

THE MYTHS OF PRIVATIZATION*

*Dr. Donald Chisholm***

Privatization has acquired a certain cachet as a panacea for the myriad ills of public organization and policy in the contemporary period. Consider the following articles appearing in the *Los Angeles Times* during the past two months:

A Bumpy Ride: Arrests Place U.S.'s Busiest School Bus Operator Under Fire.

Proposals Include Letting Banks Issue the Insurance.

State Dept. Contract Gives Wang a Boost.

There's No Free Ride on a Private Train.

Department of Water and Power, Southern California Edison to Invest in Electric Car.

The titles indicate the extent to which privatization has suffused virtually every aspect of the public discourse. It does not overstate the case to call it a movement, replete with its own assumptions, axioms, and apostles. To be sure, advocates of privatization constitute a diverse group and the term itself is used to refer to a desperate array of tactics and methods; they all, however, share in common the broad aim of substantially reducing government involvement in the provision and production of goods and services, typically by shifting responsibility for them to the private sector. The siren call of privatization at all levels of government bears certain similarities to the attractiveness over the past 30 years of management control systems such as **PERT**, **PPBS**, **MBO**, and **Zero Based Budgeting**: Its, new if not revolutionary, it promises to reduce cost, improve efficiency, and the quality of goods and services, all without significant tradeoffs in or cost to other values. But privatization has not met universal acclaim. Conflict over the virtues and vices of privatization in its various incarnations has become an important component of the public debate. Whether privatization is at its zenith now and will wane in the 1990's as some students of the phenomenon have alleged (**Bozeman**,

* Presented at the *National Conference on Public Administration*, Center of Advanced Studies in Public Management, San Juan, Puerto Rico, 20-21 September, 1990.

** From the **University of California**, Los Angeles, California.

1988), if past experience is any guide, privatization will continue to hold a fascination for local governments for some time. How we choose to answer the questions raised in this debate will profoundly affect the ways in which we address our most pressing problems for years to come.

What is Privatization?

The term privatization is used to denote a diverse group of strategies, all of which aim to reduce the scope and intensity of government involvement in the provision and/or production of goods and services. It is at root a political slogan. Advocates of privatization contend that the processes that lead to any given good or service may be subdivided into two broad functions:

Providing is a distinct policy function involving policy making, deciding, buying, requiring, regulating, franchising, or subsidizing. **Producing** implies operating, delivering, doing, selling, or administering. Each of these two functions can be broken down into several parts, each of which might be privatized separately. (Kolderie, 1986, 4)

In its most extreme forms, privatization means elimination of any public role in either provision or production, leaving decisions about both entirely to the private sector. **Load shedding**, in which government abandons all or part of some good or service, and **divestiture**, or the sale of a government corporation, agency or other body to private owners, exemplify this form. Because of limited government ownership of utilities and manufactures in the United States divestiture has not played a significant role. **Contracting out**, on the other hand, represents a less extreme approach, in which government retains the provision function while passing responsibility for production to private organizations. Institution of **user's fees** embodies efforts to reduce the general tax burden for certain services or to ration the distribution of those services. Government may retain the production as well as provision functions, but shifts the immediate load for financing certain services to the users. Conversely, in a **voucher system**, government retains the provision function, and may retain some production, but expands the allowable producers to the private sector and to other public organizations, permitting the individual consumer to make the final choice about producer. Direct government grants to students to finance their education at the institution of their choice, such as the various *G.I. Bills* is one example of this approach.

Other dimensions of privatization include awarding **franchises**, e.g., exclusivity in the production of certain services in a particular area, such as taxi service; **tax incentives**, say for particular kinds of investment; and

various forms of *insurance*—for banks, savings and loans, and credit unions and *loan guarantees*—whether for Lockheed or students. All provide incentives to private individuals and firms to engage in certain publicly desirable endeavors without funding them directly. Finally, there are *government-sponsored enterprises*, occupying an intermediate status between public and private sectors, but called *private*. Such enterprises range from the Corporation for Public Broadcasting to the Community Development Corporation to Fannie Mae and Freddie Mac.

None of these strategies was invented yesterday or even 20 to 50 years ago. In one form or another, they have been with us since at least the Articles of Confederation. In the United States we have **always** employed a mix of government and private sector involvement in the provision and production of public services. The growth of government activity has not meant a diminution of private enterprise. Substantial private participation in the production of public goods and services has been a hallmark of the American political system: private presents no novelty. The success of many government programs has been coupled to cooperation of the private sector. (*National Academy of Public Administration*, 1989). What is new about privatization is the explicit effort to increase systematically the extent of private production of public goods and services in domains where it traditionally has been active and to expand its participation to areas where hitherto it has been excluded. Even where private participation in a particular area is well established, often it has been limited to basic or intermediate components of a service—say, sales of office supplies or equipment or building maintenance—whose final delivery has remained in public hands; now we are asked to endorse privatization of the entire production of a service.

Why Privatization Now?

Motivations for privatization vary considerably, ranging from immediate to longstanding concerns.¹ In the face of an increasing proportion of the GNP consumed by government at all levels coupled with

¹ There are also, of course, reasons for advocating privatization specific to particular policy areas. For example, privatization of prisons may be seen as a response to ... *three main conditions: soaring inmate populations and caseloads; escalating costs; and the widespread perception that public-corrections bureaucracies have failed to handle convicted criminals in ways that achieve public protection, deterrence, just punishment, and the rehabilitation of criminals in a humane and cost-effective manner.* (DiIulio, 1988, 68)

In this discussion, I address those general motivations that appear to cut across specific policy areas.

a slowdown in growth of the GNP, real concerns have been voiced about the size of government. The voter's tax revolt, of which 1978's Proposition 13 in California is emblematic, is but one indication of these concerns. And many people have come to feel that government is now involved in areas that ought to remain in the hands of the private sector. This belief goes hand in glove with the supply side economics of the Reagan years.²

At the same time, many programs administered by public agencies have been perceived as less than effective if not outright failures, while wages and benefits for public employees at the local and state levels have grown at seemingly prodigious rates when compared with the private sector. Some advocates of privatization view public officials as motivated solely by self-interest rather than any sense of altruism: Their behavior is to be explained largely by selfish goals that often run counter to the public interest.

