33. Privatization

Congress should

- end rail subsidies, privatize Amtrak, and allow the company to terminate unprofitable routes;
- privatize the air traffic control system, privatize airport screening and security, end subsidies to airports, and encourage state and local airport privatization;
- privatize federal electric utilities, including the Tennessee Valley Authority and the four Power Marketing Administrations;
- privatize the U.S. Postal Service and repeal the legal restrictions on competitive delivery of mail; and
- encourage federal agencies to increase competitive sourcing for needed government services.

Introduction

Many federal government activities are commercial in nature and could be carried out by private firms in competitive markets. In some cases, private companies are currently prevented from offering services to the public because of government restrictions. For example, the U.S. Postal Service has a legal monopoly on first-class mail. Such restrictions should be repealed.

In other cases, the government performs services that are readily available in the private sector. For example, USPS parcel delivery competes with private parcel services. Another example is the federal government's National Zoo in Washington, which has been rocked by scandals regarding its poor treatment of animals. There is no need for the government to be in the zoo business—some of the best zoos in the country are private, such as those in San Diego and the Bronx.

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Privatization has many benefits, including opening new opportunities for entrepreneurs, creating higher-quality and lower-cost services, and reducing the government budget deficit and debt. For those reasons, dozens of countries have pursued privatization during the past two decades. Governments on every continent have sold electric utilities, airlines, oil companies, railroads, and other businesses to private investors. Even postal services are being privatized. Britain, Finland, Germany, the Netherlands, New Zealand, and Sweden have either opened postal services to private competition or privatized their national mail companies. Unfortunately, Americans continue to be saddled with the 774,000-employee USPS and other inefficient government businesses.

There has been an occasional attempt to bring privatization reforms to this country. Ronald Reagan established a President's Commission on Privatization that proposed modest reforms in 1988, but Congress generally did not act on them. Nonetheless, a few federal entities have been sold in recent decades. Conrail, a freight railroad in the Northeast, was privatized in 1987. The Alaska Power Administration was privatized in 1996. The U.S. Enrichment Corporation, which provides enriched uranium to the nuclear industry, was privatized in 1998.

Today, privatization makes more sense than ever for a number of reasons. First, sales of federal assets would cut the huge federal budget deficit. Second, by reducing the responsibilities of the government, members of Congress could better focus on their core responsibilities, such as national security. Third, there is now vast foreign privatization experience that could be drawn on in pursuing U.S. reforms. Fourth, privatization would spur economic growth by opening new markets to entrepreneurs. For example, privatization of USPS and the repeal of its monopoly would bring major innovation to the mail business, just as the 1980s' breakup of the AT&T monopoly brought innovation to the telecommunications business.

One roadblock to privatization is the view that certain activities, such as air traffic control (ATC), are too important to leave to the private sector. But the reality is just the opposite. The government has shown itself to be a failure at providing efficient and high-quality ATC, passenger rail, and other services. Those industries are too important to miss out on the innovations and likely greater safety that private entrepreneurs could bring to them. For example, privatized ATC would probably be safer because private firms could access capital markets in order to invest in the newest technologies. By contrast, the federal government's ATC has often lagged behind in technology because of budget constraints and mismanagement.

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Privatization vs. Competitive Sourcing

In a government-wide analysis, the Bush administration determined that about half of all federal employees perform tasks that are also performed in the marketplace and thus are not ''inherently governmental.'' The administration made a push to open some of those activities to allow private firms to bid for work that had previously been performed in-house. The administration estimates that the cost savings from such ''competitive sourcing'' averages about 20 percent.

Those are positive steps, but competitive sourcing is not the same as privatization. Competitively sourced services still consume taxpayer dollars and are government-directed activities. Policymakers go astray when they support competitive sourcing of programs that should, instead, be fully privatized or terminated. Privatization gets spending off the government's budget entirely and provides for much greater dynamism, efficiency, and innovation than is possible through government contracting.

In addition, privatization avoids a serious pitfall of contracting—opening the government to corruption. A Pentagon scandal reported by the *Washington Post* in December 2003 provides a good example. Two senior procurement officials were convicted of receiving sexual favors and $1 million in cash for awarding minority set-aside defense contracts to particular firms. One of the men headed the Pentagon's Office of Small and Disadvantaged Business Utilization, which helps minority firms win contracts. In this case, the best reform is not competitive sourcing but termination of this unneeded Pentagon office.

