CITIZENS'
Budget
2003–05

A 10-Point Plan to Balance the California Budget and Protect Quality-of-Life Priorities

Reason

The Performance Institute

Project Director: Carl DeMaio

Part 6

Enact Competitive Sourcing and Procurement Reforms

"This administration will look to the private sector and public-private partnerships to get the job done when government can't do it alone. We have much to learn from private ventures and charitable institutions. We can use joint ventures and partnerships to accomplish new goals."

~Governor Brad Henry, (D-Oklahoma)

"Going forward, I am committed to greater partnerships with the private sector, and we will continue to actively pursue new opportunities through the public-private acts."

~Governor Mark Warner, (D-Virginia)

Summary of Citizen Budget Recommendations in This Section:

1. Implement **Competitive Sourcing for State Commercial Activities** to achieve cost savings target of $2.4 billion.
2. Transition state contracts to **Performance-based Contracting and Fixed Price Contracts** for most state service contracts.
3. Generate New Revenue through **Asset Divestiture of Unused State Assets** ($200 million in 03-04; $800 million in 04-05)
4. Implement **Recovery Auditing** for all state contracts to achieve cost savings target of $100 million annually.
5. Enact **Procurement and Competitive Bidding Reforms** to increase Department of General Services oversight over purchasing activities and by encouraging the use of bulk purchasing.
6. Improve **Infrastructure Financing System** by creating a shared infrastructure fund for both state and local projects modeled after the proposal in Assembly Constitutional Amendment (ACA) 11.

California Budget FACTS:



30%

Average magnitude of cost savings on government activities using competitive sourcing—regardless of who wins

7

Number of times per ten competitions conducted by state governments where state employees win the competition

20%

Estimated amount of California's real estate assets that could be more productive if privatized

$149 million

Proceeds to the state being realized from selling surplus real estate in the Silicon Valley in 2001

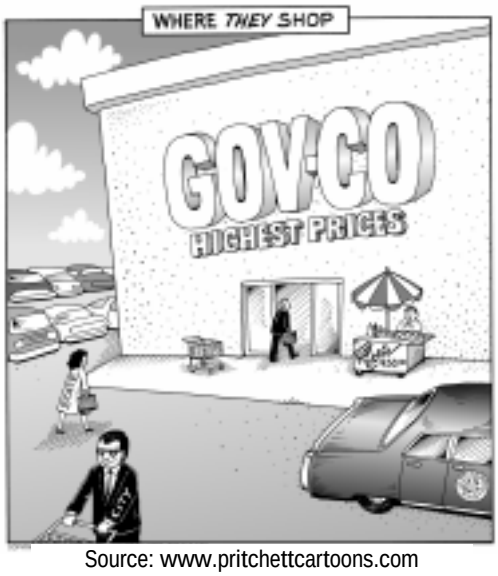
The California state government spends billions of dollars each year on purchasing goods and services—and carries out work and creates its own products and services that it probably would be better off buying from the marketplace. The Government Performance Project at Syracuse University reported that at the end of 2000, contracting consumed on average about 19 percent of

state operating budgets.[75] Given the current size of the state's General Fund budget, California spends approximately $14.8 billion annually on purchases and contracts.

Unfortunately, the current rules governing what the state buys through contracts—and more importantly what it does *not* buy through contracts—are outdated and extremely wasteful. As such, the state should reform its procurement system, tap the marketplace for ideas and solutions, and look for "best value" or bargain prices.

Implement Competitive Sourcing of State Commercial Activities

At its most basic level, competitive bidding of services is a powerful tool for improving quality and saving money when properly implemented. Competition in services involves the examination of an activity of an agency to determine whether the activity should continue to be carried out within the agency or should be purchased from an outside entity. Put simply, "Should the agency 'make' or 'buy' this activity?"



Source: www.pritchettcartoons.com

Yet in a larger sense, competition goes beyond the decision to "make" or "buy" to examine such considerations such as:

- Whether an activity is needed in the first place.
- Whether an activity should be "re-engineered" to be more efficient.
- Whether an activity should be "sourced" differently, either through another staff unit, another agency, a non-profit organization, a program partner, or a private-sector vendor.

The issue of improving "performance" should dominate the three considerations above—with the concept of "competition" driving the process to ensure the best sourcing solution is adopted by the agency. However, true "competition" can only be achieved when multiple players are competing under a fair and transparent process where performance results expected from the activity in question are clear.

As reported by the Council of State Governments, more than half of state government officials predict that states will be expanding their use of competition and outsourcing,[76] and the Government Contracting Institute points out that the dollar value of government contracts awarded to private vendors has risen 65 percent over the past five years.