Productivity and efficiency, however defined, are believed to be significantly less in public organizations than in private corporations. The consensus that difficult public problems are appropriately and effectively addressed by direct government action, born in the Progressive era, growing with the New Deal, and reaching its zenith in the early years of the Great Society has seriously begun to erode. No doubt the manifest failure of government controlled, centrally planned economies in the Eastern Bloc, and now the sweeping changes set in motion there, have contributed to a favorable disposition toward privatization.

Self-interest also clearly plays a key role in the arguments for privatization: to the extent that responsibility for the implementation of public policies is shifted from government to the private sector, those firms receiving contracts stand to receive substantial financial gain. Equally important are the benefits to be had from sales of government assets to the private sector; such sales produce immediate one-time reductions in public budget deficits, and simultaneously reduce long-term budget commitments and subsidies. Not infrequently, of course, the cost of these ends is a significant discount (below market value) of public assets sold to the private sector. Witness, for example the sale of ConRail. The 1988 *selloffs* of troubled savings and loans by federal government to private investors also illustrates the point: the sale of American Savings alone cost the taxpayers \$5.2 billion in federal assistance to the investors who purchased it with an investment of \$350 million. The savings and loan is now highly profitable. ("Gonzalez Blasts '88 S&L Selloffs as 'Giveaways,'"

² See *National Academy of Public Administration* (1989, 9-12) for a brief history of the privatization movement.

Los Angeles Times, 15 September 1990, D-1).

Where privatization is carried to its extreme and government removes itself entirely from both provision and production of a given good or service, leaving decisions about that good or service to be made entirely in the market, the argument may be couched in terms of procedures, but implicitly the rationale has more to do with substantive changes in public policy. Put more bluntly, if services are eliminated from the public sector, the bet is that they won't be picked up in the private sector, or if so, only at lower levels of resource commitment. This position is predicated on the belief that interest group politics has somehow *distorted* what would otherwise be the natural order of things:

The combination of client-advocates, the media, and the political process has worked powerfully to turn needs into rights, rights into entitlement, entitlement into programs, and programs into budgets.
(Kolderie, 1986, 13)

The same holds true for arguments favoring voucher systems; education, for example. Proponents may argue explicitly on the basis of giving parents more choice, but underlying their assertions is the belief that establishing a voucher system will facilitate a different set of educational choices, ultimately producing different outcomes, than if public schools were allowed to retain a monopoly position. At a minimum, privatization will empower citizens to make choices on their own they are now preempted from making because government has usurped that prerogative.

Last but not least, privatization offers the promise of performing what has heretofore deemed impossible. If the private sector can indeed produce the same goods and services as government but more efficiently, we may be able to retain the same level of service (or perhaps higher levels of service) without tax increases or perchance achieve a substantial decrease in tax burden.

In what follows, my remarks focus principally upon contracting out, both because of its preeminence as the most important privatization strategy in the United States (Ferris and Graddy, 1986) and because it represents the most direct and fundamental challenge posed by privatization to the public administration in the United States.³ Although

³ In fact, one of its staunchest advocates has gone so far as to say that privatization is little more than a new name for contracting out. (Kolderie, 1986) Privatization through loadshedding and divestiture of nationalized industries are much more important strategies in those states, as in Western and Eastern Europe, and in much of the Third World, where the government has historically assumed a much greater role in the economy than in the United States. In the United States we simply do not have much to sell off. See Buckland (1987) for an analysis of the problems inherent in the sale of nationalized industries to the private sector.

load shedding and divestiture represent more radical strategies, contracting out, in practical terms, is far more likely to be pursued to fruition. Certainly, contracting out, in practical terms, is far more likely to be pursued to fruition. Certainly, contracting out has been an integral part of public policy since the birth of the Republic,⁴ but in recent years it has been expanded into domains previously untouched, moving one student of the phenomenon to comment that *it has been proved conclusively that almost anything can be privatized and that even prisons and fire departments can be turned over to private contractors (Bozeman, 1988)*.

A number of assumptions undergird the movement toward privatization, including the strategy of contracting out. These assumptions are no more than their empirical warrant not having been demonstrated. As such, they are poor guides to action, and may, if left unquestioned, lead us to decisions whose consequences we may not like and which may not be remedied except at great cost.

MYTH #1: There are clearly public and clearly private domains of activity that can be deduced from general principles.

One approach to delineating the proper spheres of action for public and private has been resort to deduction from a set of first principles, say, having to do with indivisibility.⁵ Were this strategy successful it would permit a rational allocation of functions between public and private sectors in a simple and clear-cut manner. We would readily avoid *sector blaring* (Moe, 1988); government intervention in social problems would ensue only in the face of certain definable failures in the private market. However, this scheme has not proven very useful. The plain fact is that such division is and historically has been predicated on political processes. In this context, at least, such principles are not immutable, rather they result from political attitudes which are subject to change. We seem to move through periods of consensus alternating with times in which the current division of responsibilities is subject to vigorous debate. At the extremes some relatively permanent consensus may be discerned, say, for example, limiting the sovereign power of the state to wield lethal force to public

⁴ *The federal government spends more than \$200 billion annually on contracting out. The majority of contracting out occurs in the Department of Defense (DoD), which in 1987 spent more than \$155 billion for goods and service—from pencils to notebooks, to the operation of the Pentagon food service, to large weapons systems. Defense acquisition involved more than 15 million separate contract actions in 1987, representing about two-thirds of the total number of all reported contract actions. (National Academy of Public Administration, 1989, 12)*

⁵ See, for example, Champney (1988) who attempts to construct an eightfold typology of public policy predicated on the distinction between *public goods* and *private goods*.

officials,⁶ but it is the middle ground that requires guidance, and first principle provide no practical beacon for decision here. This approach carries with it an implicit assumption that there is one best or an optimal way of allocating public and private functions. The reality is that there is usually more than one satisfactory way to do anything, in biology this is called equifinality: more than one path can lead to a similar end state. In other words, there will usually be more than one satisfactory solution for any given problem.

Far better is a strategy predicated on pragmatic analysis of results, where the appropriate division is made by treating choice as experimental, subject to empirical warrant.⁷ Such an approach adapts to the basic verity that historically and today there has been an extensive admixture of public and private participation in the provision and production of public goods and services that has followed no set of consistent, higher principles.

