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Privatization and the Federal Government:: An Introduction

Kevin R. Kosar, Government and Finance Division

April 23, 2007

Abstract. This report is an introduction to privatization in the federal governmental context. It discusses the emergence of privatization on the federal policy agenda in the late 1970s and early 1980s. This report also supplies a typology of the various means through which federal agencies and activities have been privatized. Next, the report explains the distinction between privatization and marketization, an alternative to privatization, which is "the structuring of a government agency so that it provides goods and services in the efficient manner of a private firm." Finally, the report notes that, whenever policymakers consider privatizing a federal agency or activity, a fundamental issue arises - "Which activities are essential to the state and should remain directly accountable to the elected representatives of the people and which may be carried out by the private sector?"

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CRS Report for Congress

Privatization and the Federal Government: An Introduction

Updated April 23, 2007

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Prepared for Members and
Committees of Congress

Privatization and the Federal Government: An Introduction

Summary

During the past two decades, the privatization of federal agencies and activities has been much debated. That said, privatization — here defined as *the use of the private sector in the provision of a good or service, the components of which include financing, operations (supplying, production, delivery), and quality control* — is not a recent phenomenon. Since its founding in 1789, the federal government has used private firms to provide goods and services. Hence, privatization, in all its forms, which include contracting out, vouchers, and prize competitions, is of perennial interest to Congress.

This report is an introduction to privatization in the federal governmental context. It discusses the emergence of privatization on the federal policy agenda in the late 1970s and early 1980s. To some, privatization appeared as an answer to the purported failures of “big government.” Privatization attracted political support due to its rhetorically persuasive rationales, purported benefits, and political attractiveness. However, privatization also has been controversial. Critics have complained that privatization is a form of union busting and that privatization can have unforeseen and undesirable consequences.

This report also supplies a typology of the various means through which federal agencies and activities have been privatized. The typology shows that privatization is not an either/or proposition. Rather, privatization, as this report’s definition implies, is a matter of degree. Policymakers may transfer to the private sector one or more of the components of government provision of goods and services — however many they deem appropriate.

Next, the report explains the distinction between privatization and marketization, an alternative to privatization, which is “the structuring of a government agency so that it provides goods and services in the efficient manner of a private firm.” Marketization retains an activity within the governmental sector; privatization moves the components of an activity to the private sector. This distinction is significant because entities within these differing sectors tend to behave differently. Private sector firms tend to be self-directing and profit-seeking; government agencies tend to be process-oriented and pursue the multiple and sometimes conflicting goals assigned to them by Congress and the President. Hence, policymakers who wish to improve an agency’s efficiency or performance, but are leery of privatization, may find marketization an attractive option.

Finally, the report notes that, whenever policymakers consider privatizing a federal agency or activity, a fundamental issue arises — “Which activities are essential to the state and should remain directly accountable to the elected representatives of the people and which may be carried out by the private sector?” This question is complex and value-laden; no definitive answer exists. Thus, the decision to privatize is inherently controversial.

This report will not be updated.

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Privatization and the Federal Government: An Introduction

Introduction

Newspapers¹ and journals carry reports of efforts by local, state, and national governments to privatize government agencies or services.² Privatization initiatives are being considered and carried out in nation-states around the world.³

Privatization is an idea that has attracted both strong adherents and vociferous critics. Privatization reached the federal policy agenda in the United States more than two decades ago, and each Congress features new bills proposing to either expand or halt the movement of federal governmental activities to the private sector.

In recent years, President George W. Bush has advocated the privatization of military housing and the expansion of opportunities for private organizations to provide social and community services as part of his government management agenda.⁴ Moreover, the President supported the provision of housing and schooling vouchers to persons displaced by Hurricane Katrina, and the creation of a Medicare prescription drug benefit provided by private firms.⁵

¹ This report draws upon CRS Report 95-522, *Privatization: Meanings, Rationale, and Limits*; and CRS Report 89-160, *Privatization from a Public Management Perspective*, by Ronald C. Moe (both archived; available from author).

² To cite two recent examples: Samuel G. Freedman, "The Not-So-Public Part Of the Public Schools," *New York Times*, September 13, 2006, p. 9; and Eric Peter, "Privatization Will Bring Fresh Ideas," *Augusta Chronicle*, September 26, 2006, p. A5.

³ For example, the French government is considering the privatization of a state-owned gas firm, and the Algerian government, reportedly, is in the process of privatizing a state-owned Algerian People's Credit Union. "EU Energy Giants May be Broken Up," *Irish Times*, September 12, 2006; and Djalal Bouâti, "CPA to be Privatized Next February," *El-Khabar*, September 27, 2006.

⁴ Office of Management and Budget, *The President's Management Agenda* (Washington: OMB, 2002), pp. 35-42, available at [<http://www.whitehouse.gov/omb/budget/fy2002/mgmt.pdf>].

⁵ On these policies, see, respectively, CRS Report RL33173, *Hurricane Katrina: Questions Regarding the Section 8 Housing Voucher Program*, by Maggie McCarty; CRS Report RL33236, *Education-Related Hurricane Relief: Legislative Action*, by Rebecca R. Skinner et al.; and CRS Report RL33136, *Medicare: Enrollment in Medicare Drug Plans*, by Jennifer O'Sullivan.

Congress, however, has been of mixed mind regarding privatization, enacting policies that both limit and expand the private sector's access to federal funds to provide governmental services.

- Congress has enacted statutes (e.g., P.L. 104-193, sec. 104; P.L. 106-554, sec. 1) that permit private groups — including not-for-profits and religious organizations — to apply for grants to provide social services, such as substance abuse counseling and employment training, previously offered by government agencies.⁶
- During the 110th Congress, the House approved a bill that would impose a one year “moratorium on conversion to contractor performance of Department of Defense functions at military medical facilities” (H.R. 1538, Section 301).

Privatization, however, is not a recent phenomenon. Since the founding of the Republic, the federal government has hired or contracted with private firms to provide public goods and services. For example, Congress enacted a statute in 1789 that declared that

it shall be the duty of the Secretary of the Treasury to provide by contracts, which shall be approved by the President, for building a lighthouse near the entrance of the Chesapeake Bay, and for rebuilding when necessary, and keeping in good repair, the lighthouses, beacons, buoys, and public piers in the several states....” (1 Stat. 54)

Hence, privatization has been of perennial interest to Congress and likely will continue to be so.

Privatization: A Definition

Economists, political leaders, and government officials tend to define “privatization” differently.⁷ The breadth of activities covered by the term “privatization” varies greatly. The Congressional Budget Office (CBO), for example, has defined “privatization” narrowly to refer to activities that “involve a genuine sale of assets and termination of a federal activity.”⁸ The *Oxford English Dictionary*, meanwhile, defines the term more broadly to mean “the policy or process of making

⁶ CRS Report RL32736, *Charitable Choice Rules and Faith-Based Organizations*, by Joe Richardson.

⁷ On privatization as a contested concept, see Paul Starr, “The Meaning of Privatization,” *Yale Law & Policy Review*, vol. 6, issue 1, 1988, pp. 6-41.

⁸ Congressional Budget Office, *Third Party Financing of Federal Projects*, Economic and Budget Issue Brief, June 1, 2005, p. 5.

private as opposed to public.”⁹ Perhaps most commonly, “privatization” is used to refer to “any shift of activities or functions from the state to the private sector.”¹⁰

All three of these definitions have value. Arguably, though, it may be possible to define privatization more precisely. Privatization might be defined as *the use of the private sector in the provision of a good or service, the components of which include financing, operations (supplying, production, delivery), and quality control.*

This definition is useful to policymakers for three reasons. First, it enables policymakers who wish to improve the provision of a good or service to see that privatization is not an either/or proposition. Rather, privatization is a matter of degrees and there are myriad means, as this report explicates, through which the private sector may be brought into the process of the provision of a good or service. At minimum, an agency might purchase office supplies, such as printer paper, pens, and folders, from a private sector firm (supplying). Alternatively, a government agency may more heavily utilize the private sector. It might also hire a not-for-profit corporation to raise operating funds and contract with private firms to assist in the provision of a service (supplying, financing, delivery). Taken furthest, an agency might be abolished and private firms allowed to provide a good or service (financing, supplying, production, delivery, and quality control).

Second, utilizing this definition also may enable policymakers to see that a fundamental values question lies beneath the issue of privatization. Whenever government must provide a good or service, the question arises, “Which components of provision ought to be done by the government and which might be done by the private sector?” Different approaches to privatization of the components of an agency’s provision of goods and service may provoke more or less controversy. For example, permitting an agency to hire a private firm to assess its performance (quality control) may elicit some concern; permitting this same agency to acquire funds by charging citizens fees (financing) may provoke widespread criticism.

On the whole, then, the definition employed in this report may highlight for policymakers both the instrumental (e.g., “how”) and normative (e.g., “ought”) questions involved in privatization.

Background: The Recent Political Salience of Privatization

The sources of the salience of privatization are manifold, but likely include privatization’s rhetorically potent rationales, purported benefits, and political attractiveness.

⁹ *Oxford English Dictionary*, available at [<http://dictionary.oed.com/>].

¹⁰ Starr, “The Meaning of Privatization,” p. 14.

The Rhetorically Potent Rationales for Privatization

A host of rationales has been employed to advance privatization as a policy. Collectively, though, these arguments amount to a criticism of the purported failures of “big government.”¹¹

In great part, the contemporary privatization movement has its intellectual roots in free market economic theory and public choice theory.¹² Philosophically, free market theory is skeptical of government and is sanguine toward markets. As one renowned exponent of markets has written,

Economic arrangements play a dual role in the promotion of a free society. On the one hand, freedom in economic arrangements is itself a component of freedom broadly understood, so economic freedom is an end in itself. In the second place, economic freedom is also an indispensable means toward the achievement of political freedom.¹³

From this perspective, the great danger to freedom is the concentration of power in the hands of government. Economic freedom protects individual freedom by limiting the extent of political power.¹⁴ Free market theory, generally speaking, argues that markets — not governments — are the most efficient means for the production of goods and services. In arguing for markets and against government provision of goods and services, free market advocates argue that government tends to behave as a monopoly provider of goods and services. As such, it is inefficient, inattentive to public wants, and slow to reform and innovate.

Public choice theory is a near relation to free market economics.¹⁵ One of public choice theory’s criticisms of government is that public bureaucracies should not be viewed as neutral vehicles for delivering government goods and services. Rather, it posits, individual bureaucrats should be viewed as self-interested actors, not public-spirited civil servants.¹⁶ As each bureaucrat strives to achieve what he desires, he

¹¹ On the role of ideas and the movement of privatization onto the federal policy agenda, see Jeffrey R. Henig, “Privatization in the United States: Theory and Practice,” *Political Science Quarterly*, vol. 104, no. 4, 1989-90, pp. 649-670.

