CHAPTER 2

PRIVATIZATION LITERATURE REVIEW

Introduction to Chapter

This chapter begins by describing the various categories of materials found within the privatization literature, including outsourcing material, namely localized anecdotes, and discussions of the various types, history, and pros and cons of privatization. Next, the field of discussion is narrowed for purposes of this dissertation. This is followed by a discussion of the philosophical arguments underpinning privatization, after which follows a discussion of the levels of analysis, privatization effects, and a conclusion.

Literature Review Categories

Bearing in mind that the purpose of this dissertation is to provide an objective macro-view of whether or not outsourcing has been successful in terms of saving money and improving services, it is first necessary to review what literature is available to determine if that assessment has already been made. This review demonstrates that a great volume of privatization literature, of which outsourcing is a part, has been amassed over the last quarter century and entire organizations are dedicated to its promotion. However, this review failed to reveal the macro-view of outsourcing effectiveness that this dissertation seeks to provide. The literature that has been found can be divided into the following four categories, with some articles crossing two or more categories: 1) a collection of localized anecdotes; 2) a collection that provides a description of the types of privatization; 3) a collection that provides historical perspectives on the development of privatization; 4) a collection that argues for and against privatization.
1) **Localized Anecdotes about Privatization:** The literature quite often gives descriptions of the privatization actions an organization undertook and prescriptions (e.g., how to write a request for proposal, how to monitor a contract), meant to provide “lessons learned” that can be taken for improvements (Stainback, 2000, Chapter 10). While these narratives present interesting stories and give a general sense of the effectiveness of privatization, hard data is sorely lacking.

2) **Types of Privatization:** The literature is filled with descriptions of the types of privatization. In order for a meaningful dialogue to take place, a clear, more narrow definition of what will be discussed in this dissertation is provided on page 33. For now, Hebdon and Gunn (1995, p2) identify the following four most common types of privatization:

**Public/Private Partnerships:** This occurs when public funds are used to stimulate private sector investment. An example would be a public transportation system where the buses are owned and maintained by a private firm that is paid with government funds for the services it provides.

**Cessation of Service/Commercialization:** This occurs when a government ceases to provide a public service altogether, leaving it to the private sector, if they feel they can make a profit doing so, to provide the service at a fee charged directly to the public as opposed to a government agency. For example, some communities, such as Traverse
City, Michigan, have engaged in “load shedding,” such as pulling out of the garbage pickup business. Reed (May, 1997, p1) says this approach results in the elimination of the government middleman, no taxes being paid or collected for that service, and no city council meetings to register a complaint when services are inadequate. If the contractor doesn’t perform satisfactorily, an individual can fire them and hire someone else. Starr (1988, p6) identifies a less draconian version of this, what he calls “privatization by attrition.” Occasionally a government will make a service so restricted in availability or quality that it may lead to a shift by consumers toward privately produced and purchased substitutes.

Sale of State Owned Enterprises (SOE): Selling public assets (e.g., golf courses, convention centers, airports, Conrail in 1987) can produce a one-time fiscal windfall to a community, at the expense of a future stream of income. Recently as a result of the Department of Defense Base Realignment and Closure (BRAC) activities, some former military installations have been sold to the highest bidder. However, SOE has been much more prevalent in European countries where the state once owned vast swaths of the productive capacity of their respective economies. In some countries, rather than selling these assets to the highest bidder, the populace was permitted to buy shares of the biggest companies through share issue privatizations (SIP).

Contracting Out: The most common form of privatization in the United States, contracting out involves the provision of public services literally from A to Z (i.e., administrative support to zoo keeping) through contracts with private firms. While the
service is provided by for-profit companies as well as by non-profits (e.g., much social service contracting), the government remains responsible for service quality and delivery.

Eubanks (1994, p2-3) identifies five further subsets of privatization: 1) **Vouchers** are issued by government to citizens who then redeem them for services provided by the private sector. Note that vouchers are done on an individual level whereas contracting out is done by a government jurisdiction. Examples include food stamps, the GI bill, and housing vouchers provided to low-income families. 2) **Franchising** occurs when a government grants a private firm monopoly privileges to provide services in a specified geographic area such as concessions at state and national parks, and management services such as cable television or water treatment. 3) **Grants and subsidies** are funneled through a government organization to a private sector organization to encourage them in the delivery of a service such as employment training or child-care. 4) **Volunteerism** occurs when a government recruits private citizens or organizations to donate their time free of charge to deliver a service. The government still retains fiscal and administrative control. Good examples of this are the “adopt-a-highway” and “neighborhood watch” programs. 5) **Private donations**, such as computers for schools and land for dedicated purposes, are also solicited by governments and are another example of privatization.

In addition to these types, Linowes (1988, p231) identifies **user fees** as a form of privatization, because although they do not involve the transfer of government functions, they do place the burden of paying for the public service on those who benefit from it, rather than on taxpayers in general. As usual, however, when user fees are insufficient to
cover the true cost of the government service provided, the rest of the taxpayers, including non-users of the service, subsidize the shortfall.

Starr (1988, p6) contends that the underground economy is another form of privatization, as is “demand driven” privatization where demand for public services outstrips public provision and the private sector steps in to fill the void. Unlike other types of privatization, this type does not require a reduction in publicly produced services. Examples of it include private schools and pensions such as individual retirement accounts. According to proponents of privatization, this so called “people’s capitalism” leads to a deeper identification with capitalism. The retiree receiving a private pension or IRA is more likely to have a conservative view of the world than one reliant on rent subsidies or a government check each month (Starr, 1988, p14).

Governments can also encourage the growth of privatization through removing regulatory barriers that once restricted private firms from delivering a service. Further, by lowering the cost to provide a service (i.e., by lowering taxes), the private sector can be encouraged to get into that particular market. In fact, Linowes (1998, p229) states that these two methods, deregulation and tax reductions, are the most important forms of privatization in the United States.