The immediate difficulty surrounding the current debate over privatization is that few empirical studies exist to illuminate the advantages and problems of the various privatization strategies and how results may differ by policy domain. Moreover, existing studies do not have the time span necessary to race out the consequences of decisions to privatize; effects of changes in procedures and structures may require years to make themselves felt. The complexity of the problems, in combination with our inability to create controlled experimental conditions makes interpretation of findings risky business. Even subtle changes in institutional arrangements may have significant ramifications that were neither intended nor anticipated.

The most tangible effect of this paucity of evidence is that on both sides the debate is often carried out in ideological terms, with privatization's proponents making optimistic promises, its opponents making dire predictions, and neither one able to muster much empirical support for its claims. Dilulio's comments on the evidence about the privatization of prisons hold true for the broader problem of privatization:

⁶ In the wake of the resurgence of interest in privately owned and operated prisons, even this broadly held consensus appear subject to change.

⁷ This is not a position to which there is universal subscription. In a critique of work by **Bozeman (1988)** in which he advocates a *strategy based on theoretically-informed empiricism (673)*, **Moe (1988)** offers the following indictment: *In place of a legally based public administration, Bozeman offers a pragmatic theory of administration. If an organization "seems to perform well," it might be the right organizational form! If the assignment of prisoners to a private jail seems to be working well, the assignment must have been the "right" decision. Results tend to be treated as facts and for pragmatists, facts tend to speak for themselves. Facts only make sense when measured against some objective standard. The objective standard I argue for is the "law." The objective standard Bozeman advocates is "performance."* (674-675)

At this stage it is impossible to answer most of the empirical questions about the comparative cost-effectiveness and efficiency of private correctional operations ... Theoretical speculation, anecdotes and raw data abound, but there is as yet little dependable information to tell us whether or how privatization can work, and at what human and financial cost.(1988, 68).

In the end, the public suffers.

MYTH #2: Private corporations are inherently more efficient than public organizations.

Given that public bureaucracies and private corporations tend to engage in rather different activities and direct comparability of performance is a rare find, whether we choose to believe that by their very nature public organizations are inherently less efficient than their private counterparts hinges upon the explanation we accept for public *failures*. Often we fail simply because we do not know. Almost as often we attribute that failure to faulty implementation (Landau and Stout, 1979).

Three principal reasons are given for the efficiency of the private over the public sector: competition, scale economies, and differences in labor practices. Although most advocates of privatization argue that it is the competition in the private sector that distinguishes it from the monopolistic public quarter; the discipline imposed by competition creates incentives for higher levels of efficiency and performance; in point of fact the difference is more fundamental. We permit, no, we celebrate, the retention of the difference between price received and costs incurred in the private sector. We call it profit: private corporations are judged positively to extent that they are profitable. We do not, however, accord public agencies the same honor. The difference between budget appropriated and actual expenditures by a public agency returns to the general fund. We do not allow public agencies to keep reserves. Failure to spend the full appropriation in any one year virtually guarantees reduced appropriations in following years. In so doing, we create real disincentives for our public organizations to operate efficiently and we ensure end of fiscal year spending sprees.

There is no evidence that competition is favorably regarded by individual organizational actors in the private sector any more than by those in the public. Witness longstanding moves toward oligopoly and monopoly and the need for public intervention to maintain competitive markets. As with public agencies, corporations prefer no competition. But efficiencies will be obtained through contracting out only to the extent that more than one bidder exists for any given contract. Competition

directly enhances the power of the purchaser; indirectly it also does so by producing more information: *With only a single firm producing a unique product, there are no natural benchmarks against which performance can be compared* (Sappington and Stiglitz, 1987, 572).

Given the high frequency of *sole sourcing* experienced in recent history we cannot assume the ready presence of multiple bidders for government contracts. We had better not predicate decisions to privatize on such assumptions, for serious barriers to entry may frustrate competition.⁸ It is an empirical question that must be answered domain by domain. What studies do exist on contracting out unanimously conclude that it is the existence of competition, not the fact of private production of services, that leads to efficiency in service production. Put simply, without competition the balance of power between public agency and private contractor may be unacceptable. We may then wish to ask: if we must have monopoly, should it be public or private?

In evaluating the relative efficiency of private and public organizations it is also well to remember that the public directly and indirectly subsidizes much private activity, the cost of which subsidies does not enter into the accounting ledgers of private corporations.

If we find it difficult to clearly define goals for public organizations in a given policy domain, there is no reason to suppose that for the same policy domain we should be any more capable of doing so when contracting out is employed. Without clear and agreed upon goals it becomes exceedingly difficult to establish meaningful performance standards that can actually be measured. In the absence of such standards, and in the presence of pressure to justify programs, the lure of simplistic measures of expense, however inappropriate, may prove too strong to resist.

Neither is the playing field level: public agencies are constrained by more external factor: labor unions, affirmative action hiring, other social goals. Private corporations are sometimes able to offer the same services for less money because they are non-unionized. However, insofar as employing unionized workers is an integral part of the public policy, contracting out to non-unionized private organizations changes that policy, and the two cannot be compared. Choosing to contract out to a non-union private corporation is implicitly a decision to redistribute income.

⁸ Presumably there are policies we might follow to stimulate entry of private corporations into bidding for publicly let contracts and to maintain their existence once they have entered. The structure of certain problems may effectively preclude such policies, however, or they may be successful only at the cost of reductions in the efficiency that ostensibly motivated privatization in the first place.

Or, leaving aside the issue of unionization, focusing instead on wages, lower pay may make the service produced less expensive, but is it still the same service? Even assuming that some public employees are overpaid, do less well paid private sector employees perform at the same skill-level? For example, private bus companies may pay their drivers less than public school districts do theirs, but the complaint rate for private drivers runs nearly double that of the public drivers.⁹ By offering better remuneration, school districts can hire better—that is, older with cleaner driving records and fewer accidents—drivers than can the private companies. Even then, the private sector may not be as efficient as the public: the Montebello, California school district (11th largest in the state) operates its transportation service for 15-30% less than they could be produced by contract with the private sector. Fewer accidents and self-insurance account for a significant portion of this advantage.