Indeed, here in California competition and outsourcing have played an important role in helping to manage fiscal crises at the local level. In the mid-1990s, San Diego County faced a major fiscal crisis. Part of its successful strategy to return to fiscal health was a competition and outsourcing program that over several years moved at a modest pace and still generated $16 million a year in savings. And in 2000, California voters showed they understand the value of competition when they voted overwhelmingly to approve Proposition 35 to expand outsourcing of state services.

Stephen Goldsmith, former mayor of Indianapolis and one of the most accomplished practitioners of competition and privatization, has long recommended a simple guide to competition—the "yellow pages test."

> *If the phone book lists three companies that provide a certain service, the [government] should not be in that business, at least not exclusively. The best candidates for marketization are those for which a bustling competitive market already exists. Using the yellow pages test, [you] can take advantage of markets that have been operating for years.*[77]

Remove Barriers to Competitive Sourcing

Over the years laws and court decisions to protect certain public employees from competition have accumulated on the books. Article VII of the California Constitution, for example, states that, with few exceptions, public services rendered by the state must be performed by state employees. The thinking is, in effect, "if it can be done at all, it must be done by the state."[78] This is precisely the wrong approach. Rather, the thinking should be "if it can be done at all, it should be done locally or in the private sector." To ignore the vast resources and innovation of those outside the gilded halls of government would be a colossal waste of both money and human capital.



The Power of Competition

In 2002, the Office of Management and Budget broke with tradition and decided to see if private printers could beat the Government Printing Office's deal for printing the 2004 federal budget. The result—the GPO cut its price 23 percent ($108,370) and kept the work. That is $100k a year that GPO could have saved taxpayers any time they chose, but they never chose to do so until they faced direct competition.

—Brian Friel, 'Printing office cuts price, wins bid to handle 2004 budget," *GovExec.com,* December 27, 2002 http://www.govexec.com/dailyfed/1202/122702b1.htm

State leaders must recognize their first responsibility to protect the taxpayers and confront those special interest protections that prevent using competition to cut costs and improve services. A first and most crucial step would be to add an Article to the state Constitution similar to Article XXII, added by Proposition 35 in 2000, which amended Article VII to permit state and local government entities to contract out architectural and engineering services for all phases of public works projects, but that would apply to all commercial functions performed by state agencies. Oversight of state agency commercial activities inventories and of their competition plans will effectively expose additional specific legal barriers.

Implementing the Competitive Sourcing Program

The first step to figuring out where to begin applying competition to services is for the legislature in its oversight function to demand that agencies understand their own business. They need to break their functions down into core government and commercial activities, and then examine commercial activities for

places where applying competition makes sense. The federal government and state of Virginia have used such a tool.[79]

Too many states approach competition in a piecemeal fashion, with no leader taking ownership of reform and little or no follow-through on competition efforts. To overcome internal obstacles and maintain focus, it is important to have one highly organized team to implement and oversee competition goals and efforts. The team builds experience in both the politics and process of competition and can assist state agencies in implementing their programs. The oversight function is just as important, helping to ensure competition goals are met, to require agencies to document savings realized,[80] and to avoid such process problems as penalties for late payments to vendors.[81] As such, a "Competition Corps" should be created at the Department of Finance to staff all state agency competitive sourcing projects. Furthermore, each state activity should undergo a competitive sourcing examination at least once every five years—meaning an average of 20 percent of activities would be studied each year.

Cost Savings from Competitive Sourcing

Choosing state functions that have been successfully subjected to competition in other places, and applying competition to a total of 10 percent of those functions in 2003 and a total of 25 percent in 2004, at a conservative average cost savings of 15 percent would create a lower range of savings of $490 million in 2003 and $1.2 billion in 2004. A more aggressive effort to compete more services or a more typical average cost savings of 30 percent could create savings of $980 million in 2003 and $2.4 billion in 2004. Real Long-term savings will be greater as additional services are competed. (See Appendix B for a detailed list of potential outsourcing targets.)

Reforming the State's Procurement Practices Using Standards and Performance

California state government should reform its procurement system to encourage competitive bidding as well as leverage its purchasing power through the centralization of its procurement processes and use of innovative contracting vehicles. A Recent Bureau of State Audits (BSA) report roundly criticized state agencies for wasting millions of dollars on no-bid contracts without even bothering to shop around.[82] The report was requested by State Senator, and then-Joint Legislative Audit Committee Chairman, Dean Florez (D-Shafter) in the wake of the Oracle computer software scandal, in which Oracle was awarded a $95 million no-bid contract that would have cost the state $41 million more than was necessary.[83] Allegations of campaign fundraising allegations were made in connection with the deal. In response, the contract was rescinded and the Department of Information Technology was eliminated.

