PRIVATIZATION IN INDIANA

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Privatization in Indiana

I. Introduction
   a. Privatization is an option
   b. Indiana’s attempt to privatize
   c. Examine risks and benefits

II. Literature Review
   a. G. A. Mackenzie
      i. Should money received be considered revenue or financing
      ii. Government efficiency versus the private sector
      iii. Privatization is not to fill a hole in the budget
      iv. Increase in output
      v. Way revenue should be used
   b. Enrico C. Perotti
      i. Government efficiency versus public sector
      ii. Underpriced sales to private companies
      iii. Government retain stake or contract entire service out
      iv. Research worth
      v. Consider costs
         1. Real
         2. Opportunity
   c. Lyke Thompson and Richard C. Elling
      i. Elected officials need to listen to constituents
      ii. Public opinion poll results
         1. Government provides better service than private company
         2. Hesitant to privatize where coercive powers may be lost
      iii. Research in Michigan
         1. Loss of coercive powers not popular
         2. Some services okay to be contracted out
         3. Not approving of nonprofits taking over any services
         4. Prefer government to provide services
      iv. Most likely supporter of privatization
   d. Mildred Warner and Robert Hebdon
      i. Private companies provide service at a lower cost than government
      ii. Political pressure
      iii. Leadership
      iv. Efficiency equal among private sector and government as long as that is the goal
e. Ronald C. Moe
   i. Public-private partnership
   ii. Privatization forces decision makers to discuss their role in services

f. Daniel M. Otto and Mark A. Edelman
   i. County level most likely to privatize
      1. Population
      2. Property tax valuation
   ii. University or college presence
   iii. Political costs
      1. Loss of autonomy
      2. Shared resources
   iv. Educate constituents

g. Dennis Patrick Leyden and Albert N. Link
   i. Bureaucrat has to report to sponsor
      1. Face political pressure
      2. Bureaucrat must make decisions and sponsor only gets feedback from customers
   ii. Risk aversion
      1. Risk averse
      2. Risk neutral
   iii. Decision making timeline

h. Alvaro Cuervo and Belén Villalonga
   i. Quality of service
   ii. Take steps to ensure performance level is maintained
   iii. Personnel changes with privatization

i. Deborah A. Auger
   i. Different types of privatization options available
   ii. Seven lessons for those looking to privatize
      1. Lesson 1: recognize that opportunities for privatization are wide ranging, but experiences varied and complex
      2. Lesson 2: create an organizational support system capable of providing sound information and advice
      3. Lesson 3: emphasize strategies encouraging public-private competition for service delivery
      4. Lesson 4: understand how to assess feasibility and conduct effective cost analyses
      5. Lesson 5: anticipate and respond to public employee issues and concerns
6. Lesson 6: commit priority attention to contract administration and monitoring systems
7. Lesson 7: look beyond contracting to public-private partnerships, volunteerism, and other privatization approaches

III. Case Study
   a. Two efforts
   b. Varying levels of success
   c. Indiana Toll Road
      i. Important connections from the Indiana Toll Road
      ii. Indiana Department of Transportation (INDOT) was controlling it
      iii. Mitch Daniels
      iv. Indiana Finance Authority
      v. Major Moves
      vi. Funding levels prior to Major Moves
      vii. Wilbur Smith hired
      viii. Goldman Sachs hired
      ix. Statewide Mobility Partners (SMP) won the bid
         1. Gave Indiana the money up front to lease
         2. 75 year lease
      x. Operating standards manual
      xi. Savings each year
      xii. Court challenge
      xiii. Results
         1. SMP has made no money
         2. SMP lost $209 million in 2010
         3. SMP cannot cover interest payments on loans
         4. Adequate safeguards in place for taxpayers
         5. Overall success for Indiana
   d. IBM Modernization and Privatization of the Indiana Welfare System
      i. Modernize welfare system
      ii. Family and Social Services Administration (FSSA) responsible for choosing
      iii. Ten year contract
      iv. $1.1 billion
      v. New jobs
      vi. Pilot project
         1. Fragile demographic
         2. Expanded ways to apply for benefits
      vii. Complaints about service level
viii. Daniels cancels contract
   1. Cost to cancel
   2. Still being litigated

IV. Findings
a. Efficiency
   i. IBM Modernization and Privatization of the Indiana Welfare System
   ii. Indiana Toll Road
b. Political identity
c. Coercive powers
d. Proactive thinking
e. Political pressure and legislative majorities
f. Quality of service
   i. Indiana Toll Road
      1. Operating standards manual
   ii. IBM Modernization and Privatization of the Indiana Welfare System
g. Personnel
h. Leadership
   i. Political pressure
j. FSSA as leaders
k. Hiring the right people
l. Proactive approach
m. Listen to employees’ issues and concerns
n. Open communication
o. Leader needs to be willing to educate the public and employees
p. Risk averse vs. risk neutral leaders
q. Create a commission
r. Depending on the success of the Indiana Toll Road lease for the
   Modernization and Privatization of the Indiana Welfare System
s. Public-private partnerships
t. Look beyond contracting out
u. Public-private competition
v. Volunteerism
w. Reason to lease
   i. New source of revenue for Major Moves
   ii. Fill a hole in the budget
x. Due diligence
y. Be aware of costs
z. Deciding factors
aa. Managers need to commit the time and energy
V. Summary
VI. References
Privatization in Indiana

Introduction

With the government facing increasing costs and raising taxes is never a popular option, politically, it is often necessary to look at other options. One such option is to privatize public services. By having a private company assume control of the public service, it is possible for the state to save money and/or make money off of the agreement by partnering with a private company to perform those services. The idea behind going private is that these companies will be able to be more efficient because they can focus solely on that particular service instead of managing that service along with all of the others that an agency often handles.

Indiana is no different and has recently had two high-profile privatization agreements. The first is the leasing of the Indiana Toll Road in northern Indiana, which gave the state a large influx of money from the onset to invest however needed. At this point, there have been few issues with this agreement. The second is the modernization and privatization of the Indiana welfare system. In this second case, IBM was chosen as the recipient for that contract. This agreement has been less successful and can serve as a cautionary tale for future efforts.