¹² Jane Seaberry, “‘Public Choice’ Finds Allies in Top Places,” *Washington Post*, April 6, 1986, p. F1.

¹³ Milton Friedman with the assistance of Rose Friedman, *Capitalism and Freedom*, 40th anniversary ed. (Chicago: University of Chicago Press, 2002), p. 8.

¹⁴ *Ibid.*, p. 15.

¹⁵ Hugh Stretton and Lionel Orchard, *Public Goods, Public Enterprise and Public Choice: Theoretical Foundations of the Contemporary Attack on Government* (New York: St. Martin’s Press, 1994).

¹⁶ “Bureaucrats are much like other people and, in general, are more interested in their own well-being than in the public interest. The problem is to design an apparatus that leads bureaucrats in their own interest to serve the interests of the rest of us.” Gordon Tullock, “Bureaucracy,” in Gordon Tullock, Arthur Seldon, and Gordon L. Brady, *Government* (continued...)

helps produce collective organizational pathologies, often termed “government failures.”¹⁷ For example, according to public choice theory, the head of each administrative division of an agency should be expected to seek to obtain the maximum possible funding for his division. In order to justify this budget request, he will devise ways to increase projected costs. When each administrative head does this, the collective result is a greatly enlarged agency budget with funding priorities that are neither rational nor necessarily related to achieving the goals assigned to the agency by statute.

Both free market economists and public choice theorists typically believe that the nature of the goods or services to be produced determines whether the private sector or government should produce it. If the good is “non-excludable” (meaning that persons cannot be prevented from using it) and “non-rival” (meaning that one person’s use of it does not diminish another person’s use of it), then it is a “public good” and government should produce it. An example of this sort of good is national defense. As for goods that do not meet these criteria (e.g., computers, bullets, housing priced at below-market rates for occupancy by low-income persons), free market economists and public choice theorists tend to hold that private firms should be left to produce these items because they can do so most efficiently. Since public goods tend to be few, this perspective amounts to an advocacy of minimalist government, and one that would have the government use private firms as much as it can to help it produce public goods.

There also have been political and philosophical arguments that have encouraged privatization implicitly and explicitly. Primarily, these arguments have come from conservatives and libertarians who wish to shrink the federal government. Some of these critics have complained about the growth of a “behemoth” federal government that accretes power at a cost to the liberty of citizens.¹⁸ Other detractors of “big government” complain that the federal government has overstepped the bounds set for it by the Constitution.¹⁹ In both cases, the argument is that government is doing things that it should not be doing and that it should desist from doing them. These activities, then, would be left to the private sector, which may or may not perform them.

Still, other critics of big government have explicitly advanced privatization as a means for reducing the size of government and the federal deficit:

It is the demand for public services that powers the growth of the government, and there is a systematic political imbalance between those who desire more

¹⁶ (...continued)

Failure: A Primer in Public Choice (Washington: Cato Institute, 2002), p. 53.

¹⁷ Gordon Tullock, *The Politics of Bureaucracy* (Lanham, MD: University Press of America, 1987).

¹⁸ James Bovard, *Lost Rights: The Destruction of American Liberty* (New York: St. Martins Press, 1995).

¹⁹ See, for example, Robert Bork, *The Tempting of America: The Political Seduction of the Law* (New York: Free Press, 1990), chapter 2.

spending and those who desire less — an imbalance consistently favoring the pro-spending lobby.... [A] powerful coalition of beneficiaries, service suppliers, political activists, and bureaucrats tends to develop around each federal spending program. It is in the interest of those coalitions to press [Congress] for an expansion of the federal role.²⁰

Privatization, according to this perspective, can diminish these political pressures by taking an activity out of the hands of those with an interest in its expansion. Bureaucrats would be replaced by private sector entrepreneurs, and recipients of government goods and services would be transformed into customers. Whereas the former persons had an interest in greater spending, it is said, the latter will favor low-cost services.

These arguments for privatization have attracted attention, in part, because they are rhetorically potent. Economics, history, and constitutional law all have been employed to argue against “big government” and for the superior ability of private firms to provide goods and services.²¹ Proponents of privatization also have portrayed privatization as a policy that promotes widely-esteemed values, such as freedom and efficiency, as a tool for fighting the bugbears of intrusive and wasteful bureaucracy, and as a “key” to better government.

Purported Benefits of Privatization

Proponents of privatization have claimed that it provides diverse benefits. E.S. Savas, one of the earliest and best known proponents of privatization, has stated,

[P]rivatization is the key to both limited and better government: limited in size, scope, and power relative to society’s other institutions; and better in that society’s needs are satisfied more efficiently, effectively, and equitably. Privatization is both a means and an end. For pragmatists who want better government and for populists who seek a better society, privatization is a means toward those ends.²²

Generally, promoters of privatization believe that private firms can provide goods and services “better, faster, and cheaper” than government. Competition and the profit-motive, they say, goad private firms to better produce products and services than government, which they construe as a “monopoly.”²³ Advocates for

²⁰ Stuart Butler, *Privatizing Federal Spending* (New York: Universe Books, 1985), p. 2. See also Stephen Moore and Stuart M. Butler, *Privatization: A Strategy for Taming the Federal Budget* (Washington: Heritage Foundation, 1988).

²¹ Some advocates have argued that the tenets of Christianity are consanguine with the principles of free markets economics and minimalist government. See, for example, Stephen Carson, “Christianity’s Free-Market Tradition,” website of the Ludwig van Mises Institute, July 14, 2003, available at [<http://www.mises.org/story/1267>].

²² E.S. Savas, *Privatization: The Key to Better Government* (Chatham, NJ: Chatham House, 1987), p. 288.

²³ David Osborne and Ted Gaebler, *Reinventing Government* (Reading, MA: Addison- (continued...)

privatization often point to the positive experiences that some states and localities have experienced when they privatized municipal services such as waste removal, fire protection, and ambulance services.²⁴

Privatization also is desirable, some advocates contend, because it can spur economic growth by opening new areas of activity to entrepreneurs. Privatizing activities that the private sector can provide has also been justified as a means to improve government performance by forcing it to focus more sharply on its “core activities” rather than adjunct functions.²⁵

Political Attractiveness of Privatization

Privatization holds appeal to some policymakers because of its purported utility for addressing at least four salient political issues.

First, some persons in the United States have expressed disillusionment with the federal government’s performance as a provider of services and regulator of the economy. The roots of this sentiment are deep, going back at least to conservative reactions against the expansion of the federal government during the New Deal and the economic and national socialism in Europe and the Soviet Union.²⁶ In more recent decades, allegations of “waste, fraud, and abuse” by federal agencies have encouraged a search for private sector solutions to government problems.²⁷

Second, worldwide, a number of countries have experienced a host of problems with state-operated industries and entities. Corruption, escalating costs, and employee strikes inspired some central governments to consider other means to make

²³ (...continued)
Wesley, 1992), chapter 3.

²⁴ E.S. Savas, *Privatizing the Public Sector: How to Shrink Government* (Chatham, N.J.: Chatham House Publishers, 1982), pp. 111-117; Keon S. Chi and Cindy Jasper, *Private Practices: A Review of Privatization in State Government* (Lexington, KY: The Council of State Governments, 1998); and Roger S. Ahlbrandt Jr., *Municipal Fire Protection Service: Comparison of Alternative Forms* (Beverly Hills, CA: Sage Publications, 1973). For an early and more critical view, see Donald Fisk, Herbert Kielsing, and Thomas Muller, *Private Provision of Public Services: An Overview* (Washington: The Urban Institute, 1978), pp. 93-97.

²⁵ Edward H. Crane and David Boaz, *Cato Handbook on Policy*, 6th ed. (Washington: Cato Institute, 2005), p. 326.

²⁶ See James T. Patterson, *Congressional Conservatism and the New Deal* (Lexington: University of Kentucky Press, 1967); Friedrich A. Hayek, *The Road to Serfdom* (Chicago: University of Chicago Press, 1944); and Milton Friedman, *Capitalism, Freedom, and Democracy* (Chicago: University of Chicago Press, 1962).

²⁷ For example, see Donald Lambo, *Fat City: How Washington Wastes Your Taxes* (South Bend, IN: Regnery Publishing, 1980). See also President’s Private Sector Survey on Cost Control, *War on Waste* (New York: MacMillan Publishing Company, 1984).

these entities more cost effective and competitive.²⁸ Foreign governments' experiments with privatization helped fuel the United States's own experimentations in government reform.²⁹

Third, the persistent budget deficits of the past three decades have encouraged lawmakers and agency managers to develop new sources of revenue and to reduce costs. The search for solutions has stimulated both the federal government and private firms to examine government activities, to develop proposals to transfer government functions to the private sector, and to make agencies operate more like the private sector.³⁰

Fourth, private sector firms have significant interests in the advancement of privatization.³¹ These firms may reap significant financial benefits, for example, by purchasing government assets and by winning contracts to provide products and services to the government or the public. To cite just two instances: (1) In 1998, Occidental Petroleum was willing to spend \$3.65 billion to purchase the Elk Hills Naval Petroleum Reserve from the U.S. government.³² Recently, the company has said that the purchase was "an excellent investment."³³ (2) In 2005, the federal government's annual spending on contracts with private companies for goods and services grew to \$377.5 billion.³⁴ Over the past two decades, newspapers and periodicals have carried pieces by business executives that urge the government to turn to the private sector to improve government.³⁵

²⁸ William P. Glade, ed., *State Shrinking: A Comparative Inquiry into Privatization* (Austin: Institute of Latin American Studies, University of Austin at Texas, 1986); and Donald J. Savoie, *Thatcher, Reagan, Mulroney: In Search of a New Bureaucracy* (Toronto: University of Toronto Press, 1994).

²⁹ Katsuro Sakoh, *Privatizing State-Owned Enterprises: A Japanese Case Study* (Washington: Heritage Foundation, 1986); U.S. General Accounting Office, *Privatization/Divestiture Practices in Other Nations*, GAO/AIMD-96-2 (Washington: GAO, 1995); and U.S. General Accounting Office, *Budget Issues: Privatization Practices in Argentina*, GAO/AIMD-96-55 (Washington: GAO, 1996).

³⁰ On improving government efficiency, see, for example, the publications of IBM's Center for the Business of Government, available at [<http://www.businessofgovernment.org/main/publications/index.asp>].

