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A REPORT TO THE GOVERNOR ON

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PRIVATIZATION
& COMPETITIVE
CONTRACTING

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**A Blueprint for Saving
Taxpayers Money
Without Sacrificing Services**

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New Jersey Advisory Commission on Privatization

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Table of Contents

I. Introduction	2
II. Background	4
III. Implementing a Competitive Contracting Program	7
IV. Summary of Savings	10
V. Recommendations	
A. <i>Authorities</i>	11-16
Newark Airport	11
Garden State Arts Center	13
Private Management of Toll Roads	15
B. <i>Corrections</i>	17-22
Inmate Health Care	17
Prison Food Service	18
Inmate Commissary	19
Prison Operations	21
C. <i>Government Benefits</i>	23-28
Prescription Drugs	23
Medical Savings Accounts	25
Flexible Benefits	27
D. <i>Government Operations</i>	29-42
JUA/MTF Claims Settlement	29
Motor Vehicle Services	31
Technology	33
Revenue Collection	35
Wastewater Treatment Plants	37
Capital Transportation Projects	39
Veterans Memorial Home	41
VI. Areas Under Study	
A. Sports Authority	43
B. Passaic Valley Sewerage Commission	44
C. Miscellaneous Competitive Contracting Proposals	45

Introduction

In order to reduce the tax burden on taxpayers in New Jersey, Governor Christine Todd Whitman has promised to make government leaner and smarter. The Governor's objective is to deliver to the taxpayers necessary services at the least cost.

The use of competitive contracting and privatization* can help Governor Whitman achieve this goal.

Across the country and around the world, people are turning toward competitive contracting and privatization to achieve significant savings to the taxpayers while improving the quality of services.

To investigate the ways in which New Jersey can take advantage of savings in the marketplace, the Governor formed the New Jersey Advisory Commission on Privatization by Executive Order on June 19, 1994 (appendix 1).

The Commission Chairman is Lewis M. Eisenberg, Co-Chairman, Granite Capital International Group. Commission members are Philip Beachem, Executive Vice President of the New Jersey Alliance for Action; Jane Kenny, Governor's Chief of Policy and Planning; Thomas G. Labrecque, Chairman and CEO of Chase Manhattan Bank; and Arthur J. Maurice, Vice President of the New Jersey Business and Industry Association. It was assisted by John P. Mitchell, Vice President, and Michael Esposito, Executive Vice President, both of Chase Manhattan Bank; Linda Morrison, consultant for competitive contracting; Christine Steinberg, Assistant Attorney General; Larry Weitzner, consultant; and Mark Magyar, Special Assistant to the Governor.

The Governor, in her Executive Order, asked the Commission to perform the following functions:

- Conduct a review of existing feasibility studies and actual experiences of governments that have initiated privatization efforts;
- Evaluate the advantages and disadvantages associated with privatization generally;
- Conduct a feasibility study of New Jersey state government, including a cost-benefit and implementation analysis, to identify those areas where privatization would result in cost savings and quality improvements; and
- Propose appropriate and beneficial methods of implementing privatization in this state.

The Governor further asked the Commission to suggest methods for competitive contracting that would give state employees the opportunity to compete against the private sector.

This report is the result of five months of intensive review of state operations and the input of hundreds of people from the public and private sector. A public hearing was conducted on December 8 to solicit testimony from interested parties (appendix 2).

This report provides New Jersey with a blueprint for a successful competitive contracting program. The Commission believes that implementation of these recommendations will produce lower costs to the taxpayers, better services to the public and more jobs.

The emphasis of our study was to find practical opportunities for the state to save money and maintain the quality of services through competitive contracting. The Commission believes that the state can save in excess of \$200 million by following these recommendations.

The Commission recommends that it continue to investigate areas of state government it was unable to review during 1994, and that it serve as a catalyst toward seeing its recommendations carried through to implementation in 1995. The Commission is also available to study and report on how local governments and authorities can take advantage of the savings that can be realized through competitive contracting.

In the upcoming year, the Commission plans to hold round-table discussions focused on its recommendations.

The Commission worked closely with Treasury and OMB on these and other recommendations. As a result, some recommendations are already being implemented and may be included in the upcoming budget.

* Privatization can involve the sale of an asset by a governmental entity, the contracting out of services that had previously been provided by the government, or the deregulation of an area that had formerly been government's responsibility. For the purpose of this report, "privatization" will refer generally to the transfer to the private sector of services or assets. "Competitive contracting" will refer to the process of subjecting the provision of certain services to competition by comparing the true cost of government providing those services to the private sector.

Background

For the past two decades, state government spending in New Jersey has doubled every eight years. Local property taxes have risen at almost the same rate, giving New Jersey one of the highest tax burdens in the nation. That tax burden discourages new businesses from choosing New Jersey, drives away existing businesses, and takes too many dollars out of the pockets of our citizens.

The Commission believes that competition for the provision of government services will enable state and local governments to both cut costs and maintain or increase the quality or level of those services. This has been the experience of states and local governments across the country.

During its investigation, the Commission researched the concept of privatization and examined the experience of others who used privatization. The Commission met with experts in the field, mayors, legislators, government employees, and members of Governor Christie Whitman's cabinet. The Commission reviewed books, articles, pamphlets and other materials from many researchers, other commissions, academics, consultants, local governments, state governments, and the privatization experience of other countries. Privatization or competitive contracting is routinely used by thousands of governmental units.

Governments that have subjected services to competitive contracting have seen impressive results. In an 18-month period, Philadelphia subjected 21 services to competition, achieving annual savings of \$30 million. Some of the services Philadelphia privatized included custodial services in City Hall, saving \$344,000 a year; security guard services in the Philadelphia Art Museum, saving \$1.4 million; and turf maintenance in the parks, which reduced costs over 70%.

Shortly after the city government began the privatization process for the Philadelphia Water Department's sludge processing plant, department managers and employees produced a plan to drop costs by one-third. The operation was kept in-house.

Saving money is not the only reason to privatize. Privatizing the operation of the underutilized Philadelphia Nursing Home resulted in an increase in nursing home residents served, from 295 to 500; a \$4 million drop in costs; and the elevation of quality of care to meet industry standards. Privatizing the city's purchase and distribution of supplies guaranteed that office supplies would be delivered in 48 hours instead of six weeks and saved over \$1 million annually.

Philadelphia was able to implement its competitive contracting program by attrition—and no one was left unemployed. Displaced city workers were given first hiring preference by contractors and a re-deployment unit was set up in the city's personnel department to transfer workers to open positions in other functions.

Since 1991, Indianapolis has saved \$28 million a year from operations that have been privatized or where competition has prompted public employees to find alternative cost savings.

The city of Indianapolis recently signed the largest privatization contract for the operation of a wastewater treatment plant in the United States. Private management of the plant will save \$12 million in 1994. In addition, the city bid out ten trash collection districts. Four private companies won seven districts, while the Department of Public Works won three districts. Taxpayers won a three-year savings of \$15 million.

Indianapolis worked hard to implement its competitive contracting program without leaving individual workers jobless. They eliminated positions through attrition, reassigned workers and encouraged the private firms to hire government employees.

Mayor Richard Daley of Chicago has privatized 35 services in four years, including sewer maintenance, health care at city-run clinics, drug and alcohol treatment, and window washing. In every case, costs have dropped and quality has been maintained.

Most privatization to date has been accomplished at the local level. However, there is growing interest in the concept of privatization by state governments. According to the Council of State Governments' privatization survey of 1993, states are increasing their privatization activity in correctional support services, transportation services, social services, health care, and administrative and general services. More than 85% of state auditors, budget directors, and comptrollers responding to the survey predicted increased privatization in the next five years.

In recommending ways to deal with state problems, the National Governors' Association's *Action Agenda to Redesign State Government* observed that, "Privatization enhances government's ability to respond to these challenges by offering an innovative alternative to traditional methods of organizing, financing and delivering public service."

In Michigan, the state's liquor distribution system was privatized. Three warehouses and 66 state-owned liquor stores were closed, saving \$15 million per year.

In Massachusetts, the state has privatized highway road repair, ice skating rinks, a state mental health hospital, and prison food and health services.