As appealing as privatization sounds, it does not always end up being successful as the recent modernization effort of the Indiana welfare system with IBM did not perform well for the clients that needed the service. This unsuccessful and high-profile privatization agreement was much shorter lived and really put a spotlight on the risks involved with privatization of public services.
Understanding what has worked and has not worked in privatization is important to know if it can be applied to another situation in the future. If something has been proven not to work then it should not be used in the future at the expense of the taxpayers once again. Examining the risks and benefits of previous privatization efforts may prevent future failures and bring some clarity to the things that work when making future decisions.

This paper will look at existing literature and focus on two case studies of Indiana’s privatization efforts. From this research, the literature will be applied to the case studies to draw connections and see what insights can be gained. Finally, conclusions will be drawn and discussed.

**Literature Review**

Because of the amount of money involved in the privatization agreements and the fact that it is taxpayer dollars at stake, it is important to understand the risks involved. It is also important to understand what has worked and has not worked in the past so that taxpayer dollars are not lost because there was not a lot of research done to fully understand the risks and benefits. There are risks and benefits associated with privatization and looking through the existing literature is important when looking to see if privatization is an option in a certain situation.

G.A. Mackenzie’s article titled “The Macroeconomic Impact of Privatization” discusses the revenue aspect of privatization. He investigates whether money received from a privatization agreement should be considered financing or as revenue. His article is based on the assumption that the government is not providing the service as efficiently as the private sector could. He argues that when making the decision to privatize, it
should not be done to fill a hole in the budget because the government can no longer afford to provide the service. Rather, it should be done in order to improve the efficiency of the service to the consumers. Thus, once privatization of the service has occurred and there has been a private company in charge of the service, there should be a permanent increase in the output. This can either be in the growth rate or the welfare of the program. He argues that when done correctly, the governmental entity can gain a source of revenue from the effort. He does not argue that any money taken in that does not directly pertain to the privatization effort should not, necessarily, be used to pay off debts. Instead, it can be used to improve infrastructure or to decrease the reliance on the banking system by giving the government entity more of a positive balance in their funds that may prevent them from needing to borrow from a bank in the future. He also makes the distinction that privatization should not be done as a way to prevent a tax increase (Mackenzie). It is important for a government entity to examine why they are choosing to privatize and make sure that it is the right choice on behalf of the taxpayers. It should not be used as an easy way out when times get difficult with the budget. Also, it is critical for the government to decide how they plan to use any income early in the privatization process so that it can be used in the best possible way to benefit the taxpayers.

Enrico C. Perotti’s article, “Credible Privatization,” touches on the different reasons that choosing privatization would be the best choice. His first point, which is important, is that often times the government entities are not as efficient as those in the private sector (Perotti). This is important to understand and take into account because it is the government’s responsibility to provide the service as best as possible to the
taxpayers and if a private company can do it more efficiently, then it should be considered a viable option. He also focuses on the underpriced sales to private companies. In many cases, it is possible for the government to retain some of the stake in the endeavor, but, often, they just contract the entire service out (Perotti). Is this doing the taxpayer a disservice by not saving as much money as possible or keeping as much of the potential earnings as possible? Also, it is important to research what the service is actually worth to make sure that any deal made is not undercutting the taxpayers. A governmental entity needs to thoroughly consider the costs, both real and opportunity, that are associated with a potential privatization agreement.

Public support is also important if a government entity wants a privatization agreement to be successful. This is the focus of an article, “Mapping Patterns of Support for Privatization in Mass Public: The Case of Michigan,” by Lyke Thompson and Richard C. Elling. Since the United States chooses its representatives based on the number of votes that an individual gets in an election, it is critical that an elected official listen to the voters to see what they think about a certain topic. Privatization is no different. Public opinion polls have shown that citizens think that the government does a better job providing the services than private sector businesses would (Thompson). This shows that people are happy to leave things under the control of the government, but is this because they are scared of what might happen under a private business? It is important for legislators to really understand what the constituents are saying. The research by Thompson and Elling also discusses the fact that the government is hesitant to privatize an area where they may lose some of their coercive powers. With their research in Michigan, the authors also found that the respondents from that state also
disliked the idea of privatizing services that could cost the government its coercive powers. Thus, it is not liked by the government or its constituents to privatize a service that could jeopardize the government’s coercive power. In basic public services such as street cleaning, janitorial services, and garbage collection, the respondents preferred that private businesses provide the service. Overall, they were less supportive of nonprofits delivering any of the services. Also, the respondents preferred that the government provide the services in the majority of cases. There are no clear indicators of what a privatization supporter would be like, but those that are most likely to support the privatization efforts would earn higher incomes, be white, and supporters of the Republican party. The authors suggest that this is because they may be more likely to benefit from any privatization efforts (Thompson). Knowing the type of support or lack of support that exists when a government looking to privatize is important to see if it is a viable option in the future and to know what will need to be done to educate the public about the privatization effort.

The article “Local Government Restructuring: Privatization and Its Alternatives” by Mildred Warner and Robert Hebdon examines why, when it has been proven that the private sector can provide a service at a lower cost than the government, more governmental entities are not utilizing privatization as a means to save taxpayers money. They argue that it is because the politicians ignore any savings and cave into political pressure. Their study showed that leadership within the government is an important factor in a governmental entity’s decision to privatize or not. Often, they are aware of the different levels of the economy and are more likely to privatize if they fully understand the risks and are willing to be a risk taker. They also found that efficiency between
public and private entities can be similar as long as that is the goal of each. The public entity is not always focused on efficiency, which can lead to people’s opinion that they are not efficient (Warner). If there are no true leaders within a community that are willing to do the right thing with or without pressure against them then the community may need to work with others in their community and unite to become a stronger advocate for themselves and let those in charge of making the important decisions know that they favor a certain option. This may be enough pressure on that elected official to force them to listen to the constituents and act in the manner that the constituents want them to.

