THE FEDERAL ROLE IN PRIVATIZATION

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY

OF THE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
HOUSE OF REPRESENTATIVES

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CONTENTS

	Page
Hearing held on March 14, 1995	1
Statement of:	
Albano, Louis, president, Civil Service Technical Guild, accompanied by Bert M. Concklin, president, Professional Services Council	64
Jones, Andrew, worldwide privatization coordinator, Arthur Andersen; Roger Leeds, managing director, Barents PLC; and Viggo Butler, president, Lockheed Air Terminal	20
Klug, Hon. Scott, a Representative in Congress from the State of Wisconsin; and Roy Bernardi, mayor, Syracuse, NY	4
Stanley, Ralph L., senior vice president, United Infrastructure Co.; accompanied by Donald Correll, president and ceo, United Water Resources	82
Letters, statements, etc., submitted for the record by:	
Albano, Louis, president, Civil Service Technical Guild, prepared statement of	66
Bilik, Al, president, Public Employee Department, AFL–CIO, prepared statement of	94
Butler, Viggo, president, Lockheed Air Terminal, prepared statement of	53
Concklin, Bert M., president, Professional Services Council, prepared statement of	71
Horn, Hon. Stephen, a Representative in Congress from the State of California, Executive Order 12803	17
Jones, Andrew, worldwide privatization coordinator, Arthur Andersen, prepared statement of	23
Klug, Hon. Scott, a Representative in Congress from the State of Wisconsin, prepared statement of	10
Leeds, Roger, managing director, Barents PLC, prepared statement of	49
National Council for Public-Private Partnership, prepared statement of	100
Savas, E.S., director, Privatization Research Organization, School of Public Affairs, Baruch College/City University of New York, prepared statement of	93
Stanley, Ralph L., senior vice president, United Infrastructure Co., prepared statement of	85
Sturdivant, John N., national president, American Federation of Government Employees, AFL–CIO, prepared statement of	96

THE FEDERAL ROLE IN PRIVATIZATION

TUESDAY, MARCH 14, 1995

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON MANAGEMENT,
INFORMATION, AND TECHNOLOGY,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2154, Rayburn House Office Building, the Honorable Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Davis, Fox, Horn, Maloney, and Mascara.

Staff present: J. Russell George, staff director; Mark Brasher and Mark Uncapher, professional staff members; Andrew G. Richardson, clerk; David McMillen, minority professional staff; and Elisabeth Campbell, minority staff assistant.

Mr. HORN. The Subcommittee on Government Management, Information, and Technology will come to order, a quorum being present. And our first panel is Representative Klug of Wisconsin, and Mayor Bernardi of Syracuse, NY. Mayor, if you would, please come forward. We have a tradition in this committee, of swearing all witnesses. So if you just raise your right hand.

[Witnesses sworn.]

Mr. HORN. And we will start with you, Mayor. We're delighted to have you here. I congratulate you on your win. And I think they've got a sign for you right there; there you are.

Mr. FOX. Sir, will you accept the opening statements as a brief?

Mr. HORN. My opening statement will be fairly brief, and I'll be glad to recognize you after mine. I just want to get the witnesses sworn in.

Mr. FOX. Very well. Thank you, Mr. Chairman.

Mr. HORN. And let me say to all witnesses that we will put your full statement in the record automatically. What we'd like you to do is summarize it. We give every witness 5 minutes for summarization, and then each Member, alternating between Republicans and Democrats, has 5 minutes per round. And let me just make a few comments on this and I'll explain what we're about.

In 1979, Margaret Thatcher was elected as Britain's Prime Minister. Mrs. Thatcher initiated a review of the British government that included privatizing the State-owned enterprises, which had been nationalized by the Labour government, following the Second World War. The sale of British Petroleum and British Aerospace kicked off the transformation of several British firms from largely State-owned to largely private. Thatcher's Conservative Party revo-

lution even transformed the opposition British Labor Party from a party committed to public ownership of "the commanding heights of the economy," to one that accepts privatization and does not intend to undo the achievements of the preceding two decades.

That really was a shot heard around the world. Privatization has been widely copied in Latin America, Africa, Asia, Europe, even in countries which were part of the former Soviet Union, and China, which is still ruled by the Communist Party of China.

Conspicuously lacking among the ranks of the privatizers is the United States. The United States has limited experiences with nationalization of Federal ownership of corporations, except in the First World War with the railroads. The lack of State-owned enterprises has limited the scope of privatization in the United States. However, there are billions of dollars of Federal assets that are available for sale.

Congressional committees should closely examine the opportunities available to us to achieve savings, and improve the effectiveness and efficiency of various government-run programs. We should have specific goals when privatizing. There should be a solid rationale and clear criteria in order to move areas of activity away from government ownership to private ownership and management which meets a public purpose.

A demonstration of the cost savings and economic opportunities for economic benefits for society's consumers and workers are essential. These are some of the questions we hope each of the witnesses will deal with, based on your experience, so we can get a feel for where are those solid rationale and the clear criteria. Congress needs to decide whether to privatize; what form privatization should take; how Federal workers should be treated; and finally, how we can remove barriers to State and local governments for their own privatization program.

With that, I look forward to hearing the testimony of the witnesses. And to answer some of these questions, we've assembled an impressive array of talent. And, as appropriate, other hearings will follow this one over the next 2 years. I'd like to yield now to the acting ranking minority member on the committee, Mr. Mascara, the gentleman from Pennsylvania, for any opening statement he might have.

Mr. MASCARA. Thank you very much, Mr. Chairman. Let me first indicate that I'm sitting in for our ranking member, Congresswoman Carolyn Maloney. She is suffering from the flu, and I guess that's going around, and she couldn't be here today. But we all wish her a speedy recovery. Thank you for holding this hearing. We are going to seriously consider privatizing Federal Government functions and selling government assets.

This is a useful beginning, but it is only a beginning. We will touch on a number of topics in today's hearing which are highly controversial: cost accounting, contract control, and job placement for displaced workers, just to name a few. We will not resolve these issues today. At a hearing of this breadth, we can do little more than identify the issues which are to be debated. I look forward to working with you to make sure that each of these issues is fully explored before we begin divesting Federal functions and assets.

Privatization is not a cure-all for government problems. We should remember that it is just one of the tools at our disposal. The President's National Performance Review has found that in many situations, empowering the workers, not privatization, is the most effective way to improve services. We see the same decision being made each day in corporations and we hope the government will emulate these decisions. Xerox and Corning have prospered because they have invested in their workers.

They treat their front-line employees as assets—an employee and organizational style that respects workers' knowledge and experience. Often, the solution to inefficiency in government just means changing the way we do things. We saw this last year as we looked at procurement reform. Many of the problems could be solved by giving the workers the authority to act as responsible agents. In some cases, that was as simple as giving them a credit card and telling them to go to a store and buy software off the shelf.

Similarly, when we discovered the $400 hammers and $600 toilet seats at the Defense Department, we didn't rush out and hire a contractor to do military procurement. Instead, we made sure that the managers responsible understood their fiscal responsibilities. We must be cautious that privatizing a function doesn't wind up costing us more in the long run. Private trash-hauling in New York City costs 5 times what it costs in San Francisco.

But once a function is given over to the private sector, it is difficult for the government to regain control. A similar story is told by the Los Angeles school district, which wound up with a $3 million bill for deficits run up by a contractor hired to run the school food services. On the other hand, New York City gave park services workers greater control over their jobs, and found that they could be more efficient than private contractors. The 1992 experiment, the cost of tree removal in Queens and Bronx by city workers was thousands of dollars less than a contractor would have charged.

The sale of government assets must also be carefully scrutinized. In the 1980's, we set up the Resolution Trust Corporation, a government-sponsored enterprise to handle the assets of the failed savings banks. In the end, most assets were sold well below market value, and the bail-out cost the taxpayers more.

The history of management of the national forests is replete with timber being sold below market value. On top of that, we build the roads for the companies doing the logging. The least we can do when we sell assets is to get a fair price for it. Determining when to sell an asset is as important as deciding whether or not to sell. We could sell the national helium reserves today, but the results would be to depress the price of helium and decrease the savings to the taxpayers.

We cannot let privatization become another trough of corporate welfare. But to avoid that, we must scrutinize the process very carefully. First, we must have sound information on what is to be privatized and why. That information should include an estimate of what savings could be realized by improving the management of the service within the government.

Second, we must insist on sound contracts that incorporate incentives for cost savings as well as severe penalties for failure to perform. Finally, in those situations where we do privatize govern-

ment functions, we must put in place a strong and effective job placement program for the workers who are being displaced.

Again, thank you, Mr. Chairman, for beginning a dialog on this most complicated topic. I look forward to working with you to solve some of these problems. Thank you, sir.

Mr. HORN. Thank you very much. I now yield to the other gentleman from Pennsylvania, Mr. Fox, for a brief opening statement.

Mr. FOX. Thank you, Mr. Chairman. The United States is on a path of seeking better methods in meeting the needs of the American people, for both public and private institutions deserve and receive people's confidence. The American people have often complained of the intrusiveness of Federal programs, of inadequate performance and excessive expenditures.

In light of these public concerns, the government has begun to turn to the creative talents and ingenuity of the private sector to provide, whenever possible and appropriate, better answers to present and future challenges. In response to renewed interest in privatization, we must continue to address alternative approaches that can best provide the social good, and we must continue the discussion about the proper limits of government in society.

Therefore, it is important that we consider first, and most critically, the needs of the American consumer and how these needs can best be satisfied. This hearing is in progress that we may explore alternative approaches for administering many government programs and services to determine whether they can better be managed at less cost by involving the private sector and/or providing for individual consumers' choice.

I look forward to hearing from the witnesses this afternoon, especially our colleague, Scott Klug, the czar of privatization. And I further look forward to working with Chairman Clinger and Chairman Horn in examining the Federal role in privatization. Thank you very much.

Mr. HORN. I thank the gentleman. Now I'm delighted to recognize our distinguished colleague from Wisconsin, who has just been described as the czar of privatization, and is heading the Speaker's task force in that area. And we welcome you and look forward to some of your insights throughout this Congress, where we hope you will feel free to guide this committee as we hold various hearings and try to get more specific from rather grand principles and criteria and hopes.

STATEMENT OF HON. SCOTT KLUG, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN; AND ROY BERNARDI, MAYOR, SYRACUSE, NY

Mr. KLUG. Thank you, Mr. Chairman. And I will submit a longer statement for the record, but let me, if I can, just summarize what I think need to be some of the key, overarching themes in this entire debate about privatization. I was asked, as my colleague from Pennsylvania correctly characterized, some months ago by the Speaker, to try to really reenergize a number of efforts toward privatization that began in the late 1970's and the early 1980's and then, frankly, ran out of gas.

And I think we need to examine this for a number of reasons. To this point, much of the discussion that has gone on in the Fed-

eral Government—and, for example, the central theme that will dominate the welfare debate next week—is the discussion of which level of government should perform a service. Can the State, the local government, or the Federal Government do welfare reform best? And if you think of a giant flow chart, much of the discussion is really focused on the State versus national debate, in terms of what sector of government can do it most efficiently and more intelligently.

What I think, in many ways, has been overlooked is the second half of that equation, which says, should the government still be in the business? And if the answer is no, then I think the question is, how do we get out of the business? In privatization, it seems to me, it's important for a number of reasons: to balance the budget; to downsize the Federal Government; to make sure that taxpayers receive a fair return on their investments; and, in many ways, to get the government out of the way where it interferes with the free market.

There are really three categories of privatization that are very distinct. First of all, the idea of selling off government assets, or releasing off government assets, primarily in the natural resources area. Second, contracting services out now done by Federal Government employees. And I think if you look across the country, there are a number of States and municipal governments which have had terrific success with this.

Finally, functional conversion, which means, essentially, taking what is today a government entity and spinning it off and letting the private sector do it instead. In the issue of asset sales or leases, I think we have to examine a number of properties owned by the Federal Government today, and really ask why it is, in 1995, we're still in the business of running hydroelectric dams across the country and selling off the power from them.

I think we have to ask why, in 1995, we continue to hold onto a series of oil reserves and natural gas reserves established in the Roosevelt administration—Teddy, not Franklin—to guarantee we'd have an adequate supply of oil to allow the U.S. Navy fleet to make the conversion from coal and wood to oil. I think we have to ask why, in 1995, we still manage to hang on to a strategic helium reserve, first established by the Federal Government in 1920, really, then, focused on dirigible research; not a very hot commodity these days, anywhere in the world.

And I think it's time we get out of these. And quite frankly, not only do we downsize the government—for example, the Power Marketing Administration today employs nearly a third of all the employees at the Department of Energy—but second, most economic analyses that have been done suggest you can maximize your return to the government by selling off and liquidating assets, rather than holding them and attempting to milk them.

The bottom line, Mr. Chairman, quite frankly, is given the choice between taking $1 million in the lottery today, or $100,000 over the next 10 years, you always want the cash up front. The second area involves the privatization of functions now done by government employees. And just several blocks away from here, from the Capitol, I think, is the perfect example—the Government Printing Office.

Today we still have 4,000 employees in the Washington, DC, area involved in printing documents for the Federal Government. The General Accounting Office, several times, at the request of this very committee, has done long, detailed analyses on the General Accounting Office. And the bottom line is, everything that the Government Printing Office prints today could be printed at a third to half the price in the private sector.

I'd suggest what we do is shrink the Government Printing Office and make it a procurement office to use the 100,000 private printers in the United States, and to get the Federal Government out of running printing presses for a living. And frankly, anybody who knows the changes in printing—and I'm sure it's the kind of challenge you faced when you were a university president—is it's much cheaper, in this day and age of desktop publishing, to do things quietly, cheaply, in-house and farm the rest of it off, than it is to still have a university system have a large printing plant on the campus itself.

I also think, quite frankly, there's a number of other privatization areas within this building itself. Why we spend $100,000 renting beauty shops and barber shops and keeping folks on the payroll and then having those entities—for example, the barber shop—lose money is an absolute mystery to me. Where I think if you'd open up the building for competition and say, here's a place where you can put a barber shop in; what are you willing to pay us to have that privilege? I think you could turn many of those operations from losing money into for-profit operations.

The final area I want to talk about is the idea of functional conversion. In the Commerce Committee, which I sit on, we're about to complete the final steps of taking the U.S. Enrichment Corp. to a private corporation. For years the Federal Government actually took all the uranium; we processed it; processed some of it for weapons-grade plutonium; and then processed some of the rest and sold it to private utilities for nuclear power plants.

We managed to do such a wonderful job of it when it was a government entity, we used to have 100 percent of the market share in the world and we now have 40 percent of the market share. So we're about to cut the tethers, set up a private corporation, and have the government get out of the business of marketing and selling and processing uranium, period.

The final thing you will see, and there's a rather detailed explanation for you, which we'll insert in the record, is the number of laws which currently exist which make it very difficult for some of these privatization issues. For example, on the Power Marketing Administration in 1986, the last time these ideas were discussed, in the appropriations bill itself, there is now actually a barrier in place which forbids employees of the Department of Energy to talk or discuss or analyze the sale of the Power Marketing Administration; as there is a ban at this point on the executive branch, which prohibits it from procuring from commercial sources any printing-related production of government publications.

There are a number of outdated laws. And it's my hope that this committee can take the lead in repealing those to allow privatization efforts to go forward. Thank you.

Mr. HORN. Now, I'm very conscious of members' time, and I wonder, can you join with us while we hear Mayor Bernardi? Or would you prefer to take any questions now from the committee?

Mr. KLUG. I have a date with the Rules Committee, so if I could answer questions for 3 or 4 minutes, to give the Mayor plenty of time, that would work the easiest for me.

Mr. HORN. Fine. We'd be delighted to accommodate you. The gentleman from Pennsylvania, do you have some questions?

Mr. MASCARA. A couple brief questions. In your statements, you refer to the requirements to have the Department of Labor and Transportation notify Congress of any reprogramming of funds. Are there any other departments that are under the reporting requirements?

Mr. KLUG. Well, what we did—and we can give you, again, a detailed analysis—is ask the Congressional Research Service to search bills and laws and statutes to try to pin down as many specific prohibitions as possible, or other advisory referendums. And, for example, let me just give you a couple of more on here. The Farmers Home Administration and the Conservation and Soil Service are required to keep minimum employment levels.

The Department of Defense is prohibited from contracting out security and fire-fighting services. The Department of Transportation, as you said, is required to notify Congress of any specific changes. No Federal funds can be used to contract out or privatize any functions or activities presently performed by Federal employees in the Department of Labor, which just, I think, amplifies what you asked about earlier.

And in both cases, there are 15-day notice requirements for both Treasury and Labor. So those are the only specific requirements we know that require notification to Congress. But there are also actual bans in other departments which forbid it from even being discussed.

Mr. MASCARA. Congressman, don't you think it's Congress' responsibility to oversee this privatization? We have some responsibility, rather than being notified of some activities that are taking place?

Mr. KLUG. I think you're right, that we do have an obligation and a responsibility to be notified when departments are considering privatization ideas. But what I'd suggest is, in the past, those timeframes and notifications have been used as an excuse to delay any active discussions of privatization. So if it's simply a notification process, I don't have any concerns whatsoever.

If it, however, is a delaying tactic and a barrier to privatizing or downsizing in either of those agencies, then I have a post.

Mr. MASCARA. I have just one other question that relates to some testimony given before the Budget Committee. You talked about contracting out to the Internal .evenue Service some collection work.

Mr. KLUG. Right.

Mr. MASCARA. Which included about $150 billion worth of outstanding debts. Could you talk about that a little bit and tell me, how much do you think we can recover and would that be a good move on our part, and how much of that do you think is collectible?

Mr. KLUG. There's conflicting testimony from experts on how much of that money is actually recoverable. If you go back to the Carter administration, actually one of the recommendations the Carter administration asked Congress to do was to dramatically increase the number of IRS collection agents, based on some kind of projection of money we could then take in—that for every agent you hired, you'd get that agent's salary plus some other factor, which means more money would come in the door.

Despite increases in some of those IRS employment levels, it's my understanding that we've never really achieved those kinds of savings. Faced with similar frustrations, a number of States across the country—Alabama, Maine, and New Jersey—have begun to contract out with private collection firms to collect on their debt. New Jersey's experience, which is my understanding, is the longest running and the one which we have the best data on, suggests that for every $1 the State of New Jersey pays out, it collects roughly $4.

Now, clearly, some of that $150 billion or $160 billion is bad debt that nobody is ever going to collect. But I also think somewhere between where we are today and where that $160 billion is, there's a fair amount of money. And my recommendation to the Budget Committee was to move forward aggressively with the privatization of debt collection.

I don't know that you necessarily want to do that for the whole country. But it certainly seems to me, it's reasonable to pick regions for the IRS and try it as a pilot project and just to simply see what the experience has been. If it is anything similar to what the States have discovered, I think it's likely we could recover 10, 15, 25 percent of that debt, which could mean $25 billion or $30 billion, potentially.

Mr. MASCARA. Thank you, Congressman.

Mr. HORN. Just a few brief questions. No. 1, as you know, when a lobbyist comes in to see us, some of us ask, "What's the best case of your opposition?" If they can't state that pretty succinctly, we don't listen to them too much. Let me ask you this. In terms of privatization, what's the downside, socially, economically, governmentally, however you want to look at it, the kind of worries that might be out there?

Mr. KLUG. Well, I think you have conflicting goals. And I think, in many ways, it's difficult to reach a consensus in Congress on what that goal is. Is the consensus to maximize the profit? Or is the consensus to be some point less than that, but still perform public goods? And let me give you a perfect example. We privatized COMSAT—Communications Satellite Network—in the 1980's.

When we privatized COMSAT, we made a conscious decision that we didn't want to restrict that information to just a couple of people, since it was a government-financed satellite, we wanted to make the information available still to a number of parties. Well, when you did that, obviously what you did was dilute the value of the information that was marketable.

And so in the case of COMSAT, I think it was clear that on the one hand, we achieved what we wanted to do, which was to cut strings with an organization and an agency that could stand on its own. We didn't really pick the peak economic value of it because

we could have more closely held that information. I think part of the same debate, frankly, is going on right now in the Science Committee on the National Weather Service.

Even the administration, for example, has said, we need to get the National Weather Service out of some of the functions it does today. It does private crop forecasting for the cranberry industry; for the corn industry; for the maritime industry; for the aviation industry. Do we really need to do that, or should we restrict the National Weather Services' job to the core function—worrying about tornadoes and hurricanes and whether it's going to be 70 and sunny or 70 and rainy tomorrow in Washington, DC?

There again, I think you have to ask yourself that question, how do you get the most money for what you want to do, or how do you get the public good, or how do you split the difference? And I had suggested in the past, we've tried to split the difference and we've not always been very successful.

Mr. HORN. On that point, I would guess that when you fly to Wisconsin and I fly to California, we'd just as soon know we're not flying into a hurricane or a tornado.

Mr. KLUG. Absolutely. And the National Weather Service makes a good case that it wants to keep all of those emergency functions in place. But when you see the increased ability of the National Weather Service to consolidate offices, I mean, I don't have to have somebody in Madison, WI, or San Francisco, to give an aviation forecast. They can shrink some of that back dramatically.

And I would suggest that when you fly on a commercial airliner, they've got their own forecasting team, because they don't want to take the chance that the government forecast might be incorrect. So I think we can still maintain the public safety, but dramatically roll back—frankly, the Eisenhower administration suggested in the 1950's to get out of businesses where there's already private services being provided by the private sector, and where the government no longer needs to be involved.

Mr. HORN. Let me mention the Government Printing Office. One of the reasons that they do what they do and how they do it, in terms of timing, is the fact that they publish that amazing document known as the Congressional Record. And it's few publishers in the world that can have a 700-page book on your desk the next day, giving a blow-by-blow account, now that we've got fairly authentic transcripts, and you can't edit them like we used to, before the 104th Congress.

How do you solve that problem? Are we going to drop the Congressional Record in the process to be efficient and farm all this stuff out to private publishers?

Mr. KLUG. First I think, Congressman, that it's clear anybody in the private sector would understand the parameters that said, we need the Congressional Record tomorrow morning, and get it. If the Wall Street Journal can be assembled and edited in New York and then sent by satellite to a publisher in Wisconsin, and end up at my doorstep at 5 in the morning, I think the private sector can figure out how to turn the Congressional Record overnight.

But there's a real bizarre labyrinth of how the Congressional Record is produced. We have stenographers on the floor who take notes. Then they go upstairs and transcribe it electronically. Then

they make a printed copy of the document they just put in the electronic section—you're nodding your head yes over here—at which point, then, the hard copy goes over to the Government Printing Office, where they then have to retype it and enter it again electronically into a system.

I think we can, obviously, and we'll have to streamline that, so that when this young woman or any clerk goes upstairs and transcribes it, that immediately that document is sent electronically, as the Wall Street Journal would do. We're part of the Government Printing Office's problem, Congress itself is. The second part of that equation is, all of the incentives are wrong in the system right now.

If you look at the Government Printing Office, one reason it's so extraordinarily expensive is, so many documents are printed in the evenings and printed on weekends, when it's a crisis. With all due respect to our current profession, I find it hard to believe that much the government needs to do is done at a crisis period. And if we could figure out a way to really make agencies understand what it costs them to have it printed on weekends and on overtime, and made them do it in the private sector, and actually made them account for the budgeting costs, I would suspect many more documents would not be a crisis, would not be an emergency, and instead, could be done at 10 o'clock on a Wednesday morning at a private printing plant, which is much more cost effective.

Mr. HORN. I thank you. As usual, your testimony is succinct and filled with a lot of wisdom. And I am hopeful this committee—we'll probably need 15 references to other committees—can get rid of those bans and prohibitions on studying these issues.

Mr. KLUG. Thank you very much.

Mr. HORN. We should be beyond that stage. Thank you. We appreciate your testimony. Mayor Bernardi, you're on.

[The prepared statement of Hon. Scott Klug follows:]

PREPARED STATEMENT OF HON. SCOTT KLUG, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

The federal government has many opportunities for privatization today. Many of the assets and functions performed by the government duplicate what is already provided by the private sector. I don't think the federal government should be competing with private businesses. We can't afford it. It is generally estimated that the government would save approximately 20% by privatizing many of its functions. Through privatization, the federal government has the opportunity:

to balance the budget
to downsize the government
to make sure the taxpayers receive the full return for their investments
to help competition in the free market.

Privatization can be implemented through three categories:

Asset Sales or Leases
Contracting Out
Functional Conversion

I strongly believe, however, that in order to use the above options, various barriers to privatization must be lifted first.

PRIVATIZATION: ASSETS SALES OR LEASES

Since my appointment as "Privatization Point-Man" by the Speaker, my office has been approached by a number of people from the private sector who have an interest in investing in federal government assets ranging from the hydroelectric facilities under the U.S. Army Corps of Engineers and the Department of Interior Bureau of Reclamation to the Naval Petroleum Reserves under the Department of Energy.

Privatization through assets sales or leases would allow the government to not only save money by eliminating these assets from the budget, but also be a source of revenue to reduce the deficit. Asset sales or leasing has generally been done through a bidding process. By working with the private sector, the federal government can ensure that the taxpayers will receive the maximum amount for their investment.

PRIVATIZATION: CONTRACTING OUT

The federal government provides many services which can be easily contracted out. From haircuts on Capitol Hill to debt collection, to government printing, we all know that these services exist in the private industry. Many of these private businesses would like the opportunity to work with the federal government in a partnership. There is no reason to continue to have a barber on the federal payroll or to expand an already bloated staffs to perform these services. It simply makes no sense when private businesses provide these services at a cheaper costs and with more efficiency. By contracting out, the federal government would save taxpayer money and encourage competition in the private sector.

PRIVATIZATION: FUNCTIONAL CONVERSIONS

Agencies and functions which fall under the category of functional conversion because they would neither sell assets or contracted out. These functions are identical to what private industries offer and should be eliminated from the federal budget by turning them over to the private sector. Functional conversions would include certain functions within the National Weather Service, federal loan programs and government sponsored enterprises.

For example, government sponsored enterprises are privately owned and operated, but are exempt from most, but not all, laws and regulations applicable to federal agencies and to similar private enterprises. As for federal loan programs, the government should sell these loans to private markets and purchase private reinsurance for loan guarantees. Federal agencies administering these loans have inadequate collection efforts, poorly managed loan programs, and improper accounting procedures.

PRIVATIZATION: BARRIERS

Many of the obstacles Congress faces in privatization initiatives are not only from those who oppose privatizing various government entities. These obstacles were placed by the federal government. Lifting these barriers is a key first step to carrying out and, in some cases, simply looking into the possibilities for privatization.

DEPARTMENT OF AGRICULTURE

The Farmers Home Administration, Agricultural Stabilization and Conservation Service, and the Soil Conservation Service are required to keep minimum employment levels.

The Farmers Home Administration is prohibited from contracting out with private debt collection firms to collect delinquent payments.

DEPARTMENT OF DEFENSE

Army depots have a minimum civilian employment level requirement.

The Department of Defense is prohibited from contracting out security and firefighting services.

DEPARTMENT OF ENERGY

The Department of Energy is prohibited from studying the sale the Power Marketing Administration, except Alaska. [The prohibition applies to the Tennessee Valley Authority (TVA) which is not under the Department of Energy]

GOVERNMENT PRINTING OFFICE

No appropriated funds are allowed to be used by the Executive Branch for the procurement from commercial sources of any printing related production of Government publications.

DEPARTMENT OF HOUSE AND URBAN DEVELOPMENT

The Public and Indian House Program has minimum employment levels.

DEPARTMENT OF LABOR

The Job Corps is prohibited to contract out any Civilian Conservation Center.

DEPARTMENT OF TRANSPORTATION

The FAA is prohibited from contracting out functions of an airport control tower at any airport.

The Department of Transportation is prohibited from funding changes in the current federal status of the Transportation Systems Center or the Turner-Fairbank Highway Research Center.

DEPARTMENT OF TREASURY

No appropriated funds are allowed to be used for the study of the possibility of contracting out or the actual contracting out of positions under the United States Mint Police Force and the Bureau of Engraving and Printing Police Force.

Currently, Congress is required to be notified before the Department of Labor and/or the Department of Treasury contract out or privatize any functions under their jurisdiction:

No federal funds shall go to contracting out or privatizing any functions or activities presently performed by Federal employees in the Department of Labor unless the Appropriation Committees of both Houses of Congress are notified fifteen days in advance.

No appropriations shall be used for contracting out or privatizing any functions activities presently performed by Federal employees in the Department of Treasury unless the Appropriations Committees on both Houses are notified fifteen days in advance of such reprogramming of funds.

Mr. BERNARDI. Thank you, Chairman Horn, Congressman Mascara, Congressman Klug, ladies and gentlemen. It's a pleasure to be here.

Facing a $16 million revenue shortfall for our next fiscal year, the city of Syracuse, like many others, is hard pressed to support any service which cannot be best described as essential to the health and safety of its residents.

Our budgetary position, similar to so many others throughout the country, has forced us to analyze other methods of delivery of nonessential services without added taxpayer expense.

Based on competitive market conditions, fiscal constraints and decreasing levels of service, numerous State and local governments across the United States are reviewing their approach to public sector management of infrastructure, assets and services. A primary area of focus has been the introduction of entrepreneurial private sector management, and even ownership, of public sector infrastructure assets and services.

Our administration in Syracuse, like those in Atlanta, Boston, Indianapolis, Los Angeles, New York City, Philadelphia, and Worcester, is actively pursuing the opportunities which are available through privatization. Ladies and gentlemen, I can tell you right now, we're looking back home on our tax-delinquent properties, as Jersey City did, we're talking to banking experts to take that over for us; to manage that; to pay us up front; and to collect our tax-delinquent situation, which approaches about $25 million in the city of Syracuse. We're also in the process of the sale and lease-back of all of our vehicles and other equipment.

