Chapter 6

Clearing the Decks

Eliminating Functions That No Longer Serve Core Purposes

We've got a hundred ways to skin a cat and no way to kill it.

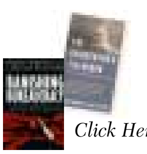
U.S. REPRESENTATIVE RICHARD ARMEY

Clearing the Decks **eliminates government functions and regulations that no longer contribute to core goals—by abandoning them, selling them, or moving them to a different level of government.**

Newt Gingrich tried in 1995 to eliminate three federal departments and hundreds of programs and subsidies. The Georgia Republican was regarded by some as the most powerful Speaker of the House since the beginning of the century; he controlled committee appointments, the drafting of legislation, and campaign funds for House Republicans. His party had won control of both chambers of Congress for the first time in 40 years. He had President Clinton on the ropes.

Gingrich and his lieutenants wasted no time. By the spring of 1995 the House had voted the largest budget "rescission" in American history: if passed by the Senate and signed by the president, it would cut some $16 billion from housing, job-training, home energy, and other programs approved the previous year by the then-Democratic Congress. Then they adopted a budget resolution for the next year that would kill more than 280 programs, as well as the Departments of Commerce, Education, and Energy.

The plan made good on a breathtaking hit list the Republicans had assembled after they won the 1994 elections. Targets included Amtrak, the Legal Services Corporation, the Maritime Administration, the Appalachian Regional Commission, the Corporation for Public Broadcasting, the National Endowment



From ***Banishing Bureaucracy: The Five Strategies for Reinventing Government,*** by David Osborne and Peter Plastrik.

for the Arts, the National Endowment for the Humanities, the Direct Student Loan Program, the Student Loan Marketing Association, the College Construction Loan Insurance Association, the Summer Youth Employment and Training Program, the Low-Income Home Energy Assistance Program, the Office of the Surgeon General, the Goals 2000 education program, family planning programs, and housing programs. The House Republicans also wanted to sell off federal assets: power companies in Alaska and the Southeast, 40 or more ski areas on U.S. Forest Service land, and Governors Island in New York City. They planned to kill some $40 billion in subsidies and tax breaks for business while severely trimming crop subsidies and price supports for farmers. Gingrich had even dreamed up a fitting symbol for his revolution: he wanted to sell off a congressional office building, so it could be dismantled and sold in pieces to the public—just like the Berlin Wall.

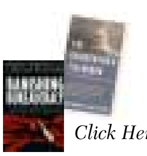
But the building is still standing. So are the three departments, and so are most of the programs and subsidies the Republicans targeted. Within a year of its birth, Gingrich's bold plan to sweep clear the decks of the federal ship of state had sunk into oblivion.

It was drowned by resistance. Business interests fought successfully to keep their subsidies and tax breaks. "All too many of [the GOP's] friends—agriculture and ranching interests, logging and mining companies, export-oriented manufacturers—have come to expect a helping hand from Uncle Sam," observed conservative political analyst David Frum. Other interests, such as veterans, railroad employee unions, and mayors, withstood the attack on their own favorite services.

Back in their districts, Gingrich's conservatives heard from well-to-do Republicans unhappy about losing federal support for cultural programs, such as the National Endowment for the Arts, or social programs, such as family planning. This had a real impact on the lawmakers, noted one GOP leader: "They're country-club Republicans who wanted to be loved by the beautiful people [who are] the richest people on the contributor list, and that affects the vote count."

A majority of the voters thought the Republican plans went too far. Democrats bombarded the public with sound bites accusing the GOP of cutting programs for the poor to pay for tax cuts for the wealthy. Moderate Republican senators, who had never signed up for the Gingrich revolution, used their bargaining power to water down bills from the House. And much to Gingrich's surprise, a revived President Clinton vetoed most of the cuts Congress did pass. "To underestimate such a politician is a serious error," the Speaker later said, "and it is, I am afraid, an error we committed."

And finally, of course, the Republican revolutionaries tripped over their own feet. After they twice in confrontations with Clinton forced much of the



federal government to shut down, public sentiment turned against them. What had started as a serious public debate over the role and size of the federal government had become "a silly, schoolyard brawl," as one analyst put it.

By the time Gingrich gaveled the first session of the 104th Congress to a close, on January 3, 1996, it had eliminated only one agency, the Interstate Commerce Commission (ICC). But the ICC had been on the ropes for years—even Clinton wanted to kill it. In the years that followed, the Republicans would score several domestic policy victories, including welfare reform and a plan to balance the budget. But when it came to clearing the decks of "unnecessary" federal functions, they failed.

STRIPPING THE BARNACLES FROM THE SHIP OF STATE

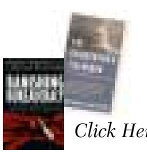
To everything there is a season, Ecclesiastes tells us—a time to be born and a time to die. Clearly, the author of that passage was not thinking of government.

In the public sector, programs rarely die. Civil servants gaze at politicians hell-bent on change and think to themselves, "I'll be here long after you're gone." And sure enough, after Gingrich resigned from the House in 1998, tens of thousands of federal employees were still performing the very functions he had tried to eliminate.

That is why clearing the decks is an important part of the Core Strategy. To use another nautical metaphor, when too many barnacles collect on the ship of state, they weigh it down. Part of steering well is stripping away those barnacles, to free up resources for better use elsewhere. Indeed, by clearing the decks, governments can free up substantial resources to invest in the other four strategies, to improve what remains.

Every government has functions that have become obsolete. More than a century ago, Congress decided there were serious problems with the quality of some imported teas. It set up a federal tea taster in an office in Brooklyn, New York, and for 100 years taxpayers subsidized the operation. After World War I, in which helium balloons were used to see behind enemy lines, Congress decided the federal government needed a helium reserve to ensure the supply of such a strategic material. By 1990 the government owned enough helium to serve its needs for 50 years—and the helium fund had built up a debt of $1.2 billion.

But not all obsolete functions are so major. When the Minnesota Department of Revenue put its divisions through a deck-clearing exercise in the late 1980s, it found that it still had three comptometer operators. A comptometer is a predecessor not to the computer, or even to the calculator, but to the adding machine. Three elderly women spent their days crunching numbers on these ancient machines. Department managers quickly got rid of the comp-



p. II/87

tometers, retrained their operators, and reassigned them to more productive work. Managers can clear the decks within their own organizations, just as elected officials can clear the decks government-wide.

In today's world, activities become obsolete far more rapidly than they did in the days of comptometers. In 1982, after President Reagan fired all air traffic controllers who had gone out on strike, the Federal Aviation Administration faced a desperate shortage of controllers. So it launched a program to improve postsecondary training in aviation, to produce more graduates who could be hired and trained as controllers. Within a decade it had spent about $50 million and solved the problem. In 1993, President Clinton's National Performance Review (NPR) recommended that the program be eliminated.

In the late 1980s, Arizona—like many states—experienced a sudden spike in the price of medical malpractice insurance. So its legislature created a program to subsidize malpractice insurance for physicians. By 1996, when the state carried out its first Program Authorization Review, the crisis was already over. The review recommended killing the program, and the legislature agreed.

Sometimes programs aren't obsolete; they simply don't work. Arizona's first review also examined a dropout prevention program in the Department of Education. The program addressed a serious problem, but there was no evidence that it was working—so the review suggested eliminating it.

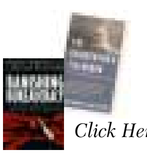
Clearing the decks will not improve the programs and agencies that remain. This fact is sometimes lost in the ideological warfare over the role of government, but it is nevertheless a fact. Partisans of shrinking government sometimes talk as if it is all we need to solve our public sector problems. Clearing the decks is certainly a good place to start, because it keeps reinventors from wasting their energy trying to improve programs and agencies that no longer serve any core purpose. But unless they follow up by using the other four reinvention strategies and the other core approaches, unresponsive, inefficient bureaucracy will remain the norm.

