

Introduction

By Leonard Gilroy, Editor, Annual Privatization Report 2006



In the two decades since the publication of Reason's first *Annual Privatization Report*, governments of all political complexions have increasingly embraced privatization—shifting the production of a good or the provision of a service from the government to the private sector—as a strategy to lower the costs of service delivery and achieve higher performance and better results.

Once considered a radical concept, privatization has largely shifted from an ideological concept to a well-established, proven policy management tool. Policymakers from Phoenix to Prague, China to Chile, and North America to the Middle East have used privatization to better the lives of citizens by offering them higher quality services at lower costs, delivering greater choice and more efficient, effective government. Virtually every government service—from local services like road maintenance, public safety, and water to national services like passenger rail, energy production, and social security systems—has been successfully privatized somewhere in the world. Decades of successful privatization policies have proven that private sector innovation and initiative can do certain things better than the public sector.

For much of the 20th century, the trend was clearly in the opposite direction. This period saw the rapid expansion of state control over the lives of citizens. Prominent

political ideologies like socialism and communism spread the belief that society's needs and problems are best addressed through government intervention. Statism even spread to capitalist economies; for example, the British government nationalized its coal, gas, rail, shipbuilding, and steel industries, and the United States nationalized the facilities of the Tennessee Electric Power Company into the Tennessee Valley Authority and adopted a number of government-run social welfare programs (such as Social Security, Medicare, and Medicaid) under the New Deal and Great Society programs. As governments grew, they increasingly constrained commerce and free enterprise, consumed an ever greater share of personal and business income, and restricted private property rights and personal freedoms.

The tide began to turn in the latter half of the century as the folly of this approach became apparent through bloated bureaucracies, sluggish economies, stifling taxes, and failing government programs. Intellectuals, policymakers, and citizens became increasingly interested in market-based policy solutions to improve the efficiency and performance of government. It is in this context that the concept of privatization began to flourish.

Reason's Annual Privatization Report:

Twenty Years at the Cutting Edge of Privatization and Government Reform

For almost four decades, Reason Foundation has worked to advance a free society by developing, applying, and promoting the principles of individual liberty, free markets, and the rule of law. In steadfast pursuit of this mission, Reason works at the forefront of privatization policy through its research, outreach, and publications like the *Annual Privatization Report (APR)*.

Now in its 20th year of publication, *APR* has become the world's longest running and most comprehensive annual report on news, developments, and trends in privatization, competition, and government reform. *APR* helps policymakers and leaders at all levels of government understand this fast-moving policy arena, highlighting tools and trends to help them improve the efficiency and performance of government and emphasizing best practices, cooperative problem-solving, and structural reform.



APR is the brainchild of Reason Foundation Trustee David Koch, executive vice president of the nation's largest privately owned company, Koch Industries, Inc. During a 1986 visit from Robert

W. Poole, Jr., founder of Reason Foundation, Messrs. Poole and Koch engaged in a wide-ranging discussion on how privatization had grown to become a global issue, largely due to the innovative, market-based policy programs developed under the aegis of U.S. President Ronald Reagan and U.K. Prime Minister Margaret Thatcher. In that conversation, Mr. Koch proposed the idea of an annual report on the status and progress of privatization efforts around the globe, with a particular emphasis on privatization's impact on U.S. public policy.



Reason Founder Robert W. Poole, Jr. with Margaret Thatcher

What emerged in early 1987 was *Privatization 1986*, a report on the status of privatization to date and important developments of that year. The publication garnered enough attention from policymakers that Messrs. Koch and Poole determined that it was worth continuing. For subsequent editions, the report was re-titled *Annual Privatization Report*.

Reason owes a debt of gratitude to David Koch, and *APR* would not have flourished without his commitment to market-based tools that enable individuals, institutions, and societies to survive and prosper. It is thanks to Mr. Koch's vision and support that the *Annual Privatization Report* has become the nation's foremost publication on privatization, outsourcing, and government reform.

In addition, the organization that has evolved into Reason Foundation would not exist without the dedication and vision of Robert Poole. In 1978, Robert launched Reason Foundation to advance the values of individual freedom and choice, limited government, and market-friendly policies. He popularized the term "privatization" to refer to contracting-out public services, and his book *Cutting Back City Hall* (Universe Books, 1980) was the first book-length examination of the subject.

Privatization in Perspective

Over the years, privatization has taken many meanings. In its purest form, the term refers to the divestiture of government-owned assets like airports, rail systems, real estate holdings, and oil production facilities. As the concept has evolved, privatization has grown to resemble more of an umbrella term to account for greater private sector participation in the delivery of services. For example, over 1,000 local governments in the United States—including Indianapolis, Seattle, and Beverly Hills—have entered into public-private partnerships for water services, contracting out the operations and maintenance of water systems to private companies. Similarly, multi-billion dollar public-private highway, bridge, and tunnel projects are operating or under construction across the United States, in Australia, Canada, Italy, France, and other countries.

Regardless of the specific form it takes, privatization introduces market-based competition into government where it otherwise does not exist. Competition benefits the public by offering expanded choices, higher quality services, and lower costs. Adrian Moore, Vice President of Reason, offers a concise articulation of the benefits of privatization:

Privatization exposes things we otherwise would not see—ideas, processes, innovations in service delivery. Within government rarely is success adequately rewarded, and innovation and new ideas are often quashed. But when privatization brings competition, accountability, and a chance for customers to have a say, then excellence and innovation are rewarded, and mediocrity and failure are penalized.

Since the first APR was published two decades ago, privatization has continued its

Privatization as Societal Transformation

In 1969, famed management guru Peter Drucker published *The Age of Discontinuity*, in which he foresaw the transition from the industrial age to the information age. According to Drucker, this transition would be accompanied by profound, transformative change in society, business, and government. One of Drucker's predictions was that governments would eventually "reprivatize" the state-owned industries in Europe, moving them back into the private marketplace. The term reprivatize resonated so strongly with Reason Foundation founder Robert Poole that when he began writing about outsourcing municipal services in the early 1970s, he popularized the term "privatization" to describe the concept.



evolution from novel concept to mainstream idea, both in the United States and internationally. Some examples illustrate this point:

- In 1986, air traffic control (ATC) services were exclusively the province of national governments. Today, over 40 countries have "commercialized" their ATC systems since New Zealand launched this trend in 1987, shifting the responsibility for providing ATC services from the national government to an independent corporation supported by user fees instead of government appropriations. Benefits of ATC commercialization include improved safety, improvements in service quality through increased flight

efficiency and delay mitigation, and lower costs relative to the United States' government-run FAA.

- According to a 2005 World Bank report, 120 developing countries carried out 7,860 privatization transactions between 1990 and 2003, generating close to \$410 billion in privatization proceeds.
- When Margaret Thatcher was first elected prime minister in 1979, the British government still owned the coal, steel, oil, and electricity industries, several auto companies, the telephone system, and a major airline, among other holdings. By the time of her resignation in 1990, all had been privatized by Thatcher. Under her leadership, the United Kingdom rose from 19th to 2nd in the OECD rankings. Further, between 1979 and 1997, stock ownership among the British population had increased from 7 to 23 percent, the middle class increased from 33 to 50 percent of the population, and the homeownership rate increased from 53 to 71 percent.

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- Congress passed the Federal Activities Inventory Reform (FAIR) Act in 1998, which classifies every federal job into categories, the most basic being “inherently governmental” (activities that can only be provided by government employees) and “commercial in nature” (activities that can and are provided by the private sector). FAIR facilitated the adoption of “competitive sourcing”—a process for determining whether the private sector or government is the most efficient and effective source for

performing specific functions. President Bush’s competitive sourcing effort is saving taxpayers money; competitions over the last three years alone are expected to save approximately \$5.6 billion over the next few years.

- The FAIR Act inspired similar legislation in Virginia, and other states use it as a baseline for determining which services are commercial and which should be contracted out.
- In the last seven years, Florida state government has launched more than 130 government reform and privatization initiatives saving more than \$550 million. That focus on management excellence has also enabled more than \$20 billion in tax cuts during that same time, and the number of state jobs has fallen from 127,000 to 113,000, an impressive feat that would have been much larger if not for the addition of workers in education and public safety.
- According to the National Solid Wastes Management Association, the percentage of contracted solid waste collection and disposal services increased from 30 percent in 1987 to 54 percent by 2000.
- According to the National Council for Public-Private Partnerships, the average American city contracts out 23 of its 65 basic municipal services—such as road maintenance, solid waste collection, and water/wastewater—to the private sector, and states contract out approximately 14 percent of their activities. Further, a 1997 survey of 1,400 cities and counties by the International City/County Management Association found that more than 90 percent of the governments surveyed said they were contracting out services that had been

done in-house just five years earlier.

- Contract cities—cities that contract with outside public or private sector providers for major municipal services, such as police and fire services, public works, and building and safety—have continued to grow in number since Lakewood, California—a pioneer contract city—was incorporated in 1954. Sandy Springs, Georgia, incorporated in late 2005, is the latest contract city and the first new city in Georgia in 50 years. Instead of creating a new municipal bureaucracy, the city opted to contract out nearly all government services. Inspired by Sandy Springs and impressed by its cost savings achieved by contracting, citizens in four nearby Fulton County communities will hold elections in the near future on cityhood, and feasibility studies for at least three more new Georgia cities are currently underway.
- A LexisNexis search of the keyword “privatization” showed that the term appeared in 957 articles in major U.S. periodicals in 1986. In 2005, the term appeared in over 20,000 articles, suggesting a significantly increased media focus on privatization.

Privatization is not the domain of any one political party or ideology. In the United States, privatization is used by leaders of both major political parties, and they have demonstrated that not only can politicians at all levels successfully privatize public services, but they can get re-elected after doing so. For example:

- Under the Democratic administration of Pres. Bill Clinton, the federal government sold the Elk Hills Naval Petroleum Reserves (\$3.6 billion), the U.S. Enrichment Corporation (\$3.1 billion),

and many billions of dollars worth of electromagnetic spectrum. It also conducted competitions for the operation of more than 100 airport control towers and numerous military base functions. It was also Clinton’s Environmental Protection Agency that declared public-private partnerships for water and sewer systems a “classic win-win.”

- Florida Gov. Jeb Bush’s Republican administration has opened more than 138 public services to competition, generating cost savings of at least \$550 million and improved service delivery. Governor Bush also created the state’s Center for Efficient Government, which has developed a centralized process for evaluating when and where competition is appropriate, as well as assessing the competitions.
- During his term as mayor of Indianapolis, Stephen Goldsmith, a Republican, identified \$400 million in savings and opened up over 80 city services—including trash collection, pothole repair, and sewer services—to competitive bidding. As a result of Goldsmith’s leadership, Indianapolis is considered the municipal leader in competition and privatization.
- Chicago’s Democratic Mayor Richard Daley has privatized more than 40 services. In fact, he was so satisfied with the \$1.8 billion privatization of the Chicago Skyway—one of Chicago’s major highways—that he is lobbying for similar deals for city-owned parking lots and the Midway airport.
- When Democrat Ed Rendell, governor of Pennsylvania, was mayor of Philadelphia, he privatized 49 city services, saving \$275 million. The list of services privatized

included golf courses, print shops, parking garages, and prisons.

Looking abroad to number, size, and type of privatizations being done in other countries, it is clear that we have barely scratched the surface in the United States. Many federal government services and agencies that are being privatized routinely in other countries are still firmly in government hands, such as Amtrak, the Social Security system, the Tennessee Valley Authority, the U.S. Postal Service, the air traffic control system, and the nation's power marketing authorities.

At the state and local level, there is also tremendous potential for saving taxpayers money and improving the delivery of services. More than half of the U.S. population still gets its drinking water from government agencies and then gets its wastewater treated by government agencies. There are still large numbers of municipal electric and gas utilities. And the United States has only just begun to tap the private sector for airports and highways, where dozens of other countries are already enjoying the savings and improvements.

In short, the ideas of privatization and competition have advanced a long way since *Privatization 1986*, yet there is still a long way to go.