The BSA report illustrated a Department of Motor Vehicles purchase of $125,000 worth of teddy bears for a promotion to get people to fill out their 2000 census forms as an example of what is wrong with the system. The bears were purchased through the use of an "emergency" procedure and no competitive bidding process was utilized. Responding to the conclusions of the report, current Joint Legislative Audit Committee Chairwoman Assemblywoman Rebecca Cohn (D-Saratoga) said, "This report highlights significant, acute and systemic problems that probably cost the state hundreds of millions of dollars in wasted spending."[84]

While the Davis administration has enacted some reforms in this area since the Oracle scandal, such as requiring competitive bids on all computer contracts and all contracts over $500,000 in value, the BSA report

suggests that further changes are needed. For example, the Department of General Services must strengthen its oversight of sole-source contracts, emergency purchases, and other state purchasing activities. The report further stated that questionable purchases, such as obtaining multiple consulting services that provided duplicative information, and generally not confirming that state agencies receive the services they paid for, "illustrate the danger of having multiple departments making purchases for a single project and not communicating with each other."

Centralizing Procurement and Contracting

"In this type of environment, authority and accountability lines become vague, the chance of error increases, and the state has less assurance that its resources are being spent wisely," the report went on to say.[85] The use of a central purchasing unit at the Department of Finance—be it for a project, an agency, or the state government as a whole, depending on the goods or services required—would eliminate errors stemming from this communication project and would additionally allow the state to realize cost savings through bulk purchases.

Performance-based and Fixed-price Contracting

Another powerful reform that can save government money and improve program results is implementing "performance-based contracting (PBC)" for as many contracts as possible. Performance-based contracting is the soliciting of bids based on what results government wants accomplished, rather than what activities it wants conducted. It relies on performance standards being included in the contract as well as payments tied to the achievement of results.

This is a significant change. By compensating a contractor for results rather than effort or activity, the transaction becomes more efficient for both the vendor and government. The vendor has the freedom and flexibility to do what he does best (produce the service) without micromanagement on activities from government. If it takes 10 hours or 10 months to deliver the service to government consistent with the quality standards of the contract, the payment is the same. And if the contractor does not perform the service according to the quality standards, he must re-do the work until the job is done. Period.

The contract is structured under a "fixed price" for each service purchase, with no payment until performance is delivered. As a consequence of this payment method, transaction costs are reduced for both government and the vendor as paperwork and auditing requirements are streamlined. And of course, the focus on performance is likely to improve chances that government gets quality service.

This scenario stands in stark contrast to the preferred contracts used by government today: "cost-reimburse" and "fee-for-service" contracts. Under these contracting vehicles, government pays every time a contractor "works" on a project—encouraging a contractor to drag on the contract for as long as possible and take every opportunity to engage in an authorized activity under the contract.

The state might want to consider a variety of other innovative contracting vehicles. Not all of these vehicles are appropriate for every service provided by government, but should at least be given consideration to see if a good fit can be made:

- *Share-in-savings Contracts:* As referenced in the reorganization part of this report, share-in-savings contracts limit the liability of government by paying contractors through the cost savings realized from a particular service. For example, the state might want to convert many information technology services into share-in-savings contracts whereby the vendor provides the information technology services for free, but collects a percentage of the cost savings to the government from use of the technology.
- *Fee-based Service Delivery*: Under this model, firms would be allowed to design a better process for delivering a state service (such as a license). The firm would then "sell" the service to the market at a fee. If the service provided was not faster and better, the market would not pay. However, if the firm could provide better services, then it would generate revenue. The state would still offer the service, but at a reduced staffing need.
- *Reverse Auctioning Online:* The state can tap the power of the Internet to procure many goods and services using online auctions similar to those seen on e-Bay. Reverse auctioning works like this: under the new reorganization plan, several state agencies will have new agency names. A state agency could advertise for a bid for new letterhead over the Internet with a set time period for submission of bids. The "current" bid price would fall as each vendor submitted a new, lower bid to win the contract. The U.S. Postal Service has achieved cost savings totaling more than $100 million on purchases of supplies and services using this reverse auctioning method.

Implement Recovery Auditing for Past and Present State Contracts

Another significant cost savings tool is the use of recovery auditing—a strategy that requires no risk and no difficult political decisions. Each year, millions of dollars are wasted through overpayments to contractors. While a few state programs have a version of recovery auditing for one or two programs, the expanded and systematic use of recovery auditing can recoup for the state millions of dollars lost to errors.