The Texas legislature created a permanent Council on Competitive Government and directed it to review state services to determine whether competition would improve productivity. A new Texas law allows private firms to make unsolicited proposals to provide state services. Government agencies are then required to conduct an analysis and seriously consider the alternative presented.

National governments have also been successfully privatizing. Since 1980, Great Britain has been a leader in all forms of privatization, most notably its airports. British privatization efforts have transferred numerous state-owned companies back to the private sector, transferred ownership of public housing units to their tenants, and contracted out many municipal services. In 1988, the Compulsory Competitive Tendering Act was passed, requiring local governments to put services out to bid on a regular basis. Overall, 64% of British local government units saw some decrease in costs due to contracting out: 16% realized savings of over 20%, and 24% realized savings of 10-20%. This strategy has produced a number of useful indirect benefits, including better cost information and better management practices.

The city of London has the world's largest system of competitively-contracted bus service, with more buses under contract than are operated by all U.S. transit agencies except New York. Almost 50% of London Transport bus service is competitively contracted. Many contracts have been won by government managers and employees. As a result, both contracted-out and in-house bus costs per mile have declined more than 25% and service quality has improved.

Closer to home, in Mercer County, County Executive Bob Prunetti saved \$6 million by privatizing custodial services and maintenance for county buildings, food service at the jail, and the county engineering department. Public employees were offered jobs with the private firms or other government agencies. Bergen County Sheriff Jack Terhune saved \$1.8 million by contracting out food and medical service at the jail.

The township of North Brunswick has saved \$1.6 million since 1985, as a result of contracting out its water treatment operation. The borough of Caldwell saved taxpayers 33% on operating costs for their wastewater treatment plant through competitive contracting. Newark contracted out the operation and maintenance of its water treatment facility and cut annual costs by \$1 million.

The evidence is overwhelming that injecting competition in the provision of government services produces typical savings of 15-25%, while maintaining or increasing service quality.

Implementing a Competitive Contracting Program

AVOIDING THE PITFALLS

While the Commission reviewed many successful examples of privatization at all levels of government, some efforts did not deliver as promised. Although the Commission believes that these unsuccessful examples are the exception rather than the rule, they do provide some important lessons for any government agency considering privatization.

Public employee unions brought to the attention of the Commission instances where competitive contracting efforts were plagued by unqualified contractors, contracts that were ultimately more costly than if the service had remained in-house, poor contractor performance, and cutbacks in service. The unions emphasized that they should be included in efforts to improve service and save money, and they expressed their concerns about the potential negative impact of privatization on individual union members.

These are all serious concerns. Competitive contracting only makes sense if it can save the taxpayer money without diminishing the level of service.

The Commission concluded that, in most instances where privatization had not succeeded, the failure was directly attributable to a complicated process, inadequate planning, and a lack of quality control on the part of top management. Most of the mistakes were found in the following areas:

- The lack of good cost information on which to base decisions.
- Poor procurement procedure—especially regarding performance standards, contractor qualifications and contract monitoring.
- Assuming that privatization is always better and not giving in-house managers and employees an opportunity to improve their operation and keep the work.
- Poor implementation plans, especially regarding the impact of contracting out on existing employees.

However, the Commission believes that intelligent management of a competitive contracting program will ensure that these errors are avoided.

To avoid the possibility that one private contractor could hold unreasonable control over the provision of a service, competitive contracting should be attempted only where a sufficient pool of qualified bidders exists.

Quantifiable and measurable performance standards should be established and the contractor's performance should be carefully monitored.

Public employees currently providing a service should be given the opportunity to compete with private bidders. If a contract is awarded to an outside provider, any employment changes due to competitive contracting should be implemented in a manner that mitigates any negative impact on employees.

As the state moves forward on particular initiatives recommended in this report, special attention should be given to the following:

1. Cost Accounting

During its investigation, the Commission heard concerns about accurate and complete cost accounting. New Jersey State Senators Richard LaRossa and Peter Inverso were persuasive advocates for reliable and complete cost analysis in any competitive contracting program. They stressed, and the Commission agrees, that the state must have a good idea of its internal costs before awarding any contracts to private providers.

Cost analysis is a methodology used to determine the cost of providing goods or services. Total cost is defined as all direct and indirect (overhead) costs attributable to the service being analyzed. The major categories of direct costs are salaries, wages and overtime, fringe benefits, supplies and materials, equipment, purchased services, maintenance and repair, rent, utilities, insurance, and equipment and service monitoring costs.

2. Intelligent and Competitive Purchasing Process

In order to receive good service at a good price, the state must do a good job putting the service out for competition. The state must have a clear idea of the desired end-results, establish quantifiable and measurable performance standards, develop a contract monitoring plan, and consider only qualified contractors with good references. The state must make sure the contract's structure makes sense—especially concerning the size of the contract, how it is priced, and the length of the contract. Evaluation criteria should stress quality as well as price.

3. Allowing the In-House Operation to Compete

The Commission's investigation of efforts in other jurisdictions revealed that subjecting a service to competition provides a real incentive for the existing operation to make itself more efficient.

Departmental managers, employee union representatives, departmental fiscal officers, budget analysts, and others should work closely to formulate a plan that responds to the expected competition.

This may be the best time to employ Total Quality Management and Work Process Improvement procedures to respond to competition. We suggest these strategies be reviewed simultaneously with the bidding process.

4. Implementation by Attrition

The most successful programs were implemented with the goal of minimizing the impact on affected employees. As much as possible, the state should implement job changes caused by competitive contracting through attrition. The state should offer workers displaced by competitive contracting "first hiring preference" for open positions in other areas of government and provide training, if necessary. In addition, every effort should be made to ensure that contractors give "first hiring preference" to existing state employees. For those for whom jobs cannot be found, the state should develop a severance pay system and an outplacement support program to help displaced workers make the transition to other work.

5. Legislative and Legal Issues

A close evaluation of all the legal issues relevant to any privatization or competitive contracting initiative discussed in this report will be necessary as specific proposals are developed. In some instances, legislation may be needed to facilitate the implementation of a particular program or initiative. In cases where an asset or improvement was acquired or constructed with the proceeds of a tax-exempt financing, the potential impact of any proposed initiative on the holders of any outstanding bonds should be considered. In such cases, restrictions imposed by current federal tax laws and subsequent rulings must be considered to preserve the tax-exempt status. In addition, the requirements of existing contracts and federal laws and regulations must be evaluated.

Summary of Savings

Initiative	Estimated Annual Savings
1. Newark Airport	To be determined
2. Garden State Arts Center	To be determined
3. Toll Road Operations	To be determined
4. Inmate Health Care	\$16.1 million
5. Prison Food Service	\$14.4 million
6. Inmate Commissary	\$500,000
7. Prison Operations	\$7-14 million
8. Prescription Drugs	\$40 million
9. Medical Savings Account	\$25 million
10. Flexible Benefit Program	\$15-37 million
11. JUA/MTF Claims Settlement	\$50 million
12. Motor Vehicle Services	\$3-6 million
13. Technology	\$70 million
14. Revenue Collection	To be determined
15. Wastewater Treatment Plants	\$1 million
16. Capital Transportation Projects	To be determined
17. Veterans Memorial Home	\$3 million
18. Sports Authority	To be determined
19. Passaic Valley Sewerage Commission	To be determined
20. Miscellaneous Competitive Contracting Proposals	\$30 million

RECOMMENDATIONS

Newark Airport

BACKGROUND

Newark Airport is operated by the Port Authority of New York and New Jersey (PA) under a long-term lease with the city of Newark. The land in Elizabeth is owned by the PA. A majority of the terminals and parking are on land owned by Newark and leased to the PA.

25.8 million passengers used Newark Airport in 1993, up 6% over the previous year. It is one of the most trafficked airports in the country (JFK had 26.8 million passengers in 1993, down 3%).

Newark Airport generated a profit of \$52 million to the Port Authority in 1993.

Federal law restricts airport profits from being used for anything other than the airport. The Port Authority is exempt from this law and uses profits to subsidize money-losing operations such as PATH.

