



## STATE LEVEL PRIVATIZATION 2011

By Ann Henkener

State governments have relied on the private sector for goods and services for many years. However, states have more fully embraced privatization since the 1980s. In the past year or two, states have accelerated their movement toward privatization, partially because of the economic crisis and the need for states to take more extreme measures to balance their budgets, and partially because of shifts in ideology.

In recent years, a number of states have established commissions and/or issued reports on privatization:

Ohio – Ohio Budget Advisory Task Force Issue Paper, “Privatization in Ohio Government,” The Ohio Society of CPAs, September 2010<sup>1</sup>

New Jersey – New Jersey Privatization Task Force Report, 2010<sup>2</sup>

Virginia – Virginia Commonwealth Competition Council<sup>3</sup>

Illinois – “Government Privatization: History, Examples, and Issues,” Illinois Commission on Government Forecasting and Accountability 2006<sup>4</sup>

Some states have tried to set parameters on the types of activities which could be performed by entities other than the state. For example, Virginia defined an “inherently governmental” activity as:

- the act of governing,
- authority to collect and spend public revenues, and
- entitlements (from the Constitution of Virginia).

The Virginia list also included these examples of inherently governmental activities:

- an effective system of education throughout the Commonwealth;
- free elections;
- transportation system;
- defense from enemy attack on the soil of Virginia;
- intercourse with other and foreign states;
- taxation and assessments at fair market value;
- ultimate control over the acquisition, use, or disposition of the property, real or personal, tangible or intangible, of the Commonwealth, including the collection, control or disbursement of appropriated and other state funds; and
- natural resources for the benefit, enjoyment and general welfare of the people of the Commonwealth.

The state also recognized that the greater the amount of discretion involved in performing the activity, the more it is inherently governmental. In addition, it looked at the effect of activities that committed the government and viewed those activities as inherently governmental.

The Ohio Society of CPAs proposed a much simpler test, the “Yellow Pages test.” In essence, if multiple vendors of the services or goods appeared in the Yellow Pages, it should be considered for privatization. Ohio’s Governor Kasich, while campaigning for governor, stated: “If we don’t need it, get rid of it. If it’s in the yellow pages, outsource it.”<sup>5</sup>

Presented below are some areas of privatization proposed in one or more states in 2011.

### **Education: Charter Universities**

About 20 years ago, St. Mary's College, a public college in Maryland, obtained a charter arrangement with the state. One purpose of the arrangement was for the state to limit its funding to St. Mary’s. The college received a yearly block grant that rose only by the rate of inflation. It also received more flexibility. In exchange, the college won more control over its own management, including setting its tuition level.<sup>6</sup>

In 2002, the Colorado School of Mines signed a "performance contract" with the state. Under the terms of the contract, the school promised to meet certain performance goals – 55 percent five-year graduation rate, 80 percent freshman retention rate, and 90 percent placement of all graduates in a relevant job or graduate program within one year. In exchange, it received more freedom to manage its own affairs and set its own tuition levels.<sup>7</sup>

In 2005, Virginia's public system of higher education was restructured, giving the University of Virginia, the College of William and Mary, and Virginia Tech more financial and administrative autonomy.<sup>8</sup>

In August 2011, pursuant to direction given in the Ohio budget bill, the Chancellor of the Ohio Board of Regents proposed that top tier public universities in Ohio be offered the opportunity to become Enterprise Universities.<sup>9</sup> Ohio’s state funded universities would be given more autonomy and regulatory relief in such areas as construction, procurement and employment. Prevailing enrollment limits would be lifted. In exchange, the colleges would agree to meet certain academic, financial and research benchmarks and would divert 10 to 20 percent of its per-student state funding to scholarships. Critics claim that public oversight would be reduced, tuition could increase and workers would have fewer rights.<sup>10</sup>

Also in 2011, the Wisconsin legislature proposed the New Badger Partnership which would permit the University of Wisconsin to have more autonomy in light of the budget cuts it would be sustaining.<sup>11</sup>

### **Education: Charter Schools**

In Ohio, charter schools began in the 1990s. Cleveland began a program that provided money, or

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"vouchers," to families to send their children to independent, non-public schools. Charter schools receive formal government incorporation, or "charters," along with state funding, and retain a greater degree of autonomy than conventional public schools. Ohio's 1997 charter school legislation allowed charter schools in the eight largest city districts. A 1999 statute permitted charter schools in the 21 largest urban districts, and, by 2000, any district designated by the state as being in an academic emergency could create a charter school.