Another propensity experienced in contracting out leads to the appearance, if not the fact, of superior private performance. In public transit, for example, private firms prefer to operate high density commute service as opposed to local service. Private prison corporations prefer to handle minimum security prisoners as opposed to maximum security and problem prisoners. Bus companies contracting with school districts tend to bid on daily school transportation while eschewing field trips. These collective behaviors are known as *creaming* or *skimming*, and represent the proclivity of private bidders to seek the easy problems within a given domain, leaving public agencies saddled with the least desirable and most difficult task. By extension we also expect private organizations to demonstrate greater interest in those policy domains where the problems are more readily solved and to avoid those domains in which solutions are more elusive.¹⁰

The appearance of greater economic efficiency in the private sector, in the short-run at least, is also generated by the practice of *low balling* bids for contracts. For example, when private bus companies come in to bid on contracts for providing student transportation for school district, it is not unknown for them to bid significantly lower than what it costs the district

⁹ I am very grateful to **David Miller**, Director of Transportation for the Montebello, California school district, for his keen insights into the transportation problems generated by the public schools and the relative vices and virtues of different approaches to their solution.

¹⁰ **Wollan** suggests an innovative way to confront this problem as manifested in corrections policy: *Pick a prison, the one with the worst problems, and say to the private sector, "This is what it costs us to run it. Take it, run it, and what's left over is your profit. If you can see your way to improvements, tell us what you think they will cost, and if they cost less, the profit is yours. And if you fail, you will have done it for no gain and we shall take it back.* (1986, 681)

to operate their own service. After about two years of contracting, during which time the district has dismantled or sold off its in-house transportation capacity, the fees charged by the bus companies tend to increase about 15 percent annually above cost of living increases.¹¹ Moreover, the lower fees generally reflect only daily scheduled transportation services; field trips, which may comprise up 30 percent of overall services, are charged at a higher level.

Even if we, for a moment, abandon these caveats and grant the superior relative efficiency of the private sector, we may still elect to eschew privatization. Decisions about institutional arrangements are largely problems of trading off one valued end against another. Efficiency as a criterion must be made to compete with other values in choices about institutions. Coming back to quality of service, we cannot simply assume that the same will be provided a lower price. For example, should a school district contract out for student transportation to take advantage of the economies of scale achieved by a large private bus company, it may find that when a bus breaks down it takes much longer for a replacement bus to arrive than when bus service was provided in-house. This, because the private bus companies maintain centralized bus yards in order to service the various and disparate school districts with whom they contract. The practical consequence is that replacement buses must travel much further than they would were the yard located in the school district itself, sometimes a difference of as much as 20 miles, which in urban areas may be as much as an hour travel time. The effect does not stop with young children being stranded. Because those children are not in school, the district loses money paid to it by the state based on average daily attendance at the rate of about \$20 per student per day.

Effectiveness and reliability, flexibility in the face of changing or heterogeneous conditions, and local control or responsiveness to clientele and constituencies must all be counted among those values. Certainly we must have effectiveness before we can think about efficiency, and for many activities where failure might spell catastrophe, reliability must assume the penultimate position in our pantheon of criteria. Even when efficiency remains our most important value, we still can do no more than permit it to become the most significant constraint, not the sole constraint on our decision. Even in the private sector, corporations may explicitly emphasize

¹¹ Poole notes that a couple of strategies have been developed to prevent the occurrence of low balling: avoiding very short-term contracts, thereby committing the contractor to provide service at a given price over a longer term, and retaining ownership of basic facilities or equipment, making it easier to hire a new contractor to continue to provide the service. (1987, 615-6)

service quality over price in their pitch to potential buyers. Look no further than the present war between AT&T and U.S. Sprint and MCI for long distance customers. AT&T concedes that its services cost more than its competitors: it offers higher quality service.

In the democratic context, attention to citizen participation in and control of the production as well as the provision of public goods and services is an essential consideration in choices from among alternative institutional arrangements. We probably ought to be willing to tradeoff efficiency against active citizen participation if such a tradeoff becomes necessary (Chisholm, 1989; Morgan and England, 1988). In the same vein, equity issues are never very far away from any consideration of altering institutional arrangements. In the wake of California's Proposition 13, the imposition of higher user fees disproportionately affected lower income groups. More indirectly, insofar as public bureaucracies have served as avenues for the social mobility of previously disadvantaged minority groups, to the extent they are reduced those channels will be constricted, with no guarantee the slack will be pricked up in the private sector. As Morgan and England argue:

an abundance of evidence documents certain negative side effects to market solutions to social problems. Thus, a preoccupation with the dominant face of privatization with its emphasis on efficiency, competition, and market forces may overlook other interests and issues that are vital to the public's social and economic well-being (1988, 982-3).

No public policy has ever been meant to serve but one goal; stated explicitly or otherwise, we ask our public policies—made concrete by organizations—to achieve entire complexes of goals. Decisions about altering present arrangements must take that into account.

MYTH #3: The distinction between political and administration is a useful dichotomy for guiding decisions on privatization.

Inherent in the arguments favoring privatization by contract is an assumption like that made by the Progressive movement of the late nineteenth and early twentieth centuries that a clear distinction may be drawn between the policy-making and policy-implementation functions, not only conceptually, but in actual practice. Making the politics-administration dichotomy permits problems raised by the exercise of discretion by private contractors to be assumed away. In this view, the proper role of the public entity is to make the policy, deciding what shall be done, how much of it shall be done, and who shall receive the goods or services, that is, the function of provision. The appropriate role of the

private contractor is presumably constrained simply to production of the publicly mandated services, thus making the private contractor no more than the neutral implementor of public policy. So conceived, provision equals politics, production equals administration.¹²

The principal problems revolve around the desire by the contracting public entity to limit the discretion of the private contractor, both to ensure that certain standards of performance are meant and to preclude deviation from expected behaviors. At the same time, the contract cannot be so specified as to eliminate all discretion on the part of the contractor. Even under the best of circumstances we cannot with any certainty predict the complete range of cases that will confront a contractor making it impossible to write a contract with rules so clear as to render all decisions *situationally determined*. Specificity of rules does not come without a price: the more clearly defined the contract, the less flexible it will be in the face of the inevitable unexpected circumstances. If the service is produced in-house by a public agency, appropriate changes mid-stream can be made without inordinate difficulty. When the service is produced by contract with a private corporation, the contract must be rewritten. Contract clauses are in this case functionally equivalent to the formal rules constraining actors in public bureaucracies. DiIulio quotes an experienced public corrections official:

Either the contractors will be allowed to run wild as they did in the old days, or we'll make the specifications, regulations, and monitoring so rigid that the firms will become as bureaucratized and inefficient as we are—killing the goose before she lays any eggs (1988, 73).