Many of the functions in the airports are operated by private contractors under contract with either the PA or individual airlines.

Airports operated by private firms include Burbank, Atlantic City, Stewart and Teterboro. No major U.S. airport is currently owned or operated by a private company.

CURRENT SITUATION

Private airport operators believe that they can operate the airport more efficiently and at a lower cost than the Port Authority. One private operator estimated a savings of at least 20% is possible.

Private operators at other airports have had great success in improving revenues by expanding retail operations.

The Reason Foundation and other research groups have argued that the private sector can improve the quality of airport operations—manage flight times better, attract new investments to the airports and improve the quality of service.

The British have had great success in privatizing their ten airports. Indianapolis issued an RFP to private firms to operate their airport for a term of up to ten years under a lease or management contract basis (Indianapolis serves 3 million passengers a year and would be the largest U.S. airport privately operated). Pittsburgh has improved its operations through private management and generated additional revenue by aggressive marketing of their retail operations.

Opponents of privatization argue that the Port Authority has successfully operated Newark Airport for many years. It is a growing and highly profitable enterprise. If it's not

broke—why fix it? They also argue that a private firm may not have the region's long-term interest at heart and may not be willing to make necessary capital investments.

Los Angeles and Albany both failed in efforts to sell their airports to the private sector, due, partly, to opposition from the FAA, airlines and unions.

CONCLUSIONS AND RECOMMENDATIONS

Given the short-term obstacles, selling the airport is an option that should not be pursued at this time.

The Commission recommends that the Port Authority finance a three-to-six month study of opportunities for improving airport operations through either a lease or management contract with a private airport operator. The study might be a coordinated effort among the PA, the Governor's office and the Commission.

Subject to the above study, if significant savings can be realized and we are assured of quality management, operation of Newark Airport should be subjected to competition.

The Port Authority should be allowed and encouraged to compete for this contract. If the PA wants to bid, a procedure would be needed to allow for a fair evaluation of their proposal as compared to the private proposals.

Under a management agreement, the PA might retain responsibility for bonding and for capital and long-term planning. The private firm could be charged with the responsibility of management of the airport and the related construction program.

A management contract would require the approval of the Board of the Port Authority and Governors Whitman and Pataki.

Garden State Arts Center

BACKGROUND

The Garden State Arts Center is operated by the New Jersey Highway Authority. When opened 27 years ago, this was a state-of-the-art amphitheater and very successful in attracting talent. However, in order to remain competitive in today's environment it will need to increase its current capacity of 10,802 (5,300 of which are under cover) by 10,000 to 20,000 additional seats.

The limited seating capacity has made attracting talent more difficult, led to higher ticket prices, and resulted in flat revenues and minimal profits for the past three years. This problem will only get worse as the facility obsolescence increases over time.

The trend in the amphitheater business is toward partnerships where government provides the land and infrastructure, and the private sector manages the amphitheater and takes the business risks.

Below are some examples:

Facility	Location	Operated by
Blossom	Ohio	M.C.A.
Nassau Veteran Coliseum	Long Island	Spectator Mgmt. Group (SMG)
Louisiana Superdome	Louisiana	SMG
Jones Beach Theater	Long Island	Delsner/Slater
Hartford	Connecticut	Nederlander Group
Camden	New Jersey	Sony/Pace

CURRENT SITUATION

The New Jersey Highway Authority has recently completed a Request For Proposals (RFP) designed to competitively contract/privatize their facility. The Authority left open the RFP options of sale versus long-term lease and whether or not alcohol will be sold.

The Highway Authority hopes to receive an annual fee from a successful bidder plus an additional override based on "real" profits.

CONCLUSIONS AND RECOMMENDATIONS

The Garden State Arts Center is an ideal opportunity for competitive contracting/privatization. The Arts Center is in need of a significant capital infusion to compete and continue to offer quality entertainment at reasonable cost to the residents of New Jersey. Successful competitive contracting/privatization of the facility to a private sector entrepreneur will provide private capital and could create a significant revenue source for the Authority.

Private investment is likely to benefit everyone—the taxpayers, the Arts Center customer, the state government, and the entrepreneur.

The Commission commends the Highway Authority for moving forward with the evaluation of privatization options for the Arts Center and for making the RFP as flexible as possible to ensure the maximum level of private sector interest in the project.

TIMELINE FOR IMPLEMENTATION

Earliest implementation 1996.

ESTIMATED SAVINGS

Undetermined at this time.

Toll Road Operation and Maintenance

BACKGROUND

New Jersey has three toll roads operating under state-created authorities. The South Jersey Transportation Authority operates the Atlantic City Expressway. The Turnpike Authority operates the New Jersey Turnpike. The New Jersey Highway Authority operates the Garden State Parkway.

The 1994 revenues of the South Jersey Transportation Authority were approximately \$30 million, expenses were about \$25 million, debt service was approximately \$5 million. A payment of \$2.5 million was paid to the state for the Transportation Trust Fund.

For 1994, the New Jersey Turnpike Authority's revenues were approximately \$345 million, operating expenses were about \$177 million, debt service was \$155 million and \$12 million was paid to the state for the Transportation Trust Fund.

The New Jersey Highway Authority operates the Garden State Parkway and the Garden State Arts Center. Annual revenues for the Parkway were approximately \$185 million, annual expenses were approximately \$123 million. Annual revenues for the Arts Center were \$13 million and expenses were \$11 million. Interest income was \$7 million, debt service was \$51 million, and \$10 million was paid to the state for the Transportation Trust Fund.

Because of stagnating revenues, rising operating costs and increasing debt payments, the toll roads are coming under increasing pressure to raise tolls.

CONCLUSIONS AND RECOMMENDATIONS

The Commission believes that private operation of the toll roads could reduce costs and increase revenues while maintaining or improving service. The savings from private operation might reduce the need for future toll hikes. Electronic toll collection and other new technologies that would improve customer service may be introduced sooner and at less cost by private contractors.

New roads in California and Virginia are being constructed, operated and maintained by the private sector. In Florida, the Orlando County Expressway Authority is contracting with Parsons Brinkerhoff to operate and maintain the expressway and beltway in Orlando.

The toll roads should explore private sector alternatives by soliciting privatization proposals from qualified, financially-strong private operators.

The scope of services for a private operator needs to be determined, but the Authority could retain title to the real estate and approval over toll and pricing policies.

Alternatively, the Authorities could consider contracting out further operations, such as toll collection and road maintenance.

An RFP, which contains performance standards and contract monitoring procedures, should be issued to qualified operators. The in-house managers and employees can be encouraged to submit a plan to be competitive with anticipated private contractor proposals. The Authority should award the contract to qualified private contractors if the Authority receives a proposal that would reduce costs without reducing the quality of service.

TIMELINE FOR IMPLEMENTATION

1-2 years.

ESTIMATED SAVINGS

If the Authorities were able to reduce costs by 10-15% and increase revenues 5-7%, substantial savings would be achieved.

Inmate Health Care

Department of Corrections

CURRENT SITUATION

The Department of Corrections operates 14 prison facilities dispersed throughout the state. A preliminary cost analysis shows that health care for 20,000 inmates housed in state facilities is approximately \$70 million. Inmates who need hospitalization are transported at considerable expense to a unit in St. Francis Hospital in Trenton. The annual per-inmate cost of the present in-house system is approximately \$3,500.

In the last ten years, a corrections health care industry has developed. There are a number of experienced, reputable and financially-sound competitors who would respond to an RFP. Corrections systems which have contracted out health care report significant cost savings and/or increases in service quality.

CONCLUSIONS AND RECOMMENDATIONS

The Commission believes that subjecting the provision of prisoner health care to competitive contracting would substantially reduce the cost to taxpayers of providing this service without sacrificing the quality of the service.

Massachusetts and the city of Philadelphia are among the many prison systems that have contracted out prison health care.

An RFP, which contains performance standards and contract monitoring procedures, should be issued to qualified operators. The in-house managers and employees can be encouraged to submit a plan to be competitive with anticipated private contractor proposals. The Department should award the contract to qualified private contractors if the Department receives a proposal that would reduce costs without reducing the quality of service.