Privatizing Stand-Alone Businesses

The federal government operates numerous business enterprises that could be converted into publicly traded corporations, including the USPS, Amtrak, and a number of electric utilities. Other countries have in-depth experience in privatizing such services that Congress can use when it moves ahead with reforms.

- **Postal Services:** A 2003 report by the President's Commission on the U.S. Postal Service and other studies have concluded that the outlook for the USPS is bleak because of declining mail volume and rising costs. The way ahead is to privatize the USPS and repeal the first-class mail monopoly that it currently holds. New Zealand and Germany have implemented reforms that Congress should examine. Since 1998 New Zealand's postal market has been open to private

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competition, with the result that postage rates have fallen and labor productivity at New Zealand Post has risen markedly. Germany's Deutsche Post was privatized in 2000, with the result that the company has improved productivity and expanded into new lines of business.

- **Electric Utilities:** The U.S. electricity industry has always been dominated by publicly traded corporations. The exceptions are the federal government's Tennessee Valley Authority and four Power Marketing Administrations, which sell power in 33 states. Those government power companies have become an anachronism as utility privatization has proceeded around the world from Britain to Brazil and Argentina to Australia. TVA and PMA privatization would reduce the federal deficit, eliminate the utilities' artificially low power rates that encourage excess consumption, and increase efficiency in utility operations and capital investment. President Clinton proposed to sell off the four PMAs in his fiscal year 1996 budget. It is time to dust off those plans and move ahead with reforms.
- **Passenger Rail:** Subsidies to Amtrak were supposed to be temporary after the passenger rail agency was created in 1970. That has not occurred, and Amtrak has provided second-rate passenger rail service for 30 years while consuming more than $25 billion in federal subsidies. Reforms elsewhere show that private passenger rail can work. Full or partial rail privatization has occurred in Argentina, Australia, Britain, Germany, Japan, New Zealand, and other countries.

Privatizing Infrastructure

Before the 20th century, transportation infrastructure such as roads was often financed and built by the private sector. But during much of the 20th century, transportation infrastructure was thought of as a government function. By the 1980s that started to change, and governments around the world began selling off, or letting private firms build, billions of dollars worth of airports, highways, bridges, and other infrastructure.

Just about any service that can be supported by consumer fees can be privatized. A big advantage of privatized airports, ATC, highways, bridges, and other infrastructure is that private companies can freely tap debt and equity markets for capital expansion to meet rising demand and to reduce congestion. By contrast, government infrastructure today is often congested because upgrades are constrained by lack of government funding and poor long-term planning by governments.

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- **Air Traffic Control:** Numerous countries have partly or fully privatized their ATC services. Canada's reforms provide a good model for the United States. In 1996 Canada set up a fully private, nonprofit ATC corporation, Nav Canada, which is self-supported from charges on aviation users (see www.navcanada.ca). The Canadian system has received rave reviews for investing in the latest technology and reducing air congestion. Meanwhile, the Federal Aviation Administration has been struggling to modernize U.S. air traffic control for two decades. The FAA's upgrade efforts have frequently fallen behind schedule and gone far over budget, according to the General Accounting Office. ATC is far too important for government mismanagement; privatization is long overdue.
- **Highways:** A number of states and foreign countries have started experimenting with privately financed and operated highways. The Dulles Greenway in Northern Virginia is a 14-mile private highway opened in 1995. It was financed through private bond and equity issues and uses an electronic toll system to maximize efficiency for drivers. In Richmond, the 895 Connector project is being financed by private capital and will be operated by a nonprofit firm. Fluor Daniel, a leading engineering company, has proposed building private highways in Virginia, including widening the Capital Beltway with four new electronic toll lanes. The company also has a $1 billion plan to build toll lanes running 56 miles south from Washington. Similar private road projects are being pursued in California, Texas, North Carolina, and South Carolina. There is clearly a strong private-sector interest in funding and building highways. Policymakers should pave the way for entrepreneurs to help reduce the nation's congestion and save taxpayer money.
- **Airports:** Most major airports in the United States are owned by municipal governments, with the federal government providing subsidies. The United States lags reforms that are taking place abroad—airports have been fully or partially privatized in Auckland, Copenhagen, Frankfurt, London, Melbourne, Naples, Rome, Sydney, Vienna, and other cities. The British led the way with the 1987 privatization of British Airports Authority, which owns London's Heathrow. In the United States, Congress needs to take the lead on airport privatization because there are numerous federal roadblocks that make U.S. cities hesitant to proceed. For example, government-owned airports can issue tax-exempt debt, which gives them a financial advantage over private airports.