We're looking at solid waste pickup, privatization of snow removal, the sale of our city golf courses, and sale of all real estate. Basically what I want to enter into the city of Syracuse, and have done so to this point, is the competition aspect of who can do it better; who can do it more efficiently; who can do it at a quicker rate of speed; and who can do it, more importantly, more economically.

Specifically, the potential to privatize and instill a level of competition, what I want to talk about here today is the Syracuse-Hancock International Airport. Our goal is simple: it's to better the service available to the traveling public, while lessening the burden placed on our municipality to own and operate this airport. Currently, the full economic and financial capabilities of our airport are not being realized.

In order to capitalize on the potential untapped benefits at the airport, a more aggressive management approach must be taken. That's why, just 2 weeks ago, I established the Mayor's Advisory Committee on Airport Privatization to assist and analyze the enhancement of services at the airport to a public-private partnership. The introduction of private sector expertise could enhance the capabilities and efforts of the city and the airport's existing management through development efforts.

Through a properly incentivized business structure, introduction of entrepreneurial management and ideas of Hancock Airport could yield significant economic and financial benefits, cost savings, and service quality improvements, while increasing the attractiveness of Syracuse as a place to do business. These benefits could accrue directly the city of Syracuse and the users of the airport, including the traveling public, the airlines, and other tenants.

In order to implement a public-private partnership through a managed competition process, our airport advisory committee must address the financial opportunities, the legal issues, and competitive structure related to an initiative of this nature. But most importantly, especially to this committee, are the constraining effects of Federal oversight and regulation. My committee is currently reviewing various alternatives, ranging from public authority ownership to a consortium of public-private partnerships, to total private ownership.

Specifically, ladies and gentlemen, we have identified one obstacle, which, if removed by the Federal Government, would accelerate our efforts to improve airport service delivery and enhance our economic opportunities. As I'm sure you're aware, under the Federal Aviation Act of 1958, the Airport and Airways Improvement Act of 1982, and subsequent amendments, the Federal Aviation Administration provides grants through the Airport Improvement Program.

We in the city have participated in the AIP program over the years to keep pace with needed improvements at our facility. Current Federal law requires the repayment by the city of all past AIP grants that we've received. This repayment inhibits our ability to enact the private sector disciplines needed to better service the traveling public. Repayment of all past Airport Improvement grants, if required, would not allow the end result to be accomplished, but would rather shift the burden from the city of Syracuse and its taxpayers to a private operator.

If the Federal Government is truly interested in promoting and assisting local government in bettering service and lowering taxpayer exposure, then this barrier required repayment must be removed. I wrote to Representative McIntosh regarding my support of his amendment to H.R. 5 to remove the required repayment of Federal grants when privatization opportunities involved public assets.

This proposal would return to State and local officials the decisionmaking power they need to effectively administer their governments in the difficult years that lie ahead. It is my belief that the removal of barriers such as the requirement of repayment of Federal grant awards will allow incentives to flow to our community in the following manner: provide superior performance and efficiencies for the airline and other airport users; would enhance the city of Syracuse's business environment and economic development; would position Central New York for growth into the 21st century; and would realize the full economic and financial benefit of Hancock International Airport.

In closing, I'll leave you with a message that you've all heard before. It's a message that has been embraced by Speaker Gingrich, Senate Majority Dole and even President Clinton, who, in his 1993 State of the Union address, said, "the real engine of economic growth is, indeed, the private sector." If we adhere to this simple message, then I think we can all win.

The traveling public wins because they're offered a broad range of new services at a fair price. The airlines win as their costs go down and passenger satisfaction raises. The community at large wins as the airport becomes and even more significant engine of economic development for the region. After looking at the successes of privatization of major airports such as London Heathrow and Gatwick Airports, as well as Toronto's imaginative public-private venture, I look forward to the day when Syracuse can mirror and compete with these accomplished transportation hubs in the new world economy.

Again, I'll thank the committee and its members for their interest, your time and attention. And hopefully your efforts here today and into the future will assist cities like the city of Syracuse and cities and States throughout the country. Ladies and gentlemen, I firmly believe that, as Congressman Klug quite aptly put it, we have to rethink everything that we do.

I think, Mr. Mascara, you asked the question, or Chairman Horn, what's the downside? Well, the downside is if there's no control. But I expect full well that my State Governor Pataki and myself as the mayor of the city of Syracuse, or Mayor Giuliani, as we embark on privatization of any aspect of government, that we would do it not only with the checks and balances of our offices, but also with the legislative bodies that are involved.

What we're trying to do here is to manage a business more efficiently and at a less cost. With the cuts that are coming from Washington and in Albany, and filtering down to our municipalities, we're in a position where we must do things differently. And if that means that I can have the snow removed from our streets by outside vendors at a cheaper rate than I can do with my own Department of Public Works, then I have no alternative.

Obviously, there's many difficulties. There are many mine fields in the way. There are employee unions. There are airlines in this particular situation. But all of that can be overcome. You give us the mandated relief, which you've done; change some of the rules and regulations at Hancock; and we'll do the rest at the local level.

Mr. HORN. Well, we thank you, Mayor, because you've obviously done a very commendable job in Syracuse. Let me ask you a few

questions. You mentioned here London Heathrow, Gatwick Airports, and Toronto's imaginative venture. Have you had an opportunity to personally visit these areas?

Mr. BERNARDI. I have not, but I will be doing that with my commissioner of aviation in the very near future.

Mr. HORN. I think you make an excellent point where you talk about the current Federal law, which requires repayment by Syracuse of all of the Airport Improvement Program funds, rather than only the depreciated value that remains. As you may know, the chairman of the full committee and I are both on Transportation and Infrastructure. And he is, in essence, the ranking Republican on that committee, but he doesn't assert that because he's chairman of this committee. And he's on the Aviation Subcommittee of the Transportation and Infrastructure Committee. In that subcommittee, we really need to look at that and see if we can't change that formula. I've run into the same thing in Long Beach, where we had the situation of a very noisy airport that we were trying to get within the noise limits. Frankly, it may be that you could get more productive use out of that airport in many other ways, with Los Angeles International 20 minutes away.

So I think that's something that you made a good comment about. Let me ask you, on your interest in privatization—and I think I know the answer, but if I could hear it from you—is it based on the need for investment in the airport or savings in the city budget?

Mr. BERNARDI. Both.

Mr. HORN. Yes.

Mr. BERNARDI. We have a tremendous amount of land space at our airport. We're very fortunate. But the economic development that I would like to see there, I think, is inhibited by the restrictions that we have. Without getting into too much detail, now, there's the air side, there's the land side. I would like to believe that if the restriction of repayment of the Federal grants can be lifted, we could provide an opportunity for the private sector in our area to take a look at some opportunities on the land side that perhaps they couldn't do before.

There are many different ways to do it, from leases to direct sale of assets. But right now no one will listen, no one will pay attention because of the prohibitive financial amount of money that would have to be returned to the Federal Government.

Mr. HORN. The gentleman from Pennsylvania, Mr. Mascara.

Mr. MASCARA. Thank you very much, Mr. Chairman. Nobody, Mayor, has more respect than I do for local government leaders, such as yourself, mayors and county commissioners. I served for 15 years as a county commissioner. I operated an airport, which was a reliever for the International Airport of Greater Pittsburgh. We upgraded that facility because we thought it was vital to our economic development plans in Washington County, PA.

We made some major investments, along with the Federal Government, to put in an ILS system—an Instrument Landing System—and upgraded our aprons. We extended our runway to 5,000 feet because we needed to get businesses into Washington County. And it paid off. I have some concerns about privatization generally, but in this case, specifically because of my close ties to economic

development in Washington County, and the importance of safety at our airport and other matters, as I'm sure you're concerned about.

My question is concerning the McIntosh bill and relieving the repayment of Federal grants when selling and leasing these facilities. Isn't that some kind of form of corporate subsidy to the private sector? I would have a serious problem with that. I mean, I know your plight as a city mayor, but isn't it sort of an oxymoron to, on the one hand, talk about the problems associated with the Federal deficit, and then to come back and say, well, we want the Federal Government to forgive these grants?

And that's not only for Syracuse, it's for the entire country. Does anybody have any numbers—in your case, do you have any numbers in your city, what it would cost the Federal Government if we were to forgive these grants? Because I'll tell you right now, my county commissioners back in Washington County would be celebrating at the thought of perhaps they would not have to repay if they sold that to a private group.

Mr. BERNARDI. I believe it's in the $60 million range. And you're right. However, as I understand it, with the cuts that are coming, there's going to be less funding available for airport improvement projects in the future; at least, I would assume so. And we will not be able to continue to make the necessary improvements and develop the economic climate that we'd like, based on the fact that the Federal Government, I believe, is going to provide less and less dollars.

So as an incentive, if you will, for the municipality, the city of Syracuse, other cities, to involve the private sector, I think that kind of an incentive, if you will, is a—money has been spent by the Federal Government in so many different ways, not repaying a grant, I think, is a—obviously you'd like to have all the money back that you've put into a particular project.

But in this case, in these cases, I feel very strongly that that would provide us with the necessary incentive to attract the private sector to do many varied other things at an airport that we presently can't do because of that restriction.

Mr. HORN. If I can follow up on that for a second, it is a grant, not a loan, from the Federal Government. So in any case, it does not get repaid to the Federal Government. It is given to the municipality or the county or the special district, whatever, to improve the airport as sort of the beneficence of the Department of Transportation and the Federal Government.

So there's no money coming back now, and if you provided that the depreciated amount would have to come back, you'd be ahead of where we are now. Am I wrong on that?

Mr. BERNARDI. No, you're correct. The Executive order by President Bush in 1992, it first stated that State and local governments receive their full, unadjusted portion of the project's cost, and then second, the Federal Government is repaid the amount of Federal grant awards, less accumulated depreciations. So indeed, they are grants.

Mr. MASCARA. Mr. Chairman, my——

Mr. HORN. If you'll excuse me a minute, without objection, at this point in the hearing, we will put in Executive Order 12803, Infra-

structure Privatization, dated April 30, 1992, signed by the then-President of the United States, George Bush.

[The material referred to follows:]

EXECUTIVE ORDER 12803 OF APRIL 30, 1992

INFRASTRUCTURE PRIVATIZATION

By the authority vested in me as President by the Constitution and the laws of the United States of America, and in order to ensure that the United States achieves the most beneficial economic use of its resources, it is hereby ordered as follows:

Section 1. Definitions. For purposes of this order:

(a) "Privatization" means the disposition or transfer of an infrastructure asset, such as by sale or by long-term lease, from a State or local government to a private party.

(b) "Infrastructure asset" means any asset financed in whole or in part by the Federal Government and needed for the functioning of the economy. Examples of such assets include, but are not limited to: roads, tunnels, bridges, electricity supply facilities, mass transit, rail transportation, airports, ports, waterways, water supply facilities, recycling and wastewater treatment facilities, solid waste disposal facilities, housing, schools, prisons, and hospitals.

(c) "Originally authorized purposes" means the general objectives of the original grant program; however, the term is not intended to include every condition required for a grantee to have obtained the original grant.

(d) "Transfer price" means: (i) the amount paid or to be paid by a private party for an infrastructure asset, if the asset is transferred as a result of competitive bidding; or (ii) the appraised value of an infrastructure asset, as determined by the head of the executive department or agency and the Director of the Office of Management and Budget, if the asset is not transferred as a result of competitive bidding.

(e) "State and local governments" means the government of any State of the United States, the District of Columbia, any commonwealth, territory, or possession of the United States, and any county, municipality, city, town, township, local public authority, school district, special district, intrastate district, regional or interstate governmental entity, council of governments, and any agency or instrumentality of a local government, and any federally recognized Indian Tribe.

Sec. 2. Fundamental Principles. Executive departments and agencies shall be guided by the following objectives and principles: (a) Adequate and well-maintained infrastructure is critical to economic growth. Consistent with the principles of federalism enumerated in Executive Order No. 12612, and in order to allow the private sector to provide for infrastructure modernization and expansion, State and local governments should have greater freedom to privatize infrastructure assets.

(b) Private enterprise and competitively driven improvements are the foundation of our Nation's economy and economic growth. Federal financing of infrastructure assets should not act as a barrier to the achievement of economic efficiencies through additional private market financing or competitive practices, or both.

(c) State and local governments are in the best position to assess and respond to local needs. State and local governments should, subject to assuring continued compliance with Federal requirements that public use be on reasonable and nondiscriminatory terms, have maximum possible freedom to make decisions concerning the maintenance and disposition of their federally financed infrastructure assets.

(d) User fees are generally more efficient than general taxes as a means to support infrastructure assets. Privatization transactions should be structured so as not to result in unreasonable increases in charges to users.

Sec. 3. Privatization Initiative. To the extent permitted by law, the head of each executive department and agency shall undertake the following actions:

(a) Review those procedures affecting the management and disposition of federally financed infrastructure assets owned by State and local governments and modify those procedures to encourage appropriate privatization of such assets consistent with this order;

(b) Assist State and local governments in their efforts to advance the objectives of this order; and

(c) Approve State and local governments' requests to privatize infrastructure assets, consistent with the criteria in section 4 of this order and, where necessary, grant exceptions to the disposition requirements of the "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Govern-

ments" common rule, or other relevant rules or regulations, for infrastructure assets; provided that the transfer price shall be distributed, as paid, in the following manner: (i) State and local governments shall first recoup in full the unadjusted dollar amount of their portion of total project costs (including any transaction and fix-up costs they incur) associated with the infrastructure asset involved; (ii) if proceeds remain, then the Federal Government shall recoup in full the amount of Federal grant awards associated with the infrastructure asset, less the applicable share of accumulated depreciation on such asset (calculated using the Internal Revenue Service accelerated depreciation schedule for the categories of assets in question); and (iii) finally, the State and local governments shall keep any remaining proceeds.

Sec. 4. Criteria. To the extent permitted by law, the head of an executive department or agency shall approve a request in accordance with section 3(c) of this order only if the grantee: (a) Agrees to use the proceeds described in section 3(c)(iii) of this order only for investment in additional infrastructure assets (after public notice of the proposed investment), or for debt or tax reduction; and

(b) Demonstrates that a market mechanism, legally enforceable agreement, or regulatory mechanism will ensure that: (i) the infrastructure asset or assets will continue to be used for their originally authorized purposes, as long as needed for those purposes, even if the purchaser becomes insolvent or is otherwise hindered from fulfilling the originally authorized purposes; and (ii) user charges will be consistent with any current Federal conditions that protect users and the public by limiting the charges.

Sec. 5. Government-wide Coordination and Review. In implementing Executive Order Nos. 12291 and 12498 and OMB Circular No. A-19, the Office of Management and Budget, to the extent permitted by law and consistent with the provisions of those authorities, shall take action to ensure that the policies of the executive departments and agencies are consistent with the principles, criteria, and requirements of this order. The Office of Management and Budget shall review the results of implementing this order and report thereon to the President 1 year after the date of this order.

Sec. 6. Preservation of Existing Authority. Nothing in this order is in any way intended to limit any existing authority of the heads of executive departments and agencies to approve privatization proposals that are otherwise consistent with law.

Sec. 7. Judicial Review. This order is intended only to improve the internal management of the executive branch, and is not intended to create any right or benefit, substantive or procedural, enforceable by a party against the United States, its agencies or instrumentalities, its officers or employees, or any other person.

GEORGE BUSH
THE WHITE HOUSE,
April 30, 1992.

Mr. HORN. Yes, the gentleman from Pennsylvania, please.

Mr. MASCARA. Mr. Chairman, my point was that the private sector will be taking advantage of the Federal grants and loans, whatever they might be. In this case, they're all grants. But the private sector, then, by assuming the airport and purchasing that airport, they will not reimburse, dollar for dollar, for the improvements that went into that.

Mr. BERNARDI. Well, the assessed value of that airport would be determined, and obviously, no one would be salient or leasing an asset that would not be based on what that particular piece of real estate is worth at this time.

Mr. MASCARA. I see.

Mr. HORN. The gentleman from Virginia, Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman. Mayor Bernardi, it's been a pleasure to have you here. I've worked close with Jim Walsh on a number of District of Columbia related issues and——

Mr. BERNARDI. You're having fun, then.

Mr. DAVIS. Yes, we're having a great time. But that's a subject for another day. I was the head of——

Mr. HORN. I'd say we have some other mayors, then, in this hearing and other hearings.

Mr. DAVIS. Exactly. I was the chairman of our county board, but functioned as the mayor, out in Fairfax County, where we operated a city government—it's a county under Virginia law, but the same kind of issues. It's a county of 900,000 people. And we also went to privatization. Trying to bring competition to government, was our goal.

The goal wasn't to privatize, it was to bring some competitiveness to your costs and test whether you were charging the right amounts or not for some of the ways we were doing business. I wanted to ask if there are any other areas you're looking at for privatization opportunities in the city.

Mr. BERNARDI. Yes. Earlier, I mentioned that we're looking at our tax-delinquent properties, privatizing those. We're looking to the sale and lease-back of vehicles and other equipment. We're going to be selling a couple of our golf courses, all of our real estate. The possibility of the competition aspect with sold waste removal—we're going to take one of the quadrants of our city and——

Mr. DAVIS. Let me ask you about solid waste removal. In my jurisdiction, part of it was done by the municipality and part of it was privatized. And it was a nice balance to keep everybody straight, keep the prices down, keep the city honest, too.

Mr. BERNARDI. We want our public employees, or laborers in the Department of Public Works, to be competitive. And we're looking very closely at privatizing one of our five quadrants.

Mr. DAVIS. Yes. That was how we started. We ended up, now, it's maybe 60–40. But we have both, and different quadrants can switch from time to time if they don't feel they're getting their money's worth. What I wanted to ask, though, is, since private waste collection fees are not tax deductible, but city property taxes are, is that a disincentive in the Federal tax system to privatization? Have you thought that through?

Mr. BERNARDI. Not really, no.

Mr. DAVIS. OK. You can do trash collection, for example, in a couple different ways. If you call it a trash collection fee, it's not deductible. But if you make it part of the property tax——

Mr. BERNARDI. It's part of our property tax.

Mr. DAVIS. Then it's deductible.

Mr. BERNARDI. It is deductible.

Mr. DAVIS. But you let the private sector come in, all of a sudden, you take that deductible payment out and it's a nondeductible payment. And I just wondered if you have any reflections on it either now or later. That's something we can address at the Federal level.

Mr. BERNARDI. Well, with our shortfall that we're experiencing in the city of Syracuse, I don't believe the tax rate would be going down if we privatized part of our solid waste collection.

Mr. DAVIS. Right, OK. I think that was my question, as we look at it. I appreciate the job you're doing. I just note that when I took over our county, we had a $200 million deficit. My only advice is, get it over right away. The longer it lingers, the tougher it gets.

Mr. BERNARDI. It's quite a challenge.

Mr. DAVIS. Yes, good luck.

Mr. BERNARDI. Whenever I get together with the mayors throughout New York State—the Big Six—we have a lot to talk about.

Mr. DAVIS. You've got the toughest job in the country, running a local government. But probably the most important in a lot of ways. Thank you.

Mr. BERNARDI. Thank you.

Mr. HORN. The gentleman from Pennsylvania has the last question.

Mr. MASCARA. Mayor, are the employees who would be effected—I'm not sure you're far along in the process of privatizing—given an opportunity to bid on purchasing these services or being able to provide those services for Syracuse? You have a group of 100 employees who do this now. Two questions, and I don't know whether you're unionized or not, and whether your union contract has a successor clause, where a company who would be absorbing this function would give these individuals the right of first refusal to do the work or to work for the company.

Mr. BERNARDI. Well, Congressman——

Mr. MASCARA. This is the human aspect.

Mr. BERNARDI. We have 114 employees who are very close out at our airport. And in the conversations that I've had to this point, both publicly and privately, we would do all that we could to make sure that if a company were to take over those services, that our employees would have the first opportunity to be part of that organization.

Mr. MASCARA. Thank you, Mayor.

Mr. BERNARDI. Absolutely.

Mr. MASCARA. Thank you.

Mr. HORN. We thank you very much, Mayor Bernardi. We appreciate you coming down here to share some of your ideas with us. And I hope they'll stimulate a lot of congressional discussion.

Mr. BERNARDI. Thank you. As difficult as our job is as mayors of cities throughout this country, this 104th Congress—you have your work cut out for you also. Thank you.

Mr. HORN. Thank you. I'd now like to call forward panel II, which will have three members in it: Mr. Jones; Mr. Leeds; Mr. Butler. And we will swear you in.

[Witnesses sworn.]

Mr. HORN. We'll start with Mr. Jones, Worldwide Privatization Coordinator for Arthur Andersen. Mr. Jones.

STATEMENT OF ANDREW JONES, WORLDWIDE PRIVATIZATION COORDINATOR, ARTHUR ANDERSEN; ROGER LEEDS, MANAGING DIRECTOR, BARENTS PLC; AND VIGGO BUTLER, PRESIDENT, LOCKHEED AIR TERMINAL

Mr. JONES. Thank you, Mr. Chairman. One of the issues that I guess is fundamental to the whole process of whether you privatize or don't privatize is the issue of whether privatization actually really creates efficiencies or whether it is merely a stimulus for change. Transferring something from the State sector into the private sector, you don't automatically create a miracle cure overnight for the functions that are being performed by government.

Privatization itself is merely the first step in the need to try to create efficiencies within government. It is the way in which you privatize companies which creates the efficiencies and the cost savings. A privatized company which is not forced to focus upon competitive aims or is not forced, for one reason or another, to function or to concentrate on trying to make its operations more efficient, will not achieve the savings that government would like to see from the privatization process.

The experience in the UK has been that privatized monopolies only achieve savings in the long run when the regulation is set in such a way that the privatized entities focus on trying to cut their own costs internally. Many people will argue that given that, why do we need to privatize anything; why can't we focus on the reinvention of government? One of the simple solutions to that is that reinvention itself is merely a process which the private sector is undertaking at the same time. And any private sector company will seek to make itself more efficient and more cost effective every year in order to keep pace with the competitive environment.

So at any one particular point in time, if the private sector is capable of doing something more efficiently than the government is, then the reinvention process will not necessarily get you any further forward because the private sector itself is undergoing the same process, and in 12 months time, when you still compare the situation, you could easily find that although the cost to government has gone down, there is still a differential between the way in which government performs the functional service and the private sector.

Some of the lessons learned, coming back to that, is that it's very important to take time to work out whether privatization is the right option. Privatization for privatization's sake does not necessarily result in cost savings to government. Doing a clear analysis and working out which method of operation, whether it be reinvention or whether it be contracting out or whether it be a straightforward sale in some form or other to the private sector, will result in the best savings not only in the short term but also, more importantly, in the long term.

The analysis was put earlier this afternoon about winning the lottery. And I think one of the important considerations is whilst receiving large sums of money when you sell a function to the private sector is important in terms of seeking to reduce deficits, one has to consider when one looks at whether it's a monopoly or a competitive environment the new company will face, is the actual way in which the cost savings will be achieved versus the cost that you actually sold that company for.

Regulation is fundamental to ensuring that where there isn't effective competition in the private sector for the entity being transferred, that the cost savings are achieved. Another issue is whether entities or functions of government services should be restructured and given an opportunity to perform along the lines of the private sector, prior to any privatization taking place.

To take an entity which is not focused upon cost, is not focused upon revenues, and merely transferring it into the private sector will not necessarily see the savings that the government is looking for. In many cases it is necessary to restructure the entity prior to

privatization. Not only will this provide a track record for that particular function as to how it performs both on a revenue basis and a cost basis, but it will also enable that entity to focus on getting those cost savings down and maximizing the proceeds that the government receives for the sale.

Finally, on the lessons learned front, I think the idea of privatization needs to include a detailed analysis of what the costs are that you will incur in the process of privatization. It is fine to look at a particular function on a purely financial basis and say, well, yes, it could be performed more efficiently by the private sector. That is not the end of the story. You need to consider in detail how much it's going to cost you to take this privatization and enact it.

There are many costs, many of which relate to the need to look after your employees in an appropriate way. And by the time you've taken in all these costs, and that includes the cost of advisors, it is necessary to look at the long-term position and see whether you actually end up with long-term savings. Some of the major barriers that exist in the United States to privatization, in my view, focus on the way in which you have to deal with employment law and conflict of interest laws.

The issue over pension funds in this country for State and Federal employees is such that, for those Federal employees who are members of CSRS, they have no ability to transfer that pension fund if they move out into the private sector. This in itself is a disincentive to those employees to transfer, particularly senior employees who have been with the Federal Government or with that function for a long term, and whose experience might be critical to any private sector company seeking to perform those functions that are being transferred.

In addition to that, there are the conflict of interest laws which seem, in my understanding, to prohibit existing employees of a function from bidding to take over or perform that function in the private sector, should they be able to put a bid together, which would be cheaper than any existing private sector company. It is very easy to separate out the sale process from the continuing performance of that function within an agency within the Federal Government.

And the conflict of interest laws, in my view, prohibit that ability to separate those two out and allow the employees to bid. In the United Kingdom, there are various guidelines which are published by the government. And one of the things they encourage agencies to look at in detail is the need to allow the management or employees to but out a particular function, should the need arise.

I have in front of me a detailed list of the guidelines to people in various agencies in the United Kingdom. And they say the responsibility for running the activity to be privatized should be separated from that of selling it. Departments should consider establishing privatization unit with responsibility for conducting the sale and dealing with potential purchasers, including any management employee group.

The department may provide the management employee team with financial support to pay advisors where necessary. A similar approach within the United States——

Mr. HORN. I wonder if this is confidential material, or can we include it as an exhibit in the record?

Mr. JONES. I would imagine that there is no confidentiality aspect over it, otherwise they wouldn't have faxed it to me. [Laughter.]

Mr. HORN. Well, at least it wasn't on the Internet. Without objection, then, it will be put in the record such as you would see deemed fit.

Mr. JONES. By encouraging the employees to participate, you encourage them to focus on the process. You give them some incentive to participate in the process. Employee participation in the privatization process is a key element of its success. I think those are the major areas that I wanted to concentrate in covering in testimony that I prepared for the written statement.

I would like to thank the committee for the opportunity to speak, and hope that I will be able to assist you as the process evolves. Thank you.

[The prepared statement of Mr. Jones and the guidelines referred to follow:]

PREPARED STATEMENT OF ANDREW JONES, WORLDWIDE PRIVATIZATION COORDINATOR, ARTHUR ANDERSEN

INTRODUCTION

Good afternoon. My name is Andrew Jones. I am a senior manager at Arthur Andersen responsible for coordinating our world-wide privatization activities.

I am here today as someone who has witnessed the privatization program in the UK, its impact on government agencies, some of the problems encountered and solutions proposed, and as someone who is currently involved in the efforts of the United States General Services Administration to seek out the way to deliver quality services in the most cost effective way to the taxpayer.

Over the last two years there has been much discussion centered on how government can work better and cost less. Recently this focus has led to discussions on whether or to what extent, the private sector should be performing many of the activities, functions and services currently being performed by the government.

WHY AND WHEN TO PRIVATIZE

Privatization has become a world-wide phenomenon largely due to privatization's ability to improve performance and reduce the cost of government. However, it is important to understand the exact make up of these costs that can be saved. Generally excess cost can be split into two components, procurement related and operation related.

The cost savings that will be realized through privatization are those that result from the ability of the private sector to carry out the tasks of the agency in a more cost effective manner.

Almost any function performed by government today can be privatized. The key to this decision relies on two elements:

First, where the safety of the taxpayer is dependent upon that function, e.g. Army, Navy, Air Force, Police, Fire and Ambulance etc., most people agree that these functions should remain within the control of government.

The question of whether to privatize other functions is more complex. Should the decision be a matter of principle or a financial matter? If the government can demonstrate that it can perform a function at the same quality level but at a lower cost to the taxpayer than the private sector is it reasonable for that function to remain government owned?

The answer to this question depends upon whether it is believed that government is inherently inefficient and that if a function is efficient now then it won't be long before it becomes inefficient. If this argument is believed then any function currently performed by both government and the private sector should be privatized.

If, however, you believe as I do that there are certain functions that for one reason or another can be performed more efficiently by government, then they should remain so.

The decision as to what to privatize then becomes a financial one of comparing the annual savings in cost that could be made against the initial costs of privatization. Any function with a positive net present value should be privatized.

One of the problems with this analysis is the ability to gather meaningful internal cost data with which to compare performance with the private sector. Most agencies account for expenses on an obligation rather than a direct cost basis.

In a time when agencies' budgets are decreasing the revenue or cost data will typically be higher than obligation data. In order to make a meaningful benchmark against the private sector cost data must be used. When such data is not available difficulties occur with the analysis and assumptions have to be made to crosswalk between the two sets of data

TAKE TIME TO MAKE THE RIGHT DECISION

One of the most significant pitfalls that legislators can fall into is trying to drive the process too fast. The failure to take sufficient time to ensure that the right decision is made, can have disastrous results on performance and quality leading in the long run to increases in cost.

For agencies looking to contract out or sell functions to private sector, the need to ensure the right decision is made and that privatization is not enacted for privatization sake is equally important.

Equally important is the need to ensure that all the costs of privatization have been considered and accounted for in the decision making process. In addition to the usual financial costs there are significant costs that can be incurred with regard to personnel.

HUMAN RESOURCES

The impact of privatization on human resources and how it is treated is a major factor behind the success of privatizations in the past. The benefits of privatization will be lost if government or management fail to make some of the difficult decisions concerning FTE (Full Time Equivalents).

If the employees believe that management is at least considering their interests, then they will "buy in" to the process to a greater extent which in turn ensures that the privatization has a greater chance for success.

The other important consideration is the need to identify the true costs of privatization.

Under current legislation any plan to outsource or privatize a function of a government agency will result in the need for a Reduction In Force ("RIF"). This process can only be avoided if legislation is passed amending the statute or if the conditions that lead to a RIF are not met.

Unless employees can be given incentives to transfer to the private sector and those who do not can be relocated within government a RIF cannot be avoided without a change in legislation.