³¹ Savas, *Privatization*, p. 9.

³² Platt's Inside Energy, "Government Sells Elk Hills Reserve," *The Energy Report*, February 9, 1998.

³³ Website of the Occidental Petroleum Corporation, available at [http://www.oxy.com/OIL_GAS/world_ops/usa/elkhills.htm].

³⁴ U.S. House of Representatives, Committee on Government Reform — Minority Staff, *Dollars, Not Sense: Government Contracting Under the Bush Administration* (Washington: U.S. House of Representatives, 2006), p. 3.

³⁵ For two recent examples, see John Torinus, "Public Sector Can Learn from Private Successes," *Milwaukee Journal Sentinel Online*, June 17, 2006, available at [<http://www.jsonline.com/story/index.aspx?id=437043>]; and Stephen L. Starling, "What Private Industry Can Teach Government," *World Trade Magazine*, April 1, 2004.

Not surprisingly, then, the past four presidents all have promoted privatization to some degree. President Ronald W. Reagan was a vigorous exponent of privatization, favored the privatization of Conrail, and appointed a Commission on Privatization in 1987.³⁶ Though less ardent than his predecessor, President George H.W. Bush spoke in favor of privatization and issued an executive order to encourage it.³⁷ President William J. Clinton, with the help of Vice President Albert A. Gore Jr., promoted the reinvention of government based upon ideas drawn from the private sector, and supported the privatization of the Elk Hills Naval Petroleum Reserve in 1998.³⁸ President George W. Bush, as noted above, has voiced support for privatization initiatives.

Criticisms of Privatization

Unlike “reinventing government,” “performance-based organizations,” or other recent government reform ideas, privatization remains much discussed in federal policy networks.³⁹ That said, proponents’ acclamation of privatization as a tool for improving the performance of government has not gone without rebuttal. Observers and opponents have raised numerous questions and issued assorted criticisms of privatization. Views include the following:

- The shifting of government work from government employees to private sector contractors has been criticized as a union-busting strategy intended to weaken the political left by decreasing the number of unionized government employees.⁴⁰

³⁶ U.S. President’s Commission on Privatization, *Privatization: Toward More Effective Government* (Washington: GPO, 1988).

³⁷ George H.W. Bush, Executive Order 12803, April 30, 1992. (57 FR 19063) Bush later remarked of this executive order, “Facilities now run by government that could be owned and operated by competitive enterprises can thus serve the public more fairly and more efficiently.” As quoted in John E. Yang, “Bush Moves to Ease Sale of Federally Financed Facilities” *Washington Post*, May 1, 1992, p. A10.

³⁸ U.S. Executive Office of the President, *National Performance Review, From Red Tape to Results: Creating a Government That Works Better and Costs Less* (Washington: U.S. GPO, 1993).

³⁹ A CRS Nexis search of *Washington Post* articles revealed 36 mentions of the phrase “reinventing government” and two mentions of “performance based organizations” over the past five years. Meanwhile, a CRS Nexis search for *Washington Post* articles carrying the terms “privatization” and “federal government” produced over 350 articles in the past five years. On reinventing government and performance-based organizations, see U.S. General Accounting Office, *Reinventing Government: The Status of NPR Recommendations at 10 Agencies*, GAO/GGD-00-145 (Washington: GAO, 2000); and CRS Report 97-72GOV, *Performance-Based Organizations in the Federal Government: A Reinvention Innovation*, by Harold C. Relyea (archived; available from author.)

⁴⁰ Craig Becker, “With Whose Hands: Privatization, Public Employment, Democracy,” *Yale Law and Policy Review*, vol. 6, issue 1, 1988, pp. 88-108, quotes at pp. 88, 89.

- Contracting out may adversely affect women and minorities collectively, as they have “tended to find jobs in the civil service more readily than in the private sector.”⁴¹
- Under the American theory of governance, political power originated with the people, who erected government and entrusted it to use this power in accordance with the law. Thus, the responsibility of those employed by government is to act in accordance with this fiduciary relationship. Accordingly, both the Constitution and federal law include oaths to be taken by elected officials and civil servants.⁴² Bureaucracies are not merely passive entities that execute the law as enacted. Bureaucracies interpret the law and sculpt policies. Thus, any effort to shift bureaucratic functions to the private sector may risk transferring away some governing discretion into the hands of private parties who are not accountable to the public and may not have its interests at heart.⁴³
- One of the objectives of creating a civil service was to provide government with a stable corps of committed employees. Federal workers were to be chosen on a rational basis, as opposed to the favor of an appointee, and provided with protections and good compensation and benefits that would encourage long tenures. It was hoped that this arrangement would develop in employees the often peculiar expertise required to carry out governmental activities and instill in them a commitment to the law.⁴⁴ Privatization may “hollow out” agencies’ expertise, replacing them with short-term

⁴¹ Ibid., p. 95.

⁴² Art. II, sec. 8 requires the President to take an oath. “Before he enter on the Execution of his Office, he shall take the following Oath or Affirmation: — ‘I do solemnly swear (or affirm) that I will faithfully execute the Office of President of the United States, and will to the best of my Ability, preserve, protect and defend the Constitution of the United States.’” Art. IV, Cl. 3 requires an oath of Members of Congress and government officers: “The Senators and Representatives ... and all executive and judicial Officers, both of the United States and of the several States, shall be bound by Oath or Affirmation, to support this Constitution.” 5 U.S.C. 3331 requires: “An individual, except the President, elected or appointed to an office of honor or profit in the civil service or uniformed services, shall take the following oath: ‘I [insert your name] do solemnly swear (or affirm) that I will support and defend the Constitution of the United States against all enemies, foreign and domestic; that I will bear true faith and allegiance to the same; that I take this obligation freely, without any mental reservation or purpose of evasion; and that I will well and faithfully discharge the duties of the office on which I am about to enter. So help me God.’”

⁴³ David H. Rosenbloom and Suzanne J. Piotrowski, “Outsourcing the Constitution and Administrative Law Norms,” *American Review of Public Administration*, vol. 35, no. 2, June 2005, pp. 103-121.

⁴⁴ See, generally, Paul P. Van Riper, *History of the United States Civil Service* (Evanston, IL: Row, Peterson, 1958).

contract workers with little commitment to the public mission of the agency.⁴⁵

- Contracting out can promote iron triangles and other corrupt relationships between the federal government and the private sector. For example, Boeing Company reached a \$615 million settlement with the Department of Justice in May 2006. The company was investigated for its role in a contracting scandal. The company fired its chief financial officer — who attempted to persuade an Air Force official, who was overseeing a large federal contract that Boeing was bidding on — to take a job with the company. This same official was jailed after she admitted that she had used the Boeing executive to get a job for her daughter and future son-in-law with Boeing and improperly favored the company in awarding the contract.⁴⁶
- The premise of privatization is that the government will benefit when firms in a competitive market compete to provide it with products and services. Competitive markets, however, require a number of conditions to be met for them to function properly. To cite just two of them, (1) firms must not face barriers to entry in this market and (2) the buyer of the goods and services must possess sufficient information to empower it to make a rational purchase. If any of the conditions for competition are not met, the buyer — i.e., an agency — may be exploited. In short, markets can fail,⁴⁷ especially if there are too few firms to compete for government contracts.⁴⁸
- Hiring private firms to carry out government work creates great management challenges for government administrators. Should an agency fail to have well-trained personnel and effective oversight procedures in place, its utilization of private providers can result in waste, fraud, and abuse.⁴⁹

⁴⁵ For example, see Mark L. Goldstein, *America's Hollow Government: How Washington Has Failed the People* (Homewood, IL: Richard D. Irwin, Inc., 1992), chapter 6.

⁴⁶ Renae Merle, "Boeing Agrees to pay \$615 Million Settlement," *Washington Post*, May 16, 2006, p. A10; and U.S. Government Accountability Office, *Air Force Procurement: Protests Challenging Role of Biased Official Sustained*, GAO-05-436T (Washington: GAO, 2005).

⁴⁷ See CRS Report RL32162, *The Size and Role of Government: Economic Issues*, by Marc Labonte.

⁴⁸ Reportedly, one company, US Investigations Services (USIS), performs 70% of the background investigations for federal employees, job applicants, and contract workers. Tim Kaufmann, "Pace of Background Investigations Challenges OPM Offshoot," *Federal Times*, July 17, 2006, p. 22. Similarly, see Renae Merle, "Rocket Monopoly Approved: Boeing-Lockheed Alliance Likely to Increase Costs," *Washington Post*, October 4, 2006, p. D1.

⁴⁹ U.S. Government Accountability Office, *Contract Management: DOD Vulnerabilities to* (continued...)

- Government may benefit when private firms compete to provide a good or service; however, should the firm providing the service go out of business there may be a time lag before it can be replaced. The costs of this time lag can be formidable. For example, when a company operating charter schools in California became defunct in August 2004, the parents of 10,000 children had but a few weeks to locate new schools for their children.⁵⁰
- Privatization does not always lead to cost savings or better service.⁵¹ In some instances, private firms have had significantly higher cost overruns than government agencies in the performance of services.⁵² In other instances, private firms have performed work that has been criticized as being grossly inadequate.⁵³

Privatization, then, has been criticized as ill-intentioned and inherently inimical to good government, and it has been faulted both in principle and in practice.

Means of Privatization

Many means of privatization have been devised, and the classification and nomenclature used for these activities varies from study to study.⁵⁴ Nevertheless, privatization, generally, is understood to include the following activities: divestiture/load-shedding, contracting for goods, contracting for services (outsourcing), vouchers, quasi governmental entities (including government-owned-contractor-operated facilities (GOCO)), third-party financing, grants to private

⁴⁹ (...continued)

Contracting Fraud, Waste, and Abuse, GAO-06-838R (Washington: GAO, 2006).

⁵⁰ Erika Hayasaki, "Charter Academy Shuts 60 Schools," *Los Angeles Times*, August 16, 2004, p. B1.

⁵¹ U.S. General Accounting Office, *Private and Public Prisons: Studies Comparing Operational Costs and/or Quality of Service*, GAO/GGD- 96-158 (Washington: GAO, 1996).

⁵² U.S. General Accounting Office, *Navy Maintenance: Cost Growth and Schedule Overrun Problems Continue at the Shipyards*, GAO/NSIAD-90-144 (Washington: GAO, 1990).

⁵³ Amit R. Paley, "Heralded Iraq Police Academy a 'Disaster,'" *Washington Post*, September 28, p. A1.