The Challenge of Interest Group Resistance

Why is it so difficult to clear the decks? Why did even the determined Republican House conservatives fail to achieve this, one of their most cherished goals?

One answer is that the GOP bit off much more than it could chew. Looking back on the wreckage of his strategy, Gingrich argued that the country wasn't ready for such huge changes. "Trying to get a free people to freely decide in the absence of a depression or a war to make decisive changes is incredibly hard," he said.

But even ending one program, agency, or regulation—whether it's a military base in California, an economic development unit that helps entrepreneurs write business plans, an underused post office, or a state police post—can re-



quire enormous effort. And the effort often fails.

Everything government does has a beneficiary, someone or some group that benefits. Individuals, organizations, or communities benefit directly; elected officials benefit when those groups support them with votes, campaign contributions, or publicity; government employees and contractors benefit because they get jobs and revenues. It's natural for beneficiaries to support functions that meet their needs; they have their "piece of the pie," and they're not interested in letting go of it. "Behind every inefficiency and goofy thing government does," says John Sharp, former comptroller of Texas, "there's always a special interest group that knows it's inefficient, knows it's goofy, and would not have it any other way."

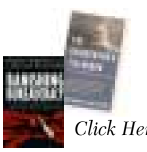
This interest group paralysis is not an exclusive problem of government. Corporate bureaucracies face similar pressures: managers, employees, and unions fight to preserve obsolete work units and product lines that provide them with jobs or status. But business leaders can usually point to their company's bottom line to cut through the resistance; if changes aren't made, the company may fail. In government, the bottom line is unclear and debatable, organizations don't go bankrupt, and most decisions are made democratically.

That is why it is easier to clear the decks when you have a crisis, such as the economic or fiscal collapse of a city, state, or country. A crisis creates the equivalent of a bottom line for government; elected officials must act decisively and quickly or face electoral consequences.

See *Banishing Bureaucracy* pp. II/2-10

When Canada's Liberal Party won control of Parliament in 1993, for instance, the federal deficit had been so large for so long that almost 30 cents of every tax dollar went to pay interest on the debt. The public was so worried about the problem—and had given the Liberals such a huge majority—that the prime minister launched a disciplined drive to kill corporate subsidies, sell off government assets, and devolve functions to provincial and local governments. In New Zealand a decade earlier, public anxieties about deteriorating economic conditions paved the way for the Labor Party to eliminate subsidies and sell off billions in publicly owned businesses. In Texas in 1991, the state faced a budget deficit estimated at $5–6 billion. Many political leaders were reconciled to imposing the state's first income tax, but they wanted to come up with at least $200 million in budget cuts as well. They asked State Comptroller John Sharp to lead a review to find the savings. When he proposed $4.2 billion in spending cuts and delays, increases in fees and federal aid, and shifts among state funds, they were in no position to resist. "The press asked [legislators], 'Why pass a tax increase when you can do these things?'" says Sharp. "So that's what the legislators were hearing when they were going home. They were coming back to me saying, 'Hey, can you go into my district and say I'm being cooperative?'"

But even when elected officials must fix a problem that is widely acknowledged and serious, parochial interests often prevent them—because the



process of making governmental decisions is highly susceptible to pressures from narrow-interest champions. A legislative committee chairman has considerable sway over which bills will advance or die, for instance; that's why Gingrich installed loyal lieutenants as the chairs of three key committees, bypassing the traditional seniority system. Or a champion may have a seat on an appropriations committee and therefore be in a position to horse-trade with other legislators: "Support my program, and I'll support yours." In 1995, Senate Republicans only had a two-vote majority on the Senate Appropriations Committee, which made it easy for moderate Republicans to trade their votes to save programs they favored. In addition, the U.S. Senate's procedural rules, which require 60 votes to end a filibuster, give narrow interests even more power to block action. At one point during negotiations over the budget rescission, Senate Majority Leader Bob Dole had to put $800 million back into the bill to attract enough Democratic votes to end debate and allow the bill to advance. And, of course, American executives can usually veto deck-clearing bills—and normally it takes a two-thirds vote to override their vetoes.

Government managers can also defend parochial interests. Perhaps the most powerful tool at their disposal is their ability to manipulate information elected officials use to make judgments. "They may mount an aggressive defense, or passive resistance, or try to co-opt you," explains Mark Murray, Michigan state treasurer and former budget director. "If I ask what a unit is doing, they say they're doing great things, and all of a sudden I'll start getting calls from people about the great things they're doing."

Champions outside government, such as businesspeople, labor leaders, and editorial writers, have the power to provide or deny what decision makers need to get elected: campaign funds, campaign workers, and publicity. Business interests used their financial might to help blunt GOP deck clearing in 1995, according to Frum, the conservative analyst. They "learned to pay their protection money to Republicans rather than Democrats," he observed, "and the well-rewarded House committee chairmen of the 104th Congress in return are transfusing cash from the taxpayers to favored industries and firms almost as enthusiastically as the committee chairmen of the 103rd."

Special interests "are usually well-organized," points out Roger Douglas, who as finance minister led the deck-clearing charge in New Zealand. "They are capable of mobilizing quite powerful opposition against reform." At the same time, the benefits of taking them on—of representing the general interest—are hard to reap. "The cost of protection is relatively small per person per item, widely dispersed across the rest of the economy, and often invisible to the people paying the bill. At best they are weak and disorganized allies of reform."

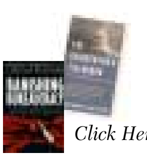
Aligning Political Will and Political Mastery

Triumph over special interests requires two things above all else: political will and political mastery. “At some point in eliminating things,” says Michigan’s Murray, “it comes down to personal leadership by public officials.” First, they must decide what to eliminate. Then, they must damn the torpedoes and lead a flat-out assault to overcome opposition.

To be successful, they need political mastery. Gingrich, after all, had plenty of will and withstood many political scaldings in his 1995 effort—but he still failed. Eliminating government functions requires a strategy for beating the special interests when the votes are counted. Murray recalls the example of a failing community college in Highland Park, Michigan. “It had few students and poor performance; there were other community colleges nearby with available space, and the local tax base supporting the college had diminished,” he says. Governor John Engler recommended shutting it down, but there was some resistance in the legislature. A face-saving deal was worked out. Legislators approved two appropriations for the college: one was its usual annual budget, the other a transitional budget to allow it to operate for only a short time before closing. Then the governor signed the transition budget and vetoed the full appropriation. “That allowed the legislature to make its statement” in support of the college, Murray explains, while also allowing the governor to kill it.

In a parliamentary system, clearing the decks is much easier, because the prime minister and his cabinet are also the legislative leaders, and party discipline is usually enforced. When the cabinet proposes something, Parliament passes it. If not, the failure triggers a vote of confidence. If the prime minister loses that vote, he or she has to call a new parliamentary election—so parliaments rarely buck their prime ministers.

In an American system, where the executive and legislature are elected separately—and are often controlled by different parties—majority votes are much more difficult to assemble. At the federal and state levels, all legislatures but one have two coequal branches, which must both pass any reform. Our forefathers designed our governmental systems to ensure that no one would gain too much power, and they were quite successful. It is extremely difficult to pass controversial reforms in these systems, particularly when party discipline is weak. To clear the decks, the political stars—fiscal crisis, party dominance, and the like—must be aligned. And this occurs only rarely. That is why some reinventors try to improve the odds by creating special processes that help the general interest triumph over special interests. Oddly enough, the search for a better clearing-the-decks mousetrap leads back to the 104th Congress.



Clearing the Bases

At exactly the moment that the Gingrich revolution began to falter, in 1995, Congress performed an extraordinary act of deck clearing. That summer, it approved plans to shut down 79 U.S. military installations and scale back 26 others, for a projected savings of $19.3 billion over 20 years. It was the fourth time since 1988 that Congress had shut bases, using a process specially designed to prevent special interests from derailing decisions. According to a 1999 report by the General Accounting Office, the process has been a huge success: base closings have saved $2–3 billion a year, and the affected communities have recovered most of the jobs they lost within two years.

