditor report also suggested that privatization may diminish the legislative and/or state administrative control over costs, benefits or changes to the plans, which would need to be addressed in the contract.

Rainwater responded to the audit in a letter noting that the report's speculation on higher insurance premiums is not supported by its own research, failed to factor in cost savings from improved efficiency, and ignored the reality that premium costs are regularly increasing already under the current structure.

He also reiterated the administration's position that any privatization would not proceed unless it could be implemented to ensure that plan members continue to receive the same level of benefits and eligibility rules, with increased premium rates continuing to be tied to medical market rates. Rainwater added that if a decision were made to move forward with privatization, it would not be implemented until the beginning of 2013.

According to Rainwater, Louisiana and Utah are the only two states that self-administer health insurance plans, putting government in the health insurance business and into competition with the private sector. Gov. Jindal echoed the point more succinctly in an April 2011 speech, asking: “What makes the state of Louisiana uniquely qualified to run a health insurance company?”[16]

Prison Sales and Outsourcing: One of Gov. Jindal's major budget proposals—the proposed sale of three prisons to generate approximately $100 million to help close a gap in state healthcare spending—was scuttled in June 2011 when the House Appropriations Committee voted 13 to 12 to reject a bill (House Bill 545) that would have set the plan into motion.

Jindal's proposed FY 2012 budget included a plan to privatize the operation of two prisons (Avoyelles Correctional Center and Dabadie Correctional Center) and sell three prisons (the Allen, Avoyelles and Winn Correctional Centers) to a private operator. In addition to the expected upfront payment from the prison sales, the administration estimated that the outsourced prison operations would lower the state's prison operating costs by over $200 million over the next 20 years.[17]

The plan was immediately met with a skeptical response from public employee unions and state legislators who objected to the proposed use of one-time revenues to cover ongoing operational costs and raised other concerns related to the potential public safety impact. Prior to the HB 45 vote, the House of Representatives had already removed language from the budget that would have

facilitated the transfer of prison sale proceeds to healthcare, and HB 45 would have only authorized the spending of sale proceeds on one-time capital expenditures.

At press time, it is unclear whether the Jindal administration will revive the prison plan in 2012, but if it does it is likely to receive significant private sector interest. In February 2011, six potential bidders submitted responses to a request for information issued by the Louisiana Department of Public Safety and Corrections seeking market interest in the proposed operational outsourcing at the Avoyelles and Dabadie facilities.

Behavioral Health Services: The Department of Health and Hospitals announced in early September that it had selected Magellan Health Services, Inc. as the winning bidder on a contract to serve as the operator of the Statewide Management Organization (SMO) that will provide behavioral health services to 100,000 adults and 50,000 children.

Gov. Jindal signed an executive order earlier in the year making Louisiana one of the first states in the nation to formally bring together the leadership of the state's four child-serving agencies—DHH, the Office of Juvenile Justice, the Department of Children and Family Services, and the Department of Education—to form a statewide, coordinated system of care for youth with significant behavioral health needs. The system is part of the Louisiana Behavioral Health Partnership, created by DHH to improve coordination of behavioral health services for all eligible children, as well as adults with serious mental illness and/or addictive disorders. The partnership covers both those in the Medicaid and uninsured populations, which will ultimately be enrolled with the SMO.

Like the larger Medicaid privatization initiative, the SMO will be responsible for improving the access, quality and efficiency of behavioral health services for its enrollees, and it will develop a network of qualified behavioral health care providers to offer a full array of services to behavioral health patients. DHH's Office of Behavioral Health was tasked as the implementing agency for the program and will serve as the lead agency overseeing the SMO contract. If both the Louisiana Division of Administration and CMS approve the contract, then the SMO will begin operations on March 1, 2012.

Business-Charter School Partnerships: In June, Gov. Jindal signed into law House Bill 421, a key legislative priority that authorizes partnerships between Louisiana businesses and charter schools (e.g., a “Business-Charter Partnership”). Under the bill, companies can receive preferred enrollment of up to 50% of school seats for dependents of its employees and a minority percentage of the charter school’s board seats in exchange for a gift or free use of land or a facility, the major renovation of an existing facility or a major donation of technology. Individual businesses or groups of businesses can apply to open new schools, or in collaboration with a school district, convert an existing school to charter status. The administration advanced the bill to increase the involvement of the business community in public education and offer charter schools a new tool for facility financing.

Part 4

Kasich Administration Advancing Privatization in Ohio

Less than a year into his new administration—and as promised during his gubernatorial campaign—Ohio Gov. John Kasich has taken significant steps to advance privatization as a key component of his governing agenda.

JobsOhio: In an early move, Kasich enacted a bill making good on one of his key campaign planks: privatizing the state's economic development functions. In February 2011, Kasich signed House Bill 1, creating JobsOhio, a new semi-private, nonprofit economic development organization created by privatizing functions of the Ohio Department of Development related to the state's corporate recruitment and expansion, marketing and job retention efforts. To fund the new entity, Kasich advanced a plan to lease revenues from the state's liquor monopoly to JobsOhio, which was later approved in the state's 2012–2013 budget.

Under the plan, JobsOhio will gain control of the liquor system's annual net revenues for 25 years in return for a $1.2 billion upfront payment funded through the sale of revenue bonds backed by liquor system profits. Approximately $700 million of the proceeds would be used to defease existing liquor revenue-backed debt, while roughly $500 million would be deposited in the state's general fund for short-to-near term uses. In return, the new nonprofit would collect liquor revenues over the 25-year term to fund its economic development activities—e.g., loans, grants, tax credits, etc. to attract businesses to locate or expand in Ohio—and debt service.

According to proponents, JobsOhio's status as a private nonprofit will make it easier to conduct the state's economic development work without the bureaucratic delays and regulatory burdens seen in the public sector, making a more nimble vehicle to attract and retain businesses in Ohio. Some critics have responded that the state should have no role in picking winners and losers in the economy, while others have raised legal objections. For example, soon after passage the advocacy group Progress Ohio joined two Democratic state legislators in a lawsuit challenging the constitutionality of JobsOhio, a case that was ultimately dismissed by a Franklin County judge in December 2011.

Corrections: In September 2011, the Ohio Department of Rehabilitation and Corrections announced the results of a large-scale procurement that will see the state raise $72 million from the

sale of one state prison to a private operator—the first sale of its kind in the nation—and two others turned over to private management, for an estimated $13 million in annualized cost savings.

Under the deal, the state will sell the Lake Erie Correctional Institution to the Corrections Corporation of America, while contracting with the new owner to continue housing state inmates there. Management and Training Corp. (MTC) will take over operations of the North Central Correctional Institution and the currently vacant Marion Juvenile Correctional Facility; both facilities will remain state-owned. One additional facility currently operated by MTC—the North Coast Correctional Treatment Facility—will be consolidated and merged with the state-run Grafton Correctional Institution, which will remain under state operation. The state's biennial budget signed in June 2011 authorized the Department to sell up to five prisons to help close the state's budget deficit and reduce corrections costs, though the Department ultimately opted to pursue a mix of asset sales, outsourced facility operations and facility consolidation/insourcing.

Like the JobsOhio initiative, Progress Ohio has filed a lawsuit against the state challenging the prison deal on constitutional grounds. At press time, no court decision had been issued.

Ohio Turnpike: In November 2011, the Ohio Department of Transportation (ODOT) took a significant step toward advancing a major Kasich administration priority—a potential long-term lease of the 241-mile Ohio Turnpike—by announcing that it had selected the firm KPMG to serve as the state's financial advisor on the proposed lease. KPMG will analyze various options and make recommendations on how to proceed, which could range from leaving the Turnpike in its current form, leasing it to a private operator, transferring it to ODOT or other options not yet identified. KPMG will issue its recommendations to the state by July 1, 2012.

The 2012–2013 state budget enacted earlier in the year authorized the proposed lease, allowing a lease term of up to 75 years and requiring solicitations and proposed business terms to be submitted to the legislature for approval before they are issued. During and after his gubernatorial campaign, Kasich signaled his interest in receiving at least $3 billion in an upfront payment in a Turnpike lease. "We would lease it with the hopes of bringing in literally billions of dollars in payments," Kasich told *The Plain Dealer* in August. "For Ohio to sit on an unused asset makes as much sense as a company sitting on an unused asset. And when companies do that, companies get taken over."[18]

Ohio Lottery: In late August 2011, the *Cleveland Plain Dealer* reported that the Kasich administration planned to issue a request for proposals from consultants to analyze whether or not the state should pursue privatization of the management of the Ohio Lottery, and if so, how to best maximize its value.[19] A provision in the 2012–2013 budget that would have authorized the privatization of lottery management was pulled in late negotiations amid legislator concerns over its constitutionality.

In other Ohio privatization news:

- The 2012–2013 budget signed into law by Gov. Kasich in June included a number of provisions granting new privatization authority to various units of state and local government. For example, the budget authorized state higher education institutions to privatize dormitories and other facilities, while authorizing K-12 schools to privatize their transportation services. Similarly, the budget also authorized local governments and other units of government to enter into long-term leases up to 30 years in length to privatize the operations and management of their garages, meters and other municipal parking assets. Ohio State University may be the first to take advantage of the new authority, as university trustees have authorized a procurement for a potential 50-year lease of their parking system to generate $375 million in upfront revenues, as well as avoid operational costs over the term of the agreement. (For more details on this initiative, see the "Local Government Update" section of Reason Foundation's *Annual Privatization Report 2011*).
- Gov. Kasich signed into law House Bill 114, authorizing the Ohio Department of Transportation to enter into public-private partnerships to finance, design, build, operate and/or maintain highways, bridges and other transportation infrastructure statewide.
- Gov. Kasich is reportedly considering subleasing the operation of the Ohio Academic Resources Network—a nearly 2,000-mile fiber optic system connecting universities, schools, medical centers and research facilities—to private businesses, according to local press reports.

Given the robust activity on privatization seen in Ohio in 2011, it is likely that the Kasich administration and legislature will return to the subject in 2012. In a news conference announcing his budget, Gov. Kasich suggested "[t]here are more privatizations to come […] [w]e don't want to leave any money on the table," according to a March 2011 article in *The Plain Dealer*.[20]

Part 5

Washington State Approves Privatization of State Liquor Monopoly; Other States May Follow

In November 2011, **Washington** State voters approved the privatization of the state's monopoly on the distribution and sale of distilled spirits, becoming the first state in the nation to fully shift wholesale and retail from public to private sector operation and potentially injecting some momentum into privatization efforts in Virginia, Pennsylvania and other states currently exploring similar proposals.

By an overwhelming 60–40 margin, Evergreen State voters approved Initiative 1183 (I-1183), a ballot measure sponsored by Costco and other major retailers that will fully privatize both wholesale distribution and retail sales of liquor, while removing obstacles to the wholesale distribution of wine. I-1183 was designed to rein in the scope of, and address the perceived deficiencies of, Initiative 1100 (I-1100), a more sweeping Costco-backed privatization measure narrowly defeated at the polls in November 2010. (For more details on I-1100, see Reason Foundation's *Annual Privatization Report 2010*.)

Among its provisions, I-1183 will:

- Dismantle the state's existing wholesale and retail monopoly by authorizing private distribution and sales of distilled spirits. I-1183 limits spirits sales to stores of over 10,000 square feet (with certain exceptions), which the state expects could increase the number of spirits retailers to 1,428, relative to 328 outlets under state operation. By contrast, I-1100 had no such limitation on store size and was estimated to result in over 3,000 potential new retail outlets. An analysis by the Washington Policy Center reviewed liquor retail outlet density in 11 western states and found that under I-1183, Washington State "would still rank among the top five states for restrictive access to liquor sales […] and would be the most restrictive non-monopoly-control state in the West."[21]
- Authorize the sale of the state's liquor distribution and liquor store facilities and equipment, including the state's distribution warehouse.
- Allow retailers to buy spirits and wine directly from manufacturers, while preserving the existing mandate that retailers purchase beer from wholesalers. While retailers may still

choose to purchase spirits or wine from wholesalers, the initiative's direct sale provisions mark a significant step away from the mandated use of the "three tier" system—where retailers are only allowed to purchase alcohol products from wholesalers, who in turn are required to purchase their products from manufacturers—prevalent across states today. By contrast, I-1100 would have gone further by eliminating the mandatory use of wholesalers for spirits, wine and beer, which generated significant opposition from existing beer and wine wholesalers in the state.

- Allow spirits and wine manufacturers to offer quantity discounts to retailers.
- Leave existing taxes on spirits, wine and beer unchanged. I-1183 would also eliminate the state's current 52% wholesale markup, creating the opportunity for retailers to compete on the level of private markup applied.
- Create a new retail license issuance fee of 17% of all spirits sales revenue (with payments required quarterly in arrears), as well as an annual license renewal fee of $166.
- Create a new distributor license fee of 10% of total annual revenue from spirits for the first two years of licensure—which drops to 5% of spirits sales revenue in subsequent years—as well as an annual renewal fee of $1,320 per license. The initiative also authorizes the state's liquor control board to issue an additional, one-time fee on distributors in 2013 if total distributor fees collected by the state have not generated an aggregate $150 million by March 31, 2013.
- Give local governments the ability to object to or prevent the issuance of local liquor licenses.
- Require retailers to train all liquor sales staff on compliance with liquor laws and regulation. Additionally, I-1183 limits the issuance of retail licenses to those outlets that adequately demonstrate effective safety, management and training protocols to prevent sales to minors and inebriated persons.

The license fee structure—designed to generate more alcohol-related revenues to the state relative to monopoly operation—was key to the passage of I-1183, as it created a strong argument that state and local governments would see a financial benefit under privatization. According to the state Office of Financial Management's (OFM) fiscal impact statement for I-1183, the measure would increase revenues to the state by an estimated $216 million to $253 million over six fiscal years, with a similar $186 million to $227 million increase in local government revenues over that same period. Further, the OFM estimated a one-time net state revenue gain of $28.4 million from auctioning off the state liquor distribution center. OFM did not estimate proceeds from the sale of existing state-run liquor stores, so actual one-time revenues from divestiture are likely understated.

I-1100's opponents had stoked fears that passage would reduce state and local government revenues, which played a key role in voters' rejection of that measure in 2010. The provisions of I-1183—in particular, provisions establishing a new license fee structure—were designed to ensure that it can fully replace revenues generated by the current state wholesale markup.

Though it remained neutral on I-1183, the Distilled Spirits Council of the United States (DISCUS) highlighted two key critiques of the measure amid the election campaign that are likely to inform similar debates in other states. First, the minimum retail outlet size of 10,000 square feet effectively excludes a broad range of small- and medium-sized retailers—including gas stations and mom-and-pop specialty spirits stores—from the market, potentially reducing competition and consumer choice. This restriction prompted groups like the Washington Food Industry Association—an organization representing independent grocers that supports the general concept of privatization—to oppose I-1183 on grounds that it gives large retailers an advantage over smaller businesses.

Second, DISCUS raised concerns that I-1183 would create franchise protection for spirits wholesalers, with the practical effect that once a supplier selects a wholesaler for a particular brand, that wholesaler would retain exclusive distribution rights in perpetuity unless it chose to forfeit them. DISCUS noted that in most states, suppliers can choose their wholesale partners and hold them to high standards of performance and service through the ability to open the arrangements to competition in the event of wholesaler underperformance.

