An Iowa Case Study of State Government Outsourcing: A Comparative Cost Analysis of Drivers License Issuance in Rural Counties*

by

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Abstract

Outsourcing has increasingly been examined by various governmental units as a potential solution to declining growth in agency revenues while attempting to enhance program service delivery in an era of devolution. An Iowa case study that examines outsourcing of state drivers license issuance services with local government offices is reported herein. Two policy scenarios representing larger leaps toward outsourcing are found to be economically superior to an existing system. The existing system of DOT itinerant teams possesses higher salaries, higher transportation costs, and lower equipment and supervision costs per license issued compared to County Treasurer's Offices involved in the pilot outsourcing project. In addition, some rural County Treasurer's Offices possess slack labor due to full-time service availability. Thus in this case, outsourcing represents an opportunity for residents to access expanded hours of service and for County Treasurers to increase productivity. While the circumstances regarding this governmental function are a little unique, this case study shows that state and local governments in one state have an opportunity to realize incremental savings that potentially would payback initial year costs within two and a half years.

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Outsourcing, decentralization, and privatization increasingly are examined by various governmental units as the era of devolution evolves. While these concepts generate opportunities to achieve reductions in governmental employment, neither administrative efficiencies or reductions in total costs are necessarily assured. In addition, health and safety, convenient access, and accountability are factors to be considered. The literature suggests that comparative analysis on a case by case basis is necessary to determine whether such efficiencies or cost savings exist (Harrigan; Fox; Porter). This article reports on an Iowa case study involving outsourcing of drivers license issuance services. The context, methods, data, and results are discussed for an actual cost analysis that was used by the Iowa General Assembly in making a policy decision. Finally, a summary of findings and implications is presented.

Iowa's Case Study in a National Context

Outsourcing is defined as utilizing a third party to test or issue drivers licenses. Privatization is defined as contracting with a private sector entity to test or issue drivers licenses. Utilizing the capacities of other state agencies and/or officials of local government is considered third-party outsourcing, but not privatization. According to a recent survey by the American Association of Motor Vehicle Administrators (AAMVA), twenty states currently utilize third-party drivers' license testing services. Fifteen of these states have privatized all or part of their drivers license issuance functions and two additional states are considering such outsourcing. Thus, only a few states have considered outsourcing with other state agencies and/or local government officials.

Administrative authority for the Iowa drivers license issuance system rests with the

Iowa Department of Transportation (DOT). The current issuance system is comprised of 9 permanent drivers license stations that serve higher volume urban areas, 21 DOT itinerant teams that serve multiple-counties in less dense rural areas, and a pilot third-party issuance project in which County Treasurer Offices in each of six rural southwestern Iowa counties issue licenses. The DOT itinerant teams typically include four to five full-time-equivalent (FTE) positions and serve three to seven counties. Two of the DOT itinerant teams are based at permanent stations but travel to neighboring rural counties for one or two days per week. The remainder of the DOT itinerant teams are typically scheduled one day per week at each rural county site for the counties in their designated region.

In 1991, a statewide commission appointed by the Governor was organized to make recommendations for resolving the state's $409 million state budget deficit. The statewide commission became known as the Fisher Commission and it recommended consolidation of all drivers license issuance and motor vehicle registration services into 19 regional centers.

At that time, the Iowa State County Treasurers' Association presented an alternative to the Fisher Commission recommendation--integrate drivers license services into existing County Treasurer's Offices. In 1993, the Iowa General Assembly passed legislation to establish a pilot project in six southwestern Iowa counties. The legislation mandated that DOT should provide training, supplies, and equipment. Since January 1, 1994, the County Treasurer's Office in each of these six counties has issued Iowa drivers licenses. In addition, one County Treasurer's Office operates a satellite station to provide additional service outside the county seat, one day per week.

The issuance services provided include written tests, vision screening, drive tests,

renewals, new licenses, and reinstatements. A full complement of testing services are provided by both DOT itinerant teams and County Treasurer stations.

The 1997 Iowa General Assembly passed House File 372 which authorized an interim study to examine the effectiveness of a third party drivers license issuance system in the form of the pilot project and to make systematic cost and quality comparisons between the experiences in the pilot counties and the Iowa DOT itinerant teams operating in other rural counties of the state. The study was designed to provide recommendations to the General Assembly in January 1998 regarding the future structure of the drivers license issuance system.