A key element of the RIF process in relation to the categories is the determination of competitive areas. A competitive area defines the geographic boundaries of the RIF. In many agencies, competitive areas are currently based on services and are invariably different to the components of a privatization program.

In some cases the privatization analysis will be dependent upon the ability of the business line to select those employees within the business line who will be required as part of the continuing oversight operation. Under current law, the option selected may require a RIF. Such a RIF may frustrate agency management's ability to assure that critical employees experienced in a business line remain to perform the function. The potential savings may then be lost, unless a RIF can be avoided.

In the case of USEC, the combination of sufficient vacancies in the government corporation, voluntary employee movement, and an option to detail employees from (and return them to) the parent agency (DoE) removed the need to have a RIF.

Employees, particularly those with a high seniority, those close to retirement and long serving employees will receive a significant benefit package, and will be reluctant to transfer due to the loss of these benefits and the lack of portability of the Federal pension scheme CSRS (Civil Service Retirement System). The private sector is unlikely to be willing to provide make up packages and so the government must make the payments necessary to ensure sufficient numbers transfer.

If an insufficient number transfer then the agency will be left with large numbers of staff who will require relocation within the agency which reduces the savings from privatization. Since the cost of the contract remains the same the net effect is that the privatization decision may not create real savings to government.

Other benefits such as Health, severance and retirement/pension benefits and whether employees who transfer to the private sector are able to maintain these benefits are other issues that must be considered.

In the UK government employees involved in privatization have certain rights under the Acquired Rights Directive implemented in the UK through the Transfer of Undertakings (Protection of Employment) Regulations 1981 and subsequent measures collectively known as "TUPE". This implies that:

> Staff are entitled to transfer with their jobs to the new owner on the same terms and conditions of employment including rights to compensation for redundancy that they enjoyed with the agency.

Whilst TUPE does not preserve for staff an entitlement to the same pension rights in their new employment the government, to avoid the risk that a case for constructive dismissal may be brought, required bidders to offer a pension scheme which was broadly comparable to that which the staff received at the agency.

With regard to accrued pension benefits earned by staff social security legislation in the UK provides three options for staff; to preserve the benefits in the Principal Civil Service Pension Scheme; to transfer them to new owner's scheme; or to transfer them to a personal pension scheme.

With regard to severance entitlements the government in the UK is under no legislative requirement to guarantee severance entitlements in the event that the company goes into liquidation without the resources to meet the obligations. However, to avoid delay and ensure a smoother process they agreed to guarantee individual employees who transferred with the business their accrued civil service redundancy entitlements for a period of three years from the date of sale.

In the US the Civil Service Retirement System is not as portable as its UK equivalent and employees are not able to transfer their benefits into either the new owner's pension scheme or a personal pension scheme. In addition the scheme is severely unfunded and if legislation was passed to allow transferability, the initial funding cost to the government would be huge. However, conversely, there is no legislation in the US that requires the new owner to provide the same level of benefits as provided by the federal government.

Consequently, there is much less protection in the US for employees transferred into the private sector.

LESSONS LEARNED

Every privatization is unique, has a different set of parameters, external influences and financial considerations and will require a unique solution. While we can learn from the experiences of others the one most overriding lesson is to ensure that the decisions are not made hastily whether through impatience, political or any other motive. Time must be taken to ensure that all the costs have been considered and that the decision is made on complete information.

One of the most important aspects, however, that can be learned from past experience is how to regulate, if at all, newly privatized businesses, particularly monopolistic government corporations. Many different types of regulation have been used to ensure the interest of the taxpayer (customer) is maintained post privatization. Some have been more successful than others in promoting competition, cost reduction and increased service. By reviewing the experiences of other countries a more informed decision on the most appropriate form of legislation can be made.

CONCLUSION

One can never hope to provide a comprehensive list of issues in the few minutes available but these are some of the major issues confronting agencies considering privatization. For almost every case Congress will be required to pass legislation in one form or another. By considering/understanding some of the roadblocks that prevent privatization in advance Congress is taking large steps in the right direction to ease this difficult process. I am grateful for the opportunity to participate in this discussion and look forward to opportunities to work with this subcommittee as this process evolves.

Thank you. I would be pleased to answer any questions.

PRIVATISATION OF CENTRAL GOVERNMENT ACTIVITIES

Guidance for departments

HM Treasury
January 1995

CONTENTS

1. Introduction 1
   - Identifying possible privatisation candidates 1
   - Speed of the process 1
2. Preparing the business for sale 2
   - Initial steps 2
   - Feasibility study 3
   - Preparation for privatisation if it is decided to sell 4
   - Accommodation 5
   - EC law 5
3. The sale process 6
   - Appointment of privatisation advisers 6
   - The method of privatisation 6
   - Trade sales 7
4. Disengagement and post-sale involvement 9
5. Costs and budgetary issues 10
6. Staff issues 11
   - Consultation 11
   - Terms and conditions of employment and redundancy payments 11
   - Pensions 11
   - Redundancy entitlements 12
   - Options for staff facing privatisation 12
   - Staff records 12

Annex A: List of contacts 14

Annex B: Bibliography 16

Annex C. Checklist of the key stages in a trade sale 18

Annex D: Extract from TUPE regulations, as amended by the Turer Act 1993 19

1. INTRODUCTION

1.1. This guidance summarises the main issues that Government departments and executive agencies need to consider during the process of privatising -normally through a trade sale- a Civil Service business or activity. It applies equally to executive NDPBs who should follow the same procedures. It is not intended that it should apply to the privatisation of nationalised industries.

1.2. The document is intended as a general guide which cross refers to a number of existing guidance notes. A list of contact points, mainly in the Treasury, is at Annex A; and a bibliography is at Annex B. Departments are advised to consult the relevant Treasury expenditure division at an early stage if they are contemplating making a privatisation. They should give staff and recognised trade unions the opportunity to comment at an early stage where privatisation looks probable.

1.3. The NAO have a right of access to papers relating to a privatisation to enable it to carry out a financial and value for money audit. Such access is limited to documents in the possession of the department. In the case of a major sale, the Comptroller and Auditor General is likely to examine the extent to which the vendor has achieved the sale objectives, including maximising value for money. A report may be presented to Parliament under Section 9 of the National Audit Act 1983.

Identifying possible privatisation candidates

1.4. An activity will normally be identified as a possible candidate for privatisation either in the department's annual Efficiency Plan, or following a "prior options" review to establish whether it should be abolished, privatised, strategically contracted out, market tested or given agency status. The Treasury and OPSS should be consulted about the outcome of such reviews. Activities which may be suitable candidates for privatisation include those already established on a customer/supplier relationship with departmental or agency headquarters; those that do not contribute directly to the department's or agency's central objectives; and those already performed under contract by the private sector.

Speed of the process

1.5. In some cases, it may be possible to privatise an activity quickly. However, where there is no trading record, it may be desirable for the activity to be established on a commercial footing with an appropriate accounting framework before sale.

2. PREPARING THE BUSINESS FOR SALE

Initial steps

2.1. The scope and nature of the function to be privatised needs to be clearly identified. In some cases, Ministers may decide that parts of an activity should remain in Government control for operational, statutory or market reasons. In such circumstances it may be necessary to restructure the activity. Departments and agencies should consult staff and recognised trade unions about the implications of any decision to retain in part, or restructure, government activities.

2.2. It may be desirable to sell the business as a single entity; or it may be split up and parts sold individually. The decision will be determined by factors such as the size and character of the business; the way it is structured; its likely commercial attractiveness; the need to ensure or create a competitive market post-sale; and which route is likely to maximise potential sale proceeds.

2.3. Before an activity can be privatised, it is desirable for it to be given as much commercial exposure as is practicable and to develop a commercial track record. Accounting and commercial deficiencies may need to be remedied. In particular:

- commercial skills and expertise might be injected into the business, eg by employing accounting, marketing and contract specialists;
- running costs status might be changed from gross to net control, possibly as a stepping stone to trading fund status or the business being run as a Government owned Companies Act company (GOCO). It might alternatively be converted directly to a trading fund or a GOCO. Various conditions have to be met, including complying with the 1932 PAC Concordat which constrains departments' abilities to own and run companies other than for brief periods. Any change in status has to be approved by the Treasury;
- intra-Government trading relationships should be established on an arms-length basis, with documentation that can easily be converted into a contractual form which becomes legally binding at the point of sale (see CUP Guidance Note 42, "Contracting for the Provision of Services", for information about the standard terms and conditions that might apply in contracts for the provision of services);
- financial and other performance targets should be established;
- accruals based accounts should be introduced;
- the business' client base might be expanded to increase its chance of success in the private sector and its value as a going concern.

However, in line with the Government's policy on selling services into wider markets (set out in PFO/91/1), this is only appropriate where a firm commitment to privatise has been announced.

The degree of progress towards establishing a commercial track record, and expanding the client base, before privatisation may involve difficult judgements about where the balance of advantage lies since such preparatory work is likely to involve significant costs, and some risks, and may delay the timing of the sale.

2. 4. Comprehensive information on the past, present and future financial position of the activity (eg statements of profit and loss, cash flow, balance sheet projections and capital requirements) should be prepared where practicable. Historic accounting information should be audited. Poor financial information on viability and prospects is likely to result in lower bids, although a balance has to be struck between detail and quality, proceeds and delay. The provision of such information may require the creation of new planning, budgeting, accounting and management reporting systems.

2. 5. The implications of the Fair Trading Act 1973 and European competition law will also need to be considered. The privatisation must be structured in such a way as to avoid infringement of the rules and, where necessary, appropriate authorisations may need to be obtained from the UK and European competition authorities. Otherwise, Government as well as the privatised company could risk liability. A trade sale could also create a merger that would fall to be considered by either the UK or the European competition authorities. (For more information, consult DTI's Guidance on UK and EC Competition Procedures for Trade Sales and NIP(90)3 paragraph 14.) In any event, DTI's competition policy division should be consulted at an early stage of privatisation plans. Departments are also advised to consider the state of competition in the relevant industry and how this might impact on future prices and relations with the supplier.

Feasibility study

2. 6. A financial adviser - normally a merchant bank or firm of accountants - should be appointed to advise on the feasibility of a sale. The vendor department should make the appointment by competitive tender to ensure fairness and value for money.

2. 7. The financial adviser should prepare an initial report on the feasibility and financial implications of the sale, and should be given full access to information relevant to the commercial viability of the business to be sold. The outcome of this report may affect the timing, method and structure of the sale.

2. 8. The Treasury's PE3 division can advise on the procedures for appointing advisers and are preparing guidance: see NIP(94)1 for a directory of advisers

appointed in the privatisation programme; and paragraphs 19-23 of NIP(90)3 on financial advisers and feasibility studies.

2.9. Depending on the relative importance of the business to their own activities, customers within government should be consulted prior to making a decision to privatise (and kept in touch subsequently).

Preparation for privatisation if it is decided to sell

2.10. Departmental lawyers should be consulted as early as possible about whether fresh legislation is needed to privatise a business.

2.11. A judgement needs to be made on a case by case basis as to whether a management and employee buy-out (MEBO) should be facilitated, merely entertained or ruled out at an early stage. Paragraphs 10 and 11 of NIP(90)3 discusses the advantages and disadvantages of a MEBO.

2.12. Where there is a MEBO proposal, procedures need to be established to ensure that officials involved in purchasing the business do not act in a way that could result in their private interest conflicting with their continuing public responsibilities. Responsibility for running the activity to be privatised should be separated from that of selling it. Departments should consider establishing a privatisation unit with responsibility for conducting the sale and dealing with potential purchasers, including any MEBO. (See NIP(90)3, paragraphs 30-35, for further advice.) The department may provide the MEBO team with financial support to pay advisers (which is repaid if the MEBO bid is successful).

2.13. Departments may find it helpful to establish a steering group to coordinate the concerns of the various interested parties. Such a group should comprise representatives of the vendor department or agency, the business (unless a MEBO had been launched), the professional advisers and the Treasury.

2.14. The business may have to be streamlined or restructured in the run up to the sale. For example, decisions may be required on site closures, asset sales, changing the management structure, staff transfers and the handling of redundancies. Such decisions must take account of the department's or agency's equal opportunities policies. The normal departmental and agency arrangements for consultation concerning transfers, relocations or redundancies should apply. (NIP(90)3, paragraph 46, gives guidance on the preparatory work that might be needed where the activity to be sold provides goods and services to public sector customers.)

2.15. Provision may need to be made for special shares in certain narrowly-defined circumstances, principally where the business being sold has had associations with national security or defence, or is of strategic importance. (See NIP(94)2 on special rights shares.)

[illegible] business as a Government Owned Companies Act Company (GOCO) immediately prior to privatisation. However, a direct transfer to the purchaser may be possible in certain circumstances. The appropriate timing for vesting will vary from case to case. (See NIP(90)3, paragraphs 65-67.)

Accommodation

2.17. Consideration is needed at the outset as to how best to handle the accommodation consequences of privatisation. The main options available are:

- in the case of singly occupied buildings, selling the accommodation with the business.
- allowing the privatised business to remain temporarily within government-owned accommodation. (This could be the case in a jointly occupied building where the department or agency has alternative plans for the accommodation.) Legal advice will be required on the terms of the temporary letting.
- allowing the business to remain in government accommodation on a longer-term basis. (This could apply where there are operational advantages in co-location.)
- allowing the purchaser of the business to use its own property.

2.18. In appraising these options, Property Holdings should be consulted about issues relating to accommodation on the Common User Estate.

EC law

2.19. European Union regulations need to be considered. There may be State Aid Directive implications if there are transactions involving the provision of Government assistance to the business on privatisation. DTI's European Community and Trade Relations Division can advise. If a proposed privatisation will involve procurement, EC Procurement Directives may apply. Departments' Procurement Units and the Treasury's PSP Division can advise.

3. THE SALE PROCESS

Appointment of privatisation advisers

3. 1. A range of advisers should be appointed by the department to assist with the privatisation:

- for **public flotations**, a city institution (eg a merchant bank) needs to sponsor the issue. Legal and other specialist advice will also be needed;
- for **trade sales**, a financial adviser will need to be appointed (this may be the same merchant bank or accountancy firm that conducted the feasibility study provided the department can achieve best value for money by such an appointment). Reporting accountants, property valuers and legal advisers are also usually necessary. (See NIP(90)3 paragraphs 56-59 for further details: the Treasury's PE3 division can advise on the procedures for appointing advisers.)

The method of privatisation

3. 2. There are two main alternatives - public flotation or trade sale. Public flotations are very costly and are only appropriate for large businesses, where there is expected to be a wide range of institutional or public demand for shares. The Treasury's PE3 division should be consulted for fuller guidance on what is involved in a public flotation. Most departmental and agency privatisations are likely to be trade sales. Trade sales usually involve a single commercial purchaser or consortium (where there are no competition policy objections) but, in some cases, it may be appropriate to split the business into components (eg regions) and sell each one separately.

3. 3. There are occasional examples where the particular circumstances of a business means an alternative method of transfer to the private sector may be appropriate. Possibilities include.

- **transferring ownership to a university** or other independent organisation through a private sale. This would achieve less than a standard trade sale in terms of introducting commercial disciplines and freedoms and it may entail a dowry. However it would secure a clean break from Government and could enhance the output and quality of the new organisation and improve staff's career opportunities.
- **privatisation as a company limited by guarantee.** This involves transferring the business to a company limited by guarantee which will often be a non profit making body. Ultimate control is left with the existing management team or with an independent body in the private sector. There is no equity capital. As with a trade sale, the company has to provide what customers want to survive; but if it is not, and cannot be, controlled by an organisation with a vested interest, customers may

perceive such a company as retaining its independence and impartiality which may help to retain some customers. On the other hand, with no shareholder pressure, the incentive to maximise use of assets is limited and with no access to equity capital, the company is vulnerable to any downturn in business. The transfer may therefore entail a dowry. For more information on this mechanism consult the Treasury's SMC division.

- **establishing a partnership with the private sector.** This brings private sector capital and expertise into the business with both the public and private sectors sharing risks and rewards. However control should rest with the private sector and the allocation of risk (and reward) between the contracting parties should be clearly defined. The Treasury's "Joint Ventures. Guidance for Departments" gives further details.

Trade sales

3. 4. NIP(90)3 gives detailed information on the principles and procedures for handling trade sales, including management and employee buy-outs. A checklist of the usual pattern of main stages involved in a trade sale is at Annex C.

3. 5. Clawback arrangements may be needed to allow the Government to capture part of the future value of assets, within a reasonable period after sale, where it has not been possible to reflect this value in the sale price, and where the vendor department judges that clawback would not have a disproportionately negative effect on sale consideration. One example where clawback may apply is the alternative use of surplus land (or other assets) which may later be sold on by the purchaser of the business for commercial development.

3. 6. Parliament should formally be informed of any impending sale through a written Parliamentary Question or other means, giving details explaining why privatisation is desirable. Additional information on the facts and analysis underlying the decision to privatise may need to be made publicly available.

3. 7. The business to be privatised should normally be advertised in the national and trade press and, where appropriate, internationally. (It is Government policy to consider overseas bidders.) The number and identity of the bidders should normally be regarded as commercial in confidence. Only general information about the business should be disseminated at this stage so as to encourage a wide response whilst ensuring commercial confidentiality.

3 8 An "Information Memorandum" should be prepared giving potential purchasers commercial, financial and management information about the business. Although there are no statutory disclosure requirements, the information must be accurate to avoid potential future litigation. Potential bidders sign a confidentiality agreement, pay an administration fee and are then allowed to examine the Information Memorandum.

3.9. Full draft sale documentation should also be prepared, in consultation with the financial and legal advisers and the reporting accountants, at an early stage in the sale process. Departments should make this documentation available to selected bidders at an appropriate stage. Bidders should be told that if they wish to propose changes to the documentation they should submit fully marked up documents with their bids.

3.10. When it is judged that all potential bidders have had adequate time to consider the Information Memorandum, a standard letter should be issued setting a date for the submission of indicative offers. Those potential purchasers who are considered by the financial adviser to have made an acceptable indicative offer should be given the chance to examine the business in more detail under the so-called "due diligence" procedure. Information made available at this stage should normally include a long-form accountant's report; and potential purchasers should be given access to all legal, business and commercial documents relevant to the business. A data room may need to be made available for this purpose.

3.11. Departments will need to consider the nature and timing of consultation with the trade unions about the sale documentation. It is desirable that trade union representatives have the opportunity to meet with shortlisted bidders so that they can commence discussions on transferring terms and conditions under TUPE regulations. These consultations would have to be conducted responsibly and in strict confidence.

3.12. A date should be set, through a formal tender letter, for the submission of final offers. Bids should be treated as commercial-in-confidence. Clear criteria for the assessment of bids by the advisers should be established, related to the sale objectives. It is important that departments should observe all undertakings given to bidders on timetable and procedures since failure to do so may result in legal action. Negotiations should then proceed with the preferred purchaser on the basis of the draft sale documentation.

3.13. The vendor department or agency must secure Treasury agreement that the sale consideration provides acceptable value for money; and that there is no dilution of the financial return subsequently as a result of clawback provisions, redundancy guarantees or other arrangements which have not been explicitly agreed with the Treasury.

3.14. A sale contract should be exchanged and completed as soon as possible.

4. DISENGAGEMENT AND POST-SALE INVOLVEMENT

4.1 The initial feasibility studies conducted by the professional advisers should have identified areas where the business to be disposed of is reliant on other public sector bodies. A programme of disengagement will need to be developed to cover issues such as:

- accounting systems;
- payroll;
- staffing;
- telecommunications;
- insurance;
- property rights;
- official records: and
- VAT registration.

Management control of the business between the exchange of contracts with the purchaser and the date of legal completion of the sale also may need to be considered.

4.2. Trade sale consideration is frequently related to the value of the net assets of the business. Consequently, the sale agreement should provide for the preparation by the vendor department of a completion balance sheet based on the policies, principles and practices used in preparing the business' most recent set of accounts. This information should be audited by the reporting accountants and agreed with the purchaser. Arbitration procedures will need to be specified if there is disagreement.

4.3. The Government generally prefers to make a clean break at privatisation, with no post sale involvement in the financial affairs or management of the business. This is consistent with the central principle of privatisation, namely that exposure to market pressures and the removal of Government support is the best way to promote efficiency to the benefit of the consumer. It is therefore Government policy not to grant sale warranties except in respect of its ownership of the shares being sold.

5. COSTS AND BUDGETARY ISSUES

5.1. Financial provision for the sale, and the necessary Vote accounting arrangements, should be agreed with the relevant Treasury expenditure division well in advance of the sale. (General guidance on procedures for handling these issues, and the treatment of sale costs and proceeds arising on privatisation, is given in NIP(92)3.)

5.2. As well as ensuring that the NAO has access to documents, provision of access to sale documentation for departments' own internal auditing purposes is important.

6. STAFF ISSUES

Consultation

6.1. Staff and recognised trade unions should be kept fully informed, and be consulted by management at the appropriate stages in the privatisation process. TUPE (Transfer of Undertakings Protection of Employment) regulations are likely to apply where staff are transferred into companies prior to privatisation; and these regulations impose a legal duty on employers to consult and provide information with a view to reaching agreement. (See the DEO letter of 28 May 1986 on "Transferring Work out of Departments-Consultation with the Unions". On the consultation requirements under TUPE, see paragraphs 10-11 of the Transfer of Undertakings Regulations 1981 SI 1794. The relevant TUPE regulations on consultation, as amended by the Trade Union and Employment Rights (TURER) Act 1993, are set out in Annex D.)

Terms and conditions of employment and redundancy payments

6.2. Legal advice should be taken as early as possible on whether TUPE applies to the sale. Under the TUPE regulations, employees' existing terms and conditions of employment (except occupational pension rights) pass unchanged when the activity is sold to a new employer. The transfer of staff under TUPE does not in itself occasion redundancy so no redundancy payments are made. Where TUPE does <u>not</u> apply, staff will be entitled to redundancy payments unless redeployed elsewhere. (However, where a transfer of an undertaking would require staff to move house, mobile staff transfer under TUPE while non-mobile ones have a choice of whether to transfer or not.) See Section 5 of the Government's "Guide to Market Testing" for detailed information on TUPE; and the Efficiency Unit's note of 27 September 1993 for a model of the information which might be sent to potential purchasers setting out Civil Servants' principal terms and conditions of employment.

Pensions

6.3. Pensions in the new employment are a matter for the new employer. The position on the options available to staff in respect of their accrued pension rights under the PCSPS; arrangements for transfer value payments to the new employer's pension scheme; and the considerations relating to pension rights with the new employer are described in paragraphs 5.15-5.19 of the Government's "Guide to Market Testing". Model forms, produced by and available from the Treasury's Civil Service Pensions Division, should be used by departments to inform staff about the options available for their accrued PCSPS pension rights and to enable them to make the appropriate choices. The department or agency must ensure that pension rights, overall, in the new

employment are broadly comparable to the PCSPS, or that staff are compensated (by improvements to other terms and conditions or otherwise). If not, there may be grounds for claims of constructive dismissal against the department or agency. The Government Actuary's Department will be able to advise whether the pensions rights offered are broadly comparable with the PCSPS and must therefore be consulted at an early stage.

Redundancy entitlements

6.4. Where TUPE applies, redundancy entitlements cannot be altered at the point of transfer. However, departments and agencies will need to consider staff concerns that redundancy entitlements in respect of public service might be changed, or not honoured, after transfer to the private sector. The strong presumption is against giving redundancy payments guarantees or other forms of redundancy assurance to staff but, if in doubt, departments and agencies should consult the Treasury. While negotiation of future redundancy entitlements are a matter for the future employer and staff, TUPE regulations place a duty on the department or agency to inform staff of any such changes which the new employer proposes to make.

Options for staff facing privatisation

6.5. Where TUPE applies, the presumption is that staff will transfer permanently with the privatised work (and the new employer may have made his bid on the basis of the transfer of certain key workers). While staff have the right to refuse to transfer where TUPE applies, if they do so there is no obligation to find them alternative work or to make a redundancy payment. The refusal can be treated as resignation.

6.6. In exceptional circumstances, vendor departments and agencies might consider the options of seconding staff to the new employer or transferring them to other work in the department (or elsewhere in Government). Such arrangements can only be made with the agreement of the prospective purchaser. Relevant considerations will include the need to ensure that enough staff are transferred to secure the viability of the future business; the scope for finding staff alternative employment in Government; and the cost of possible redundancies. Secondment is a difficult option where there is a TUPE transfer; and legal advice should be taken if departments and agencies are considering this approach.

Staff records

6.7. Certain staff information should be given to potential purchasers in cases where TUPE applies. Under the Data Protection Act, disclosure of personal information requires the permission of the individual. At the bid stage, therefore, transfers of information about staff should be the minimum necessary to allow potential purchasers to make firm bids and calculate

pension entitlements and should be provided in an anonymous, global form to ensure that confidentiality is not undermined. It is not always possible to conceal details of the most senior staff, but disclosure has to be made with their permission. Showing the trade union side the anonymised format in which personnel information is to be presented should reassure them. Any personal information should not generally be released until the new employer has taken over. (See also the Efficiency Unit's guidance of 18 August 1993 "TUPE Transfers: Confidentiality of Staff Records".)

ANNEX A

LIST OF CONTACTS

POLICY AND PROCEDURES FOR CENTRAL GOVERNMENT PRIVATISATIONS

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GENERAL PRIVATISATION POLICY AND PROCEDURES

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ANNEX B

BIBLIOGRAPHY

NIP(90)3 TRADE SALES INCLUDING MANAGEMENT AND EMPLOYEE BUY OUTS
Guidance on handling of trade sales. In particular this document offers advice on value for money matters and propriety especially where a MEBO is contemplated. (A revised version - provisionally NIP(94)3 - will issue in the near future.)

NIP(94)1 DIRECTORY OF ADVISERS APPOINTED IN THE PRIVATISATION PROGRAMME
Lists the firms which have acted in key advisory roles in the privatisation programme or which have sought appointment.

NIP(94)2 SPECIAL RIGHTS SHARES
Guidance on (limited) circumstances in which Government may seek to retain a Special or "Golden" Share in a privatised company to secure the national interest or to avoid early takeover.

NIP(92)3 PRIVATISATION: VOTE, PES AND OTHER COST ISSUES
General guidance on cost and budgetary issues, including the Vote treatment of privatisation costs and their treatment under the New Control Total.

NIP papers are available from PE3 division, HM Treasury (071 270 4778).

PFO/91/1 SELLING GOVERNMENT SERVICES INTO WIDER MARKETS
Guidance on when Government bodies should be prepared to sell services outside Government in competition with the private sector. Available from SMC division, HM Treasury (071 270 6213).

THE GOVERNMENT'S GUIDE TO MARKET TESTING
Detailed guidance on how to deal with each stage of the market testing process. HMSO, 1993. ISBN 0 11 430078 X

JOINT VENTURES, GUIDANCE FOR DEPARTMENTS
Advice on establishing partnerships with the private sector, issued on 16 March 1993. Available from Private Finance Unit, HM Treasury (071 270 5531).

TRANSFER OF UNDERTAKINGS (PROTECTION OF EMPLOYMENT) REGULATIONS. SI 1981 No 1794

CONTRACTING FOR THE PROVISION OF SERVICES. CENTRAL UNIT ON PROCUREMENT GUIDANCE NOTE NO. 42 - SEPTEMBER 1993
Advice on the use of contract terms and conditions for the provision of services.

GOVERNMENT ACCOUNTING CHAPTER 32: DISPOSAL OF ASSETS
Procedures to follow in selling off surplus assets.

GUIDANCE NOTE ON UK AND EC COMPETITION PROCEDURES FOR TRADE SALES
Available from CP3 division, Department of Trade and Industry (071 215 6777)

DEO LETTER OF 28 MAY 1986. TRANSFERRING WORK OUT OF GOVERNMENT DEPARTMENTS-CONSULTATION WITH THE UNIONS
Information on consulting staff and trade unions. Available from Cabinet Office, Efficiency Unit (071 270 0426).

TUPE TRANSFERS: CONFIDENTIALITY OF STAFF RECORDS
Note by the Efficiency Unit, 18 August 1993.

HDG LETTER OF 27 SEPTEMBER 1993. TUPE: MODEL INFORMATION ON TERMS AND CONDITIONS
Information that might be sent to tenderer at the bid stage. Available from Cabinet Office, Efficiency Unit (071 270 0426).

GUIDANCE ON THE RELEVANCE OF THE TUPE REGULATIONS TO MARKET TESTING OF PUBLIC SERVICES - 11 MARCH 1993
Guidance available from OPSS Press Office. Tel: GTN 270 6355

ANNEX C

CHECKLIST OF THE KEY STAGES IN A TRADE SALE

1. Define the business to be sold.

2. Feasibility study.

3. Decision in principle and formulation of sale objectives.

4. Prepare business for sale, eg rationalise and restructure: consider legislation and relevant regulations, set financial accounting arrangements on commercial footing.

5. Appointment of privatisation advisers.

6. Prepare offer for sale document and information memorandum.

7. Advertise the business.

8. Indicative bids invited and assessed. Shortlisted candidates examine detailed financial information.

9. Assess final bids from private sector (and MEBO team).

10. Negotiation with favoured bidder.

11. Establish the business as a Government-owned Companies Act Company and transfer the staff into it. (The appropriate timing will vary from case to case.)

12. Control arrangements in place between exchange of contracts and sale completion.

13. Implement disengagement procedures.

14. Completion of sale.

ANNEX D

EXTRACT FROM TUPE REGULATIONS, AS AMENDED BY THE TURER ACT 1993

Duty to inform and consult trade union representatives

10-(1) In this Regulation and Regulation 11 below "an affected employee" means, in relation to a relevant transfer, any employee of the transferor or the transferee (whether or not employed in the undertaking or part of the undertaking to be transferred) who may be affected by the transfer or may be affected by measures taken in connection with it; and references to the employer shall be construed accordingly.