As with I-1100, Gov. Chris Gregoire, many state legislators and the Washington State Democratic party opposed I-1183, but unlike in 2010, these political opponents did not reject the concept of privatization. Ironically, in the spring of 2011 Gov. Gregoire signed into law a bill (Senate Bill 5942) passed by the majority Democrat legislature authorizing the state to solicit proposals for a long-term lease of the state's spirits wholesale monopoly in return for a one-time, lump-sum payment. Though I-1183 proponents complained that the bill was designed to serve as an end-run around the initiative—potentially taking the wholesale component off the table in advance of the November 2011 election—those fears were rendered moot a week before the election when the state announced that it had rejected both bids it received from wholesalers as not being in the financial interests of the state.

S.B. 5942 was not the only legislative action on liquor monopoly privatization in Washington State. Legislators introduced two separate Senate bills (S.B. 5111 and S.B. 5933) that, like I-1183, would have completely privatized the distribution and sale of distilled spirits. However, both bills were referred to the Senate Labor, Commerce & Consumer Protection Committee and failed to receive a hearing in the 2011 legislative session.

With the passage of I-1183, Washington State will join 32 other states that have allowed private firms to distribute and sell distilled spirits since the end of Prohibition. Of the 18 remaining "control" states—a term referring to states that have a government-run monopoly on the sale and/or distribution of distilled spirits—Iowa and West Virginia privatized their spirits retail monopoly in recent decades (while retaining their in-house wholesale operation), and Maine has more recently outsourced the operation of its wholesale monopoly to a private manager. Since the end of Prohibition, major shifts in state alcohol systems have moved in a one-way direction toward privatization; while several "control" states have expanded the role for private enterprise to varying degrees, no state has ever shifted from a private regime to a state-run liquor monopoly.

Pennsylvania appears to be the state best poised to potentially follow in Washington State's footsteps by privatizing its alcohol monopoly. First-year Gov. Tom Corbett announced his support for privatizing the state's alcohol monopoly during his 2010 campaign, and upon taking office in 2011, his administration hired the consulting firm Public Financial Management (PFM) to conduct a valuation study for the potential privatization of the Pennsylvania Liquor Control Board's (PLCB) monopoly on the wholesale and retail sale of wine and distilled spirits.

The PFM report found that the current monopoly system provides the state with an average of $97 million in net revenues annually, but that the system's overall profitability has been on the decline as the growth in expenses has outpaced revenues. In fact, the analysis found that if the state fully accounted for indirect costs and other factors, then nearly all PLCB stores would be unprofitable today.

The PFM analysis identified two viable privatization approaches:

- *Full wholesale and retail privatization, with limits around the number or types of both licenses*. In the "limited retail license" scenario, PFM found that approximately 1,500 retail licenses would be a reasonable accommodation of consumer convenience and license scarcity, and the model could be implemented through an auction process.
- *Full privatization with limited licensing of wholesale, open licensing of retail*. Under the "open market retail" approach, PFM estimates there would likely be 3,000 to 4,000 retail licenses issued, and any qualified applicant would have an opportunity to apply for a license.

Among the key findings of the PFM report:

- The "limited retail license" option would generate more upfront revenue, for which PFM estimated a valuation of retail licenses under this scenario in the range of $730 million and a valuation of wholesale licenses in the range of $575 million, for a total estimated valuation of between $1.1 billion to $1.6 billion.
- The "open market retail" option would generate less upfront revenue but has the advantage of fewer market restrictions around retail licenses and reduced risk of sub-optimal license auction results. Further, this scenario would generate more ongoing revenue from licensing, so other alcohol taxes would not need to be as high to generate the same level of alcohol revenues to the state relative to the current monopoly system.
- Upfront revenues from the auction of wholesale licenses would be generated in both retail scenarios. PFM determined that auctioning wholesale licenses by brand was the best option, which would lead to between 10 and 30 primary wholesalers serving the state. Wholesale licensees would pay an initial franchise fee along with annual license fees that support the cost of regulation.
- PFM estimates that additional sales from the repatriation of sales currently lost to other states (e.g., "border bleed") will be approximately $100 million under privatization. A

September 2011 study by the Commonwealth Foundation found that bootlegging across state lines—in part driven by lower wine and spirits prices in some surrounding states—has cost the state billions in lost sales and tax revenue.

- PFM recommends that one-time proceeds to the state from privatization could be used to reduce the state's unfunded pension liability, invested in infrastructure, or used as incentives for economic development.
- PLCB's licensing and enforcement responsibility under privatization would remain and likely require increased staffing to accommodate additional licensing activities. Overall, after privatization PFM estimated that the PLCB would likely consist of approximately 290 full-time equivalent positions after the departure of approximately 3,200 retail, distribution and central office staff.
- With regard to product pricing, PFM estimates price neutrality under the "open market retail" approach and some potential, minor price increases under the auction retail approach. However, the analysis uses a conservative pricing model, and with the expected amount of competition in retail pricing, PFM estimates that "for the majority of sales in Pennsylvania, the product prices will be at or slightly lower" than its model suggests.[22]

In a press release announcing the receipt of the PFM report, Corbett noted, "Pennsylvania should not be in the business of selling alcohol. It's time to get state government out of the retail trade business and instead focus on essential public services—that's what taxpayers expect of us." He added that he would likely sign into law a bill offering a viable privatization alternative to the current system, if it were to reach his desk.

Corbett may get that opportunity in 2012 when state legislators turn attention to House Bill 11 (HB 11), legislation introduced in September 2011 by House Majority Leader Mike Turzai. HB 11 would privatize the state's wholesale and retail monopoly, creating a limited number of retail and wholesale liquor licenses and auctioning them to the highest bidders under a model consistent with PFM's "limited retail license" scenario (HB 11 contemplates the auction of 1,250 retail licenses, up from the current 613 state stores). HB 11 would allocate 750 retail licenses to large retailers with stores over 15,000 square feet, with the remaining 500 licenses granted to smaller retailers with a set number in each county. Also, HB 11 would replace current alcohol taxes—including the 18% Johnstown Flood Tax, the state's retail markup, and the per-bottle handling fee—with a gallonage tax of between $8 and $9 per gallon of wine and $11 and $12 per gallon of spirits, varying based on alcohol content.

At press time, the outlook for HB 11 was unclear. The bill had not yet been heard in legislative committee, and although a range of legislators have already signaled their support, it also faces stiff opposition from the United Food and Commercial Workers Local 1776, which represents approximately 2,500 state store clerks. However, numerous opinion polls demonstrate strong public support for privatization among Commonwealth residents. For example, a September 2011 Quinnipiac University poll found that Pennsylvania voters support privatizing liquor stores by a 62% to 31% margin, with support among all demographic groups.

Virginia is another state with an ongoing policy discussion on privatizing the state's spirits monopoly. Privatization of the Commonwealth's liquor retail and wholesale operations was a central pillar of Governor McDonnell's larger fiscal agenda upon entering office in January 2010, but his first privatization proposal that year—which would have privatized wholesale and retail functions to generate approximately $400–500 million for the state to invest in transportation infrastructure—failed to garner enough legislative support to advance, largely due to concerns that privatization would reduce alcohol-related revenues to the state. (For more details, see discussion in Reason Foundation's *Annual Privatization Report 2010*.)

The McDonnell administration made a second attempt in 2011, offering a more limited proposal that would have privatized retail operations—closing the 332 state-run liquor stores and authorizing the issuance of 1,000 private retail licenses—while leaving wholesale functions under state operation. The McDonnell administration hired PFM to analyze the privatization proposal, and the consultant's January 2011 report found that retail license auctions would net the state an estimated $200–400 million (which McDonnell proposed to invest in transportation) and an additional $13 million in alcohol-related revenues on an annual basis, even with the proposed reduction in the state's markup from 69% to 50%. Despite a proposal that addressed lawmakers' previous concerns over ongoing revenues, the administration's accompanying legislation never received a legislative committee hearing and failed to advance.

Despite the second legislative defeat, Governor McDonnell has indicated his interest in another privatization push in 2012, an effort that could be aided by a transition of the state Senate to Republican control in the wake of the November 2011 election.

In other news on the privatization of state alcohol monopolies:

- **Alabama**: The former state legislator tapped by Gov. Robert Bentley to serve as the Alabama Alcoholic Beverage Control Board's chief administrator, Mac Gipson, told a February 2011 gathering of state ABC agents that he had reversed his former support for privatization of the state's spirits monopoly since taking over leadership of the Board, according to *The Montgomery Advertiser*.[23] Gipson's change of heart came amid rumors the new Republican legislative majority in Alabama may be interested in exploring privatization, and he warned of potential negative fiscal and law enforcement consequences.

- **Idaho**: A January 2011 report commissioned by Idaho's Joint Legislative Oversight Committee found that privatization of the state's liquor enterprise is feasible and outlined several potential approaches.[24] Completely converting to a privatized wholesale and retail system and establishing a liquor tax to replace the current state markup could generate approximately the same amount of revenue as the state receives today. Alternatively, the state could retain the wholesale enterprise and convert all stores to private operation if it continued using a wholesale markup to maintain current revenues. Last, contracting out the operations of the 13 state-operated stores with the lowest sales was estimated to offer

$700,000 in potential annual cost savings. The report was met with a cold reception by Gov. C.L. “Butch” Otter, who told the Associated Press in February 2011 that alcoholic beverage control and promoting temperance are proper functions of government under Idaho's Constitution.[25]

- **North Carolina**: In January 2011, North Carolina Gov. Beverly Perdue announced that her administration would not pursue privatization of the state's alcohol monopoly. Like Pennsylvania and Virginia, the state hired PFM to conduct a privatization analysis, which found that the state could reap approximately $300 million upfront from retail license auctions and divestiture of the wholesale operation. However, this estimate was based on issuing the same number of retail licenses to match the current number of state-run stores; PFM estimated that one-time revenues could exceed $500 million if additional retail licenses and other systemic changes were approved. In announcing her opposition to privatization, Perdue noted her belief that the current system works well and that she was unwilling to loosen current restrictions on the number and type of retail outlets, operating hours and marketing. Despite the governor's opposition, several state legislators announced that they were still interested in exploring privatization as part of a larger government streamlining push.

- **Ohio**: Ohio Gov. John Kasich’s plan to transfer ownership of the state’s wholesale liquor monopoly to JobsOhio—a new nonprofit organization created by privatizing economic development functions formerly performed by the Ohio Department of Development—was approved as part of the 2012–2013 budget. Under the plan, JobsOhio will gain control of the liquor system’s annual net revenues for 25 years in return for a $1.2 billion upfront payment. Approximately $700 million of the proceeds would be used to defease existing state debt, while roughly $500 million would be deposited in the state’s general fund for short-to-near term uses.

- **Utah**: The Utah legislature appears poised to take on the issue of alcohol monopoly privatization in the 2012 legislative session, with State Rep. Ryan Wilcox announcing plans to introduce a bill to privatize the state's retail ABC monopoly. The proposal came amid widespread legislator frustration with recent management scandals at the Utah Department of Alcoholic Beverage Control, as well as the agency’s proposed closure of 10 profitable state-run stores in response to a $2.2 million legislative cut to the agency's budget, an outcome temporarily averted when Gov. Gary Herbert later transferred $1.4 million in savings from capital projects to the agency.

  The privatization concept was endorsed by the state Privatization Policy Board, a legislative advisory body on privatization issues that issued a letter to Gov. Gary Herbert in May 2011 supporting retail privatization. “We believe that, although there are difficult political issues, the state should carefully consider the reasons for […] being in the alcohol business and evaluate ways to move this activity to the private sector,” according to the Board’s letter.

"It should not be a function of government to sell alcohol," Wilcox told *The Salt Lake Tribune* in April 2011. "When the state gets into the retail sales, customer service and performance suffer."[26] At press time, Gov. Herbert had not taken a formal position but had publicly expressed openness to considering Wilcox's privatization proposal. More impetus for privatization may come from a November 2011 business plan for the Department commissioned by the state legislature, which recommended an expansion in the use of privately operated liquor retail outlets (known as "package stores") to generate savings and increase system profits without increasing sales.

Part 6

Puerto Rico Building Robust Infrastructure Privatization Program

In two short years, the administration of Governor Luis Fortuño has turned Puerto Rico into a privatization leader among its state peers. To address the territory's chronic deficits and unsustainable debt, the administration has advanced a range of reforms that include major spending reductions, optimization of government operations and the enactment of a new law in 2009 inviting private investors to modernize or develop new infrastructure across a variety of sectors.

That law, Act No. 29, is now bearing fruit. It authorized government agencies to enter into public-private partnerships (PPPs) with private firms for the design, construction, financing, maintenance or operation of public facilities, with a set of priority projects that include toll roads, transit, energy, water/wastewater facilities, solid waste management and ports. The law also established a new Public Private Partnership Authority (PPPA), a new center of excellence within the Puerto Rico Government Development Bank responsible for identifying, evaluating and selecting PPP projects and for monitoring and enforcing the terms of PPP contracts.

Despite its short life, the PPPA has built a world-class PPP program utilizing global best practices, and it has already seen some major successes advancing projects through the procurement pipeline:

- To help modernize K-12 school facilities and improve academic performance, the PPPA has launched the "Schools for the 21st Century" PPP program, under which Puerto Rico is contracting with private operators to design, build and maintain approximately 100 schools in 78 municipalities across Puerto Rico. A total of 47 contracts were in place by November 2011 covering the development of 76 K-12 schools for an aggregate total investment of $543 million, and 70 of those schools were already under construction. In an August Reason Foundation interview, PPPA Executive Director David Alvarez noted that the program is "an indirect way towards academic performance by providing and delivering better infrastructure, with the goal for students to perform better at school—to keep more people in school and to get better results."[27] The government of Puerto Rico is financing the project through the issuance of Qualified School Construction Bonds.
- In September 2011, the PPPA finalized its first major highway PPP when it reached financial close on a 40-year, $1.492 billion concession to operate the PR-22 and PR-5 toll roads. After initiating a yearlong procurement process in 2010, the agency pre-qualified

potential bidders and ended up with two firm bids. The winner was Autopistas Metropolitanas de Puerto Rico, LLC—a consortium of Goldman Sachs Infrastructure Partners II (an infrastructure investment fund) and Abertis Infraestructuras (a Spanish toll concession company)—which will pay the Commonwealth an upfront payment of $1.136 billion, will invest $56 million in initial safety upgrades and will make an estimated $300 million in additional investment in highway maintenance over the life of the concession. Under the terms of the contract, the concessionaire may not increase tolls until 2014, after which any future increases will require government approval. In a June press release, Gov. Fortuño wrote that the concession "will benefit hundreds of thousands of drivers who will enjoy better paved, better lit, more secure toll roads on a daily basis, and will also have an extraordinarily positive effect on our economy," citing economic benefits that include new jobs, new local tax revenues, contributions to local police, and enhanced services to drivers.

- PPPA officials made significant progress in 2011 advancing the privatization of San Juan's Luis Muñoz Marin International Airport, the busiest airport in the Caribbean. After months of discussion, the airport's leading carrier, American Airlines, agreed to the terms of a draft concession agreement, with other airlines following suit. In July 2011, the PPPA and the Puerto Rico Ports Authority issued a request for qualifications that yielded 12 responses from potential bidders. By September, the Authority had announced its short-list of six consortia eligible to bid on the project, including teams led by ASUR, Fraport, GMR and Zurich Airport. The PPPA plans to issue a formal request for proposals to the short-listed firms in the fall of 2011, with bids to be submitted by the end of the year. The PPPA anticipates awarding a 50-year lease by early 2012.