Overpayments may result from a variety of sources, including:

- Payments to ineligible beneficiaries;
- Duplicate payments;
- Payments to unsupported claims;
- Inadvertent pricing errors on invoices;
- Fraud;
- Advertised discounts mistakenly not applied by vendors;
- The omission of allowances and rebates; and
- Miscalculated freight charges.[86]

These payment errors are not necessarily evidence of gross mismanagement, but simply an unavoidable evil of conducting business for such a large organization as the state government. The private sector has been utilizing recovery auditing for decades, and the use of these services in government has increased substantially in just the past five or six years. Leading recovery audit firms have recovered billions of dollars for their public- and private-sector clients.

How It Works

The government selects one or more private recovery audit firms to analyze contracts, invoices, disbursements, and other relevant records. The firm then documents and recovers any overpayments. The recovery firm's services cost the state nothing, as recovery audit contracts are performance-based and provide that the firm is paid a contingency fee based on a percentage (typically, about 20 percent, but for government we suggest no more than 10 percent) of the savings recovered. Firms may additionally offer consulting services to help clients minimize future overpayments.

The typical overpayment error rate for large purchase and payment organizations in the private sector is about 0.1 percent. In the area of contracts and grants, error rates for government agencies may reach up to 0.4 percent to 1.8 percent.[87] Error rates vary greatly among different government agencies. (For entitlement programs, error rates are significantly higher—but that challenge is dealt with in a future part of this budget.) Simply put, overpayments may not be an issue at all in some agencies, but error rates may be significantly higher for agencies that engage in a large amount of contracting.

Table 6: Federal Government Agency Payment Errors and Error Rates

Programs	Erroneous Payments	
	Amount (in millions)	Percent
Medicare – Fee-for-Service	$12,100.0	6.30%
Earned Income Tax Credit	$9,200.0	29.35%
Housing Subsidy Programs	$3,281.0	17.38%
Unemployment Insurance	$2,251.3	9.21%
SSI	$1,590.0	5.73%
Food Stamps	$1,340.0	8.66%
OASI	$1,339.0	0.36%
Disability Insurance	$1,313.0	2.22%
Medicare – Cost Reports	$493.0	2.7%
Student Assistance Pell Grants	$336.0	0.71%
FEHBP	$241.0	1.14%
Federal Retirement	$167.0	0.35%
Student Aid – External	$65.0	0.14%
Military Retirement Fund	$18.6	0.05%
Student Aid – Internal	$13.3	0.03%
Commodity Loans	$7.6	0.09%
Federal Transit Administration	$5.5	0.09%
(7a) Business Loan Program	$0.3	1.9%
Airport Improvement Program	$0.3	0.01%
FEGLI	$0.2	0.01%

Source: Testimony of Mark W. Everson, OMB Deputy Director for Management before the U.S. House of Representatives, Committee on Government Reform, Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations

While 0.1 or 0.4 percent may not appear to represent significant savings potential, for an operation the size of the California government, the savings do add up. Consider that for every $1 billion in purchases and payments to beneficiaries, the state can expect to save between $1 million and $4 million through the use of recovery auditing. More importantly, recovery auditing is not done just on the current budget year, but can be applied to payments made in the past two to three budget years—recouping monies long-thought-spent already.

For the purposes of our model, we have assumed that relevant activities subject to recovery audit comprise, on average, approximately 15 percent of California government agency budgets. This estimate is conservative, considering that The Government Performance Project at Syracuse University reported that at the end of 2000, contracting consumed on average about 19 percent of state operating budgets.[88] Furthermore, this figure does not include the amount of budgets from agencies, such as Health and Human Services Agency programs, that are devoted to making payments to program beneficiaries, and which are typically rife with payment errors (resolution and savings for which are dealt with in a later part).

Using this estimate and the aforementioned range of error rates, we conclude that, through the use of recovery auditing, California will realize a savings of between $9.4 million and $37.7 million using one year budget expenditures (see Table 7). Assuming that the overpayments error rate for California falls directly in the middle of the range yields a median savings estimate of approximately $23.5 million annually. Moreover, the Citizens' Budget will apply recovery auditing to the previous two budget years to produce total savings of $71 million in biennial year one, and $23.5 million in biennial year two.