As an aside, the private sector has also engaged in the most common type of privatization, namely outsourcing. Large corporations, recognizing that they are good at producing something and should stick to it, contract out for services outside of their core
mission such as window cleaning or payroll. Studies of outsourcing in the private sector are even fewer in number than those in the public sector, in large part because private firms are not subject to the same information disclosure requirements as government. However, in one study cited by Lonsdale and Cox (Ballard, 2000, p6) of over 1,000 senior business executives, only 5% of firms reported “high” levels of benefit from contracting out while suffering “low” drawbacks. Thirty nine percent of respondents said benefits had been “mediocre.” They suggest that this is because contracting out invariably leads to a loss of cross-functional contact between departments. Contract employees are rarely as prepared as in house candidates to go beyond their basic job to work out ideas that may be of benefit to the whole organization.

It should be noted that the term “privatization” has become muddied over the years and conjures up different images in different parts of the world. Because privatization in Europe and the former Soviet Socialist Republics consists primarily of selling state owned enterprises, that is how the term is used in those countries (see Hodge, Megginson). However, in the United States the term “privatization” has come to be a more generic, umbrella term (Hebdon and Gunn) that includes outsourcing, the most popular type of privatization. Both are correct in their different circumstances.

3) History of Privatization

The term “privatization” wasn’t even part of the modern lexicon until the early 1980s when the conservative British Prime Minister Margaret Thatcher started her country down the path of reduced government. The term was originally coined in 1969
by Peter R. Drucker in his book *The Age of Discontinuity* (Yergin, 1998, p114) where he said, “… government should spend more time governing and less time providing, should either purchase services from the private sector, or simply stop producing.” Since then “privatization” has become a commonly used phrase throughout the world and a legitimate, core tool of statecraft by governments of more than 100 countries (Megginson, 2001, p1).

Although privatization is a relatively new term, it is not a new phenomenon (Nightengale, 1997, p2). In ancient Greece, the government owned the land, forests, and mines but contracted out the harvesting of those natural resources to individuals and firms (Megginson, 2001, p2). Sobel (2000, p21) notes that in the Roman Republic, the “publicani” or private individuals and companies, fulfilled virtually all of the state’s economic requirements. Rodinelli and Iacono (Megginson, 2001, p2) note that by the Industrial Revolution, “the private sector was ….also important in providing public goods and services.” In the United States, since 1899 Vermont has allowed towns with no public high schools to provide vouchers to their students to attend any non-parochial schools within or outside the state up to the cost of a comparable union district high school education (Linowes, 1988, p25). In 1985 nearly 25% of the state’s students used this education voucher system. San Francisco has privatized garbage collection since 1932 (Linowes, 1988, p26). Dr. Moshe Adler (1999, pp 88-99) of Columbia University has written an entire book about the contracting out of New York City’s street cleaning dating back to the early 19th century despite the continued failure of contractors.
In more modern times, President Eisenhower in 1955 approved a policy that the “Federal government will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels (Linowes, 1988, p1).” This policy originally was a Bureau of the Budget Circular and later was formalized as the Office of Management and Budget’s Circular A-76 Commercial Activities program that has been in place for over the last quarter century. Paul Light of the Brookings Institute and author of The True Size of Government says that the policy was initiated because the “Eisenhower administration was particularly worried that a growing federal government would steal jobs from the private sector (December, 2000).” Ironically, this tool has been used to do the exact opposite.

This same policy was reiterated 33 years later in the Report of the President’s Commission on Privatization entitled “Privatization: Toward More Effective Government.” The report states that the federal government should not compete with the private sector in the provision of commercially available goods and services, and contracting out through the competitive bidding process should be pursued more aggressively through the Executive Branch as a means to procure the same or better level of service at reduced cost (Linowes, 1988, p2).

Additionally, the Freedom from Government Competition Act, which morphed into the Federal Activities Inventory Reform (FAIR) Act, came about after “less government is better government” legislators became increasingly annoyed at the
purposive foot dragging by federal agencies which had resulted in only 34,688 federal positions being studied for possible privatization between 1994 and 1997. Only 420 of these positions were outside of the Defense Department. FAIR requires agencies to annually publish lists of their commercial activities and the number of full time equivalent employees required to perform them. The only way for an agency to keep some of their positions off of the FAIR list is to declare them “inherently governmental” which is defined as a function that is so “intimately related to the public interest as to mandate performance by government employees.” What this means is wide open to interpretation (Light, 1999, p9). Democratic presidential candidate Dennis Kucinich declared FAIR to be part of the “piecemeal dismantling of our republic (Light, 1999, p154).” While this may have been hyperbole, he was correct in saying that one effect of FAIR was that it forced the federal government to identify new business opportunities for contractors.

Prime Minister Thatcher’s embracing of privatization was in response to what she saw as the shortcomings of statism, namely crushing tax burdens, fat wasteful overbearing bureaucracies, and deficits (Meggison, 2001, p3). People arguing for free markets and freedom began to win the day, and the public started electing similarly minded officials who wanted to let capitalism work. The time for full-scale privatization was at hand (Reed, 1997, p1), and was well under way, not just in Europe but America as well, long before the idea of reducing the size of the United States federal government by 252,000 positions in five years was conceived as part of the National Performance