In a June 2011 press release announcing the winning bidder on the toll road lease, Gov. Fortuño noted that PPPs are just getting started in Puerto Rico: "We have come a long way in just 24 months since the enactment of our P3 legislation. We will continue to move forward with important projects and our commitment to P3s is stronger than ever." At press time the PPPA had not announced the next round of potential PPPs in its project pipeline, but in August 2010 the authority's board of directors directed staff to begin an evaluation process and develop feasibility studies for several potential projects, including a new minimum custody correctional facility, a ferry between the municipality of Fajardo and the municipalities of Vieques and Culebra, a technology project for traffic control automation and traffic violation control, and redevelopment initiative targeting areas surrounding Tren Urbano (San Juan's regional rapid transit system) stations.

Part 7

Arizona Commission Completes Privatization, Efficiency Review

Arizona's Commission on Privatization and Efficiency (COPE)—created under a 2010 executive order issued by Governor Jan Brewer (see discussion in Reason Foundation's *Annual Privatization Report 2010*)—completed its work in July 2011, issuing the second of two reports outlining a set of privatization and government efficiency recommendations to streamline the state and deliver more cost-effective services to taxpayers.

Key recommendations from COPE's September 2010 and July 2011 reports include:

- *Designing a state privatization process*: COPE recognized the value of implementing a sound privatization process to ensure that any future contracting efforts be done with proper due diligence and adherence to best practices. Specifically, COPE recommended the creation of a privatization "center of excellence" to establish a standardized privatization process, conduct business cases of proposed privatization initiatives, monitor project implementation and disseminate best practices, among other tasks. Additionally, COPE recommended that Gov. Brewer issue administrative policy guidance to state agencies stating that achieving efficiency through private sector competition is a standard policy across state government.
- *Privatizing operation and management of the Arizona Lottery*: COPE recommended that the state explore the potential private sector operation and management of the Arizona Lottery as a means to increase state lottery revenues by an estimated $107–210 million over a five-year period. COPE found that the Arizona Lottery has been an underperforming asset, with costs rising faster than revenues in recent years. COPE cited a similar privatization in Illinois—where a private operator has committed to increasing the state's lottery proceeds by over $1 billion in a 10-year management contract initiated in 2011.
- *Expanding public-private partnerships (PPPs) for state park operation*: COPE recommended the expanded use of PPPs for the operation and management of entire parks—under strict state oversight to protect the public interest—throughout the state parks system to ensure that parks remain open and properly maintained, as well as to take significant costs off the state's books.

- *Implementing an activity-based costing pilot program*: Noting its inability to acquire reliable information on the internal costs of operation for a variety of commonly outsourced administrative support services, COPE recommended that the state legislature adopt a statute setting forth an activity-based costing pilot program to assess the full costs and potential efficiency/privatization opportunities in several service areas, including vehicle fleet operations, maintenance and management, printing and document management, building/facility operations and maintenance, and mail services.
- *Introducing a state agency review process*: COPE outlined a recommended framework for a systematic review of agencies, boards and commissions for potential elimination, merger, efficiency review and/or privatization opportunities. COPE's recommended process would include the systematic review of 20% of the state's agencies, boards and commissions each year on a five-year rotating basis.
- *Adopting statewide outcome-based budgeting*: COPE recommended that Arizona policymakers shift to an outcome-based budgeting process that integrates the concepts of "zero-based" and "performance-based" budgeting. Washington State, Iowa and others have used a similar approach, whereby policymakers and the public collaboratively rank programs according to their performance and cost-effectiveness and the state funds down the list with available revenues to ensure that the highest priority and highest performing programs are funded first.

The two COPE reports detail a number of additional privatization and efficiency recommendations across a broad range of government services and systems, including:

- Public employee pension reform;
- State personnel reform;
- State procurement reform;
- Implementation of statewide student-based budgeting;
- Privatization of environmental permit processing functions;
- Privatization of highway rest areas;
- Privatization of building maintenance;
- Privatization of education data collection;
- Consolidation of email systems;
- Shared services in human resources;
- Improved real property management;
- Improved cell phone contract management;
- Improved personal computer power management;
- Expansion of electronic tax filing and reduction of revenue offices; and
- Interdepartmental exchange of surplus equipment.

In other Arizona privatization news, the Arizona Senate passed Senate Bill 1589 in March 2011, a bill that would require the director of the Arizona Department of Transportation (ADOT) to authorize third parties to perform all of its title and registration, motor carrier licensing and tax reporting, dealer licensing and driver license functions. However, the House of Representatives amended the bill to remove the privatization mandate, replacing it with language requiring ADOT to submit a report to the governor and legislature by the end of the year that reviews the agency's current provision of services by authorized third parties and offers recommendations on expanding the privatization of services provided by ADOT. The Senate later approved the House’s changes, and Gov. Brewer signed the bill into law in April.

Part 8

Texas, Connecticut Enact Broad-Ranging Infrastructure PPP Laws

Over the last decade, **Texas** has been a pioneer in using private sector financing and project delivery to deploy new transportation infrastructure through public-private partnerships (PPPs). In the 2011 legislative session, the Texas legislature re-embraced transportation PPPs in Senate Bill 1420, authorizing their use for roughly a dozen new transportation projects through 2015. Simultaneously, the legislature—with the support of Gov. Rick Perry—also enacted Senate Bill 1048 (SB 1048), significantly expanding the Lone Star State's ability to tap infrastructure PPPs for more than just transportation projects. In fact, Texas can now use PPPs to deliver nearly any type of public infrastructure, including schools, water & wastewater projects, transit, ports and other public use facilities.

Modeled after Virginia's Public-Private Educational Facilities Infrastructure Act, which has been used extensively by agencies in the Commonwealth to deliver a wide range of projects since its enactment in 2002, SB 1048 allows for both solicited and unsolicited proposals from private firms to develop infrastructure projects across a broad spectrum. Under SB 1048, qualifying PPP projects include, but are not limited to, "[…] any ferry, mass transit facility, vehicle parking facility, port facility, power generation facility, fuel supply facility, oil or gas pipeline, water supply facility, public work, waste treatment facility, hospital, school, medical or nursing care facility, recreational facility, public building, or other similar facility currently available or to be made available to a governmental entity for public use […]" Further, the law establishes the Texas Partnership Advisory Commission to provide legislative review and oversight to projects advanced.

Texas policymakers have taken inspiration from global PPP leaders like the United Kingdom and Canada, which have long used partnerships to develop hospitals and schools, in addition to transportation projects. Similarly, Puerto Rico adopted legislation in 2009 inviting private investors to modernize or develop new roads, schools, ports, water systems and energy plants (see discussion in Part 6 of this report).

In September 2011, the Texas Facilities Commission unanimously adopted new guidelines to govern the PPP process set forth in SB 1048, which the Commission sees as an important tool for further developing the Capitol complex in Austin and reducing the state's use of leased office space. However, State Sen. Mike Jackson and State Rep. John Davis—the legislative sponsors of

SB 1048—asked the Facilities Commission in October to temporarily stop accepting unsolicited proposals until the Partnership Advisory Commission established under the law is operational and able to review the Facilities Commission's new PPP guidelines to ensure their appropriateness and consistency with the intent of SB 1048.

Connecticut became the second state to authorize PPPs across a broad range of sectors in 2011, with statutory authority for PPPs included as part of a larger jobs and growth bill (House Bill 6801) signed into law by Gov. Dannel Malloy in late October. The bill authorizes state executive branch agencies to enter into PPP agreements to finance, design, construct, develop, operate and/or maintain state facilities that include:

- educational, health, early childcare or housing facilities;
- transportation systems, including ports, transit-oriented development and related infrastructure; and
- any other facility the legislature identifies or proposes as a project.

The bill is more limited in scope than Texas, however, as it limits the total number of PPP projects to five, which must be in place before PPP authority expires on January 1, 2015. The bill authorizes the blending of public and private funds to finance PPP projects, though state support cannot exceed 25% of the project's cost. PPP contracts are limited to a maximum of 50 years in length and may include the collection of user fees, except that any proposed highway tolls would require prior legislative approval.

The bill creates several layers of PPP oversight. Projects must be approved by the governor, heard in public hearings by several legislative committees, and reviewed by the state's contracting standards board before proceeding. Approved projects must be competitively solicited, and the process requires the preparation of a "value for money" analysis to assess whether a PPP procurement offers the best value to the state relative to alternate delivery methods. Further, private sector partners on completed projects will be required to submit annual independent audit reports to their public sector partner agencies.

Key to the overwhelming passage of the PPP provisions in the legislature were concessions made at the behest of public employee unions in the bill language, including requirements that subject PPPs to the state's prevailing wage laws (or labor wage rates established in project labor agreements) and carve out a potential, ongoing operational role for public employees in some PPP projects.

Part 9

Corbett Administration Embracing the "Yellow Pages Test" in Pennsylvania

Though it did not advance a major privatization initiative in its first year in office, the new administration of Pennsylvania Gov. Tom Corbett has shown clear signs that privatization may play an important role in its management strategy moving forward.

First, in an early move, the Corbett administration hired the consulting firm Public Financial Management to conduct a valuation study for the potential privatization of the Pennsylvania Liquor Control Board's monopoly on the wholesale and retail sale of wine and distilled spirits. The firm prepared a similar privatization study for Virginia Gov. Bob McDonnell in early 2011. Corbett announced his support for privatizing the state's alcohol monopoly during his 2010 campaign, and legislation to authorize privatization was introduced by House Majority Leader Mike Turzai in the fall of 2011 to be considered in 2012. (For more information on the potential privatization of Pennsylvania's state liquor monopoly, see Part 5 of this report.)

Next, in August 2011, the Governor's Office on the Budget released Administrative Circular 11-12, directing state agencies to plan for reduced operating funds in the 2012–13 cycle and to propose opportunities for outsourcing, privatization, public-private partnerships or competition to lower costs. According to the circular, "Agencies should identify opportunities for functional outsourcing or consolidations. The "Yellow Pages" test provides a good place to start. If a product or service that state government is currently providing can be found in the Yellow Pages and can be done less expensively by the private sector, then the Commonwealth should consider offering that product or service in a different manner."

The following month, the Corbett administration announced the formation of a 24-member Governor's Advisory Council on Privatization and Innovation, which will review government functions and services to determine whether the state is providing the most cost-efficient and transparent government that taxpayers deserve and whether any in-house government functions might be better and more cost-effectively performed by the private sector.

"Many people may not recognize it, but privatization has been successful in government for many years," Governor Corbett said in a press release announcing the advisory council. "From snow removal services to social services, private job-creators have been doing work that government

bodies simply could not do without an increased cost to taxpayers and a drop in efficiencies […] Too often, debates over privatization fail to recognize this simple fact—it's already working to the benefit of taxpayers."

Last, in December 2011, *Bloomberg Businessweek* reported that the Corbett administration had hired investment bank Greenhill & Co. to undertake a review of all state assets and services (with the exception of the state's liquor monopoly) to identify potential privatization and asset divestiture opportunities.[28] The firm's compensation will not exceed $150,000 for three months of anticipated work, and the state may retain Greenhill to negotiate potential deals.

Despite the administration's interest in exploring a wide range of privatization opportunities, it has also set some boundaries, most notably in signaling the governor's opposition to any long-term lease of the Pennsylvania Turnpike and the privatization of public prison operations.

In other Pennsylvania privatization news:

- State Rep. Seth Grove introduced House Bill 250 in the 2011–2012 regular legislative session, a bill that would have established a new Council on Efficient Government to assess potential privatization opportunities in state government. The bill was referred to the House State Government Committee in January 2011 but, at press time, had failed to receive a hearing.
- State Sen. Patrick Brown introduced a separate bill—the Free Enterprise and Taxpayer Protection Act (Senate Bill 557)—that would prohibit state agencies, universities, community colleges, school districts and other public authorities from competing against private enterprise in the delivery of government services. The bill was referred to the Senate State Government Committee in February 2011 but had not yet received a hearing at press time.

Part 10

Restructuring Opens Door to More Privatization in Washington State

Washington State's ongoing fiscal challenges prompted Gov. Christine Gregoire's administration to take a more aggressive approach to the privatization of government services in 2011. Privatization has thus far been an infrequently used fiscal management tool in the Evergreen State, in large part the outcome of a 2002 law granting state employees the ability to compete against private firms in proposed outsourcing efforts and requiring any agency privatization initiative to be approved in a collective bargaining process with unions before it can proceed.

Gregoire signaled her interest in advancing competitive contracting early by issuing Executive Order 10-07 in November 2010, which required agencies to use performance-based contracts when contracting for state services and directed the state's Office of Financial Management (OFM) to develop minimum performance contracting standards for client and personal services contracts. Gregoire simultaneously asked the State Auditor's Office to prepare a report on the state's use of performance-based contracting.

The auditor's report, issued in June 2011, found that agencies were in "various stages of transition to performance-based contracting":[29]

- Over 90% of state contracts reviewed met OFM's basic performance-based contracting standard by identifying deliverables and tying vendor payment to successful completion or delivery.
- Approximately 50% of contracts identified performance measures or outcomes.
- However, relatively few contracts (15%) tied payment to the successful attainment of performance measures or outcomes, and even fewer (8%) included incentives for good performance or penalties for poor performance.
- The report suggests that the state "create a centralized office or staff with a high degree of expertise in performance measurement and performance-based contracting to provide technical assistance to agencies in developing and improving their use of performance measures and outcomes."

During the 2011 legislative session, Gov. Gregoire’s plan to consolidate several administrative agencies and ease the path toward privatization of state support services advanced with the bipartisan passage of Senate Bill 5931, despite public employee union opposition. In the reorganization, several administrative agencies and activities—including state printing, motor pool, mail services and information technology—are being consolidated into two new agencies: the Department of Enterprise Services and the Department of Consolidated Technology Services. The restructuring is expected to save at least $18 million and eliminate up to 115 state information services employees.

The legislation included two key provisions that stand to expand the state's currently limited use of privatization, generating strong opposition from the Washington Federation of State Employees. The first provision exempts the new Consolidated Technology Services from provisions in current state law allowing public employees to compete against private firms in a potential contracting initiative. In a January 2011 policy brief, Gregoire explained the rationale for a more nimble IT agency that can pursue privatization at its own discretion:

> *[Consolidated Technology Services (CTS)] will be authorized to competitively procure services that all agencies need, such as desktop and helpdesk support and data center operations. This driving principle— “provide or procure” —will boost competition and lower costs regardless of who delivers the service.*
>
> *To be successful, CTS must be agile and take advantage of efficiencies available in the private sector. Accordingly, CTS would be free from many of the requirements other state agencies follow with more flexibility to hire, contract and procure than other departments. In exchange for flexibility, CTS would be subject to greater accountability.*[30]

A second provision in Senate Bill 5931 requires the state's Office of Financial Management to select six activities within the new Enterprise Services Department each biennium to competitively bid to the private sector. Bids can be cancelled if that service cannot be provided at a lower rate or more efficiently than the state. Additionally, the Joint Legislative and Audit Review Committee will conduct an independent study of the new contracting program for release in January 2018.