Scenarios, Methods, and Data

A 13 member Drivers License Issuance Study Committee was appointed and included representatives of County Treasurer interests, DOT interests, and nonaligned interests. The Issuance Study Committee, in turn, appointed a Cost Analysis Subcommittee to analyze costs of alternative policy scenarios. The authors performed staff functions in support of the Cost Analysis Subcommittee by suggesting appropriate comparative analysis concepts, and assisting with the data collection, estimation methods, and interpretation of results.

Operating costs for fiscal year 1997 were provided by the six County Treasurers in the pilot project at the request of the Cost Analysis Subcommittee. Due to the dual nature of the functions occurring within the County Treasurers' Offices (i.e., Treasurer duties and licensing duties), the Cost Analysis Subcommittee conducted a time study during a selected period of five weeks in 1997 that was judged to reflect a typical issuance work load. These results were used to allocate annual operating costs between County

Treasurer functions and licensing functions within each County Treasurer's Office. The time study results and selected Treasurer costs are reported in Table 1.

Rather than using fully allocated costs including fixed administration, building, and/or overhead, the Cost Analysis Subcommittee opted for an incremental cost methodology that measures the change in labor and operating costs for issuance services provided by DOT and County Treasurers compared to the currently existing system. As defined by the Subcommittee, incremental costs represent the additional out-of-pocket costs incurred (or saved) as a result of a service being added, reduced or changed. Direct costs include incremental costs plus all other costs directly attributable to providing the specified service. Fully allocated costs include direct costs of a service plus indirect overhead costs, such as those attributable to administration and rent.

Table 1 compares direct costs and incremental costs estimated for the County Treasurers, excluding incremental costs for supervision and equipment by DOT. The incremental cost estimates are based on predicted staff reductions if license issuance by County Treasurers was discontinued. The divergence in incremental costs and direct costs for the Treasurers is due primarily to acknowledged availability of slack labor capacity in their local offices. County offices remain open on a full-time daily schedule providing state mandated services on demand for local residents. Thus, Iowa's outsourcing proposals provide an opportunity to increase productivity of slack labor for some rural county governments. Conversely, slack labor reappears if license issuance is discontinued in the pilot counties.

Even more surprising is the initial baseline cost comparisons between the pilot counties and the DOT itinerant teams. DOT Operations and Finance personnel provided

cost and license issuance data for the 21 DOT itinerant teams at the request of the Cost Analysis Subcommittee. For fiscal year 1997, the DOT itinerant teams issued 395,761 licenses and ID cards. Cost data were based on actual division and department expenditures by the itinerant teams for fiscal year 1997. The data include salaries and benefits, motor vehicles, travel expenses, and building leases. The direct costs are $8.60 per license for the existing DOT itinerant teams compared to $5.83 per license for the Treasurers in the pilot outsourcing project. For comparison purposes, both estimates of direct costs exclude all supervision, equipment, and imaging system lease costs. These costs are exclusively paid for by DOT under both issuance systems.

What explains the cost and performance differences of the two systems? The time for issuing a license is roughly the same under both systems. But, DOT itinerant teams are paid higher salaries; require vehicles, employee time, and transportation costs to transport people and equipment to the itinerant sites on a daily basis; and utilze building space that must often be leased by DOT for itinerant teams operations at remote issuance sites.

However as noted previously, supervision, equipment costs and digital photo imaging system leases are paid directly by DOT and are not included in the above initial comparisons of direct costs. These items represent potential offsetting factors for the apparent competitive advantages of Treasurers found in the initial direct cost comparisons. System-wide, the Treasurer teams require more supervisors and sets of equipment than DOT itinerant teams. Therefore, a comparative analysis cannot be based on the above partial estimates of direct costs alone. In the remaining analyses of alternative policy scenarios reported herein, supervision, equipment costs and imaging system leases are included in the incremental cost estimates.