This was not deck clearing on the scale that the Gingrich Republicans had attempted, and it built on a clear political consensus that America needed fewer military bases in the post–Cold War era. But the base closings still had to overcome strong resistance. More than 200 congressmen complained on behalf of their districts, because of the local economic importance of the bases. President Clinton complained openly about the hit list, which eliminated bases with more than 40,000 jobs in politically important California and Texas. Yet in the end the base closings became law—approved by the president and supported by a huge bipartisan majority in Congress.

The process for determining which bases to close contained several features that helped the general interest triumph over the parochial interests of congressmen, communities, and the president. Designed in the mid-1980s, it was the brainchild of Richard Armey, then a junior congressman in the Republican minority. "The Pentagon fought against it," recalls Bob Stone, then a deputy assistant secretary of defense, "because we fought against anything that wasn't our idea."

But the military brass wanted to close bases too, and they had been unable to do so since the early 1970s, when Congress passed the National Environmental Protection Act (NEPA). Under NEPA, the Defense Department had to announce its base-closing plans before it took action, and it had to hold public hearings on them. That meant, Stone says, that "everyone who wanted to keep a base open knew they had to mobilize and had time to mobilize." Communities could—and did—create an uproar. Congressmen could—and did—lean on the Pentagon to save a base, by threatening to hold up an appropriations bill or other legislation the military wanted. "Instead of the odds being in favor of what we wanted to do," Stone says, "the odds favored total inaction."

Armey's plan created a powerful, independent advocate for the public interest and reduced the power of parochial interests to thwart or twist the decision-making process. The advocate for the general interest was an eight-member base-closing commission, nominated by the president and approved by the Senate. The 1995 commission included a former senator, an airline executive, a banker, a retired general, and a utility CEO. The commission had its own staff, which reviewed the Pentagon's recommendations for base closings and held public hearings. Then the commission issued its own recommendations, which it sent to the president. In 1995, the commission made significant, controversial changes in the Pentagon's original list. It initially added 29 bases to the Pentagon's list for possible closure, and it ultimately agreed with only 84 percent of the Pentagon's proposed list.

Armey's process also used several devices to thwart parochial interests. One required the president and Congress to take it or leave it; they could accept or reject the commission's recommendations, but they could not amend them. This made it extremely difficult, perhaps impossible, for champions to shield their projects from death. To do so, they would have to get a majority of both chambers of Congress to turn down the whole package, which was highly unlikely. As Armey had foreseen, there were always enough votes (congressmen without targeted bases in their districts) for the general interest to beat the parochial interests.

A second device forced the decision on base closings into one vote, instead of spreading it across many bills. This allowed champions of the general interest to focus their energy, and it made legislators' decisions on the issue quite visible to the public. It didn't prevent politicking, but it kept it under control. When President Clinton objected to base closings in California and Texas, he did not reject the entire list, which would have caused a political uproar. Instead, he approved it and then announced measures to ease the economic impacts in those states.

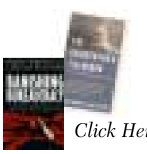
A third provision set a deadline for decision making: if Congress did not pass legislation blocking the commission's plan within 45 days after receiving it from the president, it would automatically become law. Delay was not possible.

DECK CLEARING: LESSONS LEARNED

Armey's base-closing process offers many lessons about how to overcome resistance from narrow interests and successfully shut down obsolete government functions:

1. Create a powerful, independent advocate for the general interest.

Other governments use independent boards in much the same way that Armey did. In many states, for instance, a sunset commission makes recommendations about whether or not an agency or program should be reauthorized. Canada chose a different method: the prime minister appointed a special "minister for public renewal." Unlike other members of the cabinet, he was not responsible for oversight of government departments, so he had no narrow interests



to represent. "He had no turf," says Jocelyn Bourgon, then deputy secretary to the cabinet, "and he was not the keeper of the money," a finance or budget director. Instead, his assignment was to guide the program review process, to represent the general interest of improving government.

Whatever form you choose, the general-interest advocate must have the staff, expertise, and time to carry out and publicize its analyses of government functions. It must also be able to stand up to political pressures—which brings us to Lesson 2.

2. Create a process that reduces the power of parochial interests to thwart decision making.

Again, the base-closing process demonstrated several ways to do this. By giving legislators only one vote on the commission's entire package, and no chances to amend it, the process protected the general interest from being nibbled away in dozens of subcommittees and hundreds of barely noticed votes. Similarly, the do-or-die deadline took away the special interests' opportunity to win by stalling. Deadlines force action. "That's why the tough issues usually get worked on at four in the morning on the last day of the legislative session, when there's no time left," notes Mark Murray, Michigan's treasurer. In Canada, the deadline for preparing the annual budget helped to drive the process of proposing spending reductions. In Texas, after John Sharp issued his first performance review, the legislature had only 30 days in special session to act; there was little time for special interests to mobilize. A deadline helps spring the mousetrap shut.

3. Distribute the pain as fairly as possible, by goring many oxen at once.

It is sometimes easier to clear the decks when you take on a great many interests all at the same time than it is to do so one by one. "Big packages can neutralize" interest groups, says New Zealand's Roger Douglas, because when many groups are potential losers, it is harder for any one group to complain about the damage it is suffering. Each group also has an interest in seeing that other groups don't escape the pain. And, Douglas adds, "whatever their own losses, each individual group also [has] a vested interest in the success of the reforms being imposed on all of the other groups in the room."

When Sharp prepared the first Texas Performance Review (TPR), he used a similar approach. "We kept the lobbyists at bay until the very last minute," he explains, "and then we threw so many recommendations at them, there weren't enough lobbyists to go around."

Gingrich seemed to be trying to use this tactic in his deck-clearing effort. "One of my key decisions in November of 1994 was to launch a revolutionary rather than a reformist effort," he said.

A revolutionary launches sixty battles. Two things happen: each battle attracts its particular group, so you can increase your total energy level enormously, and you spread the opposition—the establishment, the decaying old order. You spread their attention so they can't focus. They can beat you on any five things. They can't beat you on sixty.

But the Gingrich revolutionaries caved in to their own special interests—which destroyed their image of fairness. They might have fared better had they heeded this caution from Douglas: "The public will take short-term pain on the chin, if the gains are spelt out convincingly, and the costs and benefits have been shared with visible fairness across the community as a whole. If insufficient consideration is given to these balances, the reactions of aggrieved people forced to take more than their share of the costs will end up tearing the reform process apart."

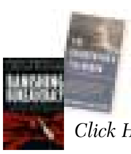
4. Make sure to have high-level leadership visibly driving the process.

Unless you have a highly structured process like Armey's base-closing procedure, deck clearing is impossible without full commitment from the top leader: the president, governor, prime minister, mayor, county executive, or city manager. Leaders must get their political allies and appointees on board, and they must stick with their agenda. In Massachusetts, Governor William Weld unveiled a full-blown review with numerous deck-clearing proposals, then announced, within a month or two, that he was going to run for the U.S. Senate. With the leader exiting, so did the leverage.

The political leader must visibly demonstrate deep personal interest in the success of the initiative. "The reason we were so successful was that John Sharp was the biggest champion of what we did, and he pushed us beyond our limits," says Andrea Cowan, a former TPR director. "You need someone who is that focused."

President Clinton tried to demonstrate his support by putting his vice president, Al Gore, in charge of reinventing government. After Gore issued the NPR report in 1993, Clinton said:

Here's the most important reason why this report is different from earlier ones on government reform. When Herbert Hoover finished the Hoover Commission, he went back to Stanford. When Peter Grace finished the Grace Commission, he went back to New York City. But when the Vice President finished his report, he had to go back to his office—20 feet from mine—and go back to working to turn the recommendations into reality.



Initially, this visible support had a real impact. But as the president's attention moved to issues he cared about more, such as health care, he lost his visibility in the reinvention battle. As a result, Congress never took it very seriously, and too many of Clinton's political appointees shrugged it off as well. Gore worked hard to build support, but a vice president has only a fraction of the clout a president wields.