A *National Academy of Public Administration* report noted that when pressured for accountability but divorced from the actual production of services, public agencies have attempted to compensate by increasing regulation of contractors: in the area of procurement there are more than 4,000 laws and 34,000 pages of regulations (1989, xi). In a world of contracting out, regulations become the mechanism for oversight and control, performing the same function as internal agency management serves in the instances where government produces services directly. In the process, much of the flexibility attributed to the private sector is lost.

We cannot simply wish away such difficulties; some discretion must be available to and be exercised by whatever actor, public or private,

¹² Sappington and Stiglitz observe that: *The production process has many stages ... Thus, the distinction between public and private provision of a service is not entirely clear-cut. The relevant distinction may be where private enterprise ends and public control begins in the sequences of productive activities that comprise a service.* (1987, 579)

implements the public policy. It is naive to suppose that such discretion will not fundamentally affect the substantive contours of public policy. Accountability constitutes an unavoidable problem. In the case of in house production by a public agency, lines of responsibility are clear and formally, at least, a common relationship exists between superiors and subordinates. Under contracting out responsibility is less clear; contracts are written to protect the rights of both parties, and may serve to insulate the contractor from requests by the public agency. The public agency retains ultimately responsibility for the services provide, but loses capacity to directly influence the delivery of those services:

A major price of this cost savings ... is the local government's reduced control over the service delivery process. How much control must be given up to achieve cost savings is critical to the contracting out decision. The local government's Willingness to make this tradeoff is determined by a variety of fiscal and political pressures. (Ferris and Graddy, 1986, 332).

The severity of the problem is compounded by the fact of different agendas for public and private organizations. Where the private contractors are driven by economic efficiency and for the public agency concerned, issues of quality, reliability, equity, and fairness of distribution are more important, some significant conflict is bound to occur, and public policy may be ill served. Fitch observes that although private *Peer Review Organizations* have been instituted in the health care domain expressly to *monitor hospital use and quality of care for Medicare patients* they have behaved more as *agents of cost containment than of quality assurance* (1987, 33). Sullivan points out more generally that

Although the United States Constitution provides many protections for citizens against arbitrary government action and infringement of individual liberties, it provides no protection from abuses by the private sector. Can government escape constitutional restraints by transferring public authority to private groups? (1987, 461)

MYTH #4: Private sector organizations are not subject to the same pathologies as public organizations.

There can be no doubt that private corporations are subject to many of the same organizational pathologies as public bureaucracies with some others peculiar to themselves. Goal displacement, for example, may be found as commonly in private as in public bureaucracies. The private sector is also no guarantor of flexibility and easy adaptation to changing environmental conditions.

Private organizations, especially to the extent that the bulk of their

business depends upon government contracts, can quickly grow accustomed to *feeding at the public trough*, the net consequence being that, just like public bureaucracies, they develop vested interests in maintaining if not expanding the programs in which they are involve, perhaps beyond what some assessment of the public interest might warrant.

Our history amply demonstrates that private contractors to the public sector also develop their own peculiar pathologies, theft, fraud, and corruption chief among them. Advocates of privatization have blithely ignored impressive examples of waste and corruption in the American experience with defense, construction projects, and health care (Starr, 1987; Morgan and England, 1988). As Fitch has remarked, *Contracts are probably the most common and lucrative source of corruption in government*. Do we forget the contract kickbacks rampant in the New York City Motor Vehicles Bureau, its Traffic Violations Bureau, the contract scandals in the Federal Interstate highway program some years ago, and, more recently, in the waste disposal industry? *Anyone who believes these are isolated instances doesn't read the papers very thoroughly and probably also believes in the tooth fairy* (1987, 23). Public bidding and other mechanisms have somewhat reduced but not eliminated this problem.

Inflated price, bills for work not performed, substitution of lower quality parts, and outright theft—it was a common complaint of Josephus Daniels, secretary of the Navy under Woodrow Wilson, that the private shipyards viewed ship-building contracts as an opportunity to steal—have all characterized private production of goods and services for the public. We would do well to remember that during the Progressive era, much of the impetus for expanding the scope of government activity had to do with reducing the *inefficiencies* associated with private provision of public services. In the contemporary period, institution of auditing and reporting requirements in response to these problems has had the unintended consequence of hamstringing honest, ethical contractors, without achieving its primary purpose.¹³

¹³ Fitch estimates that complying with the Agency for International Development's reporting system occupied 20-25 percent of the staff time of Institute of Public Administration during a contract aimed at improving public administration in Vietnam. Another 50 percent of their time was devoted simply to the logistics of living and working in Vietnam, leaving precious little time for the substantive purpose of the project. (1987, 25-26)

MYTH #5: Experience with privatization in one policy area is readily transferable to other policy areas.

Experience in one policy domain **may** be useful for understanding other domains, but the similarities between domains where we have knowledge of the consequences of privatization and domains where we do not must be treated as hypothesis subject to empirical verification. In like manner, experience with privatization at one level of government may not be readily generalizable to other levels, because of the peculiarities describing each level.

Systematic empirical study of consequences of privatization is difficult to come by, especially comparisons across policy domains. The most extensive evidence available concerns the relative economic efficiency of private versus public solid waste removal services. (Savas, 1979 a; 1977b; 1987; McDavid, 1985) Some data is also available pertaining to provision of public transit services (Perry and Babitsky, 1986; Guskind, 1987) and fire protection. (Ahlbrandt, 1974) More recently, we have some information about the performance of private prisons. (Wollan, 1986; DiIulio, 1988) and privately produced public health care. (Bovberg, Held and Puly, 1987) The first four represent highly programmable activities where the policy goals are pretty much agreed upon, the technologies are well known, and the activities are relatively simple on the one hand, and repetitive on the other. The latter are much more complex, with less agreement on goals, and appear to require a more experimental approach. Yet it is the policy domains most resembling the later two that are most likely targets for future privatization by contract. There is no good reason to suppose that the experience with privately operated prisons will perform us very much about the virtues and vices of contracting out for health care.

A study of contracting out in California found that for final services cities were most likely to seek private production of public works, health services, animal control, parks and recreation, and transportation services; while counties contracted for air pollution control, ambulance service, health care, museums, parks and recreation, and some public works. Support services most often contracted out by cities and counties included maintenance, commercial equipment, official vehicles, data processing, buildings and grounds, janitorial, and engineering and design (counties only). (Fetch, 1987) These are relatively simple, non-controversial area, with high degrees of cause and effect knowledge, all of them. Yet the unreliability of contractors.

