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# Privatizing the Public Human Services – Lessons Learned from the U.S. Experience

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# Introduction

- ♦ This brochure reflects the current United States policy and practice relative to the privatization of public human services .
- ♦ The aspects of privatization to be examined include underlying policy issues, inherent opportunities and constraints, strategies, methods, safeguards and controls to protect the public interest and the interests of those to be served.
- ♦ It is hoped that lessons learned and insights gained by examination and reflection of United States experience will assist others considering privatization of public services.
- ♦ The author had the opportunity to lead New Jersey's efforts to privatize the care of some of the state's most seriously and persistently mentally ill, and those with profound developmental disabilities, by closing state institutions and financing private organizations to care for them in community settings.
- ♦ During the author's tenure as Commissioner of the Department of Human Services in New Jersey, approximately 500,000 Medicaid recipients were enrolled in private, for profit managed health care programs, and the operation of 22 child day care centers serving hundreds of children was transferred from the auspice of the New Jersey Division of Youth and Family Services to a variety of nonprofit corporations.

# The Role of Government in the Human Services – Public Policy Options

Governments maintain a broad series of options for the human services. At the most basic level, government must determine what specific services are to be provided, the form or nature of the service, the method of delivery, and determination of who is eligible for the service and for how long, which entity can best provide the service and how it might be financed.



The United States employs three basic structures for the delivery of human services:

**Public**—consisting of units of federal, state, and local government.

**Nonprofit** — non-governmental organizations

**Private** — for profit corporations.

# Organizational Auspices for the Delivery of Health and Human Services: The United States Framework

The federal government in the United States predominately finances the broad array of health and human services that constitute the safety net for its citizens.

Income insurance provides benefits to retirees and those who become disabled.

Income maintenance provides cash benefits to low income families as well as the aged, blind, and disabled.

Child welfare is directed to the safety and well being of children.

Health care services to the aged, disabled, and individuals and families with low income.

A variety of services for individuals and families with special needs relating to such conditions as mental illness, addiction to substances, developmental disabilities, and other medical diagnoses.

# Organizational Auspices for the Delivery of Health and Human Services: The United States Framework

Religious or faith based organizations have restrictions on the receipt and use of public funds. The U.S. constitution requires a separation of church and state and generally speaking such funds may not be used by such organizations for proselytizing individuals to a particular faith or to serve or hire only individuals of that faith in the course of providing a designated service.

Another choice would be to delegate the operation of a specific service to a proprietary or for profit organization. Such entities are organized to provide a financial return on investment for owners or investors, are not exempt from taxes, can retain or distribute profits made from the delivery of delegated services to owners or investors, are self governed by a Board and chief executive officer or owner, do not have the same limitations on political activity or lobbying as nonprofits, but are subject to governmental regulations in other spheres of their activities.



# U.S. History and Trends in the Auspice of Delivery of Human Services

The U.S. has enjoyed a long history and culture of private charitable giving and the organization and delivery of human services by nonprofit and faith based organizations. A major change occurred in the 1930s with the passage of the Social Security Act. This law, as amended through the years, shifted the focus to public or governmental leadership in the organization, financing and delivery of a broad swath of health and human services.

Today, the Social Security Act continues to serve as the anchor, statutory basis and financing vehicle for the health and social welfare safety net for U.S. citizens including Medicare, Medicaid, Supplemental Security Income, child support enforcement, child welfare and other critical services and benefits.

The federal government still directly operates several other critical programs but has delegated or devolved responsibility and authority for major programs to the state level. The states in turn have delegated the responsibilities associated with operating a number of major programs and services to the private sector – both to nonprofit and for profit organizations.

## **The Nonprofit Role:**

- Emerged to be a complementary partnership relationship with government.
- The view of this role holds that nonprofits meet the health and human services needs of citizens not provided for by government and serve as a viable entity to deliver government services.
- Economic and workforce trends have driven this arrangement as public sector workers unionized at a far greater rate than those in other sectors; and, negotiated enhanced salary and benefits to the point that the costs of providing services and benefits could be accomplished for considerably less cost by the nonprofit sector.

# U.S. History and Trends in the Auspice of Delivery of Human Services

## Political thinking and values in the United States:

- Focused on crafting “a smaller and smarter government” which fueled an expansion of privatizing public services.
- Suggested the role of government as “steering the ship of state” and suggested that “rowing the ship” (or actually delivering health and human services) should be the role of the private sector.
- Pressed successfully for the expansion of faith-based services permitting the greater entry of religious organizations, with fewer restrictions, into the provision of basic governmentally funded services.
- The practice was called “charitable choice” and required if a government were to use such an organization for such services, they would be required to offer citizens a non-faith based alternative for the same service. Such services include drug and alcohol use counseling and treatment, housing development, job placement and others.