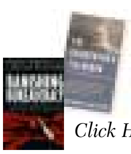
5. *Create a stage in the process for professional analysis, using performance data, before political pressures come into play.*

Ultimately, elected officials must decide whether or not to abandon or sell public functions, so political objectives will always be part of the calculation. Ideology often plays a role as well; elected officials may differ sharply over what role government should play in society. But clearing the decks is more likely to be successful if you build in a more analytical stage in whatever process you construct. "Privatization for the sake of privatization may meet some perceived ideological need, but may not make good business sense in all cases," says John Kost, who directed Governor Engler's deck-clearing process in Michigan. "Sound business judgment requires a sound analytical process, conducted by people with no vested interest in a particular outcome."

In the base-closing process, there were four stages. First, the military services offered up their suggestions for bases to close. Then a team under Bob Stone, the deputy assistant secretary for installations, subjected those lists to rational analysis, using eight criteria established in Armey's legislation. Once the Pentagon forwarded its final list, the independent commission staff analyzed it using the same criteria. They made recommendations to the commissioners, who held hearings and made the final decision. The process was remarkably free of political pressures. Stone recalls recommendations in 1993 that "basically closed everything" the U.S. Navy had in the San Francisco area. "If anybody was doing a political calculation, they wouldn't have done that. Instead, it was driven by technical and cost considerations."

In the late 1980s, Stone remembers, he built time into the process for Defense Secretary Richard Cheney to review his recommendations. Cheney declined. "He said, 'All I need is 30 seconds to sign my name,' implying he wasn't going to put bases on or take them off the list." Another time, the commission staff gave Cheney a political briefing:

> *They showed a graphic showing who the senators and congressmen were from the places they proposed to close. Cheney just blew up. He said, "This is not political. I don't even want to see those calculations; that's not part of the game."*



When you make room in the process for nonpolitical, technical analysis, you will want to examine data on performance: just what results is each function, program, organization, or regulation producing, and at what cost? This analysis can build a case for elimination that does not depend on ideology. It may expose the fact that a function provides little value or value only for very narrow interests, and it may do so in a way that has credibility with the public and some politicians.

Criteria for assessing performance vary. The eight criteria used in Armey's base-closing process included each base's military value, its return on investment, and its economic, community, and environmental impacts. The Canadian Program Review identified six key questions. The Texas Sunset Advisory Commission uses 13 standards for review, ranging from an agency's efficiency to its achievement of statutory objectives.

p. II/92

One caution is in order here, however. By demanding too much performance data, a deck-clearing process runs the risk of getting bogged down in numbers. This happened to Governor Engler's review process in Michigan (called PERM, because programs could be privatized, eliminated, retained, or modified). It established a sophisticated analytical process, but "the level of work required meant you could only do a few of these reviews at a time," says Mark Murray. "Sometimes the 50–cent answer does as well for you as the $50 answer."

6. *Bring both the legislative and the executive branch into the game.*

In parliamentary systems, such as Canada's, the same people control both branches. And in council-manager systems at the local level, the executive is a nonelected appointee of the legislative body. But in governments where the executive and legislature are elected separately, it takes two to tango. A different political party may control each branch, and even if both are run by the same party, each branch will jealously guard its power. Unless the chief executive commands a very loyal majority in the legislature, it will take collaboration to get the decks cleared.

Typically, however, one branch decides to go it alone. Once its recommendations are complete, it tries to sell them to the other branch. This is a recipe for failure. If joint ownership is established at the outset, credit for results can be shared. With both branches having something to gain, the odds increase that the legislature will enact the reforms and the executive will implement them.

President Clinton needed Congress to clear any decks, for example, but he decided against legislative proposals for a joint commission to do the job. This cost him dearly when he tried to get the NPR's recommendations passed.

Two years later, Newt Gingrich figured he could roll the president, but he was equally wrong.

"You have to have collaboration with the legislative branch," says Michigan treasurer Murray—"but at the right points in time." Though the precise form of collaboration will differ for different political structures and contexts, two points seem most critical. The first is at the beginning: if you're going to build a powerful mousetrap, you will need joint ownership of the effort. The second is when you announce the recommendations—when politicians can start taking credit.

In between these points, it's best to insulate the process from elected officials. As noted earlier, you need a professional staff that is able to do its work without too much political interference. If you had collaboration in this phase—if a review were staffed by both executive and legislative aides, for instance—every controversial idea would leak to the media, and the interest groups would immediately mobilize to start beating them down. Political leaders are usually in on the final decisions, but involving political staff in the analysis phase will usually compromise the process.

7. Give the bureaucracy a chance to contribute—and incentives to do so.

It is natural to assume that civil servants will not help to abolish their own work. Why should they? They have few, if any, incentives to offer up savings, and they may not be protected from negative consequences such as losing their jobs.

Yet government managers and employees often know the most about government functions. If you leave them out of the process, you lose an extremely valuable resource. Civil servants have been involved in some of the most effective deck-clearing exercises we have seen. "You need the two perspectives: political judgment and professional judgment," Canada's Jocelyne Bourgon explains. "People with great political courage but with no knowledge about government's activities will fail, even if they are brave. If you have great policy knowledge, but you are without political mastery, you will fail too."

The trick, then, is to provide civil servants with incentives and job security, so they will reveal their judgments without feeling they have to protect themselves. This can be difficult when they perceive that politicians are eagerly hunting for cuts, either for ideological or financial reasons. At these moments, the bureaucracy tends to batten down the hatches to wait out the assault.

Two incentives may promote different behavior. One is the simple pride involved in helping government perform better. It is easy to discount the power this has among high-level civil servants, but that is a cynical view. Many senior managers have a natural desire to be part of the solution, not part of the problem. If you handpick those you involve, you cannot find a better resource.

The other incentive is the potential to gain some of the funds saved by eliminating unnecessary functions. This is how it works in the U.S. military: savings achieved through deck clearing or other means are normally returned to the military budget. “There’s a widespread understanding that any money we can stop wasting can go to pay for vital needs that are not being met,” says Bob Stone. Even if only half the savings are returned to an agency, this “shared savings” incentive can be quite powerful.

p. III/131

DECK CLEARING FOR MANAGERS

Clearing the decks, like the rest of the Core Strategy, is mainly about steering. It is an approach for use by those who have the power to steer: elected officials, their appointees, and high-level civil servants.

But managers within line organizations can also use this approach. Most public organizations have at least a few functions that are obsolete, and efforts to weed them out are an important part of a manager’s job.

Managers can conduct their own, smaller, versions of a program review, periodic options review, asset sale, or privatization initiative. They can weed out obsolete programs, processes, assets, and regulations. They will need agreement from their authorizers—the executive and perhaps a legislative committee or two—to make big changes. But they will find many things that they can eliminate without permission. Conditions change so fast in today’s world that some degree of obsolescence is almost guaranteed.

Try the following tools:

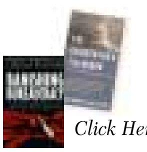
- ***Divesting to invest:*** Have your customers rank your activities in value. Use those rankings to find the 10 percent of functions that are least valuable to your customers, and see which of those 10 percent you can abandon. (This is a modified zero-based budgeting technique, but it can be used within or outside the budget process.) Use the savings to invest in improving what customers do value or to increase value through new initiatives.

p. III/131

- ***Shared savings:*** Before you start divesting, work out a deal with your authorizers that allows your organization to keep all or part of its savings. Otherwise there is limited incentive to eliminate the obsolete, because you risk having the money taken away before you can invest it.

p. III/127

- ***Gainsharing***: Get permission to share the savings with employees. If they can benefit financially from reducing spending, they will turn into an army of cost cutters. Suddenly, they will look at everything the organization does with new eyes: Do we need to use such expensive paper? Can’t we reuse our file folders? Couldn’t we use cheaper sand on the roads in winter?