(2) Long enough before a relevant transfer to enable consultations to take place between the employer of any affected employees of a description in respect of which an independent trade union is recognised by him and that union's representatives, the employer shall inform those representatives of

(a) the fact that the relevant transfer is to take place, when, approximately, it is to take place and the reasons for it; and

(b) the legal, economic and social implications of the transfer for the affected employees; and

(c) the measures which he envisages he will, in connection with the transfer, take in relation to those employees or, if he envisages that no measures will be so taken, that fact; and

(d) if the employer is the transferor, the measures which the transferee envisages he will, in connection with the transfer, take in relation to such of those employees as, by virtue of Regulation 5 above, become employees of the transferee after the transfer or, if he envisages that no measures will be so taken, that fact

(3)The transferee shall give the transferor such information at such a time as will enable the transferor to perform the duty imposed by him by virtue of paragraph (2(d)) above.

(4)The information which is to be given to the representatives of a trade union under this Regulation shall be delivered to them, or sent by post to an address notified by them to the employer, or sent by post to the union at the address of its head or main office.

(5)Where an employer of any affected employees envisages that he will, in connection with the transfer, be taking measures in relation to any such employees of a description in respect of which an independent trade union is recognised by him, he shall enter into consultations with the representatives of that union with a view to seeking their agreement to the measures taken.

(6) In the course of those consultations the employer shall-

(a) consider any representations made by the trade union representatives, and

(b) reply to those representations and, if he rejects any of those representations, state his reasons.

(7) If in any case there are special circumstances which render it not reasonably practicable for an employer to perform a duty imposed upon him by any of the foregoing paragraphs, he shall take all such steps towards performing that duty as are reasonably practicable in the circumstances.

Mr. HORN. We appreciate that. We're going to call on your other two colleagues, and then we'll have you all in a dialog with questioning by members of the panel. Our next guest is Roger Leeds, the managing director of the Barents Groups, a wholly owned subsidiary of KPMG. He's had extensive experience in Russia, Kazakhstan, Ukraine, Czech-Slovak Federal Republic, Poland, Hungary, Bulgaria, Slovenia, and Lithuania. So welcome.

Mr. LEEDS. Thank you, Mr. Chairman. It's a pleasure to be here with you and members of the committee. With the limited amount of time today, I would like to address three very basic issues that I think are relevant to the increasingly public debate that is going on about whether to privatize. First, under what circumstances does privatization make sound economic and financial sense? Which is to say, when should government privatize and when would it be advisable to refrain?

Second, the term privatization has been, in my judgment, somewhat abused. I'd like to just briefly talk about what we mean by privatization in an operational sense, so that we are clear on the definition. And third, very, very briefly, what can policymakers in this country learn from the large amount of experience gained by other countries and other political leaders that have already traveled down the same or a similar privatization path?

First, when does privatization make sense? I think all of you are aware that there are a broad range of government services and assets that are eligible privatization candidates, from the post office and FAA to every conceivable component of the Nation's physical infrastructure, such as roads, ports, airports, and so forth, and then of course, a wide variety of services.

I think that the first thing, in my view, is that the government, whether it is local or Federal, should have a very clear and objective and fully transparent set of criteria for determining what should be passed to private control and what assets and services would better be kept in the public domain. I think this is very important at a moment in history where the overwhelming global trend is to reduce State intervention on virtually every front, and increase the role of market forces and competition.

But we must be very, very careful, it seems to me, not to indiscriminately initiate a wave of privatization without a clear understanding of when the public is likely to benefit and when the odds are stacked against it. There are many criteria for determining when it makes sense to privatize. But in my judgment, one overrides all the rest, and it's been mentioned here this afternoon. Namely, will the transfer of control from the State to the private sector clearly enhance the efficiency of how the service is delivered or the product is produced? This, of course, is the economic justification for privatization, a rationale that is based on the probability that State intervention and control is reducing the efficiency and therefore, is costly to the public, relative to the private sector alternative.

We now have from all around the globe overwhelming evidence that ownership matters and that competition matters. And, that those two factors together, in many cases, will affect the efficiency of the underlying asset or service.

But I would add a word of caution here, that the calculation of efficiency is not always as straightforward as it appears. And it must be comprehensive, taking into consideration such factors as regulation, which also is costly, especially when there is going to be an absence of competition as a result of privatization. Public safety considerations and environmental concerns also have to be taken into consideration, and also may be costly. And of course, as was mentioned earlier, the transaction costs, which sometimes are substantial and have to be netted out from the cost-benefit calculation. So I think that all of these factors have to be taken into consideration when determining whether or not efficiency really is gained, whether there are cost savings and so forth.

Second, we have to be very clear about the meaning of this rather inelegant and somewhat ambiguous term we call "privatization." Privatization occurs, in my judgment, when the operational and/or the financial control of a service or a productive asset passes from the State to the private sector. And this can happen in many different ways. Less likely in this country, but very frequent in other countries around the world, the purest type of privatization is when there is an outright sale of an asset. This was the case in 1987 with Conrail, as someone mentioned earlier this afternoon. We're considering it now with the U.S. Enrichment Corp. And there are a few other examples, but not very many.

A more common technique in this country is likely to be contracting out, or as it has been called, "outsourcing" of a service to the private sector—everything from roads and public park maintenance to administering the Federal prisons. In this case, of course, unlike the first example, there's no ownership change, just a change of operational control to the private sector. And then of course, there is the so-called build-operate-transfer—BOT—schemes, whereby the financing, the operation, and sometimes, for a period of time, the ownership of a particular asset is transferred from the public to the private sector. This is very common with physical infrastructure projects—roads, airports and so forth. A good example in Virginia right now is the Dulles Toll Road; over $300 million project which has been contracted out to the private sector through build-operate-transfer scheme.

What all these techniques have in common and what we should keep in mind is that private sector responsibility replaces the government with a clear view that the facility will operate more efficiently, or the service will be performed more efficiently. And the operative term in privatization is control—the complete absence of government intervention in the operation of a service or productive facility. And if government is not willing to forfeit that control, privatization really should not occur.

Finally, a word of caution about implementing privatization programs—what we have learned from other countries, very briefly. Privatization, first and foremost, in my judgment, is a political process. Its success depends ultimately on public support for the goals of the process. And I think that political leaders from around the world have lost public support for privatization by overpromising and underperforming.

Policymakers and government leaders should keep this in mind. I recall Mrs. Aquino standing before 100,000 people in Manila and

saying that she was going to privatize Philippine Airlines in 90 days, and 5 years later, she was still at it. She had underestimated the complexity of the process. More recently, one of the so-called experts in this country projected that the U.S. Government revenues from privatization could approach $300 billion. I'm skeptical of this figure, even though, theoretically, it may be possible. So I would caution that we should not overpromise and underperform.

Second, what we have learned from other countries is that privatization is far more complex, time consuming, and expensive to execute than most people realize. The preparation, the pricing, the identifying prospective investors or contractors, the competitive bidding process—all of this takes time. It's highly complex, and we should not underestimate how important this preparatory process is. So we must have clear planning and a clear strategy for doing the work.

Third, suggests a rule of thumb that has become axiomatic the world over. Regardless of who is privatizing or what the strategy is, I would advise that the government begin with so-called "winners"—services or other assets that are relatively simple to privatize, noncontroversial, and where the benefits are clear and unambiguous.

By these criteria, avoiding controversy until the program has gained momentum and credibility with the public is highly advisable. As one minister of privatization from another country said, "if we make a mistake privatizing a bicycle factory, it is not as tragic as if we err in the sale of a national airline." So I would advise that we be very, very careful in choosing what we're going to privatize and when.

In closing, let me quote one of my favorite——

Mr. HORN. If you're on the close, fine. You're a little over time.

Mr. LEEDS. Thank you. I'll stop there and wait for questions.

[The prepared statement of Mr. Leeds follows:]

PREPARED STATEMENT OF ROGER LEEDS, MANAGING DIRECTOR, BARENTS PLC

Good afternoon Mr. Chairman and Members of the Committee. It is a pleasure to comment briefly on privatization in the United States.

I would like to address three very basic issues that are relevant to the increasingly public debate about whether and how to privatize in this country:

- First, under what circumstances does privatization make sound economic and financial sense?
- Second, what do we mean by the term "privatization" in an operational sense?
- And third, very briefly, what can policy makers in this country learn from the large amount of experience gained by other countries that already have designed and implemented privatization programs?

First, when does it make sense to privatize?

As the Members of this Committee know well, there are a broad range of U.S. Government services and physical assets that are eligible candidates for privatization—from the post office, the prisons and the FAA to every conceivable component of the nation's physical infrastructure, including ports, airports, roads, water systems and the like.

In my view, Government decision makers should establish a clear, objective and fully transparent set of criteria for determining which of these services and assets should be transferred to private control, and which should remain in the public domain.

At a moment in history when the dominant global trend is to reduce state intervention in favor of free markets and open competition on virtually every front, we must be particularly careful not to initiate indiscriminately a wave of privatization without explicitly understanding when the public is likely to benefit, and when the odds clearly suggest otherwise. Although there are many important criteria that de-

cision makers must consider, in my judgment the response to one fundamental issue overrides all the rest:

Namely, is the transfer of control from the state to the private sector highly likely to enhance the efficiency of how the service is delivered or the product is produced?

This is, of course, the economic justification for privatization; a rationale that is based on the probability that state intervention and control reduces efficiency and therefore is costly to the public, relative to the private sector alternative. There is now an overwhelming body of highly convincing empirical evidence from countries around the world that:

- private ownership matters!
- competitive markets matter!

In most cases, we have learned from global experience—efficiency is enhanced when at least one, and preferably both of these conditions are met. These are the driving forces that propel interest in the privatization alternative to government ownership and operations.

I would only add that the calculation of likely efficiency gains to be derived from privatization is not always as straightforward as it may appear. It must be comprehensive, taking into consideration such factors as regulation (especially when there is an absence of competition), public safety and other variables that are difficult to measure but vitally important to the ultimate cost/benefit calculation that must be undertaken. There also is the cost of preparing and implementing the privatization transaction, which often can be substantial.

My second observation is that we should be clear about the meaning of this rather ambiguous term, "privatization". Privatization occurs when the operational and/or the financial control of a service or productive asset passes from the state to the private sector. In a pure sense, the outright sale of an asset to private investors, as was the case in 1987 with Conrail and what currently is being considered for the U.S. Enrichment Corporation, is the most clear-cut form of privatization. The government completely divests itself of any future financial or operational control. In the U.S. there are very few enterprises that lend themselves to this "pure" type of privatization.

A second type is the "contracting out" ("outsourcing") of a service to the private sector—everything from printing government documents, to road and public park maintenance to administering federal prisons. Note, that with this method, there is no ownership change. Only operational control is transferred from the state to private contractors.

Finally there are the so-called BOTs—Build-Operate-Transfer schemes are used increasingly around the world to transfer to the private sector the responsibility for financing, building and operating physical infrastructure projects, such as roads, airports, electric generation plants and water treatment facilities.

The feature that each of these techniques has in common is private sector responsibility replacing government as the operator and/or the owner of an asset, with an explicit view that the facility will operate more efficiently. The operative term in all cases is control—the complete absence of government intervention in the operation of the service or production. Conversely, if government is not willing to forfeit control, privatization does not occur.

Finally, a few observations directed to policy makers about implementing privatization programs, based on a decade of experience working with government leaders in dozens of countries.

Privatization is first and foremost a political process—success depends ultimately on public support for the goals and the process. If the public does not fully understand the government's objectives, they are likely to become skeptical quickly.

Political leaders from around the world have lost public support for privatization by over promising and under performing, thereby eroding public support for the government's program. Mrs. Corizon Aquino, when she was President of the Philippines, made a much publicized speech shortly after taking office promising to privatize Philippine Airlines, the nation's flagship courier, in 90 days. The process took more than five years.

And, more recently one so-called expert in this country projected revenues of $300 billion would be generated from privatization transactions in the U.S. Although the figure may be correct in a theoretical sense, the likelihood that this sum will be generated in the foreseeable future, under the best of circumstances, is low to non-existent.

A second lesson learned from other country experiences, that is closely related to the first, is that privatization is considerably more complex, time consuming and expensive to execute than most policy makers realize, and this complexity must be taken into account when developing a privatization strategy. The tasks associated

with implementation, such as preparation, pricing, investor screening, designing and executing competitive bids, regulatory reform and negotiations—all take time, special skill and resources. There is a need, therefore, for careful planing, realistic budgets and a skilled implementation team.

And finally, a rule of thumb that has become axiomatic to privatization strategists the world over: Begin the program with "winners"—services or other assets that are relatively simple to privatize, are non-controversial, and offer benefits to the public that are unambiguous. By applying these criteria, the government will avoid controversy, at least until the program has gained momentum and public credibility. As one Privatization Minister commented,

> If we make a mistake with a bicycle factory it is not as tragic as if we err in the sale of an airline, or the railroad.

In conclusion, permit me to recall the wise words of Yogi Berra, who once advised, "when you come to a fork in the road, take it!" Decisiveness, as Mr. Berra believed, is an attribute all of us should strive for. With privatization however, the go/no-go decision should be made cautiously and analytically, not on political or ideological grounds. The benefits to be derived from transferring control of a government service or enterprise to the private sector can be significant, as countries the world over have realized. But the pitfalls also must be carefully considered in order to ensure that the public will be benefit from the decision.

Thank you.

Mr. HORN. Thank you very much for that most helpful statement. I now want to introduce Mr. Viggo Butler, who is the president of Lockheed Air Terminal. That's a firm that's had extensive experience in privatization and operating what are generally once public air terminals. So, Mr. Butler.

Mr. BUTLER. I'm here today just to express an interest in the private sector being a part of the equation of solving problems in the country, and specifically in transportation and on airports. We believe that the private sector does have a role in providing services to transportation, and are looking for a place at the table to do that. We have a history of providing private services to airports that is now 65 years. Our company was formed in 1929 to build a private airport in Burbank, CA, when privatization was en vogue, and has remained a private operator all these years.

The private sector rules in the transportation business, everything a consumer does in the transportation area—buying tickets from a travel agent, renting a car, staying in a hotel, flying on an airline—is provided by the private sector, and provided in surplus. The airports are the only part of the equation that are not privately operated nor owned. And they are generally in short supply. Even the areas within the airport—the concession stands, all of the factors where you deal with another human being—you're dealing with the private sector.

The facility is the only area where the public sector is involved. And in other methods of transportation—railroads, buses, trucks—their facilities and transportation centers and depots and all are privately provided. So why is one particular element publicly provided is an area that we feel needs to be brought into question.

As you've heard earlier, London is now served by privately owned airports. And to all indications, both the public and the airline industry, they are both better served by that private enterprise. And the average consumer flying into Britain has no realization that anything has changed, as far as who owns it. He does not know who owns it when he comes in.

We are currently investing a great deal of money overseas in privatization of airports. We're taking American capital and investing

it in other countries. Projects currently in the pipeline around the world are in the billions and billions of dollars. From Australia to New Zealand to Germany to Hungary to Turkey to China, all of these countries are looking at or actively putting together privatization of their airports.

And we are taking our capital and taking it there to help them build their infrastructure. And we cannot do that here—that strikes me as an anomaly that should be fixed. One other point that is discussed here today is what happens to the people? The people are not part of the problem on airports. It is the process. The difference between a public airport and a privately operated one is the process of running it and the discipline involved in that.

I come from the public sector. All of my senior staff and all my airport managers come from the public sector. The employees we hire when we take over airports are from the public sector. We do not replace workers at airports, never have. It is just the training; the mechanism by which they are measured; what are the requirements at the end of the day; and when is the end of the day, is the difference.

And that difference makes a difference in how the enterprise is run. And what the results are is what we're looking for—can it be run more efficiently and cheaper, more innovatively and quick ideas and implemented quickly? It's that type of discipline that comes with privatization. Part of this debate—as I said we work around the world, and I visit many countries, read many newspapers, deal with a lot of political leaders. And it is interesting that the debate is the same around the world.

The subject is different. It is a resistance to change issue. In France, water has always been provided by private companies, but the airline is publicly owned, and there's great debate about privatizing it. And the airline is not well-run. In Germany, there's great debate about privatizing the phone company. We don't think about it here, it's private and we've always accepted that. But there, they're talking about privatizing Berlin airports, and that's not an issue.

And in Britain, they have privatized many things, and apparently to no great travail to the public wherever they have privatized. So the debates that occur in these countries is over whether we should change it. But what they're changing is a different subject in each country. Here, we're talking about airports and infrastructure, and that is where the debate is. But the subject has always got the same messages in it—what happens to the people; what happens to controls; what about monopoly power?

All of these issues are the subjects. It's just a different topic of enterprise. So to summarize, I'm here to begin a dialog on how the private sector can help this country with its infrastructure; how can we invest our money here; how can we provide facilities for the transportation user and do it with a quick and efficient method?

And I will close by saying that in our entire history, we have always underpromised and overperformed. Thank you.

[The prepared statement of Mr. Butler follows:]

PREPARED STATEMENT OF VIGGO BUTLER, PRESIDENT, LOCKHEED AIR TERMINAL

Thank you Chairman Horn, and members of the Subcommittee, for the opportunity to testify today on the privatization of infrastructure assets. My name is Viggo Butler, and I am the President of Lockheed Air Terminal, Inc. Lockheed Air Terminal has been managing, developing and operating airports for over 65 years, contributing to the economic growth of many communities across the country. To note just one example, Lockheed Air Terminal has privately operated Burbank-Glendale-Pasadena Airport since 1929.

THE PRIVATE SECTOR PROVIDES TRANSPORTATION SOLUTIONS AROUND THE WORLD

Today, private firms develop and implement innovative approaches to infrastructure management throughout the world. Examples of foreign governments aggressively pursuing privatization programs abound. In Mexico alone, thousands of kilometers of toll roads are being privately built; significant port projects are being sold to private concerns; and telecommunications facilities have private operators. In Britain, most of the major airports—including Heathrow and Gatwick—are now privately operated.

Unfortunately, Federal policies have prevented a parallel rise in domestic opportunities for public-private partnerships. This has forced American companies, such as Lockheed Air Terminal, to rely, almost exclusively, on privatization projects abroad—driving U.S. capital out of the country. Today we have 20 operations around the world—from Guam to Turkmenistan, and governments from Australia to Eastern Europe are at various stages of development of airport privatization projects. Thus, most of our opportunities in the foreseeable future will be abroad, unless Federal policies change.

The development of our largest facility, the Trillium 3 terminal in Toronto, demonstrates both the aggressiveness of foreign governments seeking public-private partnerships, and the incentives motivating their efforts. In this instance, the government came to us with a plan to build a new terminal that would meet the rising traffic demands at Pearson International Airport, but would not further burden the taxpayers. In addition to being part owners of the terminal, we now operate the terminal under a 40 year lease with the government. The Trillium facility, which cost over half a billion dollars and is the largest independent airport privatization program in the world, stands as a clear example of the innovation and ingenuity private entrepreneurs can bring to bear on even the most complex projects. It is a long-term public-private partnership that draws from the strengths of both to create a truly unique passenger processing facility, constructed entirely with private funds.

THE PRIVATE SECTOR HAS A ROLE TO PLAY IN DOMESTIC FACILITIES

At Lockheed Air Terminal, we believe that any government enterprise that responds to market forces is a candidate to be owned and/or operated by the private sector. Some government programs such as social services, police and fire, are driven by community need, and, therefore, should be supported by the government, employing its tax powers. However, many transportation assets, such as airports, clearly respond to the marketplace—consumers choose to fly, and then choose to use a particular airport, based on economic decisions. Increased privatization of such market oriented infrastructure assets would achieve significant benefits for the users of the facility—and by users I mean both airlines and their passengers—and for the community at-large.

First, a private sector investor in an infrastructure asset replaces government debt or equity with private capital, at no expense to the government itself. Privatization, therefore, provides a public owner the means to continue existing operations and develop new ones, regardless of the availability of Federal, state and local funds for infrastructure projects.

Second, the private sector, responding to market forces, best allocates infrastructure resources. For example, most public airport authorities do not respond to the market; they respond to civic desires. An airport may, therefore, be located in the wrong place altogether—where there is little demand—while another more logical location has no facility. Or, one airport may be overbuilt, while another is underbuilt. The private sector would respond quickly to such inefficiencies.

Third, passengers and airlines will benefit from the increased efficiency and cost savings created by the private sector. Private firms, with their own money on the line, are going to find the best deal and get it done quicker, both to save financing time and to secure the revenue the project is intended to produce. This market incentive clearly benefits the users of the infrastructure facility.

PUBLIC-PRIVATE PARTNERSHIPS ARE EMERGING AS A SOLUTION TO LOCAL INFRASTRUCTURE NEEDS

During this period of increased global competition and decreased Federal resources for infrastructure projects, state and local officials must employ innovative solutions to meet their communities' infrastructure needs. A growing number of state and local officials are now recognizing the important role the private sector can play in these efforts.

Mayor Bernardi, who testified earlier about his interest in the possible privatization of Hancock Airport (the city-owned airport in Syracuse), is a national leader considering how to make the best use of the private sector. Another leader in innovative municipal public-private partnerships is Mayor Stephen Goldsmith of Indianapolis. Since taking office in 1992, Mayor Goldsmith has cut more than $100 million from the municipal budget by privatizing city infrastructure assets—including the city's waste water treatment facility—and by permitting the private sector to bid against the city government for municipal contracts. Mayor Goldsmith is also currently involved in an innovative airport privatization program. Additionally, several Governors, including Pete Wilson in California, George Pataki in New York, and Frank Keating in Oklahoma, have announced their intentions to increase the opportunities for public-private partnerships in their states.

Federal policies must not stifle these innovative approaches to infrastructure management. To highlight this point, I would like to call your attention to one particular policy which severely impedes privatization transactions.

IMPROVING EXECUTIVE ORDER 12803 ON THE PRIVATIZATION OF STATE AND LOCAL INFRASTRUCTURE ASSETS

Prior to 1992, Federal policy—known as the "Common Rule"—required state and local governments to fully reimburse the Federal government for all grants received for a federal-aid infrastructure asset upon the transfer of that facility to the private sector. This 100% repayment requirement was a prohibitive economic disincentive to privatization transactions. To address this disincentive, and "promote private investment in local infrastructure," President Bush issued Executive Order 12803, which liberalized the 100% repayment requirement—permitting state and local governments to repay the depreciated value of Federal grants in the event a federal-aid facility is privatized. Notwithstanding the articulated purpose of the Executive Order, this modified repayment requirement continues to be a disincentive to privatization transactions.

Lockheed Air Terminal strongly supports Congressional efforts to address this unnecessary restriction on the discretion of civic leaders to consider privatization as a solution to their infrastructure management needs. Specifically, Congressman David McIntosh (R–IN) has proposed legislation to permit state and local governments to transfer federal-aid facilities to the private sector, by sale or long-term lease, without repayment of Federal grants, provided the private entity is bound by contract or law to operate the facility for the purpose for which Federal aid was given and abide by Federal grant assurances. Codification of this proposal will ensure state and local leaders the flexibility to undertake privatization programs, while protecting the Federal government's legitimate interests.

LOCKHEED AIR TERMINAL WOULD LIKE TO PARTICIPATE IN A CONTINUING DIALOGUE TO ENHANCE OPPORTUNITIES FOR GREATER PRIVATIZATION OF INFRASTRUCTURE ASSETS

In conclusion, the explosion of international privatization programs demonstrates that public-private partnerships can provide innovative solutions to domestic infrastructure needs. However, we must work to overcome our widespread tendency to resist change—an ironic characteristic for a country with a history of being revolutionary. This reluctance to consider new infrastructure management arrangements is slowing the potential of the country's economy. It is time to regroup, look at change and manage differently. We should welcome new ways of financing projects, and quicker methods of completing them. Lockheed Air Terminal looks forward to participating in a continuing dialog to reach these goals.

Again, I very much appreciate the opportunity to appear before you, and I will be happy to answer any questions you may have.

Mr. HORN. Thank you very much. The gentleman from Pennsylvania.

Mr. MASCARA. More than a question, I want to speak to the part in this testimony that refers to the transfer of undertakings, the protection of employment. And I see the UK is sensitive to the

needs of the individuals involved in the transfer of this public to a private sector operation. And I wonder if you just want to comment a little more on that, to share with us how that all works.

Mr. JONES. OK. The TUPE itself arose from a European Commission directive. I guess you have a little more faith in the conservative government in the UK than maybe I do, in the sense that they were forced to implement this by the Europeans. Whether they would have done, had that not been the case, I don't know. Now, in the UK government, employees involved in privatization have certain rights under what was called, I think, the acquired rights directive, which is, as you point out, TUPE.

TUPE itself basically says we have certain legislation in the UK about constructive dismissal, which effectively says that you cannot fire somebody—or using your terminology, push somebody out of employment—by effectively making the terms and conditions of their employment so unbearable that they're left with no choice but to leave. Putting that across over here, if you, again, were to say to somebody, you either will have to transfer into the private sector or we can't position you somewhere else in the Federal Government, then, because of the way CSRS, for example, works, they would lose a lot of their entitlements under the pension scheme.

And effectively what you're doing is, you're saying—in the UK, that would be deconstructive dismissal. So there are lots of things that people have to consider within agencies in the UK that may be not considered or have to be considered here. Attached in the same document which you asked to be submitted for the record is a list of all the staff issues under TUPE and what exactly it means for pensions.

The government, in some cases in the UK, has actually insisted that the private sector provides a pension of equivalent stature and compensation as they would receive if they had remained in the private sector. Now, if you were to do that here, because of the problems of reportability, and in the UK, the civil service pension is pretty much transferable. So it doesn't create some of the same problems that implementing that type of thing here would create.

If you were to do that here, then you'd be putting a huge burden on the private sector, because the money that they take out of CSRS is what they put in. There's no major—it's not transferable. So the private sector would be forced to put all the money in to create that pension. And that's a sort of cost that the private sector is going to take into account when either putting a bid in, or working out what they're prepared to pay for a particular company.

And that, again, effects the cost of privatization. Now, you may say, well, given, we don't have TUPE, why do we need to do that? And the question is whether you—how you propose to treat your employees in this process. And I guess one of the reasons why the UK was so keen to do it right was because if you have buy-in from your employees, the process works that much better, and, to be honest, is far more likely to be politically successful.

Mr. MASCARA. So the human element is important. And the other thing that I wanted to note is, there's a section in here that says, take time to make the right decision. That somehow, if we do this in haste, that we could end up costing more than what it costs under the public sector. And I thought that was noteworthy. And

I'll close by saying that I resist the temptation to deal in oversimplifications, but you apparently have some expertise in that.

What happens—who manages disasters, when the public sector is gone and we have a firm who builds highways or bridges or who maintains them? Who do we call? I mean, if we're going to dismantle the public sector, who deals with that in the UK?

Mr. JONES. Who deals with it?

Mr. MASCARA. In California we have disasters and mudslides and fires. And if we're going to start farming out and privatizing this work, who deals with that. Maybe I'll even get more simple. I live in Chaleroi, PA, and I call the mayor and say, "Mayor, I've got a problem. We had a huge snowfall and they're cleaning some other street off, or I can't get out, or I have an emergency."

Who do I call if some private organization moves my snow?

Mr. JONES. You could call the fire brigade.

Mr. MASCARA. OK. That's all, Mr. Chairman, thank you.

Mr. HORN. Go ahead, if you'd like to respond to that.

Mr. JONES. The only point I would like to make on that is, there was a big article in "The Economist" this week on British privatization and whether it's been a disaster or not, and how now, if you actually ask people what they think of privatization, only about 20 percent of the British public think that it's been a good thing. The real answer to that is that most of the people just don't know a good thing when they see it. [Laughter.]

But it really boils down to the actual costs themselves have come down and that's because of the regulation that's used. And I guess one thing that I didn't touch on is that you have used rate of return regulation typically in this country. Britain took a completely new approach to that by looking at price capping, effectively. And that had a major impact on helping it be successful.

Mr. MASCARA. If my arithmetic is correct, then the 80 percent that really care about the service they're not getting or the change in service, it doesn't matter, as long as the cost is better, more efficient, it's more cost effective.

Mr. JONES. It is more cost effective now than it was before. But what people complain about is, prices keep going up and the profits of the privatized entities and making it get huger and huger every year.

Mr. MASCARA. How do you control those, unless you want to get into the business of regulating what people can charge? How do you regulate the cost of the private sector? You've done away with your public sector, now the private sector handles that obligation, that duty. And all of a sudden, he starts increasing the prices. The public has to pay that.

Mr. JONES. The most effective way to do it is to do it through competition. I notice from the adverts over here, you can still by long distance at 10 cents a minute from Sprint over weekends. But in the UK, in a lot of the things that are privatized, they are, some people would argue, natural monopolies. And there is no way that you can create competition. It's not strictly true, but if you do that, you have to regulate them.

And if you do regulate them, you have to regulate them in such a way that you focus their attention on reducing costs. And it

comes down to what I was saying earlier in that privatization itself does not create savings. It is the way in which you provide incentives to those people to reduce costs. And the private sector is incentive by profit and competition to cut costs. And that's the key to privatization, in my view.

Mr. HORN. Thank you. Let me ask a question of all of you. Any of you feel free to chime in on it. According to a 1992 World Bank study on privatization, workers did not suffer under the privatizations which were studied largely because, first, firms whose employees were strongly opposed to privatization are generally not sold. So that exempts one group. And the employees, organized or unorganized, could be satisfied by being offered a share of the games.

In other words, in the case of our own civil service and the President's program, Federal work force reductions would have been impossible, some feel, without buyouts. And having administered three of those as a university president, it seemed to break you for a while. But when people went out at the top step, and their replacements came in at the lower step, you recouped your costs of the buyout, or added retirement years, within a matter of 3 years.

How can we gain the support of Federal workers in our country to really buy in to help the Congress privatize? And what has been your experience you've seen in other countries where they also had large groups of organized employees? Mr. Leeds, do you want to start?