**Umbrella Fundraising:** organizations raise money directly from private sources, and uses a volunteer based planning and allocation system to distribute funds to nonprofit organizations to meet the ongoing and emerging needs of area residents. Examples: The United Way and Associated Health Charities.

**Foundations:** another form of nonprofit organization, have grown in significance as funders of the health and human services as well. Major donors will create such entities for the purpose of carrying out the donor’s social welfare agenda by providing grants to nonprofit organizations in a manner that provides significant tax advantages to the donor.



# Strategic Considerations in Determining the Auspice of Service Delivery

**1.** Review the relevant research literature. There is a growing body of research that relates to the efficacy of specific types of health and human services and factors that affect successful implementation, access, and quality of service. The process of analyzing whether or not to privatize provides the opportunity also to modify the service in content and delivery in ways that comport with research findings.

**2.** Determine the core competencies of the government in a particular jurisdiction.

**3.** What would be the specific advantages of engaging the private sector in delivering a specific service? In today's economy, relative cost usually emerges as a primary consideration. Measuring the relative difference in costs in weighing privatizing a specific service should include all related current and future costs.

**4.** Cost over time. Experience in numerous jurisdictions has revealed that private organizations may initially propose and accept a very low reimbursement rate to attract government to enter into an agreement to privatize a specific service.



# Strategic Considerations in Determining the Auspice of Service Delivery

**5.** A key strategic consideration is whether or not there is a robust and competitive private market for the service considered for privatization. Competition among many eligible and appropriate providers will contain costs, provide alternatives to government and give more control in contract management and negotiations.

**6.** Government must also consider initially and over time developments in the marketplace relating to mergers and acquisitions of firms providing the types of services under review for privatization and other market factors that reduce competition. Consolidations of vendors may reduce marketplace competition and limit the power and control government can exercise over the private provider. There may be other regulatory authority government may exercise to prevent excessive consolidation and market control by any single provider.

**7.** The capacity of the state to successfully execute and manage the privatization of a specific service. The latter activity requires the strategic planning, assessment and business skills necessary for this effort to succeed, such as:

- The ability to create and manage a competitive process among providers in a manner that results in competitive price and quality of the privatized service.
- The need to create and successfully negotiate a legally binding contractual agreement that requires the provider to provide the service at the levels of quality and comprehensiveness specified.
- The capacity to effectively monitor performance of the provider, ensure accountability and require corrective action when necessary and appropriate.
- The ability to critically analyze contract outcomes and incorporate what is learned into successor contracts with providers to improve future services and results.

# Critical Issues in the Implementation of Privatizing Public Services

## Selecting Method

An initial determination must be made as to method by which the government will organize and finance the privatized health or human service. For example, in the U.S., government utilizes four primary methods for this purpose:

1. **Cost Reimbursement**
2. **Unit Cost**
3. **Managed Care**
4. **Payment for Performance and/or Outcomes**

**1. Cost Reimbursement:** an arrangement in which the government and the provider structure reimbursement for services provided based upon the costs the provider can document as necessary and appropriate to deliver the services.

**2. Unit Cost:** an arrangement in which the government conducts market research and fixes a standard cost for a particular service. Approved providers are only reimbursed when they can document that a specific service was provided to an eligible recipient.



# Critical Issues in the Implementation of Privatizing Public Services

## Selecting Method

**3. Managed Care:** represents one of the more recent developments in the arena of privatized public services. The basic concept involves organizing a key field of services such as health care by engaging managed care organizations (MCOs) to offer eligible recipients a full array of services in a coordinated or managed framework deemed necessary in that field to achieve the desired outcomes for recipients and control costs at the same time.

**4. Payment for Performance and/or Outcomes:** the government only pays the private contractor when agreed upon outcomes are achieved.



# Critical Issues in the Implementation of Privatizing Public Services

## Protecting the Interests of the Most Needy Recipients

Recipients that have the greatest need, whose problems or issues are acute, whose required services may be the most expensive or labor intensive, or who present other difficulties to providers, may often be at great risk of not receiving what they require and what the contractual arrangement with the provider may stipulate.

The practice of “**adverse risk avoidance**” in the managed healthcare domain is one in which eligible recipients with chronic health conditions which are expensive to treat may be actively discouraged from enrolling in a particular managed care organization.