⁵⁴ For example, see General Accounting Office, *Terms Related to Privatization Activities and Processes*, GAO/GGD-97-121 (Washington: GAO, 1997), Appendix V; and E.S. Savas, "A Taxonomy of Privatization Strategies," *Policy Studies Journal*, Winter 1989/90, pp. 343-55.

parties, prize competitions, and the use of volunteers.⁵⁵ Each of these activities is described below.

Divestiture/Load-Shedding. The sale, or divestiture, by a government of an agency, corporation, or service to private ownership is the most clear-cut method of privatization. An example of the divestiture of a federally owned corporation was the March 1987 sale of Conrail to the public through a stock offering. An example of the divestiture of a governmental activity is the Office of Personnel Management's (OPM's) creation of US Investigations Service (USIS). OPM created this private sector entity and transferred the employees of OPM's Federal Investigations Division to it.⁵⁶

Another simpler form of divestiture is to sell some asset, such as real property, to a private firm or individual. Recent large-scale examples⁵⁷ include the privatization of the Alaska Power Administration (1996) and U.S. Enrichment Corporation, Inc. (1998),⁵⁸ and the previously mentioned sale of the Elk Hills Naval Petroleum Reserve (1998).⁵⁹

The government may simply give some asset away as it did when transferring land to homesteaders in the 19th century.⁶⁰ Finally, government may decide to stop

⁵⁵ Some who have examined this issue have classified deregulation, loan guarantees, and government insurance programs as forms of privatization. See, for example, President's Private Sector Survey on Cost Control, *Report on Privatization* (Washington: GPO, 1983, p. i; and Harold Seidman, "Privatization in the United States," *International Review of Administrative Sciences*, vol. 56, no. 1, March 1990, pp. 15-28. These policies, though they facilitate and subsidize private sector activities, fall outside the definition of privatization employed here.

⁵⁶ On USIS, see CRS Report RL30533, *The Quasi Government: Hybrid Organizations with Both Government and Private Sector Legal Characteristics*, by Ronald C. Moe and Kevin R. Kosar.

⁵⁷ Small-scale divestitures of government assets occur frequently. The General Services Administration (GSA), for example, uses auctions and other means to dispose of government assets, such as furniture, computers, and "real property," including the air rights of land behind Union Station in Washington, DC. GSA website, available at [<http://www.gsa.gov/Portal/gsa/ep/channelView.do?pageTypeId=10430&channelId=-13241>]; and Dana Hedgpeth, "New Life Above Union Station Tracks," *Washington Post*, October 2, 2006, p. D3.

⁵⁸ Congress authorized the privatization of the U.S. Enrichment Corporation, a government entity, in a 1996 appropriations law (P.L. 104-134, Title IV, Subchapter D). Privatization of this entity into USEC Inc. was completed in 1998.

⁵⁹ Occidental Petroleum, a division of Occidental Oil and Gas Company, paid \$3.65 billion for the 47,000-acre Elk Hills site. Platt's Inside Energy, "Government Sells Elk Hills Reserve," *The Energy Report*, February 9, 1998. See also Department of Energy, "Largest Federal Divestiture Completed, Elk Hills Transferred To Private Owner," February 5, 1998, available at [http://www.fe.doe.gov/news/techlines/1998/tl_elsold.html].

⁶⁰ A related activity might be termed "temporary divestiture" wherein the federal government may auction off an asset, such as the radio spectrum, to the highest bidder for
(continued...)

providing a good or service (“load shedding”) and allow private providers to meet any public demand for the good or service. This situation occurred when the Coast Guard stopped assisting stranded boats in the Miami area except when they are in clear and imminent danger.⁶¹

Whether the immediate objective is to provide revenue to the U.S. Treasury, increase the output from a particular resource, or assist some worthy public cause, the divestiture of a government asset fundamentally alters the legal status of the asset, moving it from the governmental to the private sector.

Contracting for Goods. The Federal Acquisition Regulation (FAR) sets the “uniform policies and procedures for acquisition by all executive agencies.” (48 C.F.R. 1.101) The FAR governs government “acquisitions,” which it defines as the “acquiring by contract with appropriated funds of supplies or services (including construction) by and for the use of the Federal Government.” (48 C.F.R. 2.101(b)(2)).

The federal government has contracted for goods since its founding. In great part, contracting for goods is a matter of necessity. Like private firms, government agencies face a “make or buy” decision and have limited funds available. Few would argue that it would be efficient or even practicable for an agency to supply itself with all the materials it needs, such as staplers and paper clips, when the agency can readily acquire them from private producers. However, it is also the case that the federal government long has had a policy that forbids competition with the private sector. A Bureau of the Budget (BOB) Bulletin of 1955 stated that the “[f]ederal government will not start or carry on any commercial activity to provide a service or product for its own use if such a product can be procured from private enterprise through ordinary business channels.”⁶²

While the idea of government contracting for goods is rarely questioned, the actual practice of contracting has been criticized frequently. In many of these instances, private firms are alleged to have failed to produce and provide the goods as agreed. Federal agencies also have experienced difficulties in overseeing the work of goods contractors and coordinating agency activities with those of contractors. For example, recently, a government audit identified significant problems in a private firm’s delivery of equipment to be installed in medical facilities in Iraq. Crates carrying the equipment were damaged and showed “unmistakable signs” that

⁶⁰ (...continued)

a period of time. See CRS Report RL31764, *Spectrum Management: Auctions*, by Linda K. Moore.

⁶¹ Hugh Victory, “‘Tough Business:’ Private Firms Handle Sea Rescues,” *Washington Times*, February 27, 1986, p. 9.

⁶² U.S. Bureau of the Budget, “Commercial-Industrial Activities of the Government Providing Products or Services for Government Use,” *Bulletin 55-04*, January 15, 1955.

equipment was missing. The audit also cited a government agency for failure to inspect the equipment upon receipt.⁶³

Contracting for Services (Outsourcing). Sometimes called contracting out, “outsourcing” refers to an agency engaging a private firm to perform an agency function or provide a service. The term often is conflated with *competitive sourcing*, a marketization activity considered later in this report.

Federal outsourcing policy is governed by the FAR and the Federal Activities Inventory Reform (FAIR) Act of 1998 (P.L. 105-270). FAIR requires agencies to produce inventories of “commercial activities” — those that are not “inherently governmental” and able to be acquired from the private sector — that may be put up for competitive sourcing.⁶⁴ OMB’s Circular A-76 provides agencies with specific directions for undertaking competitive sourcing.⁶⁵

As with the procurement of goods, the federal government long has hired private firms to help it perform services. For example, in 1819, Congress empowered the Postmaster General to “contract for the transportation of the mail in steamboats, between New Orleans, in the state of Louisiana, and Louisville, in the state of Kentucky.” (3 Stat 496)

FAIR and A-76 encourage agencies to outsource. Agencies also are attracted to outsourcing because it can provide cost-savings and flexibility. Additionally, outsourcing is a means for agencies to handle large, infrequent demands for government services. For example, the General Services Administration (GSA) uses private call-center contractors when it expects agencies it supports, such as the Federal Emergency Management Agency, to receive large numbers of telephone calls from individuals affected by episodic tumults, such as hurricanes.⁶⁶ Additionally, when an agency uses a contractor, instead of hiring a new federal employee, it need not expend resources training the contractor; nor need it provide medical benefits or pensions to the contractor.

⁶³ Office of the Special Inspector General for Iraq, *Review of the Medical Equipment Purchased for the Primary Healthcare Centers Associated with Parsons Global Services, Inc., Contract Number W914NS — 04 — D — 0006*, SIGIR-06-025 (SIGIR: July 28, 2006) available at [<http://www.sigir.mil/reports/pdf/audits/06-025.pdf>], pp. 10-18; quote at p. 14.

⁶⁴ The law also defines a process through which outside parties may challenge the inclusion or omission of an activity on an agency’s inventory. CRS Report RL31024, *The Federal Activities Inventory Reform Act and Circular A-76*, by L. Elaine Halchin.

⁶⁵ Office of Management and Budget, *Circular A-76* (revised) (Washington: OMB, May 29, 2003), available at [http://www.whitehouse.gov/omb/circulars/a076/a76_rev2003.pdf]. Circular A-76 was first issued in 1966 and has been revised six times since then. CRS Report RS21489, *OMB Circular A-76: Explanation and Discussion of Recently Revised Federal Outsourcing Policy*, by John R. Luckey.

⁶⁶ Christopher Lee, “Private Operators Take Calls in a Pinch,” *Washington Post*, September 26, 2006, p. A19.

For these reasons, in recent years, the number of federal contractors has increased, topping seven million.⁶⁷ There may also be a trend of increasing the scope of contract services to include areas not previously considered appropriate for assignment to the private sector (e.g., the operation of prisons, the performance of personnel background checks, and the protection of government officials). Reportedly, federal agencies issued \$388 billion in contracts in FY2005.⁶⁸

Vouchers. There are situations where a government may want a particular service to be funded publicly, but not delivered directly by a governmental entity. The government may choose to give the recipient of this service a “voucher” to purchase the service from private or other public sources. A voucher is “a subsidy that grants limited purchasing power to an individual to choose among a restricted set of goods and services.” As such, it can be designed in a variety of ways, such as a tax credit or a grant.⁶⁹

The objectives for using vouchers vary. Vouchers may be used to contain the government’s costs of providing a good or service. Vouchers can do this because they can be designed to have a limited per capita cost (e.g., \$5,000 per annum per person to spend on a particular good, such as housing). This contrasts with the possibly escalating costs that can occur when government attempts to produce and provide a good (e.g., the cost of an item needed in production, such as concrete, may spike due to some unforeseen factor.) Vouchers may also be employed to increase the competition and availability of a service or function and to improve the responsiveness of service providers to consumers. Finally, vouchers may be utilized for the purpose of improving equity. Advocates of school vouchers, for example, have argued that government should provide children from poor families with vouchers that would enable them to do the same as children from more affluent families — attend the schools of their choice.⁷⁰

The overt simplicity and actual flexibility of vouchers have helped make them an often-used option for policymakers at all levels of government.⁷¹ An early example of a voucher program was the “GI Bill”(P.L. 78-346; 58 Stat. 284-301), which provided World War II veterans vouchers to attend any accredited school that would admit them.⁷² More recently, the federal government has enacted a number

⁶⁷ Paul C. Light, *The New True Size of Government* (New York: New York University, August 2006), p. 11, available at [http://wagner.nyu.edu/performance/files/True_Size.pdf].

⁶⁸ Tom Shoop, “Raking It In,” *Government Executive*, August 15, 2006, p. 41.