Mr. LEEDS. Sure. I'm familiar with that study, which was done in four different countries, and I believe 12 enterprises. The first caveat, of course, is that those were outright sales of assets. They were not contracting out of services, or build-operate-transfer schemes. They were the sale of public sector assets. And I think that's a major distinction between what happens there and what most likely is going to happen here.

There are two factors, I think, if you are going to have the outright sale. One is, as was said by Mr. Jones, or alluded to, is the possibility of employee share ownership in one form or another, which is an inducement to participate. And in most of those cases that were cited in the World Bank study, they were discounted shares. So that you are providing some kind of financial incentive to the possibility of discounted shares for the employee to participate and thereby support the process.

The other is that, in 11 of the 12 enterprises that were studied under that analysis, post-privatization performance improved considerably as a result of the privatization. Which is to say that productivity went up, earnings went up, in the actual enterprise group. So that rather than having lay-offs, you had a situation where employment actually increased and the salaries went up as a result of the increased productivity that came out of the privatization.

That is the ideal that you are seeking. But I'm not sure that that analogy transfers very well to a lot of what is going to happen in the United States. Because as we said earlier, a lot of what is going to happen here is not going to be outright asset sales. But it still is something worth considering.

Mr. HORN. Mr. Jones.

Mr. JONES. I think two things—carrying on on the ESOP idea, it is a very important way of getting buy-in from your existing Federal employees. And the question is, even if you have an outright trade sale, or even, heaven forbid, a public offering, will the employees even be allowed to buy shares as it stands at the moment; would that be, again, affecting their employment as it stands at the moment?

And second, I think, the other key is that it has to be an honest process. If you look at outsourcing whatever it is, you need to convince your employees that the process you are undertaking is an honest process. And the only way to do that is to demonstrate through the process that you have integrity and honesty in doing it. And if something turns out that, gee, we're actually really outperforming this far more efficiently than anybody out there is going to, whether it be simply a function of the fact that you happen to be the government and people are prepared to give you better deals because of credit rating, risk rating, government loyalty or whatever, than they are the private sector, then don't privatize it for privatization's sake.

There's going to be plenty of things out there that can be privatized and should be privatized. But there is no need to privatize things, which, when you do the analysis, says we shouldn't privatize it. And if you keep the process honest, then the employees will understand and will do their best to help, I think.

Mr. HORN. Good. Mr. Butler.

Mr. BUTLER. I can't speak to Federal workers, per se. But our own experience has been very positive in transferring local government workers to our payroll. One aspect of our business is that we are in the service business. We have no product, other than providing people to do work for the contract we're providing. So we're very conscious of how those people are managed and how they serve us, because that is the product.

And we have been very effective in getting transfers, matching up retirement plans. About 50 percent of our locations are unionized. We have no union issues, whether the union workers are unionized is not an issue. We are very accommodating in how we transfer the people. Over time, there is a change in the number of people working for us as we change how the structure is made. That is a factor of life, public or private.

But we try to create an environment where there are more jobs created in the enterprise, and new jobs are created that people can move into, and to create growth in the enterprise that we're managing. And that growth then takes care of any dislocation.

Mr. HORN. Very good. The ranking member, Representative Maloney from New York, has arrived.

Mrs. MALONEY. Thank you, Mr. Chairman.

Mr. HORN. Any questions?

Mrs. MALONEY. Yes, thank you very much, and thank you all for your testimony. Mr. Leeds, you mentioned that two ingredients that are very important for success in privatization is ownership and competition. In New York City, we've been experimenting with privatization. And one area that we experimented with recently was tree cutting from the parks department. And we contracted out our tree-cutting services, and then we went back a year or 2 years

later, and had city employees conduct the tree cutting again and compared the costs.

And the result of the study—and I have the two news articles on it—was that the public employees performed the service at well over $100 less per hour than the private firm. So my question to all of you is, have you looked at having public employees compete with the private sector, if there is such a decision to contract out, and let them bid as would any other private company for the ability or the chance to do that work?

Mr. LEEDS. I absolutely agree with you that there should be open competition between the public and the private sector. I think that one of the misconceptions is that when you contract out a service or privatize in any way, the government walks away. And that, obviously, is not appropriate in many of these cases. There has to be monitoring and careful supervision of what is being done when the private sector takes over.

The second thing is that the way the competitive bidding is structured is very, very important. And it sounds that, in this case, it probably wasn't done very effectively. But you have to have a competitive bidding design that encourages intense competition to take over the service. And then you have a monitoring of the process. And I do not believe that in every case you're going to get a private firm that is going to perform better.

I would like to know why the public sector, in this case, was more efficient. And if you can demonstrate, in an open competition, that they can underprice and overperform, by all means, I would then say that the public sector should continue doing it. And that was my point, that unless you can demonstrate that there is an efficiency gain, there is no point in privatizing. And this may be a good example of that.

Mrs. MALONEY. Any other comments?

Mr. JONES. I think a couple of points. The real issue is why the study—I presume the study was done 2 years, which indicated outsourcing, or contracting out, was more efficient. And so I guess one of the real questions we should be asking ourselves is, what has happened in 2 years that has made the State more efficient than the private sector.

And one of the reasons, I think, why—and it's one of the things you need to be very careful of when looking at when you should contract out—is the whole overhead issue of government, and whether an individual function itself, if you isolate out overhead that is not typically incurred by the private sector. If you isolate that out, whether the actual operation of that particular function is being performed more efficiently than the private sector.

By the time you add in all of the other Federal overhead, that particular agency or that particular city or whatever it is, then the thing becomes less efficient. And so the issue that needs to be addressed is not contracting out the actually function itself, but reducing the overhead that is there. And maybe what might have happened, and there is no fact to back this up whatsoever, but what might have happened is that when you took it out to the private sector, you might have, over the 2 years, have lost a lot of that. So then when you go back and look at it 2 years later, you now see those savings by performing it back in-house.

Mrs. MALONEY. In England, did you allow public employees to compete in the contracting out?

Mr. JONES. Yes. It's one of the things that is specifically mentioned, and I think I touched on it during my testimony, about it is part of the government's regulations issued by Her Majesty's treasury, which says that any agency or department thinking of privatizing its service must allow the management employee group to bid. But they can't do that in this country under the government ethics, as I understand it.

Mrs. MALONEY. I'd like to refer to another news article. This was from California, Los Angeles, where special audit shows, "district lost millions." And here was an example where a local government hired private contractors to perform functions and then found itself forced to cover the debts incurred by the contractor. And what advice would you give to an agency to avoid this situation?

And again, this was a case where they contracted out food services to Marriott, who, by the way, is doing our food services now. [Laughter.]

And they overran the budget dramatically, millions. And then the school agency had to cover the loss of the mismanagement of the corporation that privatizes delivery of the service. And how would we avoid this happening?

Mr. LEEDS. I would refer, again, back to what I said in my testimony, which is that we underestimate how complex privatization is in the preparation and execution of privatization. And this is a case, quite clearly, where it was poorly planned and executed. It probably was not a good competitive bid; there was not good control; there was not good monitoring of the process; and maybe there was not good accounting of what appraisal of the company. Because if they were taking over debts, that's clearly a mistake.

And I think that these types of errors are made very frequently. We underestimate how difficult it is to execute privatization effectively in a cost sense and in a political sense. And I do not conclude from the example that you just gave that this should not have been done, that this food service should not have been contracted out. But I certainly conclude that it was poorly executed.

Mrs. MALONEY. Your testimony interested me. My time is running out, I see from the light—but one of the things that you said that I found very interesting is that it was successful, particularly with ownership. That meant there was a stake in it; the business grew, and this type of thing. I have seen ESOPs very successfully executed in this country in the private sector.

I have never seen a public sector ESOP. I'm not aware of one, are you, Mr. Chairman, or anyone, where we've contracted out an ESOP type of situation in the United States? Are you aware of any with public service?

Mr. LEEDS. No, I'm not.

Mr. JONES. It doesn't mean it couldn't work. And can I briefly just touch on something in your last question?

Mrs. MALONEY. Sure.

Mr. JONES. Mr. Leeds already mentioned, one of the critical things is, you don't walk away from it when you outsource. And I think that is fundamental. You have to monitor the contracts with the private sector. You have to have people remain in Federal em-

ployment to monitor the contracts. And the other thing is, if you force people, for political reasons or for cost reasons, to privatize things now and do it without taking into the time, as I mentioned earlier, to get it right, it goes horribly wrong.

But it doesn't mean that privatization doesn't work. It's just a case of getting it right.

Mrs. MALONEY. Well, one area where local government has historically fallen down is in monitoring. They're so strapped that they don't have the resources to monitor situations. So I see that as a problem. Thank you.

Mr. HORN. I'm told by staff that on the ESOP situation, there's apparently a provision in Federal law that the problem is a conflict of interest, and that the Civil Service Subcommittee of the full committee, of which we're all a part, will be holding a hearing on that matter. Let me ask a last question. The staff will follow up with some other questions, and we'd appreciate your answers in writing, as appropriate.

Both Mr. Jones and Mr. Leeds have had extensive foreign experience. Have you had some experience in the United States, with various privatization efforts? I'd like to know how you would compare those experiences with what you've found in Eastern Europe. Mr. Jones.

Mr. JONES. As in my written testimony, I'm currently working to help assist the General Services Administration in their efforts to seek out ways in which they can perform quality services in the most cost effective way to the taxpayer. As you point out, I've also worked in Central and Eastern Europe, in the Middle East and many parts of the world.

And I think one of the things I would say is that every privatization is unique. And you can't just take a package—you can't like go into the shop and buy an off-the-shelf package and say, this is how we're going to privatize. It's almost impossible to do that. Many people look to the UK and say, there is the beacon of how to do privatization successfully.

A lot of Eastern European countries say, we want to do that, or a lot of people in the Far East say, we want to do that. And the real issue is that the conditions in the UK were such that they're not applicable in many other countries. Our telecommunications company was capable of making huge profits. And we have a huge international stock market on our doorstep, and these things are not open to everybody else, necessarily.

Those things are available here. But then when you look at the major utilities in this country, most of them are already in private hands. What you're really looking at is agency privatization. And so I guess the closest parallel I can really come to is looking at the agencies that are being privatized in the UK now as being the most applicable thing, from foreign experience, that I can see that relates to the United States.

And that is why I brought along this thing from the treasury, which is a guideline to those people on how to go about privatization. So many of the issues of whether—in Central and Eastern Europe, virtually nothing is profitable because the prices are so low that it's very difficult to—and the level of the standard of living is

so low for most of the population that they can't afford to pay huge prices for goods.

And so you need to take care, in terms of what you do, to ensure the survival of these things, post-privatization. That is not really as much of an issue over here. In the Middle East, the problem is the fact that there is no private sector—95 percent of employees of the Kuwait population is employed in the State sector. How do you go about privatizing and creating competition when there is no private sector out there to start off with?

And there is no private sector for employees to transfer out of the State sector into when there is a reduction in the levels of staffing. And so those are issues there which don't necessarily apply here. But I think the real issue over agency privatization, I think, that's where we'll see most of the focus, probably, in this country, and the issues that can be learned over the ability of the private sector to regulate itself.

For example, with the Federal Aviation Authority and air traffic control, I guess, one of the debates is, if you transfer that into the private sector, how do we ensure that safety is maintained? Is it safe to transfer it into private hands? Well, the answer should be yes, as long as the regulation is right. And so the issue over how you regulate bodies that have been privatized is something I think we can learn from. And if you like, I can go into it in more depth in a written statement afterwards.

Mr. HORN. We'd appreciate that. Mr. Leeds, do you have any thoughts on that?

Mr. LEEDS. On the surface, privatizing in this country should be immeasurably easier than in the countries you mentioned. First of all, these are mainly services as opposed to asset sales. But the infrastructure to get privatization done is so much better. As was said, the enterprises themselves or the services are in far better condition and, therefore, should be easier to sell.

The capital markets are more efficient; accounting is more reliable; banks intermediate more effectively; the legal framework is in much better shape. So for all these reasons, all of which are relevant to the privatization process, it should be a lot easier in this country. The only question is execution, which we talked about in various forms this afternoon. And I think that we cannot pay too much attention to execution.

Mr. HORN. Mr. Butler, does Lockheed Air Terminal have any operations overseas where you've had privatization?

Mr. BUTLER. Yes.

Mr. HORN. Can you tell me about that?

Mr. BUTLER. The biggest airport privatization project where independent financing was used is in Toronto, which is not overseas, but it's across the border, which is a $600 million terminal building, roadway complex, freeway interchange and ramps and taxiways. The whole complex was privately financed, and where we pay a lease payment to the government for the use of the land.

And we operate that as a stand-alone business. Whatever revenues we can collect from the terminal building is all we have to operate with.

Mr. HORN. Was that a new project, or one that was existing?

Mr. BUTLER. All new terminal. It's an existing airport with old terminals, and this is the add-on terminal. And so it stands next to the government-owned terminals.

Mr. HORN. Do you own the runway, for example?

Mr. BUTLER. No, we do not.

Mr. HORN. They did maintain control of that.

Mr. BUTLER. Right.

Mr. HORN. It's strictly the terminal.

Mr. BUTLER. Right.

Mr. HORN. And do you have some of the taxiing on the ground?

Mr. BUTLER. All the taxiway is ours out to the runway.

Mr. HORN. Did you find that experience any different from what you might do in the United States with a municipality?

Mr. BUTLER. As far as implementing it, it would be not much different than how you could do it here. Here you cannot do that in the context of Federal law and regulation. In how to achieve profitability of a private project on an airport, the law here is very restrictive in that regard.

Mr. HORN. Well, as I suggested, we're going to try and change that. Mr. Mascara.

Mr. MASCARA. I just wonder what happens if the private sector becomes unable to, because of insolvency, to continue to offer these services. What happens then?

Mr. BUTLER. In the case of Canada, and in most of the cases we're looking at, it's the best thing that ever happens to the government—they get everything back for free. If we fail in Toronto, we've got to return the building to the public owner.

Mr. MASCARA. But if tonight, somehow, they go into bankruptcy, chapter 7, and everything is closed down. We're trying to run an airport here. They control the runways and you control the taxiways and whatever. I mean, couldn't that become a real major dilemma for the operation of an airport in this instance?

Mr. BUTLER. Well, my view is that you can structure it in a way that that would not occur. And it appears, in this country, that it is just as likely to occur to a government agency. So I don't know if there's a differentiation here.

Mr. MASCARA. That's chapter 9.

Mr. BUTLER. OK. [Laughter.]

Different chapter, but a similar result could occur. The lenders—if you want to get into a complex answer, maybe this should be done in writing—the lenders putting the package together would want the place to remain open for the revenues. Who would take over the facility and operate it would be a structural issue in contracts. I see nothing that would prevent a revenue generating, operating airport from continuing in business.

And putting the right paragraphs in an agreement to allow that to occur is something that can be done and has been done.

Mr. MASCARA. Thank you, Mr. Butler.

Mr. HORN. Any further questions? OK. If not, thank you very much, each of you. We appreciate your contribution. As I said, the staff will follow up on both sides with some questions. And if you think of some things you think would be helpful to this committee as we sort out the pluses and minuses and criteria and rationale,

feel free to write us and we'll put those letters in the record so our colleagues can read them also. Thank you very much for coming.

Mr. BUTLER. Thank you.

Mr. HORN. The next panel is primarily the services panel. Mr. Albano and Mr. Concklin.

[Witnesses sworn.]

Mr. HORN. Please be seated. Mr. Albano is president of the Civil Service Technical Guild. I was fascinated by your background. You've had a lot of experiences in New York and elsewhere.

STATEMENT OF LOUIS ALBANO, PRESIDENT, CIVIL SERVICE TECHNICAL GUILD, ACCOMPANIED BY BERT M. CONCKLIN, PRESIDENT, PROFESSIONAL SERVICES COUNCIL

Mr. ALBANO. If I may, I like to do all the mechanics first. I am a professional engineer, and I worked for better than 20 years in the city of New York as an engineer, designing schools. I was in the transportation subway unit and located the wayside equipment, and I also provided departmental personnel examinations. So I've been more of an engineer than I have been a union leader.

If I may, I want to thank the committee, the chair, the committee members, and a special thanks to Congresswoman Maloney, for being able to be here today and to speak on what I consider a very important topic. As you stated, I am a professional engineer, and I represent engineers, architects, in the city of New York, some 7,000 members. And we are one of the oldest professional unions in the United States. And this unit recognized privatization from its inception.

We had our own St. Valentine's Day massacre in 1934, on a Saturday, when the Little Flower laid off 3,000 professional engineers and architects. The beauty of it was that these people did not get mad.

Mr. HORN. The Little Flower?

Mr. ALBANO. Mayor LaGuardia.

Mr. HORN. It's Mayor LaGuardia, for those who don't remember that colorful mayor. [Laughter.]

A good independent Republican, by the way.

Mr. ALBANO. No, he was a fusion candidate, like Mr. Giuliani.

Mr. HORN. That's the only way Republicans can win in New York City. [Laughter.]

Mr. ALBANO. Well, there was one person, Mr. Lindsay. I happen to be from New York, so—but I am a member of District Council 37 and the American Federation of State and County Employees. I believe there was a lot said today, and I don't mean to repeat what has been stated, but I believe there has to be a balance in government, just as our forefathers set it up to have a Congress, an Executive, and a Supreme Court.

We need to provide accountability. Somebody has to be there in the system who will protect the owner. We need to understand that that accountability can only be prepared by and put in place by people who are trained professionals; who have a dedication to the service; who believe there is a career and a job that they care for, and that they are treated appropriately.

As an engineer, I understand that you need a good foundation to provide the structure of government so that the services are pro-

vided. And that can't be done unless workers are properly managed. And what has saved Japan—and what I really foster with a great deal of enthusiasm in every opportunity that I have when I deal with management—is to put forward the Dr. Deming's principles.

Go to the people who are doing the job. They will provide you with the most efficient ability and the ways of delivering the service. But there is also, I believe, a requirement on the part of government that they are provided with the training, with career advancement. And that dedication pays off. They need to have jobs which are challenging. They have to have fair salaries and benefits.

And when you have a dedicated employee, that to me is the most substantial product in this country, and the most successful resource that we have to call on. Now, I am not against privatization, per se. It's the manner in which it is put forward, and was stressed very well by several of the gentlemen before. It has to be very carefully studied. But the method of awarding it, unfortunately, in New York City, usually is done on the basis of patronage.

And what occurs there is you do not get the best consultant, the design, and the engineering or architectural work. They do not put on their best people. The work is not as good, and the attention to the city is not as devoted as the in-house staff. And invariably, as stated in my testimony, the work performed in-house is superior in a number of ways.

First, since the work is repetitive in a sense—I came from one of those agencies, the Board of Education, we designed schools. So after the first school, I designed another school. And I can honestly say, because of the repetition, I was able to say that second school was better, the third school was better. The consultant who comes in to do the design work doesn't necessarily have the chance to do repeat work, nor has a staff that might practically stay on and continue in that area of expertise. They're required to do a greater variety of work.

So I'm speaking to the area in which I have the most understanding. You have, within any job, a process. And you need that accountability, that even if the job is contracted out, if the in-house staff doesn't have the understanding or the ability to know what they are reviewing, then that job fails, because the best product is not being put forward.

It has to be that the owner being represented provides the specifications and the job estimates and preliminary drawings in such a good fashion so that if you are to transfer that work over to the private consultant, there is a good guide. And the only way that can be done also, is that sufficient work is maintained in-house, so that that training is there and that accountability is maintained.

So you have to have the professionals, as I represent, work that's interesting, that provides them a background so that when work is privatized, they know what to look for, they know how to guide. And in many areas, in jobs that have been done, the consultants really look to the city personnel to help them, because they understand they have expertise that the private firms don't have.

Mr. HORN. Pursue that, our time is limited.

Mr. ALBANO. I'd just like to make one last statement, if I may.

Mr. HORN. Fine.

Mr. ALBANO. Stan Brezenoff, who was the deputy mayor under Mayor Ed Koch, expressed a great desire to privatize and contract out work. He then left city service and became the head of the World Trade Center. And as you well know, there was a slight explosion. And he found that he was able to sit down with the in-house staff and, in 24 hours, have light back on, because they had the institutional memory. They had the ability to recall the way the building was put together and what were the problems, what was out and how best to fix it.

There has to be a balance. There has to be accountability. I'm not afraid of competition. I'm afraid that in many instances, we in city government are not given the opportunity to compete.

[The prepared statement of Mr. Albano follows:]

PREPARED STATEMENT OF LOUIS ALBANO, PRESIDENT, CIVIL SERVICE TECHNICAL GUILD

My name is Louis G. Albano. I am a licensed professional engineer and President of the New York City Civil Service Technical Guild, which represents over 7,000 professional and technical employees of the City of New York. My union is an affiliate of District Council 37, of the American Federation of State, County and Municipal Employees, AFL–CIO, which represents 1.3 million public employees throughout the United States.

I appreciate the opportunity to address several of the questions the committee has raised for this hearing, both from the perspective of our own experiences in New York City and those of our national union throughout the United States.

The questions that I will address are:

1. What are some of the pitfalls of privatization of which Congress should be aware?
2. How should workers at the privatized entities be treated in the privatization process?
3. On what basis does one decide when to privatize an asset or function?

Let me say at the outset that we welcome this inquiry. There is no constituency, no group of Americans, who have more to gain from making government more efficient, honest and responsive than public employees. That is our job and the reason we have chosen public service. We share with you and all the other men and women who work in government a common purpose and mission, aptly summed up more than 200 years ago: "to form a more perfect union, establish justice, insure domestic tranquility, provide for the common defense, promote the general welfare and secure the blessings of liberty to ourselves and our posterity."

I believe this is a useful point of departure. For while there is much talk these days about "entrepreneurial" government and of course privatization, it is essential to remember that the business of government is not just another business. We are in the business of preserving and constantly renewing the greatest democracy in the world. We measure our effectiveness by the vitality of certain values, most of which we all agree upon, rather than by the accountant's ledger. Having said that, let me quickly add that the American people have every right to expect that their taxes are being wisely spent—and that they are getting what they believe they are paying for.

Our experiences in New York City provide a unique and I believe extremely valuable perspective on the question of privatization. In my own field of engineering and architectural services, New York City now has nearly 40 years of experience with the contracting-out of these services.

During the 1950s the city's need for filling the void in capital plant left during World War II was met by supplementing city technical staff with private consultants. In later years the city's announced goal for more contracting-out was greater flexibility. In the 1980s we first heard the term "privatization," which became the rationale for accelerating the pace of shifting the delivery of these services to the private sector. Forty years ago about 80 percent of this work was done by in-house staff and 20 percent by contractors. Today the ratio has been reversed. So I would suggest to you that we have here a unique opportunity to evaluate over a long period of time the effectiveness of this experiment in privatization.

The results are clearly visible to the people of our city: schools in a disgraceful state of disrepair, sewers replaced at a rate equivalent to once every 250 years, defective street construction and interminable delays in modernizing subway stations,

half of our bridges rated deficient, to name only a few of the more glaring manifestations of the deterioration of New York City's physical infrastructure.

A decade ago, in the midst of this rapid privatization process, the City's Office of Construction reviewed 6,000 capital construction projects and found $109 million in cost overruns, or 7.2 percent of contract value, a sum that translated to $3 billion over the life of the city's 10-year capital program. This report identified nine "problem" projects with costs averaging 235 percent above original estimates, an alarming signal of the City's inability to cope with its accelerating capital program. It is relevant that eight of these nine projects were designed and carried out by private contractors.

This report by the City's Office of Construction was only one of several done by a wide range of government and private entities that illuminate the relative cost-effectiveness of in-house and private engineering services. Virtually all of these reports and audits have reached similar conclusions: Under most circumstances, New York City would be far better served by having its own staff designing and supervising its capital program rather than contracting-out for these services. The question is why, in the face of these studies. has the City persisted in this policy of contracting-out the work?

The answer is not simple, but I believe it can be summarized by looking at five unexamined assumptions that seem to underlie this illogical policy.

1. CONTRACTING OUT WILL SAVE TAXPAYERS MONEY.

This assumption often fails to take account of the costs of writing contract specifications, administering the bidding process, resolving legal issues, monitoring contractors to guard against overbilling, insuring that structures are finished or correcting work not done properly. It almost always fails to calculate the costs of unemployment insurance and public assistance for laid-off public employees—and the loss of their tax revenues, nor does it account for the tendency of nationally based contractors to use their own suppliers, which cuts out local vendors and drains profits from the community.

2. THE COMPETITIVE MARKETPLACE WILL REVITALIZE GOVERNMENT SERVICES.

Competition for government contracts exists more in theory than in practice. When competitive bids are opened to the private sector, frequently only one or two companies make a bid. In a typical year New York City awards more than $1 billion in contracts to companies that were sole bidders. And even when competitive bidding takes place at the time a contract is first awarded, it rarely occurs at renewal time. The result is the opposite of competition—a virtual monopoly of taxpayers vulnerable to higher costs and poorer service.

3. QUALITY IMPROVES WHEN PUBLIC SERVICES ARE PRIVATIZED.

Private contractors must find a way to sustain their profit margin, and that often comes at the expense of quality. These companies either hire low-wage, temporary and often unqualified workers, or slash costs on the services they provide. We could fill an encyclopedia with examples just from New York City of shoddy work done by private contractors trying to cut corners—streets that begin to disintegrate months after they are repaired, equipment and materials improperly tested and schools that are freezing in winter.

4. CONTRACTING OUT IS BENEFICIAL TO THE COMMUNITY.

This assumption ignores the often serious and debilitating consequences of privatization on workers and the local community. It is not accurate to say that public sector jobs are being replaced by better private sector jobs. When privatization takes place, stable public sector jobs are often replaced by low-wage, temporary private sector jobs, many of which pay so little that the workers must seek public assistance to feed their families. Not only does the tax base decrease, but families suffer and the extra burden of support is placed on the community. The public employees most harmed by privatization are minorities and women. Because discrimination continues to be prevalent in the private sector, government employment has become an avenue for minority advancement. If these jobs are privatized, the impact is felt disproportionately among women and in minority communities.

5. PRIVATE SECTOR EMPLOYEES ARE MORE EFFICIENT THAN PUBLIC EMPLOYEES.

Inefficiency has less to do with the private or public sector than with an old and outmoded management structure prevalent in every sector of the economy. In the 1992 report of the Secretary's Commission on Achieving Necessary Skills (SCANS),

the Bush Administration's Department of Labor cites the hierarchical and rigid workplace as a key factor in slowing down the American economy. As long as workers are treated as costs to be controlled, not investments to be developed, we will never reach the economy's full potential. A high performance workplace is built on trained workers, flattened bureaucracies and decisions moved close to the front lines. This is especially true in the service sector of the economy whether public or private. To return to one of the questions raised by the committee, workers in privatized entities, and in the private sector generally, should be treated the same way as workers in the public sector: with respect and dignity.

The observations I have offered come from my own direct experiences with New York City government over the past 30 years, and as an officer of the National Society of Professional Engineers, but they reflect a national pattern that has been documented by AFSCME, which they would be happy to provide for the record.

The pattern is really quite clear and I believe goes to the heart of this inquiry. The principle problem in the delivery of public services is a problem of public management. Our most successful companies treat their frontline workers as assets, not expendable parts. These companies have transformed themselves by replacing the hierarchical workplace of old with one that respects workers' knowledge and experience. They have defined their core mission and then trained, deployed and motivated the staff needed to carry out that mission.

If we were to begin with this assumption, I believe we would be asking ourselves a different question today. Not how do we find ways to privatize more public services, but rather what is the mission of government and what kind of workforce is necessary to carry out that mission. The answer would obviously indicate some degree of private sector participation in the delivery of services to the public. But the results will be very different, depending on how we ask that question. The unexamined assumption that more privatization is necessary, for example, denies the irrefutable evidence in the case of our own experiences with engineering and architectural services in New York City that in fact the opposite is true: We would save money and improve the quality of service in New York if more of this work were done in-house.

Nobody should be surprised by this. In maintaining the huge and complex physical infrastructure of a city like New York, the public interest requires a significant core of highly motivated and skilled professional engineers who have a grasp and intimate understanding of the entire system. This knowledge is sometimes referred to as "institutional memory."

I will conclude my remarks with a story behind a story that made headlines a couple of years ago. It is a story about "institutional memory."

Stanley Brezenoff Executive Director of the Port Authority of New York and New Jersey and former deputy mayor of New York City, has offered a dramatic example of what this can mean. Speaking before an audience of municipal engineers shortly after the bombing of the World Trade Center, which is operated by the Pork Authority, Brezenoff explained the role played by the Authority's professional and technical staff in the wake of the bombing.

"It struck me," he related, "as we discussed the various strategies to restore the building's labyrinth of systems, how the engineering staff displayed an intimate familiarity with the building complex's life safety, utility and structural systems. This permitted them to answer questions and brainstorm solutions without having to first study plans and specifications. . . . What I was witnessing was instantaneous access to the Port Authority's institutional memory. . . . This staff knowledge proved invaluable. It made possible an efficiency that could never be matched by contract staff, no matter how highly qualified."

Every enterprise, public or private, has a need for this kind of personnel. It makes no sense whatsoever to deny government, which has both a legal and moral responsibility to provide the public with a wide range of vital services, this essential component in its ability to function effectively. The real question is how to provide the best balance between the private and public sector in the delivery of services. Unfortunately, in the current privatization mania, political rhetoric and narrow economic interests have too often substituted for objective criteria in determining that balance.

Such criteria would assure that public entities retain a staff of sufficient size and skill to carry out the many routine functions of government that study after study has demonstrated to be more effectively done by in-house staff. It would also assure that this staff had the capability to compete with private contractors for larger and more complex work. This serves two important functions. It provides government with personnel capable of supervising contractors and also guards against government becoming totally dependent on a single or small group of contractors. While much attention has been devoted to the need for competition in delivering public

services, the truth is that the artificially limited debate around privatization has rarely allowed for realistic competition to take place.

It is my hope that this hearing will begin to correct that deficiency.