The legislation's contracting provisions were the product of a bipartisan coalition of Republicans and moderate Democrats that had made their support for the bill contingent upon the privatization language. The coalition had previously sponsored even stronger language in an earlier bill draft that would have directly privatized real estate, mail, motor pool and printing services. Some impetus for the privatization push came from the State Auditor’s Office release of a performance audit in April 2011 that found that the state’s print services were not a core function of government and recommended that the Department of Printing be required to compete against private printers for all printing work.

Part 11

Interest in State Parks Privatization on the Rise

As reported in Reason Foundation's *Annual Privatization Report 2010*, policymakers in several cash-strapped states—Arizona and Utah, most notably—have begun to explore the expanded use of privatization in the operation of state parks as a means to keep parks open and thriving amid strained budgets and heightened competition for limited state funds.

The most promising privatization model under discussion—and one used extensively by the U.S. Forest Service (USFS) for over 25 years—is an innovative method of public-private partnership (PPP) in which a state would enter into a lease (concession) authorizing the operation of one or more parks by a private recreation management company (concessionaire) under a performance-based contract. Under a park operations PPP, a concessionaire would take most or all of a park's operations and maintenance costs off the state's books and would retain the revenues collected from entrance, camping and other user fees, in return paying the state an annual lease payment based on a percentage of the fees collected (typically 5–15% of gross revenues). The state would retain full ownership of the land, and the company would be subject to strict state controls on operations, visitor fees, maintenance and other key issues. The park operations PPP model offers states an opportunity to minimize, or potentially eliminate, public subsidies to the parks, while keeping them open for public enjoyment.

This PPP model would expand the scope of private operation in state parks beyond the ubiquitous concessions used by many states in which a private company runs a retail store, food, lodging or equipment rental operation within a government park. For example, private concessionaires currently operate the commercial activities (e.g., lodging, retail, food) in the "crown jewels" of the national parks, including the Grand Canyon, Yosemite and Yellowstone.

However, this is a more limited type of concession than discussed above. Agencies such as the USFS, Tennessee Valley Authority and the Lower Colorado River Authority have made extensive use of concessionaires to operate and maintain complete parks and campgrounds under park operations PPPs. In fact, the USFS has been consistently and successfully applying this model for over 25 years throughout many parts of its system after Reagan-era budget cuts forced the agency to seek alternate means of keeping its recreation areas open.

In **Arizona**, massive budget deficits and threatened park closures have brought the parks funding crisis to a head, prompting policymakers to explore alternate management options designed to lower costs and create a self-sufficient parks system. While Arizona State Parks (ASP) has entered into a range of partnerships with local governments and Indian tribes to keep several parks open, these partnerships are of a short-term nature and do not ensure the long-term viability of the parks, leading to calls to explore the potential for park operations PPPs.

In September 2010, the Arizona Commission of Privatization and Efficiency—a gubernatorial advisory body—issued a report recommending the expanded use of park operations PPPs to ensure that parks remain open and properly maintained. Two months later, the Arizona State Parks Foundation issued its own report evaluating ways in which the state could pursue more partnerships with private entities and introduce systemic efficiencies to lead the state parks system toward financial sustainability. The report found that "[t]here are certain functions of the Arizona State Park System, as well as potential new opportunities that are better suited for the private sector or other public providers to either manage or pursue, or to share the responsibilities with state parks."[31] Services identified as most ripe for privatization within the state park system included asset management and maintenance, accommodations, food, hospitality, retail and recreational services.

The Foundation report assessed each of the state's 28 parks on the potential for partnerships with either for-profit or nonprofit organizations, identifying 10 parks with high partnership potential, 12 parks with moderate partnership potential, and six parks with low partnership potential. Distinguishing qualities of parks with a high potential for partnerships included:

- Large or reliable visitation;
- Significant revenue generation capacity;
- Moderate to few land restrictions;
- Moderate to few legal/land use encumbrances;
- Moderate to few resource management challenges; and
- New revenue development potential.

Additionally, the report recommended transitioning ASP to a quasi-governmental entity that could operate in a more business-like manner and be more nimble in pursuing financially beneficial partnerships with public and private entities. The report also identified a series of constraints and challenges to privatization that included:

- The costs of effective contract management;
- The need for measureable performance criteria that can be incorporated into all PPP agreements;
- Potential legal restrictions arising from agreements that established state parks on land leased from federal land management agencies (or owned by the State Land Department);

- Compliance with federal rules on privatization related to ASP's use of federal conservation dollars; and
- Suboptimal infrastructure and the need for capital investment at many parks.

On the heels of the two privatization reports, ASP issued a request for information (RFI) to private vendors in December 2010 to "solicit feedback and recommendations regarding the feasibility of transitioning or enhancing various operations at ASP with the private sector." The RFI was open-ended in terms of scope, offering vendors the opportunity to present creative ideas and concepts for the agency to consider for further procurements. ASP received responses from several interested recreation management companies, and at press time, the agency was still evaluating the proposals received. Additionally, in September 2011, ASP issued a request for information seeking concepts from private concessionaires on taking over operations of the lodge at Tonto Natural Bridge State Park, as well as potential enhancements and additions to the lodging operations.

Arizona's neighbor to the north, **Utah**, has also been seriously examining the potential for park operations PPPs in recent years, and the subject returned to the forefront in 2011 in the wake of a performance audit of the state parks system issued by the Utah's legislative auditor general in January 2011.

The audit—prepared at the request of a legislative subcommittee to identify ways the parks system can be more self-sufficient and less reliant on general fund dollars—recommended that the state's Division of Parks and Recreation adopt a more business-like operation to improve park system efficiency and recommended the adoption of a pilot program to evaluate the effectiveness of park operations PPPs.

Noting that park operations PPPs have been seldom used to date at the state level, the audit found that privatization "is a feasible operational model," pointing to the USFS as an example:

> *Of all federal land owners in Utah, the best example of full operational privatization is the USFS. Officials from the USFS report it is a common practice in federal forests to allow private businesses to manage forest campgrounds and marinas, as well as offer additional concession services through the issuance of permits. Yet officials also report that the operations of private area managers are highly regulated through agreement terms and oversight by a reduced federal staff. The USFS typically issues five-year concession permits with a possible five-year extension based on performance; however, they also consider a longer-term permit if concessioners will utilize their own capital goods on forestry land. Typically, the USFS retains responsibility for capital projects, unless special terms are negotiated, and retains the right to revoke a concession permit at any time. The local county sheriff typically provides law enforcement.*[32]

The audit found that Utah could contract for camping and/or marina services (and potentially some visitor centers) to essentially privatize the operations of 33 state parks, but as an initial step it suggested that the legislature consider implementing a pilot program covering the operations of

only a few state parks. Further, the audit reviewed the operating costs and revenues at five state parks that provide camping and/or marina services and found that three out of the five parks operating at a deficit in FY2010 would have had surpluses if run under a PPP model similar to that used by USFS.

The audit also suggested that the agency should begin to manage parks as independent business units, adopt better accounting tools for managing the park system and consider return on investment before advancing capital projects. Noting that staff accounts for 60% of agency spending, the audit suggested shifting to a lower-cost staffing methodology more reliant on the use of seasonal staff, downsizing law enforcement at parks and consolidating park manager positions. Additional recommendations included scaling back seasonal operations in winter months with low visitation, modifying days and hours of operation, and potentially closing some parks or transferring operations to a local government.

In May 2011, the Utah Privatization Policy Board—an advisory body to the legislature on privatization and PPPs—issued a set of recommendations to Gov. Gary Herbert that echoed the call for establishing park operations PPPs for at least a portion of the state parks, as well as proposing the sale and/or lease of Utah's four state-owned golf courses. While the Board rejected any outright sales of state parks, it found that “private contracting of the operations of state parks or a portion of them will be in the best interest of the taxpayers and that it can be done without harming environmental amenities or the recreation experience.” The Board also encouraged Utah's Division of State Parks to develop comprehensive and easily monitored PPP contracts. Additionally, noting significant variation in average public subsidies per round of golf, the Board also recommended the sale of the state's Green River and Palisade State Park golf courses and either selling or contracting out management of two other state-run courses.

Thus far, the Utah Division of Parks and Recreation appears to be taking these recommendations seriously, prompted by a major reduction in state funding from $12 million in FY2010 to $6.7 million in FY2011 and legislative directives preventing the agency from closing parks or raising entry fees. The agency implemented a 6-month PPP experiment at Otter Creek State Park that concluded in October 2011, which at press time was being assessed for its success and viability for replication at other parks.

Other noteworthy developments on the parks and recreation front include:

California: Months after voters overwhelmingly rejected a ballot measure that would have increased vehicle registration fees to fund the state parks system, California Gov. Jerry Brown announced plans to shutter 70 of the state's 278 state parks by July 2012 in response to the state's ongoing fiscal challenges. The proposed closures prompted Assemblymember Jared Huffman to introduce Assembly Bill 42—signed into law in October with bipartisan support—granting the state Department of Parks and Recreation the authority to enter into PPPs with nonprofit organizations to take over the operations of state parks threatened with closure. “[M]y bill represents a creative solution that will allow the state to secure partnerships to enable a number of

the state parks on the closure list to stay open," Huffman said in a press release. "Particularly in these tough economic times, creative public/private partnerships are an essential tool in providing ongoing protection of, and continued access to, these treasured public assets."

Florida: In June 2011, Florida's Acquisition and Restoration Council approved a state Department of Environmental Protection plan to accelerate a proposed PPP initiative that would expand camping and RV facilities at 56 state parks currently lacking those amenities. Under the agency's proposal, the new camping/RV facilities would be financed, built and operated by private entities, with the agency retaining full control over all aspects of planning, design, construction and operation. However, a backlash from park advocates and state legislators in regarding the proposed expansions at the highly visited Honeymoon Island State Park prompted Gov. Rick Scott to abandon the PPP plans for that park and to evaluate how to proceed with the other 55 state parks. Scott also instructed the agency and the Florida Park Service to meet with local communities, park advocates and other stakeholders before formally proposing the addition of amenities or services at any state parks.

The agency currently uses nearly 100 private-sector partners to operate various concessions within the state parks system. Most recently, in July 2011 the recreation service provider Cape Leisure Corp. took over various concession operations at three state parks—Weeki Wachee Springs State Park (food, retail and boat rentals); Wakulla Springs State Park (lodge, food, retail) and Homosassa Springs Wildlife State Park (retail)—and the state is reportedly pursuing additional concession opportunities at Hillsborough River State Park and Rainbow Springs State Park.[33]

Hawaii: In May, Hawaii Gov. Neil Abercrombie signed into law Act 55 (Senate Bill 1555), transferring state-owned lands to a new Public Land Development Corporation, a development arm of the state's Department of Land and Natural Resources authorized to form PPPs to develop state land, renovate public recreation and leisure assets and generate revenues to offset major departmental budget cuts in recent years. The corporation can also issue revenue bonds for land acquisition and the construction or renovation of state facilities.

New Hampshire: In June 2011, Granite State legislators rejected a Senate-sponsored budget proposal that would have leased the state-run Cannon Mountain Ski Area to a private operator to generate additional revenue to fund major capital improvements at the facility and supplement funds for other state parks. Legislators plan to revisit the issue in 2012, despite Gov. John Lynch's opposition to the proposal.

New Jersey: In November 2011, Gov. Chris Christie announced the release of a parks sustainability plan designed to improve the financial self-sufficiency of the state parks system and improve visitor services by partnering with private for-profit and nonprofit entities to expand revenue-producing amenities (e.g., food, boating) in the parks. Under the plan, the state's Department of Environmental Protection will continue to own, manage and operate the parks, and park entrance fees will not increase (though some amenity-related fees may increase). In the near term, the plan aims to increase non-tax resources to $15 million by 2015 through an initial round of

partnerships at some of the state's largest parks, and in the longer term, the plan seeks to raise about two-thirds of the annual operating budget for the park system from alternate funding sources, reducing reliance on budgeted funds. Currently, the parks system generates just $8 million in fees and concessions, or 21% of the total $39 million parks operating cost.

The state has already begun taking steps to implement the plan. In March 2011, the New Jersey Department of Environmental Protection (NJDEP) announced a five-year concession contract with Linx Golf Management and H&L Golf Course Maintenance Co. to take over operations and management of the 18-hole Spring Meadow Golf Course in Monmouth County. Under the concession, the consortium will pay the state an annual $130,000 fee (with 3% increases each year), as well as 15% of total gross revenues in excess of $1 million annually. In 2010, the Spring Meadow course was cited by the New Jersey Privatization Task Force as an example of a state asset that could benefit from a shift to private sector operation and for which privatization could generate revenues to supplement existing state park funds.

Later in August, NJDEP issued a request for proposals for the private management and operation of two additional state-owned, 18-hole public courses: Cream Ridge Golf Course in Monmouth County and White Oaks Golf Course in Gloucester County. Both courses were purchased by NJDEP in 2006 and have been managed by private companies since then, with the existing agreements having expired in December 2011. Similar to the Spring Meadow concession, the initial terms sought for Cream Ridge and White Oaks courses will be six and five years, respectively, and vendors that undertake certain capital improvements during the first term would have the option of renewing for longer second terms (14 years and 15 years), respectively. The winning bidders will pay the state a fixed annual fee (adjusted 3% each year to account for inflation), plus a percentage of the annual gross revenue earned from course operations. At press time, NJDEP was evaluating the responses received from this solicitation.

Separately, NJDEP issued a request for proposals in September 2011 for the private operation and management of food service, catering and events services at Liberty State Park in Jersey City. Under the proposed 10-year contract, the successful bidder would be responsible for the full-time management and delivery of food, beverage and concession sales and catering and events management services, as well as marketing and commercial development. The winning bidder will pay the state a fixed annual fee plus a percentage of the annual gross revenue earned from park operations.

New York: In April 2011, the New York State Office of Parks, Recreation and Historic Preservation (OPRHP) announced plans to partner with private golf course management companies to operate two state-run golf courses. The state will enter into a five-year concession contract with CLAW Golf Management to operate the 18-hole Springbrook Greens State Golf Course and a separate five-year concession with CDK Golf Enterprises to operate the 9-hole Pinnacle State Golf Course. Under both concessions, the private operator will assume all aspects of golf course operation—including revenue collection, turf management, food sales, retail sales and cart rentals—and will cover all associated operating costs, including staff, utilities and insurance.

At Springbrook, CLAW will pay the state a $5,000 license fee and 10% of any gross receipts over $175,000. At Pinnacle, CDK will pay the state a $15,000 license fee and 5% of any gross receipts over $265,000. In both concessions, the state will retain ownership of the golf course, and both contracts will be eligible for one five-year renewal.

Later in July, OPRHP issued a request for expressions of interest from private entities interested in partnering with the state for the adaptive reuse of unused structures and facilities at Knox Farm State Park. The request aims to solicit ideas for projects to enhance and improve the park—with a particular focus on proposed improvements to a 14,400-square-foot estate house and an 11,200-square-foot stable complex located on the site. Vendor responses were due in September 2011; the agency will review all recommendations submitted and identify specific projects and programs that are consistent with the park's character and are financially viable.