The U.S. Advisory Commission on Intergovernmental Relations (ACIR) in 1976 published a report call *Pragmatic Federalism: The Reassignment of Functional Responsibility* (pp 68-70). Eubanks (1994, p1) maintains that the goal of Pragmatic Federalism was to develop a program for allocating government functions to those jurisdictions that would be able to fund them appropriately. These “functional transfers” were anticipated to flow from local to regional to state jurisdictional responsibility because smaller, local levels had severe budgetary constraints. The thought was that economies of scale would be realized by transferring functions up the chain, thereby increasing efficiency and decreasing costs. However, Eubanks maintains, when the Reagan administration came into power, they had a completely opposite view of which level of government should be responsible for various functions. During the 1980s, Reagan’s New Federalism reduced the amount of federal monetary aid to state and local governments and far from allowing responsibilities to flow upward, emphasized a downward shift. At the same time, tax revolts like California’s Proposition 13 greatly reduced the ability of state and local governments to raise revenues. A study by the Federal Reserve Bank of Boston confirmed these fiscal pressures faced by governments as evidenced by heavy debt burdens in the early 1990s (Kodrzycki, 1998, p40). Consequently, local governments were forced to look at ways to reduce outlays and to become more efficient. Enter privatization.
4) Arguments for and Against Privatization

A review of the privatization literature illustrates some of the possible arguments that may be found of those strongly for, partially for, partially against, and strongly against privatization, which can be summarized as follows:

**Proponents** of privatization are plentiful and vociferous. Entire nongovernmental organizations have been established to promote privatization such as the Mackinac Center and the Outsourcing Institute. Entire publications are dedicated to the subject such as the Reason Public Policy Institute’s Annual Privatization Report. Offices within federal agencies such as Defense, and the Office of Management and Budget focus on encouraging privatization.

Starr (1988, p8) maintains that those in favor of privatization draw their inspiration from the following three different visions of a good society: a) economic efficiency, b) returning power to communities, and c) reducing government overload.

a) **Economic efficiency.** As Lawrence Reed (1997, p2) says, “The theory is simple, but grounded in profound truths about the nature of humans and their responses to incentives and disincentives. Tie up the performance of a task with red tape, bureaucracy, and politics within a system that is guaranteed to exist regardless of outcome, and the result is usually mediocrity at great expense. Infuse competition, accountability, and the fear of losing a valued customer into the task and mediocrity becomes the exception, excellence the rule.” Putting it simply, proponents are convinced
that whatever government does, the private sector can do better. They have confidence that the pursuit of private gain serves the larger social order ala Adam Smith’s “invisible hand.” According to proponents, economic efficiency can be gained by allowing the free market and laissez-faire individualism through privatization to determine the best way to deliver services. A smaller government and greater individual choice would result if property rights and market forces were expanded (Starr, 1988, p8) and (Savas, 1987, p167).

For example, private companies can invest in snow removal machinery and specialized labor and use these to service several municipalities, rather than each locality having big capital outlays and keeping snow-removing employees on their respective payrolls all year long. Privatization proponents argue that private sector labor costs are lower because government workers are notoriously “overpaid” and have higher benefits. Additionally, the private sector, unlike the public sector, has the flexibility to hire and lay off employees as required. Public sector unions see their power, namely the threat of strikes, greatly diminished because privatized services are often decentralized among many contractors. This last point, trying to reduce the power of public unions, is not lost on privatization proponents (Starr, 1988, p19). They know all too well that while unions have lost membership in the private sector, public employee unions currently are the only type of union with growing membership.

Proponents further maintain that the argument that privatization necessarily leads to loss of jobs, wages, morale, and job satisfaction is not conclusive. Nightengale and
Pindus (1997, p2) say there are many examples of negotiated arrangements for transferring public employees to private employment or to other public agencies. Starr (1988, p19) reports New York City privatized its school busing, but the drivers remained represented by the same union with no change in wage levels. A report by the National Commission for Employment Policy (Nightengale, 1997, p13) found that: 1) privatization caused a shrinkage in the rate of growth of the public sector work force since the mid-1970s; 2) that of 2,000 workers studied in 34 privatized city and county services, 62% were hired by the private contractors, 24% transferred to other government jobs, 7% retired, and 7% were laid off; and 3) privatizing results in lower benefits but a modest increase in wages.

Along those same lines, a 1985 General Accounting Office (GAO) study of Department of Defense downsizing showed that of 9,650 employees impacted by privatization, 94% transferred to other government agencies or retired, 3% went to work for the private contractor, and only 3% were laid off. Johnson (2001, p1-2) also cites a study of privatizing Illinois municipalities that found only 3% of the 516 responding cities reported laying-off employees. In fact, many governments are insisting that as part of their privatizing strategies, contractors have to hire all existing public employees at comparable wages and benefits (e.g., Atlanta, Buffalo, Milwaukee, and Indianapolis water services).

With regard to quality of service, proponents contend that because contractors are always in danger of not having their contracts extended, they are driven by market
discipline to provide quality services efficiently. The same cannot be said for
governments that have a monopoly over some services. Proponents of privatization
would prefer that when services are poorly delivered, protesters would set up shop
outside the private service provider’s door, or even better, switch to a different provider
leading to what Hirschman terms going from “voice to exit” as the usual and preferred
tactic of coping with dissatisfaction (Starr, 1988, p14). As to social equity, proponents
contend that by saving the government money, consumers will be rewarded with lower
taxes, meaning more money in their own pockets that they can spend as they choose,
which will stimulate the economy.

Proponents of privatization use the market as the standard for judging the value of
public organizations. Whereas private firms have to earn a profit to stay alive, public
institutions only have to obtain approval through the political process. Believers in
privatization feel that society would be better off if public organizations had to meet the
same test as private sector firms. Done correctly, proponents believe that privatization
can produce a win-win-win outcome for taxpayers, employees, and contractors.