Mr. HORN. I thought you had a beautiful sentence in here, where you said, "As long as workers are treated as costs to be controlled, not investments to be developed, we will never reach the economy's full potential."

Mr. ALBANO. That's true.

Mr. HORN. That's something with which I agreed. Mr. Concklin, welcome. Mr. Concklin is the president of the Professional Services Council.

Mr. CONCKLIN. Thank you very much. Is this on?

Mr. HORN. It should be, pull it a little closer to you. That's usually the problem.

Mr. CONCKLIN. All right, how's that?

Mr. HORN. And I wish you'd explain, as you do in your opening paragraph, the Professional Services Council and its role.

Mr. CONCKLIN. Thank you, Mr. Chairman, and members of the panel. We appreciate very much the opportunity to be here today to express our views on privatization. The Professional Services Council is a trade association, a creature in the Washington milieu that numbers along with three or four other thousand similar organizations. We are basically a policy voice and an advocate on behalf of the high technology, knowledge based services sector of the United States.

We have approximately 140 members, representing somewhere in the vicinity of 350,000 employees, and do an estimated $25 billion worth of business. A substantial part of that business, historically and through the moment, is with the public sector, the Federal Government. An increasing share is represented by international business, both with public and private sector international sources, as well as commercial business.

The products, if you will, that we supply as a services purveyor are problem solving techniques which literally span the spectrum of government. We do health research. We do education program development. We are heavily involved, and have been historically, in defense, space, environment, energy and virtually any area of government. I might say at this point, and this is a somewhat subtle underlying phenomenon.

The Federal Government buys about $70 billion worth of services each year. And conservatively, 25 to perhaps 35 percent of that $70 billion is privatization or what you might call de facto privatization; meaning the U.S. Government, over the last 30 years, has contracted out functions on a continuous basis, such as the operation of computer facilities, the operation of test ranges for missiles and space equipment and other high-tech type systems, and many other examples, which we'd be happy to submit for the record.

I'd just like to make a sidebar comment that I hadn't planned to make. But there's been some suggestion in some of the statements by previous witnesses having to do with quality or functions that are critical to human life or critical in the case of fast response to disasters. The company that I worked for for 11 years, a well-known services company, designed and supervised the assembly

and building of the space launch complex at Kennedy Center in Florida.

There is no single entity in western civilization that combines as many high-technology, critical functions as that space launch complex. And of course, human lives are involved every time a button is pressed and there's a launch. We want to commend you, Mr. Chairman, and your colleagues, for stepping up to a thoughtful consideration of this very complex and very critical subject.

We think that properly pursued, with all the caveats and more that have been offered here today in terms of infrastructure, rigor, counting 10, great care before embarking, that the benefits of privatization are profound. And, in the most fundamental sense, they involve right sizing, or properly sizing, the Federal Government; substantial improvements in the economic efficiency of what the government does or brokers outside sources to do; and finally, improving Federal performance through a release of so many Federal employees who are ostensibly in charge to do what one author has called, "steer, rather than row."

And that's a bumper sticker slogan, but in many respects, it's a metaphor for what privatization should be about—policy functions, regulatory decisions, budget functions, war powers, and those high level, inherently governmental functions certainly need to reside with full time, dedicated, confident government employees. A great preponderance of what is now done by the Federal Government can be contracted out.

Now, I want to simply echo what previous witnesses have said in terms of the cultural transformation that is an absolute imperative if privatization is to be done successfully over time. And it is not rocket science, but it's a matter of extremely careful attention to training, to education, to organizational structures, to analytical tools and protocols to do it right, and also to the existence of a structure to measure what you're doing with a fast, serious, directive action, as appropriate.

I see the yellow light, so I will move ahead smartly. I did mention that there are innumerable functions that have been contracted out by the Federal Government that range from very esoteric R & D labs; include computer centers; include every-day functions, such as guard service, firefighting, security service; include prominently, in the Department of Defense, a $10 billion to $20 billion market in the maintenance and repair of weapons, such as airplanes, ships and other military assets.

We, as a collective voice for professional and technical services, believe that it's vitally important that you focus seriously on contracting out not to the exclusion of other models, but we think there are significant risks and orders of complexity when you get into government corporations and like models. And we can talk more about that at your convenience.

Let me just quickly summarize our recommendations. They may seem a little bit premature, given that this is the kick-off of this examination. But in order to be able to look back 5 or 10 years from now and believe we've had a successful privatization legacy, we think several things need to happen. One is a clear, resounding legislative mandate to move ahead with a Federal Government strategy for privatization.

A second is an implementing mechanism that would have to be a high order, compelling and forceful mechanism. We do not have an answer for you today in design terms. Certainly, what has been done in the DOD sphere with the Base Realignment and Closing Commission provides a model that has worked fairly well—not perfectly, but well. And finally, we think a judicious use of further targets and ceilings on the civil service population, carefully ramped down over time, with a requirement on the part of all Federal agencies to set forth viable, sensible, early targets for privatization will be in everybody's best interest.

And last—and this is somewhat in contradiction to some of the previous witnesses—we would respectively suggest that you go very slow in terms of head-to-head public private competition. That can have many side effects and inequitable, uneven playing field ramifications, in our view.

[The prepared statement of Mr. Concklin follows:]

PREPARED STATEMENT OF BERT M. CONCKLIN, PRESIDENT, PROFESSIONAL SERVICES COUNCIL

Good afternoon Mr. Chairman. On behalf of the Professional Services Council (PSC), I want to thank you for the opportunity to present the PSC's views on privatization.

PSC is a national trade association representing the fastest growing sector of our nation's economy—the professional and technical services industry. One of PSC's primary objectives is to improve the process by which the professional and technical services firms contract with the federal government. Our sector's products are ideas and problem-solving techniques—primarily the applications of professional, expert and specialized knowledge to assist government and private-sector clients in solving operational, technical and management problems. PSC members include firms providing services to the government in the areas of defense, space, environment, energy, education, health, international development and others. Members use research and development, information technology, program design, analysis and evaluation, and social sciences tools in assisting the government to carry out its programs.

The PSC views the current privatization debate and the leadership, which you have assumed, as a watershed event for all parties who believe that the federal government can be profoundly more effective and responsive through innovative strategies such as privatization. At the most fundamental level, privatization offers distinctive benefits to the American citizens and the federal government:

(1) Rightsizing the Federal Workforce. The size of the permanent government workforce can be reduced with improvements in the delivery of service:

(2) Achieving Economic Efficiency. Significant economic benefits will accrue through intelligent use of competitive procurement procedures to engage private-sector organizations in place of in-house government organizations; and

(3) Improving Federal Management Reform. Federal policy and operational activities will become more focused and effective as the federal government shifts more to the "steering" role and assigns more of the "rowing" to the private sector.

In moving to embrace privatization, we believe that it is very important to keep foremost in our minds certain qualifications. First, privatization is not a stand-alone solution. It will require alterations in culture, infrastructure and tools to be successful. Second, contracting out is the most immediate high payoff option for implementing an effective privatization strategy. Other more exotic schemes such as public corporations, "franchising," and civil-service employee buyouts all entail significantly higher risks and degrees of continued government underwriting or subsidization of markets and operating budgets (e.g., Postal Service, Amtrak).

We will address the following related topics in our remarks today:

- Balancing the Use of Public and Private Resources
- Government's Privatization Legacy 1980-1995
- Broad-Based Capabilities of Private Sector-Services
- Key Issues
- Recommendations

THE CHALLENGE OF BALANCING PUBLIC AND PRIVATE RESOURCES

The federal government has been engaged in successful privatization for over three decades, with a sharp increase pattern emerging in the 1980–1995 period. Most of this "contracting out" activity has been performed by for-profit service contractors through competitive procurement procedures. Today, services contractors do approximately 70 billion dollars of business with the federal government per year. A substantial percentage of this work qualifies as defacto privatization in the sense that the government has engaged service contractors to perform clearly defined functions over a long period of time.

The PSC has consistently taken the position that public policy should be clear as to what functions of government are inherently governmental—must be retained in-house as the exclusive responsibility of government employees—and what functions are eligible to be contracted out without infringing on these inherently governmental functions.

Public policy should recognize three distinct levels when balancing public versus private roles in support of federal missions.

Inherently Governmental Functions—The first and most critical level consists of those functions of governance which are clearly the exclusive province of the government employees. Fortunately, a solid working definition of inherently governmental functions is available in the form of an OMB policy letter developed in 1992. This policy document[1] sets out very clear boundaries on functions which must be retained in-house—such as policy and budget decisions, regulatory strategy, waging war, revenue raising and many others. It also enumerates functions which should be contracted out—such as operation and maintenance of facilities, studies and analysis, technical support to development of systems, management assistance to complex programs and others.

Government Core Capability—The second major level is equally important but somewhat less distinct. This level contains the core capabilities that the government must possess in order to oversee and direct activities carried out by nongovernment parties. The governing principle should be the retention in government of the technical, management and administrative skills to competently plan, program, direct, review and validate the results of efforts performed by the private sector, but not perform the work unless the functions are deemed to be inherently governmental in nature.

Private-Sector Role—The third and last level to be considered in balancing public and private-sector roles is the private sector. Here the central question is, can the private sector perform a given function and is there sufficient competition to assure high-quality results at reasonable, market-determined prices? Typical examples of successful private-sector performance include operating federal computer centers, maintaining and operating missile test ranges and launch facilities, and training federal employees in the operation of complex equipment.

GOVERNMENT'S PRIVATIZATION LEGACY 1980–1995

Over the past 15 years, there has been a growing trend in the federal government in implementing privatization through contracting out.

The primary scenarios for privatization have been, in order of magnitude, direct contracting out, the creation of GOCO's (government-owned, contractor-operated facilities) such as the Sandia National Laboratory, and the so-called government corporations such as the Student Loan Marketing Association.

CONTRACTING OUT

- The dominant contracting-out category is typically driven by an agency's judgment that a given function (operating and maintaining a computer facility) can be more effectively and economically performed by a service contractor acquired through competitive procurement.

  This form of privatization has been especially successful because it affords the government customer complete flexibility to vary the level and content of the contractor's support activity in response to real demand (e.g., mission changes).
- During this same time period, OMB has sponsored a little used policy (referred to as "A–76") which calls for contracting out commercial type activities. The A–76 decision to contract out is based primarily on an attempt to compare the costs of retaining the work in-house with contracting out. The A–76 program has had limited impact because agencies have resisted the policy and the congress has effectively stalled the program. More importantly, the principle de-

[1] OMB Policy Letter 92–1, Inherently Governmental Functions, September 23, 1992.

cision mechanism in the A–76 process is a cost-comparison methodology which is seriously flawed and has generated a continued and unresolved controversy.

• The executive branch's efforts to privatize have been impeded by contracting out limitation's imposed on major functions. A prime example is the Department of Defense (DoD) depot (equipment maintenance and repair) function where the congress has said that 60 percent of all depot work (a 15 billion-dollar market) must be performed in-house, thus severely limiting the extent of privatization.

GOVERNMENT-OWNED, CONTRACTOR-OPERATED FACILITIES

• GOCO privatization has been implemented primarily in the Department of Energy and the DoD. It is most appropriate where the function requires substantial investment in development or production assets which would not normally be capitalized by the private-sector for-profit community—such as laboratory facilities to conduct research into advanced nuclear weapons or space-launch vehicles and payloads. GOCOs are not necessary where private-sector performance does not require special-purpose assets such as laboratories and test facilities.

GOVERNMENT CORPORATIONS

• Government corporations take a number of forms, but have in common the government providing capital and market guarantee assistance. Perhaps the most obvious form of this model is the U.S. Postal Service where the federal government has provided hundreds of millions in subsidies annually since its inception in 1971—in an area where there is a highly competitive and high performance private sector capable of performing the Postal Service mission. Many of the government corporations are special-purpose financial institutions dealing with the home mortgage market, federal deposit insurance, student loans and similar functions.

In summary, direct contracting out has been the most frequently used method of achieving privatization and represents a mature, low risk, economically sound and rapid approach to successful privatization.

BROAD-BASED CAPABILITIES OF PRIVATE-SECTOR SERVICES

The private, professional and technical services sector of the U.S. economy, represents approximately 400 billion dollars in annual sales or roughly ten percent of the gross domestic product. Its diverse capabilities cover virtually every field of activity with major concentrations in fields such as information technology, environmental technology, space, defense, health, transportation, energy, education and international development.

The federal government spends approximately 70 billion dollars on services each year and it is conservatively estimated that 50 percent of this amount is spent on activities which represent privatization in the sense that these activities are discrete functions which the government contracts out for on a continuing basis. This extensive use of service contracts provides unique benefits through continuous access to leading edge technologies, contemporary problem-solving capabilities and modern management.

The services sector, owing to its size, diversity and financial stability is fully capable of responding to additional opportunities to perform for government functions which qualify for privatization

KEY PRIVATIZATION ISSUES

Qualifying Privatization Candidates—A clear, flexible set of first principles is needed to guide federal decisions on what functions to privatize. This is critically important as a device to add objectivity to a process that tends to be highly politicized. Candidates for privatization should be subjected to a rigorous analysis before they are converted to private-sector stewardship.

Creating a Self-Perpetuating Mechanism—Cultural resistance to privatization within the federal bureaucracy will range from passive to overt and intense. A highly innovative, high-leverage mechanism will be needed to stimulate and motivate the executive branch to move forward with diligence and commitment. A variation on the generally successful Base Realignment and Closing Commission used by the DoD should be considered.

Avoiding Unfair Competition Between the Public and Private Sector—A potential exists to create unfair competition between the public and private sector, depending on what privatization model is employed. For example, in the previous congress

there was a legislative initiative to permit DoD depots to compete directly with established private-sector organizations who routinely perform the same service (e.g., overhaul of aircraft engines). This would have been a patently inequitable scheme since the federal depot would be partially underwritten or otherwise subsidized by the government.

Special Problem of Public-Private Competition—The A-76 commercial activities program and the DOD's depot program have both involved direct competition between the public and private sectors which has been a highly controversial and politically volatile process. The primary defect in this process is the use of "cost comparisons" as the primary tool for determining whether a proposed contracting-out action should go forward. The cost comparison methodology is seriously flawed in the view of many federal experts, most industry practitioners, the accounting and audit community and other informed observers. Public-private competitions should be used only in the most unusual circumstances and cost comparisons should never be used unless the current flaws are corrected—a process which would require a radical transformation of the government's financial and accounting systems.

RECOMMENDATIONS

1. Promote Privatization—A statutory base is needed which sets forth strong, unequivocal direction for the executive branch to move forward with a strategically-based privatization program. This statutory instruction would form the backbone of a comprehensive long-term movement of commercial-type activities from the government to the private sector.

2. Create a Self-Perpetuating Process—The new statutory base should call for one or more privatization mechanisms which are as close as possible to self-perpetuating through creative and judicious use of incentives, performance goals, measurement criteria (metrics) and realistic timetables with penalties for default.

We suggest consideration of at least three mechanisms: (1) something similar to the DoD's Base Realignment and Closing Commission; (2) continued use of federal personnel ceilings or target reduction goals to help catalyze pursuit of productive privatization opportunities; and (3) a requirement for each major federal agency to submit (within six months of passage) to the congress a list of their most promising privatization candidates (e.g., top ten) along with an implementation strategy.

3. Prohibit Public-Private Competition—Because of the inherent inequity arising from pitting the government against the private sector, compounded by the deeply flawed use of questionable cost comparisons, public-private competitions should not be used as a privatization strategy.

Mr. Chairman, and members of the subcommittee, we thank you for the privilege of presenting our views on privatization. We respectfully commend you on your wisdom in undertaking an examination of this promising area of government policy. Successful privatization will reduce the cost of government, improve performance and enhance the average citizen's perception of the responsiveness of the federal government.

Mr. HORN. Let me ask the first question. I don't quite understand that last paragraph. What are the side effects of public-private competition?

Mr. CONCKLIN. Well, No. 1, in the last decade and a half, there have been abortive, largely unsuccessful efforts to move ahead with a program called A76, sometimes referred to as a commercial activities program. The nervous system, the heart of that program, is something called a cost comparison. And I'm going to skip over a lot of detail, but cost comparisons between doing work in-house by Federal employee associations, and the private sector are analytically deeply flawed because the government's accounting system does not reflect and faithfully collect indirect costs.

So you get a substantial understatement, certainly in the range of 10 to 20 percent, conservatively, of overhead when you compare the government's cost of running a motor pool, let's say, versus the private sector. The private sector cannot hide overhead. The IRS, the SEC and the mandatory Federal cost principles require you to show all your overhead. If you hide it, you're committing a criminal act, or a civil act.

In the case of the government, the government does not flow down—accounting terms—does not flow down the overhead from the Pentagon such that every gallon of the Secretary's gas spent flying around the world gets fractionally allocated to that motor pool. That's the problem, in simplest terms.

Mr. HORN. As a former dean of research, I can understand the problem of indirect costs. I must say, some government agencies have tried it and they've dumped everything they can think of. For example, naval shipyards, of which I'm becoming a junior grade expert, and you've got competition there, and a standard, that the public yards provide. Frankly, if there were no public yards, there would be a scalping of the Department of Defense every day. I believe in private enterprise, but not gouging the Defense Department on a defense contract.

So I worry about that. I think you're right on that.

Mr. CONCKLIN. It is.

Mr. HORN. But indirect cost isn't that much of a concept. But now they're dumping that type of cost on their own cost, which is ballooning the cost beyond reason.

Mr. CONCKLIN. Yes, sir.

Mr. HORN. And some of them aren't necessary.

Mr. CONCKLIN. May I make an additional very quick statement about the financial structure, which I failed to make?

Mr. HORN. Sure.

Mr. CONCKLIN. There was a comment, I guess, referring to the UK experience, of ballooning profits, or profits out of control. When the U.S. Federal Government contracts, using services contracts, for things like running a test range or running a computer center, there is zero point zero probability or possibility that profits will balloon out of control, because the Federal system controls profits.

Profits, for example, gross profits are in the 4 to 8 percent range. Net profits are 2 to 4 percent for most of our members. There is no mystification whatsoever about that. Profits are controlled if you obey the Federal cost principles, which are part of the regulatory architecture when you do business with the Federal Government.

Mr. HORN. The gentleman from Pennsylvania.

Mr. MASCARA. Is there anything in the Federal Government that's off limits to privatizing, or how far do we go?

Mr. CONCKLIN. Yes, sir, I would start with—not to be too theoretical—but there is an OMB, Office of Management and Budget, directive that defines, with respectable precision, what are inherently governmental functions. And they are such things as designing programs; making all policy decisions; formulating budgets and managing budgets; making all regulatory decisions; all the war power or war fighting aspects.

Although, that's not adhered to because service contractors get deeply involved in battlefield advanced front line support in many instances. But those are fairly well spelled out. And again, I want to associate myself with the previous speakers. I think it's important to go slow and take the low risk, feasible targets first. For example, computer centers are widely contracted out. I see no reason why virtually all Federal computer centers couldn't be contracted out.

That would fit the——

Mr. MASCARA. And the last question, Mr. Concklin, is in reference to your final statement about going head to head with public and private sector. I didn't quite understand that, other than there was some kind of an accounting function that you had a problem with as it relates to indirect cost.

Mr. CONCKLIN. The history, both in the so-called A76 program, as well as the Department of Defense's depot program, the history is one of great contention, great unresolved problem, great order of unresolved problems with respect of the so-called comparison of the Federal cost to the contractor cost because the overhead is usually not accurately or totally reflected on the Federal side, so the costs look smaller.

And then academicians, people from accounting firms, most government employees will readily admit that that so-called cost comparison methodology is mortally flawed. We've had debates throughout government. We've had debates with the General Accounting Office where they have made that concession. It's not fair. It doesn't provide a level playing field when you use that methodology.

Mr. MASCARA. But we have two groups here. We have the private sector and we have a group of public employees who are bidding on a certain job. How does the fact that we weren't taking into consideration indirect costs affect the size of that bid or the amount of that bid?

Mr. CONCKLIN. Because—and I apologize if I sound theoretical—but the contractor cost—if I'm a contractor, I must when I bid to run the government's motor pool, I must incorporate into my costs all of the allocated overhead that is associated with running a motor pool as a private sector contractor. Even if I had malign intent, the IRS, SEC and Federal regulations absolutely require me to do that.

The government is not engaging in necessarily subterfuge, but the point is, the government doesn't have the accounting structure to identify and aggregate its overhead, other than what is often called the marginal or very local overhead, or the marginal cost associated with that motor pool. This is no theory, they are real dollars. The government's cost of running the Pentagon is——

Mr. MASCARA. But isn't all that reflected in the bid of the people bidding? I mean, it costs so much——

Mr. CONCKLIN. The methodology—you obviously have to take this on faith, and I realize it's arguable—but the methodology that the government uses does not capture, other than local and therefore a limited amount, of overhead, rather than the total overhead.

Mr. MASCARA. When the employees bought Hertz—not Hertz, Avis, I mean, didn't they have to take everything into consideration when they bought that company out—what it was going to cost to run it and what kind of a profit they hoped to generate? And if you have a public sector and a private sector here, and they're bidding on a job, what makes the difference whether one is or isn't? I mean, they would both have to consider what the cost would be and how much profit they hoped to realize, regardless of all these other nuances, accounting nuances.

Mr. CONCKLIN. Congressman, I don't mean to be argumentative, but it's straightforward accounting. There is a way for accounting

for overhead that is pervasive and required by law in the private sector. The Federal Government—and this is not a criticism, it's the government is different than the private sector—the Federal Government—I've spent half my career in the Federal Government—is not, other than in a few rare instances like some naval repair facilities and air repair facilities, the other 90 percent of the Federal Government does not account systematically for overhead.

Mr. MASCARA. I understand that. But it still costs x number of dollars to perform the service. And regardless of whether it's the former public sector, and these people are now going to be private sector people, bidding on a government job, they still have to take into consideration what it costs to perform that duty, and then they put their mark-up in it. And regardless of who's bidding on it, they both have—they're heading in the same direction.

Mr. CONCKLIN. No, the mark-up that the government assigns in its paper study, in its paper analysis is artificially low. And, therefore, they have a lower—when you add direct costs, mark-up and profit to each side, the government ends up with an implicit 10 to 20 percent handicap. That's not my theory, that's the result of a lot of analytical and audit work that's been applied to it.

Mr. MASCARA. Well, I don't want to continue this debate. I'm just saying that regardless of whether it's the private or public, the public now becomes private and they'll be bidding on a job to make a profit. So regardless of what these former public indirect costs were that were not being added in, it doesn't make any difference, is what I'm saying. I'm finished, Mr. Chairman, thank you.

Mr. HORN. Does the gentlewoman from New York have any questions?

Mrs. MALONEY. I would like Mr. Albano to comment on Mr. Mascara's question if there's some inequity, why can't we just level the playing field? It seems to be unfair, if we're going to aggressively pursue privatization, to cut out the private sector. Who knows—maybe they can save us some money by doing the job better and cheaper and faster.

Mr. ALBANO. I can't speak for the Federal Government. And it's just sad to hear that they have an inability to cost out an item. Prior to my coming here, we have sat down with the city of New York. We've spoken to the issue of managed competition. We have put together the papers and the cost analysis to actually compare the costs between doing the work. So there is an even playing field.

I don't see this as some mystery. I don't think it's something that is so innate that somebody couldn't sit down who has the experience and say, well, this is the cost of government, this is what the cost is, and set some equation. I'm astounded if it's true what he's saying. I, quite frankly, don't see that in the city. We've been, how should I say, doing managed competition for many years.

The Office of Management and Budget, in my estimation, I have somebody who was a former employee who now comes on as a consultant to my union as a volunteer, who believes in the practice. And he provides us the cost analysis, and we make very sure of the fact that all costs are taken in. And invariably, as my testimony states, we can, in most instances, compete and save money.

Mr. CONCKLIN. May I respond?

Mrs. MALONEY. Yes, Mr. Concklin.

Mr. CONCKLIN. All right, I'll respond briefly. My answer to your question is, the problem could be solved if the Federal Government systematically, across the board, put in place a finance and accounting system which required the full collection and full representation of overhead. It's not a state-of-the-art problem. It's just that public administration, at least at the Federal level, has been not concerned with collecting all the costs associated with doing a thing such as having a military battalion deployed to the Middle East.

It tends to budget in terms of manpower or peoplepower, training, operating costs. But it doesn't associate costs with functions as I know some State and local governments do a better job of. And in the private sector, that's the way it's aligned. It's aligned by the function, production function or service function.

Mrs. MALONEY. I'd like to ask both panelists, the panel before you discussed employee stock ownership, which has been very successful in growing private firms. How do you think that would work with public employees if we changed the law so that certain services could be bought by either the private sector or by the public employees? I'd like to ask both panelists how they feel about that concept.

And first, the public employee. Mr. Albano, would you support that concept or not?

Mr. ALBANO. It would really have to be studied, because basically there is a question of setting an equal playing field and whether we could really be able to get the cohesiveness. I think that might be a problem. It's a new concept. I have never been ashamed or afraid of new concepts. We have been very flexible in the city. We have set up new agencies. We're ready to sit down. We'd have to take a very careful look at it.

I think it's something that, like everything else, with modernization and efficiency and changes that are being made, we have to take a serious look.

Mrs. MALONEY. Thank you. Mr. Concklin.

Mr. CONCKLIN. It is a very complex question. Our preference, as professional and technical service purveyors is for the most direct, straightforward way, which, we would submit, is contracting out, to the extent that you're going to do privatization. There are other models. The notion of Federal employee buyouts, I think, is a fairly fanciful notion. We do not favor it, as a general proposition.

It presupposes almost an instant ability to take on the behavior patterns and the cultural architecture of a high-performance private sector organization. And there are cultural differences between public employees and private sector employees that are not easily erased or replaced.

Mrs. MALONEY. In your testimony earlier, Mr. Albano, you stated that contracting out has become the new patronage system. And as both of us know from our service in New York City, we've been plagued by a long series of scandals not with city employees, but with private contractors. The city source scandal; the parking meters, when we contracted out; the collection services; the waste management; the sanitation department—just a whole series of private contracts that, when they were contracted out, ended up in court in some scandalous situation.

My favorite was Mr. Brezenoff that you mentioned earlier. For some reason, he decided to contract all of the oversight and the study of city hospitals to firms in California. I couldn't understand why. I mean, I think you could have found some universities in New York that would have been willing to do if for free. But we were contracting with all of these California firms to "study" the municipal hospital system. And we were hurt very deeply and very badly by all of these scandals in contracting out.

And I just would like to hear your comments on it. We tried many ways to improve oversight and monitoring, but it unfortunately has been one long series of abuse of taxpayers' funds. My favorite was the hauling of the city sludge. We were paying 8 times more than any surrounding county. I even went to court and sued the mayor over it. But it was a whole series of one scandal after another without contracting out.

And maybe you could start, Mr. Concklin.

Mr. CONCKLIN. Sure. I certainly have limited to no knowledge of the details of what went on in New York City. But I can tell you that professional technical services contracting by the Federal Government, as I said, is a $70 billion per year enterprise. We have been virtually free of any scandal or major performance problems of any type over a period of three decades plus.

This is not to say there aren't occasional problems in Federal contracting. There are, but by and large, it has worked very well to the benefit of the Federal Government and ultimately the taxpayers. Just listening to the examples you gave, I would certainly look very deeply and very critically at the behavior of both the buyer and the seller. If somebody was paying 8 times the going rate for a given unit of service, then I would gain the impression that there must have been something mortally wrong with the management of that contract that would have approved the contract that was going to generate that kind of price or rate.

This is not to say the contractor wasn't a charlatan as well, for being party to that.

Mr. HORN. Thank you very much. The gentleman from Virginia, Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman.

Mr. ALBANO. I thought of—I would like to add something to that question, if I could?

Mr. HORN. Sure. Well, let me ask you, do you have anything that you'd like to add to that last question?

Mr. ALBANO. I appreciate that, Mr. Chairman.

Mr. DAVIS. Then I've got a question for Mr. Concklin.

Mr. ALBANO. The parking violation bureau was something that was a horror because of the fact that they set up a separate agency and then contracted out the work. There was not one civil servant in that agency. It was a political agency. It was set up without any standards or specifications. And the people involved had no dedication to civil service. They were political appointees, no examinations. It was a horror.

And it goes right back to the basic statement I made at the beginning. You need accountability. You need people in place who can do the evaluation and to be sure that the public is being protected.

The owner has to be protected, and you need to have the people there to do it.

Mr. HORN. Mr. Davis.

Mr. DAVIS. I'll ask each of you, if we can start with Mr. Concklin, who I've known for many years and, I think, represents an outstanding organization, the Professional Services Council. In local government, we found many times that before we would make a decision to go private, we would allow our public employees to compete as well. This is in a new area. We would allow our public employees to work up their own strategy for trying to deal with the RFP, and allow the private sector at the same time.

And we found many times that the public sector could win out, but they would streamline the strategies that we had been using over time, it would lower the cost to the taxpayer, which is ultimately what you're after. You're not after privatizing, simply for the sake of privatizing. You're trying to deliver the best service that you can at the lowest price to the taxpayer.

Has the Federal Government done this? Is it workable? I'll ask each of you all, starting with Mr. Concklin.

Mr. CONCKLIN. Yes, I've responded to part of that before, and I'll keep this brief. We have a serious problem with public-private competition at the Federal level, again, because of the fact that the Federal Government does not have a competent system for accumulating its costs, especially are indirect or overhead costs. So you can't get a valid factual or analytical comparison on paper before you make at least a tentative decision to attempt a competition.

So we have opposed that. And my impression is that State and local governments have more rigorous and thorough accounting systems so that it's more possible to do a side-by-side, level playing field cost comparison than it is at the Federal level.

Mr. DAVIS. Let me follow up. One of the problems we found is to get the private sector to participate, sometimes they didn't want to go on a wild goose chase.

Mr. CONCKLIN. Right.