8. *Win the battle for public credibility.*

Many deck-clearing efforts come down to a fight for the public's approval, since elected officials pay attention to what the voters say. And the more controversial the proposal, the more important it is to get voters on your side. "If you don't come up with something that the public is interested in," observes John Sharp, "you're going to have a hell of a time explaining the rest of that stuff to a reluctant group of legislators who deep in their hearts don't want to change any of it anyway." As comptroller in Texas, Sharp was a master at translating his proposals into something that television viewers could understand. The key, he believed, was to emphasize how much money would be saved. "There have been so many studies and so many reports through the years that most people don't know and don't care," he says. "But I can assure you that Bubba knew the scope and importance of our study by the time it was published."

Sharp and his deputies brought this approach to the National Performance Review (NPR), which they helped run. The management team at the NPR fought hard to make sure that their recommendations would add up to savings of more than $100 billion—the magic number they thought necessary to establish credibility with the press and the public.

But saving money is not the only thing people care about, as Gingrich's failure demonstrated. You also have to establish the basic necessity and fairness of your deck-clearing proposals. The key here, says former TPR staff member Alan Pollock, is how you present your case: "Our background material, and the way we characterized problems and inefficiencies—everyone agreed we were right on the money. And that's where our credibility came from."

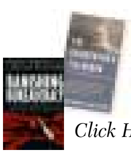
Making your case in the media, the main source of information for most people, is critical. Sharp knew he would get into fights over his recommendations, so he actively cultivated the press. "We went to the press at the very beginning," he says, "and begged them for this. We said, 'If somebody says something bad about one of our recommendations, before you print it we want a chance to respond.' That was critically important, because once you miss that first response, it's out there and it's over."

Sharp thought it important to respond to every attack. When officials at a state university held a press conference to charge that some of his recommendations would kill indigent care programs, Sharp retaliated immediately. "I was there that afternoon," he recalls, "saying something to the effect that these high-paid bureaucrats are 'a handful of gimme and a mouthful of bull,' some ridiculous quote like that. There weren't any more of those kinds of press conferences."

See *Banishing Bureaucracy* pp. III/18-20

9. *Mitigate the shock of death.*

When eliminating government functions, it is important to manage the transition humanely, as we recommended in *Banishing Bureaucracy.* Unless



your government is under severe fiscal stress, you can use attrition, early retirement incentives, and other methods to downsize without resorting to layoffs. You can even find ways to send positive signals to other government employees. When the British sold government businesses, for instance, they sometimes helped employees purchase discounted stock in the private firms. "If the people who move out of activities that you are killing prosper, that's a powerful message to the rest of the organization," says Mark Murray.

p. III/81-82

p. II/110

This lesson also applies to the interests of government's customers. For instance, when the Canadian government wanted to eliminate transportation subsidies for grain growers, it offered several years of transitional funding. Similarly, when Governor Engler in Michigan eliminated a community college, he provided a transition budget that allowed some nursing students to finish their program.

10. Getting government right is an ongoing problem, so set up an ongoing process to address it.

The base-closing process involved four separate rounds, over seven years. In Texas, after the success of the comptroller's first performance review, the legislature authorized reviews every two years. In Canada, the 1994 Program Review led to a continuing process for examining the necessity of government functions.

Each of these examples was a response to a practical consideration: the need to spread the deck-clearing process out over several years. Trying to judge every aspect of government all at once is simply too enormous and complex a job. "It is much too intense, too difficult," says Canada's Jocelyne Bourgon.

To build the habit of deck clearing into the fabric of government, you can create targeted reviews that bite off one piece at a time. In general, we think these "periodic options reviews" provide more value, over time, than do one-shot program reviews. (If you attach a do-or-die deadline to the review, by requiring the legislature to reauthorize the program to keep it alive, you have what is widely known as a sunset review.)

p. II/100-102

One option besides abandoning the function is to turn it over to the private or the nonprofit sector. You can do this either through an asset sale or by using a quasi-privatization tool, such as a 50-year lease or an agreement by which the private sector builds the asset and operates it but ultimately transfers ownership to the public sector.

TOOLS FOR CLEARING THE DECKS

Program Reviews provide comprehensive, in-depth analyses of the results, costs, and necessity of specific government functions and regulations, with recommendations to maintain, eliminate, or improve them. See p. II/90.

Periodic Options Reviews establish regularly scheduled examinations of agencies and their functions to determine whether they should be abandoned, sold, devolved, or otherwise reformed. See p. II/100.

Asset Sales move government assets, such as publicly owned businesses, corporations and pieces of physical infrastructure (airports, dams, railroads) to private ownership. In most countries this is synonymous with the word *privatization,* although in the U.S. that term is also used to describe contracting out. See p. II/105.

Quasi-Privatization Methods let the private sector lease or build physical assets, such as prisons, hospitals, and highways, and use them to deliver services governments want. The asset may be owned by government or may shift to public ownership at a specified future date. See p. II/114.

PROGRAM REVIEWS

On February 27, 1995, a prominent North American politician declared that progress toward a balanced budget "can only happen if we redesign the very role and structure of government itself." The country, he said, needed "a new vision of the role of government in the economy. In many cases that means smaller government."

> *We are dramatically reducing subsidies to business. We are changing our support systems for agriculture. We are putting government activities on a commercial basis wherever that is practical and productive. . . . In creating this budget, no activity of government has gone unexamined. Nothing less than a complete rethink has been required—top to bottom.*

The country in question was not the U.S., but Canada. The speaker was not an acolyte of Newt Gingrich, he was the Canadian finance minister. He was not a rabid conservative, but a leader of the Liberal Party, the Canadian equivalent of the Democrats. Paul Martin was unveiling his party's 1995 budget proposal in Ottawa.

The Liberals had swept into power in late 1993, gaining an enormous majority in Parliament. Their first priority was to reduce the federal deficit, which was significantly higher than the U.S. deficit, both as a percentage of spending and as a percentage of gross domestic product (GDP). Previous Canadian governments had tried across-the-board budget cuts—14 times in eight years. While failing to tame the deficit, this hurt all programs indiscriminately. "Cutting everything across the board leads to incompetence across the board," observed Jocelyne Bourgon, then secretary of the cabinet.

The Liberals tried a different tool. As we reported in *Banishing Bureaucracy,* they conducted what they called a Program Review, a comprehensive examination of spending in every federal department. Instead of cutting across the board, the Liberal government decided to make choices and eliminate lower-priority programs.

The first phase of the review produced recommendations that would save \$17 billion over three years, cutting roughly 10 percent of departmental spending and eliminating 14 percent of federal jobs. A second phase identified an additional \$2.2 billion in potential savings. Overall, the Liberals shrunk spending on all federal programs to the lowest level since 1950, as a percentage of GDP. Economic programs such as corporate and transportation subsidies took the biggest hits, whereas social programs expanded their share of the dwindling pie.

Perhaps the most radical overhaul took place in Canada's transportation sector. The Liberal government decided to:

- Sell the Canadian National Railway System to stockholders.
- Transfer ownership and operation of most smaller airports to interests in local communities.
- Turn over the Air Navigation System and the operations of the St. Lawrence Seaway to private, not-for-profit corporations.
- Transfer regional and local ports to provincial and local governments or community organizations.
- Largely end transportation subsidies for business interests and reduce those supporting passenger railways and ferries.
- And abolish subsidy payments to railways for grain transport.

The Canadians carefully organized the Program Review to get the nation's political leaders working hand in glove with the civil service's top managers. They started by developing six criteria for judging the value of each program (see the box on p. II/920). Then, in each of the 25 federal departments, the elected minister and the deputy minister (the top civil servant) used those criteria to develop proposals for changes. They relied not on outsiders but on themselves and their staff of civil servants.

These proposals then went to a special review committee made up of six handpicked, top-level civil servants with deep knowledge of the 25 departments. As the cabinet's secretary, Bourgon chaired the group. "The membership was carefully selected," she says. "Collectively, the six of us had been in every department."