Oftentimes, people are either anti-government or anti-private sector when asked about privatization and why they either support the idea or do not. Ronald C. Moe published an article in 1987 on behalf of the Congressional Research Service with a third option about privatization. He thinks that privatization does not necessarily have to be all public or all private. Rather, it can be a combination of the two that makes the service better for everyone involved and both sectors are linked. Another positive for privatization is that it forces the decision-makers to start discussing the role that they play in services (Moe). A government that has always provided a certain service to the public can now see if the private sector would provide a better level of service for the public. If there was no other sector that could provide the service, there would be no need for discussion.

Daniel M. Otto and Mark A. Edelman authors of “Innovation in Structural Change of Local Government” cover the types of government systems that are more likely to adopt an institutional innovation, which includes privatization. The theoretical
model that they conducted at a county level was able to typify the most likely adopters of institutional innovation. Those counties with higher population and a relatively lower property tax valuation were more likely to adopt these innovations. Those counties that are more sparsely populated and with a relatively larger property tax valuation would be less likely to adopt these innovations. Furthermore, those counties that house a university or college, a larger proportion of agricultural land in the property tax base, and those with higher total local revenues were more likely to adopt. The loss of autonomy and shared resources outweighed the political costs associated with innovation, which is more difficult for smaller communities and those with fewer tax dollars to lose (Otto). If it is going to be a difficult task to convince the constituents that privatization will be a viable option, the officials may want to approach the idea in a different way and not just announce that they are going to privatize a service. It is important to educate the constituents on the risks and rewards associated with the effort to show them the value of it. If the officials are willing to hold discussions with constituents they may be able to gain some insight that they would otherwise not have. It could make all the difference in the decision to privatize and if they choose to privatize, these decisions could yield better results in the long run.

Dennis Patrick Leyden and Albert N. Link’s work covers the types of governments that are most likely to undertake a privatization effort, but they do so from a risk aversion viewpoint. Their research focuses on the bureaucrat in charge of providing the service to the public while still reporting back to what they call a sponsor (Leyden). For example, if the bureaucrat is the governor of a state then the sponsor would most likely be the state legislature. In this case, the state legislature would not be able to
oversee everything and must rely on the governor to make the right decisions and can only base the performance on the feedback of customers. The governor would be required to provide this service while still facing political pressures, which Leyden and Link claim will reduce the governor’s ability to produce the service. Therefore, the governor must decide at what level it is no longer feasible to continue providing the service with the resources available to him or her. This is often a personal call because the legislature is busy with so many other things that they are not familiar enough with the service and its performance level to know what the right choice would be. If the governor decides for whatever reason that he or she does not want to continue providing the service with the resources at his or her disposal, then privatization is usually a strong consideration when there is a private company that can provide a comparable service. Once the decision is made, it is possible to tell if the governor is risk neutral or risk averse by the agreement that is agreed upon by both parties (Leyden). It is good to know what type of leader is in charge because they will be making decisions with taxpayer money at stake so putting political pressure on someone that the public feels is being too risky with their money may be the only way that they can get their point across and have a say in the decision making process.

If the governor is risk neutral there is a fixed fee with an agreed upon output guarantee. In other words, if the governor is risk neutral, he or she will most likely privatize if there is a firm willing to produce the product for the same amount that the governor could do with his or her own in-house resources. There will be a fixed-fee contract that is fully insured between the governor and the private firm. If the governor is risk averse then there will be a cost-plus agreement. That means that there will be
specific points in the agreement and payment will depend on the level of success that is reached by the private contractor. In other words, if the governor is risk averse, they would go after a contract that will only be partially insured with the decision on whether to privatize or not depending on whether privatizing will save money over doing it in-house based solely on the budget proposed by those in-house and the private firm. Having the decision based on the budget allows the private firm a chance to manipulate figures to show that they can provide a better deal when they really may not. This type of manipulation can possibly be reduced if there is a penalty and reward structure in place that will dissuade a company from partaking in such behavior (Leyden). An understanding of how taxpayer money is being spent is important because those in charge need to remember that it is not their money that they are paying with. They are responsible to other people for their actions. When it is not their money, they may possibly make decisions that are riskier than the taxpayers would like.

Another point made by Leyden and Link is about the difference in the decision-making time line that differs when privatization is not in place and when it is in place. When privatization is not in place, there are four steps in the process. It starts with the legislature providing a budget that expects a certain level of output. The next step is for the bureaucrat to choose the level of effort that he or she can put towards a particular service. Next, the political or production risk is realized. Finally, the output is produced. When privatization is in place, it starts with the legislature providing a budget. Next, the bureaucrat will choose a firm to partner with or to take over the service. The firm then begins to provide the service. Once that happens, the political or production risk is realized. Finally, the firm finishes production (Leyden). The major difference is that the
political or production risk is in a different place in the time line. When there is no privatization, it does not occur until after the bureaucrat decides the level of effort, but when the service is privatized it occurs after the production begins.

Alvaro Cuervo and Belén Villalonga’s article titled “Explaining the Variance in the Performance Effects of Privatization” discusses the way that privatization can affect the quality of service to the public. There have been many cases where the quality of service has decreased once a private company took over operations. Their work focused on a company looking to privatize, but the ideas can be applied to the public sector as a learning tool. They note that it is important for an organization to take proactive steps to ensure that the performance level is maintained or increased under a privatization agreement. Also, they discuss that there are different methods available, both inside and outside, to politicians and should investigate them all when looking to privatize. If, when a service is privatized, the same people remain in charge there are likely to be fewer changes and any increase in performance may be held back because they are unable or willing to implement changes (Cuervo). This article shows the importance of investigating options and looking at protecting the entity looking to be privatized so that any possible changes to make the relationship better are addressed before a contract is signed. The government owes it to their constituents to make sure that their needs are met in any partnership.

Deborah A. Auger’s articles “Privatization, Contracting, and the States: Lessons from State Government Experience” is beneficial because it looks at different places where privatization efforts have been undertaken at the state level. By examining these and learning from them, it is possible to prevent similar issues from occurring again. Her
article is the only one that breaks privatization into different types. These include contracting, voucher, public-private partnerships, franchise, grants and subsidies, asset sales, volunteerism, and private donation. Contracting out is the most common form of privatization taken on at the state government level (Auger). Her research found seven important lessons from state privatization efforts. Each lesson and a discussion of each lesson follows.