Table 7: Estimated Savings From Recovery Auditing (Dollars in Thousands)

Agency	2003-04 General Fund Expenditures	Budget Subject to Review (15% of Total Expenditures)	Estimated Savings Range (0.1-0.4%)
Legislative, Judicial, and Executive	$2,167,000	$325,050	$325-$1,300
State and Consumer Services	$438,000	$65,700	$66-$263
Business, Transportation, and Housing	$216,000	$32,400	$32-$130
Technology, Trade, and Commerce	$21,000	$3,150	$3-$13
Resources	$959,000	$143,850	$144-$575
Environmental Protection	$100,000	$15,000	$15-$60
Health and Human Services	$15,146,000	$2,271,900	$2,272-$9,088
Youth and Adult Corrections	$5,639,000	$845,850	$846-$3,383
K-12 Education	$27,390,000	$4,108,500	$4,109-$16,434
Higher Education	$8,509,000	$1,276,350	$1,276-$5,105
Labor and Workforce Development	$90,000	$13,500	$14-$54
General Government	$2,094,000	$314,100	$314-$1,256
Total	**$62,769,000**	**$9,415,350**	**$9,415-$37,661**

Source: Data in column 1 from 2003-04 Governor's Budget Summary, P.40



Research on Savings from Competition and Privatization:

- Center for Naval Analysis, *Long-run Cost and Performance Effects of Competitive Sourcing*, 2001—**Average savings are 34 percent and are sustained over time.**
- John Hilke, *Cost Savings from Privatization: A Compilation of Study Findings*, 1993—**Savings usually range from 20 percent to 50 percent**.

Note: In this report, we used a conservative range of 15-30 percent average savings, even though many sources suggest greater savings can be realized.



Key Questions To Ask State Agencies:

- How much of your agency's activity is commercial in nature?
- How much of your agency's activity is currently contracted out?
- How many real property assets do you have? What is their value? What is the cost of maintaining them?
- How much is spent on contracts each year?

Case Studies in Recovery Auditing in Government

As noted previously, private firms have recognized the value of recovery auditing and have been reaping the benefits of these services for many years, but government use of these auditing services is a relatively new trend. The use of recovery auditing seems to be a natural cost-savings strategy for government, given the size of programs and the amount of contracts and beneficiary applications involved in providing services. The financial statements of federal government agencies, for example, have revealed overpayments totaling approximately $20 billion for each of the past few years.[89]

The federal government began experimenting with recovery auditing in the mid-1980s for the Army Air Force Exchange Service and Naval Exchange Command. In 1996, the Department of Defense (DOD) initiated a recovery audit demonstration program in response to a federal mandate to explore the option of using private firms to identify overpayments to vendors. The Defense Supply Center, Philadelphia was able to identify $17.9 million in overpayments between 1996 and March 2000.[90] Of this amount, $5.3 million was quickly recovered, and the government is negotiating with vendors for several million additional dollars worth of disputed payments.[91]

Although the pilot program ended in 1999, the Department of Defense has since expanded its use of recovery auditing. Section 831 of Public Law 107-107, the National Defense Authorization Act for Fiscal Year 2002, reauthorized the pilot program and required all executive agencies that enter into contracts totaling $500 million or more to implement programs for recovering any amounts erroneously paid to contractors, including the use of recovery audits. The use of recovery auditing has spread outside the DOD as well and is now used by the Department of Veterans Affairs, the General Services Administration,

the Federal Aviation Administration, the Federal Highway Administration, and the Federal Transit Authority within the Department of Transportation.[92] Indeed, the Bush administration has recognized the value of recovery auditing, making it a key part of the President's Management Agenda, issued in August 2001.

A recent GAO report reported the successful implementation of recovery auditing programs in other government agencies:

> *When Illinois had assessed the risk of improper payments in its Medicaid program, based on the results, it implemented initiatives to improve payment accuracy. To monitor the effect of the new initiatives, the state uses random claims sampling to test the accuracy of payments. The goal of the project, which reviews 1,800 claims per year, is to ensure that every paid claim faces an equal chance of random review. This approach not only provides periodic estimates of payment accuracy rates but helps deter future erroneous and fraudulent billings*.[93]

The GAO report also noted the key role performance measurement plays in maintaining agency accountability for overpayments and ensuring the accuracy of the payment errors identified:

> *Performance measures are key to monitoring progress in addressing improper payments. The government of New Zealand, for instance, requires audited statements of objectives and service performance to be included along with financial statements. These statements include performance measures related to improper payments. Work and Income New Zealand (WINZ), a government agency that provides income support and employment assistance to eligible people, has established performance measures for entitlement accuracy, services to reduce benefit crime, and debt management. WINZ's financial statements are the main accountability reports used by Parliament to monitor the agency's performance. In addition, Parliament uses the audited information to make informed decisions on resource allocation, and through a monitoring body, to hold the entity's chief executive officer responsible if performance standards are not met.*[94]

Since recovery audit programs have been effectively implemented in governments at the federal and state levels, there is no reason to believe that California would not similarly benefit from their use. The mere fact that this cost-savings strategy is rapidly becoming more and more widely adopted in the public sector is testament of its success.

