

Strong Words and Weak Arguments

by Jack L. Stout

Note: This article is the first chapter of a soon-to-be-completed book entitled, "Procurement Strategies," revised and edited for jems.

"I don't want some damn private sector rent-a-medec responding to my cardiac arrest!" testifies the physician, himself in private practice.

"May I point out that 'Paramedic of the Year' Thom Dick is employed by a private emergency medical services (EMS) firm, and has been for umpteenth years?" counters the opposition.

"They're in it for the money; we're in it because we care," charges the union representative of government EMS workers.

"That's strange talk coming from medics who are usually better paid, enjoy more generous fringe benefits, transport fewer patients per on-duty hour, and who would rather die than sacrifice 24-hour shifts to improve peak period coverage," respond indignant paramedics from the private sector.

"Maybe our system isn't as efficient as it could be, but efficiency isn't everything, and anyway the voters support us," confesses/brags the director of a popular government EMS service.

"Does that mean you see yourself as champion of the people's right to inefficient government?" asks the owner of a private EMS service.

Jack Stout has been at the forefront of innovations in the design and implementation of EMS systems for the past dozen years. If you have a question, a problem, or a solution related to the public/private interface in prehospital care, address your letter to "Interface" jems, P.O. Box 1026, Solana Beach, CA 92075.

"From the standpoint of pure logic, if a system could be designed to allow bid competition where all things were truly equal, the two bids would be separated only by the private operator's profit margin," writes government EMS advocate Dennis Murphy in the May '86 jems.

"But if all things were truly equal, including the caliber of management running the competing organizations, why bother conducting a competitive procurement at all?" wonders a certain smart-aleck columnist.

A clash of opinions is no substitute for thoughtful consideration and informed debate.

Strong words and weak arguments — from both sides. To deal effectively with a subject of such importance and complexity, we need more than clever repartee, more than pompous claims of selfless motivation. We need to understand the issues.

Common Ground

Most of us can agree that there are some things government must do, some things government should do, and some things that are best left to the private sector. And we can also agree that of those responsibilities which government must or should assume, some are best carried out by "in-house" government operations (i.e., socialized functions), while others can be better

accomplished by regulation alone, and still other functions of government can be best carried out by arranging for the job to be done by others — "others" being private firms, non-profit organizations, other government entities, and multi-jurisdictional organizations specifically created to combine certain functions of the participating units of government.

Our disagreements start when we try to decide *which* functions should be performed in-house. Discussions of these matters are often quite unproductive, partly because some of us are more powerfully persuaded by financial self-interest than by reason, but mostly because few of us have taken the time to think out rational criteria for deciding these kinds of questions. Unencumbered by reason or logic, we proudly believe what we wish to believe.

Our tiny ambulance service industry and the people we serve are being profoundly affected by conflicting opinions on privatization. These conflicts are usually philosophical. Their results are not. With so much at stake, a clash of opinions is no substitute for thoughtful consideration and informed debate. An opinion is not the same as a reason.

During several years of writing for jems, I have deliberately focused upon "nuts and bolts" issues — e.g., vehicle maintenance, system status management, third-party reimbursement, bidding procedures. This article is different. My aim is to improve the quality of argument on *both* sides of the privatization issue.

So, you wanna argue about privatization? Okay with me. But let's stow the

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opinions and break out the reasons. We may get somewhere, and we'll have a lot more fun.

The Question of Intervention

There are, of course, the extreme views — i.e., the influence of either government or the private sector cannot be trusted and should be limited to the maximum practical extent. Neither position, even if accepted, can furnish a useful guide for policymaking because both beg the same question: What is the maximum practical extent?

Unless you've given this question serious thought, you might simply say that society's essential functions should not be left to the uncertainties of the private economy. EMS is essential, so . . .

The problem with such a criterion lies with its practical application. Food is essential, yet not even the most ardent supporters of socialized EMS are clammering for government takeover of farms, grocery stores, and restaurants. Healthcare is essential; raise your hand

if you favor expanding the VA's hospital system to serve every U.S. citizen. Few will disagree (after giving it some thought) that merely being essential is not enough to justify government takeover.

My own view is that government intervention of some sort is justified when, left alone, the normal market forces in our private economy fail to ensure reliable production and adequate distribution of an important product or service. How "reliable" is reliable enough, and the definition of "adequate distribution" depends upon the product or service involved. Everyone must have food, but not necessarily escargot.

Applying my own criteria to the EMS industry, it is clear that EMS is important and that EMS should be universally available (for practical as well as ethical reasons). Furthermore, it has been repeatedly demonstrated that, left alone, retail competition ensures neither reliable production nor adequate distribution of EMS. Thus, by my own criteria, government intervention in the EMS industry (which does not necessarily imply a government takeover) is clearly justified.