CANADA'S DECK-CLEARING CRITERIA

The Program Review asked departments to review and assess their activities and programs against the following six criteria:

1. *Public interest test.* Does the program area or activity continue to serve a public interest?
2. *Role of government test.* Is there a legitimate and necessary role for government in this program area or activity?
3. *Federalism test.* Is the current role of the federal government appropriate, or is the program a candidate for realignment with the provinces?
4. *Partnership test.* What activities or programs should or could be transferred in whole or in part to the private/voluntary sector?
5. *Efficiency test.* If the program or activity continues, how could its efficiency be improved?
6. *Affordability test.* Is the resultant package of programs and activities affordable within the fiscal constraint? If not, what programs or activities would be abandoned?

The committee raised questions about the proposals and made suggestions. But, says Bourgon, "We were not to instruct the departments and were not to force them to change the proposal. *They* were accountable—not us." To ensure that departments paid attention to its advice, the committee wrote up its assessments and passed them on to a special committee of elected ministers, the next stop for the departments' plans. This group had also been handpicked by the prime minister. "Assume you are a deputy minister," says Bourgon. "You would want to take on board as much advice as possible because you want your minister to have clear sailing in that next meeting."

Only two departments disregarded the criticisms and took their proposals unchanged to the ministers' group. "They went ahead, and they failed," Bourgon says. "That sent a huge signal to the others."

Once the committee of elected ministers approved proposals for every department, the cabinet examined the whole puzzle they had been assembling. "I remember telling them at the beginning [of the process], 'You may hate this camel at the end,'" Bourgon says. The cabinet took several two-day retreats to look over the pieces and decide if the package as a whole was politically feasible. Bourgon says they looked at the impact of the reductions in various ways: effects on regions of the country, on the economy, on the nation's fiscal deficit, and so on. "At the end of the day, let's be honest, it is a subjective judgment," she explains. “It’s mainly a political judgment: Can you marshal support? Do you have the political will?”

Prospecting for Gold

Canada’s Liberals were not the first to use this kind of review. During and after the long recession of the early 1990s, many American states did some kind of review, whether they called it a performance review, as Texas did; a PERM review, as Michigan did; or a performance audit, as North Carolina did. Many local governments did the same thing. And, of course, the Clinton administration launched its National Performance Review, which came up with nearly 300 recommendations to save $108 billion over five years; reduce the federal payroll by 252,000 positions; reform the budget, personnel, and procurement systems; and make many other improvements.

We call this kind of review a program review rather than a performance review because it typically focuses less on how well programs are performing than on whether they should be abolished, reformed, or restructured. In six or nine months, it is impossible to do a true “performance review” of more than a small slice of a typical government. But by whatever name, prospecting government-wide for inefficiencies and obsolescence often uncovers mother lodes of gold. Not all of the savings come from eliminating functions; typically, most result from improvements in management.

Some governments use this tool to eliminate regulations as well as programs. Indianapolis created a Regulatory Study Commission to help eliminate outdated and unneeded rules. In California, Governor Pete Wilson’s Office of Planning and Research held six regional roundtables to gather recommendations for regulatory streamlining; it identified 3,100 regulations for abolition. New York governor George Pataki created the Governor’s Office of Regulatory Reform, which claimed to have reduced operating costs to individuals, businesses, nonprofits, and local governments by more than $1.6 billion in its first two years of reviews.

The basic components of a program review are deceptively simple:

- You need a mandate that describes the scope of the review. Will it cover all departments? Will it review administrative systems? Regulations?
- You need to assemble a team to conduct the review.
- The team needs to lay out and implement an analytical process, including data gathering, assessment, and options development.
- The team should establish a timetable, with specific deadlines along the way.

- And finally, the review should produce a set of recommendations and sell them to decision makers.

In reality, the exhaustive, in-depth nature of program reviews creates many complications in implementation. And the fact that a program review lives—or dies—in a political environment adds even more. There is no "right" way to conduct a program review, but past experience does suggest some lessons. For starters, all 11 of the general deck-clearing lessons outlined previously apply to program reviews—in spades.

pp. II/81-89

Program Reviews: Lessons Learned

1. Don't try a program review unless the political stars are aligned.

Though powerful, a program review "is a tool that only works when the stars are in alignment," says Richard Paton, a veteran of Canada's two reviews. In Canada and in Texas, they were. Fiscal crises forced action, political majorities had enough power to pass tough measures, and public opinion supported dramatic change. But in many other cases, when the stars have not been so well aligned, even herculean efforts have failed. The NPR, for instance, led to significant reforms and significant downsizing but few votes to eliminate programs. Clearing the decks is just too difficult unless political will, political mastery, and the political stars all line up behind it.

2. Use fiscal targets to drive the process.

An undertaking as massive as a program review needs a powerful lever to gain the attention and cooperation of politicians and civil servants. Improved efficiency and effectiveness may be enough to generate enthusiasm in some governments, but not in most. Experience shows that a financial bottom line—money saved—has the most power to attract political support, stimulate the creativity of agencies, and keep the public interested.

In Canada there was a strenuous debate over the use of fiscal targets in the Program Review process. Although the Liberal government had an overall target for reducing the federal deficit, some officials felt it was unwise to set department-by-department targets for savings, because the targets could become de facto ceilings on savings. What if an agency could do even better? Others felt it was essential to have targets so departments would know what they had to accomplish. In the end the cabinet decided to use targets, but it called them "advisory," says Richard Paton, then an official with the Treasury Board.

Although we believe that an overall fiscal target is almost always useful, the utility of departmental targets depends a great deal on the situation. If civil servant employees of a department or agency are doing the review, for example, a challenging fiscal target is probably necessary to force them outside the box—outside their usual view of change as incremental. If outsiders are doing the review, however, departmental targets may be less necessary.

If you do choose to set departmental targets, make sure they are not arbitrary. When a new administration comes in, there is a danger that it will launch a program review and set half-baked targets based on the anecdotal impressions of a few recently elected or appointed leaders. To have any credibility, departmental targets should be set by people who are well informed about realities inside the departments, such as Canada's deputy ministers.

Of one thing we are sure: don't set the same target for every department. Program reviews are about making choices and setting priorities, not about making across-the-board cuts.

3. Articulate a clear and feasible scope for the review; don't try to bite off more than you can chew.

In any large government, it is impossible to review all functions overnight—or even in six months, which was how long the NPR was given to get the job done. Clinton and Gore bit off too much for a six-month review; the short time span precluded doing true in-depth analysis in some departments. And in the rush, Gore's team did not have time to develop an implementation strategy. Predictably, Clinton and Gore launched a second review two years later.

In Texas, John Sharp had only five months to complete his first performance review—enough time to generate nearly 1,000 recommendations, but not enough time for a thorough review of the entire state government. Every two years, Sharp came back with another report—and hundreds of new recommendations. In North Carolina, the government-wide performance audit took 18 months.

The appropriate length of time for a review depends on its scope. For shorter reviews, you can narrow the focus—for example, to the most costly and troubled programs. The Canadians left out of their Program Review several very hot issues, including federal transfer payments to the provinces and major entitlement programs such as unemployment insurance. These required a very different sort of analysis than the Program Review did of the departments' service and compliance programs, says Bourgon. The North Carolina audit looked not only at government programs but also at administrative control systems, such as procurement and personnel, and at health care costs. It divided the vast terrain into separate major reports, which were issued sequentially rather than all at one time.

If the review's focus is unclear, it will hamper the team's effectiveness. Because Clinton's mandate for the NPR was fuzzy, for example, different NPR work teams sometimes operated on different assumptions. No one was quite sure just how bold the president wanted to be, and different people gave the teams different advice. As a result, some teams were timid, while others spent time generating lists of programs for the chopping block that were ultimately rejected by the White House because they would upset Congress.