⁶⁹ C. Eugene Steuerle, “Common Issues for Voucher Programs,” in C. Eugene Steuerle et al., *Vouchers and the Provision of Public Services* (Washington: Brookings Institution Press, 2000), pp. 4 and 3.

⁷⁰ For example, see Joseph P. Viteritti, *Choosing Equality: School Choice, the Constitution, and Civil Society* (Washington: Brookings Institution Press, 1999).

⁷¹ For a list of voucher programs, see Paul Posner et al., “A Survey of Voucher Use: Variations and Common Elements,” in Steuerle et al., *Vouchers and the Provision of Public Services*, pp. 522-538.

⁷² David O’Neill, “Voucher Funding of Training: Evidence From the GI Bill,” *Journal of* (continued...)

of voucher policies, including Section 8 public housing and “school choice” programs.⁷³

Quasi Governmental Entities/GOCO. Quasi governmental entities are those entities that possess both private sector and governmental legal attributes.⁷⁴ For example, the American National Red Cross (ANRC) was chartered by Congress, some of its board members are appointed by the President, and it has statutorily-prescribed duties; yet, ANRC is a private corporation.⁷⁵ Quasi governmental entities come in many types, such as government-sponsored enterprises (e.g., Freddie Mac), congressionally chartered not-for-profit corporations (American Legion), and government venture capital firms (e.g., In-Q-Tel), and are involved in diverse policy areas, from housing, to veterans affairs, and intelligence.

Quasi governmental entities may be viewed as a form of privatization because they are substitutes for fully governmental agencies. They are private vehicles for achieving a governmentally declared good.⁷⁶ Policymakers have been attracted to quasi governmental entities for a number of reasons, including the popular perception that the private sector is more efficient than government and budgetary constraints (i.e., quasi governmental entities usually are off-budget).

The GOCO facility is a well-known species of quasi governmental entity. A difference, though, is that GOCO facilities are established to produce goods for governmental, not private, consumption (e.g., military technologies). Sandia National Laboratories, one of the federally funded research and development facilities, is operated by Lockheed Martin for the Department of Energy’s National Nuclear Security Administration.⁷⁷

Third-Party Financing. Third-party financing is perhaps the least known means of privatization. In part, this likely is due to its complicated nature. Third-

⁷² (...continued)

Human Resources, Fall 1977, pp. 245-55. Henry M. Levin, “The Economics of Educational Choice,” *Economics of Education Review*, Spring 1991, pp. 137-58.

⁷³ See CRS Report RL33270, *The Section 8 Housing Voucher Program: Reform Proposals*, by Maggie McCarty; and CRS Report RL33506, *School Choice Under the ESEA: Programs and Requirements*, by David P. Smole.

⁷⁴ See CRS Report RL30533, *The Quasi Government*.

⁷⁵ See CRS Report RL33314, *The Congressional Charter of the American National Red Cross: Overview, History, and Analysis*, by Kevin R. Kosar.

⁷⁶ Thus, for example, the Federal National Mortgage Association (Fannie Mae) was established initially as a government agency in 1938 to confront a national problem — geographic barriers to credit for housing purchases and construction. Over the next three decades, Congress altered and privatized its operations. Though private, Fannie Mae retains government-prescribed objectives.

⁷⁷ On federally funded research and development centers, see CRS Report RL30533, *The Quasi Government: Hybrid Organizations with Both Government and Private Sector Legal Characteristics*, by Ronald C. Moe and Kevin R. Kosar. On Sandia National Laboratories, see its website at [<http://www.sandia.gov/about/index.html>].

party removes the federal government from the direct financing of a government project or service and replaces it with the private sector.

So, for example, a government agency might decide that it wants to build a new facility. To do this, the agency might sign an agreement with a private company to incorporate jointly a special purpose entity or vehicle (SPE or SPV) that would own the new facility.⁷⁸ This SPE could borrow money in private capital markets to build housing because the agency has agreed to rent the facility under a long-term contract (thereby guaranteeing a flow of revenue for many years.) Third-party financing has been used “to fund various infrastructure projects, such as housing on military bases, government office buildings, and electric power facilities.”⁷⁹

Agencies see this as advantageous because they can then record the investment costs of the project in the federal budget over the life of the project instead of in full when the investment is made. The Congressional Budget Office has criticized this practice, arguing, among other things, that third-party financing is more costly to the federal government and understates the size of the federal government and its obligations.⁸⁰

Grants to Private Parties. The federal government long has utilized grants of funds and property to private parties for the sake of achieving public purposes. For example, in 1819, Congress enacted a private law to provide a tract of land to the privately founded Connecticut Asylum for the Education and Instruction of Deaf and Dumb Persons (6 Stat. 229). The logic behind grants as policy is straightforward — if a private party is undertaking work that provides a public benefit, then the federal government may wish to support that work. The least expensive means to this end may be to provide funds or property directly to this party.

Today, the federal government provides grants for enormous numbers of diverse purposes. Grants are provided to support students pursuing higher education, to scientists undertaking research, to religious groups working with persons addicted to drugs and alcohol, to artists producing public performances, and to persons operating small businesses.⁸¹ According to a recent estimate, between 2.4 and 2.8 million persons received grant monies per annum between 1990 and 2004.⁸²

⁷⁸ This SPE or SPV might be a limited liability corporation or some other legal entity.

⁷⁹ Congressional Budget Office, *Third Party Financing of Federal Projects*, p. 1.

⁸⁰ *Ibid*, pp. 1-5.

⁸¹ An appreciation for the breadth and diversity of federal grants programs may be gained by perusing the forms of aid available to private parties at [<http://www.grants.gov>]. This account of grants does not include mention of the grants provided to states and localities, which, then, direct the monies to private companies to construct and repair roads, build waste treatment plants, fund community renewal efforts, and so forth. On recent efforts to expand “faith-based” organizations’ access to federal grant funds, see CRS Report RL32736, *Charitable Choice Rules and Faith-Based Organizations*, by Joe Richardson.

⁸² Light, *The New True Size of Government*, p. 11.

Prize Competitions. In recent years, federal agencies have held prize competitions. The aim of such competitions is to draw upon the creativity of private individuals and firms to produce technologies desired by the federal government. Perhaps the most well known of these is the “Grand Challenge” held by the Defense Advanced Research Projects Agency (DARPA), held annually since 2004. DARPA’s goal is to develop autonomous — meaning, unmanned — vehicles that can be used in a combat theater.⁸³ Rather than attempt to develop this technology in-house, DARPA offered large cash prizes to the competitor whose vehicle most quickly completes the race course.⁸⁴ The federal government, meanwhile, acquires privileges to utilize the technology developed.⁸⁵

The DARPA example may be encouraging further experimentation with prize competitions. At least two prize competition bills were introduced in the 109th Congress. H.R. 5143 would have provided \$11 million per year for hydrogen energy prize competitions; and H.R. 1021 would have permitted the National Aeronautics and Space Administration to award prizes to inventors of useful technologies.

Use of Volunteers. The federal government has relied upon volunteers to perform public services for over a century. Perhaps the most high-profile example is the American National Red Cross (ANRC). Congress first chartered ANRC in 1900, charging this private voluntary organization to “continue and carry on a system of national and international relief in time of peace and apply the same in mitigating the sufferings caused by pestilence, famine, fire, floods, and other great national calamities.” (31 Stat. 278) Though staffed in part by salaried, professional staff, ANRC and its local chapters have large numbers of volunteers. ANRC reports,

175,000 volunteers worked to prevent, prepare for and respond to nearly 64,000 disaster incidents last year [2005]. Over 15 million Americans turn to us to learn first aid, CPR, swimming, and other health and safety skills. Last year, more than 230,000 people volunteered to teach those courses. Half the nation’s blood supply — six million pints annually — is collected by more than 190,000 Red Cross volunteers.⁸⁶

More recently, Congress has enacted the National and Community Service Act of 1990 (42 U.S.C. 12501 et seq.) and the Domestic Volunteer Service Act of 1973 (42

⁸³ DARPA has said it is holding these challenges because it views them as a means to achieve a goal set by the National Defense Authorization Act for Fiscal Year 2001 (P.L. 106-398; 114 Stat. 1654). Sec. 220 of this law stated, “It shall be a goal of the Armed Forces to achieve the fielding of unmanned remotely controlled technology such that ... by 2015, one-third of the operational ground combat vehicles are unmanned.” DARPA, *Model agreement for competitors*.

⁸⁴ For further details, see DARPA’s website at [<http://www.darpa.mil/grandchallenge/index.asp>].

⁸⁵ See DARPA, *Model Agreement*, pp. 11-14.

⁸⁶ American National Red Cross, “Volunteer Services,” website of ARNC, available at [http://www.redcross.org/services/volunteer/0,1082,0_325_,00.html].

U.S.C. 4950 et seq.)⁸⁷ These acts provide funding for a number of federal, state, and local programs, such as Americorps, which encourage citizens to undertake public service.⁸⁸

Privatization: Ramifications

Behavior of the Entity

The difference between having a governmental entity and a private firm perform an activity is significant. Privatization moves components of the provision of goods and services out of the governmental sector and into the private sector. These two sectors are not identical. As the National Academy of Public Administration noted,

In point of fact, there are some fundamental differences between the [governmental and private sectors].... Most basic, perhaps, is the [government's] distinctive claim to exercise sovereignty, to enact and enforce binding laws, and to act on behalf of the nation or the community in certain constitutionally prescribed ways.⁸⁹

Furthermore, the movement of an activity from the governmental sector to the private sector, or vice versa, has significant ramifications. Most obviously, the behavior of the entity carrying out the task will differ because each sector has different incentives and constraints. One public administration scholar has suggested that the incentives amount to this: a government entity may do only what the law permits and prescribes; a private entity may do whatever the law does not forbid.⁹⁰ Speaking to the differing constraints, a political scientist has observed the following:

To a much greater extent than is true of private bureaucracies, government agencies (1) cannot lawfully retain and devote to the private benefit of their members the earnings of the organization, (2) cannot allocate the factors of production in accordance with the preferences of the organization's administrators, and (3) must serve goals not of the organization's own choosing. Control over revenues, productive factors, and agency goals is all vested to an important degree in entities external to the organization — legislatures, courts, politicians, and interest groups. Given this, agency managers must attend to the

⁸⁷ CRS Report RL30186, *Community Service: A Description of Americorps, Foster Grandparents, and Other Federally Funded Programs*, by Ann Lordeman and Alice D. Butler. On funding for major federal voluntary programs, see CRS Report RS20420, *AmeriCorps and Other Service Programs: Program Overview and FY2005 and FY2006 Funding*, by Ann Lordeman.