The first lesson is to “recognize that opportunities for privatization are wide ranging, but experiences varied and complex.” Eighty percent of privatization agreements are contracts with a private provider. This is because it is easiest to do and the government is able to maintain some control because of the flexible nature of the contractual obligations. The behind the scenes areas within an organization that are most likely to be privatized first because they are easier to control and monitor, it is less controversial, and it serves as practice for future privatization efforts. Future privatization efforts may expand to mission-related services. The types of mission-related services most likely to be privatized are in the health, mental health and social services, corrections, and transit fields. Since privatization efforts are done to reduce costs, the decision on whether to privatize or not often depends on the amount of money that will be saved. The true value of savings may be exaggerated by each side for political reasons. Researchers have found that it can save between twenty and forty percent, but that governance costs can cut into the savings. Research also suggests that service areas with a narrow scope are those that are most likely to be privatized because the ability to save money is the greatest. The decision makers must keep the risks in
mind when weighing whether to privatize or not and to not solely focus on potential savings (Auger).

The second lesson is to “create an organizational support system capable of providing sound information and advice.” Traditionally, any system meant to provide advice on privatization is done at the discretion of an individual agency with no requirements form a higher level requiring certain criteria be met. The agency would start with a risk-benefit analysis, look at where it would be best to start, and to look at the levels of privatization already existing within the organization. The staff would be the ones responsible for finding a way to standardize the approaches and deciding when it would be best to move forward with privatization efforts. Over time, as privatization efforts gained in popularity, legislatures or governors started to require that there be state commissions to advise agencies on privatization efforts. These commissions, which vary in size, could include a wide variety of people including the governor, important state legislators, representatives from non-profit or private organizations, labor unions, representative of state employee associations, and often an individual from academia that is knowledgeable in the field. There are arguments for and against having a commission in place. Those that argue for having the commission think that it can help bring to light the different barriers that the agency may have to overcome if they choose to privatize, it can increase the likelihood that something will happen, and, finally, it gives the managers a way to deflect blame if they are being singled out and accused of being too political. Those that are against the commissions think that they raise the political profile and stakes of the efforts, they can cause people to oppose the idea because of the increased political profile, and employees may oppose it (Auger).
The third lesson is to “emphasize strategies encouraging public-private competition for service delivery.” Though contracting out has been the most popular option utilized for some time, public-private competition is gaining in support and adoption. The public-private competition encourages state employees to compete with the private companies in order to get the chance to continue providing a service. The competition between the two is based on the cost effectiveness. The idea behind using this competition is that people are competitive by nature and this will bring out the best in the employees to save money and provide better service. The competition also adds value to public sector employees by giving them the chance to show what they have to add to the organization. Prior to an organization’s decision to start using the public-private competition, there is no discussion as to whether the service should even be provided at all by either sector. The first of the positives for this type of competition is that it keeps both sides aware of the goal of efficiencies. Also, it will prevent possible government collusion with private firms. Another is that it will help to prevent replacing public sector services with private monopolies. Finally, it can cause the public sector to continue to find new innovations and productivity changes no matter who ends up providing the service (Auger).

The fourth lesson is to “understand how to assess feasibility and conduct effective cost analyses.” Effective cost-accounting methods need to be used in order to ensure that the program is performing at the intended level because if not then the managers may become subject to allegations of personal biases in the decision to privatize or not. In the states that are more active in the privatization efforts, they have been creating frameworks to base decisions off of or feasibility assessment frameworks in conjunction
with more methodologically advanced cost accounting systems. Much of this work has come from state privatization commissions. One of the most difficult questions to answer when deciding to privatize or to continue providing the service in-house is if there will be actual savings because it is difficult to project all expected costs to be incurred accurately. These costs include both direct and indirect costs. Indirect costs are measured differently between states are the most varied. Money should not be the only deciding factor on privatization. Other factors include quality of service, continuity of care, and adverse impacts on other state programs or agencies (Auger).

The fifth lesson is to “anticipate and respond to public employee issues and concerns.” Since privatization often takes place to save money, it often results in job loss within the public sector, which can hurt employee morale. It is the responsibility of the employer to work as proactively as possible to make the transition as easy on the employees as possible. Sometimes employers will offer early retirement, severance packages, or outplacement assistance to those that will be affected by privatization efforts. With the popularity of privatization efforts, some state are requiring that employee mitigation plans or no layoff policies be put in place to protect the employees and to improve the morale. Planning ahead is important so that the employees affected can be limited or eliminated. Hiring freezes or delaying the implementation to allow natural attrition to reduce the number of employees affected has been successful in some cases. The critical step in the employee issue is to have open communication between management and employees (Auger).

The sixth lesson is to “commit priority attention to contract administration and monitoring systems.” Managers must realize that because they contract a service does
not mean that they are no longer responsible for ensuring the level of service that is being provided. The managers are the ones that have to report to the constituents. The manager’s oversight of the contracted service is, perhaps, the biggest hurdle to state privatization efforts. Managers are already so busy with their many responsibilities so it is difficult for them to find the time to oversee the private company and gain invaluable informal information, which could be beneficial in the long term. Having this information as soon as possible can help the manager foresee issues before they become too big to manage. Time is not the only obstacle that a manager must overcome to make a privatization effort better. They are often times working with performance standards that are not developed properly, that are weak, or are not thoroughly thought out. The focus needs to be on service outcomes or substantive effects from a particular program and not always on the work process. The staff needs to be trained on how to oversee the privatization effort in order to know what how to evaluate the relationship and to be able to foresee issues (Auger).

The seventh, and final, lesson is to “look beyond contracting to public-private partnerships, volunteerism, and other privatization approaches.” Two of the most common types of partnerships that are gaining support are public-private partnerships and volunteerism. It is important for the managers to continually look for different ways to provide the public services. Many governments continue to limit themselves to contracting out, but there could possibly be more beneficial options available (Auger).

Auger’s lessons are basic principles that all agencies looking to privatize should consider because it requires them to keep the taxpayers in mind and not to focus on
getting the plan in place fast. It needs to be a thought out process with open communication and letting people offer their opinions.