4. Create a team that combines expertise with a willingness to think outside the box.

Conventional wisdom suggests that civil servants will never develop bold proposals to clear the decks—that for truly innovative thinking you need outsiders, such as businesspeople. But conventional wisdom is wrong. Reviews dominated by outsiders, such as the Reagan administration's Grace Commission, typically offend the insiders so profoundly that they stonewall any action. Reviews done by insiders, such as Canada's Program Review, usually get much further.

But the real question is not whether to use insiders or outsiders; it is how to assemble a team that has deep knowledge of what government does, expertise about possible alternatives, and the courage to suggest bold new ideas. This is difficult to orchestrate, especially if you're in a hurry.

One way to get insiders involved is to borrow them. For the first TPR, Sharp's office borrowed staffers from various agencies, then set them loose on other agencies to find improvements. This way, says Sharp, they had the advantage of not being captives of the agencies' "spheres of influence"—and they could go back to their agencies without fear after the review. Sharp's deputies used the same technique when they staffed the NPR's teams that examined federal departments. The disadvantage, of course, was that the temporary staffers knew very little about the terrain they were invading. And it is very hard to make bold recommendations when you feel you are on shaky ground. With just a few months to pull together their recommendations, some of the NPR's departmental teams were remarkably timid. (In Texas, after the legislature authorized Sharp to conduct repeated performance reviews, he greatly increased the permanent staff in his office to handle the task, and he sometimes contracted with outside experts to review particular programs or systems.)

The NPR staffed the other half of its teams—those examining administrative systems and structures—by handpicking both insiders and outsiders who had real expertise in their subjects. This nonrandom method worked far better than selecting staffers from agencies indiscriminately, and the mix of insiders and outsiders was more effective than relying only on insiders.

In North Carolina, the performance audit team obtained an outside perspective by hiring a consulting firm, Peat Marwick. The outsiders "brought no predisposition to the table," says Curtis Clark, then manager of the state's performance audit division. "They were not hesitant to trample on sacred ground."

Yet in Canada, no outsiders were involved in the Program Review. Instead, a heavy burden fell on the deputy ministers, the highest-ranking civil servants in the system. Canada's method worked because the elected officials set a bold fiscal target and made it very clear that they wanted the decks swept clean—and because the deputy ministers brought deep knowledge and years of experience to the table. In general, however, we believe program reviews are most effective when done by a handpicked combination of insiders and outsiders. The right insiders bring the deep knowledge of government; the right outsiders bring knowledge of potential alternatives and a greater ability to think outside the box.

5. *Use a variety of methods to gather information and ideas.*

When Sharp launched the first TPR, he did what any good politician would instinctively do: he held public hearings around the state and publicized a hotline (1–800–BEAT-WASTE) to generate ideas. The hotline received 2,600 calls. These efforts fit well with Sharp's combative approach, which treated the review as an incursion into the agencies' turf. They also generated great press. But they didn't produce many useful ideas. The TPR staff learned that public hearings "are a huge waste of money, especially when you have to do them statewide," says Mary Buckley, then a special assistant to Sharp.

> *The first time we put up the hotline we got over 2,000 recommendations, and maybe 5 or 10 of them were worthwhile. Now, one of them was a $500,000 savings, but those were few and far between. It was a great PR tool. But we did it for school district performance reviews also, and we never got anything useful.*

Over the years, Sharp, Buckley, and their colleagues learned to use five different sources of information: an environmental scan, agency employees, experts, customers, and the general public. They found the first two to be the most useful and the public to make the least useful contributions.

• ***Environmental scanning.*** Both the TPR and the NPR told their staffs to begin by reading every existing report they could find on the agency or program in question. This usually surfaced an enormous amount of valuable information, while also orienting the staff to their topic. As the Internet matured, it became an extremely useful tool for this kind of scanning. "We found a lot of good ideas from other states, or the private sector," says Andrea Cowan, a former TPR director. You have to be willing to read "everything you can get your hands on. A lot of our ideas didn't come from experts—they came from scanning the globe, seeing what others were doing."

• ***Public employees.*** Civil servants often know the most about how programs really work and how they can be improved. Occasionally, says Sharp, these employees "were disgruntled folks that we found out about."

> *But a lot of times there were very low-level people within the agency that always knew something was screwed up but never could get their ideas past the first tier of management. We took their ideas and we did something they could never do. We took them to the top.*

"Talking to them one-on-one was best," adds Cowan, "because sometimes in a group they would get nervous, and not want to criticize the agency." Once they learned to trust the TPR, agency employees would sometimes hand over legislative proposals that their directors wouldn't take forward, says Cowan. "We probably got the best ideas that way."

• ***Experts.*** Academics and consultants with particular expertise in an area are often helpful in outlining alternatives to current practice. They weren't usually very familiar with the actual process being examined, Buckley notes, but they knew other models and had opinions about which were best. Both the TPR and the NPR routinely invited experts in and picked their brains. Occasionally the TPR even organized day-long policy roundtables, involving a few experts, a few agency managers, and a few legislative staff members, to delve into an issue.

• ***Customers.*** Surveys, focus groups, and other methods for listening to the customer were also somewhat helpful—although as we explain later, they help less with deck clearing than with performance improvement. Mary Buckley says she learned the most by actually walking through a process—such as welfare intake—as a customer.

p. II/101
p. V/56

• ***The public.*** Hotlines and e-mail generate a lot of heat but not much light. Most citizens know what makes them angry, but they don't know enough about the inner workings of the bureaucracy to suggest useful solutions. Public hearings tend to attract special interest groups, who are there to defend their self-interest, and cranks. The TPR had much greater success with "charettes": day-long (8 A.M. to 8 P.M.) forums that citizens could drop in on when it was convenient, to register their views. Rather than using a hearing format, TPR simply set up numerous tables, each manned by a staff member and focused on a particular kind of issue. Citizens could talk with the staff member, or if they were too timid or too hurried to do that, they could simply write their comments on poster boards mounted on the walls. This didn't result in great insights, Buckley and Cowan found, but it did give them a sense of what most concerned people.

pp. II/85-86

6. Develop an implementation strategy before you issue recommendations.

Unfortunately, a recommendation made is not a recommendation implemented. Many proposals offered in a program review will have to run the legislative gauntlet, where they will be attacked by various interest groups. As with any major piece of legislation, before the process begins, you should have a plan for succeeding.

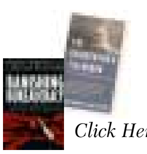
At the outset, it is critical to line up as much political support as you can—by sharing the credit for the review with the other branch of government, for instance. You must also carefully package and broadcast the report's unveiling so that it will build positive public and media support. President Clinton and Vice President Gore unveiled their report on the White House lawn, in front of forklifts piled high with volumes of government red tape. They then blitzed the country for several days, even taking their show onto late night television. Gore constantly used visual props, like the ashtray he smashed on David Letterman's television show to satirize the government's bureaucratic procurement specifications.

One common mistake in the marketing of program reviews is overselling. "In order to push governmental reform proposals through the many veto points in the American system," observes R. Kent Weaver, a senior fellow at the Brookings Institution, "political executives need to promise greater returns than are likely to be achieved." If opponents can point to a specific claim that is inflated, they may be able to discredit much of the report.

But implementation is not just about winning political and media wars over recommendations. It is also about winning support within the bureaucracy, which must do most of the actual implementing. To do this you will need a high-level, government-wide steering group of appointees and senior civil servants to develop strategies, clear away obstacles, and monitor progress.

RESOURCE ON PROGRAM REVIEWS

Andrea F. Cowan. *Performance Review: Streamlining Government Operations and Management.* Austin, Tex.: Sheshunoff Information Services, 2000. Written by a former manager of the Texas Performance Review, this looseleaf manual and CD provide guidance on implementing a program review, based on experience in Texas and elsewhere. Available for $345. Phone: (512) 305–6658. Web: www.sheshunoff.com.