Oklahoma: An Oklahoma legislative committee launched an interim study on state parks privatization in July 2011. At a September committee hearing, Oklahoma Department of Tourism and Recreation Executive Director Deborah Snodgrass highlighted the agency's increased use of private concessionaires to provide specific services (e.g., food, retail, etc.), but told the committee that full privatization of additional state parks—the agency closed seven parks earlier in the year—was infeasible due to federal restrictions that prevent removal of lands from the state park system that were originally acquired using federal conservation funds.

Oregon: In February 2011, Oregon State Rep. Jason Conger introduced House Bill 3477, which would require the State Parks and Recreation Department to establish a new park operations PPP pilot program, whereby the agency would enter into contracts with one or more private concessionaires to operate and maintain between 10 and 20 state parks. The bill received a public hearing in May but failed to advance out of the House General Government and Consumer Protection Committee.

Part 12

States Exploring Private Lottery Management

On July 1, 2011, a private consortium took over operations of the Illinois Lottery, formally launching a first-of-its-kind lottery privatization initiative that is already prompting policymakers in other states to consider similar arrangements.

As reported in Reason Foundation's *Annual Privatization Report 2010*, Illinois Gov. Pat Quinn announced the winning bidder for a contract to take over the management of the state lottery in September 2010. Officials expect the move to generate $4.8 billion for the state over the next five years, a $1.1 billion increase over the revenues projected under state management. Under the terms of the 10-year contract, the winning bidder—Northstar Lottery Group, a partnership between GTECH, Scientific Games and Energy BBDO—will take over responsibility for lottery operations, management and marketing functions in exchange for a portion of revenues. The state will continue to exercise control and oversight over all significant business decisions, including the state approval of annual business plans and ability to access all vendor information regarding lottery operations.

The deal also ties the operator's compensation to its performance at enhancing lottery revenues. Through a combination of an annual $15 million management fee and incentives for extra profits, Northstar stands to earn over $330 million over five years if it reaches state-determined revenue targets. However, the contract includes a 5% total net income cap on the potential profits for the contractor, as well as penalties paid to the state if the company fails to hit revenue targets. The contractor will retain all current lottery employees and has announced its intention to hire an additional 100 private sector employees.

Under the privatization initiative, enhanced lottery revenues will be earmarked for education funding and new capital projects included in an infrastructure program approved by the legislature in 2009. Northstar's strategy to increase revenues involves a combination of attracting more players, expanding the product line and adding hundreds of new outlets for lottery ticket purchases across the state. A June 2011 article in *The State Journal-Register* noted that Northstar is making progress on several of these fronts:

- In the transition phase leading to the July 1st takeover date, Northstar introduced a new logo, new signage and several new instant "scratch off" games.
- Throughout the spring of 2011, the lottery received over 1,000 applications from businesses seeking to sell lottery tickets, and over 400 of them had been approved by July 1st.[34]

In August, the Illinois Lottery announced that it had ended the 2011 fiscal year with a record $2.28 billion in sales and record net transfers to the state totaling $686 million. "Northstar is taking our already successful business to levels beyond what we have seen before and will be able to continue to grow it through methods that would not have been possible as a purely state-run entity," acting Illinois Lottery Superintendent Jodie Winnett said in an August press release. The press release also noted that five of the final six months of the fiscal year saw the highest instant ticket sales months in Illinois Lottery history, demonstrating that "the new energy and excitement brought by Northstar is yielding results," given that the private operator began to take on management functions during an early transition that began in March 2011.

Illinois' innovative shift to private management is already prompting policymakers elsewhere to consider similar transactions. For example:

- **Arizona**: In its final July 2011 report, Arizona's Commission on Privatization and Efficiency issued a recommendation that the state explore the potential private sector operation and management of the Arizona Lottery as a means to increase lottery revenues. COPE's analysis found that the Arizona Lottery has been an underperforming asset, with costs rising significantly faster than revenues in recent years. COPE cited Illinois' lottery management contract as a model worth exploring, noting that even assuming less generous terms than Illinois received, Arizona could potentially increase revenues by an estimated $107–210 million over a five-year period if it were to pursue a similar transaction.
- **California**: The *Sacramento Bee* reported in October 2011 that Gov. Jerry Brown has "expressed tentative interest" in an Illinois-style lottery management contract that would generate approximately $1 billion in additional revenues to the state.[35] According to the report, the Camelot Group—which operates the national lottery in the United Kingdom and advises California's lottery—has had preliminary conversations regarding the proposal with the governor's office and some state employee unions. Any move to privatize lottery management would require legislative approval and would be subject to competitive bidding.
- **Missouri**: The State Senate's Rebooting Government working group—designed to develop a package of streamlining and cost-saving reforms—issued a set of recommendations in January 2011 that included privatization of the Missouri Lottery. The Senate's Governmental Accountability Committee subsequently held a spring informational hearing on lottery privatization where it heard from lottery officials and private vendors on the concept. No formal action was taken at that time, and at press time legislators had not decided if they would revisit the issue in 2012.

- **New Jersey**: In early 2011, the New Jersey Department of the Treasury contracted with a consultant to assess the financial performance of the New Jersey Lottery and assess the desirability of privatizing its management.[36] At press time, the results of this evaluation were not yet available. A 2010 transition report recommended that the incoming administration consider privatizing lottery operations. According to the report, "The Lottery would benefit from privatization with operations conducted by private management contracted by the State to manage, staff, and operate the administration of the Lottery. […] The committee believes a significant increase in gross and net revenues to the State will result from privatization."[37]
- **Ohio**: As discussed in Part 4 of this report, the Ohio state legislators removed a provision in the 2012–2013 budget before passage that would have authorized the privatization of the management of the Ohio Lottery. However, the Kasich administration has announced plans to issue a request for proposals from consultants to analyze the potential for privatized lottery management and ways to maximize the lottery's value. The firm Intralot already has a long-term contract in place to manage the backroom operations of lottery games, so the proposed privatization would cover management of the lottery itself, including marketing, employee management and other operations.
- **Washington State**: In December 2011, Gov. Christine Gregoire announced a series of reform measures her administration will present to the state legislature in the 2012 legislative session to help close an estimated $2 billion budget deficit. One element of the reform package includes directing the state lottery to issue a request for proposals to determine the feasibility of shifting lottery operations to the private sector to generate more revenue for education. Any savings achieved would be directed to the state's Washington Opportunity Pathway account that supports higher education and early learning programs. "I want to see if the state lottery can be managed for less money through the private sector," Gregoire said in a press release. "If it works, it could provide more funds to support critical education programs."

Part 13

Indiana's Welfare Eligibility Privatization Program Expands, Improves Performance

After years of implementation challenges that prompted a dramatic overhaul, Indiana's privatized welfare eligibility modernization program significantly improved its performance in 2011, prompting federal officials to authorize its expansion throughout the state.

As discussed in recent editions of Reason Foundation's *Annual Privatization Report*, the state launched a 10-year, $1.34 billion contract with IBM in 2006 to automate eligibility determinations for food stamps, Medicaid and other welfare benefits and significantly reduce face-to-face meeting requirements via more computerized processes. However, the system was quickly overwhelmed with a recession-related spike in applications and widespread complaints from people who lost their food stamps or Medicaid coverage or who had difficulty utilizing new call centers or the new, online application for welfare benefits.

Indiana Gov. Mitch Daniels gave prime contractor IBM an opportunity to correct the deficiencies, but ultimately the firm failed to sufficiently improve its performance. This led the state to cancel its contract with IBM and pursue a revamped "hybrid" approach that relies more on face-to-face contact while enhancing some of the previous technological improvements made by IBM. To implement the hybrid approach, the state contracted for the services of Xerox subsidiary Affiliated Computer Services (ACS)—IBM's primary subcontractor on the original privatization—in an eight-year, $638 million service contract.

Steps taken by Indiana Family and Social Services Administration (FSSA) to improve performance under the hybrid system include:

- Renewed emphasis on client services.
- Adjustments to business processes, including the adoption of a regional focus on service delivery and shifting away from a single statewide call center to locating call centers in ten different regions of the state.

- Implementation of a new telephone service that routes calls to and from local offices to the regional call centers.
- Re-allocation of staffing levels to ensure appropriate numbers of employees at each of the state's 108 local offices.

According to administration officials, the FSSA has dramatically improved performance metrics:

- Client inquiries are down 40%.
- Caseload backlogs have been reduced by 79%.
- Call abandonment rates remain below the standard of 5%.
- The current timeliness rate for food stamp application processing is 95.97%.
- Positive and negative error rates remain below the national average.

In June 2011, the FSSA announced that the federal government had awarded the state $1.6 million in recognition of its progress at reducing its error rates for food stamp processing in FY 2010. An agency press release noted that the U.S. Department of Agriculture (USDA) identified Indiana as one of the top three most improved states, with the award being "a direct result of improvement Indiana has made in its eligibility processing as part of the Hybrid System." In addition, the USDA's most recent ranking of 53 states and territories showed that Indiana had dramatically improved to 10th in the nation for positive error rate and 12th for negative error rate in FY 2010, compared to rankings of 53rd and 45th in FY 2009, respectively.

"This is evidence of the success of our hybrid model for public assistance service delivery and the dedication of our statewide team," FSSA Secretary Michael Gargano said in a press release. "This is national recognition of the improvements we've made in the past couple of years, and echoes the feedback we've received from advocates and clients in the hybrid regions."

Commensurate with the improved performance of the hybrid privatized system, the USDA Food and Nutrition Service gave FSSA authority to incrementally expand the program to more counties throughout 2011 from the 37 counties covered at the end of 2010. An October 2011 FSSA press release highlighting the most recent expansion noted that nearly all of the state—91 of 92 counties—is covered by the hybrid system.

"Even as the number of Hoosiers enrolled in social services programs has increased, Indiana has delivered improvements in quality and service," according to Gargano. "This enhanced system is timely and more accurate thanks in large measure to the good work of state employees and our technology partners."

Part 14

Higher Education PPP Update

Ongoing fiscal pressures are prompting state university systems to explore innovative service and asset delivery models to help reduce costs, better maintain facilities and create new ways to build and modernize their assets. Some systems and schools have turned to the private sector to achieve these goals in various ways, ranging from the outsourcing of specific operational services to public-private partnerships (PPPs) that bring private sector capital and expertise to bear on the financing of university facilities.

Noteworthy developments on the privatization and PPPs in higher education in 2011 include:

Arizona: In May 2011, officials at the University of Arizona announced the selection of Capstone Development Corp. and Peach Properties, respectively, to develop two new student apartment housing facilities under PPPs. Capstone will develop "Plazo Centro," a mixed-use, 720-bed student apartment housing facility to be located along the new streetcar line in downtown Tucson. The plan also includes a parking garage and more than 25,000 square feet of commercial space. Similarly, Peach Properties will develop a 320-bed apartment complex along the streetcar line that includes 18,000 square feet of commercial space.

Florida: In August 2011, officials at Florida Atlantic University (FAU) officially opened the Innovation Village Apartments, a 1,216-bed student residential & mixed use project on the Boca Raton campus developed under a $123 million PPP with Balfour Beatty Campus Solutions, LLC and Capstone Companies. Accelerated construction on the $123 million project began in March 2010 and was delivered on schedule for the start of the 2011–12 academic year. Under the PPP, the private partner developed the new facility and will co-manage both it and the other existing student housing facilities on the Boca Raton campus in tandem with the university. Though this project was financed through a combination of tax-exempt and Build America Bonds issued by the FAU Finance Corporation, partner Balfour Beatty invested in the project by purchasing $3.4 million of tax-exempt bonds.

Kansas: In February 2011, the Kansas House Appropriations Committee approved a resolution sponsored by state Rep. Joe McLeland that directs the Kansas Board of Regents to explore the potential outsourcing of university functions like dormitory operations and custodial services to private vendors. The report was not completed at press time.

Louisiana: In August 2011, RICOH took over operations of university mail and copying services at Louisiana State University in an initiative officials expect will eliminate an annual operating subsidy for these services of over $400,000 annually. The company has renovated the ground floor of the LSU Student Union, creating a central location for students to receive mail, copying and other related services. The 10-year contract sets maximum rates that RICOH can charge students for mailboxes and gives the university approval over postal rates charged to customers.[38] The move was partially driven by the planned closure of the U.S. Postal Service's on-campus location.

Missouri: In December 2010, officials at the University of Missouri hired a brokerage firm to analyze the potential privatization of the university's animal research laboratory. According to the *Columbia Daily Tribune*, the firm will help the university identify potential buyers and financing options for the facility and will estimate its market value.[39] The Research Animal Diagnostic Laboratory has been at the university for more than 40 years and serves companies that care for and use animals in biomedical research, also providing biological and genetic testing services.

New Jersey: In August 2011, Montclair State University announced the completion of The Heights, a new, state-of-the-art residential complex that is the first PPP completed under the 2010 New Jersey Economic Stimulus Act. The new $211 million complex was financed by tax-exempt bonds issued by Provident Resources Group—the owner-operator that developed, operates and maintains the complex under a long-term lease—under the auspices of the state's Economic Development Authority. "The State of New Jersey has not invested any direct capital funding in higher educational facilities in more than 25 years," University President Susan Cole noted in an August press release. "Therefore, in order to grow and develop as a competitive university, we have had to find creative and cost-effective solutions to build new facilities and make capital improvements to existing structures."

The title to the facility will transfer to the university in 40 years, unless bonds are paid off early, and until that transfer the operator is responsible for collecting rents and managing and maintaining the property in top condition. The new housing complex—which accommodates approximately 2,000 students and includes a 24,000-square-foot dining area—was built by the Alabama-based Capstone Development Corporation and the New Jersey-based Terminal Construction Corporation and opened in September 2011.

New York: Despite the support of Gov. Andrew Cuomo and some legislative Republicans in 2011, University of Buffalo (UB) officials were unable to persuade the state legislature to give it more flexibility in procurement and the authority to implement PPPs for new capital projects, both key components of the university's ambitious UB 2020 long-range strategic plan that envisions billions of dollars of capital investment. Instead, state leaders enacted a law (S.5855) granting UB and other public universities more flexibility in setting tuition rates without legislative approval and committing $140 million toward a university challenge grant program. The legislation will allow UB to get started on the initial phase of its strategic plan, though it will need to continue to seek PPP authority from the legislature to implement future phases, a challenging endeavor given strong opposition from public employee unions.

Public universities in New York State have demonstrated growing interest in PPPs since 2009, when a state asset maximization commission created by former Gov. David Paterson issued a report framing a role for PPPs in the delivery, upgrade and modernization of state infrastructure assets, including higher education facilities.

Ohio: In November 2011, The Ohio State University (OSU) announced that it had qualified seven of ten consortia submitting responses to a request for qualifications for a potential long-term lease for the operations and maintenance of its parking assets. The university is seeking to lease over 35,000 parking spaces to a private operator in return for a minimum $375 million upfront payment under a concession not to exceed 50 years. Proceeds would be used to defease debt and invest in campus transportation services. The bidding process is expected to conclude by the spring of 2012. (For more details on this parking initiative, see Reason Foundation's *Annual Privatization Report 2011: Local Government Update*.)

OSU's parking initiative is the first project advanced as part of a larger, comprehensive review of all of its non-core assets to see how they could be leveraged to generate additional revenue to support the university's academic mission. After parking, the university administration has announced that it will review the Don Scott Airport, the university's golf courses and other large tracts of land not necessary to the core academic mission to determine if leasing or selling them could benefit the school's core mission. However, university officials have indicated that the list of potential assets for full or partial divestiture will not include housing, as they feel that the provision of residential student housing is intimately tied to OSU's academic mission.