Abuse of prior authorization for more costly services may occur so that the process of receiving authorization to obtain the required service may be made onerous to the point of effectively discouraging the recipient.

Cost reimbursement providers may similarly avoid such eligible recipients and unit cost providers may not be given an adjusted rate to accommodate additional costs for service.

# Critical Issues in the Implementation of Privatizing Public Services

## Rate Setting and Payments to Private Organizations

*In order to protect public funds and the recipients of public services, governments must assure that funds paid to private entities for the delivery of public services are sufficient in amount to assure quality, are based on market research, and are not excessive so that unreasonable profits accrue to provider organizations.*

- ◆ Market research is essential to determine fair rates and payments for these purposes and monitoring of rates and contracts is also necessary to achieve this end.
- ◆ To prevent excess profiteering by MCO's, a number of governments have employed what are called **medical loss ratios** which limit the percentage of payments received by the MCO from the government that may be used for profit and administrative expense.
- ◆ On the other hand, some governments have incorporated what are referred to as **stop loss provisions** into MCO contracts to provide for additional payments to the MCO under certain conditions if the magnitude of financial loss for the MCO exceeds a pre-established level. These contractual limitations can provide reasonable limits to profit and losses to protect both government and private providers in this financial risk-based context.

# Critical Issues in the Implementation of Privatizing Public Services

## Conducting an Effective Procurement Process

Governments strive to obtain the highest quality of public services for the lowest possible cost from highly qualified provider organizations. In order to achieve this end, governments must administer a competitive, effective and disciplined procurement process, which includes:

- 1.** Development of a detailed document representing a solicitation of proposals for the quantity, quality, scope and duration of the defined services desired to be procured on behalf of service recipients.
- 2.** A process that distributes and communicates that document to potential providers.
- 3.** Establishment of standards for eligible providers .
- 4.** Standards and expected outcomes for service delivery.
- 5.** The submission of detailed proposals by eligible providers incorporating the means and methods by which services would be delivered and any all costs to be reimbursed.
- 6.** Review proposals that effectively compare quality and costs.
- 7.** Provider selection based upon demonstrated capacity of the applicant organization, responsiveness of the proposal to the solicitation issued by the government, history of the organization in delivering like and similar services, financial capacity and solvency of the applicant provider and the magnitude of costs and reimbursements proposed for the delivery of services.
- 8.** Safeguards to assure a fair and open process and the absence of conflicts of interest by government employees in the selection process.
- 9.** Develop a contract.

# Critical Issues in the Implementation of Privatizing Public Services

## Crafting Contract Content and Monitoring Implementation and Performance

Effective contracts for the privatization of public services should include the following elements:

- ◆ A formal identification of the responsible governmental and private entity along with officials designated for each party.
- ◆ A clear statement as to the time period or term of the agreement.
- ◆ A detailed description of the content, duration, scope, number and level of the quality of services to be delivered.
- ◆ An identification of any other specific performance benchmarks.
- ◆ A detailed budget of payments, compensation, and method and timing of payments.
- ◆ A process for modifying the terms and conditions of the agreement.
- ◆ Identify Equal Employment Opportunity procedures.
- ◆ Develop protocols for reporting on program and fiscal performance.
- ◆ Clarification of ownership of any real property or equipment purchased with contract funds.
- ◆ Specifications of legal liability.
- ◆ A clear process for notification to the provider of any deficiencies in performance.
- ◆ A process for notification, preparation, approval and implementation of any corrective action plan.
- ◆ Identification of the types, scope, and amounts of any penalties that may be imposed for violation of terms and conditions.
- ◆ A clear process for termination of the contract.
- ◆ Instructions as to the process for any continuation or renewal of the agreement.

Subsequent to the execution of an agreement or contract for the privatized service, responsibility and authority must be clearly vested in the unit of government and a specific governmental employee responsible for monitoring the implementation and performance of the private organization.

# Summary and Conclusion

There is no general rule as to which public services might be best operated by either public or private organizations. The answer in each case requires a strategic analysis and individualized determination based upon the content of the service, the capacity and history of public and private entities in its delivery, the relative costs of delivery of the relevant public and private entities; and, the culture, tradition and values of the people of the governmental jurisdiction.

Experience has shown that introducing marketplace competition and applying controlled market forces in managing public and private health and human services enhances quality of services and helps contain costs.

Effective privatizations involve relatively sophisticated strategic and business planning activities. In addition, governments must develop the business management capacities to effectively implement privatizations in a manner that assures quality and controls cost.

Successful privatizations of health and human services can result in higher quality services at lower cost, further the tradition of public/private partnerships, and strengthen civil society.

# Resources

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