TIMELINE FOR IMPLEMENTATION

An RFP could be issued by March 1 and a contract awarded by November 1.

ESTIMATED SAVINGS

Savings of \$16.1 million per year could be realized were the state able to reduce its per-inmate cost to \$2,700 through competitive contracting.

Prison Food Service

Department of Corrections

CURRENT SITUATION

The Department of Corrections operates 14 prison facilities dispersed throughout the state. Preliminary cost analysis shows that the Department serves approximately 24.5 million meals to 20,000 inmates and 7,000 staff at a cost of approximately \$45 million or \$1.84 per meal. Inmates are trained and supervised in the preparation of meals. The Bergen County Sheriff's Department reported to the Commission that their service was contracted out at a cost of \$1.09 per meal.

The corrections food service industry is well-developed. There are a number of experienced, reputable and financially-sound competitors who would respond to an RFP. Correction systems which contracted out food service report significant cost savings, increase in service quality, and enhanced inmate culinary training programs.

CONCLUSIONS AND RECOMMENDATIONS

The Commission believes that subjecting the delivery of food service to competitive contracting would substantially reduce the cost to taxpayers of providing this service without sacrificing the quality of the service. The experience of Bergen and Mercer counties and other government jurisdictions shows that this service can be provided at costs well below what the state is now paying.

The Commission recommends a cost accounting be completed, showing all costs of delivering the service including service monitoring costs. An RFP, which contains performance standards and contract monitoring procedures, should be issued to qualified operators. The in-house managers and employees can be encouraged to submit a plan to be competitive with anticipated private contractor proposals. The Department should award the contract to qualified private contractors, if the Department receives a proposal that would reduce costs without sacrificing quality.

TIMELINE FOR IMPLEMENTATION

An RFP could be issued this spring and a contract awarded by January 1, 1996.

ESTIMATED SAVINGS

Savings could reach \$14.4 million per year based on \$1.25 per-meal cost.

Inmate Commissary

Department of Corrections

CURRENT SITUATION

The Department of Corrections operates 14 prison facilities dispersed throughout the state. Currently, the Department maintains 14 separate commissary operations that sell a variety of items such as toothpaste, cigarettes and potato chips to its 20,000 inmates. The commissaries are "pick and bag" systems where inmate workers select merchandise from a written order form. The merchandise is put in a bag by prison workers and is either delivered to individual inmates in their cells or picked up at a centralized location. State employees purchase the merchandise and handle the book-keeping and accounting for commissary transactions.

A preliminary review of the revenues and costs of the present system shows that these 14 commissaries are run at approximately break-even.

The corrections commissary industry is well developed. There are a number of experienced, reputable and financially-sound competitors who would respond to an RFP. Private commissary operators have been able to save other states money by taking advantage of their nationwide buying power. Private operators also employ sophisticated systems for ordering, inventory management and inmate account processing. Correction systems which have contracted out commissary services report increases in service quality, lower costs and additional income from more profitable sales.

CONCLUSIONS AND RECOMMENDATIONS

The Commission believes that subjecting the operation of commissary service to competitive contracting would substantially reduce the cost to taxpayers of providing this service without sacrificing the quality of the service.

It is also likely that the commissaries can be run more profitably by a private firm. Private commissary operators typically sign concession agreements where they are allowed to sell personal items to inmates and the prison system receives a percentage of the sales.

The Commission recommends a cost accounting be completed, showing all costs of delivering the service including service monitoring costs. An RFP, which contains performance standards and contract monitoring procedures, should be issued to qualified operators. The in-house managers and employees can be encouraged to submit a plan to be competitive with anticipated private contractor proposals. The Department should award the contract to qualified private contractors, if the Department receives a proposal that would reduce costs and increase profits without sacrificing quality.

TIMELINE FOR IMPLEMENTATION

An RFP could be issued by May 1, 1995 and a contract awarded by February 1, 1996.

ESTIMATED SAVINGS

Savings could be realized through increased revenues of about \$500,000.

Prison Operations

Department of Corrections

CURRENT SITUATION

The Department of Corrections operates 14 prison facilities dispersed throughout the state. There are approximately 20,000 inmates. Bayside State Prison in Cumberland County is a combined medium- and minimum-security prison with a population of approximately 2,000 inmates and operating costs of approximately \$52.6 million per year. Mid-State Correctional Facility in Burlington County is a medium-security prison with a population of 570 inmates and an annual operating cost of approximately \$21.5 million. A new prison in Bridgeton is being constructed for 3,000 inmates and is due to be completed in 1997.

Prisons are being operated by private firms in several states, including Texas, Florida, California, New Mexico, Arizona, Kentucky and Mississippi.

In the last ten years, a private corrections management industry has developed. There are a number of experienced, reputable and financially-sound corrections management firms which would respond to an RFP. Correction systems which have contracted out specific prisons report significant cost savings and/or increases in service quality.

CONCLUSIONS AND RECOMMENDATIONS

The Commission believes that subjecting the operations of prisons to competitive contracting would substantially reduce the cost to taxpayers of providing this service, without sacrificing the quality of the service.

The Commission recommends that a cost accounting be completed for both Bayside and Mid-State, showing all costs of delivering the service including service monitoring costs. An RFP, which contains performance standards and contract monitoring procedures, should be issued to qualified and experienced operators. Great care should be taken in this procurement process to allay concerns about public safety and loss of control to an unqualified contractor.

The in-house managers and employees should be encouraged to submit a plan that would be competitive with anticipated private contractor proposals. The Department should award the contract to qualified private contractors if the Department receives a proposal that would substantially reduce costs without sacrificing public safety.

An RFP should be issued in 1997 for the operation of the newly-constructed state prison in Bridgeton.

TIMELINE FOR IMPLEMENTATION

An RFP could be issued by June 1, 1995 and a contract awarded for Mid-State and Bayside by February 1, 1996.

ESTIMATED SAVINGS

It is difficult to estimate savings because each prison facility is unique. The Department will not know what savings or operational improvements are possible until an RFP is issued and qualified contractors respond. However, based on the experience of other governments, savings of 10-20%—or \$7-14 million—may be realized by subjecting both Bayside and Mid-State to competition.

Millions in avoided future costs might be saved by private operation of Bridgeton.

Prescription Drug Management Program

BACKGROUND

Prescription drugs represent one of the fastest growing cost components of the health care network. Management of prescription drug costs is common in the private sector. These programs typically save between 10% and 15% of prescription drug expenditures while improving monitoring of patient drug use. An estimated 47 of New Jersey's top 100 employers utilize prescription drug benefit management.

Benefit management reduces overall costs to government for prescription drugs and minimizes the opportunity for fraud and abuse.

CURRENT SITUATION

New Jersey governments subsidize prescription drug costs in various programs with no managed benefit system. These programs include Medicaid (\$165 million/year) and Pharmaceutical Assistance to the Aged and Disabled (\$169 million/year). State government has successfully applied managed benefit techniques in the government employee New Jersey Prescription Drug Program (\$67 million/year). There are, however, 300,000 government employees and 145,000 government retirees who do not participate in the New Jersey Prescription Drug Program and who may not receive the cost and service benefit of managed prescription drug benefits.

Drug manufacturer rebates are provided to state government in the Medicaid and PAAD programs. Even with these rebates—which equaled \$77 million for state purposes in the latest year—New Jersey's average prescription costs are higher than the industry average, due, in part, to less use of generics and higher provider compensation than in the private market.

CONCLUSIONS AND RECOMMENDATIONS

The Commission recommends that a prescription drug benefit management be implemented in all government prescription drug programs along the following lines:

- All pharmacists should be allowed access into any prescription benefit network as required under state "willing provider" legislation.
- State requirements for network access should exceed federal Medicaid standards providing maximum choice for recipients.
- Utilization reviews should be mandated under a prescription benefit program.
- The benefit managers should assure access to necessary medication. However, incentives should be created to encourage use of preferred drugs.

- Retirees from government employment should be eligible to participate in the New Jersey Prescription Drug Program. Participation should be mandated for state government retirees.
- Contracting with multiple benefit managers should be considered to encourage maximum competition.
- Local governments should be encouraged to participate in the New Jersey Prescription Drug Program. A marketing effort should also be considered to advertise the benefits of this program.