Recovery auditing may not be a dramatic way to save money, but it is effective. Its use presents no risk to the government, as nothing is paid to the contracted auditing firms unless savings are realized, and even then payment is just a percentage of that savings. Furthermore, since recovery auditing can provide savings without the need for difficult political decisions, there is no reason not to use these services.

Recovery auditing may not result in multi-billion dollar savings to the government, but the millions of dollars saved do add up and become significant in an environment where numerous agencies are trying to stretch their appropriations as far as possible and taxpayers are clamoring for the elimination of government waste. The use of recovery auditing, in addition to strengthened anti-fraud measures, would represent a large step in the right direction to reducing this unnecessary waste.

Divestiture of Under-utilized State Assets and Improved Asset Management

The final reform involves improving the state's management of public assets and infrastructure. It involves improvement in the construction, operation and maintenance of assets. It also involves getting rid of things the government has bought or built in the past, but no longer has a use for.

The state must improve its management of public assets—which constitute an important element of a state's economic prosperity. Roads, water, energy, and other types of public works constitute an integral component of service delivery. Transportation networks consisting of roads, railways, airports, and harbors foster a vibrant, interconnected business climate by providing the avenues through which trade takes place. The Information Age has also created an increased emphasis on quality of life, while parks, schools, public hospitals and recreational facilities serve to make a community more attractive to potential residents and businesses, all demands that place further stresses on infrastructure. Infrastructure renewal and maintenance is vital to sustained growth and development.

Each year the American Society of Civil Engineers (ASCE) issues a report card on the status of the nation's infrastructure. California received a one of the worst grades in America. Among other things it reported that:

- 47 percent of California's major roads are in poor or mediocre condition;
- 28 percent of the bridges are structurally deficient or functionally obsolete;
- 87 percent of California's schools have at least one unsatisfactory environmental condition;
- 71 percent of schools have at least one inadequate building feature; and,
- California's drinking water infrastructure needs $18.8 billion over the next 20 years. [95]

Most alarming though is that driving on roads in need of repair costs California's motorists $7.4 billion a year in extra vehicle repairs and operating costs – nearly $354 per motorist.

Additionally, under new state government accounting standards, all government entities must determine the value of their infrastructure facilities and reflect that value in their books. They then must either maintain the facilities to sustain their value or depreciate the value in their accounts. This is likely both to improve the data on infrastructure values and needs and to create new incentives to avoid deferring maintenance.

Another serious problem plaguing Californians is the amount of congestion on the freeways. Less than three years ago, Governor Davis enacted the Traffic Congestion Relief Program (TCRP) to alleviate congestion and gridlock. The program called for an initial appropriation of approximately $1.6 billion and annual allocations from the sales tax on gasoline, as stipulated by Proposition 42. However, none of the sales tax revenue has been allocated, and almost all of the initial appropriation has been "borrowed" by other state programs in the General Fund.

To add insult to injury, the Governor has called for additional cuts in the 2003-04 budget including, further suspension of Prop. 42 funding and $500 million in loan forgiveness of funds borrowed by the TCRP.

To better prepare and align statewide priorities the state implemented a five-year strategic plan. However a Legislative Analyst's Office (LAO) review of the plan noted several flaws in the plan.[96] For starters, the LAO noted that the strategic plan failed to accomplish its goal and purpose.

> *While the plan presents various departmental priorities, it does not place these priorities in the context of the administration's overall, statewide priorities. For example, the plan does not state whether the administration's priorities are: the renovation of aging facilities, addressing certain critical deficiencies, the development of new facilities and capacity, or a combination of these. We believe that such a context is needed in order to better understand and assess the departmental proposals and priorities in context of the entire state budget.*[97]

Another critique of the "strategic plan" is that it only identifies projects where funding has been identified or is available. This approach fails to properly assess the state's needs and is unrealistic if the backlog of deferred maintenance is accounted for.