Reflections from Privatization Pioneers

In this 20th issue of *APR*, we present a series of exclusive articles by the world's leaders in privatization. Our contributors include pioneering policymakers and researchers at the forefront of privatization and government reform, including:

- Margaret Thatcher, prime minister of the United Kingdom from 1979-1990;

- Mitch Daniels, governor of Indiana;
- Mark Sanford, governor of South Carolina;
- Stephen Goldsmith, former mayor of Indianapolis;
- Robert Poole, Jr., founder and transportation studies director of Reason Foundation;
- Professor E.S. Savas, former assistant secretary of the U.S. Department of Housing and Urban Development and former first deputy city administrator of New York City;
- Ronald Utt, senior research fellow at the Heritage Foundation;
- John Blundell, director general of the Institute of Economic Affairs in London;
- William Eggers, formerly with Reason, now global director for Deloitte Research—Public Sector;
- Roger D. Feldman, partner at Bingham McCutchen LLP and former Chair of the National Council for Public-Private Partnerships;
- Dr. Lawrence Martin, director of the Center for Community Partnerships at the University of Central Florida; and
- Grover Norquist, president of Americans for Tax Reform.

It is impossible to look back on the last 20 years of privatization without acknowledging the leadership and dedication of these individuals in advancing the idea of competition in government. Reason Foundation is honored to have them share their expertise and insights on privatization, competition, and government reform in the 20th anniversary edition of our *Annual Privatization Report*.

Rebuilding an Enterprise Society through Privatisation

By Margaret Thatcher, former Prime Minister of the United Kingdom



All too often the state is tempted into activities to which it is either ill-suited or which are beyond its capabilities.

Perhaps the greatest of these temptations is government's desire to concentrate economic power in its own hands. It begins to believe that it knows how to manage business. But let me tell you, it doesn't—as we discovered in Britain in the 1970s when nationalisation and prices and incomes policy together deprived management of the ability to manage. And when we came to privatise and deregulate in the 1980s it took some time before these skills returned.

A system of state control can't be made good merely because it is run by “clever” people who make the arrogant assertion that they “know best” and that they are serving the “public interest”—an interest which of course is determined by them. State control is fundamentally bad because it denies people the power to choose and the opportunity to bear responsibility for their own actions.

Conversely, privatisation shrinks the power of the state and free enterprise enlarges the power of the people.

The policies we introduced in the 1980s were fiercely opposed. Too many people and industries preferred to rely on easy subsidies rather than apply the financial discipline necessary to cut their costs and become competitive. Others preferred the captive customers that a monopoly can command or the secure job in an overmanned industry, rather than the strenuous life of liberty and enterprise.

But we understood that a system of free enterprise has a universal truth at its heart: to create a genuine market in a state you have to take the state out of the market.

For Britain, the 1970s was a decade of decline: even worse than that, our people seemed to accept it. Our nationalised industries were inefficient, overmanned and weakened by restrictive practices. Government had no business being in business.

We tackled privatisation in the way which best suited us.

First, we had to put the balances of the industries we wanted to sell in good order. Where redundancies had to be made because of overmanning we were determined to

“We showed that privatisation worked.”



ensure that those who lost their jobs would receive a capital sum related to the length of their service. For the first time in their lives this put capital into their hands and each industry helped them to find other jobs or to set up businesses of their own. Thus we made clear our concern to look after those who were losing their livelihoods as well as those who were staying on.

Second, I saw it as part of my purpose to have a policy which extended ownership of capital more widely. It is most people's ambition to have something to pass on to their children. In doing so, we link the generations and create a deep and abiding interest in the future. I have already outlined how we achieved this goal for those leaving an industry, but we also wanted those remaining in the newly privatised industries to have a greater stake. So we reserved a block of shares for employees which they could purchase at a discount.

Third, those companies which could not be floated on the stock market were sold to companies who were willing to buy them at the best possible price.

Fourth, some industries were so thoroughly outdated that they would have cost too much money to modernize. Others such as shipbuilding had lost their markets as business had moved to the Asia Pacific. The subsidies required by our shipyards each year were equal to their entire wage bill, and we were told that we could not stop them because people would lose their jobs. Clearly we could not go on that way. Some shipyards had to be closed, others were offered for "sale".

It was an unusual type of sale, buyers were not asked to pay anything for the land or for the plant. They were even offered substantial capital sums to cover the

necessary redundancies and to help build a modern effective industry in the private sector. This recipe, also applied to other industries, offered a way forward in the worst cases.

We faced vociferous opposition, particularly when we came to privatise the public utilities, but the facts show that they too are much more efficient in private hands and that they have become some of our most successful businesses.

Altogether, through our programme, we demonstrated that we could rebuild an enterprise society and we showed that privatisation worked. It was better for the consumer, better for the taxpayer and better for the health of an industrial and commercial country. Many others followed our example.

Indeed as the *Economist* put it:

Nationalisation, once all the rage, is out; privatisation is in. And the followers of the new fashion are of the left, the right and all hues in between.

Baroness Margaret Thatcher, LG, OM, PC, FRS was Prime Minister of the United Kingdom from 1979 to 1990. Baroness Thatcher is widely credited with reviving the British economy, reforming outdated government institutions, and reinvigorating the nation's foreign policy during her term of office. By successfully shifting British economic and foreign policy in a free-market direction, her governments helped to encourage wider international trends which broadened and deepened during the 1980s and 1990s, as the end of the Cold War, the spread of democracy, and the growth of free markets strengthened political and economic freedom in every continent.

Reforming Government Through Competition

By Mitchell E. Daniels, Governor of Indiana



In a moment of apparent epiphany, Mario Cuomo is recorded as having said “It is not government’s obligation to provide services, but to see they’re provided.” However sensible and straightforward this notion seems, it remains heresy in much of American public administration. The Indiana state government our crew inherited a year ago was still doggedly cooking its own food, cleaning its own buildings, and running its own power plants. Six departmental print shops sat side by side a few blocks from the nearest Kinko’s; the state owned one motor vehicle for every three employees. Predictably, dysfunction and inefficiency were rampant.

More than ineptitude was at work; shrewd politics was a central factor. On arrival, we found dozens of state employees spending 100% of their time on public employee union business, zero for the taxpayer. By gubernatorial executive order, 25,000 state employees were paying compulsory union dues of almost 2% of their pay, money faithfully recycled into political campaigns of the staunch union allies running state government.

The orthodoxy of Big Government was so rigid that it produced some true absurdities. Having built a \$135 million prison, our bankrupt state government found it could not afford to open the facility at the state’s cost of nearly \$60/inmate/day. Rather than accept private service provision within our state, Indiana left its white elephant vacant and shipped hundreds of prisoners to a private prison in Kentucky. When our administration took the obvious step of inviting private management to run our paid-for prison, our state reaped multiple pluses: we “brought our boys home” and began using the empty facility; 300 Hoosiers were hired to replace the Kentuckians guarding our offenders; and the taxpayers saved \$2 million per year.

The case for judicious private contracting rests, of course, not just on superior efficiency but also on grounds of sound philosophy: anything that strengthens the private sector vs. the state is protective of personal freedom. And in an economically struggling state like ours, channeling more public dollars to private businesses can make a modest contribution

to a stronger economy. We couple our privatization initiatives, and all government procurement, with strong and unapologetic preferences for Indiana firms.

But basically our choices are driven by the duty of stewardship. We approach each activity with the question, “Assuming this service is proper for government at all, what is the best way to deliver it?” Personally, I never use the word “privatization”, because it connotes an orthodoxy of its own, a preconception that things should be done privately as a matter of doctrine, not practicality.

Applying these approaches first at the federal level, as Director of OMB, and now as governor, I’ve labeled our policy “Competitive Sourcing,” to indicate that it is the cost-reducing, service-enhancing power of competition that we seek to capture for government’s customer, the taxpayer. Wherever possible, we encourage and assist incumbent public employees to submit their own bids, and I confess to a special gratification when any such bid is the winner.

Specializing in delivering a given product or service and spurred to constant improvement by competition and the profit motive, people can achieve their goal better than the best-intentioned administrators of the best-organized government bureaucracies.

Shortly after taking office, our new Corrections Commissioner asked me “Did you know we’re cooking our own food in 26 separate kitchens, and we’re paying \$1.41 a meal to feed the offenders?” “No,” I answered, “is that a lot?” “It only cost us 95 cents where I worked last” he said, so I

authorized an immediate competition.

A well-established food service company won most of the business, at a cost of 98 cents per meal (nutritional quality and consistency improved, by the way, by the terms of the contract). But, in one delightful outcome, the employees of one facility trimmed middle management, reorganized their processes, and won the right to continue while cutting a minimum of 30% from the previous costs. At this writing, they are doing even better than that, and seem sure to qualify for substantial bonus checks at the end of the fiscal year.

We have applied the “Yellow Pages” test (if you can find a service there, maybe government should not try to do it itself) to a host of activities, ranging from janitorial service (annual savings = \$500,000) to debt collection of delinquent taxes (achieving a return of 16:1). Next, we hope to contract for the more accurate adjudication of entitlement claims—Medicaid, food stamps, welfare, and so forth—to improve on a system where error rates average 25%, and administrative costs are exorbitant while deserving citizens are left stranded in long waiting lists.

Again and again these reforms demonstrate that people specializing in delivering a given product or service, and spurred to constant improvement by competition and the profit motive, can achieve their goal better than the best-intentioned administrators of the best-organized government bureaucracies.

To date, the most noteworthy of Indiana’s new initiatives involved our approach to transportation infrastructure. In a problem almost universal among the states, we faced a shortfall of some \$3 billion, equal to ten years of new road

construction at the current level, between road-building needs and projected revenues.

Meanwhile, a 40-year-old Indiana Toll Road across the northern part of our state continued losing money and deferring maintenance and expansion, while charging the lowest tolls of any comparable highway. Tolls had not been raised in twenty years; at some booths the charge was 15 cents. (As the new governor, I innocently inquired what it cost us to collect each toll. This being government, no one knew, but after a few days of study the answer came back: “34 cents. We think.” I replied, only half in jest, that we’d be better off going to the honor system.) With politicians in charge, neither sensible pricing nor businesslike operational practices were likely, ever.

As a faithful *Reason* subscriber, I was well aware of the growing role around the world of private capital in financing public infrastructure.

As a faithful *Reason* subscriber, I was well aware of the growing role around the world of private capital in financing public infrastructure. Without knowing what level of interest to expect, we offered to lease our toll road long-term to any interested operator willing to pay for the privilege.

Independent estimates of the road’s net present value in state hands ranged from \$1.1 billion to \$1.6 billion, the latter figure aggressively presuming that all future politicians, unlike all their predecessors, would raise tolls at least in line with inflation. I had resolved that only a bid far in excess of that range would be worth advocating to my fellow citizens.

In the event, we received a best bid of \$3.8 billion. Upon closing, we will cash

a check in this amount and commence the largest building program in our state’s history, while transferring the burden and the risk of running the toll road to the private firm. At one stroke our seemingly insurmountable transportation gap will be closed. Needed projects that have sat around in blueprint stage for years will now become reality. The jobs generated by the construction alone will be measured in the tens of thousands, and the permanent payoff in incremental economic activity should far exceed that.

Any businessperson will recognize our decision here as the freeing of trapped value from an underperforming asset, to be redeployed into a better use with higher



Source: Gregg Gearhart / The Times of Northwest Indiana

Indiana Toll Road looking west in LaPorte County.

Source: Christopher Smith / The Times of Northwest Indiana



Toll booth on the Chicago Skyway.

returns. We viewed it as critical that the dollars liberated from one capital asset must all be reinvested into long-term capital uses, and not dribbled away on any short-term operating purpose.

However obvious from a business and economic standpoint, this proposal touched off enormous controversy and opposition when proposed in the political realm. Many citizens, with a sincere sense of responsibility, misperceived that value was simply being pulled forward from future years. Many have not yet understood that the state is being paid more than \$2 billion more than the road conceivably would have been worth in public hands. Far from “stealing from our children,” we have acted to leave our children billions in new public assets—roads, bridges, airports—that they would otherwise not have enjoyed. Turning down this deal would have been the real theft from the future.