Part 15

Privatization and Child Welfare Reform: Implementation Update

A. The Importance of Funding Flexibility for Privatization and Child Welfare Reform

Flexible child welfare funding, where the money follows the needs of the child rather than the service provider, has allowed states to innovate and is a key component in the successful implementation of privatization and child welfare reform. In September 2011 Congress passed and President Obama signed into law the Child and Family Services Improvement and Innovation Act.[40] This new child welfare law creates a foster care financing framework that more readily supports child welfare reform and privatization efforts. Passage of this law means that states will be better able to invest in initiatives that help improve child safety and family stability as well as move children from foster care into safe, permanent homes.

Since 1994, the Department of Health and Human Services has granted waivers to states to widen the options available under the Title IV-E funds, which otherwise are tethered almost exclusively to paying for foster care placements. However, that waiver authority was limited to a few states and expired in 2006. The new law renews child welfare waiver authority to allow more states to invest in new ways of serving children at risk of abuse and neglect. The Department of Health and Human Services can now grant up to 10 new state waivers per year through fiscal year 2014. These renewable waivers last for five years and allow states to be innovative and let them have more flexibility in the use of federal foster care dollars. In addition, the law establishes a process to create uniform child welfare data standards that can help drive further improvement to the foster care system.

Existing waivers in places like Ohio, Illinois and Florida have helped prevent child abuse and neglect, helped more children remain safely in their own homes, and improved the quality of services to vulnerable children and families.[41] For example, in a Casey Family Foundation report on child welfare privatization in Florida there was consensus among those interviewed that the Federal IV-E Waiver has been one of the most crucial components of the success of privatization.[42] The waiver allows federal foster care funds to be used for any child welfare purpose rather than being restricted to out-of-home care as generally required under federal law. This allows the lead

agency to flexibly move the money in the way that it determines is best for children; simply put, the money follows the child and not the foster care placement.

These waivers have led to better outcomes for kids using the same resources. This approach relies primarily on the ability to use existing resources more flexibly and effectively, not on additional federal funding.

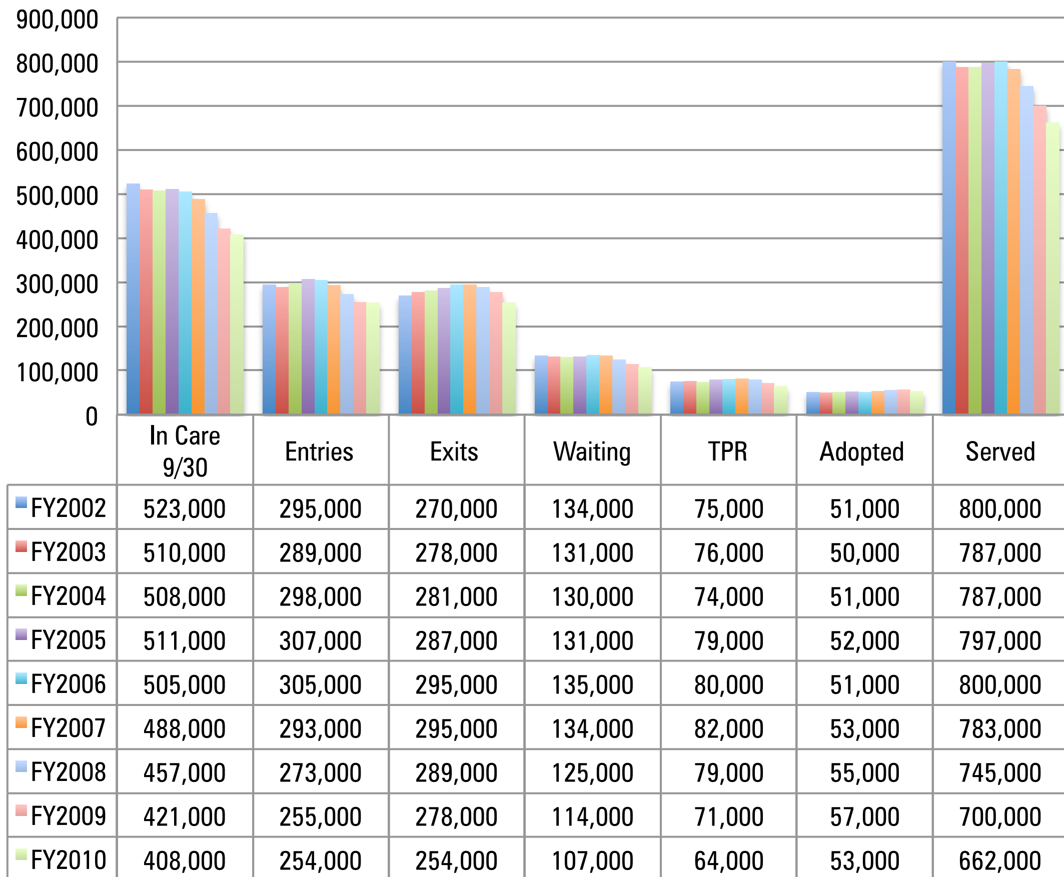
These waivers and the new law that expands their use are critical because they correct the perverse incentive in child welfare funding. The federal government spends more than $15 billion each year to support states' child welfare programs, representing almost half the funds that states expend on child welfare. The largest source of federal financing, Title IV-E, primarily pays for maintaining eligible children in licensed foster care, rather than providing services for families before, during and after contact with the child welfare system. Title IV-E does not provide jurisdictions with stable funding to support programs other than foster care. The federal government pays a large part of the cost for every eligible child placed in foster care. It's an open-ended entitlement, and it creates an absurd incentive: Though alternatives to foster care cost less in total dollars, foster care sometimes can cost a state or a county less because the federal government is picking up so much of the tab. In the majority of states without a waiver, this money can be used only for foster care. While this does not mean states "make money on foster care," it can create a perverse incentive to resort to foster care even when better options cost less in total dollars. The bottom line is that the majority of federal financing only supports child removal. An Urban Institute survey found that 6% of federal child welfare spending supports in-home care while the remaining 94% goes to foster care and adoption. In addition, Title IVE requires a state match to draw down federal funds the perverse incentive repeats at the state level.

Texas provides a clear example of how the perverse incentives work.[43] Approximately 90% of Texas funding goes to foster care and other out-of home care. However, in 2008 Texas created a pilot project called Strengthening Families that provided cash assistance for groceries, car repair, rent and other in-home services to solve family issues. This program led to a 30% drop in the rate of removal and the 248 children who were able to remain in their homes saved the state $8.2 million. Yet, the program was eliminated because federal and state child welfare dollars could not be used for front end services and the Texas budget constraints meant there was no funding available for the program.

Despite these perverse incentives, in the past decade there has been significant progress in child welfare reform as evidenced by an impressive decline in the number of children in foster care, while maintaining child safety. The number of U.S. children in foster care dropped to 408,000 in 2010, from 523,000 in 2002, according to the federal Department of Health and Human Services. The number of children in the foster care system has declined by more than 130,000 kids over the last ten years and by more than 40,000 over the last two years alone. Much of the reduction in the number of foster children in the system has been in states that no longer have the perverse incentive to keep kids in foster care. Four of the five states that have most reduced the number of children removed from their homes did so with waivers to experiment with federal funds.

California, New York, Florida, Ohio and Illinois all reduced the number of children placed out of the home by more than 30% between 2002 and 2010. New York is the only state that made the change without receiving a waiver.

Figure 2: Trends in Foster Care and Adoption, FY2002-FY2010



	In Care 9/30	Entries	Exits	Waiting	TPR	Adopted	Served
FY2002	523,000	295,000	270,000	134,000	75,000	51,000	800,000
FY2003	510,000	289,000	278,000	131,000	76,000	50,000	787,000
FY2004	508,000	298,000	281,000	130,000	74,000	51,000	787,000
FY2005	511,000	307,000	287,000	131,000	79,000	52,000	797,000
FY2006	505,000	305,000	295,000	135,000	80,000	51,000	800,000
FY2007	488,000	293,000	295,000	134,000	82,000	53,000	783,000
FY2008	457,000	273,000	289,000	125,000	79,000	55,000	745,000
FY2009	421,000	255,000	278,000	114,000	71,000	57,000	700,000
FY2010	408,000	254,000	254,000	107,000	64,000	53,000	662,000

(Based on data submitted by states as of June 2011)

Note: Based on data submitted by states as of June 2011. In the above chart, TPR means Termination of Parental Rights.

Source: AFCARS Data through June 2011, U.S. Children's Bureau, Administration for Children, Youth and Families.

During this large reduction in children being removed from their families, child abuse did not increase. In fact, the latest child maltreatment report released in 2011 that analyzes data through 2009 does not show an increase in substantiated maltreatment.[44] "Overall substantiated child maltreatment actually declined 2% from 2008, including a 5% decline in sexual abuse." The total number of substantiated maltreatment cases was 763,000, which is the lowest number recorded since the federal data collection system was put in place in 1990.The majority of states experienced declines in abuse. Thirty-two saw a drop in sexual abuse cases, 21 had physical abuse declines, and

29 states reported fewer neglect cases. There were 15 states where all three types of maltreatment declined.

In addition, Fourth National Incidence Study of Child Abuse and Neglect (NIS-4) released in 2011 found that the 2005–2006 study year reflects a 19% decrease in the total number of maltreated children since the NIS-3 in 1993.[45] Taking into account the increase in the number of children in the United States over the interval, this change is equivalent to a 26% decline in the rate of maltreatment per 1,000 children in the population since 1993.

The reduction in foster care is a positive outcome for kids because the evidence shows negative outcomes from placement in foster care. Foster children fare far worse on key outcomes compared with comparably maltreated children left in their own homes. For example, according to a study by MIT's Sloan School of Management economics professor Joseph Doyle, kids who stayed with their families were less likely to become juvenile delinquents or teen mothers and more likely to hold jobs as young adults, "The size of the effects surprised me, because all the children come from tough families," Doyle said in an interview with *USA Today*.[46] Doyle's research, which tracked at least 15,000 kids from 1990 to 2002, is the largest study to date looking at the effects of foster care.[47]

B. Examples of Waiver Outcomes in the States

Florida is the case in point for the combination of privatization and flexible child welfare funding. In 2006, Florida became the only state to accept, statewide, a five-year waiver from federal funding restrictions on how the state spent its portion of federal foster care aid under Title IV-E (well over $100 million a year).[48] Florida agreed to accept its foster care money as a flat grant, adjusted for inflation. In exchange, Florida is free to use the money for better alternatives, instead of just for foster care. And as Florida reduces foster care, it can keep the savings, as long as the money is reinvested back into child welfare services. In Florida, the Department of Children and Families put the waiver to good use, bolstering services enough to cut both entries into foster care and the number of children in foster care by 37% between 2006 and 2010. Most important, independent evaluations required by the waiver have shown that even as foster care has been sharply reduced, child safety has improved.[49] A 2010 evaluation found that since the waivers began in Florida, fewer children are being placed in out-of-home care, more foster children are being reunited with their families, community-based services have expanded and agencies are instituting more innovative approaches for at-risk families.

The implementation of Florida's IV-E waiver began in October 2006 in conjunction with Florida's implementation of a privatized child welfare system in which 20 lead agencies manage service delivery in Florida's 67 counties.[50] These lead agencies have funded a wide array of prevention and early intervention services, as well as services designed to find permanent families for children in foster care who cannot safely be returned to birth parents. Most lead agencies have expanded diversion services, including intensive in-home services that use a family team approach and that

support families through a variety of educational and concrete services, ranging from housecleaning services to parent classes. Florida's lead agencies have also made major new investments in family team meetings and enhanced relative search, and in specialized staff who expedite permanency planning and ensure that children are placed in permanent homes that can meet their needs.

Florida's foster care population declined from almost 29,000 children in FY 2006, when the waiver agreement was signed, to 18,534 children in care in February 2010, a reduction of more than one-third in less than four years. Some Florida counties have reduced their foster care populations by 50–60% since the waiver was implemented. It is apparent that Florida's lead agencies have developed a new paradigm of child protection based on strengthening in-home services to children and families. It is extremely encouraging that during the timeframe that entries decreased, maltreatment recurrence also declined significantly and is currently consistent with the national average.

For example, in Florida, programs like Youth Villages worked with local privatized child welfare organizations to provide intensive reunification and targeted prevention services. Youth Villages reports that of 225 children and families served across the states in 2010, over 77% were still living at home or in a home-like environment at six months post-discharge. It is estimated that the savings to the state associated with serving these families in their homes rather than foster care amounts to roughly $19 million dollars that can be reinvested in family services that prevent foster care.

Illinois is another state that has had positive outcomes from privatization under a foster-care waiver. Illinois contracts 80% of its child welfare services with private providers. The state child welfare department and its private sector partners have safely reduced the number of children in foster care from more than 52,000 in 1997 to less than 15,500 today through reunification with birth families, subsidized guardianship, kinship care and adoption. This dramatic reduction in the number of children in state care has served as a national model in child welfare systems and has been accompanied by increased measures of child safety, resulting in a decline of physical and sexual abuse in Illinois.[51]

In Illinois, independent court-appointed monitors have found that as the number of children taken away has declined, child safety has improved. Illinois is also a positive example of how financial incentives can be changed at the state level for private agencies to improve child welfare outcomes. Until the late 1990s, Illinois reimbursed those agencies the way other states typically do: They were paid for each day they kept a child in foster care. Thus, agencies were rewarded for letting children languish in foster care and punished for achieving permanence. Today, private agencies in Illinois are rewarded both for adoptions (which often are conversions of kinship placements to subsidized guardianships) and for returning children safely to their own homes. They are penalized for prolonged stays in foster care. The foster care population plummeted, and children are safer. Today, Illinois takes away children at one of the lowest rates in the country.

Ohio has also seen a significant reduction in foster care loads because of the foster care waiver. In Ohio, 18 counties are permitted under the waiver to use federal foster care money to help families using other services, such as counseling, substance abuse treatment and parenting classes. At the end of 2009, the state's foster care population stood at 12,360—a 29% decrease since 2005.[52] In the second year of the waiver, $4 million in savings were reinvested in system improvements.

C. Nebraska Struggles with Statewide Child Welfare Privatization

In 2009, the state of Nebraska began contracting with private companies to provide child welfare and juvenile justice services after calls for change prompted by the state's propensity to remove children from their homes and low marks from the federal government. Nebraska's privatization efforts were prompted by years of ranking among the top states in the proportion of children removed from their home. For example, a comparison of federal FY2009 data by Casey Family Programs showed Nebraska's rate was 12%—more than double the national average of 5.6%. Nebraska has rated either first or second highest in this category for at least 10 years.[53]

Since January 2011 Nebraska legislators have been investigating the state's implementation of child welfare privatization. Three of five private agencies selected in July 2009 to oversee services to children and families had withdrawn from the effort by November of 2010. In addition, while the Department of Health and Human Services (DHHS) initially insisted that privatization would be accomplished within existing resources, by August 2011 it had, in fact, paid the contractors $30.3 million more than originally planned. In Nebraska the private contractors and the state agencies underestimated the cost of foster care and the private providers assumed too much risk. A November 2011 Legislature's Performance Audit Committee report found the state's child and family services division failed to conduct a cost-benefit analysis or set clear goals and timetables to enact the overhaul, which began in 2009.