Seven scenarios associated with alternative levels of outsourcing and service delivery were defined by the Subcommittee for purposes of comparative analysis. Scenarios 1, 2, and 3 expand issuance by 24, 42, and 84 additional County Treasurer Offices, respectively, and eliminate existing DOT itinerant teams. Scenario 3 would outsource all license issuance services except those at the 9 permanent full-time DOT sites serving the more urban counties.

Scenarios 4, 5, and 6 eliminate the six county pilot project and respectively add 3, 5, and 10 new DOT itinerant teams to expand the available hours of local service. Scenario 7 eliminates the six county pilot issuance project by adding one additional DOT itinerant team.

Several assumptions are used in developing the cost estimates for each scenario. These assumptions reflect the Cost Analysis Subcommittee's best efforts to predict the future equipment and staffing levels for the different scenarios outlined and to assure efficient and effective transition. For example, the Subcommittee assumed that administrative authority for all drivers license issuance activities would remain with the DOT. In addition, clusters of four to six counties would be required to jointly opt-in or opt-out of County Treasurer issuance. This assures that complete DOT itinerant teams are replaced by clusters of counties without disrupting other existing DOT service areas.

A third set of methods and assumptions developed by the Subcommittee related to procedures used to estimate costs for the digital imaging equipment. The digital imaging technology used by Iowa is relatively new and has only been applied to drivers license issuance during the past decade. Thirty-two states currently use digital imaging technologies for issuing driver licenses and seven additional states are seeking bids for

digital systems (Snodgrass). The costs of the technology has continued to decline. However, multiple use features, durability and tamper-resistant security features are being added in many states, which increases the costs. The imaging equipment costs represent a significant portion of issuance costs. As previously stated, more sets of imaging equipment are needed as additional counties participate in outsourcing.

The Subcommittee defined an operational set of digital imaging equipment to consist of one Document Processing Unit (DPU) and one Application Processing Unit (APU). The DOT itinerant teams and the County Treasurer Offices require access to an operational set of digital equipment to perform their issuance functions. After considerable testimony regarding inflation and technological obsolescence for the desired equipment, the Cost Analysis Subcommittee approved a cost estimation methodology for leased digitized imaging systems based on actual bids previously received by Iowa DOT from its current digital imaging equipment vendor. The bids covered equipment, maintenance, and materials cost for a four year period and had been submitted on a per license issued basis as requested by DOT. The three bids used to estimate the equipment costs were submitted on the same date as part of a package submitted by the vendor.

The bids for the digital operating systems were $1.648 per document for 44 sets of equipment, $1.777 per document for 50 sets of equipment, and $2.52 per document for 106 sets of equipment. A polynomial model was used to estimate equipment costs for various levels of digitized equipment sets based on the three bids received by DOT. Figure 1 shows the relationship between the lease bid cost per document and the number of digitized sets of equipment provided by the vendor for the alternative levels of service used in this cost analysis. Table 2 presents the estimated incremental digital system

costs and sensitivity analysis on the resulting cost variations for the scenarios. It is important to note that the cost per document for the digitized imaging system lease is extremely sensitive and that a slight change in the bid price results in a significant change in cost. For example, a change of only $.005 in the cost per document per unit will change the total equipment leasing cost estimate from 23.5 percent to 35.5 percent. This prompted one analyst to suggest that future bids by DOT should separate equipment leasing costs from maintenance and materials.

The state's previous decision to lease equipment rather than purchase may have increased the vendor's bid prices, since leasing requires the vendor to assume greater financial risks and capital requirements. After considering time and costs for obtaining additional relevant data, the Subcommittee determined that the previous bids provided the best available information. However, the sensitivity and limitations of the bid data are acknowledged in the report.

Cost Analysis Results

Two cost estimates were calculated for each scenario. The first estimate reflects the incremental costs incurred during the first year of operation which includes one-time costs of training and equipment necessary for making the new teams operational. The second cost estimate represents the annual ongoing incremental costs for operational expenses under each scenario. Both sets of annual cost estimates are presented in Table 3 for all scenarios. These costs only reflect the costs of supplying the service. Excluded from the analysis is any differences in licensee costs in accessing the testing services under the alternative scenarios.