TIMELINE FOR IMPLEMENTATION

Once an RFP is written to solicit prescription drug benefit managers, a three-month period is needed for vendor response preparation, response evaluation and contract award. An estimated four-month period is then necessary for implementation of the managed benefit program.

ESTIMATED SAVINGS

With benefit management of the Medicaid and PAAD programs, annual savings of \$40 million can be estimated. Efforts to expand the New Jersey Prescription Drug Program to retirees and non-participating local governments would likely produce taxpayer savings of an additional \$10 to \$30 million annually.

Medical Savings Accounts

BACKGROUND

The state's Health Benefit Plan covers approximately 310,000 employees—active and retired—in state government, school boards, municipalities, agencies, authorities and counties. Benefit costs are one of the single highest expenditure categories in the state budget.

Currently, the choices offered are traditional indemnity insurance with a low deductible and HMO-type plans where choice in care is limited. This coverage costs \$7,000 per family for an indemnity plan and \$6,000 for an HMO-type plan.

Under the current system, there is almost no incentive for the individual employee to shop for the best price and care or to limit the amount of care purchased.

CURRENT SITUATION

In the last few years, a growing number of private and government organizations have used Medical Savings Accounts to lower employee health care costs, including the Golden Rule Insurance Company of Indianapolis, Forbes, the Spurwink School in Portland, Oregon, and the United Mine Workers of America.

A typical plan works like this:

1. The employer purchases a high-deductible (\$2,000–\$3,000) catastrophic insurance policy for the employee. The premiums on these policies could be 40% lower than the premiums on low deductible policies.
2. The employer deposits the amount of the deductible in a special account for the employee to spend on medical expenses, including IRS-recognized care such as eye care, dental, physicals, preventive care, etc. The employee has total freedom in choosing who delivers the care. If the employee does not spend the full amount, the employee can keep the difference.

CONCLUSIONS AND RECOMMENDATIONS

Medical Savings Accounts will give power to consumers who will benefit financially from prudent spending. Medical Savings Accounts would turn the present incentives around, giving state employees the fruits of controlling health care costs. Benefit costs can be lowered without reducing the quality of health care.

The state should carefully review the experience of others who have used Medical Savings Accounts, and tailor a plan that would provide good medical coverage for employees and significantly reduce costs.

TIMELINE FOR IMPLEMENTATION

The Commission estimates that an agreement to establish Medical Savings Accounts could be negotiated with employee unions, necessary statutory changes made, and a new program implemented before the end of 1995.

ESTIMATED SAVINGS

Estimate: 5% savings of current costs. Savings to state budget: \$25 million.
Savings to other budgets: \$41 million.

Flexible Benefit Programs for Government Employees

BACKGROUND

New Jersey state government does not offer flexible benefit, or so-called "Section 125" cafeteria plans for its employees.

In their simplest form, these plans, which are common in the private sector, allow employees to make payroll contributions on a tax-deductible basis for health care and dependent care/child care spending accounts. The employee reduces his or her taxes and has money available to pay health care deductibles/copayments and other out-of-pocket expenses for child care. Employers save because no employer Social Security taxes are paid on amounts employees contribute to these plans.

Another advantage of flexible benefit plans is that they facilitate the offering of health insurance opt-out programs to government employees whose spouses have duplicative health insurance coverage.

There is a mature industry of vendors experienced in establishing flexible benefit plans for the private and public sectors who can craft plans that will maximize employee benefits and employer savings.

Health insurance opt-out programs encourage employees to drop duplicative health insurance policies where a family member also has coverage. The financial savings are great for employers who share their savings with participating employees in the form of incentive payments.

CURRENT SITUATION

Flexible benefit plans are common in the private and public sector. According to a recent national survey of private and public sector organizations with 1,000 or more employees, 59% of organizations offered health care spending accounts and 60% of organizations offered dependent care accounts.

The two most common flexible benefit plan programs—tax-free payroll contributions to health care spending and dependent care accounts—are popular options with employees that also reduce employer Social Security tax payments (typically 7.65% on most of the employee payroll contribution).

New Jersey is one of only two states that has not conformed its state tax law with federal tax code as regards health insurance opt-out plans. In New Jersey, an employee can be taxed on the value of the opt-out incentive payment even if the employee does not opt to take the incentive payment. The federal government and 48 states only tax the incentive payment, if received.

Many local governments would like the ability to offer "full service" flexible benefit plans to their employees. The program is supported by the League of Municipalities and the Association of Counties.

CONCLUSIONS AND RECOMMENDATIONS

The Commission recommends that:

- New Jersey law be modified as needed to permit governments to offer a full range of flexible benefit options to government employees;
- State government offer, at a minimum, health care and dependent care spending account options with a corollary incentive program to allow employees to opt out of duplicative health insurance coverage;
- The legislature move to enact legislation conforming the state tax code to the federal code as regards health insurance opt-out payments.

TIMELINE FOR IMPLEMENTATION

An RFP for health plan administrative services was issued in November 1994. Procurement of an administrator to establish and operate a flexible spending account could occur shortly. This program could start in 1996.

ESTIMATED SAVINGS

Applying the typical plan design and employee participation rates found in existing flexible benefit plans to New Jersey state government results in annual savings estimates of between \$15 million and \$37 million, once the plan is fully utilized.

JUA/MTF Automobile Insurance Claim Pools

BACKGROUND

The New Jersey Full Insurance Underwriting Association (JUA) and its successor, the New Jersey Market Transition Facility (MTF), were insurance companies created by state government to write "bad driver" policies. The companies stopped writing policies in late 1993. However, there are outstanding claims estimated at \$1.5 billion that must be settled and another \$500 million of deferred claims that must be paid.

CURRENT SITUATION

The JUA and the MTF have separate, duplicative administrative staffs and will spend approximately \$30 million during 1995 and 1996 on administration. Beginning in 1997, administrative costs will drop dramatically as the number of open claims decline.

Presently, 19 servicing carriers settle claims for the JUA/MTF. Servicers are compensated a set claim fee that varies by type of claim. There are no economic incentives for servicers to seek to reduce claim costs. Servicers are also compensated for direct expenses which have averaged \$11 million per month for the past year.

CONCLUSIONS AND RECOMMENDATIONS

The Commission believes the present system does not provide sufficient control nor incentives to reduce cost. Such controls and incentives could best be provided by private administrators.

The Commission recommends the following actions:

- The Department of Insurance should competitively consolidate and contract the management of the JUA and MTF pools;
- The private manager should negotiate termination contracts with inefficient carriers and be prepared to take over any remaining claims;
- The private manager should be given incentives to cost-effectively manage claim settlements and expense requests.

TIMELINE FOR IMPLEMENTATION

An award to administer the program could be made in four months. However, implementation of the full plan with removal of inefficient carriers may take longer.

ESTIMATED SAVINGS

Savings occur from several actions. Consolidating administration of the two pools would save \$4 million. Exit payments representing refunds of servicing fees paid in advance to terminated carriers could approximate \$7 million. Assuming a 3% improvement in claim cost settlements, a 10% reduction in expense reimbursements, and competitive vendor incentive payments, bringing in a qualified manager should produce savings of \$40 million. These estimated savings total approximately \$50 million.

Motor Vehicle Services

BACKGROUND

In most states, vehicle inspection is provided by licensed private garages. New Jersey is one of only three jurisdictions with a government-operated motor vehicle emissions and safety inspection system, although New Jersey also permits private inspection as an adjunct to its centralized system. New Jersey is presently negotiating with the federal Environmental Protection Agency (EPA) over changes in the vehicle emissions testing program to ensure compliance with the federal Clean Air Act. Nationwide, a private industry exists that specializes in the establishment, management and construction of enhanced systems to provide the required inspection services.

Because this is a new program, any changes will increase system capital and operating costs.

CURRENT SITUATION

New Jersey presently has 35 vehicle stations with 86 vehicle inspection lanes, operated at a cost of approximately \$30 million annually. This state-operated system is staffed with 600 employees. Additionally, there are about 4,000 private inspection centers that perform about 25% of all inspections.