These articles that have been discussed cover many important topics pertaining to privatization. Some of the important themes include educating the public, thoroughly understanding the risks and benefits involved, making sure that the necessary leadership is there for a successful privatization effort to occur. If any of these things are lacking, it can make it difficult for a privatization effort to be successful. Privatizing a public service at the taxpayers’ expense needs to be done correctly and for the right reasons. If the government is looking to privatize because they need the money to fund something else then it may be time for the constituents to look at getting new legislators in place that can be more proactive.

Examining existing literature and applying major themes to a government entity looking to privatize is important. A lot can be learned and a lot of hardship can be prevented if there are precautions taken to make sure that those involved know what is at stake and what can be done to prevent a bad experience. The major concern should be that the taxpayers’ best interest is the focus to make sure that money will be saved and/or the level of service will be increased.

**Case Study**

The state of Indiana has attempted to privatize major services twice in the last decade. One is the leasing of the Indiana toll road and the other is the privatization and modernization of the state welfare system by IBM. Each has had a very different level of success. In the following portion of this paper, an overview of each attempt, or case
study, will be covered. Once this is complete, there will be a findings section where each of these case studies will be applied to the literature.

**Indiana Toll Road Lease**

The northern part of Indiana there is home to a 157 mile stretch of road that runs from the Ohio border to the Illinois border. This stretch of road is the primary connection to downtown Chicago and the Chicago Skyway. Travelers can connect to the southern part of the country by using this road to connect to Interstate 65 and Interstate 69. This stretch of road is commonly known as the Indiana Toll Road and it has been in operation since 1956. The Indiana Department of Transportation (INDOT) had been in charge of it since 1981 (Redondo). INDOT, funded by taxpayer dollars, was responsible for the maintenance and costs associated with it.

Once Mitch Daniels was elected as Governor in 2004, he wanted the Indiana Finance Authority (IFA) to look into the options of leasing the Indiana Toll Road to earn some much needed revenue to improve infrastructure around the state for his proposed Major Moves program. The Major Moves program is a ten-year transportation plan that will expand the state’s highway infrastructure. The goal, by 2015, is to have 104 new roadways with 1,600 lane miles. Prior to the Major Moves proposal and implementation, Indiana averaged about $750 million for construction. Of that, about one-third of the money was used for new construction with the remaining used to take care of existing construction (Indiana Toll Road Lease).

The IFA hired Wilbur Smith to prepare a revenue analysis and Goldman Sachs to provide financial advice. The IFA released a Request for Toll Road Concessionaire Proposals on September 28, 2005 and there were four bids that came in before the
October 26, 2005 deadline. The Indiana General Assembly passed a law on January 23, 2006 giving him authority to lease the Indiana Toll Road (Federal Highway Administration).

The company that won the lease was the ITR Concession Company LLC on behalf of Statewide Mobility Partners LLC (SMP). This is the first public-private partnership to occur at the hopes of saving taxpayers money and to earn the private company a profit. SMP gave the state of Indiana $3.8 billion upfront for the leasing of the toll road, which Indiana used $2.6 billion to fund the Major Moves initiative that it had been pushing for. The agreement was for a 75 year lease on the toll road (Indiana Toll Road Lease).

There is an operating standards manual that addresses the service level that is expected of SMP throughout the lease agreement. The major components are that SMP is responsible for all costs and expenses associated with the toll road. These costs can include “operation, maintenance, restoration, resurfacing, reconstruction, and tax liabilities.” (Coleman) This portion of the contract alone saves the state around $100 million each year in the maintenance and upkeep of the road (Wolf). Another important part of the agreement is that SMP has to buy at least ninety percent of their goods for maintenance and construction contracts from Indiana and hiring preference should be given to qualified Indiana workers (Coleman).

Once the agreement was approved, there was a court challenge to the legality of the lease, but the agreement was upheld by the Indiana Supreme Court and SMP will have control and responsibilities of the toll road until the year 2081. Up to this point, SMP has not made any money on the toll road. In fact, they have not even been close to
breaking even. For the entire length of the agreement up to this point, they have been losing a lot of money. In fact, in 2010 the company came up about $209 million short (Wolf). According to an article that cited a report in Debtwire, the company is losing money so fast that revenue is not even able to cover the interest on the loans that the company took out to pay Indiana the $3.8 billion dollars. This same article cites a member of the Indiana Toll Road Oversight Committee saying that there are more than adequate safeguards in place to protect the taxpayers and that no taxpayer dollars are at risk (Benman).

The Indiana Toll Road lease has been a success for Indiana because they were able to secure the money at the start of the lease and use it right away to make necessary infrastructure improvements. For the SMP group, time will tell whether the leasing is a success or not. Being a private company, their focus is to make money and up to this point they have not. Fortunately, the state took precautions to protect its taxpayers in the event that something went wrong with the lease agreement.

**IBM Takeover of the State Welfare System**

In 2006, Daniels again wanted to try to save the taxpayers some money by privatizing a public service. This time it was to modernize the welfare system in Indiana. The Family and Social Services Administration (FSSA) oversees the welfare system in Indiana and was responsible for choosing the company that got the modernization contract (Office of the Governor). IBM won the contract to privatize and modernize the welfare system in Indiana, with the contract beginning in 2007. The contract was for ten years and was for $1.1 billion over that time period for IBM (Senate Democratic Caucus Staff). According to a report by The Indiana Department of Administration Procurement
Division, the contract was supposed to save the state between $350 million and $500 million over the length of the contract. According to a report from the Office of the Governor, the contract was supposed to save Indiana $100 million each year of the contract. Also, according to the same report, it was supposed to add 1,000 new jobs within the state in the first four years with 850 of those in the first two years of the contract (The Indiana Department of Administration Procurement Division).

The project had a pilot area early on in north central Indiana, which was put in place to protect the FSSA clientele, which tend to be a fragile demographic. The project’s motto was “Do it right, not fast.” During the first nine weeks, over 143,000 individuals called the toll-free number to inquire about benefits. Over 2,858 individuals applied for benefits online. A new service was added that allowed clients to arrange personal appointments, many of these appointments were able to be held at a community organization that the FSSA had partnered with for this pilot program (Office of the Governor).