With regard to winning, privatization advocates argue that even when a
competition fails to result in a contract being awarded to the private sector, the taxpayers
still win because the competition itself will have forced the government agency providing
the service to become more efficient. Instead of contracting out being the objective,
Savas says, “The primary goal of any privatization effort is, or should be, to introduce
competition and market forces in the delivery of public services (Van Slyke, 2003, p297)."

b) **Return of Power to Communities.** More socially conservative thought visualizes a good society that strips the state mega-structure of its responsibilities for service provision, thereby returning more power to communities, particularly families, churches, and non-profit institutions. Berger and Neuhaus (Starr, 1988, p 13) believe in privatization with a human face. They want to strengthen local, small-scale, “people-sized” forms of social provision of services. Like Lester Salamon, they argue that government programs should only be permitted where there has been a demonstrated failure of the non-profits in delivering a public service (Starr, 1988, p12).

c) **Reduce Government “Overload.”** Some proponents of privatization visualize a good society that restricts governments to focusing on what few things they should be doing, and leaving the provision of the remaining services to the rigors of the free market. According to Hebdon, “Privatization allows policy makers to steer rather than row (1995, p5).” By diverting demands away from the state, the overload that governments are faced with will be diminished and public spending coalitions will be broken. Proponents believe that the role of government should be restricted to that of enforcing the laws. While some (Starr, 1988, p19) contend that because wages tend to be more equal in the public sector, privatization is likely to skew the income distribution in the direction of greater inequality, proponents counterclaim that governments don’t exist for the benefit
of those who work for it; they exist for the benefit of those who pay its bills or need its services.

*Moderate proponents* of privatization believe that cautious and selective use of privatization can be a tool to help government run efficiently (Osborne, 1993, p107). Where quality of service is easily judged, privatization can be appropriate, even non-controversial. When the U.S. Naval Academy created an 856-acre dairy farm in the early 1900s, it was in response to a typhoid epidemic. That danger has long since disappeared, but it took nearly a century for the Navy to divest itself of the farm. The Elk Hills Naval Oil Reserve in California was established before World War I when the Navy was converting from coal powered ships to oil. In 1997, it was producing only .36% of the nation’s total oil consumption and was sold (Yergin, 1998, p358). Moderates maintain, however, that when more subjective criteria are involved, when savings are hard to quantify, when jobs are threatened, government should be very careful about privatizing. For moderates, the bottom line is that government is to be manager and regulator.

*Skeptics* of privatization believe that when evaluating the effectiveness of privatization, economic efficiency should be considered, as well as accountability to “public values” (Donahue, 1989, p1). Kickbacks, campaign contributions, bid collusion, and conflicts of interest have to be closely monitored or else public confidence in the democratic process will be eroded. Public input to contract awards and oversight of performance must be maintained because the bottom line is that private sector corruption requires the government to retain its role as overseer of the public good.
**Opponents** of privatization such as Ralph Nader’s vociferous organization Public Citizen, for example, believe privatization often comes at a cost, namely the loss of good jobs that pay better, are more secure, and have more benefits than similar private sector jobs. These job losses disproportionately impact women and minorities who have found career tracks in the public sector. Voicing similar concerns is the American Federation of State, County, and Municipal Employees. They maintain that even if privatization saves on direct costs which they see as highly unlikely and doubtful, the indirect costs can be larger than any of those savings (Storrs, 2001). For example, converting workforces from public to private costs money in the way of sick leave and pension payouts. The privatization process itself, including developing a statement of work, putting a service out to bid, choosing a contractor, negotiating and monitoring the contract, is expensive. Finally, costs stemming from litigation or disputes with contractors can also erode any savings.

Public worker unions also point out that because of the specialized nature of most contractors, worker opportunities for training and advancement are diminished. For example, a janitor working for a local government may work his/her way up in the system via a series of vertical and horizontal moves through different departments. These opportunities all but disappear for all but the most skilled employees in specialized firms (Ballard, 2000, p3). Of course privatization proponents dismiss these arguments by saying public worker unions oppose privatization simply because they fear the loss of
union dues and the erosion of their bargaining clout that results when the private sector starts providing services that were once provided by government.

Luria and Rogers (1997, p1,) further argue that privatization is not only bad for the individual employee, it is bad for the community as well. They contend that localities that in response to competitive pressures favor “low road” development strategies such as privatization with what they say are its incumbent lower wages and benefits, encounter more economic insecurity, rising inequality, and poisonous labor relations. In contrast, “high road” organizations rely on better quality products and superior services to beat the competition. This approach requires a well-trained and highly committed quality workforce, which translates into higher wages, cooperative labor relations, and more innovative and productive workplaces which in turn attract better corporate citizens, creating a higher standard of living for all and thus healthy and stable local communities.

Further, opponents of privatization maintain there are hidden costs associated with it. Government agencies have to administer the bidding process, write contracts, and monitor performance. Instead of having blue-collar service providers on the payroll, the government agency ends up being manned by contract administrators. Because the government is still responsible for providing the service, if the contractor doesn’t do a good job, the government will have to take over or re-bid the contract. Since government budgets are available to the public, it is easy for contractors to know how much the government can afford, and to “low-ball” their bid to just that level to get their “nose under the tent.” Later the contractor recoups his losses either through extensive use of
change orders, or by demanding a higher price at renewal time after the government has lost all of its corporate knowledge and equipment such as snow plows, and has become dependent on the expertise of the contractor.

Opponents of privatization also argue that government workers are more efficient, competent, and experienced than private sector employees doing the same work because they have longevity whereas the private sector is constantly paying for employee turnover. This turnover leads to the damaging of an organization’s “learning capacity,” (Fisher, 2000, p244-251) health, vitality, and networks that develop from the day-to-day interaction of the same group of experienced employees working to solve problems. As Campbell, California, city manager Bernie Strojny says, “City workers provide better service because they possess a sense of ownership that is unique to public employees” (Ballard, 2000, p12), and because they hold the public trust and feel obligated to serve the citizenry well as a result.

As to social equity, opponents raise the issue of “cherry picking”, meaning that because it will be less profitable for a contractor to deliver services in poorer areas, they won’t do so. Consumption of public goods by one person, according to economists, does not preclude the consumption by another because it is costly to do so. Yet opponents say that this is exactly what privatization does. Privatization involves the substitution of private goods for public goods, and in so doing, endangers the availability of those public goods to those who cannot afford it. Starr (1988, p3) is concerned privatization can “signify another kind of withdrawal from the whole to the part; an appropriation by an
individual or a particular group of some good formerly available to the entire public or community. Like the withdrawal of involvement, privatization in the sense of private appropriation has obvious implications for the distribution of welfare.”