New Jersey's experience with private inspection stations has been a success. Motorists are familiar with the program; licensed private garages have successfully performed inspections and repairs; and motorists have favored the convenience option this provides to them. However, federal mandates limit the ability of combined inspection/repair private facilities to fully participate in the program. Although under the Clean Air Act inspection/repair private facilities will continue to play a role, EPA requires New Jersey to operate a centralized system for Clean Air Act inspections.

The state's Division of Motor Vehicles has explored competitive contracting options for this centralized system.

CONCLUSIONS AND RECOMMENDATIONS

The Commission recommends that New Jersey competitively contract operation of its state-operated emissions inspection system by including the following in the RFP:

- One or two vendors to operate the system.
- A 5-10 year contract, with determination of optimum number of lanes/locations based on state performance standards.
- Vendor lease or ownership of state-owned facilities, with rehab of lanes performed by the vendors.

- Vendor acquisition of new facilities/lanes; title transferred to state at end of contract.
- Vendor option as to policy vis-a-vis current employees, with a minimum requirement that current employees receive hiring preference.
- Minimizing of driver inspection fees.

However, the Commission recommends that the above not be included in statute, so managers can maintain maximum flexibility. The Commission also recommends continuation of the combined inspection/repair private option in the state's reconfigured emissions control system.

TIMELINE FOR IMPLEMENTATION

Much of the groundwork for drafting of an RFP has been accomplished. Therefore, the process can begin without undue delay. The following schedule is achievable:

RFP response preparation	3 months
Proposal evaluation and selection	3 months
Protest period/contract award	4 weeks
Implementation	12 months

ESTIMATED SAVINGS

Competitive contracting of existing emissions inspections will reduce annual state spending by approximately 10-15%, or based on the present system, a \$3-6 million savings.

Savings estimates do not include avoided operations and capital costs related to compliance with the Clean Air Act. Privatization of the Clean Air Act emissions system may provide an additional opportunity for savings.

Technology

BACKGROUND

State government's use of technology is extremely complex. The total scope of technology and the costs associated with it are not readily available. The Office of Telecommunications and Information Services (OTIS) is the central data center and has a budget of \$89 million. Their budget is exclusive of a variety of direct costs (i.e., employee benefits, depreciation, rent, etc.) which would normally be included in cost estimates developed by the private sector.

The growth of technology in state government has occurred without the benefit of a strategic game plan. This has created inefficiencies and promoted the expansion of technology related activities outside of OTIS. Estimates are that in excess of \$200 million per year is spent on technology in the State Department outside of OTIS. It is possible that this estimate could be in a range from \$300 million to \$400 million when all costs are factored in.

CURRENT SITUATION

New Jersey's major systems are currently run on a variety of hardware and much of the software and hardware are antiquated. Common standards and procedures do not exist. This impedes the implementation of cost-efficient technology.

A well-designed procurement system is critical to implementing state-of-the-art technology in a cost-effective manner. The current procurement process is time-consuming, cumbersome and does not maximize leverage or support the benefits of equipment standardization.

At a time when technology is dramatically growing, changing, and becoming more critical, as well as costly, New Jersey does not have a central point of responsibility and there is no overall vision or strategic plan for technology in state government.

To date, efforts to re-invent the technology area have been confined to OTIS, which comprises less than one-third of the technological activities in the Executive Branch.

OTIS has limited resources to respond to the day-to-day needs of its current customers and virtually no resources to dedicate to defining a strategic direction.

In addition to OTIS, virtually every department of state government has its own technological component. The costs associated with those individual components are difficult to identify and are understated due to the lack of a cost-accounting system.

An RFP to study OTIS has been issued. This focuses solely on OTIS and is not designed to deal with the overall issues of technology in the state.

CONCLUSIONS AND RECOMMENDATIONS

Given the critical importance of technology and information today and in the future, as well as the need for a strategic direction, consideration must be given to elevating this function within the Executive Branch or to the creation of a public corporation to manage all technology. Unless this function has departmental level authority, significant change is unlikely. Nine states have created a Chief Information Officer position, reporting directly to the Governor. The State of California has just completed an extensive study of technology—the first recommendation was for Governor Wilson to create a C.I.O. reporting to him.

In the short term, OTIS should move ahead with a baseline study of its organization and structure. OTIS is only a part of the problem; however, such a study should still identify savings opportunities in the \$5 million to \$10 million range.

The Treasury should prepare an RFP requesting a comprehensive study of all technology units in state government. The focus of the effort should be to derive efficiencies from consolidation and standardization. Technical experts indicate that this type of effort has typically resulted in savings from 20% to 40% prior to any privatization decision.

While privatization is possible in the short term, it appears to be premature, given the fragmented nature of the function as well as the potential for significant efficiencies prior to any privatization decision.

TIMELINE FOR IMPLEMENTATION

Immediate implementation should result in short-term savings in 12-18 months. Total implementation will probably take two to four years.

ESTIMATED SAVINGS

Annual technology expenses are in the \$300 million to \$400 million range and industry experts indicate typical savings deriving from this kind of effort from 20% to 40%.

Revenue Collection

BACKGROUND

The State of New Jersey collects \$14.8 billion in revenues annually. Over 50 separate units of government have a collection function. Changing collection techniques, as well as the need for sophisticated cash management skills, trends toward electronic collection, and the securitization of receivables, all impact on this critical function.

CURRENT SITUATION

Professional skills in the various collection units vary from highly sophisticated to nonexistent. Cash management practices vary, reducing revenue opportunities which reduces the state revenue potential by not maximizing the investment potential of taxes and fees.

Most units of government do not routinely maintain information on collection rates and receivable aging schedules, which is basic to any professional collection activity. The state does not presently package and sell aged receivables.

Electronic collection activities are just beginning to be undertaken in the state and will require increased expertise and capital.

CONCLUSIONS AND RECOMMENDATIONS

The consolidation of collection activities of over 50 units will offer significant opportunity to reduce costs based on efficiencies and competitive contracting opportunities. Consolidation and competitive contracting will bring to all revenue sources the benefit of professional cash management skills.

Professional collection and money management skills, if brought to all state collection units in a single focused collection unit, should substantially increase revenues. The increase in revenue collected will also increase investment return.

There is an opportunity for the state to package for sale aged, uncollected accounts receivables. The size of this opportunity is unknown, but perhaps significant. Many states and other governmental units are already using this approach.

With the assistance of this Commission, the Department of Treasury has issued a comprehensive RFP, requesting consulting assistance in a large-scale management and operational restructuring of revenue collection/debit recovery in the State of New Jersey.

The primary objective is to evaluate the current options and recommend an implementation plan for centralizing the function.

All options will be reviewed, including a state-developed and -operated solution; outsourcing; public/private partnerships; or other feasible alternatives.

TIMELINE FOR IMPLEMENTATION

An RFP has already been issued. Implementation is expected in early 1996.

ESTIMATED SAVINGS

Savings will need to be determined as part of the project. Given the size of the existing revenue base, as well as the current cost of operation, the potential for savings is significant.

State-Owned Wastewater Treatment Facilities

BACKGROUND

The State of New Jersey owns and operates wastewater treatment facilities. These facilities are owned and managed under the auspices of the Department of Human Services and the Department of Corrections, primarily at state institutions. Some of these facilities have been fined by the DEP for failure to comply with state environmental laws.

DEPARTMENT OF CORRECTIONS

The Department of Corrections is constructing a new 550,000 gallons per day (GPD) facility at the Bayside State Prison to achieve compliance with environmental regulations. The annual operating costs of the present facility are \$645,000.

Mountainview Youth Correctional Facility—Main Unit is constructing a 360,000 GPD plant under a design/build contract. Present operating costs of the existing facility are \$1.46 million per year. The facility, which serves the Mountainview Youth Correctional Facility—High Point Unit, has been cited for environmental violations and is forced to haul all raw sewage from the facility. However, a licensed plant operator must still be maintained at the facility to provide discharge monitoring reports to the DEP. Current operating costs, including sludge removal, are \$269,000.