There were reports that customers were experiencing long response times, inaccurate information, lost documents, and dropped benefits. At one point in the transition to the modern system, FSSA voluntarily stopped the transition to counties that it had not been started in because the problems were so bad. There were 33 counties that the new system had not been implemented in (Senate Democratic Caucus Staff).

Three years after the contract was awarded, Daniels canceled the contract because the people that were supposed to be served were not being served any better than they previously had been. The canceling of the contract could cost the state between $100 million to $125 million (Legislative Services Agency).
Because this case is still being argued in court, it is difficult to find a lot of information about the specifics of the agreement and the case. Once the litigation is complete, it would be worthwhile to investigate the specifics of the case to see what could have been done differently to possibly create a better outcome. This could be a learning experience for Indiana in the future and other states as well.

Knowing that privatization does not work in every situation as it did with the Indiana Toll Road is important to serve as a reminder to proceed cautiously and to thoroughly examine all of the people bidding on a contract. Being clear on expectations is also a key because IBM did not meet the expectations of the state. Since Indiana was the first state to have a public-private partnership toll road, it serves as an example for other states that may be looking to privatize their system. Since the private company is not earning a profit, it will be interesting to see if there are any more partnerships forged in this sector and, if so, if the contract and money exchanged will be vastly different.

**Findings**

Now that the literature has been covered and the overview of the privatization efforts in Indiana have been discussed, it is time to apply the literature to the Indiana cases to see what was done in line with the literature and what could possibly have been done different in the beginning to improve the relationships between the companies and the state. The literature allows someone looking to privatize the opportunity to see what has worked in the past and what has failed in the past and to give that person something to base his or her actions and plans on. It would not be wise to try to pursue an avenue that has proved to fail in the past. It is wiser to take a look at what has worked in the past and
try to build upon that in whatever ways it is possible to carry those successes over to another organization.

One of the prevailing themes in the literature was that the private sector could provide services more efficiently than the government. Mackenzie, Perotti, Warner and Hebdon, and Cuervo and Villalonga’s articles all touched on this issue to some extent. The hope for Indiana when privatizing each of the services covered in this paper was to contract with a company that could save the taxpayers’ money and increase the level of service. In the modernization and privatization contract with IBM, it is not certain that any money will be saved since there are still ongoing litigation hearings and the final settlement is not known. Since Indiana has had to retake control of the welfare system and correct any issues, it is logical to think that it is costing them more money and resources than had they kept the work in-house from the beginning. In the case of the Indiana Toll Road, the state has been able to make vast improvements to the highway system. Without the funding from the lease, it is highly likely that this would have never happened. In this case, the greater good is for the state and not, necessarily, those that use the service the most.

Privatization efforts in Indiana may be able to occur because of the state’s political identity. In the article by Thompson and Elling, they say that the most likely supporter is white and Republic. Indiana falls into both of these categories in many cases and the legislature definitely represents that as the state Senate has been controlled by the Republican Party for over two decades. Their article also discusses the fact that privatization is less likely to happen if the coercive powers of the government are likely to be lessened. This is not the case in either of the privatization cases discussed. Rather,
the state took proactive steps in each of the contracts to retain control in the event something happened to prevent the winning bidder from completing its responsibilities within the agreement. This proactive thinking is necessary in order for a government entity to retain its powers with this type of agreement. Having the power over the winning bidder is able to help the government ensure that a certain level of service is provided to its customers and that the government will receive a certain level of service for the money that they pay the winning bidder.

Leyden and Link’s article relates to that of that of Thompson and Elling regarding political identity. Their work centers on political pressure. The political pressure will be less when there are more like minds. Indiana, when these two privatization efforts were completed and put into place, was controlled by a Republican governor and Senate. The House was not controlled by the Republicans, but the majority in the House was not a super majority. Therefore, it was a lot easier for the governor to get the agreements passed and in effect than if he had to face a lot of political pressure from the General Assembly. The article notes that the bureaucrat, in these cases the Governor, needs to make the decisions and the sponsor, in these cases the General Assembly, would need to rely on feedback from customers about the performance. The public that utilized the welfare system was very vocal about their issues they were facing as IBM started to take control of the system. This caused the governor and legislators to take note and see why these individuals were having issues.

Cuervo and Villalonga’s article also discusses the quality of service that is expected when a private company takes over the service. With the operating standards manual that was agreed to in the Indiana Toll Road lease, Indiana was able to secure a
certain quality of service for the consumers of the toll road. There is no proof that there was anything of the like in place with the modernization effort of the welfare system, which may be why it was unsuccessful. Their article also goes into detail about the personnel that is in place when the privatization effort starts and if there is significant enough of a turnover to allow new ideas to succeed. There are no statistics on this for either of the privatization efforts. It is very likely that there was little personnel change on the toll road except at the leadership levels and the FSSA probably kept the same leaders after the modernization effort. It would not make sense to fire all of the former employees and hire new ones to replace them when the work is not highly-skilled. Also, there were safeguards in place to protect employees. Was the FSSA unable or unwilling to work with IBM in the manner needed to make the transition successful? These are questions that will likely be answered in the court hearings that will be occurring with this case. It is worth taking a look at after all of the proceedings are done to see if existing FSSA staff was unwilling to work with the IBM people or if there was something else at fault for the failed effort. Taking steps to ensure the success is a vital step in safeguarding the taxpayers’ level of service.

Auger’s lesson number five covered the needs for employees’ issues and concerns to be heard and for the employer to be receptive. Indiana did a good job of this with the toll road as there were safeguards put in place to protect the jobs of those employees with the toll road. There is no information about this with the modernization effort with FSSA so it is difficult to tell if the employees’ concerns were acknowledged and taken into account before the agreement was put in place. If the employees that were there before the privatization became effective and are still employees after it is in effect and felt that
their concerns were not heard, they may not perform as well as they could because they harbor ill feelings or go into the arrangement with preconceived ideas that may not be true. If these are true or not true does not matter because the discussion was not had between management and employees about these concerns and the employees will feel devalued and may be unwilling to discuss issues, concerns, or new ideas with the new management because of their previous experience. For these reasons, and countless others, it is best that there be open communication between the managers and the employees to prevent misunderstandings.