But we almost did turn it down. The fact that the winning bidder was an Australian-Spanish joint venture struck many of my fellow citizens negatively, and this reaction emboldened a partisan opposition that united to almost defeat the necessary enabling legislation. The irony of this “anti-foreigner” argument in an export-dependent

state that is home to hundreds of foreign-owned firms was lost on many Hoosiers. Over time, one hopes that a modernized, more customer-friendly toll road, coupled with the highly tangible benefits to our state as the proceeds are reinvested, will overcome misplaced patriotism.

I often advocate policies of competitive sourcing as “antitrust for government,” appealing to Americans’ natural suspicion of bigness, whether in business, labor, or government. But the very best arguments are usually pragmatic: which approach will get the food cooked, the offices cleaned, or the roads built in the most effective way, at the least cost to taxpayers?

However strong the philosophical case for freedom and a limited state, it is the relentless march of the evidence, through statism’s many spectacular failures, that has discredited Big Government in the minds of our ever-practical fellow Americans.

More than a decade has passed since a president who had just attempted the biggest expansion of American government ever proclaimed “The era of Big Government is over.” However strong the philosophical case for freedom and a limited state, it is the relentless march of the evidence, through statism’s many spectacular failures, that has discredited Big Government in the minds of our ever-practical fellow Americans, and that furnishes the template for progressive proposals of better ways forward against our common challenges.

The Honorable Mitchell E. Daniels is the governor of Indiana. He previously served as the director of the federal Office of Management and Budget from 2001 to 2003.

Advancing Limited Government, Freedom, and Markets

By Mark Sanford, Governor of South Carolina



Any read through history demonstrates how essential limited government is to preserving freedom and individual liberty. What life experience shows us is that limited government is equally important in both making your economy flourish and in enabling citizens to get the most for their investment in government.

Let me be clear up front that in the long run the only way to make government truly efficient is to make it smaller, and this seems to me to be the real clarion call in highlighting the importance of privatization efforts. Efficiency and government are mutually exclusive in our system, and if our Founding Fathers had wanted efficiency I suppose they would have looked more closely at totalitarian systems. They wanted not efficiency, but checks on power in our republic.

In attempting to advance limited government, personal freedom and free markets over government fiat, here are a few things we have found in South Carolina:

Friedman, not freedom, sells: So much of why we should limit government is tied to freedom, but sadly we have found greater

leverage in talking about how Thomas Friedman's new-found and so-called Flat World necessitates limits to government. The point we have made continually over the past three-plus years is that for our state to survive and thrive in this new competition of 6.5 billion people across planet earth, we must make changes to our government cost structure.

Business principles trump ideology in advancing limited government: As an example, many of the successes that were built into the \$100 million in last year's budget savings in South Carolina were sold by talking about business principles. We argued that in the world of business, when your business model changes, you change with it. South Carolina used to institutionalize every mental health patient in the state on a single piece of property, but then the business model changed and the number of patients our state institutionalized dropped from several thousand to fewer than 200. Despite the change, we continued to hold on to the \$50 million piece of property. We made the business case, and pointed out that if the

vastly underutilized property were sold, there would be three dividends: one to mental health patients, another to taxpayers and a third to children in the local school district because the property would be back on the property tax rolls.

Similarly, in the business world, you constantly reshuffle the cards, from low performers to high performers. Government doesn't. The case in point for us was the port in Port Royal, which does less volume in a year than the Port of Charleston does in a week. We said let's reshuffle the cards and after a fair amount of consternation, the sale is now in motion. That's been matched by our efforts to maximize return on investment to taxpayers through privatization of things as wide ranging as the state-owned car fleet, golf courses and even bait and tackle shops once run by state government prior to this administration's arrival!

There is no substitute for time and focus: Milton Friedman once said the ultimate measure of government is what it spends. This is certainly not the only measure—but it is a very good place to start. As a consequence, we have spent a lot of time digging into the budget—in fact, ours is the first administration in South Carolina history to have ever produced an operational executive branch budget. It is said in Washington that Presidents often get diverted and focused on foreign policy because it is seemingly a loftier issue. At the state level, there are a wide variety of things to take a chief executive's eye off budget matters, but I think we all need to remember the first real barometer on whether we are advancing the conservative cause of limited government is the budget. It was Paul Kennedy in his book *The Rise and Fall of*

the Great Powers who talked about how not foreign policy but, ultimately, economic might was the driver of a nation's viability in the long run.

Finally, you can go back to the Ten Commandments to see warnings on envy—on coveting what someone else has. Tragically, envy is part of human nature and in some cases it can be used as a tool in attempts to limit government. We frequently make the point that government shouldn't grow faster than the people's pocketbooks and wallets—and what we've found is people, when they compare their wallets with the growth of government, nearly always agree!

Long story short is that it occasionally gets lonely holding our position in the struggle between the growth of government and freedom—and in advancing market-based solutions in areas such as education or health care. And, as a consequence, I've grown to that much more appreciate fellow soldiers in this greater battle for freedom.

On this front, Reason Foundation has been a great partner in our efforts to infuse a business mindset in government through competition and free market principles, to improve services and reduce costs—and in our greater efforts to bring change to South Carolina. Congratulations to Reason on 20 years of privatization success. The 20th anniversary edition of the *Annual Privatization Report* clearly establishes Reason's role as the world leader in privatization and government reform ideas.

The Honorable Mark Sanford is the governor of South Carolina. He previously represented South Carolina's 1st Congressional District in the U.S. House of Representatives from 1995 to 2001.

Privatizing to Improve Government

By Steven Goldsmith, Kennedy School of Government, Harvard University



The conditions facing the privatization movement today differ fundamentally from conditions 30 years ago, when Reason Foundation first began documenting and analyzing this important shift in government management and policy. In the United States, local, state, and federal government all deliver ever-increasing high-quality government services through third-party providers. The continuously declining ratio of government employees to contractors provides evidence of the momentum of this trend. At the same time, the public continues to witness all too frequent headlines touting examples of poor services, corrupt or flawed processes, and personal abuses resulting from contractual services.

This article looks at not only the inevitable future growth of privatization but also why the term “privatization” is less relevant today and how success should be measured and ensured. Thirty years ago, in the wake of the Thatcher initiatives, privatization often dealt with the ownership of a public asset. In my tenure as mayor of Indianapolis, though, I found that framing the choices was more a matter of inducing competition for the delivery of services than

simply implementing privatization. Thus, the choices seemed more varied: Should I sell the wastewater plants, contract out the operation of them, or keep the ownership and management inside government?

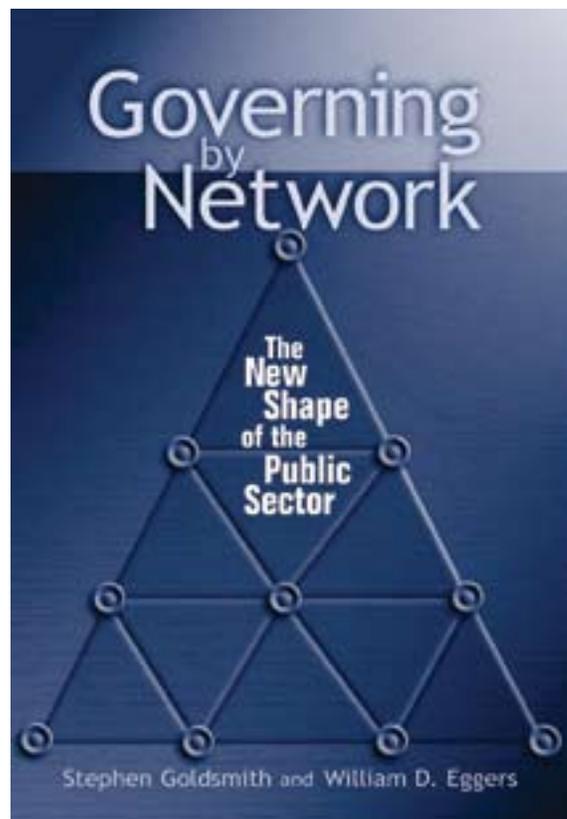
Today, however, a mixture of private, not-for-profit, and government employees works together to produce almost every complex government service. The right and left continue to frame the public/private choice as a bilateral one, pitting private profiteers against lazy bureaucrats, but these opponents miss the point entirely. Whether the issue involves welfare-to-work, roads, defense, or health, the solution requires sectors working together. Government monopolies cannot measure up; nor does the private sector provide optimum value without the oversight of talented public employees.

Neither critics nor advocates should evaluate success based on how much privatization has occurred; success should be determined by how well government performs as a result. The real test for those who advocate this process must not be whether government is smaller but whether outsourcing furthers better government,

enhancing the quality of life and providing the foundation for a robust economy. The defenders of privatization must argue in units of public value: the more units of public value produced per dollar spent, the more successful the trend.

Governments of developed countries face hugely complex problems, from providing homeland security to mitigating social ills, and must utilize delivery systems that do more than efficiently deliver antiquated processes. For government to move forward, private and not-for-profit providers need to contribute public value by providing solutions. For example, Mayor Anthony Williams of Washington, D.C. did not privatize the operation of an obsolete public hospital to reduce losses; rather, he worked with private and not-for-profit community health partners in order to achieve the true goal of “making better health” for citizens (*Governing by Network*, p.58).

Fundamentally, privatization will increase because government simply cannot successfully discharge all of its current and future responsibilities by itself. The stark reality, for better or worse, is that bureaucratic, “progressive” government can no longer produce enough good government and meet citizen demands with the money available. Progressive government (now a misnomer) started 75 years ago as local and national reformers imposed bureaucratic “command-and-control” procedures in an attempt to reduce corrupt or patronage-infested governments. Progressives did indeed reduce corruption and abuse of discretion, but they did so by *eliminating discretion*. This arrangement ensures that as problems become complicated, government cannot keep up. In fact, traditional government processes struggle to solve complex



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horizontal problems with vertical solutions. Inherently, public officials cannot run fast enough in their assigned places to deal with these problems.

In addition to the increasing complexity of public problems, a rising imbalance between citizen demands and available resources will strain even the best-run operations. An aging population will demand health, pension, and nursing home services that will exceed the most optimistic projections of tax revenues.

Faced with complexity and service demand growth, government officials must figure out how to better manage a government whose role is transforming from that of service provider to that of

network facilitator; government is doing less itself and more through third parties. Until government officials adapt and respond to this transformation, taxpayers will not get the results they deserve. As suggested in *Governing by Network*, this new generation of issues requires more than “privatization to save money,” which is worthwhile but not enough. It demands “outsourcing as part of government transformation.” Outsourcing an antiquated system in order to more efficiently deliver an outdated process skips the threshold question: What is the public value I am trying to add?

With the goal of adding public value in mind, what rules should government

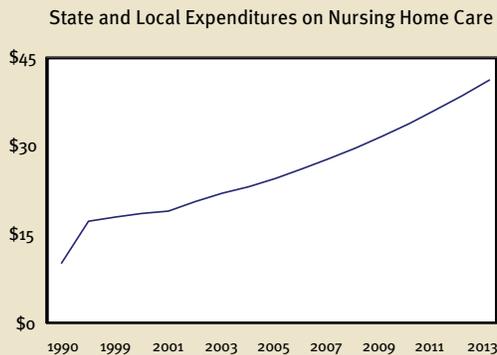
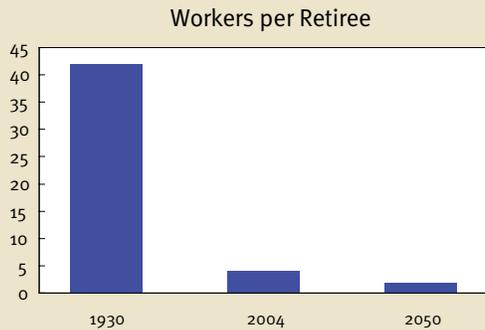
officials apply in order to produce positive results? Of course, external factors can provide momentum or create obstacles, but, after competing-out 80 public services (and observing or advising dozens of officials engaged in privatization), I highlight six issues that if managed well will dramatically increase the chances of success. Despite a relatively strong foundation, the future of the privatization movement depends on getting these issues right.