The initial year costs include one-time training, unemployment compensation,

equipment installation and non-imaging equipment costs. Note that the digital photo imaging equipment lease payments are made annually over the life of the system. A list of one-time equipment purchase needs was specified by the Subcommittee based on current DOT standards and experience. The cost analysis considered the one-time equipment costs as part of the first year cost requirements and did not explicitly consider the cyclical replacement of equipment purchases, which the DOT typically depreciates over a 5 to 10 year period. The one-time equipment list includes software, hardware, modems, printers, vision machines, manuals, ID checking guides, Examiner ID Stamps, CDL and motorcycle cones, stop watches, and initial certification testing.

In addition, the Subcommittee recommended one supervisor for every six issuance sites based on existing standards of DOT oversight. A list of one-time equipment purchase needs for supervisors was also specified by the Subcommittee based on DOT current experience. The supervisor's equipment list includes laptop computer and printer, CDL and motorcycle cones, back-up printer, back-up vision machine, stop watch, initial cell phone and pager costs, and vehicle cost.

It should be noted that minority reports to the Subcommittee Cost Analysis suggested that the Treasurer system would involve more staff who would be conducting license issuance activities on a part time basis in addition to their other Treasurer functions. The minority reports suggests this results in greater administrative costs and potential safety concerns (Van Helden; Rensink).

Some perceived differences in safety were identified in a user satisfaction survey (Padgitt). However, the initial training standards and oversight required for Treasurer employees involved in license issuance and testing are identical to standards and

oversight required for DOT itinerant teams. The initial training costs assume regionalized courses requiring 8 weeks of training for each new issuance team member. Travel, meals and lodging costs are included for new staff, along with equipment leasing and additional salaries and expenses for DOT trainers.

Table 3 shows that any policy change results in higher combined DOT/Treasurer costs for the initial year of implementation. After the first year, however, Scenarios 2, 3 and 7 provide combined ongoing incremental cost savings compared to the existing system. Furthermore, Scenarios 2 and 3 result in expanded hours of local service delivery access, which presumably increases customer convenience and/or reduces licensee access costs. This attribute was identified as an important factor to local residents in a user satisfaction survey (Padgitt).

The ongoing incremental cost savings for Scenario 2 would payback the initial year incremental costs in under 2.5 years. However for Scenario 3, it would take longer to payback the initial year incremental costs. Subcommittee members also raised concerns about whether the expected level of voluntary interest by County Treasurers was realistic under Scenario 3. In the end, the Cost Analysis Subcommittee recommended a variation of Scenario 2 for passage by the General Assembly.

Revenue Sharing Analysis

The incremental costs were estimated for each scenario without regard to the existing mix of state and local revenues used to finance the license issuance system and without regard to the existing revenue reimbursement policy. An important issue separate from estimating costs for the alternative scenarios involves a policy decision regarding any payment from the state to County Treasurers for performing drivers license services. Table

3 clearly shows that ongoing incremental savings accrues to DOT under Scenarios 1, 2, 3 and 7 while the incremental costs accrue to County Treasurer offices under these scenarios. In most cases, Treasurer Offices would have little interest in providing issuance services for the DOT without a minimum reimbursement for incremental costs.

Before the final fiscal impacts of the various policy options can be determined, the reimbursement policy options must be clarified. The Cost Analysis Subcommittee outlined six reimbursement policy options for discussion: (1) no state payments to counties; (2) state payment to counties at incremental costs; (3) state payments to counties at direct costs; (4) state payments to counties at fully-allocated costs; (5) allow counties to charge an extra convenience fee to cover local costs; and (6) a combination.

Currently, Iowa pays up to $5.00 per transaction to the County Treasurers in the six counties involved in the pilot outsourcing project. This amount was designated in previous legislation and was loosely based on a previous estimate using fully allocated costs. Table 1 shows Iowa's current reimbursement rate to be less than the $5.83 direct costs per license in the six county pilot project area, but higher than the $3.06 cost per transaction estimated for Treasurer incremental costs.

The fifth reimbursement option was generated from testimony presented to the Committee (Edwards), which indicated that a convenience fee of $5.25 per license above the normal license fee is charged by all outsourcing sites in Florida. While the cost of the license is charged for licenses issued directly from the Florida Department of Highway Safety and Motor Vehicles, the convenience fee is not. Of the $5.25 convenience fee charged, $1.00 per license is remitted to Florida Department of Highway Safety and Motor Vehicles, while $4.00 per license is retained by the local Tax Collector's Office to cover

local costs. Committee testimony by Florida officials indicated a significant number of licenses are issued by local Tax Collectors in Florida because of geographic convenience and reduced waiting time.