Leadership was something brought up in the Warner and Hebdon article. They argue that it is important to have a leader that is willing to do the work necessary to educate everyone involved about the privatization efforts and to be able to get the necessary laws passed. Also, the leader needs to be able to stand strong in the face of political pressure. Governor Mitch Daniels was able to do that in both cases because he was a new governor with a respected background in finance. The state was also in a state financially where the revenue from the Indiana Toll Road lease was very much needed. This money that came from someone other than the taxpayers was thought to be a good idea, although it was controversial at the time. Still, Daniels continued moving forward with the plan and was successful in finding someone to bid on the lease. The state was able to get the money upfront and that enabled them to make many necessary infrastructure improvements that most likely would not have been able to get done otherwise. If Daniels had not stood his ground and believed that what he was doing was the right thing, it would have been easy to fall prey to pressures that wanted the state to continue to oversee the Indiana Toll Road costing taxpayers millions each year. Daniels
was the leader that Indiana needed to make a push forward and generate new revenue for the state.

Leyden and Link, in their article, point out the difference between a risk averse leader and a risk neutral leader. Governor Daniels would fall into the category of risk neutral because of the way that the contracts have played out. The toll road lease was based on an agreed upon fee at the outset of the contract. The FSSA modernization and privatization effort, it was also agreed upon that the state would pay IBM a set amount throughout the duration of the contract with certain criteria being met. Currently, IBM is suing the state for money that they are saying they are owed because they did not do anything that should have justified the state cancelling the contract early. The state is suing IBM for money that they were paid, but that they did not provide a service for. These cases could answer many of the questions that individuals have about this privatization effort. Furthermore, it may be possible that the effort to privatize FSSA would serve as a reason for the state to be more risk averse in the future in order to save themselves money and political stress if a future privatization effort were to end in a similar way.

In the modernization and privatization of the Indiana welfare system, the FSSA was given the task of deciding who would get the contract. Since the department was already understaffed and under fire prior to the privatization effort, it leads to questions about whether the department should have been the group in charge of finding a suitable private company. Should there have been a third party involved in a larger role? Should Governor Daniels have taken on the project to find a suitable company? What were the requirements that FSSA was looking for from the private company? These are all
questions that should be answered in order to learn as much from this failed effort as possible. These answers may never be fully given, but an attempt to get them should be done by someone in the future, but that is unlikely to happen until all legal proceedings regarding the attempt to privatize FSSA are complete.

Auger’s second lesson covered the organization support that should be in place in order to provide the needed advice on the decision to privatize or not. If there are too many individuals from the agency being considered for privatization providing information on the decision to privatize or not then there may not be enough people from the outside bringing in new ideas that could possibly provide a different opportunity that had not been thought of previously. The new perspectives brought in by the outsiders could be invaluable and allow the decision makers to have a reason to deflect blame if something does not work the way that it had been envisioned at the onset. One way to bring in outsiders would be to implement a commission that is responsible for the decision making and bringing in new ideas.

With the successful lease of the Indiana Toll Road lease, it seems, from the literature, that the state took a very proactive role in determining if privatization was the correct move for the state. Individuals were hired to study and evaluate the state of the country and their insight was very valuable in the final selection process. This was touched on in the Cuervo and Villalonga article as well as the Perotti article. Doing this research early on was an asset to the taxpayers because Indiana was able to know what a fair value was for the state and knew that the bid by SMP was above that. The literature does not state that this was the case for the modernization with IBM. There is little discussion about the activities leading up to the contract approval and the contract itself.
It is worth following up to see if there was a proactive role taken with the IBM contract just as there was with the Indiana Toll Road contract. If there was not, it could be a main reason why the modernization effort failed.

Moe’s research discussed public-private partnerships, which may have been something considered for the modernization of FSSA. One of the positives of this type of partnership is that it forces the decision makers to discuss the services in fuller detail instead of giving the daily decision-making powers to a private company. Keeping the government more involved could have been the difference between success and failure. Did the governor and his staff take too much of a step away to help with the transition or was IBM able to make the sales pitch that they knew what they were doing and were competent to take over the welfare operations? Either way, the blame, at least mostly, falls on the governor for not finding the best service provider for the citizens of Indiana even if that meant keeping the service in-house and not privatizing at all. All citizens, not just those on welfare, have been affected because of the taxpayer money that is being spent in litigation to see who owes who money. If the goals of privatizing the welfare system were to improve service and save money, the governor’s administration failed the citizens of Indiana.

Auger’s research that resulted in the seven lessons for states to follow has also pointed out that governments need to look at other ways to privatize other than just contracting a service out. Her first lesson was the focus of this topic, perhaps because she found it to be of the utmost importance or the one that most governments look over when debating whether to privatize or not. The toll road lease is not the typical contracting out of services so in that instance the state of Indiana was able to look beyond the normal to
find a good fit. The privatization of FSSA was simply a contract awarded to IBM to provide the services that the state had previously been providing. Could there have been a better option? That is most likely the case since the contract did not work out and had to be cancelled early.

Auger and Moe both discuss in their research about a possible alternative that could have been used for the privatization and modernization of FSSA. A public-private partnership, or competition, could be the answer. A public-private partnership, covered by Moe, would allow the government sector to still be involved as the private company began to integrate changes. This would allow knowledge that each side possessed to be shared with the other and to possibly prevent some major mistakes from happening by getting input from the other side. The public-private competition discussed by Auger in her third lesson would serve to force each side to work against each other to get the opportunity to provide the service. This causes the government employees to come up with better ways of doing things and thinking up new ideas in order to win this opportunity because, as they know, there are usually employee reductions taken in the government sector when a service is privatized. They would be working for their jobs and livelihood. Those are very motivating factors for an individual. The private business would be working to show that they can perform the task more efficiently so that they can win the contract and bring more money to the organization. This will allow them to bring more money to the business to invest, raise wages, hire new employees, or a multitude of things. The motivation that the individuals, from either sector, would feel would cause them to work harder to show that they could perform a particular service better than the other group that they are competing against. Either one of these options, a public-private
partnership or a public-private competition, would, perhaps, have been a better fit for the needs of the FSSA and their vision for where they wanted to take their program in the future.