1. Control Results, not Processes

Officials worry about the wrong things when they focus on control. Public officials stay wary of surrendering control of service delivery to nongovernmental agents and employees because they are painfully aware of the ultimate responsibility they have for meeting public expectations. However, this reasonable anxiety should take officials down another track, one in which they allow processes to be flexible but retain control over quality outcomes. Put another way, it is not so important whose uniform the meter reader wears, but whether clean drinking water—a public value—can be secured in all parts of town for an affordable price. The private sector produces, in a generally agnostic way, what it commits to, so it is the public sector that must impose the values. For example, how can both fairness and efficiency be achieved? How can access and equity be enhanced? And, how can privacy and transparency be protected? Safeguarding these values is the responsibility of public officials and requires scrutiny and rule-making at every stage of the process, from initiation to management. Governments that insist on spending all their management talent on the delivery system and not on larger values often get both wrong.

An Ominous Future?

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2. Manage the Flexibility/ Accountability Tension

The new shape of government by network requires the management of both flexibility and accountability. Not-for-profit and for-profit partners produce better results when they are free to use their talents to deliver services. These private partners should be given substantial discretion because they are closest to the problem or client. Micromanaging slows down the provider's ability to be responsive. However, private providers must remain accountable when they use public dollars. Clearly, too little oversight can also lead to problems, namely, cost overruns, services failures, and even scandal. Public officials must allow flexibility in what is delivered and how it is delivered, but accountability in terms of performance outputs and outcomes.

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I have observed this tension in my own work as chairman of the Corporation for National and Community Service, the quasi-government parent of AmeriCorps and other programs. When one organization out of thousands does something wrong, the natural tendency is to enact new regulations that burden thousands of high-performing grantees. Government agencies all too frequently act similarly—rather than targeting the response to the individuals or vendors in the wrong, they place new requirements on all partners, thereby restricting flexibility. The innovative public

manager must be on-guard against using extreme amounts of authority and control and mindful of how they are deployed.

3. Articulate the Case for Privatization

Strangely, often even bold public officials do not spend enough time making the case for change. A full list of stakeholders, including the inchoate ones that will benefit from change but do not yet know or believe it, provides a starting point. Usually, the immediate benefits fail to inspire, but the immediate risks, including employee displacement, energize opposition. In these situations, taxpayer savings alone usually do not carry the day. Documenting poor customer service and weak infrastructure that will be improved will help garner the support necessary for privatization.

We based the Indianapolis privatization/managed-competition strategy on a pro-growth agenda that was necessary to generate private-sector jobs. City employees and citizens came to understand that making public units competitive with their private counterparts was the only way to decrease taxes and still offer better services.

4. Establish Benchmarks Early

Privatization initiatives often stir controversy. Even if the status quo is mediocre, change produces the prospect or perception of loss—job layoffs, less human interaction with providers (more automated services), or cutbacks in service—and often attracts strident critics. A favored media technique involves finding something wrong with an outsourcing, even a highly personal anecdote, and promoting it through headlines as an example of failure. While no approach will inoculate the

innovator against this attack, an important mitigation strategy involves carefully and accurately benchmarking the process before outsourcing: i.e., how long do people wait in line to get their welfare checks? How many trips to the motor vehicles registration department are unnecessary? How much does it cost to fill the (proverbial) pothole?

These metrics help both the public relations aspect of an outsourcing and the eventual contract monitoring, as the government must ensure that the private provider is meeting the specified service requirements. In addition, having accurate cost and performance data is crucial, not only to guard against low bidding by vendors who later wish to modify their contracts for greater profit but also to counter understated or overstated in-house cost estimates. Finally, benchmarking helps foster realistic expectations about what the vendor can actually deliver.

5. Implement Successful Contract Monitoring

High-quality contract monitoring enables both good vendors and the public at large to benefit from privatization. In order to carry out this type of monitoring, officials must overcome a number of serious obstacles: inadequate knowledge management tools that restrict information from passing easily from one sector to another, poorly conceived quality or service-level agreements, too much prescriptive input oversight, too little output oversight, and the inability to capture dynamic changes. Technological tools allow private and government organizations to be merged and managed as a seamless delivery system. The challenge lies in balancing the burden of risk placed on each party. Managing

public services through private-sector agents requires some degree of aptitude in negotiation, mediation, risk analysis, trust building, collaboration, and project management. Considering these factors in advance will go a long way in ensuring that privatization results in public value.

6. Treat Public Employees Fairly

An official interested in government by network can assume that a large percentage of government workers will respond well to appropriate incentives and good management. Indeed, many of these workers operate in very difficult environments with mediocre management, unclear performance standards, and no reward for productivity. In a privatization initiative, communication must happen early and frequently, and affected unions and public employees have a right to understand the rationale, direction, and range of possible outcomes. Clearly explaining options to existing employees, reassuring good employees about their futures, and encouraging vendors to be open to continuity of employment will help to ensure success.

Over the last two decades, privatization has grown into a well-respected aspect of government at all levels. But, as outsourcings attempt to solve more complex problems and become more complicated to manage, the stakes will increase. Officials who pay attention to these six issues will increase their chances of adding public value and garnering public support.

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Reflections on 30 Years of Promoting Privatization

By Robert W. Poole, Jr., Founder and Transportation Director, Reason Foundation



In the early 1970s I read two books that would have a profound effect on my career in public policy. In his 1969 book, *The Age of Discontinuity*, Peter F. Drucker used the term “re-privatization” to refer to the eventual return of nationalized industries to the private sector. It was an electrifying thought to a young libertarian, eager to shrink the state. And then I discovered William C. Wooldridge’s 1970 book, *Uncle Sam, the Monopoly Man*. Here was a series of chronicles of entrepreneurs who had developed private-sector alternatives to government services, some unsuccessful (e.g., Lysander Spooner’s private mail company) and others that were great successes.

In those (pre-Reason Foundation) years, I was working for a consulting firm in Santa Barbara that worked with city and state governments. On assignment in Phoenix, I realized that right next door was Scottsdale, the largest client of one of the successful privatized services profiled in Wooldridge’s book: Rural/Metro Corporation, a for-profit fire department company. How could I not pay them a visit?

In the course of that visit, I got to know founder and CEO Louis A. Witzeman, who became a good friend over the years. My

1976 *Reason* article about fire privatization’s success would lead to a very positive “60 Minutes” story two years later, the first time *Reason* hit the major networks.

In the course of my work with cities and states, I encountered case after case of privatized (or as we say today, “outsourced”) public services, mostly in fast-growing Sunbelt states. A few political scientists had noticed the phenomenon, and I eagerly snapped up UCLA and Indiana University papers on the California contract-cities phenomenon—newly incorporated cities set up without service-delivery departments, relying largely or entirely on contracts with private firms and larger nearby governments (e.g., the county sheriff’s department) for their public services.

Yet the world at large seemed almost entirely unaware of this phenomenon, and I was itching to make it better known. So when my friend and colleague Mark Frazier in 1976 challenged me to document privatization of municipal services, and provided a publishing opportunity, I researched and wrote a 46-page handbook, “Cut Local Taxes—without Reducing Essential Services.” It was widely distributed by the National Taxpayers Union (on

whose board Mark sat) in hopes of giving credibility to the budding grassroots tax revolt movement around the country. The booklet created enough interest that it led to a contract with Universe Books in New York for what became the first-ever book on privatization, my *Cutting Back City Hall*, published in 1980.

Mark also made a deal with NTU to distribute a monthly column by me on these ideas to local newspapers around the country. Beginning in autumn 1976, it was called “Fiscal Watchdog.” It eventually evolved into the Reason Foundation’s *Privatization Watch* newsletter. But even in its fledgling days as a newspaper column, “Fiscal Watchdog” (and the “Cut Local Taxes” handbook) had a much wider impact than I imagined. At some point in the late 1970s, I was contacted by a young Conservative Party local council member in England, John Blundell. He’d heard about municipal privatization in the United States and wanted some details. So I sent him the assembled “Fiscal Watchdog” columns and the handbook, and wished him well. Only many years later did I learn that the booklet he co-authored on the subject, “Reservicing Britain,” had helped to introduce Margaret Thatcher to the concept of privatization.

Needless to say, watching the Thatcher revolution of the 1980s dismantle the edifice of state-owned industries and utilities in the United Kingdom was breathtaking—not only the traditional targets of British Coal, Britoil, British Steel, British Airways, and British Leyland (autos), but also the airports, seaports, electricity, gas, water, and telephone monopolies. As this grand strategy was put into action, and with great political success, I was increasingly frustrated that no comparable privatization agenda emerged from the Reagan White House. To be sure,



Robert W. Poole, Jr. testifies at the United States House of Representatives.

there was much talk of privatization in Reagan’s first term, but it never seemed to lead to any serious policy proposals.

After having done a few consulting assignments for people in the White House Office of Policy Development, I finally made a persuasive case that the second-term Reagan administration should at least try to develop a Thatcher-type privatization agenda. So Reason Foundation helped to organize a White House seminar on privatization. It took place in late July of 1985, and it laid the groundwork for the creation of the President’s Commission on Privatization. And during the second term, DOT Secretary Elizabeth Dole managed an all-out effort that privatized Conrail (the northeastern freight railroad that the government had nationalized some years previously) and divested the two Washington, D.C. airports from the federal government to a newly created local airport authority.

Unfortunately, the federal government moves very slowly, so the President’s Commission was not appointed until 1987, which meant that its report appeared in 1988, at the end of Reagan’s second

Presidents Who Privatize



Republican and Democratic administrations alike have taken the idea of privatization seriously. During his term, Ronald Reagan changed the nature of the debate over the size and scope of the federal government, leading to the establishment of President's Commission on Privatization, the privatization of Conrail, and the divestiture of the two Washington, DC airports to a new local airport authority. Upon Reagan's departure from office, privatization was a low priority in George H.W. Bush's administration, but was subsequently embraced by the Clinton administration.

In fact, the Clinton administration's privatization successes exceeded those of Reagan. Under Clinton, the federal government sold the Elk Hills Naval Petroleum Reserves (\$3.6 billion), the U.S. Enrichment Corporation (\$3.1 billion), and many billions of dollars worth of electromagnetic spectrum, as well as the competitive contracting of more than 100 airport control towers and numerous military base functions. Further, a 1994 plan by Vice President Al Gore called for air traffic to be converted into a self-supporting government corporation, though the administration's 1995 proposal to create the U.S. Air Traffic Services Corp. failed to get congressional support.



In 2001, the Bush administration adopted the President's Management Agenda, and one of its elements—competitive sourcing—has had a significant impact. Since 2003, agencies have conducted almost 1,100 public-private competitions for about 41,000 federal positions, generating \$5.6 billion in cost savings over the next few years. Fixed costs and expenses to provide central direction and oversight between 2003 and 2005 totaled \$211 million—better than a 27 to 1 return on investment; i.e., for every dollar spent on competitive sourcing, 27 were saved.

term. The many recommendations in the report were not embraced by the new Bush administration. Ironically, after languishing for more than four years, some of them were picked up by the new Clinton administration, especially due to the work of Vice President Gore's *National Performance Review*. Hence, the Clinton years saw the privatization of the Naval Petroleum Reserve and the Helium Reserve, the U.S. Enrichment Corporation, the Alaska Power Marketing Administration, Sallie Mae, extensive spectrum auctions, and a serious effort to create a nonprofit corporation to take over air traffic control.

Despite the fact that we still have government-owned electric utilities (TVA, Bonneville, and the rest), a government-monopoly post office, and a whole raft of other government corporations, the worldwide embrace of privatization by governments of all stripes over the past 20 years has been exhilarating to me. If Canada can privatize its air traffic control system, France its major highways, and China its banks and countless other state-owned enterprises, I still have hope for privatization of the many remaining federal enterprises in the USA.