A large percentage of the Ohio charter schools are affiliated with Whitehat Management, an education corporation owned by Akron industrialist David Brennan.<sup>12</sup>

As a part of the budget bill for the next biennium, the Ohio Senate added provisions lessening control and accountability for charter schools. The provisions would:

- Give for-profit companies the ability to use tax dollars to open unlimited numbers of schools without disclosing how public funds are spent and without oversight from sponsors as now required.
- Exempt the school, if an operator is running it without a sponsor, from current law that allows it to be suspended or put on probation for failing to meet student performance requirements, fiscal mismanagement, a violation of law or other good cause.
- Allow a governing board, if it contracts with an operator, to delegate all rights to the operator; specify that funds paid to the operator are not public and that property purchased by the operator belongs to the operator; and require the school to offer the operator the chance to renew its contract before seeking another operator.
- Require a charter school board to give an operator 180-day notice before terminating a contract, up from the current 90 days. It also gives the operator final say over the renewal of a contract between a school and its sponsor.<sup>13</sup>

Lobbyists for David Brennan proposed a number of these changes. Throughout the first part of 2011 these lobbyists worked with legislators and directly with the Ohio Legislative Services Commission to draft language for the bill.<sup>14</sup> The proposed changes passed in the Ohio House, but not in the Senate, and did not appear in the final budget.

Ohio was not alone in further privatizing education. Indiana expanded the availability of vouchers. The new law, based on a sliding income scale, allows parents who meet certain income and other guidelines to use state dollars to help pay tuition at parochial and private schools. For example, a family of four earning less than \$41,000 a year is entitled to a \$4,500 voucher for a student in grades one through eight and \$4,964 for a high school student. The voucher law also includes a tax deduction of \$1,000 for each child currently enrolled in a private school or home school. The new charter school law expands the number of universities and colleges in the state that are eligible to sponsor a charter school. It also increases funding for online virtual charter schools and allows charter schools to take over unused buildings owned by a public school district.<sup>15</sup>

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### **Medicaid**

Medicaid is a health care program funded by both individual states and the federal government. It pays for health care benefits for a variety of low income and disabled individuals. The federal government pays approximately 57 percent of the cost of the program, with states paying the balance.<sup>16</sup>

The federal government has determined the minimum types of benefits that must be offered but states can choose to offer additional benefits. For the most part, payments are made on a fee-for-service basis, with the state directly paying the provider of the services.

Many states require that beneficiaries (other than long-term care) obtain part of their services from HMOs. In 2006, Florida initiated a pilot program: It put Medicaid recipients in five counties into a private managed care program run by for-profit HMOs. Critics of the program claim that vital services are delayed or denied by the HMO and providers are scarce. Many doctors would not take individuals with Medicaid HMO coverage because it paid providers virtually as much as Medicare paid.<sup>17</sup> In May 2011, the state of Florida expanded the program to the entire state. The expansion needs to be approved by the federal government.

### **Lottery**

In 2010 Illinois became the first state to privatize the operations of its lottery.<sup>18</sup>

In 2011, Ohio's Governor Kasich recommended privatizing the Ohio Lottery if it will cut the state's expenses. The legislature considered ordering the state budget director to study ways to convert the lottery to a private enterprise. Legislation was drafted by GTECH, a private entity which once ran the Ohio Lottery's back office operations. GTECH's draft was added to the Senate's version of the bill, and the bill was passed. It spells out the qualifications a company must meet to operate the lottery and includes authority to conduct additional games that are not "subject to the state lottery commission's rule-making authority."<sup>19</sup> The proposal was not included in the final budget.