⁸⁸ In some instances, these programs are not purely voluntary. For example, Americorps participants receive living allowances.

⁸⁹ National Academy of Public Administration, *Privatization: The Challenges to Public Management* (Washington: NAPA, 1989), p. 9.

⁹⁰ Ronald C. Moe, "The Importance of Public Law: New and Old Paradigms of Government Management," in Phillip J. Cooper and Chester A. Newland, eds., *Handbook of Public Law and Administration* (San Francisco: Jossey-Bass Publishers, 1997), pp. 41-57.

demands of these external entities. As a result, government management tends to be driven by the constraints on the organization, not the tasks of the organization.⁹¹

The private sector firm, then, has one essential goal: to pursue profits; all other goals are subordinate.⁹² Thus, it faces strong incentives to undertake activities that promote this essential goal. This can prove beneficial to the government, should the private firm devise more efficient means of production and develop new products and services.⁹³ This might also negatively affect the government, should the private firm lower its costs of production by reducing the quality or quantity of the product or service. The private firm, in large part, is rewarded for achieving results pleasing to its owners and shareholders. How it achieves this may or may not prove beneficial to the government.

Accountability

Government agencies, unlike private firms, usually operate under complex accountability hierarchies that include multiple and even conflicting goals. Federal agencies, for example, are subject to the corpus of federal management laws. These laws serve as means for keeping executive branch agencies accountable to Congress, the President, and the public.⁹⁴ They also embody principles of democratic justice, such as the allowance for public participation and government transparency. To name just a few, the general management laws include the following:

- the Freedom of Information Act (5 U.S.C. 552), which provides persons the right to request information about government operations;
- the Administrative Procedure Act (5 U.S.C. 551 et seq.), which prescribes the process for agency rulemaking (i.e., interpretation and operationalization of law), public participation in this process, and judicial review of rules; and
- the Government in Sunshine Act (5 U.S.C. 552(b)), which requires agencies to hold open meetings and provide public notice thereof.

⁹¹ James Q. Wilson, *Bureaucracy: What Government Agencies Do and Why They Do It* (New York: Basic Books, 1989), p. 115.

⁹² Tullock, "Bureaucracy," in *Government Failure: A Primer in Public Choice*, p. 56.

⁹³ For example, GAO found that the Department of Defense achieved savings when it contracted out some activities, such as custodial and laundry services. U.S. General Accounting Office, *Federal Productivity: DOD's Experience in Contracting Out Commercially Available Activities*, GAO/GGD-89-6 (Washington, GAO: 1988), p. 15.

⁹⁴ See CRS Report RL30795, *General Management Laws: A Compendium*, by Clinton T. Brass, Coordinator.

Thus, in shifting an activity from the governmental to the private sector, the nature of government oversight is transformed.⁹⁵ As the components of government provision of goods and services are privatized, the jurisdiction of federal management laws, Congress, the President, and the courts is reduced.

Moreover, privatization shifts government administrative management from implementation to oversight as hierarchical oversight may be replaced by contractual relationships. Government oversight of privatized government activities, or “third-party government,” on a large scale is a recent phenomenon and one that many federal administrators and public administration scholars have found vexatious.⁹⁶

Finally, the entire question — “What constitutes governmental action and what constitutes private action?” — becomes ambiguous when activities once carried out by officers of the federal government are replaced by private persons. The Constitution requires “all executive and judicial Officers, both of the United States and of the several States, [to] be bound by Oath or Affirmation, to support [the] Constitution.” (Article IV, Cl. 3) Contractor and subcontractors, though, need not take such an oath. The legal distinction between officers of the federal government and all other persons is significant as an officer of the federal government has rights, duties, powers, and liabilities different from non-officers.⁹⁷ Thus, for example, under the Federal Tort Claims Act (28 U.S.C. 1346(b)), the government may be held liable for injuries caused by the negligent or wrongful act or omission of a federal employee. But what if that person is the employee of a private contractor or subcontractor? If this individual should, say, injure somebody, who would be liable for damages — the employee? the contractor? the subcontractor? the federal government? The answer is not immediately obvious, which may prove a matter of concern to (1) persons who believe themselves adversely affected by the individual’s actions; and (2) the agency which issued the contract and legislators, who may be viewed by the public as responsible for the oversight of the government projects.

Privacy

The potential blurring of the difference between a governmental action and a private action may also have ramifications for personal privacy. For example, an individual who is in a dispute with the Internal Revenue Service (IRS) over unpaid taxes may find himself receiving a telephone call from a private debt collection company. Under an arrangement with the IRS, this private firm will possess the individual’s name, contact information, and Social Security number. The citizen may

⁹⁵ Barbara H. Craig and Robert S. Gilmour, “The Constitution and Accountability for Public Functions,” *Governance*, January 1992, pp. 46-67.

⁹⁶ See U.S. House of Representatives, Committee on Government Reform, *Waste, Abuse and Mismanagement in Department of Homeland Security Contracts* (Washington: Committee on Government Reform, July 2006); U.S. Government Accountability Office, *Contract Management: DOD Vulnerabilities to Contracting Fraud, Waste, and Abuse*; and National Academy of Public Administration, *Privatization*.

⁹⁷ See CRS Report 95-717, *Federal Tort Claims Act: Current Legislative and Judicial Issues*, by Henry Cohen.

be troubled that, in his dispute with the government, one which he might find embarrassing, there is a private sector intermediary.⁹⁸

Similarly, the person applying for a federal job must provide a great deal of information about himself to the government. This citizen might be troubled to learn that the federal government uses private firms — who, in turn, sometimes subcontract to other private firms — to check the backgrounds of job applicants.⁹⁹

Marketization: An Alternative to Privatization?

Privatization, as already discussed, involves removing the federal government from one or more of the steps in the government provision of a good or service. Marketization, which is sometimes called “commercialization,”¹⁰⁰ is a management strategy that attempts to make a government agency perform better rather than replacing it with a private firm.

Marketization, like privatization, is a term that has been used to mean different things in different contexts. In former communist nations, for example, the sale of state-owned manufacturing enterprises to private parties has been called “marketization.”¹⁰¹ Commentators also have used “marketization” to refer to the practice of requiring government agencies to compete with the private sector for government work contracts.¹⁰² (This report calls this practice “competitive sourcing.”)

⁹⁸ The use of contractors can lead to further complexities. There have been incidents where scam artists have posed as private debt collectors for the IRS in attempt to get individuals to reveal personal financial information, which the scam artist may then use for criminal purposes. Mary Dalrymple, “IRS Warns Taxpayers on Fake Debt Collectors,” *Washington Post*, August 24, 2006, p. D2.

⁹⁹ “Investigative Services Agencies, Inc. ... a Chicago-based security- and investigations-oriented firm, has announced it was selected by U.S. Investigations Service ... one of the nation’s largest background check companies, to assist in providing personnel clearances for U.S. government agencies and approved government contractors.” *Business Wire*, “Investigative Services Agencies, Inc. Awarded Major Contract to Conduct Personnel Background Checks,” *Business Wire*, October 2, 2006, retrieved via [http://nexis.com].

¹⁰⁰ U.S. General Accounting Office, *Management Reforms: Examples of Public and Private Innovations to Improve Service Delivery*, GAO/GGD-94-90-BR (Washington: GAO, 1994), p. 30.

¹⁰¹ Marcus J. Kurtz and Andrew Barnes, “The Political Foundations of Post Communist Regimes: Marketization, Agrarian Legacies, or International Influences,” *Comparative Political Studies*, vol. 35, no. 5, June 2002, pp. 524-553.

¹⁰² Mark H. Moore, “Privatizing Public Management,” in John D. Donahue and Joseph S. Nye Jr., eds., *Market-Based Governance: Supply Side, Demand Side, Upside, and Downside* (Washington, DC: Brookings Institution Press, 2002), p. 318.

Generally speaking, marketization denotes the adoption of the methods and values of the market to guide its operations and activities.¹⁰³ Hence, this report uses the term “marketization” to refer to *the redesign of a government agency in order to make it provide goods and services in the manner of a private firm*. Typically, marketization involves altering the incentive structures facing a government agency in order to make it operate more efficiently.

An example may prove illustrative. For much of its history, the U.S. government had a department that provided postal services. The U.S. Post Office received large annual appropriations from Congress, whose members were deeply involved with its operations, including the selection of management and the pricing of postal services. Under this configuration, the U.S. Post Office ran into operational difficulties and developed a reputation for incompetence and corruption.¹⁰⁴ In the 1960s, some critics called for the abolition of the Post Office and privatization of postal services. In 1970, Congress chose a less dramatic means for reform. It enacted a statute that marketized the U.S. Post Office (P.L. 91-375; 84 Stat 725 et seq.) The new U.S. Postal Service (USPS) became an independent entity of the executive branch with greater freedom to run its operations. Critically, USPS was statutorily required to earn sufficient revenue to cover its costs of operation; it could no longer rely on annual appropriations.¹⁰⁵ Since its marketization, USPS has reported considerable productivity growth and is generally acknowledged to be better operated.¹⁰⁶

There are many ways in that an agency may be marketized. For example, Congress might require an agency meet its costs of operations and deny it annual appropriations. Congress might also permit an agency to set up bonus programs, under which employees may be rewarded for reaching productivity targets. In short, any reform that aims to alter an agency’s incentives so that they are more like those facing private firms might be called marketization.

¹⁰³ Angela M. Eikenberry, Jodie D. Kluver, “The Marketization of the Nonprofit Sector: Civil Society at Risk?” *Public Administration Review*, vol. 64, issue 2, March/April 2004, p. 13.

¹⁰⁴ The view of the U.S. Post Office as an agency riddled with patronage and scandal began long ago. Joseph L. Bristow, who served as an assistant postmaster general from 1897 to 1905, provides accounts in his book, *Fraud and Politics at the Turn of the Century* (New York: Exposition Press, 1952).

¹⁰⁵ USPS does continue to receive appropriations, but these are minute and serve only to compensate USPS for costs incurred in carrying out assorted governmental mandates, such as subsidized mail services for the blind. See CRS Report RS21025, *The Postal Revenue Forgone Appropriation: Overview and Current Issues*, by Nye Stevens.