Mr. DAVIS. They would be expending a large amount of money and maybe end up with something that wouldn't go. But there may be an abbreviated process here where you can start to ballpark some of those. It may depend on the agency.

Mr. ALBANO. Well, with the city of New York, basically, we, in negotiations, set up what we call a section 11 to provide some sort of an equal playing field. In the majority of cases where workers contracted out, they do not provide the employees the benefits or the same salary levels. And so the cost comparison there makes it very difficult for city employees to compete.

Section 11 of our contract was one aspect of that, and then we were able to get the city council to pass a new law 35, again, stating that there has to be, built into the contract cost, benefits, basic salary levels. Because all too often what happens is that the employees of these contracted out jobs fall back on the city dole, so to speak, because they don't have the basic protections. They don't have hospitalization insurance. If they get sick, they don't have time off. And they go back on welfare in many cases.

The problem is that there's not an equal playing field, all too often. And the only way, in many cases, the city employees are beat

out is the fact that private firms do not pay equal standards in the salaries and benefits. It's a major problem. What happens is, you're just downgrading the economy, in my opinion.

Mr. CONCKLIN. If I could respond briefly to that?

Mr. DAVIS. Sure.

Mr. CONCKLIN. And I don't mean to sound rand about it, but certainly in professional and technical services as we know them, employees are our assets. And we depend 100 percent on the morale motivation and meeting of obligations by employees for our success, for repeat business, for our reputation building. And you cannot take the risk of a disenchanted, alienated employee by wage gouging or withholding or provision of minimal fringe benefits.

The market determines that. The market determines what you pay a Ph.D. physicist or a technician who is doing environmental tests in a laboratory that you may run for the Federal Government. And it is virtually devoid of that kind of syndrome. And I don't challenge that that happened in New York City.

Mr. ALBANO. I just wish you were bidding for city contracts.

Mr. DAVIS. I yield back. Thank you, Mr. Chairman.

Mr. HORN. Thank you very much, Mr. Davis. I think you raise a very interesting point on the proper financial records. We should get a balance sheet as a condition of consideration for privatization. This committee and the full committee, for 3 years at least, have been trying to get these two administrations to get the Chief Financial Officer Act implemented.

There have been some successes; there have been some failures; and there's been a lot of dragging of feet in a few agencies. We're going to get back to that this summer and fall. But your point, I think, is well taken, Mr. Concklin, on the indirect cost situation. I suspect we'd have to define it a little differently here and not give one-millionth of 1 percent to Secretary Perry's car in the Department of Defense, as you do at a university, where you throw in the library, the percent of time the central administration spends on the research project, et cetera.

So those things ought to be clarified so you are able to compare apples and apples. I'd just like to ask one question of Mr. Albano. On page 2 you note—and I agree with your institutional memory statement. I thought that was very well put. But I note on page 2 in that third paragraph, you say,

> The results are clearly visible to the people of our city. Schools in a disgraceful state of repair; sewers replaced at a rate equivalent to once every 250 years; effective street construction, interminable delays in modernizing subway stations; half of our bridges rated deficient, to name only a few of the more glaring manifestations of the deterioration of New York City's physical infrastructure.

I guess my query is, is that really the result of privatization, the so-called consultants, technical staff, or is it a lack of capital outlays and lack of political will of the city of New York?

Mr. ALBANO. It's a combination. Basically, as Carol said before, the question of accountability. In the 1950's and 1960's, you had a full staff. You provided inspectors in the field. Every job was monitored. With the downsizing and the cutting back, there are less people available, and we do not have the same level of inspection and literally watching the contractor do the installation.

It also has caused us to put jobs out that aren't completely designed. I've had arguments with city council people, the mayor, that 10 percent more time spent in the development of the drawings would eliminate, at the minimum, 10 percent of the construction costs. And that's a multiple at least 10 to 15 times. So if you spend $10,000, you'd save $100,000 easy on the actual site.

The major problem is the fact that we don't have the staff. We are not doing the real overview. And a lot of shoddy work is getting approved because, again, if the inspector does the type of job, he finds that he may live in Brooklyn. He does a great job in Brooklyn; he's very happy. And his boss says, you know, you're doing such a good job, we're going to put you up in the Bronx. And he does a good job up in the Bronx and the next thing you know, he's at Staten Island. And he gets a message.

And it's a very difficult problem for the union, because sometimes our own people are involved. And we need to do more accountable work. We need to provide the professional staff and we should develop that staff so that you can get an honest contractor to do the work. A lot of good contractors don't bid for city work. And it's a problem. The whole procurement system needs to be revised, and we're trying to work on that.

Mr. HORN. Thank you. Any further questions? I thank both of you very much for coming to share these experiences and your wisdom with us. Thank you very much. Our last panel for the day, panel IV, is the infrastructure panel, Mr. Stanley, Mr. Correll. Would you please come forward?

[Witnesses sworn.]

Mr. HORN. Please be seated. We'll start with Mr. Stanley, the senior vice president of the United Infrastructure Corp.

STATEMENT OF RALPH L. STANLEY, SENIOR VICE PRESIDENT, UNITED INFRASTRUCTURE CO.; ACCOMPANIED BY DONALD CORRELL, PRESIDENT AND CEO, UNITED WATER RESOURCES

Mr. STANLEY. Thank you, Mr. Chairman. My name is Ralph Stanley, and I'm currently working for United Infrastructure Co., a joint venture of Bechtel and Peter Kiewit, two diversified construction companies with combined revenues of more than $11 billion. UIC is a newly formed developer whose purpose is the development and ownership of infrastructure projects, such as roads, bridges, water plants and airports.

We're a company formed to assist in addressing the shortfall in infrastructure resources. We're also dedicated to working with this committee and others in developing policies at the Federal, State and local level to encourage private involvement. Prior to joining UIC, I served as the founder, chairman and CEO of the Toll Road Corp. of Virginia, the company building the private extension of the Dulles Toll Road.

I've also served here in Washington for 6 years as Chief of Staff to Secretary of Transportation and Administrator of the Federal Transportation Administration, where I actively sought to increase the role played by the private sector to provide transportation infrastructure. I've served on two Presidential commissions that

looked at privatization of services, as well as a new means to involve private capital in infrastructure projects.

I mention my background to demonstrate that I've been on both sides, attempting to implement public-private partnerships, and am very well aware of changes in Federal policy needed to increase private investment in infrastructure. As you know, it is well documented, and has been for years, that this country needs to make substantial new investment in its basic infrastructure.

The public sector is spending approximately $140 billion annually, and the projected shortfall each year is from $40 billion to $80 billion a year. EPA alone indicates the need for $200 billion in new finance over the next decade to bring communities into compliance with the Clean Air and Clean Water Act. Our highway administration estimates that $29 billion a year is needed to merely maintain the conditions of the Nation's roads and bridges.

It's clear that these needs cannot be met by government alone, whether at the Federal, State or local level. The use of the private sector to develop, own and operate infrastructure projects is truly a global phenomenon. It is occurring in both developing and developed countries. According to a recent survey, there are more than 900 projects in 72 countries with a total requirement of $680 billion that are in development or have been put under construction by private sponsors since the 1980's.

The trend is everywhere from Eastern Europe to the Asia Pacific, where former Treasury Secretary Lloyd Bentsen estimated a need of $1 billion a week to meet that country's infrastructure needs. In the past 2 years, a number of funds have been created to meet that need, and many include American institutional investors. As mentioned earlier, as the competition for capital increases globally, we as a Nation find ourselves in the position of providing resources from U.S. insurance and pension funds to finance infrastructure overseas.

As those capital resources are utilized to improve the infrastructure of other countries and their economies that compete with us, surely now is the time to remove the barriers that prohibit private investment and ownership of infrastructure in the United States. I'd like to take the balance of my testimony to just mention specific steps that I think this Congress in this session can take that would have a profound effect on freeing up private sources of capital to invest in our infrastructure.

As I mentioned earlier, I served on the Infrastructure Investment Commission in 1993. That panel also included Neil Goldschmidt, a former Transportation Secretary, Governor and mayor; Kay Bailey Hutchison, who's now in the U.S. Senate, and former Treasurer of the State of Texas; and Frank Hanley, who was the general president of the Union of Operating Engineers.

The commission was bipartisan, unanimous in its recommendations, and recognized two fundamental truths. One, there would be a decrease in Federal funding for infrastructure; and two, new ways were needed to leverage existing funds. It resulted in the introduction, last Congress, of the Infrastructure Development Act of 1993. I'd encourage this committee and the Transportation Committee to take a look at that legislation, a copy of which I will provide.

That legislation recommended the creation of the National Infrastructure Corp., an entity that would provide debt, equity, credit and risk insurance to private entities for revenue-based infrastructure projects. It would be funded with a 3-year capitalization through the sale of common stock to the Treasury. Total startup funds were recommended at $1 billion a year, and any further investment would be prohibited.

After a 3-year period, there would be a complete conversion to private ownership. NIC would provide four functions. First, it would make senior and subordinate loans, as well as investments, to private entities for revenue-based infrastructure projects. Second, it would provide limited financial insurance on the debt of projects that would have difficulty obtaining credit. Third, it would provide limited preconstruction risk insurance. And finally, it would certify the eligibility of projects for public benefit bond status, another commission recommendation, that would allow pension funds to invest in infrastructure in a manner competitive with tax exempt rates.

My second recommendation, in addition to looking at that legislation, would be to codify Executive Order 12803. As was mentioned earlier, there are a number of infrastructure facilities, such as airports, highways, and wastewater systems, built with Federal grants during the last 20 or 30 years. A common feature of these grants, thousands of which I signed at FTA, require a repayment of the Federal portion if the asset is transferred to the private sector.

I think the effort made in 1992 by President Bush in issuing Executive Order 12803 improved on the situation. There still has been very little activity. The repayment requirement has hampered that. I would recommend the Congress enact a measure, the McIntosh bill, that allows State and cities to privatize their federally aided infrastructure by sale or lease, as long as it is kept in its original use.

At least one estimate has been that there are about $227 billion worth of such assets eligible to be transferred. My third recommendation is to remove the current ban on tolls on interstate highways. As I mentioned earlier, there have been numerous studies about the underfunded infrastructure in our Nation's roads and bridges. Congress, in the last two highway bills, has gradually relaxed the ban regarding tolls. And, in the next highway bill, the current restriction on tolls on the interstate should be removed completely.

This would be particularly helpful to repair the more than 280,000 bridges in this country that are unsafe. Our company is currently negotiating a franchise on the Tacoma Narrows Bridge in Seattle that would allow tolls to be installed and improvements made to that facility, including the possibility of a new bridge. We also are going to be shortly submitting to the Secretary of Transportation, along with Brown & Root, the contractor on the Dulles Toll Road extension, a proposal to design, finance, build and operate a replacement facility for the Woodrow Wilson Bridge here in the Washington area.

A removal of the ban on tolls would greatly add to that effort. Finally, I want to mention a couple of changes in the tax code

which I think would go a long way toward increasing investment in our infrastructure. The first would be to remove the current 5-year limit on operating and maintenance contracts. It has the practical effect of curtailing a private entity's willingness to make capital investment.

If this restriction were abolished, billions of dollars of capital improvements would be made to facilities, such as wastewater treatment plants. In addition, I would like to see the distinction between public and private ownership eliminated when it comes to the eligibility for tax exempt bonds. Tax exempt status should be made for all public purpose infrastructure, or should be eliminated for those facilities that are self supporting.

In conclusion, I'd like to thank you for the opportunity to testify today. And what I've tried to do is suggest some changes that I think can be easily implemented and whose cumulative effect would be to attract billions of dollars of capital to meet this Nation's infrastructure needs. Thank you very much.

[The prepared statement of Mr. Stanley follows:]

PREPARED STATEMENT OF RALPH L. STANLEY, SENIOR VICE PRESIDENT, UNITED INFRASTRUCTURE CO.

Good morning. My name is Ralph Stanley, and I am currently a senior vice president of United Infrastructure Company, a joint venture of Bechtel and Peter Kiewit, two diversified construction companies with international operations and combined revenues of more than $11 billion. United infrastructure is a newly formed developer whose purpose is the development, and ownership of infrastructure projects such as roads, bridges, wastewater and water plants, and airports. We are a company that was formed to assist in addressing the shortfall in infrastructure resources. We are also dedicated to working with your committee and others in developing policies at the federal, state, and local level to encourage private involvement in infrastructure.

Prior to joining UIC, I served as the founder, chairman, and chief executive officer of the Toll Road Corporation of Virginia, the company now building the private extension of the Dulles toll road the country's first effort at infrastructure privatization. I have also served here in Washington for six years as chief of staff to the Secretary of Transportation and Administrator of the Federal Transportation Administration, where I actively sought to increase the role played by the private sector in providing needed transportation infrastructure. I have also served on two Presidential commissions which examined both the potential for general privatization of government services as well as new means to involve private capital in the delivery of infrastructure projects. I speak of my background to demonstrate that I have been on both sides attempting to implement public/private partnerships, and am very well aware of what changes in federal policy are needed to increase private investment in infrastructure.

It has been well documented that this country needs substantial increased investment in its basic infrastructure to remain competitive in a global economy. The public sector currently is spending $140 billion annually on infrastructure investments. Projections of the shortfall range from $40–$80 billion a year to meet our critical infrastructure needs. The United States Environmental Protection Agency alone projects the need for $200 billion in new finance over the next decade to bring communities into compliance with existing federal mandates for clean water and clean air. The Federal Highway Administration has estimated that $29 billion dollars a year is needed to merely maintain the conditions of this nation's roads and bridges. It is quite clear that these needs cannot be met by government alone, whether at the federal, state, or local level.

The use of the private sector to develop, own, and operate infrastructure projects in partnership with the public sector has become a global trend in both developing and developed countries. According to a recent survey by the authoritative publication, public works financing, more than 900 projects in 72 countries with a total requirement of almost $680 billion dollars are in development or have been put under construction by private sponsors since the 1980's. This trend is evident from Eastern Europe to the Asia-Pacific, where former Treasury Secretary Lloyd Bensten estimated a need of $1 billion dollars a week in China alone to meet that country's in-

frastructure needs. In the past two years, a number of funds have been created to meet this need, and many include American institutional investors such as insurance companies, banks, and pension funds. Thus, as the competition for capital increases, we as a nation find ourselves in the position of providing resources from U.S. insurance and pension funds to finance improved infrastructure overseas. As our capital resources are utilized to improve the infrastructure of other nations, and their economies that compete with us, surely now is the time to remove the barriers that prohibit private investment and ownership of infrastructure in the United States.

I would like to focus the balance of my testimony on specific steps that the Congress can take in this session that will have a profound effect on freeing up private sources of capital to invest in America's infrastructure. This committee is charged with the task of making difficult choices on spending priorities, and the steps that are suggested here today will more than offset those reductions by leveraging the capital available and allowing for private capital to be invested.

ADOPT THE NATIONAL INFRASTRUCTURE DEVELOPMENT ACT

The infrastructure investment commission upon which I served in 1993 also included:

- Neil Goldschmidt, a former mayor of Portland, Governor of Oregon and Secretary of Transportation;
- Kay Bailey Hutchison, now a U.S. Senator and formerly a treasurer of the State of Texas; and,
- Frank Hanley, general president of the union of operating engineers.

The commission was bipartisan, unanimous in its recommendations, and it recognized two fundamental truths: there would be a decrease in federal funding and new ways would be needed to leverage funds that were available. This committee is now confronting the former and needs the recommendations from that commission that were very ably incorporated into legislation written and introduced last Congress by Congresswoman Rosa DeLauro with the assistance of Robert Spring of Milbank, Tweed, and David Seltzer of Lehman Brothers. That legislation would establish a government corporation, the national infrastructure corporation (NIC) that would provide debt, equity, credit and risk insurance to private entities for revenue-based infrastructure projects. NIC would be funded with a 3 year capitalization through the sale of common stock to the Treasury. Total startup funds would be $1 billion a year for 3 years only, and any further investment would be prohibited. After a period, there would be a complete conversion to private ownership, at which point the federal government would be repaid.

NIC would provide four functions. First, it would make senior and subordinate loans as well as investments to private entities for revenue-based infrastructure projects. Second, it would provide limited financial insurance on the debt of projects that would have difficulty obtaining credit. Third, it would provide limited preconstruction risk insurance, and finally, it would certify the eligibility of projects for public-benefit bond status. Public benefit bonds, another commission recommendation, would allow pension funds to invest in infrastructure projects in a manner competitive with tax-exempt rates.

The establishment of NIC could be achieved quickly, and the funds for its capitalization could come from existing grant authorizations. Indeed, its function could be performed by a simple amendment to the charter of an existing government sponsored entity, such as Connie Lee. The result of the creation of an entity to perform the functions of NIC would be $30 billion worth of new infrastructure investment and three quarters of a million jobs.

CODIFY EXECUTIVE ORDER 12803

There are a number of infrastructure facilities such as airports, highways, and wastewater systems that have been built with federal grants during the past 30 years. A common feature of such grants, thousands of which I signed at FTA, requires a repayment of the federal portion of the grant if the asset is transferred to the private sector. This restriction has prevented many such transactions, such as Albany, New York's attempt to sell and then lease its airport in 1989. In 1992, to increase private involvement in infrastructure, President Bush issued Executive Order 12803, which, while better still, requires the city or state to repay the undepreciated portion of the grant. Nevertheless the repayment requirement has hampered any real activity. This Congress should enact a measure that allows states and cities to privatize their federally aided infrastructure, by sale or lease, so long as they are kept in their original use. Bob Poole's reason foundation has esti-

mated that there are approximately $227 billion of such assets eligible to be transferred.

REMOVE CURRENT BAN ON TOLLS ON INTERSTATE HIGHWAYS

A recent estimate by the federal highway administration indicated that there are $212 billion in needed highway work and $78 billion in bridge improvements needed on our nation's roads. Congress has gradually relaxed the ban regarding tolls on federal aid highways in the past eight years, and in the next highway bill the current restriction on tolls on the interstate should be removed completely. This would be particularly helpful to repair the 280,000 bridges in the country that are unsafe. Our company is currently negotiating a franchise on the Tacoma Narrows Bridge in Seattle that would allow tolls to be installed and improvements made to that facility, including the possibility of a new bridge, under a fifty year franchise. I would also like to announce today that our company and Brown & Root, part owner and contractor of Dulles Greenway, will shortly be submitting a proposal to the federal government to design, finance, build, and operate a replacement facility for the Woodrow Wilson Bridge. A removal of the ban on tolls would greatly add to this effort.

TAX CODE CHANGES

Finally, there are several very simple changes in the tax code which, if made, would bring billions of additional investment into our nation's infrastructure. The single most significant barrier to infrastructure privatization is the rate difference between tax-exempt bonds, which increase the federal deficit, and taxable bonds. The first step would be the adoption of the public benefit bond also incorporated in the DeLauro bill, which would allow the nation's pension funds, with over $4.5 trillion in assets, to invest in infrastructure.

A second change would be to remove the current five year limit on operating and maintenance contracts, which has the practical effect of curtailing a private firms willingness to a make capital investment. This restriction should be abolished, and if it were, billions of dollars of capital improvements would be made to facilities such as wastewater treatment plants. These improvements would be made with taxable revenue bonds, which would have the additional benefit of adding revenue to the treasury.

A third change would be to eliminate the distinction between public and private ownership when it comes to the eligibility to use tax exempt bonds.

Tax exempt status should be made for all public-purpose infrastructure, or it should be eliminated for those facilities that are self-supporting.

CONCLUSION

These specific changes I have suggested can be achieved in this Congress and can be easily implemented. The cumulative effect would be to attract dollars of private capital to meet this nation's infrastructure needs, more than enough to offset whatever reductions in outlays for federal grants are made in the budget. These suggested policy changes should be included in the budget resolution as policy issues to be reviewed by the relevant Senate committees and adopted in this Congress.

Mr. HORN. Thank you very much.

Now, Mr. Correll, president and chief executive officer, United Water Resources.

Mr. CORRELL. Good afternoon, Mr. Chairman and members of the subcommittee. My name is Don Correll, and I am chairman and chief executive officer of United Water Resources, an investor-owned water utility holding company based in northern New Jersey which provides water service to 2 million Americans in 14 States.

I'm also a member of the Board of Directors of the National Association of Water Companies and chairman of its government relations committee. The National Association of Water Companies is a trade association representing the Nation's investor-owned water utilities. We recently celebrated our 100th anniversary as an organization, and many of our members have been in business for much

longer periods. Our 381 members in 41 States provide safe, reliable drinking water to over 22 million Americans every day.

By contrast, approximately 80 percent of the population in the United States receives its water services from various governmental agencies and authorities. And for wastewater services, the percentage of governmental ownership is greater than 95 percent. Many of these municipal water and wastewater systems have aging infrastructure and are now facing the daunting task of trying to comply with the Safe Drinking Water Act and the Clean Water Act. All of these factors are placing enormous strains on the funding and technical capabilities of many of these systems. The EPA's 1992 needs survey estimates that the Clean Water Act will cost Federal, State, and local governments $137 billion over the next 20 years. This is $57 billion more than the 1990 estimate. Further, an estimated $49 billion will be required to meet the requirements of the Safe Drinking Water Act just through the end of this century. To address these growing financial responsibilities, government systems across the country are exploring various privatization alternatives, often with our NAWC companies. However, while we explore these privatizations, localities regularly encounter legislative and administrative obstacles. My company and the other members of the NAWC have the experience and the resources to professionally operate first-class water and wastewater facilities. The private sector has proven that it's capable of providing safe, reliable drinking water to the public in an efficient manner.

For these reasons, on behalf of the members of the NAWC, I applaud this subcommittee's efforts to investigate the issues that are affecting privatization.

The NAWC members have encountered many privatization impediments, some of which have existed for many years. Understandably, resolutions of these problems may fall under the jurisdiction of many different committees. However, I will briefly describe the significant issues for your information and elaborate on those that we believe may be within the purview of this subcommittee.

The first is the publicly owned treatment works, known as POTW. The regulatory requirements for municipally owned wastewater treatment facilities is less stringent than industrial dischargers. Due to how facilities are defined, this has resulted in confusion when a private company has attempted to assume ownership of a municipal facility or a POTW. This confusion has existed since the enactment of the Clean Water Act in 1972. The NAWC would support a uniform definition of POTW based on purpose rather than ownership within the Clean Water Act reauthorization to facilitate private sector investment in wastewater treatment facilities.

The second issue is contributions in aid of construction, known as CIAC. Investor-owned water utilities are taxed on capital contributions from developers for system expansion. This tax creates competitive advantages for government systems and indirectly discourages privatization efforts.

The NAWC has sought relief of this provision since 1986 and supports H.R. 957, sponsored by Congresswoman Nancy Johnson, which would both repeal and pay for this tax.

The third is the Revenue Proc. 93–19. This IRS ruling severely limits the ability of governmental bodies to contract with private operators for water and wastewater management services. Amongst other things, it limits the term of the management contract to periods of 3 years if tax-exempt debt the government entity is outstanding. This time limit precludes significant investment by private contractors to attain efficiencies or to make system improvements. And this is particularly problematic for the water industry, where most of the assets have long lives going as long as 25 to 50 years and, in some cases, even longer. The NAWC is currently both working with the administration to address this concern in pursuing a possible legislative remedy. Congressional attention to timely resolution of this matter would expedite privatization activities.

The last item is Executive Order 12803, which has been discussed almost ad nauseam today already by a number of panelists. But it was issued in 1992, and it was designed to facilitate the sale of government facilities that receive funding through Federal grants.

Many of the municipal water systems and almost all of the wastewater systems were financed during the last several decades in whole or in part with Federal grant money. Grant repayment conditions were imposed by the OMB if the facility is sold or leased. The presumption of this grant repayment was partially that the asset's use might be changed with private ownership. But unlike housing or other general purpose structures, water and wastewater facilities are almost never converted to some alternate use.

Executive Order 12803 requires a local government to repay the undepreciated portion of the grant. The local government, however, is allowed to recover its costs before the funds are paid back. The Executive order also places restrictions on the use of the proceeds received by the city as a result of the sale or lease. The Executive order directs Federal agencies to adopt rules to carry out its requirements. To date, the implementation has been very disappointing and clearly has not achieved the order's intent of streamlining privatization efforts.

Our association would support legislation to codify an improved version of this Executive Order 12803. Under the plan, we would envision the city would not be obligated to repay any of the Federal grants, and the local governments could use the proceeds it received as a result of the transfer without the restrictions found in the Executive order.

Our business is perhaps the most basic of enterprises, and that is why it is often taken for granted. But the continued economic growth or other larger, high-profile privatization ventures that have been presented before this subcommittee will be academic discussions if the aging government water services infrastructure concerns remain unresolved. Examples of increased water supply and operating problems, including here in Washington, DC, have been reported in the media with increasing frequency in recent years. Support for private sector participation in this basic service is vital.

I thank you for your opportunity provided for our association to speak before you.

Mr. HORN. We thank you very much. Let me ask a couple of questions here, Mr. Correll. According to the Environmental Protection Agency, we have a large number of communities across the country—and that has certainly been the finding of the Committee on Transportation and Infrastructure—where substantial capital investments are required.

Most of these communities have no way to get the millions they need to build these facilities, which would be under the Clean Water Act or any number of other acts we're talking about. And the estimate of EPA is that we need about $137 billion in capital investments to bring municipal water systems up to the Clean Water Act standards.

Would privatization increase access to capital for these projects? What's your feeling?

Mr. CORRELL. I think the increased opportunity for management services, as well as investment capital, I think it would be increased substantially if the private sector were to be involved in this process.

Many of the municipalities—I can speak firsthand about many we have spoken to surrounding our primary service areas in northern New Jersey and in New York State—they literally cannot do any additional financings. They are at their limits.

They are already having their bonds downgraded to below investment grade, and their ability to attract any additional capital is severely limited. So I think the introduction of private sector participation would increase substantially the opportunity for many of the municipalities to get the necessary financing to meet the requirements.

Mr. HORN. Have these municipalities pledged as collateral their current water system?

Mr. CORRELL. Many of the systems have already issued revenue bonds where they have supported the cash-flow from their operations, and they are at the limits of how much they can finance, even having pledged the cash-flow.

What will happen in many cases is that the municipalities also will have to increase the rates that are charged to the customers. It becomes one of will, as well, to increase the rates to the customers.

And to meet the current requirements, it's not unusual to see estimates of water or wastewater charges not only increasing in double digits but sometimes actually doubling.

Mr. HORN. So the political damage is done by the council that votes for privatization, and then the prices go up. But at least they wouldn't throw them out each time the rates went up, because it's no longer their problem and responsibility; is that the political analysis of it?

Mr. CORRELL. I think that's one way one can look at it. I think that was some of the background and the privatization that occurred in Great Britain that you alluded to in your opening remarks.

The type of regulatory environment and oversight that they implemented when they privatized the entire country's water system recognized that they had severe infrastructure problems and the equivalent of our Clean Water Act requirements to face, as well.

And it was easier to do it and to set up a new regulatory framework in that case to allow for the charges for water to increase over time.

Mr. HORN. With reference to the Executive order that you mentioned, suppose a municipality built with a Federal grant a very attractive, up-to-date wastewater treatment plant for $10 million, and then it sold it the next year.

Should Congress adopt some sort of prohibition against this type of churning or the immediate reselling of a federally funded infrastructure project? What's your feeling on that?

Mr. CORRELL. The question regarding whether or not they should allow an immediate sale?

Mr. HORN. Permit an immediate sale. Some people say, "Hey, why don't you depreciate that and not stick them for the entire $10 billion? But after 15, 20 years, maybe it's worth about 3 or 4 million."

Mr. CORRELL. I think in the—I can't speak for airports or some of the other broader-scale privatizations. I think in the case of water or wastewater, particularly, if there were a plant that were built within the last 2 to 3 years, the motivation for privatization would probably be far less than it is today.

Chances are that if they have built a plant in the last several years, it's up to the current requirements of the Clean Water Act, and there is not the same motivation to sell an asset, if you will.

Mr. HORN. The gentleman from Pennsylvania.

Mr. MASCARA. Thank you, Mr. Chairman.

Mr. Stanley, I missed a little bit of your testimony, but I do have a copy of it in front of me, and there's some interesting comments there that you and I would have mutual agreement on.

As a former chairman of the Southwestern Pennsylvania Regional Planning Commission and its chairman for the Plan Policy Committee, which implemented the 1991 ISTEA and the 1990 Clean Air Act amendments, which were companion bills, there's supposed to be as a result of the gasoline taxes—and I understand a penny generates somewhere around $1 billion—that somehow over the life of the current ISTEA, that we would generate somewhere in the neighborhood of $157 billion, and specifically, Pennsylvania should recover about $9 billion of those dollars.

I was just wondering whether you had given some thought in addition to—and I agree about the tolling. I think under the Eisenhower administration, which founded the Federal Highway Act and built some 40,000 miles of highways across this country, that somehow, ISTEA is different now because of the Clean Air Act amendments?

But couldn't some of this money be used for programs as regards to new highways and infrastructure development, coupled with the bridge program in this country?

Mr. STANLEY. I agree totally. And one thing I want to emphasize, there is a lot of capital. Our companies and these funds, there's a lot of capital to be invested in infrastructure. But the introduction of private capital isn't a substitute for the funds that are being generated under ISTEA.

I would say, though, that the flexibility to allow user fees or user charges to repair, rehabilitate, or build new facilities is critical. As

you mentioned, the interstate highway system was built in the 1950's. The good news is, it's about to be finished. The bad news is, most of it has to be repaired and replaced.

As I mentioned earlier, we have at our company on a computer all of the Nation's bridges, including Pennsylvania. And, as you're well aware, Pennsylvania has a number of aging bridges that need to be repaired or replaced, and we would propose to put a user fee on for a fixed period of time with a regulated rate of return. We could find private capital to do that, and I think that freedom ought to be allowed.

Mr. MASCARA. I agree wholeheartedly that we need to lift the restrictions regarding tolling. And studies have shown that people will pay a toll if you give them a good highway to ride on. And I'm very supportive of that.