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Privatization: Past, Present, Future

By E. S. Savas, City University of New York



Privatization means relying more on the private institutions of society—the market, the family, and voluntary groups—and less on government to satisfy people’s needs. Privatization ultimately led to the founding of the United States inasmuch as Queen Isabella hired a private Italian contractor to explore the western ocean instead of relying on the Spanish navy. But privatization almost thwarted American independence: the British hired contract troops, Hessians, to prevent the colonies from breaking away. History is rich with such examples, but a significant change in privatization took place in the last third of the Twentieth Century.

The Past

Governments have always used the private sector for public purposes. They bought supplies from private firms: horses and trucks, desks and books, food for prisoners, uniforms for soldiers. Public infrastructure was also constructed by private firms: roads, schools, courthouses, city halls. All this long preceded the concept of privatization. The word “reprivatize” was introduced in 1969 by the management guru Peter Drucker, referring to the need to have the private sector resume many functions that had been ceded to big government a generation or more earlier. Robert Poole, Jr. seized the term and coined “privatization,”

which first appeared in a dictionary in 1983. The profound change from the past role of the private sector in public services was the deliberate use of privatization to improve the performance of government and, indeed, of society by introducing competition and alternatives in the delivery of public services.

The first media notice of the idea of which I’m aware was in 1970, when the *New York Times* featured a front-page story about my plan, as First Deputy City Administrator of New York, for an experiment in which private firms would compete against the city agency for garbage and trash collection. In 1971 *Harper’s Magazine* published my article, “Municipal Monopoly,” and in 1977 the first two books on the subject (both by this author) were published. One of those books and several research articles showed unambiguously that public garbage collection was 30 percent more costly on average than collection by private contractors. The National Solid Wastes Management Association picked up these research findings and heralded them to virtually every city, town, and village in America in the late 1970s; it played a vital role in arousing interest in privatization by disseminating the information to decision-making public officials that books and journals did not reach. In the meantime, in 1976, Bob Poole, the founder of Reason Foundation, started

an invaluable newsletter—still published monthly—that keeps readers abreast of privatization happenings. He authored the first solo-written book on privatization, *Cutting Back City Hall*, in 1980. After that came a deluge of books and articles about this new concept for improving government.

The Present

Schopenhauer once said, “All great ideas go through three stages: In the first stage, they are ridiculed. In the second stage, they are strongly opposed. And in the third stage, they are considered to be self-evident.” Privatization has reached the third stage. It is now a worldwide practice, adopted in democracies and dictatorships, developed and developing nations, and communist, socialist, and capitalist countries. In the United States it is a routine management tool, employed at all levels of government by Democrats and Republicans, liberals and conservatives, and black, white, and Latino officials.

The changed nature of public administration is called “the New Public Management,” which recognizes a large role for civil society and for market principles: privatization, public-private partnerships, choice, competition, deregulation, user charges, and pricing strategies. They are all of a piece: less reliance on conventional government tools.

The bipartisan nature of privatization is illustrated by President Reagan’s sale of Conrail, the government-owned freight railroad, and President Clinton’s sale of Teapot Dome, the U.S. Enrichment Corporation, and a dairy farm owned by the U.S. Naval Academy. Vice President Gore headed the National Performance Review, in which privatization was prominently featured.

President George W. Bush aggressively pursued A-76 competitions, that is,

classifying government jobs as either commercial in nature, and therefore slated for competitive sourcing, or inherently governmental and exempt from competition. The Office of Management and Budget conducted an inventory of 173,000 jobs in 35 federal agencies in 2003 and found that 51 percent (88,000) were commercial. One wishes that more details about individual A-76 competitions were readily available, but raw statistics show that 879 competitions were conducted in FY 2003–04. They covered 30,168 full-time positions and resulted in estimated net savings of \$2.5 billion over three to five years. As is generally the case, competition forces the in-house unit to improve its performance or see its jobs outsourced. In fact the government agency won 90 percent of the competitions but only after it made large efficiency improvements under the threat of outsourcing. Contractor associations complain that in-house costs are not calculated properly.

A different kind of privatization has emerged at the local level: the private community. More and more of these private, voluntary, self-governing units are springing up, appealing to those who like the features of such neighborhoods. In the meantime, some newly chartered cities are adopting the Lakewood Plan: private and intergovernmental contracts for most of their services and only a skeleton workforce.

The difficulties of contracting under emergency conditions were highlighted by the experiences in Louisiana after Hurricane Katrina and in Iraq. Large-scale fraud is easy in hectic circumstances and honest costs are inevitably high because many layers of subcontractors are necessarily involved.

Private security firms in the United States perform expedited screening of trusted travelers, and other kinds of security firms provide security for individuals and offices

in dangerous areas, including Iraq. Overall, in the 1990 Gulf War there was one contract employee for every 50–100 soldiers; in the Iraq War there are 10 for every 100.

One can list the imaginative ways that innovators are privatizing a vast array of public activities, but space does not permit that luxury. One can however, look ahead.

The Future

With respect to social security reform, President Bush’s plan did not gain enough legislative support and neither did Governor Schwarzenegger’s plan for the California retirement system. Nevertheless, I have enormous confidence that government will make the right decision—but only after it has exhausted every other conceivable alternative. After trying higher social security taxes, later retirement, reduced benefits, and increased taxes of all kinds, a future administration must ultimately produce a more privatized system. Deferred tax plans are already proliferating; what remains is to make them available to all workers and to displace much of the current social security system.

Costs are rising for all medical services in today’s malfunctioning health-care system except one: cosmetic surgery—which is the only part that is based purely on market forces with no insurance or government subsidies. Therefore I see a more privatized health care system unfolding in the United States, with medical savings plans, health-insurance vouchers for low-income families, and a variation of Governor Romney’s compulsory health-insurance plan for Massachusetts. Countries proud of their socialized health care are quietly allowing private medicine to return as their citizens complain about long delays and rationing of medical care.

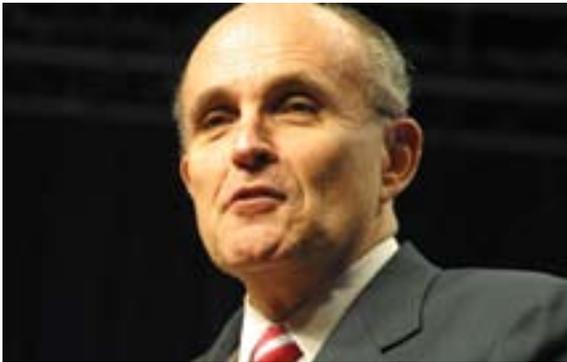
Recent opinion surveys show that the

African-American community has shifted decisively in favor of school choice, diverging from its “leaders” who reflexively support teachers’ unions that vigorously oppose it. This augers well for continued growth in charter schools and vouchers, as well as tax credits for private-school tuition and even home schooling. Mayor Anthony Williams of Washington, D.C., in desperation, provided the breakthrough by endorsing a Republican voucher plan for his city, saying that any change had to be better than the status quo.

Local government privatization seems to be reaching a plateau in terms of outsourcing. The average city contracts out about a third of the 70 common city services and growth is tapering off. In many cases the engineering services like public works have already been extensively outsourced; those are services for which it is easy to write good contract specifications and to monitor and measure contractor performance. But other services are also outsourced, such as emergency ambulances and social services. The latter are often contracted to nonprofit agencies although these services pose more difficult problems of assuring competition, specifying desired outcomes, and monitoring performance.

Municipal services are frequently dominated by strong public-employee unions; therefore stronger political will—so often in scarce supply—is needed if further progress is to be made. Those unions are getting very sophisticated in their opposition, for example, pressuring public-employee retirement systems to disinvest in firms that provide privatized services.

There is still ample opportunity in city, county, and state governments, however, to divest government-owned buildings and land and to form public-private partnerships to finance, design, build, operate, and maintain



Even in liberal bastions like New York, Mayor Rudolph W. Giuliani outsourced, divested, and privatized several municipal services.

needed infrastructure such as high-occupancy toll lanes, roads, bridges, tunnels, airports, water systems, and government buildings.

Mayor Rudolph W. Giuliani demonstrated that there are many other ways to introduce privatization even in a liberal bastion like New York. An examination of his accomplishments shows, besides outsourcing and divestments, numerous small privatizations carried out by a combination of methods including municipal withdrawal or default and voluntary organizations stepping in to take over and provide, in whole or in part, city services the groups found wanting. For example, what is perhaps the world's most famous urban park, Central Park, was judged by nearby (wealthy) residents to be poorly maintained and managed, an example of municipal default. They formed the Central Park Conservancy, raised funds for the Park, and soon entered into a contract with the city to manage the Park; the city pays the contractor, but the latter raises four times that amount of private money and maintains a much higher standard than the city ever achieved. In effect, the city outsources to a philanthropic organization. This model has been adopted for other selected sites.

Another well-known example is the Business Improvement District (BID). Property owners, typically in commercial areas, form a corporation and levy a special property tax on all properties (collected by the state on their behalf) in their defined geographic area. The BIDs provide extra security and cleaning, and beautification through fancy street lighting, well-designed street signs and newspaper vending boxes, trees, and plantings. They realize higher sales in their stores and increased property values.

Adopt-a-highway, adopt-a-library, and adopt-a-school programs attract private sponsors who improve services that suffer from government default. Cultural institutions were successfully encouraged, through a matching grant program, to seek more funds from donors and accept less from the city; that is, the city partially withdrew from providing its costly support.

These examples from New York might profitably be emulated elsewhere. They represent an expanded pattern of municipal privatization that goes beyond conventional outsourcing and divestment.

At the federal level, the greatest opportunities lie in continuing the A-76 competitions for activities deemed commercial, and, even more important, privatizing the numerous federal corporations: Amtrak, the United States Postal Service, the Tennessee Valley Authority (TVA), and the power marketing administrations (PMAs) are the most attractive candidates.

The large, continuing, and widely deplored drain on the public purse by Amtrak suggests that this might be the first to go. New Zealand, Germany, The Netherlands, France, and Denmark are well along on privatizing their postal services. In the United States postal services are partly

privatized: Federal Express, UPS, and DHL (which is majority owned by Germany's Deutsche Post) provide private mail services, but more privatization can bring large efficiency improvements. TVA and the PMAs have long outgrown their special status as government corporations; they can and should be set free to make their way in the marketplace.

The welfare states of Western Europe are stumbling toward liberalization, but backward-looking economic chauvinism remains a force that weak politicians have not tackled. Unless the move to free markets is accelerated and the remaining state-owned enterprises are privatized, the countries are doomed to continued economic stagnation as well as demographic decline. The post-socialist states of Eastern Europe, on the other hand, emerging from the bleak past to which they were consigned for four decades and hardened by that involuntary experience, are determined to avoid the errors of their western neighbors.

Free-market environmentalism can also be expected to grow. It is the proven private alternative to costly and ineffective command-and-control schemes for protecting endangered species and habitats. To avoid the tragedy of the commons, one can look to the creation of more private, voluntary arrangements for "property rights" over animals, fish, and ecologically sensitive lands—via auctions of cleverly designed contracts to limit kills and catches and via binding covenants to preserve natural lands in perpetuity. Conservation banks, first created in 1995, now number 70 and represent another approach to environmental protection for endangered birds and animals.

Stephen Goldsmith and Bill Eggers offer a compelling, expanded view of privatization.

The role of government has evolved from a hierarchical producer of services to a partner with private organizations—outsourcing, public-private partnerships, "third-party government"—and is now becoming a facilitator, convener, and broker engaging the talents of all sectors of society and often multiple government levels. That is, government now addresses many of its policy objectives by involving and managing external partners. The authors call this governing by network, because problems transcend organizational boundaries.

One can look ahead with hope to the gradual acceptance of Charles Murray's revolutionary proposal to transform entitlements. It is breathtaking in its simplicity. Instead of politicians gaining votes by dispensing largess through a multitude of particular benefits going to selected segments of the population, an annual payment would go to every adult. This would be funded by eliminating all current transfer payments. Neither tax revenue nor total government spending would decline, but government would be far less powerful in this better-balanced society, and the benefits would be enormous: a civil society in which individuals live meaningful and secure lives in an age of plenty.