After considering the various reimbursement policy alternatives, the Subcommittee settled on an approach that generated ongoing savings for both the DOT and County Treasurers. Table 4 shows estimated impacts on County finances and state budget finances for the Subcommittee recommended reimbursement rate of $3.75 per license issued by the County Treasurers.

Summary of Findings, Lessons Learned, and Implications

This study of Iowa's drivers license issuance services supports several findings related to outsourcing of government services. First, the results show that all policy scenarios other than continuing the existing system generate significant initial year transition costs. Therefore, none of the outsourcing policy scenarios generated incremental savings until the second year.

Second, some outsourcing policy scenarios were economically superior to the existing system while others were not. In this study, two policy scenarios representing larger leaps toward outsourcing are economically superior to the existing system compared to a policy scenario representing a smaller step toward outsourcing.

Third, there are factor input tradeoffs between the existing system and various outsourcing scenarios. The existing system of itinerant teams possessed higher salaries, higher transportation costs, and lower equipment and supervision costs per license issued compared to similar attributes for local Treasurers involved in the pilot outsourcing project.

Fourth, many rural County Treasurers Offices possess slack labor because of mandated service availability. Therefore, Treasurer incremental costs are lower than Treasurer direct costs. So, outsourcing represents an opportunity for residents to access expanded hours of service availability and for County Treasurers to increase staff productivity.

As a result, analysis of the driver license issuance outsourcing scenarios indicate that state and local government in Iowa has an opportunity to realize savings in ongoing costs that would payback the initial year transition costs within 2.5 years. The cost analysis was used by the Cost Analysis Subcommittee to develop a revenue reimbursement policy recommendation that allowed both state and local government units to share ongoing incremental savings from outsourcing.

The Driver License Issuance Study Committee Final Report was submitted by the Iowa Legislative Service Bureau to the General Assembly on January 3, 1998 and it served as a basis for debate on the issue. House File 2424, which embodied the Issuance Committee's recommendations and the cost analysis (performed by the Cost Analysis Subcommittee), was passed by the Iowa General Assembly and signed by the Governor to become effective July 1, 1998.

However, the Bill included a provision that requires the DOT to issue a Request for Proposals for the lease of the digitized photo imaging systems and make the responses available to the Iowa General Assembly by January 2, 1999. The Bill also specifies the

General Assembly may use the results for determining whether or not to proceed with expansion of the drivers license outsourcing activities with counties. However, outsourcing under House File 2424 will be implemented if the General Assembly does not take any action before March 1, 1999.

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Table 1. Time Study and Incremental Costs of Drivers License Issuance by County Treasurers in Outsourcing Pilot Project.

	Drivers License Issuance Outsourcing: Pilot Project Counties						Pilot Counties Combined
	Adams	Cass	Fremont	Mills	Montgomery	Page	
Licenses Issued FY1997	3,578	7,134	2,434	3,576	4,121	5,729	26,572
Issuance Time % Total Staff Time from Time Study	(23 %)	(18 %)	(12%)	(15%)	(18%)	(25%)	(18%)
Salary Costs Allocated to Issuance	$17,607	$28,228	$15,683	$19,056	$30,538	$38,359	--
Direct Costs Other	$823	$554	$948	$330	$1,299	$1,615	--
Total Direct Cost for Issuance	$18,430	$28,782	$16,631	$19,386	$31,837	$39,974	$155,040
Direct Cost/ License	**$4.85**	**$3.89**	**$6.61**	**$5.10**	**$7.35**	**$6.39**	**$5.83**
Incremental Salary Costs	$6,758	$18,897	$5,716	$8,771	$15,528	$20,042	--
Incremental Costs Other	$823	$554	$948	$330	$1,299	$1,615	--
Incremental Costs Total	$7,581	$19,451	$6,664	$9,101	$16,826	$21,657	$81,280
Incremental Costs /License	**$2.12**	**$2.73**	**$2.74**	**$2.55**	**$4.08**	**$3.78**	**$3.06**
Incremental Costs as % of Direct Costs	**44 %**	**70 %**	**41 %**	**50 %**	**56 %**	**59 %**	**52 %**

Figure 1. Quadratic Relationship Between Iowa Bid Costs per Document and Quantity of Digital Imaging Equipment Sets.