Privatization undermines the foundation of claims for public purpose and public service and in the process, Starr says, it narrows our involvements, interests, and vision of a good society and a good life (Starr, 1988, p20). Community empowerment and the general welfare come from more intervention, not less. Without it there will be a loss of connection to society and more “bowling alone (Putnam, 2000, p1).”

The opportunity for corruption, the ugly stepchild of privatization, leading to public distrust of the democratic process (Hebdon, 1995, p2) is another reason opponents give for being against privatization. “Privatization exposes government to be taken advantage of,” says Steve Alviene, Deputy Director of Field Operations of the Civil Service Employees Association (Hebdon, 1995, p6). This distrust and contempt for government can be realized another way say opponents. It is a truism that the beneficiaries of many social programs are principally the poor. Because of this, the middle class objects to any publicly provided service that is of as high a quality as they would have to pay for privately. Consequently, the quality of the service provided is held down which leads both the poor and the middle class to develop contempt for the public sector and eager to get away from it. The movement toward privatization promotes this contempt and puts the advocates of more generous public programs immediately on the defensive.
Robert Roman of the Chicago Democratic Socialists of America (1995, p1) contends that the cost efficiency of privatization has become an article of political correctness, regardless of any evidence to the contrary. He says, “…. it helps, of course, that all the pigs at this particular trough (e.g., EDS, IBM, Lockheed, Andersen Consulting) are potential campaign contributors.” He sees privatization as the next step in the commodification of politics. The first step was the destruction of political parties and the rise of free enterprise style politics. The next step was the mad auction of public capital, and now the auction of government itself. The final step could be a form of industrial feudalism. However, in the end, even he acknowledges that there may be instances when privatization is more efficient.

From a practical standpoint, opponents of privatization argue that it opens the door to a different type of government failure. Specifically, contract announcing, awarding, monitoring, and payment can result in long drawn out bureaucratic and political wrangling that is dominated by endless due process (Yergin, 1998, p358). Further, if a government starts privatizing without due diligence, it can lead to poor contractor performance, low customer satisfaction, and runaway costs. The ICMA reports that more than half of the governments that contract out do not have any formal procedures for monitoring contract arrangements (Ballard, 2000, p12).

Ballard (2000, p1), contends that privatization is the “low road” available to local governments to improve productivity, while new management innovations to increase
internal productivity, such as restructuring through improved labor/management cooperation, are the “high road.” They cite Warwick, Rhode Island, where management and the local public employees union worked together to redesign the way residential trash was collected, saving over $1.1 million over five years. In Akron, Ohio, city workers designed a plan to combine water and sewer line repair simultaneously with road repair, thus only tearing up roads once and saving money (Ballard, 2000, p17). In Fort Lauderdale, Florida, an organization called CALM (Cooperative Association of Labor and Management) successfully bid against private sector firms to keep work such as infrastructure pipe construction in house. The authors maintain that empowerment of the public sector employees, and providing them with the tools and resources necessary to bring about change, are the keys to innovative policies and programs that can save taxpayers money and still provide the service quality that is necessary, without resorting to the low road of privatization.

Opponents of privatization are also concerned about the impact on the perceived legitimacy of public administration when third parties act in the name of the state to deliver services. Often used to describe this arrangement is the term “hollow state” with “…the existence of organizations simply consisting of a multitude of contracts managed by a hollowed-out (government) organization too often suffering from a large staff turnover and corporate amnesia (Hodge, 2000, p241).” Setting aside for the moment whether or not it is a good idea, it is seemingly possible to outsource practically any government function. Taken to an extreme, opponents of privatization argue, this could lead to government being seen as little more than an extension of the private sector.
The issue of the “hollow state” leads to the question of accountability. More than just how privatization opens the potential for corruption discussed previously, the accountability question has to do with how does government managed on a day to day basis by third-party providers stay accountable to the people it is supposed to serve? Dudley (1999, p49) maintains that to ensure that government remains accountable, it is imperative that citizen involvement, what she calls “the missed opportunity,” be encouraged. Further, Rohr (Wamsley, 1990) reminds public administrators that they have a constitutional obligation to act like statesmen which means appreciating, understanding, and thinking like judges, legislators, and executives.

Opponents of privatization are concerned that in its rush to the bottom line, privatization ignores other democratic values. While it is true that government has an obligation to spend taxpayer dollars wisely, it is also true that government has traditional public sector values such as openness for public action, equity with respect to needs, needs-based resource distribution, and citizens’ role in collective action (Hodge, 2000, p55). Focusing entirely on lowering costs can lead to public administrators forgetting that they have other obligations to the citizenry they serve.

The impact of privatization on the organizational effectiveness of government agencies that outsource is also a concern to opponents of privatization. Organizations that contract out can end up losing their core competencies and instead become little more than contract monitors. As discussed earlier (see page 29-30), should a contractor fail to deliver on its promises, the government organization can find itself left in the
unenviable position of having lost its institutional knowledge by disposing of its own capability to deliver those services. The end result is an ineffective government organization.

Opponents of privatization finally maintain that only in obvious clear-cut situations should governments give up their role as providers of public services. Otherwise, activities should remain in the public sector precisely to protect them from the pressures of profit making at the expense of other values such as equality (Starr, 1988, p15).

Finally, while a review of the literature reveals volumes of localized anecdotes and information regarding the types, history, and pros and cons of privatization, what is lacking is an objective, overall assessment of its effectiveness in terms of saving money and/or improving service quality. This dissertation will provide that methodologically defensible account.

**Narrowing the Focus of this Discussion**

The privatization literature review demonstrates that the field is quite large and touches on too many areas to do all of them justice. Therefore, before continuing, it is necessary to focus more narrowly on what will be discussed in this dissertation.