A number of reforms are advocated by the Citizens' Budget:

- **Improved Financing System:** Serious financial commitments to rebuild, rehabilitate, and renew the state's infrastructure are needed. Assembly Constitutional Amendment (ACA) 11 is a bipartisan bill that would amend the state Constitution to create an infrastructure fund for both state and local projects. If passed by voters in March, ACA 11 would establish the California Twenty-First Century Infrastructure Investment Fund to provide a dedicated fund source for capital outlay. It would require that monies in the Infrastructure Fund be allocated by the legislature for capital outlay purposes, of which 50 percent would be for state-owned infrastructure and 50 percent would be for local government infrastructure.
- **Performance-based Contracting and Outsourcing**: The state should expand its use of performance-based contracts for construction, operation and maintenance of all public assets. Moreover, no state employee should be charged with operating and maintaining state assets. These are responsibilities more efficiently and effectively performed by professional contractors under fixed-price contracts with clear performance standards. Numerous studies indicate that from road repairs and building improvements to bike trail maintenance and snow removal, performance-based contracting and outsourcing of operations and maintenance saves significant resources.
- **Asset Divestiture**: With such a large inventory of assets needing improvements, it is important for the state to prioritize and shed any unused or under-utilized assets. Divestiture of assets is examining what real property the state owns and if it can be put to more productive or efficient use if it is privately owned and used by the state under agreement with private owners.

The Little Hoover Commission for California state government has issued several reports criticizing the state for not effectively managing its real property assets.[98] While there is certainly room for improvement and money to be saved, there have also been some examples of success. In 2001, for instance, Governor Davis sold surplus state real estate in Silicon Valley for $149 million. Building on California's existing experience in identifying and selling surplus properties is a good place to start. In addition, many other government agencies have more advanced experience in figuring out how to benefit from privatizing real property and equipment, where appropriate.[99]

Focusing first on state real estate assets, estimating that about 20 percent of it could be more productive if privatized, and a very conservative estimate of land and building values, selling half of those viable properties would generate a lower bound estimate of **$1 billion in 2003 and in 2004**, while an accelerated pace of sales or selling prices more in line with typical California market values would generate **$1.5 billion in 2003 and 2004.**[100] Additional revenue benefits kick in after assets are sold and enter the property tax rolls.

Table 8: Major State Infrastructure

Program Area	Major State Infrastructure
Water Resources	▪ 32 lakes and reservoirs ▪ 17 pumping plants ▪ 3 pumping-generating plants ▪ 5 hydro-electric power plants ▪ 660 miles of canals and pipelines ▪ 1,595 miles of levees and 55 flood control structures in the Central Valley
Transportation	▪ 50,000 lane miles of highways ▪ 9 toll bridges ▪ 11 million square feet of Department of Transportation offices and shops ▪ 209 Department of Motor Vehicles offices ▪ 138 California Highway Patrol offices
Higher Education	▪ 192 primary and satellite campuses of higher education, including 10,000 buildings containing 138 million square feet of facilities space
Natural Resources	▪ 266 park units containing 1.4 million acres and 3,000 miles of trails ▪ 238 forest fire stations and 13 air attack bases ▪ 21 agricultural inspection stations
Criminal Justice	▪ 33 prisons and 38 correctional conservation camps ▪ 11 youthful offender institutions ▪ 12 crime laboratories
Health Services	▪ 4 mental health hospitals comprising over 4 million square feet of facilities and 2,300 acres ▪ 5 developmental centers comprising over 5 million square feet of facilities and over 2,000 acres ▪ 2 public health laboratory facilities
General State Office Space	▪ 8.5 million square feet of state-owned office space ▪ 16.6 million square feet of leased office space



Unanimous and Bipartisan "Competitive Sourcing" Guidelines from the Federal Commercial Activities Panel



The federal government recently completed work through a bipartisan commission examining how best to use competitive sourcing in government. The results were historic—demonstrating how a commission of Republicans, Democrats, union leaders and businesses could endorse 10 common principles for doing competitive sourcing well.

In order to guide the new process of competitive sourcing in government, the Commercial Activities Panel (CAP) offered these ten principles:

- **Align to Mission and Goals of the Agency:** Federal agencies should link any competitive sourcing program they undertake to program strategic plans and performance goals.
- **Link to Human Capital Planning:** Competitive sourcing initiatives should include investments in training federal workers to be more competitive, as well as identify areas where recruitment shortages are projected to be the greatest.
- **Recognize Inherently Governmental Activities:** Federal agencies should clearly and carefully identify "inherently governmental" activities and ensure federal workers continue to oversee those functions.
- **Create Incentives for Performance-based Management:** Competitive sourcing must be fully integrated into a comprehensive performance-based management system for the agency that encourages and rewards high-performance.
- **Ensure Transparency and Consistency in Competitions:** The federal government should devise a clear and transparent process for managing competitions and be consistent in applying that process across federal agencies.
- **Avoid Arbitrary Targets for Outsourcing:** The Administration and individual agencies should refrain from setting quotas or goals for how many activities or positions should be outsourced.
- **Provide for Full Competition:** When activities are competed—whether they are inside the agency or already contracted out—the process should allow for full competition between federal workers and the private sector.
- **Ensure Fairness in the Competitive Sourcing Process:** It is not enough to allow both sides to bid on federal activities—bids must be evaluated and judged fairly. Without fairness, and confidence in the system by all parties, the interests of the taxpayer (the ultimate beneficiary of competitive sourcing) cannot be safeguarded.
- **Focus on "Best Value" in Determining Winning Bid**: Competitions for federal activities should be evaluated and judged based on cost and performance standards. Moving to a best value formula will remedy one of the biggest flaws in the existing competitive sourcing process: the single-minded focus on cost cutting rather than performance improvement.
- **Provide for Accountability throughout the Process**: Regardless of who wins the competition, federal agencies should demand accountability for performance from the winners. Only by measuring performance—and managing contracts for results—can accountability be guaranteed.

Overview of Innovative Government Procurement Models

A variety of alternative service delivery techniques can be employed to maximize efficiency and increase service quality. Some methods will be more appropriate than others depending on the service. In searching for ways of cutting costs and increasing delivery, consider using a combination of these techniques:

a. ***Contracting Out (also called "outsourcing").*** The government competitively contracts with a private organization, for-profit or non-profit, to provide a service or part of a service.

b. ***Management Contracts***. The operation of a facility is contracted out to a private company. Facilities where the management is frequently contracted out include airports, wastewater plants, arenas and convention centers.

c. ***Public-Private Competition (also called "managed competition," or "market testing").*** When public services are opened up to competition, in-house public organizations are allowed to participate in the bidding process.

d. ***Franchise.*** A private firm is given the exclusive right to provide a service within a certain geographical area.

e. ***Internal Markets.*** Departments are allowed to purchase support services such as printing, maintenance, computer repair and training from in-house providers or outside suppliers. In-house providers of support services are required to operate as independent business units competing against outside contractors for departments' business. Under such a system, market forces are brought to bear within an organization. Internal customers can reject the offerings of internal service providers if they don't like their quality or if they cost too much.

f. ***Vouchers.*** Government pays for the service; however, individuals are given redeemable certificates to purchase the service on the open market. These subsidize the consumer of the service, but services are provided by the private sector. In addition to providing greater freedom of choice, vouchers bring consumer pressure to bear, creating incentives for consumers to shop around for services and for service providers to supply high-quality, low-cost services.

g. ***Commercialization (also referred to as "service shedding")***. Government stops providing a service and lets the private sector assume the function.

h. ***Self-Help (also referred to as "transfer to non-profit organization").*** Community groups and neighborhood organizations take over a service or government asset such as a local park. The new providers of the service also are directly benefiting from the service. Governments increasingly are discovering that by turning some non-core services—such as zoos, museums, fairs, remote parks and some recreational programs—over to non-profit organizations, they are able to ensure that these institutions don't drain the budget.

i. ***Volunteers.*** Volunteers are used to provide all or part of a government service. Volunteer activities are conducted through a government volunteer program or through a non-profit organization.

j. ***Corporatization.*** Government organizations are reorganized along business lines. Typically they are required to pay taxes, raise capital on the market (with no government backing—explicit or implicit), and operate according to commercial principles. Government corporations focus on maximizing profits and achieving a favorable return on investment. They are freed from government procurement, personnel and budget systems.

k. ***Asset Sale or Long-term Lease.*** Government sells or enters into Long-term leases for assets such as airports, gas utilities or real estate to private firms, thus turning physical capital into financial capital. In a *sale-leaseback* arrangement, government sells the asset to a private sector entity and then leases it back. Another asset sale technique is the *employee buyout*. Existing public managers

and employees take the public unit private, typically purchasing the company through an Employee Stock Ownership Plan (ESOP).

l. ***Private Infrastructure Development and Operation.*** The private sector builds, finances and operates public infrastructure such as roads and airports, recovering costs through user charges. Several techniques commonly are used for privately building and operating infrastructure.

m. With **Build-Operate-Transfer** (BOT) arrangements, the private sector designs, finances, builds, and operates the facility over the life of the contract. At the end of this period, ownership reverts to the government.

n. A variation of this is the **Build-Transfer-Operate** (BTO) model, under which title transfers to the government at the time construction is completed.

o. Finally, with **Build-Own-Operate** (BOO) arrangements, the private sector retains permanent ownership and operates the facility on contract.