The position I have taken is more

than an opinion. It is also a reasoned conclusion. To oppose my conclusion (effectively) you must argue that EMS is *not* all that important, or that every person should *not* have a right to EMS, or that, left alone, normal market forces *do* ensure reliable production and adequate distribution of EMS. In other words, you must do battle with my criteria or my description of the facts.

The Nature of Intervention

Even if we agree that government intervention is justified, we still must decide what sort of intervention is in order. Socialized production (e.g., government-operated EMS) is only one of several intervention options we may choose. We cannot claim to know which form of government intervention will work best until we have considered the options — all of them.

There isn't space here to list and discuss all the different ways a government can intervene to influence an industry's performance. Outright socialization is, of course, the most dramatic, the most intrusive. Public education programs and advertising restrictions are among the least intrusive. Somewhere in between lie such

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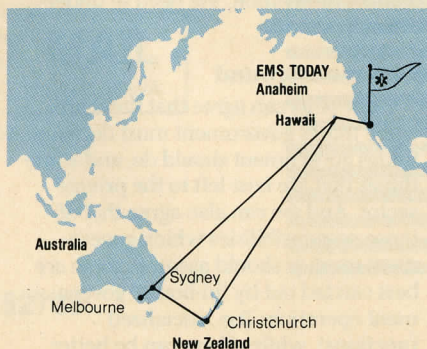
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tools of intervention as tax incentives, licensing laws, restricted awards of market rights, rate regulation, price supports, import restrictions, producer subsidies, consumer subsidies (e.g., food stamps, vouchers), and various forms of government contracting.

Each of these forms of government intervention is, in effect, a different management tool. And as with any tool, each has advantages, disadvantages, and a proper application. Using full-scale socialization to improve EMS production and distribution may be like using a nine pound sledge, perhaps even a pile driver, to insert a 20 gauge IV catheter. But unless we understand the various tools of intervention and their uses, how could we know?

The Matter of Efficiency

Efficiency, the ability to do a job well at minimum cost, has always been a factor in deciding which form of government intervention will be used in a given situation. Today, as governments struggle to maintain services, efficiency is often *the* factor.

Studies comparing the efficiency of government agencies with that of private producers of similar services generally support the following conclusions:

1. Two problems often make it difficult to obtain apples-to-apples comparisons: problems in determining government's true production costs (even marginal costs), and lack of objective performance standards and measurements for many government services.
2. In general, but not always, private contractors are more efficient than government producers of similar services.
3. A poorly designed contracting arrangement is, in terms of efficiency, no better than a poorly managed in-house government operation. Successful privatization is not an *alternative* to good government; it is a *product* of good government.
4. A well-designed and well-administered contracting arrangement will, in most cases, prove more efficient than production of the same service by a well-managed agency of government.

Some argue that lower wages explain the private sector's efficiency advantage. For example, wages of government paramedics currently average about 20 percent higher than wages of paramedics employed in the private sector. This difference does not, however, account for the much larger differences in the efficiencies of socialized versus privatized paramedic systems.

Consider the case of two well-established producers of urban paramedic services — those serving Austin, Texas

(a government service) and Tulsa, Oklahoma (a privatized service). The quality of service and response time performance produced by the two systems are arguably similar. The difference in wages is even greater than the industry average. Wages in the Austin system are about 30 percent higher than wages in the Tulsa system.

Since labor costs of field personnel and dispatchers account for about 60 percent of Tulsa's total cost of production, it follows that if wages in Tulsa were made equal to Austin's, Tulsa's total production costs would be increased by about 18 percent (i.e., 30 percent of 60 percent). The problem is that Austin's total system cost per patient transport (\$420) is not 18 percent higher than Tulsa's (\$166), but is instead more than two and one-half times that of the Tulsa system. Put another way, even if Tulsa's field personnel were paid two and one-half times as much as their counterparts in Austin, the Tulsa system would still have a lower total cost per patient transport (i.e., \$29 lower).

There is no simple explanation for the tendency of private firms to operate more efficiently than government agencies. Internal and external financial

government, only those employed by government could afford beer. There are also the subtle evils of economic distortion.

In the "Readers Report" section of the July 14, 1986 *Business Week*, reader Maurice Manner offered a suggestion for helping out the U.S. auto industry. Quoting Mr. Manner: "Historically, higher tariffs, quotas, and non-tariff protectionist measures to limit imports have proven to be temporary stopgaps, ignoring long-run consequences of a possible worldwide trade war. Consider, instead, giving a tax deduction to buyers of automobiles manufactured in the U.S. This would increase tax-flow income, and the U.S. auto industry, which many consider to be the bulwark of our economy, would benefit from increased sales."