Of the thirteen types of privatization mentioned earlier, this dissertation is focused on contracting out because this is a dissertation about American public
administration and because outsourcing is the most common type of privatization in the United States. Accordingly, this dissertation will discuss American government at all levels engaged in all types of contracting out/outsourcing for services. The ultimate question is: Did these attempts save money and/or improve service quality?

On the other hand, this dissertation will not discuss to any great extent, the sale of public assets such as golf courses, because compared to contracting out, selling government assets is such a relatively rare phenomena in American government privatization. A discussion of public school vouchers, Social Security privatization, and health care privatization, will not take place, because these three issues are just too large and too politically charged in their own right to do them justice. The experiences of foreign organizations will not be discussed, because this is a dissertation about U.S. public administration. Nor will there be a discussion of the conversion of public agencies into state-owned moneymaking, or attempting to be, enterprises, such as the Post Office. Experiences of the private sector with outsourcing of services will be discussed only to the extent they can be gainfully compared to those of the public sector. Franchising, grants/subsidies, volunteerism, donations, user fees, the underground economy, deregulation, and tax reductions as forms of privatization will not be discussed because there are even fewer reliable, methodologically defensible sources regarding their effectiveness than there are about contracting out.
Philosophical Underpinnings of Privatization

As discussed earlier, privatization has been around in varying forms in the United States since its inception as a country. Privatization has survived while the dominant public philosophy in the United States has come full circle, going from laissez-faire, to progressivism, to interest group politics, to public choice, and back to a more controlled version of laissez faire called economic progressivism. In this section, these changes in philosophy and how they have led to the current state of privatization are discussed.

Up until the late 19th century, individualism and free market laissez-faire economics combined with social Darwinism were the prevailing schools of thought in the public philosophy of the United States. Adam Smith’s invisible hand was allowed to work its magic, with the belief that expanded private property rights and market forces would ultimately lead to the public good, and the only government necessary would be a small, yet efficient one. More than two centuries after Smith, his argument is still one of the main reasons given by the “less government is better government” proponents of privatization.

Over time, these philosophies encouraged certain excesses such as cronyism and corruption which ran rampant in American government during the “Gilded Age.” In response, a countervailing force came into existence. This oppositional force was best characterized by Progressivism led in the business arena by Frederick Taylor with his “scientific management”, and in government by Frank Goodnow. According to Dwight Waldo, a leading commentator on Progressivism, these men “… concluded that the New
Day would not dawn until science was applied to the realm of human affairs just as it had been to the physical world. .... An easy optimism abounded that at last a technique for solving problems lay hidden within the mystery of science” (Waldo, 1984, p12). Instead of using habit, tradition, casual opinion, or common sense, progressivism sought the application of scientific thought to decision making.

Progressive theory divided government into a political part and an administration part. The former would remain an area where subjective questions not suitable for scientific resolution would be answered. Politics and interest groups would prevail. On the other hand, the larger, administration part of government would be run by professionals and experts using science and following the march of human progress.

It is this progressive belief in the use of science to solve the administrative problems of government that is the basis for using privatization as a way to bring more efficiency to government operations. Successful privatization relies on all politics and other irrational influences being set aside with decisions being made in rational ways based on accurate accountings of all costs and benefits. Unfortunately, as this literature review has demonstrated, the decisions public administrators make regarding whether or not to privatize are more often than not based on the irrational factors that progressives abhor.

Over time, progressivism gained its detractors. Waldo found that the actual conduct of government involved a “seamless web” in which politics and administration
were thoroughly interwoven and the administration-politics dichotomy was not a philosophically tenable idea (McSwite, 1997, p170). Norton Long (1949, p1) argued that while the technical expertise of public administrators is crucial, of equal importance are their political skills. Herbert Simon (Fry, 1989, p187) condemned the scientific “principles” used by Progressive public administrators, as little more than a set of practical “proverbs,” some of which were mutually contradictory. Charles Lindblom (1959, p79-88) said that far from being scientifically run, the normal way government operated was by incrementally “muddling through,” with no clear goals, and little advance planning.

Robert Dahl also maintained that Progressivism had it all wrong. In his view, science, rationality, and efficiency, had little to do with how American government really works. Rather, interest group politics was the only satisfactory way of reaching consensus in pluralist American society, and, he said, “For the past century, it seems to have been a highly stable system (1961, p311).” Theodore Lowi (1969, p3) added to the discussion by saying theories of democratic government in which Congress made policies and disinterested public administrators implemented them were perhaps best left in the high school civics classes. However, Lowi went on to say what he coined “interest group liberalism” deprived government of its legitimacy, turning it into a vehicle for the expression of private interests. These interests become very visible when it comes to privatization where one group is pitted against another. For example, a conflict between unionized government workers, an insulated “incentiveless workforce” according to Ed
Rendell, Philadelphia’s mayor (Yergin, 1998, p359), and contractors, is inevitable whenever privatization becomes a possibility.

In response to the interest group politics theory, a group of economists led by James Buchanan developed a “public choice” school of thought. The main tenet of this school was that interest group politics would lead to very large irrational inefficiencies, such as free riding, in the use of resources by society. This is because while one group with concentrated interests could form a coalition with other not necessarily needy groups to pressure government to provide greater goods and services for them, the costs of the services would be diffused over the rest of the taxpayers. Similarly, bureaucrats seek to maximize budgets and obtain greater power, salaries, and other perquisites. At the same time, each of these interest groups would have little incentive to oppose the demands of other interest groups, because each of these individual demands would be too small to impact the overall budget and tax situation. However, the opposite disincentive would happen on the revenue side of the equation. When it comes time to raise general taxes, all of these interest groups would be opposed. Further, since future taxes are perceived as being less painful than current taxes, there is a bias toward raising government revenue by borrowing rather than through direct taxation. Public choice theory predicted that government would tend toward ever growing budget deficits, the fulfillment of which took place in the 1980s and today.