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Privatizing Loan Programs

The federal government runs a large array of loan and loan guarantee programs for farmers, students, small businesses, utilities, shipbuilders, weapons purchasers, exporters, fishermen, and other groups. The Federal Credit Supplement in the federal budget lists 59 different loan programs and 70 loan guarantee programs. Loan guarantees are promises to private creditors that the government will cover borrower defaults. At the end of 2003 there was $249 billion in outstanding federal loans and $1.2 trillion in loan guarantees.

In the 1970s federal loans and loan guarantees grew rapidly as politicians discovered that they could pay off special interests with loan programs, while not paying any political cost for supporting higher spending directly. Like other federal programs, loan programs that make no economic sense can survive by creating an ''iron triangle'' of interests that resist reform. Loan program supporters include loan beneficiaries, financial institutions, federal loan administrators, and congressional committees that authorize loan programs.

In the 1980s the Reagan administration tried to cut federal loan programs but did not have much success. Policymakers should revive Reagan's initiatives and begin terminating or privatizing federal loan programs. The provision of credit is a centuries-old market institution that does not need government help, especially given the sophistication and liquidity of financial markets today.

Some federal loan programs target borrowers who could have received private financing. In such cases, there is no need for government loans because they simply displace private loans. Other loan programs target borrowers who cannot secure private financing. In that case, federal loans support borrowers who are poor credit risks, and taxpayer money is likely to be wasted when loans are defaulted on. For example, Farm Service Agency loans are aimed at farmers who are unable to obtain private credit at market interest rates. But such farmers are probably bad credit risks with poor business prospects. Indeed, FSA loans have high default rates.

The FY05 federal budget says that government loan programs are needed because private markets suffer from ''imperfections,'' such as lack of perfect information about borrowers. For example, banks might be more hesitant to lend to start-up businesses because they do not have lengthy credit histories. But it is appropriate that start-up firms face more scrutiny and pay higher interest rates because of their higher risk of failure. Since failure creates economic waste, it is good that creditors are more

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hesitant to lend to riskier businesses. Government loan subsidies result in too many loans going to excessively risky and low-value projects.

Free-market allocation of credit is far from perfect, but markets have developed mechanisms for funding risky endeavors. For example, venture capital and angel investment pumps tens of billions of dollars of investment into new businesses every year. There is no need for the government to compete with such private financial mechanisms.

Government distortions are a bigger problem than market ''imperfections.'' For example, federal loan guarantees make financial institutions overeager to lend to those with shaky credit because the government will cover losses in case of default. Also, federal loan programs are generally poorly managed. For example, federal student loans have been on GAO's high-risk list for waste, fraud, and abuse every year since 1990. Lax enforcement of student loan repayments has led to large losses from defaults, costing taxpayers billions of dollars.

Privatizing Federal Buildings and Real Estate

At the end of FY03 the federal government owned about $1 trillion in buildings and equipment, $200 billion in inventory, $550 billion in land, and $650 billion in mineral rights. Many federal assets are neglected or abused and would be better cared for in the private sector. It is common to observe government property that is in poor shape, with public housing being perhaps the most infamous federal eyesore. The GAO finds that ''many assets are in an alarming state of deterioration'' and has put federal property holdings on its high-risk waste list (GAO-03-122). The solution is to sell federal assets that are in excess of public needs and to better manage a smaller set of holdings.

The federal government owns about one-fourth of the land in the United States. But only a portion of that land is of environmental significance, and the government has proven itself to be a poor land custodian. There are widely reported maintenance backlogs on lands controlled by the Forest Service, Park Service, and Fish and Wildlife Service. The solution is not a larger maintenance budget but to trim down holdings to fit limited taxpayer resources.

The government owns billions of dollars worth of excess buildings. The GAO has found that the government has ''many assets it does not need,'' including 30 vacant Veterans Affairs buildings and 1,200 excess Department of Energy facilities. The GAO figures that the Pentagon spends up to $4 billion each year maintaining its excess facilities. The Pentagon

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owns excess supply depots, training facilities, medical facilities, research labs, and other installations. Federal asset sales would help reduce the deficit, allow improved maintenance of remaining assets, and improve economic efficiency by putting assets into more productive private hands.

Suggested Readings

Edwards, Chris. ''Downsizing the Federal Government.'' Cato Institute Policy Analysis no. 515, June 2, 2004. This report provides cites for facts and data used in this chapter.

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