Mountainview Youth Correctional Facility—Stokes Forest Unit has also been cited for violations, and has been hauling its raw sewage since 1991. Hauling costs are \$127,000 per year.

Violations have been identified at the New Jersey Training School—Jamesburg Facility, and the Department is moving to correct them. Operating costs are \$98,300 annually.

The Wagner Youth Correctional Facility's sewage treatment operation has also been cited for violations. The Department is in the process of requesting proposals for design/build of a new plant. A vendor presently operates the plant at a cost of approximately \$500,000.

DEPARTMENT OF HUMAN SERVICES

The Department operates wastewater and water treatment plants at 12 residential facilities: Ancora Psychiatric Hospital, North Princeton Developmental Center, Woodbine Developmental Center, Hagedorn Geriatric Center, Brisbane Child Treatment Center, Greystone Park Psychiatric Hospital, Marlboro Psychiatric Hospital, North Jersey Developmental Center, New Lisbon Developmental Center, Johnstone Training Center, Warren Residential Group Center, and Albert Elias Residential Group Center. Many of these plants have been cited for violations by the DEP and have paid fines.

A preliminary cost analysis shows operating costs of at least \$1.4 million for all of these facilities. In addition, over \$300,000 in fines and attorneys' fees have been paid.

CONCLUSIONS AND RECOMMENDATIONS

Contract operation and maintenance of water and sewerage treatment facilities is a growing industry. Across the United States there are numerous examples where local officials have improved quality and significantly lowered costs. The Commission has collected information from contracted facilities in New Orleans, LA; Indianapolis, IN; Newark, NJ; Maple Shade, NJ; Cranston, RI; Oklahoma City, OK; and others. Savings ranging from 30-40% are common. In the last 15 years, hundreds of Operation and Maintenance contracts have been entered into. This industry has grown and there are many experienced, qualified, reputable, well-financed firms who would submit a proposal for this type of business.

A cost accounting should be completed, showing all costs of delivering the service. Service monitoring costs should be included. RFPs, which contain performance standards and contract monitoring procedures, should be issued to qualified operators. The in-house managers and employees should work together to submit a plan to compete with anticipated private contractor proposals. The Department should award the contract to qualified private contractors if the Department receives a proposal that would reduce costs without sacrificing quality.

TIMELINE FOR IMPLEMENTATION

RFPs on many of these facilities could be issued by May 1 and contracts awarded before December 1, 1995.

ESTIMATED SAVINGS

Approximately \$1 million per year.

Public/Private Partnerships in Capital Transportation Projects

BACKGROUND

Many states are permitting the private sector to build and operate transportation projects which had been exclusively done by governmental entities. Examples include the Dulles Toll Road and four major highways in California. In the State of Washington, the "Public/Private Initiatives in Transportation" program provides a wide range of opportunities for businesses to propose and undertake all or a portion of the study, planning, design, financing, construction, operation and maintenance of transportation systems and facilities.

The New Jersey Department of Transportation is moving toward engaging the private sector in design/build projects. Based on the experience of other states, private design and construction of transportation projects has reduced costs and the amount of time it takes to complete a project.

CURRENT SITUATION

According to a Foundation of the New Jersey Alliance for Action study, New Jersey has transportation infrastructure needs of \$47.9 billion. They include:

- \$31.8 billion for state highways and bridges.
- \$3.5 billion for public transit.
- \$5.9 billion for toll road facilities.
- \$2.7 billion for bi-state authorities.
- \$4.0 billion for county and municipal roads and bridges.

The state's Department of Transportation reports that at current funding levels, the state will be unable to fund \$10.3 billion in needed highway and mass transit projects between the years of 1995 and 2002. These projects include rail transit expansion replacement buses, new bridges and added highway lanes.

In order to meet the state's backlog of unfunded transportation projects over the seven-year period, New Jersey needs to increase its transportation capital investment by \$1.3 billion annually—from \$1.5 billion to \$2.8 billion.

Participation of the private sector in the design, building, ownership and financing of many of these projects is needed.

CONCLUSIONS AND RECOMMENDATIONS

The Department of Transportation should evaluate all options for private design/build projects. The objective should be to enhance the Department's ability to complete a growing number of projects on a timely- and cost-effective basis.

The Commission also recommends adoption of a plan similar to the State of Washington's New Partners Public/Private Initiative in Transportation. This program has resulted in six significant projects being built by the private sector. Under the Washington program, private firms are invited to propose construction projects to be built and operated by the private sector. The state negotiates the details of each project with the private firms.

The enactment of a program like this in New Jersey has the potential for stimulating some creative and important transportation projects. Possible projects include the construction of S-92 in Middlesex County, the renovation and expansion of the Route 9 Bridge on the Raritan River, the construction of a new Route 9 Bridge, operation of the Hudson River Waterfront System, the extension of Patco in South Jersey, and many others.

TIMELINE FOR IMPLEMENTATION

Legislation may be needed before an RFP can be issued. Based on Washington state's experience, it should take a little over a year to draft an RFP, receive proposals and award a contract.

ESTIMATED SAVINGS

Savings cannot easily be determined, but the state might save hundreds of millions of dollars by avoiding major capital and operating expenses.

Veterans Memorial Home at Paramus

BACKGROUND

The State of New Jersey owns and operates a 334-bed veterans nursing home in Paramus.

The Veterans Memorial Home at Paramus was built in the late 1980s and was fully completed four years ago. The home serves veterans and veteran spouses (whose husbands are already in the home) and "Gold Star" parents—parents of veterans who have been killed in combat. The residents who have not depleted their personal assets pay for their care.

CURRENT SITUATION

The Veterans Memorial Home in Paramus is staffed by approximately 400 state employees, including managers, doctors, registered nurses, licensed practical nurses, health care aides, and building maintenance, food service, custodial and other support service workers.

The FY95 operating budget of the home shows \$17 million in operating expenses, including maintenance, and \$6.4 million in revenues—\$3 million from payments by private individuals and \$3.4 million from federal Veterans Administration reimbursements. The difference between operating expenses and revenues is made up by state taxpayers in the amount of \$10.6 million. If operating expenses were significantly reduced, this would have no effect on the amount of reimbursement provided by the Veterans Administration. Cost per bed is about \$140 per day.

The nursing home industry is well-developed, and there may be many experienced, reputable and financially-sound and competitive operators who would respond to an RFP and provide quality operation of this home.

CONCLUSIONS AND RECOMMENDATIONS

A cost accounting should be completed which shows all costs of operating and maintaining the home, including service monitoring costs. An RFP, which contains performance standards and contract monitoring procedures, should be issued to qualified and reputable operators. This is a very important service upon which hundreds of lives depend. Therefore, a great deal of care should be taken with this procurement process. Veterans service organizations should be consulted during this process.

The in-house managers and employees should be encouraged to submit a plan to restructure the in-house operation to be competitive with anticipated private contractor proposals. A comparison between private proposals and in-house reduction in operating costs should be made. The Department should award the contract to qualified private contractors if the Department receives a proposal that would reduce costs without sacrificing the quality of care.

TIMELINE FOR IMPLEMENTATION

An RFP could be drafted and issued to qualified operators by March 1, 1995.

An award could be made by September 1, and service could begin by December 1995.

ESTIMATED SAVINGS

\$3 million in operating expenses.

AREAS UNDER STUDY

The New Jersey Sports and Exposition Authority

BACKGROUND

The New Jersey Sports and Exposition Authority manages Monmouth Park; the Meadowlands Sports Complex, including Giants Stadium; the Byrne Arena; and the Meadowlands Racetrack. The existing Atlantic City Convention Center is leased and operated by the Authority. The Authority oversees the development of the new Atlantic City Convention Center. In addition, the Authority owns undeveloped land in the Meadowlands.

The Authority has \$947 million in bonds outstanding. Due to the restrictive covenants in the bonds and IRS regulations, a sale of any of the assets would be difficult.

In FY95, the state contributed \$35 million toward the payment of Authority debt service.

CONCLUSIONS AND RECOMMENDATIONS

The Commission commends the Authority for taking significant steps toward privatization of various functions. It is seeking a private operator to run the Atlantic City Convention Centers, a private developer to construct new elements of the master plan, and has contracted out many of its support services.