Just as it is difficult to generalize from one domain to another,

experience with contracting out for standard, off-the-shelf equipment, supplies, or services will not do much to enlighten us about the problems relevant to *contracts to develop and produce complex military systems, manage a large facility or research and development operation, or to provide employment services to the hard-core unemployed*. Again, the problem is that it is precisely these latter domains—such as education—where contracting out is assuming greater importance, policy areas intrinsic to which are *difficult tradeoffs about what services to provide and to whom*. (*National Academy of Public Administration, 1989, 12*)

At a minimum, the available evidence makes a very slender thread upon which to hang any generalized policy of privatization through contracting out. It is worth noting that our various social institutions did not spring into being over night; they are the results of evolutionary processes lasting decades, if not centuries. Cautious movement, founded upon carefully constructed policies whose empirical warrant may be established, on a domain by domain basis, will serve us best.

Based on existing evidence, the following non-surprising generalizations can be made about the conditions under which contracting out is most likely to work:

1. It involves narrow objectives that may be easily defined and their attainment measured.
2. The service is comprised of specifiable tasks performed at a familiar production cost that can be monitored at an acceptable cost.
3. There exist numbers of willing and able organizations competing to produce the service.
4. Government is sufficiently competent and honest to enforce the rules of a fair market. (*Fetch, 1987, 34*)

In other words, if the problem is non-controversial, our cause and effect knowledge is near perfect, and competition is assured, we may entertain some confidence that contracting out will work. Policy domains possessing those characteristics make good prospects for privatization. But then, any domain with those attributes will probably also be readily handled entirely in the public sector. Standing this statement on its head, we would say that difficult problems remain difficult irrespective of the institution, public or private, we ask to solve them.

Finally, to these characteristics should be added one more requisite qualification: areas where the cost of failure will be relatively minimal, or at a least bearable, make better prospects for privatization than domains

in which failure may prove catastrophic. We may, for example, find it worthwhile to keep such endeavors as toxic waste disposal in the public sector, specially given the track record of the private sector in this area.

MYTH #6: Privatization will reduce the need for government activities and personnel.

An explicit aim of privatization is to reduce the scope and extent of government activity. Implicit in this aim is an assumption that shifting production of goods and services from public to private will result in a net gain to society because of the efficiencies to be achieved by using private producers and because the size of public agencies will be correspondingly diminished. The exact gain to be realized in any given policy domain, if any, is an empirical question, the answer to which we will know only after the fact—in fact, the cost of public oversight seems likely to run typically to 10 percent of a contract, this in addition to the administrative overhead billed by the private contractor.

We can make the following general statement, however: the government function will not disappear—except under load shedding—rather, the task of government officials will shift from doing to overseeing. Negotiating and bargaining skills will replace more traditional management skills, as superior-subordinate relationships are replaced by contractual relationships between near-equals. In some ways this is a more difficult set of tasks, one for which government officials are presently not so well trained. To monitor performance of contracts effectively, public agencies will have to retain significant numbers of personnel with expertise in the relevant areas. Retention may meet with difficulties caused by superior private sector salaries.

The bottom line is that under contracting out although operations personnel will no longer be required, the government function will not wither away, it will change in character, in many ways it will become more difficult to execute effectively, and it will continue to consume a significant proportion of the budget allocated for any particular service.

Alternatives to Privatization

It is striking how limited is our imagination when it comes to conceiving of alternate ways of organizing the public administration. Few seem capable of thinking beyond the standard form of monopolistic bureaucracy when it comes to the provision of public goods and services. Under such a purblind perspective, should we become unhappy with the standard form of public organization, our alternative are apparently restricted to

efforts to improving that form or to abandoning it entirely. Historically, the creation of a neutral civil service, the professionalization of the bureaucracy, and adoption of scientific management techniques exemplify the former. In recent decades, the same approach has been manifested in attempts to install management control systems of various stripes in bureaucracies at all levels of government. The various privatization strategies currently advocated reflect, implicitly at least, a recognition of the bankruptcy of management control systems, but by seeking simply to abandon public provision of goods and services share the same myopic vision for the possible remedies.

In this sense, to ask whether we should privatize is really to ask the wrong question. Framing the question improperly unnecessarily restricts our repertoire of response. The more useful question to ask is: What alternate organizational arrangement might prove more effective and efficient in providing and producing public goods and services than monopolistic public bureaucracy? At the same time, we should ask what mix of other important goals may be met more effectively by alternative organizational arrangements? With our query couched in these terms, privatization broadly defined becomes only one of a number of options we might elect to investigate.

1. *Decentralization*

The existence of more than one public organization in the same policy domain has been called *multiorganizational suboptimality*. When in the private sector tendencies toward consolidation and merger are viewed with alarm, particularly in the past decade, in the public administration, the recipe for improvement has been nothing less than complete monopoly, with central control and vertical integration. Those who view natural market forces as a profound coordinating mechanism abandon this view when it comes to the public sector. Most of our governmental reorganizations have been directed toward formal integration and consolidation, but such reorganizations have not brought the improvements in performance expected from them. (Imersheim, *et alia*, 1986) They have exacerbated the inherent inflexibility, slowness to change, and inability to contend with anomaly that characterize large bureaucracies. Such highly centralized systems also create a gap between the formal authority to make decisions and the capacity to make them. (Chisholm, 1989, Chapter I)

In the face of these considerable problems it is worth experimenting with formally decentralized public organizations. By permitting ready

adaptation to a variety of circumstances, by not imposing the same formal organizational routines on all situations, we are likely to find improvement in the efficiency of our public organizations. Where the individual organizations exhibit interdependence with one another, informal mechanisms, such as informal channels and contracts, may be developed to deal with that interdependence, without losing the independence of action created by each organization through decentralization.

At the same time, decentralization facilitates greater local control, citizen participation, and responsiveness to individual constituencies. A comparison of the highly decentralized transit systems of the San Francisco Bay Area with the highly centralized Washington D.C. Metropolitan Area Transportation Authority reveals greater adaptation to local condition, more citizen input, no greater administrative overhead, and, in some cases, more effective coordination.