¹⁰⁶ USPS, *2005 Comprehensive Statement on Postal Operations* (Washington: USPS, 2006), pp. 63-64. Although USPS has not increased its productivity as quickly as the private sector, even critics of USPS do not dispute that it is more productive than it was. For example, economist Michael Schuyler in his generally critical study, *The Postal Service’s Productivity Problem* (Washington: IRET, 2002), reports that USPS increased its labor productivity 40% between 1970 and 2000 (p. 1). Available at [ftp://ftp.iret.org/pub/ADVS-137.PDF].

Four often-employed means for marketization are franchising, user fees, government corporations, and competitive sourcing. Though quite different, all four approaches share a similar characteristic — they require an agency to compete for revenue.

Agency Franchises. In the private sector, a franchise is a firm that is authorized to sell or distribute another company’s goods or services. In the federal governmental sector, though, franchising means something quite different. Here, franchising refers to the fee-basis provision of a government agency administrative service by another agency.¹⁰⁷ As such, franchising might be viewed as a form of outsourcing — an agency hires an outside provider, in this case another agency, to perform a function. In a sense, though, franchising also is the inverse of contracting out. Outsourcing tasks an agency to become more efficient by hiring an outside provider to provide a service or good; franchising invites an agency to attempt to market one or more of its administrative services to other agencies. The former, then, aims at reducing the production of goods and services in-house; the latter would expand in-house production of a particular good or service.

Thus, for example, the National Finance Center (NFC) in the Department of Agriculture (USDA) provides payroll services to many other agencies, including the Library of Congress.¹⁰⁸ In 1994, Congress encouraged further federal experimentation with franchising through the Government Management Reform Act (108 Stat. 3410). This law authorized OMB to approve the establishment of six pilot franchise funds (31 U.S.C. 501 note). The Departments of Commerce, Homeland Security, the Interior, the Treasury, and Veterans’ Affairs and the Environmental Protection Agency have established franchises.¹⁰⁹ In 2004, OMB announced its “lines of business” initiative. Its objective is to reduce the federal government’s administrative expenses by encouraging franchising activities (“lines of business”) common to agencies, such as financial, grants, and human resources management; federal health architecture; and information technology security.¹¹⁰

User Fees. Governments have a choice when providing a service; they may decide to provide the service “free” to all who choose to use it, or they may charge

¹⁰⁷ See Joseph N. Coffee, “Creating Entrepreneurial Government: The Franchising Movement,” *Public Administration Quarterly*, vol. 20, no. 1, 1996, pp. 71-88.

¹⁰⁸ For an introduction to the activities of the NFC, see the NFC’s website at [<http://www.nfc.usda.gov/>].

¹⁰⁹ On franchise funds and their near-relation, intragovernmental revolving funds, see U.S. Government Accountability Office, *Budget Issues: Franchise Fund Pilot Review*, GAO-03-1069 (Washington: GAO, 2003).

¹¹⁰ Office of Management and Budget, *Lines of Business*, OMB website [<http://www.whitehouse.gov/omb/egov/c-6-lob.html>]. Staff, “OMB Opens Eye to Consolidating Budget, Records, and Other Functions,” *Government Computer News*, April 4, 2005.

a user fee that is sufficient to cover all or part of the cost for providing the service. In FY2005, the federal government booked \$185.2 billion in user fees.¹¹¹

User fees may be employed as a means for an agency to raise revenues to help cover costs attributable to a particular activity. The USDA charges quarantine inspection fees, the Department of State assesses fees for passports, and the U.S. Postal Service requires customers to pay for mail services. In other instances, an agency may cover all its costs through fees; such is the case with the U.S. Patent and Trade Office.¹¹²

Promoters of user fees argue that it is more fair to have those who draw upon a government resource pay for it than to tax both users and non-users.¹¹³ They also argue that user fees make agencies more like private firms. Agencies relying on user fees must undertake activities to attract users; they must, in short, strive to discern and provide for customers.

Furthermore, proponents of user fees have argued that fees may discourage the indiscriminate use of a service or resource. The rationing of a service or resource through user fees imposed by a public sector authority may achieve a balance between use and resource renewal.¹¹⁴ This rationale has been cited by the National Park Service in charging fees to enter and use the national parks.¹¹⁵ Similarly, the Office of Management and Budget has stated that user fees are means to “promote efficient allocation of the Nation’s resources” and “allow the private sector to compete with the Government without disadvantage in supplying comparable services, resources, or goods where appropriate.”¹¹⁶

Detractors of user fees have argued that government services should, as a matter of principle, be available to the public free of charge. They also have claimed that the imposition of fees may inhibit the access of lower-income individuals.

¹¹¹ On user charges and “other collections” of the federal government, see Office of Management and Budget, *Budget of the United States Government: Analytical Perspectives, Fiscal Year 2007* (Washington, GPO: 2006), p. 272.

¹¹² See CRS Report RS20906, *U.S. Patent and Trademark Office Appropriations Process: A Brief Explanation*, by Wendy H. Schacht.

¹¹³ Adam B. Summers, *Funding the National Park System: Improving Services and Accountability with User Fees* (Los Angeles, CA: Reason Foundation, 2005), p. 7.

¹¹⁴ The “tragedy of the commons” refers to an instance when a individuals seeking their own good so heavily utilize a common good that they deplete it. User fees, some argue, can lower usage to sustainable levels. On this phenomena, see Garrett Hardin, “The Tragedy of the Commons,” *Science*, December 1968, pp. 1243-1248.

¹¹⁵ For a general discussion of fees and their potential impact on recreational and timber activities, consult Terry L. Anderson, “To Fee or Not to Fee: the Economics of Below-Cost Recreation,” *Multiple Conflict Over Multiple Uses*, ed. Terry L. Anderson (Bozeman, Montana: Political Economy Research Center, 1994), pp. 11-16.

¹¹⁶ Office of Management and Budget, *Circular A-25, User Fees* (July 8, 1993), sec. 5. The notion that the private sector should be permitted to compete with the federal government for the production of goods and services may also be found in OMB’s *Circular A-76* (p. 1).

Government Corporations. The distinguishing characteristics of a government corporation are that it is an agency of government, established by Congress to provide a market-oriented public service, and intended to produce revenues that meet or approximate its expenditures.¹¹⁷ At present, there are 18 government corporations that cover a spectrum from large, well-known corporations such as the U.S. Postal Service and the Federal Deposit Insurance Corporation, to small, low-visibility corporate bodies such as the Federal Financing Bank and the Valles Caldera Trust.

Each government corporation is unique; each has been granted different exemptions from particular management laws for the sake of providing it with flexibilities similar to those possessed by private firms. For example, Congress has partially exempted the Export-Import Bank (12 U.S.C. 635, Amendments) from federal-employee classification and pay-rate restrictions (5 U.S.C.5101-5115 and 5331-5338 and 5341-5349). This waiver may help the bank to offer salaries to attract highly skilled persons who might otherwise work for private financial-services companies.

In some discussions of privatization, proposals to establish a government corporation (e.g., reorganizing the U.S. Patent and Trademark Office into a government corporation)¹¹⁸ are equated with privatization because the term “corporation” is seen as making it similar to a private corporation. This similarity in titles, however, is misleading because a government corporation is an agency of the U.S. government, not unlike the Internal Revenue Service, performing a mission established by Congress, and is managed by officers of the United States.¹¹⁹ These characteristics are not present in private corporations.

Congress has established government corporations for a variety of purposes. Government corporations have had mixed success. The Saint Lawrence Seaway Development Corporation (SLSDC, 33 U.S.C. 981), which manages the waterway between Lake Erie and Montreal, Canada, is generally regarded as a well-run entity.¹²⁰ Other government corporations have been less successful. For example,

¹¹⁷ CRS Report RL30365, *Federal Government Corporations: An Overview*, by Ronald C. Moe and Kevin R. Kosar. See also U.S. General Accounting Office, *Principles of Federal Appropriations Laws*, GAO-01-179SP (Washington: GAO, 2001), vol. iv, pp. 17-119 - 17-216; and U.S. General Accounting Office, *Government Corporations: Profiles of Existing Corporations*, GAO/GGD-96-14 (Washington: GAO, 1995).

¹¹⁸ National Academy of Public Administration, *U.S. Patent and Trademark Office: Transforming to Meet the Challenges of the 21st Century* (Washington: NAPA, 2005).

¹¹⁹ In recent years, Congress has created agencies titled “corporations” which do not perform commercial-type activities and are almost totally reliant on regular appropriations. Corporate bodies in this category include the Millennium Challenge Corporation, the Corporation for Public Broadcasting, the Legal Services Corporation, and the Corporation for National and Community Services.

¹²⁰ For example, according to the OMB’s Program Assessment and Rating Tool, SLSDC’s “operations and maintenance” program was deemed an “effective” in 2005. This is the highest PART score; programs so rated “set ambitious goals, achieve results, are
(continued...)

AMTRAK, which was established to provide intercity passenger railroad service, has run deficits for more than three decades and been criticized for service and operational shortcomings.¹²¹

Competitive Sourcing. Competitive sourcing, as described above, refers to the process of an agency putting up the performance of one of its functions for competition between the agency and outside parties. Thus, one possible result of competitive sourcing is outsourcing, a form of privatization. However, competitive sourcing is a form of marketization because it requires agencies to do as private firms do — compete to provide a service.

As described above, FAIR and Circular A-76 require federal agencies to compete their commercially available activities. The Office of Management and Budget under President George W. Bush has advocated the expansion of competitive sourcing. For example, in April 2006, OMB announced that activities performed by 26,000 government employees would be opened up to competitions, “a five-fold increase over the number competed last year.”¹²²

This move to expand competitions has sparked controversies. Government employees, not surprisingly, may feel their jobs are threatened. Meanwhile, private firms, coveting more business opportunities, have challenged agencies’ exclusion of activities from competitions.¹²³

Marketization, clearly, is a more incremental reform than privatization. Marketization alters some of the incentives and constraints faced by an agency in hopes that it will behave more like a private sector firm.¹²⁴ However, since marketization does not move an activity from the governmental to the private sector, it may not produce an entity as likely to achieve as many efficiencies and innovations as a private firm. This is because the marketized government agency, unlike the private firm, cannot retain profits or compete against other firms.¹²⁵

¹²⁰ (...continued)
well-managed and improve efficiency.”

¹²¹ See CRS Report RL31473, *Amtrak Profitability: An Analysis of Congressional Expectations at Amtrak’s Creation*, by D. Randall Peterman; and Joseph Vranich, *End of the Line: The Failure of Amtrak Reform and the Future of America’s Passenger Trains* (Washington: AEI Press, 2004).

¹²² Chris Gosier, “26,000 Jobs Will Open to Competition,” *Federal Times*, April 24, 2006, p. 3.