### **Sale/Lease of Infrastructure**

#### Buildings

In January 2010, Arizona sold its archives building, the tower that houses the Governor's office and six prison buildings. The state received \$735.4M by going to the public bond market and selling certificates of participation. The certificates mature in three to 30 years and carry a 4.57 percent interest rate. The state will lease the building back from investors. Previously the state sold a state hospital, the state legislative offices and its Veterans Memorial Coliseum.<sup>20</sup>

In California, then Governor Schwarzenegger planned to sell state-owned properties, such as the California Supreme Court Building and the attorney general's office in Sacramento. The state would then lease the buildings from the private buyers. The Governor hoped to gain about a billion dollars for 11 buildings. In 2011, current Governor Brown cancelled that plan.<sup>21</sup>

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In 2011, Ohio authorized the sale of five of its prisons with plans to contract with private operators to provide prison services to the state at those locations. It also allowed local governments to privatize their parking facilities and meters through leases up to 30 years, and permits state higher-education institutions to privatize assets such as student housing.<sup>22</sup>

The common theme in these transactions: selling buildings the state is still using and receiving a large one time infusion of money in exchange for paying to lease the same buildings for many years into the future.

### Turnpike

Ohio is discussing leasing the Ohio Turnpike. The budget bill permits the Ohio Department of Transportation to enter into a turnpike lease with a private operator with the approval of the Controlling Board. Ohio will continue to own the toll road. While other states have signed 75- to 99-year leases, Ohio is considering a 30- to 50-year lease. One requirement will be a substantial one-time up-front payment, probably several billion dollars. The state says that revenues would go to improvements such as highway construction and harbor dredging, mainly in northern Ohio where the turnpike is located.

Supporters point to the new projects the up-front lease payment could fund. Supporters say the turnpike could be run more efficiently. For example, it would be likely that a private operator would install automated fare collection machines, eliminating jobs of current unionized employees. Critics fear increases in tolls, which in turn would push more traffic onto routes running parallel to the turnpike. Critics also fear that maintenance will deteriorate.<sup>23</sup> The budget bill recently passed in Ohio lets the Governor explore leasing options, but the final contract must be approved by the General Assembly.<sup>24</sup>

Ohio is not the first to consider leasing a toll road. The Chicago Skyway and Indiana Toll Road have been leased to private operators in exchange for sizable upfront payments. The Chicago Skyway was leased in 2005 on a 99-year lease. Chicago received a \$1.83 billion upfront payment. Toll increases were capped. The Indiana toll road was leased in 2006 on a 75-year lease. The upfront payment was \$3.8 billion. In both cases some of the up-front money was used to pay off debt, improving the Chicago's and Indiana's credit ratings.<sup>25</sup>

The common theme in all three of these examples is shifting a stream of revenue that would continue over many years to a large infusion of funds in one year.

### **Development Department**

A number of states have turned to public private partnerships to perform economic development functions formerly performed by departments of development or departments of commerce. The earliest is Enterprise Florida, which began in 1992. Since then, other states have followed: Rhode Island Economic Development Corporation in 1995, Virginia Economic Development Partnership in 1996, Wyoming Business Council in 1998, Michigan Economic Development Corporation in 1999, Indiana Economic Development Corporation in 2003 and Economic

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Development Corporation of Utah in 2005. In 2011, the concept was proposed by governors in Arizona, Wisconsin, Iowa and Ohio.<sup>26</sup>

Ohio created JobsOhio in February 2011. It is a non-profit corporation formed for the purpose of promoting economic development, business recruitment, job creation, job retention and job training. Directors and employees of JobsOhio are not covered by Ohio's ethics laws for public employees, and financial disclosure requirements are less than those required of public employees. Ohio's open meetings law does not apply to JobsOhio, but it must open its in-person meetings to the public. Also, Ohio's public records law does not apply. The program is funded by an appropriation from the General Assembly, and Ohio's current stream of income from liquor sales may be diverted to fund profits of JobsOhio.

Similarly in 2011, Iowa Gov. Terry Branstad proposed to privatize economic development by replacing the current state Department of Economic Development with the Iowa Partnership for Economic Progress. It will include a newly formed state authority and a separate nonprofit corporation that will be able to raise money from private-sector interests, industrial revenue bonds and other sources to instigate and help finance job-creation projects.<sup>27</sup>

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## ENDNOTES

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