In fact, privatization is working in southwestern Pennsylvania, where we built an interchange on somebody's land that would be enhanced, the value of it would be enhanced because we located an interchange there. We have a program where we have worked with the Federal Government, State government, and the private sector to build interchanges.

And local governments benefited because, as the value of the land went up, then, of course, taxes were increased for local and county governments. So it's working well. And I think the Federal Government needs to work more closely in enhancing all of those programs for the private sector to work with the public sector.

Thank you, Mr. Chairman.

Mr. HORN. We have no more questions. I hear we're about to go into an hour of votes on the floor. I want to thank you both. Did you have an additional comment, Mr. Stanley?

Mr. STANLEY. If I could just add one point that came up earlier. I would just like to clarify for the committee and the record, with regard to ESOPs, there was a 15 percent ESOP provision in the sale of Conrail for the employees.

And they have done remarkably well with that investment and that ESOP. But I know that question has been asked by Congresswoman Maloney, and that has been very successful.

Mr. HORN. Very good. Anything you would like to add?

Mr. CORRELL. No.

Mr. HORN. Well, we thank you both. I would like to thank the minority for excellent questions and thank the staff that set up this hearing and will be setting up the others in privatization, Mark Brasher, professional staff member, specializing in this area; the subcommittee counsel, Mark Uncapher; Andrew Richardson, clerk; Wallace Hsueh, staff member; and our legislative fellow, Tony Polzak, on leave from the Department of the Army; and our faithful official reporter, Donna Ferguson. We thank you all.

So without objection, we'll adjourn this hearing and go vote. Thank you very much.

[Whereupon, at 5 p.m., the subcommittee was adjourned, subject to the call of the Chair.]

[Additional material submitted for the record follows:]

PREPARED STATEMENT OF E.S. SAVAS, DIRECTOR, PRIVATIZATION RESEARCH ORGANIZATION, SCHOOL OF PUBLIC AFFAIRS, BARUCH COLLEGE/CITY UNIVERSITY OF NEW YORK

Thank you for the opportunity to offer testimony at your important hearing. For brevity, I will confine my remarks closely to the questions suggested by the Subcommittee.

IMPLEMENTATION

BE AWARE OF PITFALLS

1. The most important requirement for successful privatization is political will at the highest level of the jurisdiction or agency. Privatization is not basically an economic or fiscal act; it has economic consequences—usually for the better—but ultimately it is a political act, in the sense that it alters the relative power of different actors in the public policy arena.

2. Many privatization tools are available. One must select the right one for the particular application, for example, divestment, contracting out, franchise, voucher system, or deregulation to allow the private sector to enter a field and start providing services on a market basis. Each of these can be illustrated: divestment of Amtrak, contracting out maintenance of government buildings, franchising a private bus line, using vouchers for home care or education, and repealing the express mail statutes in order to permit private firms to deliver messages without harassment by the US Postal Service.

3. Privatization should not mean abdication. Too often agencies contract out a service but fail to monitor the performance of the contractor. (But often they also fail to monitor the performance of their own, in-house work force.)

TREATMENT OF WORKERS

The most comprehensive study of the matter shows that only about six percent of workers are laid off as a result of privatization. Typical programs to mitigate the effect of contracting out on employees are: (1) Contracting out a service gradually, at the rate of normal attrition (usually about six to nine percent a year) so no layoffs are required; (2) effecting a hiring freeze in other agencies in the jurisdiction so that affected employees can be placed in those openings; (3) requiring the winning contractor to offer the right of first refusal to affected employees (without requiring that he hire all the workers and without dictating the terms of their employment); (4) offering severance pay; (5) offering early retirement; (6) allowing the employees to start their own company and giving them a negotiated contract for a limited period, after which they would be subject to normal competition in the marketplace.

HOW TO DECIDE WHEN TO PRIVATIZE

Bearing in mind the different forms of privatization identified above, the criteria for selecting a candidate service or function for privatization are the following:

1. Are substantial savings possible without a loss of service quality or decline in the level of service? Remarkably, few governments know how much anything costs! Government officials tend to look at budgets as the authoritative source of spending data. But budget documents are not intended to be cost-accounting documents and are totally misleading if used for that purpose. A deliberate study is needed to determine the cost of a service that is a candidate for privatization, and all costs, direct and indirect, should be included. At the same time, a contractor should be given credit for the taxes he pays that a government agency does not, as this is a rebate to the public.

2. Is there an existing competitive market of suppliers of the service, or can a market be created, maintained, and institutionalized?

3. If divestment is the privatization tool of choice, are there buyers?

4. If contracting is the tool of choice, can contract performance be monitored effectively?

5. If the service under consideration does not lend itself to dear, unambiguous specifications (many social services are in this category), can an effective voucher system be designed and implemented?

6. If a franchise is awarded competitively but the effect is to create a monopoly, can the monopoly be effectively regulated?

7. All things considered, is it worth the political effort to privatize?

FEDERAL BARRIERS

Many Federal Government barriers inhibit privatization at the state and local levels.

1. With respect to mass transit, Section 13(c) of the Urban Mass Transportation Act places an enormous obstacle that inhibits localities from contracting competitively for bus services. That provision effectively thwarts privatization if any jobs might be lost. This restriction should be eliminated.

2. The express mail statutes are confusing but are nevertheless used by the US Postal Service from time to time to attack private delivery services such as Federal Express. These statutes should be eliminated.

3. One of the greatest barriers to more cost-effective medical care is the tax treatment of health insurance premiums. At present, employers pay for their employees' health insurance and this is treated as a tax-deductible business expense. Instead, this should be treated as remuneration to the employee, who should be allowed to purchase medical insurance and to treat it as a tax-deductible expense.

4. The evidence indicates that user charges lead to more cost-effective government services. Such charges, however, are treated as normal household expenditures and are not tax deductible, whereas when local taxes are used to pay for the same service provided by a government agency, the taxes are deductible on Federal income tax returns. (Example: In a small town the residents may subscribe to a private waste collection service and pay a user fee to the firm. If the town provides the service with its own work force, paid for by taxes, the local tax is deductible for the homeowner but the fee is not.) An effort should be made to eliminate this inequitable situation, which acts as a barrier to greater use of the private sector.

5. FAA rules limit the flexibility of local governments in privatizing municipal airports, because they require that any savings be reserved for airport use rather than applied for general municipal purposes. This mandate should be eliminated.

6. Many contracts for social service programs discriminate in favor of not-for-profit organizations and against for-profit firms engaged in the same activity. This is unfair and unnecessary. Localities should be allowed to make their judgements based on cost and quality, regardless of the tax situation of the service provider. If a non-profit provider can produce the same quality and level of service at a lower cost, this will be manifested in the bidding. Any such discriminatory language should be expunged, in order to level the playing field and thereby to give localities more options and more competitors from which to choose.

7. Vouchers are arguably a better tool than contracts for many social services, such as day care for children, home care for adults, job training, and services for drug addicts, alcoholics, and AIDS patients. Organizations that provide these services under contract, however, vigorously oppose vouchers, just as homebuilders opposed housing vouchers and preferred to continue getting HUD grants instead. Legislation involving such services should make it clear that vouchers are an acceptable form of service delivery and are not to be eliminated from consideration.

CLOSING

The Subcommittee is to be congratulated for holding this hearing and thereby beginning the process of pruning unnecessary constraints to prudent privatization.

PREPARED STATEMENT OF AL BILIK, PRESIDENT, PUBLIC EMPLOYEE DEPARTMENT, AFL–CIO

In recent years, our nation has focused on the question of how to make government work better. Many have suggested privatization as a wholesale remedy that will solve all the complexities of our civic life. They would have us believe that government usually fails and that the answer is not to try to correct its failings, but to turn to the private sector.

The time has come to look beyond simplistic solutions. Citizens are demanding improved and more efficient service from all government institutions, not less government. But, when looking for ways to improve government, we cannot afford to forget our history. We must remember the countless scandals and stories of fraud, political corruption, and unreliable services that flooded newspapers in the early decades of this century, inspiring the public to insist that government hire workers directly to collect garbage, maintain roads and infrastructure, police our neighborhoods, treat the ill, and teach our children. We must remember how private sector promoters reaped hundreds of millions of dollars at the taxpayers' expense from Sam Pierce's ill-advised privatization schemes at the U.S. Department of Housing

and Urban Development just five years ago.[1] We must remember that it is U.S. taxpayers who are paying the tab for the Savings and Loan fiasco. We must remember these things so that when the claim is made that the private sector is inherently more efficient than government and that it is in the nation's best interest to privatize or contract out, we know "it ain't necessarily so."

It is true that public services are not always delivered by public employees and public managers in the best or most efficient manner, but the notion that dismantling government is the necessary first step in correcting that problem is unacceptable. If we are to reach our common goal of a government that works better at reasonable cost less, the answer will lie not in abdicating our responsibilities through privatization, but in meeting government's unique challenges head-on through new partnerships between government agencies, employees and their unions. A new era of labor-management relations is emerging as we draw closer to the 21st century. Based on innovative programs in both the private and public sector, many managers, workers and their unions are engaging in cooperative efforts to solve a wide range of problems and improve the workplace, services and products.

CREATING HIGH PERFORMANCE WORKPLACES

At the federal level, The National Partnership Council is making recommendations to promote the conversion of government from a top-down bureaucracy to a high-performance, customer-driven organization. At the state and local levels, Secretary of Labor Robert Reich has created the Task Force on Excellence in State and Local Government Through Labor Management Cooperation for the same purpose. The premise of a high performance workplace is a simple one—that employees know more about their jobs than anyone else. Given the encouragement, opportunity, recognition and security, public employees are willing and eager to contribute ideas for making their jobs more productive. However, in both the public and private sector, when employees are not empowered, when they do not have the security of a collective bargaining agreement, when they are under constant threat that their jobs could be given away at any point to the lowest bidder, when employers do not invest in training or skills development, you will find little commitment to excellence. A high skill, high performance workplace is not built on contingent, part time workers earning poverty-level wages. Excellence depends on committed, career public employees.

This theme was taken up in 1992 by the Secretary's Commission on Achieving Necessary Skills (SCANS), headed by the Secretary of Labor Lynn Martin. In its report, Government As A High Performance Employer, the commission reported that "by moving to a high performance model of organization, government will be better able to attract and keep quality workers."[2]

SCANS found that "Employee involvement, empowerment, teamwork, and labor-management cooperation are the engines that drive the entire system of high performance. Improving work processes and procedures will not be fully successful unless all employees are involved in making it happen. When the intelligence and energies of the entire work force are engaged in the pursuit of high performance goals, the potential for successful and quality results is virtually limitless. It makes sense—the workers that have to deal with the problems every day usually have the best solutions, and they have a vested interest in solving those problems to make their work easier."

The number one recommendation of SCANS for achievement of a high performance work place is the involvement of public employee unions in reform efforts. The commission found, "With support, cooperation, and participation of employee unions from the start, an organization greatly increases the likelihood of success in its quality efforts."

SCANS also found that governments at all level must make investment in the training and development of their workforce a top priority, largely immune to budgetary cutbacks. The commission reported that "an ongoing commitment must be made to training the government workforce, especially the frontlines. Training and development must be viewed as an investment in higher productivity and quality, not as a cost to be controlled."

In too many cases, savings from privatization have come from reducing worker pay and benefits or the use of part time and temporary workers. Public employment was once considered by many as a secure life time job where often that security was

[1] Schifrin, Matthew, "Come and Get It: In the Name of Privatization, The Government Deputized over 50 Firms to Issue Mortgages on Multi-family Rental Projects. Is Another S&L-type Mess in the Making?" Forbes, May 15, 1989

[2] U.S. Department of Labor, The Secretary's commission on Achieving Necessary Skills, Government As A High Performance Employer.

a substitute for compensation. For the first time, federal, state and local employees no longer have the security that was guaranteed when they entered public service. Some cynics among us will say that we can no longer afford this—that public employees have become "America's Protected Class."

What we can no longer afford is the preconception that government is destined to fail at what ever it does. Government has the distinctive capability to meet a variety of problems which are poorly handled by the market or private charity. Privatization should never be confused with excellence. The issue is not public versus private. It is one of quality of service. And, it is an issue of the quality of our lives as citizens and as workers in our democratic society. A passage from the SCANS report provides a fitting conclusion to my statement, as they outline the challenges before us.

The challenge that the public sector faces in the 1990s is to continue to create high performance organizations at all levels of government. Current efforts in this direction are encouraging, but much more is needed if government is expected to experience truly systemic reform. High performance reform is not a one-time effort. It will require consistent, on-going commitment from public managers, elected leaders, unions, and front-line workers if it is to succeed. While the task is daunting, the examples of high performance in government outlined in this report suggest that the public sector is up to the challenge.

PREPARED STATEMENT OF JOHN N. STURDIVANT, NATIONAL PRESIDENT, AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES, AFL–CIO

On behalf of the American Federation of Government Employees, AFL–CIO, which represents over 700,000 federal employees across the nation, let me take this opportunity to respond to the testimony offered by various witnesses at the hearing on contracting out/privatization held by the House Government Reform and Oversight Committee's Subcommittee on Government Management, Information and Technology, on March 14, 1995.

While not reflexively opposed to contracting-out and privatization, federal employees are also working and middle class taxpayers who are sadly familiar with both the extraordinary growth in service contracting expenses as well as the consistent and documented inability of service contractors to perform work in a cost-efficient manner. As the record clearly shows, the federal government is contracting-out more and more, but the American people are getting less and less. Since federal employees and their representatives were not invited to testify at this recent hearing, I am using this letter to present you with their views and concerns. After all, they are the men and women who deliver important services to the American public seven days a week, 365 days a year. That is to say, they are the people who know best how government works—and when it fails to work, why that is so.

AFGE members can't help but find this newfound determination sweeping Capitol Hill to sell off large chunks of the federal government to politically well-connected firms in the private sector to be highly ironic. After all, the federal workforce hasn't been this small since the Kennedy Administration. At the same time, service contracting is the costliest part of federal procurement and one of the fastest-growing expenses in the entire federal budget. According to the Office of Management and Budget (OMB), federal service contracting costs the American taxpayers $105 billion every year.[1] (The $70 billion estimate provided by the Professional Services Council in its testimony is patently inaccurate.) That staggering sum is at least $25 billion more than the combined salaries and wages of every single federal employee.

Just how many service contractor employees are on the federal payroll? I wish I could say, but such records are not kept. Considering that the federal government now spends a whopping $105 billion per year on thousands and thousands of labor-intensive contracts, I can conservatively estimate that the contractor workforce is some 2,000,000 employees. As points of reference, I ask you to consider that the 2,017,197 employees who make up the entire federal workforce earn a combined $75.3 billion in salaries and wages per year.[2] We hear a lot of talk these days about making the federal government run more like a business. But is there a single firm in the private sector that fails to keep any records about a burgeoning subset of em-

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[1] Office of Management and Budget, "Summary Report of Agencies' Service Contracting Practices" (January 1994), p. v.

[2] Office of Personnel Management, "Pay Structure of the Federal Civil Service" (March 31, 1993), pages 12–13.

ployees that makes up anywhere from one-third to one-half of its entire workforce? I very much doubt it.

Are the taxpayers well-served by this explosive growth in service contracting? A mountain of evidence stacked up in one damning General Accounting Office (GAO) report after another indicates that the answer is "No!" Only last year, GAO surveyed nine studies on service contracting and found that in each case savings, often substantial, could have been realized if the work had been done in-house.[3]

Why has service contracting been consistently found to be so inefficient? Limitations of space make it impossible to spotlight each and every reason, but permit me to list a few:

1. Statements of Work, the forms used to describe specifically the services to be contractually procured, are so poorly-written that competition is limited and performance cannot be measured.[4]

2. Cost comparison requirements are often ignored. As OMB has reported, cost analyses and independent government estimates are not performed by many agencies prior to renewal, extension, or recompetition of existing contracts.[5] And in far too many instances, OMB must admit, cost estimates are not even prepared prior to entering into new contracts.[6]

3. Contract administration is almost non-existent. As OMB reported, agencies believe that they are contracting for mission-essential services; as a result, most of their contract administration efforts focus on ensuring that they purchase the required services with costs often becoming a peripheral concern.[7] In addition, most contract administration is not done by contracting officers who are skilled in determining whether the service was actually rendered for the price specified in the contract, but rather by program officers, who are merely determined to have the service rendered, regardless of cost.[8]

4. Contractors have no incentives to provide quality service for the lowest cost under the current payment system. As GAO reported, widely-used cost-reimbursable contracts, which reimburse contractors for all allowable costs incurred, "provide contractors with little incentive to control expenses and place a considerable administrative burden on the federal government to oversee, control, and identify inappropriate costs."[9] Further, agencies do not always review the effectiveness and efficiency of the services performed by contractors prior to the issuance of payments.[10] If you had a $105 billion bill, I think you'd check to see if the work was done correctly. So why doesn't the federal government?

5. Agencies fail to properly audit the work of their contractors. As GAO reports, "(i)ndependent audits show millions of dollars in unallowable costs and questionable costs have been charged that do not contribute directly to the agency's intended mission.[11] During just a six-month period in FY 93, defense contractors returned to the government $751 million, and in FY 94, they returned $957 million, most of which appears to have been overpayments that were detected by service contractors.[12] If those gigantic sums are being returned, would it be too cynical to ask just how much is being kept?

6. Contractors are allowed to steal from the American taxpayers. I know "steal" sounds harsh, but, unfortunately, it's the right word to use. Several years ago, the House Committee on Government Operations reported that more than $40 billion worth of materials and equipment purchased by the federal government for use by contractors in the performance of their services was still in the possession of those contractors.[13] The report noted that, in many cases, contractors had improperly

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[3] General Accounting Office, "Government Contractors: Measuring Costs of Service Contractors Versus Federal Employees" (GAO/GGD–94–95) (March 1994).

[4] Office of Management and Budget, Ibid. The report noted that "(t)he statements-of-work used to describe the specific tasks or services to be procured by contract are frequently so broad and imprecise that vendors are unable to determine the agency's requirements. As a result, competition is limited and performance cannot be assessed."

[5] Ibid.

[6] Ibid.

[7] Ibid. "Contracting personnel concentrate on the award of contracts and the obligation of funds."

[8] Ibid. "Contract administration, particularly in most civilian agencies, is conducted by agency program staff and not by contracts personnel. The program staffs are often ill-trained in contract administration."

[9] General Accounting Office, "Federal Contracting: Cost Effective Contract Management Requires Sustained Commitment" (GAO/T–RCED–93–2) (December 1992), p. 3.

[10] Office of Management and Budget, Ibid.

[11] General Accounting Office, Ibid, p. 11.

[12] General Accounting Office, "Defense Contract Management" (February 1995), p. 6.

[13] House Report 99–139 (May 21, 1985).

used this federal government property to perform commercial work unrelated to the contract. In addition, according to the report, some of that property had even been sold back to the government. Last year, GAO reported that almost $75 million of government property had been lost by a single contractor at just one Department of Energy (DoE) facility.[14] Even worse, that $75 million figure is only the proverbial tip of the iceberg. As GAO reports, "this amount represents only what the contractor reported to DoE as missing. We believe that figure probably understates the actual amount of missing property, particularly in light of our detailed review of property management at the (facility)."[15] Where are Rush Limbaugh and the rest of the radio shock show hosts when you really need them?

There were several references during the hearing to "barriers" to contracting-out/privatization. As the evidence reviewed earlier in this letter suggests, it might be more accurate to refer to the provisions in question as "safeguards." Unfortunately, none of the hearing's participants mentioned the costliest "barrier" of all to cost-efficient service delivery: agency personnel ceilings.

As OMB reported, several agencies—including the Departments of Agriculture, Health & Human Services, Housing & Urban Development, State, Education, and Treasury, as well as the Environmental Protection Agency—said that they each could have saved several million dollars by performing functions directly rather than having them performed by contractors but did not do so because either their requests to OMB to take on the necessary full-time employees (FTEs) were refused or the agencies were so sure such requests would be turned down that they were not even submitted.[16] In other words, even when it's been shown that it would save money for the taxpayers by keeping services in-house, the arbitrary personnel ceilings force agencies to waste money on inefficient service contractors.

(Incidentally, federal employees do not fear competition with service contractors. What federal employees fear is rules that are increasingly crafted in such a way that fair competition is impossible—a pernicious phenomenon exemplified to chilling perfection by the FTE ceilings. Our hearty embrace of competition distinguishes federal employees from service contractors. You'll notice that the Professional Services Council, in its testimony, pleaded with Members of the Subcommittee, time and time again, to spare service contractors from the rigors of competition with the public sector.[17])

If Members of the Subcommittee really want to eliminate barriers to the delivery of cost-efficient services to the American people, then it should work to lift agencies' in-house personnel ceilings. Congress can continue to cut the jobs of federal employees, and make it necessary for agencies to contract out in order for the work to be done. However, as the OMB report indicates, this sort of "down-sizing" is actually leading to significant increases in federal spending.

In light of the foregoing evidence, it appears that the Subcommittee should broaden the scope of its inquiry to include several important issues:

—Considering the long trail of damning audits, broken promises, and busted budgets, how is it possible that a mania is sweeping Capitol Hill that causes Members of Congress to consider substantial increases in contracting-out and privatization? In other words, shouldn't Congress, instead of looking for new ways to contract-out and privatize, be concentrating more of its attention on bringing work that had been given away to private sector operators back in-house where it can be performed by reliable, experienced, and cost-efficient federal employees?

—Shouldn't the Subcommittee take a long, hard look at how service contractors have performed—or, more accurately, how they have failed to perform—before spending even more money on service contracting, already the biggest part of fed-

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[14] General Accounting Office, "Managing DOE: Government Property Worth Millions of Dollars Is Missing" (GAO/T-RCED-94-309) (September 1994).

[15] Ibid., p. 2.

[16] Office of Management and Budget, Ibid. "Agencies often assume that additional personnel will not be authorized and, therefore, there is no alternative but to contract for needed services. Several agencies requested that they be given more flexibility with respect to determining whether work should be performed by agency or contractor staff. Examples were reported where the government (based on the agencies' projections) could save several millions of dollars by performing functions directly rather than having them performed by contract." In the report's Appendix 2, p. 30, OMB reported that it was the consensus of agencies it surveyed that "OMB needs to review the cost-effectiveness of bringing contracted work in-house when there aren't sufficient Full-Time Equivalents (FTEs) to perform the work. More flexibility with the budget limitation on FTEs is necessary when it can be demonstrated through studies that it would be less expensive to perform the work in-house but governmental personnel ceilings prevent that decision."

[17] Some examples: "Avoiding Unfair Competition Between the Public and Private Sector" (page 6), "Special Problem of Public-Private Competition" (page 6), "Prohibit Public-Private Competition" (page 7).

eral procurement and one of the fastest-growing expenses in the entire federal budget?

—Shouldn't Congress reform service contracting practices that have been proven to result in unconscionable amounts of waste, fraud, and abuse by private sector operators?

—Let's take a closer look at DoE where service contracting has been allowed to run amok—partly as a result of the FTE ceiling which the agency admits has inspired much wasteful service contracting. In FY 93, almost four-fifths of DoE's $24 billion budget went towards paying off service contractors.[18] Almost $11 billion was used to provide compensation for the service contracting workforce.[19] DoE's federal employees received slightly more than $1 billion in salaries and wages.[20] As one DoE official said, "Basically, we've concluded that our analysis shows that the only way of making a significant dent in DoE's budget will be to require substantial reductions in contract personnel."[21] To the agency's credit Secretary Hazel O'Leary and her staff are seriously attempting contracting reform. And they've found that no elaborate schemes or strategies are necessary. They merely hinted to DoE's service contractors that their contracts would no longer be reflexively renewed. The results? Service contractors offered to reduce their billion dollar bills by 15% to 20%.[22] If taking the first step towards real service contracting reform is that easy, why is Congress sitting by idly while service contractors "working" for other departments continue to conduct business as usual, taking the taxpayers to the cleaners time and time again?

If Members of the Subcommittee are genuinely interested in saving money for the taxpayers and improving services, I urge them to support a 10% reduction in the federal government's service contracting expenses. Such an initiative will save the American people $50 billion over five years, but without adversely affecting the performance of service contractors.

—Considering that agencies are having to resort to service contracting that has been proven to be cost-inefficient because of in-house staff shortages, shouldn't the Subcommittee support a revisiting of the whole issue of using arbitrary FTE ceilings to down-size the federal workforce?

—In the pitched, partisan battles taking place these days in our Nation's Capitol, there are few public policy objectives that unite Americans on the right, middle, and left segments of the political spectrum. One such objective that is gathering increasing bipartisan support is the need to abolish corporate welfare. Last week, the libertarian Cato Institute, the moderate Democratic Leadership Council, and Secretary of Labor Robert Reich held an extraordinary joint media conference to press Congressional lawmakers like yourself to take a long, hard look at costly taxpayer subsidies to politically well-connected businesses.

Corporate welfare—estimated by the Cato Institute to be more than $86 billion per year and by the Democratic Leadership Council to be almost $265 billion annually—includes a wide variety of ingenious but completely taxpayer-subsidized giveaways, everything from income tax exemptions worth more than $18 billion over five years for firms doing business outside of the U.S. to subsidies for ski resorts and casinos in some of America's toniest towns. But, as "The New York Times" pointed out, "little is being done to curb (corporate welfare) practices." Why, one might ask. "Many of them are popular with politically influential businesses and other groups that are heavy contributors to both Republicans and Democrats."

AFGE's members draw two lessons from this corporate welfare scandal. First, the taxpayers, whose backs are already straining from having to support "politically influential businesses and other groups that are heavy (campaign) contributors" should not now be required to take on the additional burden of propping up an army of service contractors that possesses connections and influence, but, as the record shows, offers little in the way of effectiveness and efficiency. Second, the Subcommittee—which, in holding its recent hearing on contracting-out/privatization,

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[18] Inside Energy/with Federal Lands (March 6, 1995), p. 2.

[19] Ibid.

[20] Ibid.

[21] Ibid., p. 3.

[22] The mere prospect of competition at the Department of Energy has "already led some contractors to reduce costs by 15 percent to 20 percent." (Imagine the savings that could be generated for the taxpayers if the federal government insisted that service contractors cut that much waste, fraud, and abuse out of all their contracts!) "The success of the department's strategy probably will not be known for some months . . . But Thomas P. Grumbly, the assistant secretary for environmental restoration and waste management, said the 'specter of competition' has already led some contractors . . . to offer to reduce costs by 15 percent to 20 percent. 'If implied competition will do that, imagine what real competition will do,' Grumbly quipped." (The Washington Post, "Energy Dept. Plans Competition for Big Contracts" (July 7, 1994). p. A24.)

has shown an interest in determining the extent to which the federal government should be involved in the private sector and the extent to which the private sector should be involved in the federal government—should give serious consideration to expanding its mandate from the narrow perspective of contracting-out/privatization to include the growing problem of corporate welfare.

Thank you for allowing AFGE the opportunity to respond to the various witnesses heard at the Subcommittee's recent hearing on contracting-out/privatization. Please contact Beth Moten or John Threlkeld, of AFGE's Legislative Department, at (202) 639–6413, if you have any questions about this letter.

PREPARED STATEMENT OF THE NATIONAL COUNCIL FOR PUBLIC-PRIVATE PARTNERSHIPS

This letter of testimony is submitted on behalf of the National Council for Public-Private Partnerships. The Council is a non-profit, non-partisan educational organization dedicated to increasing the availability and effectiveness of public services through co-operation of government and private enterprise. The Council's members constitute a cross section of public officials, business leaders, and non-profit organizations. Its active divisions include task forces on environment, transportation, real estate/public facilities and health. Public-private partnerships combine the strengths of the public and private sectors, fostering market competition under the watchful eye of representative government.

The Council applauds your efforts on behalf of greater private sector participation to improve governmental efficiency and productivity. We offer the following comments for the record.

In 1992 President Bush issued Executive Order 12803, which permits the sale of a publicly owned infrastructure facility that was financed with the assistance of federal grants or tax-exempt funds. In 1993, President Clinton reaffirmed the intent of E.O. 12803 issuing a subsequent Executive Order dealing with public-private partnerships for major federal investments, and reiterating the opportunity to sell or lease infrastructure facilities constructed with the aid of federal monies. However, both Executive Orders require that any undepreciated portion of the federal share be repaid. This repayment requirement and difficulties with resolving issues related to valuing such facilities have virtually precluded use of the capabilities permitted under the Executive Orders. The National Council for Public-Private Partnerships suggests that the power to sell or enter long term lease arrangements be codified in legislation. However, we urge a modification, believing that the repayment requirement should simply be eliminated in the legislation to facilitate formation of public-private partnerships.

The Council also supports legislation to eliminate the five year maximum term placed on private maintenance and operation contracts for publicly owned water and wastewater systems and other forms of infrastructure. The existing limit is based on the fact that in most cases, tax exempt bonds financed construction and a need was felt to ensure continued public ownership. Under a contract arrangement limited to five years, any capital investments a private manager might make to introduce new, cost-effective technology or to upgrade the facility to modernize its operations are uneconomical. Recognizing this, the Treasury Department has issued a proposed regulatory change to extend the contract limitation, but a final revision does not appear to be imminent and the issue remains unresolved. The Council urges that legislation be enacted to affirm the Congress's interest in permitting contracts of twenty to twenty-five years with private entities. This longer time frame would permit the private operator to make investments that would both lower operating costs and increase the facility's useful life.

Several other technical issues beyond the scope of this testimony on which the Council is prepared to provide comments, include:

- limits on private contractor's use of tax exempt debt to finance public-use environmental facilities.
- revival of accelerated depreciation and the investment tax credit to stimulate private participation in the market,
- alternative minimum tax treatment to include public or privately owned treatment works that are operated for general public use.

The Council appreciates the opportunity to provide comments and would be happy to respond to any questions which you or your staff may have.

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