2. *Competition Among Public Agencies*

In the same way, where we cherish the creation and maintenance of competition in the private market, we view its presence in the public administration a anathema: it is wasteful duplication and overlap. Where such competition does exist, it usually has to do so *sub rosa* and is subject to constant pressure for its elimination. But we would do well where possible to experiment with the production of public services by explicitly competing public organizations; as in the private sector, competition creates incentives for performance and generates information about the real costs of producing goods and services, thereby reducing the phenomenon of rent and giving power to the purchasers of those goods and services. In the San Francisco Bay Area Alameda-Contra Costa County Transit District (AC and the Bay Area Rapid Transit District (**BART**) both public agencies, for nearly twenty years have competed for passengers on the busy East Bay to San Francisco commute corridor, with substantial gains to the public interest. (Landau, Chisholm, and Webber, 1980) At the same time, reliability the overall system is promoted by the redundancy such competition permits.

3. *Competition Between Public Organizations and Private Corporations*

We already have competition between public and private organizations. The U.S. Postal Service has competed for a very long time against United Parcel Service for the delivery of packages. More recently it has begun competing against Emery, DHL, Federal Express, and a host of smaller private actors in the express mail domain. Rather than contracting out the

premium services, private corporations have been allowed to enter the market to compete against the former public monopoly, giving consumers choice, thereby greater power, and generating considerable information about the economics of postal services. Privately owned parks and recreation areas have also been a longstanding feature of the natural terrain in the United States and appear to have worked quite well. Such an approach creates external pressure on the public agency to perform because it has lost at least part of its monopoly on a given good or service. Efficiency improves as does response to constituencies and clientele. It is an option that we should consider more seriously and for mere domains than we have in the past. Where public-private competition is possible, we ought carefully to experiment with it, observing its effects, and expanding it as judged appropriate.

4. *Contracting Between Different Public Agencies*

There is no reason to restrict contracting out by public agencies to private producers. Contracting out between one government entity and another has a long and splendid record. In California, the so-called *Lakewood Plan* has permitted local constituencies to incorporate so as to gain greater local control over local services and land use planning by an older, neighboring city with higher tax rates and different interest groups, while simultaneously averting incorporating and trying to support necessary services with a small tax base. (Miller, 1981) Such cities contract with the county for police, fire, engineering and design, and other services on an annual basis.

In the San Francisco Bay Area, AC Transit and BART have longstanding contracts under which AC provides express bus service to BART passengers in areas where Bart rail lines do not yet reach, but which BART wishes to serve. Between the same two agencies exists an emergency agreement in which AC and BART provide back-up services for each should either suffer breakdowns in their systems. Other transit agencies exchange specialized equipment, often on no more than a handshake. (Chisholm, 1989)

More recently, the city of Long Beach, California elected to contract with the county of Los Angeles for police services in part of its jurisdiction—a four year, \$19.9 million contract—this, though it has its own police department. Budget woes and severe undermining in the city's police department, combined with a skyrocketing crime rate in its north and northeast sections prompted the action. City officials expect faster response time and better service. (**Deputies Mean Faster Police Response, L.B. Officials Say**, *Los Angeles Times*, 9 September 1990, J-1)

In each instance, contracting with other public agencies permits taking advantage of the efficiencies of economies of scale, and gaining access to specialized expertise and equipment. At the same time, there do not appear to be the same monitoring and compliance difficulties associated with private contractors and local control and constituency responsiveness are maintained.

It is also worth pointing out that the so-called New Federalism is another name for contracting out—but from one level of government to another. In this case, the federal government does less and less itself, depending on state, county, and city governments to actually carry out public policies decided and wholly or partially funded at the national level.

5. *Consortiums of Public Agencies*

Consortiums, permanent or task specific, formed by public organizations with common interests, permit smaller public entities to avail themselves of the efficiencies of economies of scale. The potential inefficiencies associated with decentralized public agencies may be reduced or eliminated by such an approach. In the San Francisco Bay Area, for example, the Regional Transit Association (RTA) formed voluntarily by the six largest transit operators, has for some 15 years regularly engaged in joint purchases of supplies and equipment. Although initially differences in specifications proved problematic, over time these difficulties have been surmounted, and the joint purchasing works quickly and smoothly on everything from bus tires and batteries to fluorescent tubes and office fixtures. (Chisholm, 1989)

In Southern California, rather than contract out to private charter companies, the East Whittier, Whittier Union High, South Whittier, Las Nietas, and El Rancho school districts formed a joint powers agreement, governed by a separate board comprised on one member from each district, to provide school transportation to each of the member districts. Each district brought its own equipment and personnel, which now operate under one management. This strategy has reduced costs, but permits the school districts to retain higher levels of service than if they contracted with private companies. At the same time, considerable local control is maintained. There is no reason why such a strategy cannot be more widely employed by public sector organizations at all levels.

6. *Public Investment*

Rather than diminish the role of public administration in the provision and production of public services, taking an investment approach ought

to strengthen it. From this perspective, it is assumed that many agencies, policies and programs are *investments in the nation's economic growth and technical progress, international competitiveness, capacity to manage technology, and continuing pursuit of social equity*. (Carroll, 1987, 109) This strategy focuses on the public administration of investment rather than the public administration of consumption, seeking to redress the relative imbalance that now exist, particularly at the federal level, between programs targeting investment and those concerned only with consumption. Carroll suggest a multi-faceted strategy:

1. A stable macroeconomic policy to reduce the distortion effects of deficits on the economy, especially the absorption of savings to finance the debt.
2. Tax, research and development, regulatory policies designed to encourage private investment, training and technical innovation.
3. Organizational policies to facilitate coordination among government, business, universities, and research and development organizations to increase the productive efficiency of labor and capital through the development of expertise and technology.
4. Policies to recognize, increase, and improve public investments in people research and development, technology, education and training, natural resources and the environment, and the national physical infrastructure.
5. Policies to strengthen and improve the analytical, managerial, and organizational capacities of public organizations to manage the mix of public-private programs which now characterizes much of public action. (1987, 110)

The public investment approach goes well beyond the other alternatives listed above. It calls for a shift in attitude on the part of our decision makers toward a long-term development of capacities at a variety of levels, but sharing in common the expansion of our knowledge base. Rather than focus directly on organizational arrangements, public or private, it directs our attention to improving the larger society's productive efficiency for all kinds of goods and services through a systematic and self-conscious set of policies.