Auger’s seventh lesson suggests that managers and agencies look beyond the normal contracting out to private businesses and look at partnerships, volunteerism, and other approaches that have been successful in other locations. The modernization of the welfare system was a typical contracting out that did not utilize any other form of privatization to any extent. The lease of the toll road is not a typical contract since it is a lease. The state received a large sum of money upfront and the private company agreed to run the toll road for over seventy years. The state still maintains ownership of the toll road so it is a type of partnership, but the partnerships that Auger is suggesting would be more of the government and private sectors working together to run the toll road. This type of partnership would be difficult because of the actors involved. It would take quite a bit of work on the part of all actors to make sure that everyone knew what their role was and to not extend beyond those. This lesson goes against the research of Thompson and Elling where their public opinion polls showed that people favored the government providing the service and not a private company or a nonprofit.

The reason that the Indiana Toll Road was leased and why the Indiana welfare system was privatized seem to be different. The toll road was privatized as a way to bring in new revenue for a new program that was very much needed. The Indiana highway system had not seen significant improvements in decades and the funding to do the improvements was not there. The state was also paying a great deal of money on the upkeep of the toll road. Privatizing it gave them a lump sum of money that they could
use to immediately improve the highway system and save money by no longer having to pay for the upkeep of the toll road. The welfare system on the other hand, seems to have been done to move the costs associated with the welfare system to a private company, who could do it more efficiently than the state could itself. Both of these issues were covered in Mackenzie’s article. He wrote that it was acceptable to use the revenue received up front to fund a new program like the Major Moves program. On the other hand, he does not approve of the use of privatization efforts to fill a hole in the budget. This seems the case with the privatization effort of the welfare system. This could be one reason why the effort failed. If it was done for the wrong reason, it could have been destined to fail from the beginning. Another question to ask is whether the privatization effort of the welfare system was hoping that the success of the Indiana Toll Road lease was the norm and, therefore, did not do its due diligence to ensure that it was researched correctly and that the necessary information was gathered from the outset. Hopefully, this type of insider knowledge will surface at some point in the future to allow future scholars the chance to see if this was the case. If not, what could have been done differently in this case to provide a better outcome? At some point in the future, the answers may be found.

It is understandable that privatization is gaining in popularity as a way to save money because, when done properly, it can save the taxpayers’ money and/or improve the level of service that they receive. Auger’s fourth lesson focuses on making sure that the manager and agency are aware of the costs that actually go into providing a service. Sometimes these costs are not fully understood or the company’s bidding to win the contract underestimate what they will need in return when providing the service. Either
way, it is important for the manager to learn and understand as much as he or she can about the service so that they know what a reasonable bid and expectation should be. In the case of the FSSA privatization, it seems that no one really understood the costs and the level of service needed to properly provide the service to the public. If the managers had understood, they would have realized that IBM was not fully aware and could have inquired on the discrepancy to see how they planned to do it differently. Auger also notes that money should not be the only deciding factor. There should also be discussions of quality of service, continuity of care, and adverse impacts on other state programs and agencies. It seems that Indiana did a very good job with the toll road lease in regards to these issues. They also did a good job with the IBM takeover because they were guaranteed that a certain level of service would be maintained and when that did not happen, they were able to retain the responsibilities and serve the consumers as they thought best.

This relates to the sixth lesson that she discusses as well. She writes that managers need to commit the time and energy to make sure that the privatization efforts are being monitored for performance and efficiency. Indiana must have been doing this with the FSSA privatization because they canceled the contract and took the welfare system over once again. If the managers had not taken the time to monitor IBM’s actions and listened to the feedback of citizens, there may not have been any changes made and the individuals trying to get assistance would still be working at getting it. The toll road lease seems to be going over well and there have been no reasons for the state to step in and take over the responsibilities associated with the maintenance and operation of it. Therefore, overall, it seems that Indiana is diligent in overseeing the private contractors
to ensure that they are doing their jobs at the expected level. This is good for the customers of the services and the taxpayers.

Each of the articles in the literature review is pertinent to both cases from Indiana discussed in this paper. Understanding how they are able to be applied and how they are different from what has worked in the past can be the difference between a success and a failure. The Indiana Toll Road has aligned with the literature more than the privatization and modernization of the Indiana welfare system did. Perhaps that is why the lease of the toll road has been more successful than the privatization of the welfare system. There are major differences between the literature and the actual cases, but that is to be expected as no privatization effort can be “by-the-book.” However, it is important to try and extract aspects of successful and proven efforts and apply them to future privatization efforts so that there is a greater chance of success. These two cases exemplify how it can look so easy to be successful, but that the next case may not be so positive. It is important to understand the risks associated with privatization efforts and to be willing to do the planning early on in order to do as much as possible to ensure the success of the endeavor.

**Summary**

Privatization is sometimes an easy way to make the best use of taxpayer dollars, but any government entity looking to privatize a service needs to examine the type of community, the risks and benefits, and the expectations very closely to see if it is the right fit for his or her constituents. Even though it may seem easier to privatize now, it is important to make sure that it is the right thing because as the privatization and
modernization of the Indiana welfare system showed, it can end up costing the taxpayers and those that use the service a lot more in the long run.

Indiana had the political climate and leadership needed to make a successful privatization effort happen. If there are too many things going against the effort, then it will likely not be successful. It is an important factor in deciding whether to look at privatization as a viable option. If it is going to be an uphill battle the entire time, it is important to see if the efforts could be placed elsewhere.

By looking at what has worked in the past and what has not, it can help a government entity weigh the options and decide what is best. Having a clear understanding of where the privatization efforts should take the entity is important so that clear expectations can be laid out in the contract early on. Both sides need to agree to the terms of the contract and fully understand what it will take to meet those expectations before taking control of the service.

Privatization, when all of the factors at play are able to fall into place, is a chance to save the taxpayers some money and increase their level of service. If done incorrectly, it can cause the taxpayers to pay even more money and receive a level of service that was worse than before. Education is important for all actors involved in the process to make sure that everything will work in the long term and allow the privatization effort to flourish and benefit everyone.
References