The Commission recommends a more intensive study of Authority activities be undertaken in order to determine the potential for reducing costs through the introduction of competition. Competition could generate new ideas and solutions for reducing the Authority's need for a state subsidy.

TIMELINE FOR IMPLEMENTATION

Due to the multifaceted nature of the Authority's activities and the complex legal restrictions in its bond covenants, an additional three to six months will be required for the Commission to complete the study.

Passaic Valley Sewerage Commission

CURRENT SITUATION

The Passaic Valley Sewerage Commission is a legislatively created authority which operates a sewerage treatment plant located in Newark. In 1993, revenues were \$114 million, operating expenses were \$75 million, repairs and maintenance were about \$12.5 million and annual debt service payments were \$19.7 million. Any surplus in annual revenues over expenses is returned at the end of the year to PVSC's customers.

The PVSC sewerage treatment plant is one of the largest in the country and serves 1.5 million people and 4,500 businesses in parts of Bergen, Essex, Hudson and Passaic counties. All of its operating and debt service costs are passed on to its customers. These charges make up a significant portion of the charges in customers' water and sewer bills.

Contract operation and maintenance of sewerage treatment facilities is a growing industry. Across the United States there are numerous examples where local officials have improved quality and significantly lowered costs. The Commission has collected information from contracted facilities in New Orleans, LA; Indianapolis, IN; Newark, NJ; Maple Shade, NJ; Cranston, RI; Oklahoma City, OK; and others. Savings ranging from 30-40% are common. In the last 15 years, hundreds of Operation and Maintenance contracts have been entered into. This industry has grown and there are many experienced, qualified, reputable, well-financed firms that would submit a proposal for this type of business.

CONCLUSIONS AND RECOMMENDATIONS

The Privatization Commission believes that subjecting the operation of the PVSC to competitive contracting could reduce the cost to ratepayers of providing this service without sacrificing the quality of the service.

The Commission recommends that the PVSC perform a cost accounting, showing all costs of delivering the service, including maintenance and service monitoring.

There is no accurate way to forecast how much a private contractor might save until the operation is subjected to competition in the marketplace. Therefore, the PVSC should be encouraged to issue an RFP to qualified operators for an Operations and Maintenance agreement, which contains performance standards and contract monitoring procedures.

The in-house managers and employees can submit a plan to compete with anticipated private contractor proposals. The Commission recommends the PVSC award the contract to a qualified private contractor, if the PVSC receives a proposal that would reduce costs without sacrificing the quality of services.

Miscellaneous Competitive Contracting Proposals

BACKGROUND

The Commission, working with Treasury, OMB and the departments, has uncovered a number of opportunities to competitively contract services at possible savings to the state without reducing the quality of services. Actions have been taken on some of these services, such as operation of day care centers in Human Services. Others are still under study.

Among the services under review are: custodial services; institutional grounds-keeping and food service; forensic medical exams; law enforcement data entry and collection; "bad driver" surcharge billing and collection; DMV accident reporting, licensing and testing; laboratory testing; state-run school district support services; state-operated adult training centers; fleet maintenance; and maintenance and reconstruction of NJ Transit rail track.

CONCLUSIONS AND RECOMMENDATIONS

The Commission recommends further consideration of the above services for competitive contracting. If these services can be performed at a lower cost without reducing the quality of services by a private firm, they should be competitively contracted.

The Commission recommends that a cost accounting be completed for each of the above, showing all costs of delivering the service including service monitoring costs. For each service that is subjected to competitive contracting, an RFP, which contains performance standards and contract monitoring procedures, should be issued to qualified operators. The in-house managers and employees can be encouraged to submit a plan to be competitive with anticipated private contractor proposals.

ESTIMATED SAVINGS

Based on a preliminary review of the costs of the above services that are performed by the private sector, as compared to costs for the state to operate them, a savings of \$30 million per year is feasible.

APPENDIX 1

STATE OF NEW JERSEY EXECUTIVE DEPARTMENT

EXECUTIVE ORDER NO. 17

WHEREAS, saving tax dollars without compromising the availability and quality of State services is a cornerstone of this Administration; and

WHEREAS, State government must identify and pursue innovative methods of achieving these goals; and

WHEREAS, privatization, through reliance on private enterprise, market forces and competition for providing public services, may be one alternative by which to save tax dollars and maintain, and possibly improve, State services; and

WHEREAS, a comprehensive study should be conducted to analyze the feasibility of prudent privatization of selected government services and evaluate the potential consequences of such privatization;

NOW, THEREFORE, I, CHRISTINE TODD WHITMAN, Governor of the State of New Jersey, by virtue of the authority vested in me by the Constitution and by the Statutes of this State, do hereby ORDER and DIRECT:

1. There is hereby established the New Jersey Advisory Commission on Privatization, hereinafter referred to as the Commission.
2. The Commission shall consist of a chairperson and four (4) other members appointed by the Governor.
3. The Commission shall: (1) conduct a review of existing feasibility studies and actual experiences of governments that have initiated privatization efforts; (2) evaluate the advantages and disadvantages associated with privatization generally; (3) conduct a feasibility study of New Jersey State government, including a cost-benefit and implementation analysis, to identify those areas where privatization would result in cost savings and quality improvements; and (4) propose appropriate and beneficial methods of implementing privatization in this State.

New Jersey Advisory Commission on Privatization

STATE OF NEW JERSEY
EXECUTIVE DEPARTMENT

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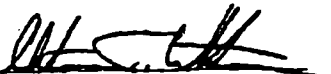
4. The Commission shall periodically report to the Governor and shall issue its recommendations in writing by December 31, 1994.

5. The Commission is authorized to call upon any department, office, division, or agency of this State to supply it with data and other information, personnel or assistance it deems necessary to discharge its duties under this Order. Each department, officer, division or agency of this State is hereby required, to the extent not inconsistent with law, to cooperate with the Commission and to furnish it with such information, personnel and assistance as is necessary to accomplish the purpose of this Order. The Attorney General, or her designee, shall act as legal counsel to the Commission.

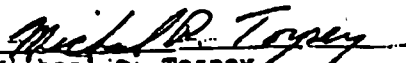
6. This Order shall take effect immediately.

GIVEN, under my hand and seal,
this 18th day of *APRIL*
in the Year of Our Lord, One
Thousand Nine Hundred and
Ninety-Four and of the
Independence of the United
States, the Two Hundred and
Eighteenth.




Christine Todd Whitman
GOVERNOR

Attest:


Michael P. Torpey
Deputy Chief Counsel to the Governor

FILED

APR 18 1994

LONNA R. HOOKS
SECRETARY OF STATE

APPENDIX 2

Commission on Privatization and Competitive Contracting Public Hearing List

1. Personnel Commissioner - Linda Anselmini
2. Professor Steve Savas - Director, Privatization Research Organization, Baruch College
3. Esmor - James F. Slattery, President
4. Mercer County Executive Bob Prunetti
5. Metcalf & Eddy - Donald Deiso, President
6. CWA
7. Congressman Dick Zimmer
8. Systems Control - James Caffey, Marketing Representative
9. Bergen County Sheriff Jack Terhune
10. United Infrastructure - Senator Thomas Gagliano
11. AFSCME
12. GC Services - Lawrence Smith, Marketing Manager
13. System House - John Bay, Managing Director
14. Cherokee Solutions - Leonard T. Bier
15. Martin Marietta - Neal Linkon, Director of Public Affairs
16. Construction Industry Advancement Program - John Clearwater
17. Michael Francis - Chairman, New Jersey Sports & Exposition Authority
18. United Water Resources - Bob Senatore, Marketing Manager
19. Lewis Thurston - Executive Director, New Jersey Highway Authority
20. S.E.I.U./I.F.P.T.E
21. New Jersey Turnpike Employees Union - Frank Forst, Consultant
22. Project Build - Fred Mihelic
23. Wheelabrator Clean Water Systems - Ken Gibson
24. Mercer Street Friends - John Connolly, Executive Director
25. Public/Private Partnership Council of New Jersey - Vince Miller
26. Construction Industry Advancement Program - John Clearwater