Not a single strategy will solve all problems. Taken together they will go some distance toward improving the quality of our public services, reducing costs of delivery, maintaining public accountability, and other values we hold dear. Weaknesses in one approach may redressed by other approaches.

Some Concluding Remarks

Ultimately we should be quite wary about rushing to privatize, whichever strategy is employed, and we should be more alert to the possibilities of alternative public organizational designs. Given the essential and unavoidable tradeoffs among competing values inherent in any decisions about how to organize and deliver public services, decisions to employ one mechanism or another are ultimately and necessarily political decisions. We need remember that in our public policy decisions we can only evaluate any given approach to a problem in comparison to what other alternatives are realistically available. There is no reason we can not develop and sustain a rich diversity of approaches to the provisions and production of public goods and services that will strengthen rather than diminish or weaken the public administration. The answer is **not** to be found in choosing simply between traditional forms of public bureaucracy and private corporations.

REFERENCES

- Ahlbrandt, Roger S. Jr. "Implications of Contracting for a Public Service." *Urban Affairs Quarterly* 9 (1974): 337-357.
- Bovberg, Randall R., Philip B. Held and Mark V. Pauly. Privatization and Bidding in the Health-Care Sector." *Journal of Policy Analysis and Management* 6 (1987): 648-666.
- Bozeman, Barry. "Exploring the Limits of Public and Private Sectors: Sector Boundaries as Maginot Line." *Public Administration Review* 48 (1988): 672-674.
- Buckland, Roger. "The Costs and Returns of the Privatization of National Industries." *Public Administration* 65 (1987): 241-257.
- Carroll, James D. "Public Administration in the Third Century of the Constitution: Supply-Side Management, Privatization, or Public Investment?" *Public Administration Review* 47 (1987): 106-114.
- Champney, Leonard. "Public Goods and Policy Types." *Public Administration Review* 48 (1988): 988-994.
- Chisholm, Donald. *Coordination Without Hierarchy: Informal Structures in Multiorganizational Systems*. Berkeley: University of California Press, 1989.
- DiIulio, John J., Jr. "What's Wrong with Private Prisons" *Public Interest* 92 (Summer 1988): 66-83.

- Ferris, James and Elizabeth Graddy. "Contracting Out: For What? With Whom?" *Public Administration Review* 46 (1986): 332-344.
- Fitch, Lyle C. *The Rocky Road to Privatization* Berkeley: University of California, Institute of Governmental Studies, 1987.
- Guskind, Robert. "Leave the Driving to Us." *Planning* July 1987, pp. 6-10.
- Haas, Lawrence J. "Mixing Missions." *National Journal* 6 May 1989, pp. 1114-1118.
- Hanke, Steve H. ed. *Privatization and Development*. San Francisco: Institute for Contemporary Studies, 1987.
- Imersheim, Allen W, Larry Polivka, Sharon Gordon-Girvin, Richard Chackerian, and Patricia Martin. "Service Networks in Florida: Administrative Decentralization and Its Effects on Service Delivery." *Public Administration* 46(1986): 161-169.
- Johnson, Gerald W. and John G. Heilman. "Metapolicy Transition and Policy Implementation: New Federalism and Privatization." *Public Administration Review* 47 (1987): 468-478.
- Kolderie, Ted. *What Do We Mean by Privatization?* St. Louis: Center for the Study of American Business, Washington University, 1986.
- _____. "The Two Different Concepts of Privatization." *Public Administration Review* 46 (1986): 285-291.
- Landau, Martin and Russell Stout. "To Manage is Not to Control or the Folly of Type II Errors." *Public Administration Review* 39 (1979): 148-56.
- _____, Donald Chisholm, and Melvin Webber. *Redundancy in Public Transit, Volume I: On the Idea of an Integrated Transit System*. Berkeley: University of California, Institute of Urban and Regional Development, 1980.
- Levin, Henry M. "Education as a Public and Private Good." *Journal of Policy Analysis and Management* 6 (1987): 628-641.
- McDavid, James C. "The Canadian Experience with Privatizing Residential Solid Waste Collection Services." *Public Administration Review* 45(1985):602-608.
- _____. "The Two Different Concepts of Privatization." *Public Administration Review* 46(1986): 285-291.
- Miller, Gary J. *Cities By Contract: The Policies of Municipal Incorporation*. Cambridge, Massachusetts: M.I.T. Press, 1981.
- Moe, Ronald C. "Exploring the Limits of Privatization." *Public Administration Review* 47(1987): 453-460.
- _____. "'Law' Versus 'Performance' as Objective Standard." *Public Administration Review* 48(1988): 674-675.
- _____. *Privatization From a Public Management Perspective*. Washington, D.C.: Congressional Research Service, 1989.

- Morgan, David R. and Robert E. England. "The Two Faces of Privatization." *Public Administration Review* 48(1988): 979-987.
- National Academy of Public Administration. *Privatization: The Challenge to Public Management*. Washington, D.C.: 1989.
- Pack, Janet Rothenberg. "Privatization of Public-Sector Services in Theory and Practice." *Journal of Policy Analysis and Management* 6 (1987): 523-540.
- Perry, James L. and Timlynn T. Babitsky. "Comparative Performance in Urban Bus Transit: Assessing Privatization Strategies." *Public Administration Review* 46(1986): 57-66.
- Poole, Robert W. Jr. "Privatization of Public-Sector Services in Practice: Experience and Potential." *Journal of Policy Analysis and Management* 6(1987): 612-625.
- Sappington, David E. M. and Joseph E. Stiglitz. "Privatization, Information and Incentives." *Journal of Policy Analysis and Management* 6(1987): 567-582.
- Savas, E. S. *The Organization and Efficiency of Solid Waste Collection*. Lexington, Massachusetts: Lexington Books, 1977.
- _____, ed. *Alternative for Delivering Public Services: Toward Improved Performance*. Boulder, Colorado: Westview, 1977.
- _____. *Privatization: The Key to Better Government*. Chatham, New Jersey: Chatham House, 1987.
- Starr, Paul. "The Limits of Privatization." In Steven H. Hanke, ed, *Prospects for Privatization*. New York: The Academy of Political Science, 1987.
- Sullivan, Harold J. "Privatization of Public Services: A Growing Threat to Constitutional Rights" *Public Administration Review* 47(1987): 461-567.
- Wollan, Laurin A., Jr. "Prisons: The Privatization Phenomenon." *Public Administration Review* 46(1986): 678-681.