Both the Goldsmith-Eggers insight and Murray's vision fit the definition of privatization cited at the beginning of this essay: Relying more on the private institutions of society and less on government to satisfy people's needs.

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Privatization: Are We Finally Turning the Corner?

By Ronald Utt, Senior Research Fellow, The Heritage Foundation



How odd it is that the United States continues to lag most other nations in privatization of government activities—the process of shifting commercial activities from government ownership and operation to private sector providers. With government involvement in our economy lower than most other advanced nations (36 percent of GDP in U.S. compared to 55 percent in France and 45 percent in the United Kingdom in 2005), and where the virtues of capitalism and competitive markets are openly endorsed by both political parties, the U.S. has yet to embrace the concept to the extent that other nations have.

Where Britain, Canada and 38 other countries have privatized or commercialized their air traffic control systems, the U.S. maintains an inefficient and high cost government monopoly, whose overpaid worker force is now lobbying Congress for a compensation package that would average more than \$200,000 per year per controller. Even worse is our warm and generous embrace of a socialist passenger rail system (Amtrak) whose losses nearly match the revenues it earns from ticket sales. Whereas

Argentina, Japan, Britain, Australia, and others have all turned—with great success—to the private sector to own, operate or manage their passenger rail systems, the U.S. remains committed to the kind of socialist business model that Russia and other former communist countries have been abandoning since 1990.

Although the reasons for America's slow progress in shifting government commercial operations to the private sector are many and varied, chief among them is America's comparatively greater wealth and prosperity that has allowed us to avoid making tough financial choices for the sake of budgetary savings that many other countries have had to adopt and endure. So what if Amtrak loses \$1.2 billion per year serving a tiny fraction of the traveling public? Unlimited access to global capital markets allows us to borrow the money to pay the subsidy and avoid a rate hike for passengers, thereby burdening future generations with the irresponsible self-indulgence of those now in power.

But are things changing for the better? Twenty years ago I had the good fortune to be appointed by OMB Director Jim Miller

to be the federal government's first (and last!) director of privatization at the U. S. Office of Management and Budget. With the full support of President Ronald Reagan, we proposed a bold agenda that included the privatization of federal lands, Coast Guard rescue responsibilities, adjudication of federal tax disputes, the U.S. Postal Service, the Naval Petroleum Reserves, the U.S. Helium Reserves, the uranium enrichment program, and many others. I would like to say that but for an obstinate, left-wing Congress we would have quickly prevailed and put the nation on a course of money-saving, service-enhancing privatization; in point of fact, the most serious opposition to our bold privatization agenda mostly came from the people President Reagan appointed to run the many departments that comprise the federal government.

Worried about congressional reaction and opposition from the civil servants who were opposed to any change in their jobs, and who saw privatization as a threat to their power and status, many of the president's political appointees opted to protect their workforce from the competitive pressures that President Reagan wanted to incorporate into the federal bureaucracy. Indeed, had it not been for OMB Director Jim Miller's success in getting the president to agree to devote time at one of his cabinet meetings to review each agency's progress on privatization—thereby forcing action to avoid embarrassment—the outcome would have been even less impressive. Despite this clever gambit, agency opposition and foot dragging persisted and limited our progress, and much of what was accomplished during the 1980s was undone during the subsequent Bush I administration, whose enthusiasm for privatization was markedly

less than Reagan's. Nonetheless, a few of the Reagan ideas quietly progressed—the Naval Petroleum Reserve and the uranium enrichment program—and these were ultimately privatized during the Clinton Administration.

But with the exception of a renewed commitment to competitive contracting within the federal bureaucracy (and some notable achievements including the contracting out of FAA's flight service stations), the Bush II administration has not pursued the kind of privatization opportunities that have been proven successes in other advanced countries, particularly in air and surface transportation programs. Nor has the president revived the position that I held—OMB Associate Director of Privatization—to ensure that at least one federal official has full time responsibility for the program. Instead, responsibility is diffused throughout the government, and privatization becomes everybody's secondary concern, and not much happens.

Indiana's \$3.8 billion windfall got the nation's attention, and many states are now looking for ways to cash-in on the bonanza.

Although federal enthusiasm for privatization has waxed and waned over the past 25 years, support for the concept has been picking up steam at the state level—especially in highways where a number of states have embarked on ambitious programs in partnership with private sector investors, builders and operators. Virginia, Georgia and Texas have enacted legislation to encourage private contractors and investors to build new roads in their states in partnership with the state's department of



Texas has already received an offer of about \$7 billion for a new toll road.

transportation. Virginia's program has been in operation for more than a decade, and in recent years the state has received proposals from major corporations that, combined, would provide more than \$10 billion in private money for new roads in the state. Texas enacted a similar law a few years ago, and it has already received an offer of about \$7 billion for a new toll road, while another group of investors has proposed a billion dollars for a new road in Georgia.

Once some states became comfortable working with private investors to fund and operate new roads, the selling or leasing of existing roads to private investors was less controversial than would have been the case had these transfers occurred in isolation. Thanks to this growing acceptance, both the city of Chicago and the state of Indiana were able to lease existing toll roads to private investor/operators for a combined sum in excess of \$5 billion. As a result of these successes, a number of other states with potentially valuable toll facilities are taking a closer look at converting their roads to cash to fund other public needs.

One reason these recent road privatizations and partnerships have succeeded where others have failed has been the financial necessity of such transactions.

Because the user fees/taxes that fund most state transportation programs have been growing slowly in recent years, and voters and motorists have been reluctant to support an increase in taxes, many state (and federal) transportation programs have been experiencing funding shortfalls in comparison to their building and maintenance needs. With their traditional options for new revenues shrinking or closing, more and more state transportation programs are adopting, or seriously considering, different forms of privatization as a substitute for traditional construction and public finance.

Whether the growing interest in privatized roads will spill over into other public programs and infrastructure remains to be seen. State transportation systems are generally self-funded with dedicated taxes and operate independent of a state's overall budget. As a result, financial shortfalls confronting the transportation sector may extend no further, in which case the pressure to privatize may be isolated just on roads.

Still, some of the recent successes are hard to ignore, and more and more states will likely begin looking to convert other tangible assets to cash that can be redeployed to meet public needs. Indiana's \$3.8 billion windfall got the nation's attention, and many states are now looking for ways to cash-in on the bonanza. Advocates of privatization should be prepared to help them meet that goal.

Ronald Utt is a senior research fellow for the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation. Utt also served as former associate director of the U.S. Office of Management and Budget during the Reagan administration.

“Q” Privatised? James Bond More Efficient?

By John Blundell, Director General, Institute of Economic Affairs



Given the British Labour Party was the primary architect of the nationalisation of so much of the UK economy, it is worth remarking how the tide of privatisation has risen so high the reinvented New Labour Party has not blocked further privatisations and indeed has gone to areas where others feared to tread. It has been bold where the Tories were diffident. It has also adapted regulatory regimes to open previously closed markets.

The UK Air Traffic Controllers were an agency of the state that the Conservatives had funkied reforming. Where Ronald Reagan had had in 1981 one of his greatest victories, Mrs. Thatcher and her team were reluctant to privatise these functions. I think they were intimidated by the synthetic but real fears that air safety might be compromised or even perhaps sabotaged by militant trade unionists. Prime Minister Blair insisted that the tentative proposals were conducted through to full privatisation.

Another remarkable New Labour sell off was the diverse Research and Development laboratories of the UK Ministry of Defence. These were the “Q” figures familiar to

fans of the James Bond books and movies. Nobody doubted the scientific ingenuity of these units but it had not occurred to any Tory Minister they could be brought to the market. Given a radical overhaul, Quiniteq plc was floated on the stock market to acclaim.

As I write Mr. Blair is in a tussle with the producer groups to open up the state’s near monopoly of hospitals and schools. New Labour is trying to devolve decision-taking down to local clinicians and break the hierarchical system of the National Health Service. The Government is bringing in private companies to supplement or displace NHS units now deemed expensive and slothful. The arrival of alternatives is impressive in its ability to confound long-standing assumptions.

By a subtle process the dental profession has been discreetly privatised by changing the contract of dentists with the NHS. Most British dentists are ceasing to be civil servants and becoming private practitioners, both screening services and specialist operations. I think it fair to say this is something Mrs. Thatcher would not have dared to attempt—nor John Major.

Source: <http://www.g8.gov.uk>



Mr. Blair is in a tussle with the producer groups to open up the state's near monopoly of hospitals and schools.

Tony Blair is investing much of his political capital in creating a network of semi-private schools which will be no part of the local authority schools, which seem to be as flawed as U.S. public schools. This is inviting the vehement hostility from the National Union of Teachers but the schools that have opted out of municipal control seem to be prospering. Parents are clear—they value them. We are still however far short of creating a true schools market.

The very first act of the new government in 1997 was not quite to privatise the Bank of England but to instruct it to act autonomously. This was as bold and radical as Mrs. Thatcher's very early decision to abolish exchange controls. The setting of interest rates and other policy matters are no longer done on command from the UK Treasury.

Technical innovations have changed much of the British commercial landscape. The British Broadcasting Corporation, a state body often “lovingly” called Big Bunch of Communists, has seen its superior status challenged and dissolved as first satellite then broadband and other “platforms” were allowed to transmit. The BBC still exists, cozy in its protective cocoons, but it is now just another broadcaster amongst many albeit tax financed.

There is no shortage of candidates for market principles to be applied afresh in Britain. The brilliant Macquarie Infrastructure Group of Australia constructed and now runs a significant chunk of the M6 Motorway, a prime British trunk route. The road system of the UK is run by the state and impervious to price information...or rather pricing and timing. The nominally hard Leftist regional regime in London, led by Mr. Ken Livingstone has imposed a “Congestion Charge” in Central London. This is a relatively crude innovation but it has shown that something rare and precious—road space—can be priced. Central London's roads flow much more freely and as soon as you leave the zone the difference is startling. The Conservatives, for rather short-sighted tactical reason opposed road pricing throughout its birth but have suddenly welcomed it on environmental grounds. In my view it will be applied extensively after the next election. How odd that we should be told to “Vote Green Vote Conservative” while “Red” Ken delivers road pricing.

The Labour Government has not sold off the Royal Mail, the state's delivery system akin to the U.S. Mail. It has not been privatised but its privileges have been lifted. Rival postal services are entering a market

Source: HM Treasury



Gordon Brown is particularly clear about the need for free trade and is an unyielding critic of the European Commission with its protectionist and interventionist instincts.

from which they have been barred since 1660. My assumption is that a slimmed-down Post Office will be converted to a limited liability company before the decade is out with a heavy bias towards shares being given or sold at knock down prices to their staff. It is about the last place we ever see strikes and they too will disappear. We will be a no-strike country soon.

The British State is still a holder of a vast portfolio of land. The Ministry of Defence is the single biggest landowner followed by the Forestry Commission. In addition the Crown Estate, nominally the

property portfolio of the Royal Family, owns all the marine foreshore and estuarial acres of the country. The pace is slow but Defence, Forestry Commission, and Crown Estate are selling off or leasing their vast estates.

It would be false to depict New Labour as disciples of Mrs. Thatcher. Yet they do invoke the mantra word “reform.” Tony Blair seems to regard the public services as slothful and expensive and slow to experiment. For three successive elections, the once emboldened Conservatives have been as frozen as a popsicle when it comes to innovation.

Perhaps a significant sign is the acclaim and respect afforded to Adam Smith by the heir apparent to Mr. Blair, the Chancellor of the Exchequer, Mr. Gordon Brown. He is particularly clear about the need for free trade and is an unyielding critic of the European Commission with its protectionist and interventionist instincts.

In a sense I fear more for the British Conservative Party’s attachment to liberal economics. Its new leader has spoken out against “Big Business,” whatever that is. He is adopting all the nostrums of Global Warming and prescriptions that I fear will handicap the market’s price signaling. He has an uncanny ability to latch onto every crazy green notion and bit of junk science going. Perhaps an occasional appointment with reality is the best ploy to teach politicians what their options truly are.