The public choice school (Linowes, 1988, p234) that has been greatly influenced by Friedrich Hayek and Milton Friedman, to name a few, maintains that the economic
irrationality created by interest group politics is greater than that created in the private sector. This is because “political exchanges accomplished through democratic institutions are in effect a special form of barter. Yet, like any other barter system, political trading lacks a common currency (other than political power) or prices to rationalize the system of exchange. Compared with exchanges accomplished in private markets, the allocation of resources achieved by interest-group trading is likely to be no more rational or efficient than a barter economy would be in relation to a market economy.” To summarize, interest group liberalism is no way for a government to achieve efficient allocation of resources because it leads to government growth and excessive budgets due to myopic, selfish coalitions of interest groups, politicians, and bureaucrats. In other words, privatization won’t necessarily lead to the demise of interest group politics because contractors are as likely as any other group to lobby for larger budgets (Starr, 1988, p15).

The contribution of the Public Choice School to the contemporary privatization movement was to demonstrate the inefficiencies of interest group politics and to show that competitive marketplaces produce services efficiently, while monopolies, such as those run by non-privatized government agencies, breed inefficiencies. It was the Economic Progressives such as John Maynard Keynes who argued that the private sector was the answer to these inefficiencies, although they argued there are occasions where government interference in the private sector is called for such as to control macro-economic instability through such tools as negative income taxes, vouchers, tax credits, and monetary policy. More recently, most mainstream economists have argued that the
circumstances under which government involvement in the economy is warranted are very limited, and sometimes this interference can do more harm than good. If efficiency is the goal, they argue, it is better to model government as much as possible in the private sector image. Privatization is a reflection of the failure of big government to bring about these efficiencies.

This walk through a few of the many antecedents of the intellectual history of privatization has demonstrated that the excesses of interest group politics and the pro-market trend within the economics profession have illuminated a few of the intellectual roots of current ideas. Graeme Hodge (2000, pp 35-46), in addition to discussing public choice theory and interest group politics (what he calls historical/contingency theory), cites the following intellectual foundations upon which privatization stands in the field of economics that have influenced the contracting out movement: agency theory, transaction cost analysis theory, and property rights theory. Two other reform concepts (new public management and measurement issues) also appeal to the rational desire to improve efficiency through better organizational performance and control.

Agency theory holds that how an organization functions can be viewed from three perspectives: 1) as a bureaucracy; 2) as a community; or 3) as a market. Contracting out most closely reflects the market perspective so it will be focused upon here. Building on that perspective, the delivery of services from the organization can be accomplished through a series of contracts, where the principal or owner (i.e., a government agency) enters into contracts with managers (i.e. agents, private contractors) to deliver those
services. Since the principal and the managers have different interests, the principal must install monitoring controls to ensure that the services are delivered in an appropriate manner. Agency theory focuses on finding the best way to set up and operate these contracts, while still meeting the requirements of the principal.

Transaction cost analysis theory states that large organizations aim to minimize the costs of transacting their businesses by vertically integrating (i.e., taking over) either the firms to whom they sell, or else their suppliers. The outsourcing trend in this country can be said to be a phenomena of business organizations trying to take over the firm they sell to (i.e. government organizations), not in the sense of taking over control and ultimate power of the government bureaucracy, but rather from whom the government buys the services it requires. For example, once a privately owned organization that owns buses gets a contract with a city to provide public transportation, that organization can lower its transaction costs (e.g., uncertainty) by doing a good job and over time encouraging the government agency to get out of being public transportation providers, and instead becoming public transportation facilitators, by contracting out.

Advocates of outsourcing often cite property rights theory to make their case why it is better for a government agency to contract out for services rather than to retain those services in-house. This theory relies on the popular and simple logic that privately owned property is better tended than publicly owned property, and that the market should therefore be the standard for assessing the performance of public organizations. Hodge states, “… since the shareholders (in this case the public) cannot sell their equity, and
since the community as owners are not rewarded through the production of a residual financial profit, the performance of the public organization is, by definition, less than it might otherwise be (Hodge, 2000, p42).”

New public management involves the marrying of managerial approaches such as “let managers manage” and “managing for results” with public choice theory and institutional economics. This new public management is not shy about using private sector practices such as corporate plans, short term contracts, monetary incentives, and cost-cutting in solving public administration problems. The objective is to improve productivity as opposed to cutting services, and to apply management solutions to what were previously perceived as being political problems. Perhaps most importantly, the new public management prefers private ownership and the use of contracting out in the provision of public services.

Finally, Hodge (2000, p43) opines that “Measurement issues can also form an important intellectual foundation underpinning efficiency reform.” Because the delivering of some government services can be so complex and hard to measure, they lend themselves to being taken over by a private sector that can, or at least maintains that it can, better measure the cost of providing those services.

The philosophies that set the table for the emergence of privatization also raised many issues left unanswered. While the great economists and thinkers mentioned above dealt with the broad question of how to best govern, they avoided the more mundane
issues of public administration. For example, in this day and age of privatization, what should or should not be privatized? Are there some functions that are “inherently governmental” such as defense or running prisons? Should the “commons” such as public water systems be without question left in the public domain to prevent “greedy” contractors from getting their hands on the source of life? How much monitoring of contracts is necessary to ensure the government gets its money’s worth, without conversely spending so much money on monitoring that any savings gained by privatizing are lost? Put differently, Phillip Cooper, (2003, p3) questions whether as much time should be spent by government on the entire contract relationship, including monitoring and auditing, as is spent on the bid and award process? In a privatized world where the bottom line is the only thing that matters, how do small business and minority set asides fit in the picture? How do contractors balance their accountability to their customers, namely the public, with their accountability to their profit oriented stockholders? Should not contractors be as equally interested in the “commonweal” as government workers are expected to be? Is a nation governed or at least administered more and more by contractors truly a nation with representative government? How do we as a nation ensure that public-private competitions are conducted in a transparent and fair manner so that the process does not provide an inherent competitive advantage to either the public sector or the private sector? These are just a few of the more earthbound questions that surround the discussion of privatization.
Levels of Analyses

The literature reveals privatization has been examined from three different levels of analysis:  a government-wide level (i.e., state, federal, local); a type of service area level (i.e., prisons, child welfare, unemployment compensation administration); and an individual government organization level.