¹²³ Government Accountability Office, *Competitive Contracting: Agencies Upheld Few Challenges and Appeals Under the FAIR Act*, GAO/GGD/NSIAD-00-244 (Washington: GAO: 2000).

¹²⁴ On two apparently successful examples of marketization via franchising, see John J. Callahan, *Franchise Funds in the Federal Government: Ending the Government Service Monopoly* (Washington: The PricewaterhouseCoopers Endowment for Business of Government, 2002).

¹²⁵ For example, by law, only the U.S. Patent and Trademark Office may issue patents,
(continued...)

On the other hand, government overseers may find that a marketized agency is less vexatious to oversee and hold accountable. This is because the marketized firm remains within the governmental sector; though given some operational flexibilities, it remains a governmental entity with a statutorily prescribed mission and subject to all government management laws except those from which it has been specifically exempted.

The marketized agency also may be less prone to the pathologies that afflict some private firms. The contrast between two entities, the Government National Mortgage Association (Ginnie Mae, 12 U.S.C. 1716-1723) and the Federal National Mortgage Association (Fannie Mae, 12 U.S.C. 11A), is illustrative. Both of these entities were created by Congress to provide liquidity to the secondary home-mortgage market. Ginnie Mae is a government corporation; generally, it has been viewed as competently operated.¹²⁶

Fannie Mae, on the other hand, is a private entity charged with governmental responsibilities. While its successes are manifold, it has been reproached frequently in recent years. Critics have said that Fannie Mae's pursuit of profits has led it to undertake a number of undesirable behaviors. In order to protect its profits, the firm has been accused of aggressively lobbying Congress, perhaps through questionable means.¹²⁷ It has been criticized for excessively compensating its top executives.¹²⁸ Fannie Mae's efforts to grow its business also have been criticized for threatening to create "spill-over" effects that might negatively affect world financial markets.¹²⁹ Recently, the company also has found itself accused of manipulating its financial reporting for the purposes of producing earnings pleasing to investors and enabling its top management to collect large annual bonuses.¹³⁰

¹²⁵ (...continued)

making it a monopoly provider of this service (35 U.S.C. 2). Similarly, the "Private Express Statutes," a collection of laws and federal regulations, convey a near monopoly to USPS in the carriage of letters over postal routes (18 U.S.C. 1693-1699, 39 U.S.C. 601-606, and 39 C.F.R. 310, 320). U.S. Postal Service, *Understanding the Private Express Statutes* (Washington: USPS, 1998), available at [<http://www.usps.com/cpim/ftp/pubs/pub542.pdf>].

¹²⁶ U.S. Government Accountability Office, *Ginnie Mae Is Meeting Its Mission But Faces Challenges in the Changing Marketplace*, GAO-06-9 (Washington: GAO, 2005).

¹²⁷ See Ross Guberman, "Balancing Act: Fannie Mae Projects a Happy Image. But as Its Debt Grows Bigger and Its Executives Get Richer, Should Taxpayers Start to Worry?" *Washingtonian*, August 2002.

¹²⁸ Terence O'Hara, "Exit Packages in Dispute at Fannie Mae," *Washington Post*, December 28, 2004, p. E1.

¹²⁹ International Monetary Fund, *Global Financial Stability Report*, September 2003, available at [<http://www.imf.org/external/pubs/ft/GFSR/2003/02/index.htm>]. See also CRS Report RS22307, *Limiting Fannie Mae's and Freddie Mac's Portfolio Size*, by N. Eric Weiss.

¹³⁰ CRS Report RS21949, *Accounting Problems at Fannie Mae*, by Mark Jickling.

To Privatize or Not — The Inevitability of Political Controversy

Ultimately, in considering whether to pursue privatization as a strategy to improve the provision of goods and services, the question arises, “What is the proper role of government?” Few would dispute that some broad functions should be handled by government and its employees, while others should be left to the private sector. But which ones?

Definitive guidance is unavailable. The Constitution enumerates many of the broad functions that are to be carried out by the federal government.¹³¹ However, the Constitution does not enumerate which of the tasks required to carry out these broad functions must be performed by governmental employees and which may be performed by private persons. For example, the Constitution states that “The Congress shall have Power ... To establish Post Offices and post roads.” (Article I, Sec. 8, Cl. 7) However, it does not declare whether the federal government must use government employees to build these roads or whether it may hire private contractors. Furthermore, the Constitution is of limited utility because the federal government’s activities extend far beyond those listed in the Constitution.¹³²

Federal statutory law provides some guidance. FAIR requires “government personnel” to perform “inherently governmental activities.” FAIR defines “inherently governmental activities” as those “so intimately related to the public interest as to mandate performance by government personnel.” It further defines the term to include

activities that require either the exercise of discretion in applying Federal Government authority or the making of value judgments in making decisions for the Federal Government, including judgments relating to monetary transactions and entitlements. An inherently governmental function involves, among other things, the interpretation and execution of the laws of the United States so as —

- (i) to bind the United States to take or not to take some action by contract, policy, regulation, authorization, order, or otherwise;
- (ii) to determine, protect, and advance United States economic, political, territorial, property, or other interests by military or diplomatic action, civil or criminal judicial proceedings, contract management, or otherwise;
- (iii) to significantly affect the life, liberty, or property of private persons;
- (iv) to commission, appoint, direct, or control officers or employees of the United States; or
- (v) to exert ultimate control over the acquisition, use, or disposition of the property, real or personal, tangible or intangible, of the United States, including the collection, control, or disbursement of appropriated and other Federal funds. (112 Stat. 2382(b))

¹³¹ For example, see Article 1, sec. 8.

¹³² For example, the Constitution contains no explicit authorization for federal education policies. Thus, it would be of little use to turn to the Constitution in hopes of determining, say, whether private contractors could be used to grade federally administered academic achievement tests, such as the National Assessment of Educational Progress.

Additionally, FAIR explicitly excludes some activities from this category.

The term does not normally include —

- (i) gathering information for or providing advice, opinions, recommendations, or ideas to Federal Government officials; or
- (ii) any function that is primarily ministerial and internal in nature (such as building security, mail operations, operation of cafeterias, housekeeping, facilities operations and maintenance, warehouse operations, motor vehicle fleet management operations, or other routine electrical or mechanical services). (112 Stat. 2382(c))

Yet, this statutory guidance leaves much unclear.¹³³ Debates have and will erupt over the application of these terms to specific activities. For example, currently, the federal government’s National Response Plan for mass disasters charges a private organization, the American National Red Cross, with responsibility to lead and coordinate efforts to provide mass care, housing, and human services after disasters that require federal assistance.¹³⁴ Under FAIR, do such activities constitute “the interpretation and execution of the laws of the United States so as ... to significantly affect the life, liberty, or property of private persons”? If so, then ought these activities be carried out by the Department of Homeland Security? Or, to take a second example — does the aforementioned portion of FAIR permit the federal government to outsource the housing of federal prisoners?

Moreover, this statutory guidance is of limited utility in considering a fundamental question beneath the privatization debate. FAIR provides guidance on the permissible extent of private sector participation in current federal activities. It does not, nor was it intended to, provide answers as to which broad activities the federal government *should be involved in* and which should be left to the private sector:

- Should the federal government be involved in commuter rail service, as it is with AMTRAK?
- Should the federal government operate energy-generating facilities, like the Bonneville Power Authority and those of the Tennessee Valley Authority?
- Should federally established entities provide liquidity to the secondary housing loan market?
- Should the federal government provide comprehensive long-term health insurance to the aged?
- Should the federal government use private contractors to provide security in Iraq?

¹³³ OMB’s *Circular A-76* does offer some elaboration of what sorts of activities that it interprets the phrase “inherently governmental” to include.

¹³⁴ CRS Report RL33314, *The Congressional Charter of the American National Red Cross: Overview, History, and Analysis*, by Kevin R. Kosar.

These questions and others have been debated at length in recent years without easy resolution.¹³⁵ “What ought government do?” is a question that is inherently value-laden and intimately bound up with individuals’ varying perspectives on the role of government, the proper extent of its power vis-a-vis state and local governments, the fairness of free markets, and other political-philosophical issues.

Conclusion

In the past two decades, privatization emerged on the federal policy agenda. Surveying this policy movement, one social scientist has written,

Private and market-style mechanisms are increasingly employed to provide what government had taken as duties. Religious groups join secular nonprofit and for-profit providers of services paid for or sought by government. Decision makers in education, health care, social services, and law constantly cross the boundaries between public and private, religious and secular, profit and nonprofit.¹³⁶

The very newness of privatization as a policy idea likely helped cause some of the confusion over its definition.

This report defines privatization as *the use of the private sector in the provision of a good or service, the components of which include financing, operations (supplying, production, delivery), and quality control*. This definition, though imperfect, is useful insofar as it enables one to view privatization activities upon a spectrum; that is, an agency may more or less privatize its provision of goods and services, depending on how many of the components of the provision process have been moved to private sector providers.

This report also differentiates privatization from marketization. As described above, the ramifications of this difference are significant. Entities couched within the governmental and private sectors do not behave identically; each has its strengths and weaknesses. Those uncomfortable with privatization may find marketization a more attractive option. Meanwhile, those favoring privatization may view marketization as a half measure that cannot be expected to produce goods and services as efficiently as privatization.

¹³⁵ See, respectively, CRS Report RL32709, *Amtrak: Historical Background to the Political and Social Aspects of Federal Intercity Passenger Rail Policy*, by John Fritelli and Robert S. Kirk; CRS Report RL32798, *Power Marketing Administrations: Proposals for Market-Based Rates*, by Kyna Powers; Peter J. Wallison, Bert Ely, and Thomas H. Stanton, *Privatizing Fannie Mae, Freddie Mac, and the Federal Home Loan Banks* (Washington: AEI, 2004); CRS Report RS20784, *Long-Term Care: What Direction for Public Policy?* by Carol O’Shaughnessy and Bob Lyke; and CRS Report RL32419, *Private Security Contractors in Iraq: Background, Legal Status, and Other Issues*, by Jennifer Elsea, Nina M. Serafino.

¹³⁶ Martha Minow. *Partners Not Rivals: Privatization and the Public Good* (Boston: Beacon Press, 2002).

It can be expected that privatization will remain a controversial idea. Any attempt to improve the federal government's provision of goods and services through privatization likely may elicit concerns over the intentions and possible consequences of the proposal. Meanwhile, implicit in the debate about privatization lurks the old and nettlesome question — "Which activities are essential to the state and should remain directly accountable to the elected representatives of the people and which may be carried out by the private sector?"