Table 2. Incremental Costs for Digital Imaging Systems and Sensitivity Analysis on Iowa Lease Bids and Equipment Cost Relationships for Alternative Policy Scenarios.

	Digital Systems Quantity Change (A)	Current Bid Cost per License (B)	Est. Bid Cost per License (C)	Incremental Cost per License (C-B)/A (D)	Licenses Processed Statewide (E)	Digital Equipment Incremental Costs and Sensitivity		
						Estimate (AxDxE)	Bid +/- $.005	+/- % Change
Scenario 1	22	1.777	2.131	0.0161	875,000	310,097	96,250	31.0%
Scenario 2	40	1.777	2.341	0.0141	875,000	493,452	175,000	35.5%
Scenario 3	86	1.777	2.993	0.0141	875,000	1,063,716	376,250	35.4%
Scenario 4	-3	1.777	1.715	-0.0624	875,000	-54,575	13,125	24.0%
Scenario 5	-1	1.777	1.757	-0.0203	875,000	-17,793	4,375	24.6%
Scenario 6	4	1.777	1.854	0.0770	875,000	-67,404	17,500	26.0%
Scenario 7	-5	1.777	1.671	-0.1063	875,000	-93,013	21,875	23.5%

Source: County Issuance of Motor Vehicle Licenses Study Committee Final Report, Jan. 1998.

Table 3. Estimated Initial Year and Ongoing Annual County, DOT and Total Incremental Costs (Savings) under Alternative Policy Scenarios for Issuance of Drivers Licenses

Policy Descriptor	**Alternative Policy Scenarios**						
	1	2	3	4	5	6	7
Change in Co. Treasurer/ DOT Teams	24 Treas. - 5 DOT	42 Treas. - 10 DOT	84 Treas. - 21 DOT	-6 Treas. 3 DOT	-6 Treas. 5 DOT	-6 Treas. 10 DOT	-6 Treas. 1 DOT
Digital Systems Added *	22	40	86	-3	-1	4	-5
Change in Avail. Service Hours/Year	39,520	66,560	131,040	-6,240	-2,080	8,320	-10,400
Initial Year Incremental Cost (Sav.)	**Alternative Policy Scenarios**						
	1	2	3	4	5	6	7
Treasurers	277,501	655,524	1,363,395	-68,652	-68,652	-68,652	-68,652
DOT	22,084	-321,273	-639,955	487,640	894,158	1,919,528	79,467
Total	299,584	334,251	723,440	418,988	825,506	1,850,876	10,815
Ongoing Incremental Cost (Sav.)	**Alternative Policy Scenarios**						
	1	2	3	4	5	6	7
Treasurers	253,405	613,356	1,279,059	-81,310	-81,310	-81,310	-81,310
DOT	-215,613	-763,241	-1,543,357	454,863	837,869	1,788,625	70,203
Total	37,782	-149,885	-264,299	373,553	756,559	1,707,315	-11,108

* Includes equipment for continuation of itinerant sites not located in county seat cities that may already exist in some counties.

Table 4. Impacts of Reimbursement Policy Recommendation on Net Incremental Costs (Savings) for Treasurers in 42 Counties and Iowa DOT under Scenario 2.

	Initial Year	Ongoing Annual
Effect on County Finances		
County Revenue from State for Issuance @$3.75/license	($751,661)	($751,661)
County Incremental Costs	$655,524	$613,356
Net Costs (Revenue) to Counties above Incremental Costs	($96,137)	($138,305)
Effect on State Budget Finances		
State Payments to Counties @$3.75 /license	$751,661	$751,661
DOT Incremental Cost (Savings)	($321,273)	($763,241)
Net DOT Cost (Savings)	$430,388	($11,580)
Total DOT/Treasurer Incremental Cost (Savings) *	$334,251	($149,885)

* Equals amounts reported in Table 3 for Scenario 2.