The audit by the Legislature's Performance Audit Committee, which was released November 2011, concluded:

- The child welfare department failed to set goals that privatization would accomplish. "Without clear goals, it is very difficult to hold the division of Children & Family Services—or any other part of the system—accountable, and the CFS leadership's failure to recognize that is concerning," the audit report said.
- The state has not made significant progress reducing the number of children placed out of their homes—one of the reasons for privatization in the first place.

Despite these challenges, the DHHS is moving forward with the privatization effort and has some modest positive outcomes.

DHHS officials report the state has exceeded the national standard for absence of abuse of children by foster parents. In addition, the number of children in state custody declined from a record high

of 7,803 in April 2006 to 6,250 on December 31, 2010. In addition, Nebraska has made proportionally more kinship placements since privatization began in 2009, increasing 9% since 2006 and 6% since 2009. This means that children removed from their homes are now more likely to be placed with family or friends than with strangers.

To pave the way for further improvement, Kerry Winterer, chief executive of the Department of Health and Human Services, says the department is creating an operational plan that will establish precise goals and timetables for privatization. Nebraska is also exploring the possibility of a Title IV-E waiver, which would offer funding and incentives to focus on lower cost in-home services that could help contain costs during the ongoing privatization effort and help the state reduce its rate of out-of-home care. As of January 2012 the Nebraska legislature has made child welfare reform a top priority and will likely determine the future of the Nebraska child welfare privatization initiative in the 2012 legislative session.

Part 16

Virginia, Georgia Advance Highway Rest Area Partnerships

Though federal law prevents most states from fully privatizing the operation of highway rest areas, Virginia and Georgia both advanced initiatives in 2011 to significantly increase the scope for private sector funding and operation.

In August 2011, Virginia Gov. Bob McDonnell announced the award of a three-year contract to CRH Catering Co., Inc. to develop and manage a new program to expand traveler services at the state's 42 safety rest areas and welcome centers, using new revenues generated through sponsorships, vending and advertising to offset rest area operating costs. Under the Sponsorship, Advertising and Vending Enhancement (SAVE) program, CRH will pay the Virginia Department of Transportation (VDOT) a guaranteed annual fee of approximately $2 million—nearly $300,000 more per year than VDOT previously received from vending and advertising—to help offset costs for operating the rest areas, in addition to annual revenue-sharing payments based on a percentage of sales generated from sponsorship, advertising and vending operations. The private manager will oversee the installation of new advertising and vending machines at rest areas with more consumer choices for food, beverages and merchandise, as well as new ATM machines and interactive kiosks at welcome centers offering information on Virginia's top attractions and travel destinations.

“As part of this innovative program, we see great opportunity to offset rest stop costs now and into the future,” Gov. McDonnell said in a press release. “This contract represents an innovative initial step forward to enhance the travelling public's experience and maximizing the revenue-generating assets of our rest areas within the confines of federal law. Partnering with the private sector will enable us to expand and improve the services that we offer visitors while saving taxpayer dollars.”

In Georgia, state transportation officials announced in January 2011 that they had shortlisted two private bidders in a similar procurement to advance the state's Rest Area and Welcome Center Management Program, which aims to sell or lease advertising space and sponsorships at 17 safety rest areas and 9 welcome centers along the interstate system in Georgia to fully fund the cost of maintenance and operations of those facilities. The two bidding teams—DBi Services/The InterConnect Group and Infrastructure Corporation of America/Traveler’s Marketing—will compete to develop, implement and manage an advertising and sponsorship program and serve as a

turnkey operator to manage facility operations and maintenance. State officials announced plans to select the winning bidder by mid-2011, but at press time a selection had yet not been made.

The Virginia and Georgia initiatives follow on the heels of a more comprehensive project underway in Connecticut. As reported in Reason Foundation's *Annual Privatization Report 2010*, the state of Connecticut has entered a 35-year public-private partnership (PPP) with the Carlyle Group to refurbish and operate the state's 23 highway service plazas in return for a state share of revenues raised. Under the deal, the Carlyle Group will invest $178 million in the state's rest areas and will attract new restaurants and businesses to the facilities.

Connecticut was able to pursue a greater degree of privatization than Virginia or Georgia because it is one of several states with rest areas built before the 1956 Interstate Highway Act; for these states, the ability to privatize or outsource rest area operation was ultimately grandfathered in as highways were integrated into the interstate system. The long-standing federal privatization restrictions were originally intended to shield local restaurants and businesses from competition as new interstate highways diverted traffic away from downtowns. In recent years, transportation officials in Arizona, New Jersey and other states have sought the elimination of federal statutory prohibitions on the privatization of rest areas on highways built with federal funds, and a 2010 survey by the American Association of State Highway and Transportation Officials found that transportation department officials in over 25 states supported greater flexibility in funding and operating rest areas.

Part 17

Other State Privatization News

In other notable state-level privatization news:

California: In September 2011, the California legislature passed Assembly Bill 740, a public employee union-supported bill that would require state agencies to immediately cancel service contracts with private vendors if the State Personnel Board deems those contracts to be in violation of state law. In those circumstances, the bill would also prohibit agencies from entering into another contract for the same or similar services or to continue the services that were the subject of the cancelled contract. Gov. Jerry Brown signed the bill into law in October 2011. Former Gov. Arnold Schwarzenegger vetoed similar legislation enacted in the 2009–10 session, citing legal concerns over the cancellation of contracts and potential negative operational impact on state agencies.

Colorado: In June 2011, Gov. John Hickenlooper signed Senate Bill 235 into law, creating a new process to expedite air quality permitting in the Colorado Department of Public Health and Environment by allowing the agency to prequalify and use private-sector modeling contractors. Applicants seeking permits can use the pre-approved third party modeling firms to accelerate the permitting process if the applicant agrees to cover both the contractor's and the state's costs. According to a Joint Budget Committee analysis of the bill, the state receives up to 3,000 air permit applications annually, but it faced a backlog of about 1,200 unprocessed air permit applications in 2011 alone, predominantly from the oil and gas industry.

In other news, Hickenlooper announced the appointment of a task force in November 2011 to review a restructuring proposal from Pinnacol Assurance—the state-owned insurer that provides over half of the workers compensation insurance policies in the state—that would transform it into a private mutual insurance company.

Under Pinnacol's proposal, the insurer would convert itself into a privately held mutual assurance company, granting the state a $340 million, 40% ownership stake that would generate $13.6 million in annual dividends potentially split between education and economic development. The company would remain headquartered in Colorado but would be able to expand its business into other states. The 19-member stakeholder task force will review the proposal, considering its potential effects on policyholders, the terms of the proposed privatization, and the size and use of any related payments to the state resulting from privatization. The task force will report to Hickenlooper at the end of its review and provide guidance on potential legislation.

A 2009 legislative proposal to raid over $500 million from the workers compensation insurer Pinnacol to keep the state budget afloat prompted the company's management to offer legislators an alternate solution in 2010: a $330 million payment to the state by Pinnacol in return for turning it into a private mutual insurance company. Legislators ultimately failed to act in 2010, but the first-year governor's willingness to explore privatization has brought renewed interest among policymakers and stakeholders.

Connecticut: Privatization became a key issue in a summer 2011 standoff between state public employee unions and the administration of Gov. Dannel Malloy over a $1.6 billion package of union concessions needed to balance the budget. After unions originally rejected Malloy's proposed concession package, the administration proposed over 5,000 state layoffs, budget cuts and pension/health benefit reform, and during a special legislative session called to close the budget deficit, it asked the legislature for a two-year suspension of state contracting laws that place restrictions on privatization and mandate a formal process before services can be privatized. Legislators quickly rejected Gov. Malloy's request, and the administration backed away from its privatization push after unions subsequently agreed to a modified concessions package in August.

Florida: As new Gov. Rick Scott began his administration’s first term amid ongoing fiscal challenges, privatization remained a central issue on the policy radar in Florida, with major initiatives advanced in corrections and Medicaid.

In May 2011, Gov. Scott signed into law a state budget that authorizes a cutting-edge public-private partnership (PPP) that will privatize nearly all correctional facilities and services in South Florida. Far from a typical outsourcing, it represents a groundbreaking approach to corrections PPPs that will hold providers directly accountable for reducing recidivism, expanding offender treatment and programming, and achieving other key rehabilitation and safety goals.

Under the new Florida initiative, the state plans to privatize all correctional facilities and services within an 18-county region of South Florida—and the resulting contract is required under law to include a wide range of performance measures that include reducing recidivism, expanding offender treatment and programming and achieving other key rehabilitation and safety goals. Privatization will not proceed unless the state realizes savings of at least 7%, as required under state law.

Key to achieving the co-equal goals of spending reduction and improved performance in rehabilitation is the structure of the privatization initiative, which bundles up the bulk of correctional services in a large geographic area under one contract. The key to Florida’s proposed PPP approach lies in applying a continuum of care approach that coordinates and links evaluations, programs and resources for an inmate across all facilities and levels of care, maximizing the effect of the care and programming he receives. According to proponents, spending a lot of resources on uneven, uncoordinated programming for an inmate across various facilities and levels of care

delivers a poor return on expenditures, and coordination across a continuum of care would maximize the value of every tax dollar spent.

Florida's privatization initiative will be the first attempt to create a continuum of care in corrections, one expected to yield hundreds of millions in savings over the long term by strategically tying cost savings to improvements in system performance. Though targeted for completion by the end of 2011, the procurement for this PPP was placed on a temporary hold in the fall of 2011 pending the resolution of multiple lawsuits filed by public employee unions representing state prison guards seeking to thwart the initiative. At press time, the legal challenges were ongoing. (For more details on Florida's corrections PPP, see Reason Foundation's *Annual Privatization Report 2011: Corrections Update*).

On the Medicaid front, Gov. Rick Scott signed into law two bills (House Bills 7107 and 7109) in June 2011 that will expand a five-county Medicaid privatization pilot program statewide, creating a fully integrated managed care system for nearly 3 million Medicaid recipients for all covered services, including primary and acute care and long-term residential or community-based care. Scott and other bill proponents estimate that the shift could save the state approximately $1 billion in the first year and better control the escalation in Medicaid spending, which currently costs Florida $20 billion annually.

In 2005, the legislature approved a five-year, managed care pilot program for Broward and Duval Counties, expanding it to Baker, Clay and Nassau Counties in 2007. HB 7107 would expand this program by establishing a statewide managed care program, under which qualified managed care plans will compete to provide services under a set of strict selection criteria. The program will be broken down along regional lines, with the state selecting a limited number of competing plans in each of 11 regions to ensure coverage in rural areas. Participation is mandatory for most patient populations, though the law includes an opt-out program to allow Medicaid recipients to use their state subsidies to purchase other forms of healthcare coverage. The law envisions varying models of managed care (e.g., health maintenance organizations, specialty plans, medical home plans, etc.) that offer recipients choices and customized benefits, with each plan held to specific accountability measures that include network standards, achieved savings rebates, fraud and abuse measures and more.

The companion bill, HB 7109, amended provisions of existing Medicaid law to conform to the new managed care system put into place by HB 7107 and authorized a number of other technical changes to the Medicaid program.

At press time, the Agency for Health Care Administration—the state agency authorized to manage, operate and make payments for the Medicaid managed care programs—had submitted an application to the federal Centers for Medicare and Medicaid Services, which must approve the waivers of applicable federal laws necessary to implement the new managed care program. However, a clear path to federal approval remains uncertain, as federal health officials have asked

the state to adjust the program to require private health plans to spend a minimum 85% of funds on patient care.

In other Florida privatization news:

- On the first day of his administration in January 2011, Gov. Rick Scott issued Executive Order 11-01, which put a moratorium on new state regulations, created a new Office of Fiscal Accountability and Regulatory Reform, and required the new office to approve all new agency contracts with a value over $1 million for a period of 90 days. In September 2011, the *Miami Herald* reported that the Governor's Office of Policy and Budget had issued a memorandum to state agencies announcing that the contract review would continue indefinitely, with all contracts, contract amendments, requests for proposals, invitations to negotiate and other competitive solicitations subject to review.[54] The contract review process appears to be filling a void left by the June 2010 closure of the state's Council on Efficient Government (CEG) amid budget reductions. Since its establishment in 2006, the CEG had been charged with implementing a standardized process for reviewing business cases for outsourcing and disseminating procurement best practices and lessons learned across state agencies.
- In September 2011, members of the Florida Government Efficiency Task Force announced a set of recommendations that included streamlining the state procurement process, creating a real property database to help assess asset divestiture opportunities, and privatizing a range of assets and services that include state insurer Citizens Property Insurance Corporation, public sector toll roads, ports and correctional facilities.[55] The task force was created under a 2006 law to serve as an advisory body that meets every four years to issue recommendations on streamlining government.
- The idea of privatizing Citizens Property Insurance Corp., Florida's state-run insurer of last resort, was also proposed by its own chairman, Jim Malone, at a board of directors meeting in July. Malone and other observers have warned that Citizens, the largest state insurer at 1.4 million policies, is an increasingly risky enterprise, given that its below-market rates are not estimated to be generating sufficient revenues to cover large-scale hurricane losses, leaving taxpayers at risk of having to cover any losses. Malone told the *Insurance Journal* in August 2011 that, "any organization that has 1,400,000 customers, that has a premium revenue stream of close to $3 billion a year and a nice chunk of liquidity sitting on its balance sheet potentially has some value to the private world […] We owe it to the state to see if it's a viable option."[56] Gov. Rick Scott later stated his support for exploring the privatization concept, according to media reports.

Georgia: The Georgia Department of Transportation (GDOT) initiated a major highway maintenance privatization project in June 2011, awarding a 3-year, $6.8 million contract to Roy Jorgenson Associates to maintain the state's stretch of Interstate 95, which was recently widened in a $1 billion expansion project. The contract is Georgia's first performance-based highway maintenance project, with the contractor responsible for all normal maintenance activities along Georgia's entire portion of Interstate 95. This includes litter and roadway debris removal, mowing,

guardrail repair, routine bridge repair, pothole repair, tree trimming, maintenance of drainage features, signage, traffic control devices, emergency incident response and clearance assistance. The contract also covers all related ramps, frontage roads, bridges and roadway appurtenances.

In a June 2011 press release, GDOT Commissioner Vance C. Smith, Jr., wrote that, "The General Assembly and the State Transportation Board have encouraged us to find an appropriate section of roadway to conduct this type of privatization test. I-95 is a perfect location and we think there is a great opportunity here to save money; free our own employees for other critical work; and still keep a high standard of highway maintenance."

In other news from the Peach State, the Georgia Department of Audits and Accounts released a January 2011 performance audit of contracts the Department of Community Health (DCH) holds with three private care management organizations (CMOs) to administer healthcare programs for approximately 1.1 million low-income individuals in the state's Medicaid and PeachCare for Kids programs.[57] The audit found that the programs were successful at keeping healthcare cost escalation in check. Collectively, the CMOs were paid approximately $2.7 billion in fiscal year 2010, an increase of about $400 million in two years primarily due to membership growth. Per-patient payments rose from $203.15 per month in FY 2008 to $206.02 in FY 2010, an increase of 1.4%, significantly lower than premium escalation in the larger private healthcare market.