True, Mr. Manner. A tax break for domestic car buyers amounts to a government voucher good for partial payment of the purchase price — i.e. an intentional distortion of consumer behavior. But with Uncle Sam paying part of the new car tab, his nieces and nephews would not only buy fewer foreign cars and more U.S. built cars, they would also buy fewer boats and

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incentives, competition, the superior economies of scale and management bench strength allowed by multiple site operations, better paid managers with greater expertise in more narrowly defined specialties, freedom from cumbersome purchasing requirements, more objective public oversight, a well-developed body of management science more easily applied in a private setting . . . the list of possible explanations goes on.

In socialist countries, bright and often well-intentioned people have struggled long and hard to squeeze private sector performance out of public sector organizations. The result: a worldwide trend, evident even in Russia and China, toward an expanded role for the private economy.

The Hidden Evils of Distortion

"What's so terribly wrong," you may ask, "with a little inefficiency, especially in the delivery of a service as important as EMS?" There is, of course, the obvious argument that if we felt that way about every important function of

more U.S. built cars, fewer stereos and more U.S. built cars, fewer of lots more (unsubsidized) products than foreign built cars. Economic distortion, once unleashed, refuses to be controlled.

In a similar manner, money wasted through inefficient EMS production cannot be available to hire more cops or to fund a drug education program. Inefficiency in one government agency distorts the entire governmental budget process. A nasty form of economic distortion, a little governmental inefficiency goes a long way.

Magnifying Good Influence

A few years back, the Advisory Commission on Intergovernmental Relations (ACIR) was trying to find ways to speed up the rate of technology transfer among local governments. Studies have shown that when a new way of doing something was developed and *proven effective* within one local jurisdiction, other jurisdictions were taking an average of seven years to discover and adopt the new technology (see Bibliography for these studies).

To deal with the problem, ACIR pro-

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moted government executive exchange programs, in-service training programs, more effective use of consultants, and a host of other strategies. To deal with the poor economies of scale plaguing the turf-protected agencies of local government, ACIR developed a model state statute, "The Interlocal Cooperation Act." The model statute has since been adopted in some form by almost every state, allowing governments to combine functions for better service and improved efficiency.

ACIR's approach was to *make it easier* for local governments to keep pace with progress and to improve performance by combining functions. The results have been less than impressive. Progress requires effort, and efficiency can be damned inconvenient. More than a way to do better, governments need a *reason* to do better — an incentive. Given incentives, ways will be found.

Privatization offers a more direct approach to these problems. Expansion opportunities, competition, and the profit motive furnish powerful incentives for private contractors to keep up

with technology and to maintain efficiency. While governments must be encouraged to learn from each other, private contractors covet their competitors' trade secrets, sometimes to the point of theft.

As for combining government functions, privatization allows a successful contractor to extend its success (and the influence of its management expertise) to benefit many jurisdictions, simultaneously shrinking the influence of less capable organizations. (That, in a nutshell, is the logic of capitalism.) Interlocal Cooperation Acts have made the same effects *possible* without privatization, but not *probable*. (How many fire departments still operate in your county?)

The Advantage of Competition

In many industries, the good old "invisible hand" of first semester microeconomic theory does a fine job directing the flow of capital, distributing goods and services, setting prices, and rewarding producers.

In the ambulance service industry, the invisible hand fumbles. Lack of practical opportunity for emergency customers to quality/price shop, distortions induced by third-party payment and 9-1-1 access, the extreme vulnerability of efficient providers to cream-skimming competitors . . . these and other facts of EMS life pervert and neutralize the productive forces of retail competition. In our industry, the invisible hand needs a hand.

Government intervention in the form of privatization can change the *form* of competition, making the invisible hand more visible. Socialization amputates it. There are, of course, a zillion ways governments can screw up a procurement process, and when that happens, results may be far worse than a little socialized inefficiency. Still, when it comes to picking organizations to serve us, mankind has found nothing that can compare with organizational competition.

The Matter of Profit

Here's a little accounting quiz. Do you think Dennis Murphy's statement about profits (quoted at the beginning of this article) is correct, even theoretically? That is, do you agree that the prices of two otherwise identical bids, one from a government agency and the other from a private firm, would differ by the amount of the private bidder's projected "profit margin?" Well, do you? (Hint: you don't.)

Even given Murphy's unusual stipula-

tion of perfect equality, the difference in prices bid, if any, would depend upon how the bidders intend to finance their working capital, facilities, and equipment, whether they intend to build net worth over the period of the contract, and on other factors. For example, say the government bidder would get its working capital from invested cash reserves, while the private bidder's working capital would come from shareholders' equity.