There is no shortage of opportunities for liberalising British institutions but the pace of reform since 1979 has created a phenomenon that seems unstoppable and other nations are now following.

John Blundell is the director general of the Institute of Economic Affairs. He is a former president of the Atlas Economic Research Foundation and the Institute for Humane Studies.

The New Public-Private Landscape

By William D. Eggers, Global Director, Deloitte Research, Public Sector



I can't say I was around for the *Annual Privatization Report's* inaugural issue but I had the opportunity to help pull together the third one—and many more after that. The world has changed dramatically since those early issues—the fall of the Berlin Wall, end of the Cold War, rise of China and India—and so not surprisingly has the privatization landscape. Four trends in particular define the new environment.

Dramatic Growth in Public-Private Partnerships

When Tony Blair first became prime minister, many analysts wondered whether or not the first Labor party prime minister since the 1970s would undo much of the Thatcher reforms. Speculation was rampant that many of the newly privatized enterprises would be renationalized. These fears thankfully proved unfounded.

Prime Minister Blair surprised many by building upon the Thatcher successes to bring—for the first time really—private-sector finance and innovation to bear on the core businesses of government. Over the past decade, the United Kingdom has become the world's undisputed leader in using public-private partnerships (PPPs)

to develop and deliver all manner of infrastructure, from schools and hospitals to roads and defense facilities. More than 100 new schools and 130 new hospital projects have been developed using private finance since the mid-1990s.

The United Kingdom's creative use of PPPs has produced a bevy of benefits: faster construction, big gains in on-time and on-budget delivery, reduced lifecycle costs, better value for money, and a vastly improved overall investment climate for infrastructure.

Prior to the PPP push, decades of neglect had resulted in deteriorated schools, hospitals and other public assets. The introduction of private finance reversed this trend, with £50B invested in capital infrastructure projects over the last decade, and a £26B expansion of Private Finance Initiative (PFI) deals pledged this year. Moreover, a 2002 U.K. audit office survey found that 78 percent of PPP projects were delivered on budget (compared to 27 percent of public projects), and cost overruns were far less frequent.

To be sure, there have been failures—both big and small—over the course of the hundreds of PPP projects delivered in the

United Kingdom. In the face of these, many governments would have backtracked or abandoned the enterprise completely. The Blair/Brown government, however, didn't "go wobbly." They instead learned from each failure and used them as an opportunity to continually innovate in the PPP models employed, developing more creative and flexible approaches.

| | Traditional | PFI |
|----------------------|-------------|-----|
| Projects over budget | 73% | 20% |
| Projects late | 70% | 24% |

Just as the Thatcher privatization program stirred governments around the world to sell off state-owned enterprises, the success of the Blair PPP program has inspired imitators the world over. In India, for example, the once-socialist Congress party government has targeted \$30 billion in new infrastructure to be done through PPPs over the next five years. In Europe, the volume of PPP deals is doubling, tripling and even quadrupling year to year in many countries. One hotbed is Ireland where over 100 water and wastewater PPP projects are either operational or in construction and planning.

Meanwhile in the emerging democracies of Central Europe, public-private partnerships are becoming the delivery model of choice for new infrastructure, with governments viewing PPPs both as a way to complete projects on time and on budget, and as a means to attract foreign investment. Explains Czech Republic Prime Minister Jiri Paroubek: "Just like any other market economy, we are trying to multiply the economic potential of the Czech Republic and implement projects for which the public sector alone has neither the strength nor the resources. We are striving to make services accessible to taxpayers that we would

otherwise be unable to offer."

Across the pond, in British Columbia, 20 percent of all new infrastructure is now designed, built and operated by the private sector. The United States has been slower to this party. However, with about half the states passing PPP-enabling legislation in recent years and huge PPP projects underway or planned in Texas, Florida, and elsewhere, some analysts predict the states could soon become the world's largest market for PPPs.

Post Ideological

Back in the mid-1980s when the *APR* was first published, the concept of turning over public services or infrastructure to the private sector was strongly associated with center-right parties and politicians like Ronald Reagan and Margaret Thatcher.



Center-right parties and politicians like Ronald Reagan led the charge for greater private sector provision of government services.

Not anymore. Since then center-left (often Labor) governments in Australia, New Zealand and the United Kingdom have championed far-reaching PPP and privatization programs. Meanwhile, in the United States, Democratic politicians such as former Virginia Gov. Mark Warner and Chicago Mayor Richard Daley outsourced major areas of government and pioneered partnership approaches for infrastructure. All in all, private provision of public services has been increasing relative to government delivery for decades in every region of the world regardless of which party is in charge at the time.

The result: a far more pragmatic and sophisticated view of private involvement in public services has come to the fore. The polarized and simplistic debates about the pros and cons of privatization or contracting out government services haven't completely gone away, but thankfully they're becoming increasingly rare.

Emergence of “Governing by Network”

The post-ideological phase we've entered means that the important question is no longer whether a service should be delivered by a private or a public player. The question now is how the sectors, including nonprofit groups, should be arrayed and managed to produce the best public services. In a book I co-authored in 2004 with Stephen Goldsmith, we term this development “Governing by Network.”

In this model, government executives redefine their core responsibilities from managing people to coordinating resources for producing public value. Government agencies, bureaus, divisions, units and offices become less important as direct service providers and more important as

levers of public value inside the web of multi-organizational, multi-governmental and multi-sectoral relationships that now constitute modern government. The issue is how to conceptualize, configure, and manage a network of public, private and nonprofit providers in a way that produces more value for citizens for each dollar spent.

Government by network has become a fixture at every level of government in nearly every area of the public sector, from Kansas—where a network of nonprofit and for-profit providers delivers all foster care and adoption services—to the battlefield in Iraq—where the U.S. military relied on thousands of contractors to do everything from maintain computer systems to set up base camps.

The U.S. Department of Interior's new partnership model illustrates the networked governance trend. Deputy Secretary Lynn Scarlett, a former Reason Foundation president, has spearheaded a major transformation in the agency toward a heavy reliance on partnerships, a philosophy of leveraging non-governmental organizations to enhance public value, and varied and innovative business relationships. At the 76,000-acre Golden Gate National Recreational Area (GGNRA), for example, partnerships are so extensive that National Park Service employees constitute only 18 percent of the workforce; partners, concessionaires, contractors, cooperative associations, and volunteers compose the other 82 percent. GGNRA's partners have contributed more than \$100 million in capital improvements to the park.

Choice Movement

Governing by network represents the confluence of several important trends; one is the growing number of governments that

are injecting choice into public services. The provincial government in Alberta, Canada now offers parents a wide range of publicly funded schooling options including online, public, charter, and private. Meanwhile, state governments in the United States are beginning to shift job training, elder care, mental health, education, and other services to choice-based approaches. South Carolina's new Personal Choice proposal establishes personal health accounts for most of the state's 850,000 Medicaid recipients, allowing beneficiaries to customize the healthcare they receive to suit their individual health needs. Across the pond, the U.K. National Health Service, public schools and social services are offering increased consumer choice, along with more diversity and competition among service providers. Propelling these initiatives forward is the belief that letting people choose encourages a greater diversity of providers, which in turn allows for a better match between citizen preferences and the services received. Choice can also help improve service quality by weeding out poor performers and driving competitors to deliver a consistently higher standard of care.

The choice movement builds on a steadily emerging post-World War II trend: government funds and sets the rules for safety nets while injecting market-based creativity and freedom into the delivery of those services. Instead of inputs and processes, government focuses on accountability, rule setting, and outcomes, such as a quality education. Watch for continued growth and innovation in this area.

Lastly, a Cautionary Note

Reformers need to acknowledge that greater private provision of government

services by itself is no panacea. Newspaper headlines reveal the serious difficulties governments often have getting this right. In Iraq, private-sector involvement has been critical but also at times controversial. Atlanta's effort to outsource wastewater treatment failed miserably. And in Kansas, two large, venerable nonprofits went bankrupt as a result of too much risk-shifting in the state's child welfare privatization.

Figuring out how to avoid such failures and better manage a government to do less of the work itself has become one of the central public management issues of our time. Management must move to center stage. Holding providers accountable and measuring and tracking their performance has to become a core government responsibility that is as, or perhaps even more, important than managing public employees.

The government's ability to meet its obligations depends on both sides understanding that a profound change is occurring in how governments fulfill policy goals. If this change is managed well, we'll have a new model of government that protects the public better but produces less itself, focuses on goals instead of processes, and harnesses the dynamism, efficiency, and flexibility of the private sector. And that, ultimately, can only lead to greater public good.

William D. Eggers is the global director for Deloitte Research—Public Sector. He is the author of *Governing by Network: The New Shape of the Public Sector* (Brookings, 2004) and *Government 2.0: Using Technology to Improve Education, Cut Red Tape, Reduce Gridlock, and Enhance Democracy* (Rowman and Littlefield, 2005).

The New Privatization: Applying Old Lessons to New Problems

By Roger D. Feldman, Partner, Bingham McCutchen LLP



Privatization's most important future role is in the national energy and security fields. The basis of this New Privatization challenge lies in its evolution over the past two decades.

Twenty years ago, "privatization" was about dismantling or "reinventing" government, depending on whom you asked. In either case, it involved letting privately performed personnel or businesses relieve government of its growing pseudo-commercial role, in such key agencies as national defense. Privatization was philosophically linked with deregulation: it too involved removal of "unnatural" government constraints on the operation of markets in areas like energy. The resulting "city on a hill" would be better, because whatever was done by it would be operated more efficiently and its resources would be more productively allocated.

Privatization then moved into a "public-private partnership" phase, particularly in the infrastructure development and operation sphere. This has proved to involve an on-going struggle to entice private developers to accept the carrot of government-compensated concessions in

exchange for finely tuned governmentally negotiated project acceptance and performance risks.

Privatization/public-private partnerships continue to emerge throughout the infrastructure world, albeit glacially. The rearguard defensive action of public employees has been supplemented by the determined defense of the public treasury and dogged efforts to shift public risk to the private sector through the efforts of public officials guided by very diligent counsel. Some efforts to achieve public/private partnerships expired or lumbered into limbo. We are now seeing a resurgence in fields like transportation where project costs exceed public budgets and the will to tax directly.

Today, the national challenge has shifted: in a physical security sense and in terms of the sustainability of our energy resources, we are a nation at risk. We are all suddenly in a maelstrom together. And when that happens, throughout history, there is always a cry for stronger central government. Confidence in private marketplace solutions to serve the commonweal, as opposed to private providers' interests, tends to wane



When systems fail, if only because of the technical complexity involved, and the eggshell is broken, the yolk is on us. Only Katrina isn't laughing.

rapidly. The need for dramatic innovation seems to cry out for the risk-taker or regulator who will go where no single profit-driven enterprise can independently take financial risk. The significant unremarked problem is created of the headstrong “public entrepreneur” who sees insufficient longer-term danger in the suspension of markets.

Therefore now, more than ever, in the nation’s most critical areas—security and energy—we need public-private partnerships that link the capabilities of government to affirmatively provide governance effectively and of private entities to achieve the performance levels identified by government.

Nowhere is the need for effective collaboration clearer than in the areas of introduction of “distributed generation” and “renewable resources.”

The nervous system of our nation is made up of many “critical nodes” that flip on and off in response to predefined decision roles and user commands. It is ultimately energy-driven. Not only do we have massive national grid and pipeline networks, we have hyper-reliability-sensitive computers and communications switches. That system in America is to a large extent serviced, at the macro level, by our oldest public-private partnership, “public” utilities regulated by

“public service commissions” and our newest federal effort of regionalizing electric system operations, so-called “Regional Transmission Organizations.” In the event of natural or man-made emergencies, all the king’s horses and men cannot hold this thin-shelled system together. And when systems fail, if only because of the technical complexity involved, and the eggshell is broken, the yolk is on us. Only Katrina isn’t laughing.