At the government-wide level of analysis, there are few studies at all, other than some that show trends in terms of numbers of jobs affected and dollars involved. At the service area level of analysis, privatizing issues are concerned mainly with whether to do it at all, and how to do it (i.e., guidelines). At this level, there are numerous accounts, although much of it is anecdotal and politically slanted. At the individual government agency level of analysis, substantial literature exists but much of it too is anecdotal. While later privatization literature tends to be more positive, earlier studies tend to focus on A-76 commercial activities studies and emphasize the negative outcomes.

Privatization Effects

The effects of privatization revealed by the literature are wide and varied. Many full time jobs after privatization become seasonal or part-time, and without health or pension benefits. The holders of these jobs after privatization tend to rely on community services more than when they were full time government workers with benefits (Ballard, 2000, p15).
The literature views privatizing as having a profound effect on government organizations, even when they do not privatize. Employees who survive a privatization attempt and then remain with the government organization can still be affected because that organization may actually adopt some privatizing strategies intended to improve organizational flexibility, increase employee responsibility, and streamline operations. Privatization proponents maintain that even when they lose, they win, because they forced government organizations to change. Once an organization goes through an episode of privatization, productivity can actually increase because the remaining employees fear their jobs might be outsourced. They argue that even when an organization decides not to privatize, this “fear factor” can have the same effects in terms of cost savings and improving service quality. However, eventually this “fear factor” can dissipate, and employees may get angry and respond with lower trust, morale, and organizational commitment when they feel the organization broke its 'psychological contract' with them. Sometimes the result of privatizing is what a 15 March 1993 article in *Time* magazine called “dumbsizing” because of the deleterious actions taken in pursuit of getting smaller.

A small part of the literature examines another effect of privatization, “cherry-picking,” where private service companies only provide services to those who can pay. For example, in Charlotte, North Carolina, taxi drivers who provided para-transit service for the elderly and disabled viewed these passengers as less desirable fares than other passengers because they were less likely to tip (Ballard, 2000, p13).
The literature also examines the emergence of corruption as an effect of privatizing. In Iowa, a laundry service charged its government customer based on the weight of the laundry when it was wet instead of dry. Another way in which private sector firms try to take advantage of governments is through change orders which work as follows. First, a contractor bids low and wins a contract to perform a certain level of work, for example providing bus transportation for the city. Second, the contractor waits for the government to get out of the transportation business completely and therefore becomes unable to present a viable alternative to the contractor. History shows that once the government retreats from providing a service, it usually does not get back into that business because the start up costs such as new maintenance equipment, buses, and hiring new employees, are excessive. Lubbock, Texas gets around this by only contracting out about one third of any given task at any given time. Mildred Cox, the director of Lubbock’s Public Works Department says, “This way we never lose the ability to keep the private firms on their toes (Ballard, 2000, p15).” Third, the contractor presents the government with change orders to the contract, to recoup any losses they have incurred to date on providing the service. The city, having no alternatives, pays the cost of the change orders which invariably end up costing the city more than if they had kept the bus service in-house all along.

On the other hand, researchers have found evidence of a “reverse privatization” effect, that is to say work efforts being brought back in house after a period of having been contracted out. A survey by the International City/County Management Association (ICMA) (Ballard, 2000, p11) is done every five years with responses sought from
counties with a population over 25,000, cities over 10,000 people, as well as one in eight cities and counties with fewer than 25,000 people. Questions are asked regarding 64 public services. In 1997, 1,500 municipalities responded to the survey. Between 1992 and 1997, survey respondents reported on average contracting out for eight new types of services. However, they also reported contracting back in for five types of services during the same period.

Reverse privatization takes place when there is difficulty in specifying contractual requirements with complex services; the cost and difficulty of monitoring contractor performance is overwhelming; and/or there are limited cost savings. The biggest reason for reverse privatization is the high standards the public expects from service deliverers and the failure of private firms to meet changing citizen demands. For example, New York City established its street cleaning department in 1881 in response to decades of failure by private contractors to clean the streets of horse manure (Yergin, 1998, p358). Campbell, California brought public park maintenance back in house after two years of the city responding to complaints of poor quality service provided by the contractor, (Ballard, 2000, p14). The same held true for Pinellas County, Florida, which terminated its contract for grass mowing at 360 water-pumping stations because of its inability to control service quality (Ballard, 2000, p14). Whittier, California, Charlotte, North Carolina, and Fort Collins, Colorado, all brought their public bus services back in house after the contractors were providing poor, unreliable service by rude, unqualified, accident prone drivers that were causing higher than expected vehicle repair costs.
(Ballard, 2000, p16). How much of these problems could have been solved by more clearly communicating the expectations of the two groups was unclear.

**Conclusion**

The categories of material found during the review of the privatization literature have been discussed, as well as the philosophies underpinning privatization over the years, the levels of analyses found in the literature, and the effects privatization has on organizations. The literature review showed that the subject of privatization is too broad to be analytically manageable, so for purposes of this dissertation it has been limited to American government at all levels engaged in all types of contracting out with non-governmental organizations for services. Further, the literature review shows that an objective, comprehensive review using the vote counting methodology for assessing the effectiveness of outsourcing in the United States in terms of cost savings and service quality improvement could add substantially to the literature. Addressing this deficiency is the purpose of this dissertation. The next chapter will discuss the methodology used to extract from the vast amount of privatization literature those sources that are usable for this vote counting procedure.