If the government bidder's price includes its cost of working capital (in this case, "opportunity cost"), as it should, the bidders' bottom line prices would *not* differ by the amount of the private bidder's projected profit. That's because the private contractor's working capital costs would be shown as a return on shareholder's equity — i.e., part of "profit," but the same type of cost would also exist in the government bid under a different accounting label. (I know, bo-r-r-r-in-n-ng, but stick with me.)

Some government operations are allowed to accumulate "net worth." For example, the overseeing government agencies in public utility model ambulance systems are usually allowed to build net worth up to about one year's operating expenses. The purpose is to build long term financial stability, and to fund routine equipment replacement without going back to the city budget. When a private firm does the very same thing, the growth in net worth is called "profit."

I could go on with examples, but they wouldn't get any more interesting. Two important lessons: First, "profits," or their public sector equivalent, are needed to finance both socialized and privatized production of services. Second, with socialized production, taxpayers assume 100 percent of financial risks (e.g., risks of cost overruns, premature equipment failure, tort claims, etc.), while a well-designed contract transfers a defined portion of those risks to the private sector. The dollar value of the assumption of risk by a private bidder is usually unrecognized — both as an advantage of private contracting, and as a hidden cost of socialized production. (Bet you never thought of that.)

Objective Public Oversight

So, anyway, this fire chief stands in front of this city council and he says, "We've completed our evaluation and are sad to report that our overall performance, including our productivity, is quite poor and isn't getting any better. Frankly, ladies and gentlemen, we're just not a very good fire department.

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Podunk would be better off hiring another organization." Get it? It's a joke.

Here's another one: There's this guy who thinks incompetent city paramedics killed his dad, so he phones the city manager who promises (now get this) "to conduct a complete and objective inquiry into the matter and report the findings in full." Yuck, yuck.

The story about the fire chief is a joke because it will never happen, especially if it should. The story about the guy's dead father is a joke because, if the guy is right, the city and the dead man's heirs are about to square off in court, and the city attorney will just . . . well, be upset, if the city manager wrecks the defense by shooting off his mouth with the truth.

Besides all the financial and philosophical arguments, some of us doubt that *any* organization can objectively oversee its own operations. Privatization strengthens the objectivity of public oversight by inserting an arm's length business relationship between government and the organizations performing its functions. With socialization, government is the organization performing those functions.

Labor Relations

On one side of the bargaining table, workers negotiate for money and benefits which, if they win, will benefit them personally. Across the same table, government officials negotiate with

And to some extent, privatization insulates elected officials from political heat generated by less than scrupulous government workers willing to exploit the trust and gratitude of patients and their families for personal gain.

On the other side of the argument lurks the temptation of outright bribes from private contractors, the obvious influence of hefty contributions to political campaigns, and post-award hirings of government officials by the more than lucky winners of the procurements they managed. Privatization trades one set of sticky problems for another. The question is, do the advantages of privatization justify the trade, and which set of problems are most susceptible to control?

So Why Not "Privatize" Everything?

Because first, like socialization, government contracting is only one of many options for government intervention. Each has its proper application. Second, because we haven't developed the administrative technologies, not to mention management skills, needed to reliably contract for the production and distribution of many government services.

Even assuming a decision to privatize has been made, complex choices remain: Should bidders be prescreened, and if so, by what criteria? What, in a given situation, should be the com-

emphasis: Should we focus our energies upon making our governments *better buyers*, or *better producers*? And what about all those other tools of governmental intervention? □

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The dollar value of the assumption of risk by a private bidder is usually unrecognized — both as an advantage of private contracting, and as a hidden cost of socialized production.

someone else's money. Some observers see a problem here.

In EMS, there can also exist a temptation for government workers to exploit the special relationship between paramedic personnel and the patients they serve. I once knew a city councilman who, because his own life had been saved by the city's paramedics, abstained from voting on EMS issues. He could not vote objectively and he knew it. An honest man.

Of course it is possible for government EMS workers to successfully solicit vigorous political support from patients and their families, regardless of the merits. And that's the point — regardless of the merits. Privatization helps even the score during labor negotiations because neither side is negotiating with someone else's money.

petitive bid variable — rate structure, subsidy requirements, quality of service, quantity of service, credentials, or something else? What form of performance security is in order? There are many options. Is the "supply side" ready? Should "lame duck" safeguards be employed? What about restrictions on outside use of contracted resources? Length of contract, earned renewal provisions, use of arbitration, end term equipment replacement . . . the list goes on and on. These are the ingredients of successful privatization, but there is no simple recipe, no cookbook for their use.

Successful privatization is no simple matter, but then neither is achieving and sustaining efficient performance in a socialized production setting. So we are faced with the question of future