The technology to enhance operating energy security exists. It needs to be established on a distributed basis that corresponds to our modern telecommunications-linked (and vulnerable) society. Government needs to respond to this fact by finding ways to tap from the private sector the new technologies (some of which, happily, can also be lower polluting and many of which do not use foreign fuels) to deal with this problem.

In addition to taking up this physical vulnerability challenge, government needs help to reduce reliance on insecure fuel supplies. Under the Energy Policy Act, Congress sought to direct public capital and resources to stimulate private solutions to public problems through use of bio- and coal-based fuels. Less emphasized was the need to open up regulatory bottlenecks and private inertial resistance to the national distribution and consumption of these fuels. New public-private interstate networks vital to the American future need to be fostered.

In short, new public-private partnership formats to foster distributed power and domestic renewable energy use are needed. Policy innovations can draw from the lessons learned—some better from the trying experience over the last 20 years—both as they relate to the question of who should do things and how performance

goals (taking into account national policy requirements) can be set. Private action, overseen by enlightened public regulation and an emphasis on civic cooperation, is the necessary combination to perpetuate these aspects of American security.

So looking back at privatization over the past 20 years, I come to the following conclusions:

- It was good the battle was fought; it broke the ground for ideas for future action;
- We face a new and stronger struggle with a higher ticket: national survival (perhaps the way Margaret Thatcher saw privatization in the 1980s for the U.K.);
- To fight that struggle requires learning from our recent history, saving the best of government but making sure it guides private innovation into new markets, thereby reducing the vulnerability of our systems or making possible needed changes and improvements to national fuel consumption patterns.

In short, the privatization we helped build over the past 20 years will have earned its place in American history if it provides the foundation for an enlightened New Privatization effort which responsively blends public and private initiatives. That, I believe, is the challenge for those of us who were present at the first “birth” of privatization.

Roger D. Feldman, a partner in the law firm of Bingham McCutchen LLP in Washington, D.C., was one of the founders of The Privatization Council and long time Chair of its successor, The National Council for Public-Private Partnerships.

Privatization: Looking Backward, Looking Forward

By Lawrence L. Martin, Ph.D., University of Central Florida

Can this really be the 20th anniversary of Reason Foundation's *Annual Privatization Report*? It seems like only yesterday that Reason Foundation began its quest to bring research and policy analysis to bear on the then still relatively new phenomenon of privatization. Twenty years ago was also just about the time the term "privatization" first entered the popular lexicon. While the concept of privatization had bounced around for a few years, it was the increased public attention created first by Prime Minister Margaret Thatcher (1979-1990) in the United Kingdom and then by President Ronald Reagan (1981-1989) that put it firmly on the public policy agenda.

In the same year (1986) that Reason Foundation published its first *Annual Privatization Report*, I defended my doctoral dissertation on privatization. Since that time, I have continued to observe with keen interest the progress of both privatization and Reason Foundation. This 20th anniversary provides an opportunity as well as the motivation to pause and reflect on the past and future of privatization. Realizing that others are also contributing

to this special 20th anniversary issue and that privatization will be addressed from a number of perspectives, I would like to focus my comments around three specific areas. First is the general acceptance of privatization by public managers today. Second is the continued equivocation of academics and scholars on the question: Does privatization work? And third is the issue of privatization and partnerships.

The General Acceptance of Privatization by Public Managers

Two indicators of the general acceptance of privatization by public managers today are the decline in anti-privatization rhetoric and the actual use of privatization at the federal, state and local government levels.

How the term "privatization" has been viewed over the last 20 years tells us much about its growing acceptance. In 1989, the National Academy of Public Administration (NAPA) released a report entitled, *Privatization: The Challenge to Public Management*. The report could just as easily have been called, *Privatization: the Challenge for Public Management*. Perhaps



At the federal level, an estimated \$400 billion is now being spent annually on the purchase of goods and services from the private sector.

never in the history of public management has a proposition contained more policy significance. The general view 20 years ago was that privatization constituted an assault on public management, an assault that had to be repulsed. A few enlightened individuals, primarily at the state and local government levels, recognized that privatization was actually a new tool that public managers needed to master, but this view was in the minority.

Fast forwarding to the present day... Lester Salamon, of Johns Hopkins University and one of the principal authors of the 1989 NAPA report, now sees privatization in its many forms (e. g., contracting, vouchers, public-private competition, public-private partnerships) as part of the basic tools of government. Much of the literature on privatization today is no longer ideologically driven, but rather seeks to better understand this tool, its uses and limitations. Of course there are exceptions to this statement. The American Federation of State, County and Municipal Employees (AFSCME), for example, continues to publish anti-privatization studies, but it is

unclear that anyone today take this research seriously.

Additional evidence of the general acceptance of privatization by public managers today is provided by the International City/County Managers Association (ICMA). In a series of five studies conducted between the years 1982 and 2003, the ICMA documents the increase in the number, as well as the proportion, of local governments utilizing privatization strategies. For some specific services (e. g., solid waste collection), the most recent ICMA data suggest that some slowing down may be occurring. However, this leveling off is more in keeping with the normal S-shaped growth curve that would be expected of any mature public policy.

At the federal level, an estimated \$400 billion is now being spent annually on the purchase of goods and services from the private sector. And the Office of Management & Budget (OMB) Circular A-76 continues to mandate public-private competition as the official privatization policy of the federal government.

Does Privatization Work?

The bottom line for privatization, or any public policy, is the basic issue: Does it work? To the question “Does privatization work?,” the unequivocal answer is YES!

I am amazed, and sometimes appalled, by many of my learned academic colleagues who continue to equivocate when it comes to addressing the question: Does privatization work? The most frequently heard response is that the “data conflict” or that “no clear pattern has emerged.” Nothing could be further from the truth. What exactly do the data say?

In a forthcoming book *Contracting for Public Sector Services* being published by the National Institute of Government Purchasing, I make the following statement: “the preponderance of the creditable evidence from domestic as well as international experience suggests that privatization generally results in lower service delivery costs and equal or better service quality.” Now, in the spirit of transparency, I am referring specifically to contracting out and outsourcing. How do I come to this conclusion? By reviewing hundreds of research reports and case studies compiled over the last 20 years.

What then accounts for the academic equivocation when the question is posed: Does privatization work? I suggest that the answer lies in the standard of proof utilized. Borrowing terminology from the legal field, if one uses the preponderance of the credible evidence from domestic and international experience as the standard of evidence, then there is no doubt that privatization results in lower service delivery costs and equal or better service quality. However, if one insists on using beyond a reasonable doubt as the standard of proof, then a case can

be made that the research is less clear. Why academics continue to cling to the standard of beyond a reasonable doubt says more about social science “niceties” than it does about the realities of the complex world in which public policy plays out.

Privatization & Partnerships

The comedian Mort Sahl was found of saying that “The future lies ahead.” While somewhat of a tautology, his comment nevertheless reminds us that the future is always just out of reach and therefore our crystal ball will always be just a little bit cloudy. What then can be said or ventured about the future of privatization? My crystal ball is probably as cloudy as any. However, one bright point of light does shine through clearly: partnerships. My crystal ball says that in the future, privatization will be concerned less with competition and market forces and more concerned with creating partnerships between the public and private sectors. In support of this contention, I refer to the pragmatic words of the Copenhagen Institute, “No single actor, public or private, has the all-encompassing knowledge, overview, information, and resources to solve complex and diversified problems.” I can also point to recent domestic and international research that supports this contention. In this future of privatization and partnerships, trust will become the basic building block. Consequently, we will need to understand better the role trust plays in public-private partnerships and how best to develop and maintain it.

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Cutting the Government in Half: Three Reforms

By Grover Norquist, President, Americans for Tax Reform



The goal of the modern conservative movement is to cut the cost of government as a percentage of the economy in half over the next twenty-five years—one generation.

Why then has federal spending as a percentage of national income increased from 19 percent in 2000 to 23 percent in 2006 during a period of Republican control of the House, Senate, and Presidency? And this after federal spending as a percentage of national income had fallen from 23 percent to 19 percent from 1992 to 2000—with Clinton facing a Republican Congress?

Three Reasons

First, the modern conservative movement consists of the “leave us alone coalition” of groups where concerning their primary, vote-moving issue, what they want from the government is to be left alone. This includes gun owners, small businessmen, taxpayers, property owners, and homeschoolers.

Raise taxes as Bush 41 did and taxpayers leave the room. Challenge gun rights and National Rifle Association (NRA) members leave the room. But no constituency walks out of the room when government spending creeps too high. The moving parts of the conservative

movement all grumble. They would all like less spending. But there is no organized anti-spending NRA equivalent. Thus overspending is the issue that gets ignored.

Second, this administration has targeted the wrong metric by announcing that its goal is to “cut the deficit in half.” The real measure of success is reducing spending as a percentage of the economy. This can be accomplished by slowing the growth of spending and by having pro-growth tax cuts (like cutting capital taxes) create a larger economy. Both are issues conservatives dominate: spending cuts and pro-growth tax cuts. Focusing on the deficit suggests that tax cuts are part of the problem, not part of the solution. And tax hikes are the economic equivalent of spending cuts if you are targeting the deficit.

Lastly, it is politically difficult to “cut” the budget. Even reducing the growth of spending in Washington is considered a “cut.”

Within this context, three major areas of government spending for our federal, state, and local governments exist. The first area of reform is retirement security such as Social Security, and federal, state, and local government worker pensions. The second area of reform is health care costs, such as

Medicaid, Medicare, and Veterans Affairs hospitals. And the third reform is education, K-12 and state universities. One never cuts education, pensions, or health care.

The solution to the spending problem is to replace politically suicidal, or at best difficult, efforts to “cut” spending with politically profitable “reforms” of programs that will reduce their long-term costs.

The best example of this is “privatizing” or “personalizing” social security, moving the system from the pay-as-you-go, unfunded, Ponzi scheme to a fully funded, independently held personal savings account system. When fully phased in, every American will be required to save, say, 10 percent of their income and accumulate real resources to buy an annuity at retirement that will keep one out of poverty and allow one to keep all savings beyond that minimum to be spent as one wishes. Social Security can be reformed to cost not its present 20 percent of the federal budget from rather remove it from the budget.

Medicare can be similarly financed through allowing Americans to save their Medicare tax payments. Health savings accounts can give Medicare and Medicaid programs real competitive pressures to reduce costs without voting for any “cuts.”

On education the only reform worth enacting is real parental school choice. With private schools costing half of government schools, over time public schools will have to become as cost efficient and effective as private schools.

Pipe dream? No. We are on track to make all three key reforms a reality in the next decade. The case for Social Security reform is politically strengthened as more and more Americans own shares of stock directly through mutual funds, IRAs, and 401Ks. When Reagan was elected only 17 percent of adults owned stock directly.

Today it is more than 50 percent of households and two out of three voters in the 2004 election. That number grows as all new companies use defined contribution retirement systems rather than defined benefit plans. And the old-line defined benefit plans are ebbing in the airline, auto, and steel industries. Even government pensions are moving to defined contribution plans in a number of states. Eight of the last 10 changes to state pension plans over the past decade have been towards defined contribution.

Health Savings Accounts (HSAs) have jumped from one million in 2004 to three million in 2005 and Forrester Research predicts 24 percent of all Americans will be covered by a consumer health plan by 2010.

Education choice is within spitting distance in New Hampshire, Florida, Texas, Wisconsin and steps have been made in Pennsylvania, Arizona, and Minnesota. A breakthrough in one or two states is the breach of the dam we need. Scare tactics against school choice (they will sell your kids to the Arabs or harvest their organs) will fall apart with a major state’s experience for all to see.

Other reforms with real savings include expanding competitive sourcing, where the private sector competes regularly to provide the services now done by 800,000 government employees whose work can be found in the yellow pages—food services, lawn care, fixing eyeglasses, etc.

Cutting small spending programs like the National Endowment for the Arts is satisfying. But real reduction in the cost and scope of government flows from reforming government spending towards zero rather than nicking it.

Grover Norquist is president of Americans for Tax Reform.