The audit also found that the CMOs had relatively small or negative profit margins in calendar year 2009, with none exceeding 1.6%. CMOs also spent more than 85% of revenue on members' healthcare benefits in 2008 and 2009, consistent with industry best practices. According to surveys conducted for two CMOs, the percentage of providers satisfied with the performance in the two areas was higher in 2009 than two years earlier and similar to their satisfaction with other health plans in the market.

The current Medicaid managed care system was an initiative implemented under former Gov. Sonny Perdue that began in the Atlanta region in June 2006 and expanded statewide in September 2006. The partnership between DCH and its CMOs was designed to better manage costs through more efficient operation, establish contractual accountability for healthcare access and service quality, simplify administration and bring more predictability to the state budgeting process. The CMOs administering the Medicaid managed care system include AMGP Georgia Managed Care Company, Inc., Peach State Health Plan, Inc., and WellCare of Georgia, Inc.

Hawaii: In July 2011, Hawaii Gov. Neil Abercrombie approved Act 231 (House Bill 1505), establishing a new State Facility Renovation Partnership Program in which the state may enter into PPPs to modernize and repair aging state buildings. Under the program, the state's Department of Accounting and General Services can sell state buildings to private investors, who would finance renovations (or new facility construction) and lease the assets back to the state. The state would continue to own the land underneath the facility, and it would have the option to repurchase the facility back from the private partner. According to bill sponsor Rep. Sharon Har, "[t]hese types of

[PPPs] work in other states and will assist the State of Hawaii in moving forward with our ailing building infrastructure."

Iowa: Gov. Terry Branstad achieved a major campaign goal in signing House File 590 into law in July 2011, which replaced the state's Department of Economic Development (DED) with a new public-private partnership intended to boost the state's economic development activities. The new Iowa Partnership for Economic Progress consists of a seven-member advisory board (Economic Progress Partnership), a new state-funded authority (Iowa Economic Development Authority) with its own politically appointed board, and a private, nonprofit economic development corporation (Iowa Innovation Corporation) responsible for raising private funds to help finance startup businesses.

Also, in June 2011 Branstad struck language from a 2012 appropriations bill that would have required the Iowa Department of Corrections to consult with public employee unions and legislative leaders prior to entering into any new privatization contract over $100,000 in value. In a transmittal letter to the Secretary of State explaining his line-item vetoes in Senate File 510, Branstad wrote that the provision "would prevent the department from obtaining services for inmates in an effective and efficient manner" and "unnecessarily [infringe] on the department's management authority."

Kansas: The Kansas House of Representatives passed House Bill 2194 in 2011, which would have established a new, 11-member Advisory Council on Privatization and Public-Private Partnerships to evaluate privatization opportunities in state government and advise agencies on best practices in contracting and procurement. However, the Senate later gutted the bill, stripping out the House language and substituting new language on a different subject.

In other Kansas privatization news, Gov. Sam Brownback's proposal to shutter the state-funded Kansas Arts Commission and replace it with a privately funded, nonprofit arts foundation was rejected by the state legislature in the 2011 session. However, Brownback may achieve a similar result after having vetoed all Commission funds in the final 2012 budget—effectively ending its work—and a separate Kansas Arts Foundation has recently formed to solicit grants and private arts funding.

Kentucky: After hitting an impasse in negotiations on closing the state's Medicaid budget deficit during the regular legislative session, Kentucky Gov. Steve Beshear called a special legislative session that saw lawmakers approve the administration's plan to privatize Medicaid services to help close a deficit in the state's Medicaid budget.

In July 2011, Beshear announced that the state is awarding four contracts to managed care organizations to provide services to Medicaid recipients across Kentucky. Three of those contracts are with new vendors—CoventryCares of Kentucky, Kentucky Spirit Health Plan and WellCare of Kentucky—and will serve more than 560,000 recipients. The state's existing annual contract with

Passport, previously the state's only managed care provider, was renewed to provide services to 170,000 Medicaid recipients in Jefferson and 15 nearby counties.

According to the Beshear administration, the new Medicaid managed care contracts will save $375 million in general fund spending and $1.3 billion across all funds over the course of the three-year contracts, allowing the state to fully balance the Medicaid budget in FY 2012. The companies will create nearly 550 new jobs in Kentucky by January 1, 2012 to administer the managed care contracts, according to administration estimates. The administration received federal approval of the Medicaid changes in late October, allowing the program to proceed to full implementation.

"We were confident that moving Medicaid from a mostly fee-for-service system to managed care would create significant savings, preventing unnecessary and devastating cuts to our priorities such as education and job creation. These contracts show the savings are real," Governor Beshear said in a July press release.

Maryland: In March 2011, the Maryland House Health and Government Operations Committee rejected House Bill 451, which would have established a Council on Efficient Government to conduct pre-budgetary analyses of proposed agency privatization initiatives and hear complaints regarding government competition with private enterprise. "I don't think the government should compete with the private sector," bill sponsor Del. Michael Hough told the *Frederick News-Post* in February. "I'm from a philosophy of limited government. That's not limited government."[58]

In other news, the Maryland Transportation Authority issued a second request for proposals in July 2011 in its ongoing attempt to replace two aging travel plazas on Interstate 95 via a PPP. The agency was forced to revamp its procurement approach after vendors offered a tepid response to the original solicitation in late 2010, which was so overly prescriptive that the request for proposals itself totaled over 700 pages.

Michigan: In October 2011, a Michigan circuit court judge blocked the state's plans to contract out nurse aide positions at the Grand Rapids Home for Veterans on grounds that the privatization might endanger care. A resident of the home sued the state over its privatization plans earlier in the year, claiming that the contracted staff would receive inadequate training and would experience high turnover. In September, a coalition of public employee unions made similar arguments in requesting that the state's Civil Service Commission stop the planned layoffs of 170 nurse aides as part of the initiative. The privatization was expected to cut costs by $4.2 million, according to the 2012 budget signed into law by Gov. Rick Snyder, who plans to appeal the ruling.

In other news, a Senate-initiated plan to privatize Medicaid and day care eligibility functions in the Michigan Department of Human Services was removed from the 2012 budget in final House and Senate negotiations. Public employee unions raised objections over the potential loss of hundreds of state positions. Despite the removal of the privatization plan, the final 2012 budget included language directing the Department to study the potential cost savings and service improvements

associated with privatizing Medicaid eligibility processing, according to the *Lansing State Journal*.[59]

Montana: In May 2011, Gov. Brian Schweitzer vetoed Senate Bill 307, which would have required each legislative interim committee to provide, on a biennial basis, an opportunity in at least one public meeting for citizens to recommend terminating or privatizing any program administered by an executive branch agency. The interim committee would then submit any recommendations for the termination or privatization of any programs to the legislative auditor, who would be required to review and report to the next legislature on the recommendations. A veto override vote passed in both legislative houses by an 81 to 51 margin but it failed to reach the required two-thirds majority vote in each house needed to sustain an override.

In other news, in March the Montana House of Representatives voted to restore funding to a state-run veterans home in Columbia Falls that had previously been cut as a first step toward privatization. Initial momentum for privatization was driven by a report finding that the Montana Veterans Home had significantly higher per-bed operating costs than those seen at a privately operated home elsewhere in the state. Public employee union opposition and concerns that the two homes analyzed may not be comparable in facility type and services delivered prompted some legislators to withdraw their initial support for privatization.

New Hampshire: In October 2011, the New Hampshire Department of Health and Human Services issued a request for proposals from managed care organizations to cover administration of the state's Medicaid program. The governor and legislature approved Senate Bill 147 earlier in the year, which authorized the shift away from a Medicaid fee-for-service to a privatized managed care system.

In other news, State Sen. Jeb Bradley introduced two privatization-related bills in the 2011 legislative session that ultimately became law. Senate Bill 156 was enacted in June 2011, authorizing auto dealers to act as agents of the state Division of Motor Vehicles for vehicle registrations and title applications. Previously, vehicles could only be registered at town or city halls; under the new law customers can electronically register their vehicle at the dealership when sold. Also, Senate Bill 157 became law in June 2011 without Gov. John Lynch's signature, allowing private, registered service technicians to issue state seals of approval on gasoline pumps and other scales used to measure goods and services sold by weight, a function currently performed by the state's Division of Weights and Measures.

New Mexico: In October 2011, Gov. Susana Martinez signed a law giving in-state firms an even greater preferential advantage over those based out-of-state in contracting for state construction projects. The new law treats bids by in-state firms as being 5% lower than actually submitted, creating a significant disadvantage for lower cost, out-of-state competitors.

North Carolina: In 2011 the state's Program Evaluation Division began work on a study (expected in spring 2012) reviewing the operations of all state-owned attractions—including state parks,

aquariums, historic areas and the state-run zoo—in a move observers expect to result in at least some recommendations for privatization. In advance of the state report, the nonprofit North Carolina Aquarium Society has already begun to prepare plans to take over operation of the state's three aquariums. The Aquarium Society currently raises private funds to supplement state appropriations, but recent budget cuts have prompted the nonprofit to explore an expanded operational role. Any privatization would need to be authorized through legislation.

"It tends to be more efficient, more entrepreneurial in nature. You are able to be more focused on that facility than the state probably could be, especially in this time of budget cutbacks," Aquarium Society Executive Vice President Mark Joyner told Wilmington's News 14 in September. "As you look around at zoos and aquariums all over the country, privatization does seem to be the most efficient model, and that is why the majority of them, the trending is towards privatization."

South Carolina: South Carolina Gov. Nikki Haley met some resistance from state legislators in advancing the privatization of the state's school busing system, a key budget priority of the new administration. In June 2011, both legislative houses overrode Haley's veto of $12.4 million for new school buses, restoring the spending to the state budget. Haley vetoed the funds on grounds that the state should not be purchasing new buses when the administration is exploring the potential privatization of the school bus fleet.

Gov. Haley explained the rationale for privatization in her first State of the State address in January 2011: "We must also privatize our school bus system. We are one of the last states in the nation to do so, and our government just doesn't need to be in the school bus maintenance business. Making this change would deliver our state a check for our old buses. It would deliver our children a new fleet of buses. It would keep our school bus drivers employed while transferring our mechanics to the private sector. And it would put the focus of our Education Department where it needs to be: teaching our kids."

Haley's privatization push was complicated by the release of a May 2011 Department of Education report on the state's ongoing school bus maintenance privatization pilot program that found that the contracted maintenance facility was costlier than those run in-house. Administration officials acknowledged flaws in the contract and procurement in the pilot project that led to the vendor's performance. The following month, the Haley administration announced that it had received eight vendor responses to a request for information it issued soliciting proposals on how to privatize the only state-owned school bus fleet in the country. Potential bidders outlined concept proposals on how to implement privatization in ways that reduced state expenditures while making investments in modernizing the state's aging bus fleet.

Texas: In July 2011, Texas Gov. Rick Perry signed into law Senate Bill 7, a healthcare omnibus bill that included provisions that will expand the state's privatized Medicaid managed care program—currently utilized in several counties—statewide, a move designed to provide $467 million in budget savings. The bill also establishes a framework for the development of new healthcare collaboratives. "Texas faces unique challenges when it comes to health care delivery,

and Washington's one-size-fits-all approach doesn't fit our needs," Governor Perry said in a July press release. "SB 7 provides state-based solutions to rising health care costs by providing millions in savings, rewarding innovation and improving the health care of Texans."

Utah: In March 2011, Utah Gov. Gary Herbert signed into law House Bill 174, which requires the state's Department of Health, Department of Workforce Services and Privatization Policy Board to undertake a study of the state's Medicaid eligibility determination system to assess whether consolidation of the system or privatization would create greater efficiencies. The study, to be completed in advance of the 2012 legislative session, will review the structure of and potential privatization opportunities for the state's eligibility determination systems covering the state Medicaid program, children's health insurance program, primary care network and other eligibility systems administered by the Department of Workforce Services.

West Virginia: The five-year privatization of West Virginia's Workers Compensation Commission was completed in September 2011 when the state announced a $19 million, one-year contract with Zurich Insurance Co. to provide workers compensation insurance to state agencies. The privatization was the result of a 2005 law transforming the Workers Compensation Commission—the state-run monopoly insurer—into a private insurance carrier, BrickStreet Mutual Insurance Co. BrickStreet was given a temporary monopoly as it made the conversion to a private sector enterprise, and since 2008 has faced competition from other firms in the private sector market.

The 2005 law preserved BrickStreet's monopoly on providing workers compensation insurance to state agencies through July 2011, prompting the state to solicit bids. Zurich's bid topped a $26 million bid received from BrickStreet, and if successful, the Zurich's one-year contract could be extended for up to two additional years.

The *Charleston Daily Mail* reported in September 2011 that nearly 180 companies are now competing to provide workers compensation insurance policies in West Virginia—compared to none three short years ago—though BrickStreet still holds a strong 60% market share—and by the end of 2011, insurance rates in West Virginia will have declined by nearly 52% since 2005 as a result of competition.[60] As reported in Reason Foundation's *Annual Privatization Report 2010*, the initiative also dramatically reduced the outstanding unfunded liabilities of the old state-run system (from $3.2 billion to $1.9 billion in the first two years), the number of protested claims and the amount of time required for a ruling on protested claims. Given these results, West Virginia Acting Insurance Commissioner Michael Riley told the *Daily Mail* in September that the privatization "has been a wonderful success for the citizens of West Virginia."[61]

Wisconsin: In the fall of 2011, Wisconsin Gov. Scott Walker's administration abandoned its plans to expand the privatization of eligibility determination for FoodShare, the state's food assistance program, after federal officials complained the plan was noncompliant with federal law and threatened to withhold millions in federal funds.

Walker's plan would have expanded upon an initiative begun in 2009 under former Gov. Jim Doyle that tapped a private firm to handle a surge in enrollment applications for a new state-run healthcare program for childless adults. Since determinations for food and healthcare assistance eligibility are handled concurrently in Wisconsin, the private contractor ultimately took on both functions. Walker planned to expand the program to replace the remaining county-based application offices with a set of privately operated call centers in a move anticipated to result in 270 public sector job cuts and $48 million in annualized cost savings.

This prompted a threat from the U.S. Department of Agriculture (USDA), which argued that the plan would jeopardize millions in federal USDA funds since federal guidelines restrict states from privatizing the function of determining an applicant's eligibility for federally supported state food assistance programs (though related administrative support tasks may be privatized). In addition, the USDA found that the state had failed to comply with a 2010 agreement in which it pledged not to expand the number of contracted employees. However, a June 2011 state legislative audit found that the number of contracted employees had quadrupled from 106 to 432 between January 2010 and March 2011.

In May 2011, USDA officials sent a letter to the state's health secretary giving the state 30 days to develop a corrective plan, lest the state forego future federal food assistance funds and be forced to compensate the federal government for funds spent on contractor salaries since January 2010.

In response, Walker's administration submitted a plan to reduce the number of contracted employees by 20% by December 2011. However, the USDA notified the state in August that the proposed correction plan was insufficient and directed it to increase the December cuts to 40%, with a final target of eliminating 319—approximately 75%—of the state's private eligibility workers by March 2012, according to *The Capital Times*.[62]

Despite the setback on food assistance eligibility determination, Walker was successful in advancing his plan to privatize the state's economic development activities. In February 2011, the state legislature passed a bill that abolished the state's Department of Commerce and replaced it with a new Wisconsin Economic Development Corporation (WEDC), a public-private corporation that took over the state's economic development functions in July 2011.

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