PERIODIC OPTIONS REVIEWS

***Periodic Options Reviews* establish regularly scheduled examinations of agencies and their functions to determine whether they should be abandoned, sold, devolved, or otherwise reformed.**

A program review usually generates savings and modernizes government operations. It also inevitably leaves some stones unturned. So why not try it again? Like John Sharp in Texas, many reinventors decide that once is not enough; they want a process that is done regularly and constantly.

pp. II/89-92

When Canada wrapped up its first Program Review, officials realized that the process was too massive to use regularly. "You have to allow people to breathe," says Jocelyne Bourgon, then secretary to the cabinet. They decided not to institutionalize the Review's focus on efficiency and savings, only its focus on the proper role of government. "Our view was that efficiency gains are marginal improvements only. What really matters the most is to focus on what should be the role of government."

pp. II/131-4

The British created periodic reviews as the heart of their Next Steps reforms. Every five years, British departments review the executive agencies under their purview to examine their roles and decide if all or part of their functions should be abolished, sold, contracted out, merged with other agencies, or restructured. Two central organizations, the Treasury Department and the Next Steps Team, monitor the process to make sure it is thorough. Based on the reviews' results, the departments negotiate a "framework document" with each agency, specifying its mission, role, and performance criteria for the next five years. In their first five years, the British reviews resulted in decisions to privatize about a dozen organizations.

The state of Arizona created its own version of this tool in the mid–1990s, first called Program Authorization Reviews, then renamed Strategic Program Area Reviews. They begin by asking the selected agency to do a self-assessment of a particular program it administers. Then, to engage both the executive and the legislative branch, evaluations are prepared by both the Governor's Office of Strategic Planning and Budgeting and the Joint Legislative Budget Committee staff. Each staff makes recommendations on whether to retain, eliminate, or modify the program. When both staffs agree on a recommendation, it has more credibility with the legislature.

In our view, periodic options reviews, when done well, have far greater value than one-time program reviews. Why? Because they institutionalize the habit of examining whether functions are still needed and, if they are, how to improve them. Since agency managers know the reviews are coming, they keep a critical eye on these core questions. The first two Texas Performance Reviews "accomplished some short-term things; they saved some money," says

Mary Buckley, then a special assistant to the comptroller.

> *But I think in the long term they have done a lot to change the way people think about how they do business. Managers ask themselves, "How could we save? How could we do it better?" To the extent someone does it on an ongoing basis, not as a one-shot deal, people know it's out there and they've got to be thinking about it. They know they're going to have go through a review, and so they keep an internal process of rethinking going on.*

Periodic options reviews also:

- Allow governments to sequence their reviews, so they can cover the entire waterfront over time, rather than trying to do it all at once.
- Encourage leaders to reinvent for the sake of reinventing, not just to cut budgets.
- Give government officials a regular opportunity to engage in public dialogue about the proper role of government, which prompts them to explore the issues related to each function in depth.
- Require government leaders to develop and maintain an ongoing capacity to perform this work, in special units and within departments, rather than building that capacity from scratch sporadically.

Periodic Options Reviews: Lessons Learned

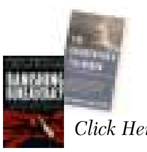
pp. II/81-89, II/94-99

All of the general lessons about clearing the decks are relevant to this tool. And all but the first two lessons on program reviews apply to periodic reviews as well. In addition, we offer the following advice, gleaned from experience in Texas, Canada, Arizona, and the U.K.

1. If you don't have the performance information and evaluation capacity necessary to make informed judgments about programs, don't try to use this tool.

Because periodic options reviews examine smaller slices of government than program reviews, they allow for greater focus on performance. And because they are repeated, they tend over time to weed out most of the functions that no longer serve a core public purpose—leaving the question of how to reform existing functions even more prominent. Hence they require good data on performance and, at times, evaluation to understand what the data means. If you don't have these capacities, you are probably not ready to use this tool.

pp. II/65-8, 247–271



2. Build consultation with customers and other stakeholders into the review process.

Decisions about clearing the decks can be informed by input from customers and stakeholders, but ultimately they are made in the interests of government's "owners"—the citizens—by their elected representatives. They have less to do with how customers feel about a service function than with whether its owners feel it still needs to be performed by the public institution in question. Customers may want the service to continue, for example, even though the owners feel it is not worth continuing, given fiscal constraints, or could be better handled by the private sector. But because periodic options reviews get beyond clearing the decks and into performance issues, customer feedback becomes much more important. A review process should build in a variety of ways to get input from customers and other stakeholders.

pp. IV/86-92

3. In an American system of separately elected legislative and executive branches, special efforts are necessary to ensure buy-in and action by both branches.

A periodic options review is much more difficult in a system that separately elects the legislative and executive branches than in a parliamentary system, particularly in these days of weak party discipline. In parliamentary systems, legislators in the majority rarely object publicly when the prime minister, their party's leader, proposes to abolish, sell, or devolve a function. In most American systems, however, no such proposal can be implemented without legislation, and most are hotly debated.

Arizona dealt with this problem by having both the executive budget office and the legislative budget staff review programs and recommend whether to retain, eliminate, or modify them. This two-branch process "is half the genius of this thing," says Peter Burns, former director of the Office of Management and Budget. "With the joint things going, you boil down to what are the facts, and you get opinion out of the way—because sometimes we have wildly different opinions on something." When there are disagreements, Burns says, it forces the two offices to discuss their views and negotiate. "If both of us agree, people assume it to be true."

Even with both branches involved, however, the Arizona legislature gradually lost its sense of urgency about the reviews. The Texas legislature also lost much of the sense of urgency it felt early in the 1990s about TPR recommendations. These realities suggest that some jurisdictions would be wise to create a version of the federal base-closing process described earlier. For example, a legislative body could require that each government agency or program undergo a thorough review every five years—whether it is conducted by two of-

pp. II/81-82

fices, as in Arizona; by an independent office, like the Texas comptroller; or by an ongoing, independent commission, selected by the executive and legislative branches. That office or commission would be authorized to recommend whether to abolish, sell off, devolve, or in some other way reform the agency. Its recommendations could become law within two, three, or four months, unless the legislature voted against them or the chief executive vetoed them. In this way, the normal inertia of the legislative process could not kill a recommendation; only deliberate action by either branch could do so.

Such a process would clearly have to be handcrafted to fit the political realities of the government involved. And like any periodic options review, it would need strong champions in both branches—and probably in both houses of a bicameral legislature.

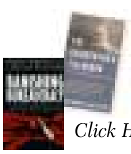
4. Review all organizations working in the same policy arena at the same time.

Jeremy Cowper, who ran the U.K.'s Next Steps Team from 1994 to 1997, suggests performing reviews for all agencies related to a particular policy area, such as criminal justice or employment and training, at the same time. In this way, the government can examine its overall policy, set new directions, and make sure all agencies in that area are aligned with the new direction. Problems that fall between agencies, conflicts between agencies, and duplication or overlap among agencies can also be addressed. Agencies that need to work more closely together can be directed to do so.

Arizona learned this lesson in its first review. "We set [Program Authorization reviews] up to examine a program in isolation," explained State Senator Carol Springer. "We should be trying to examine programs that overlap or duplicate. We would have a better chance of eliminating a program if it could be absorbed into another program." In the second round, Arizona began reviewing similar programs together.

5. Tie the timing of reviews to the business planning cycle used by the organizations being reviewed.

One critical issue in institutionalizing a review process is how often to review each agency or program. In the U.K., each review is followed by the negotiation of a new framework document between the department and agency, which clarifies the agency's mission, role, and key performance criteria for the next five years. The Canadians decided to follow suit, timing their review cycle to the business planning cycle they require each department to use, either a three-or a five-year span. "Every time a department or large organization produces a business plan," explains Bourgon, "their first step is to pause, look ahead, and think of the future and what their role should be."



Large governments tend to gravitate toward a five-or six-year cycle, because they have so many agencies. (The Swedes, for example, use a six-year cycle.) Smaller governments, particularly local governments, often want a shorter cycle. But in either case, they should tie the review to a strategic management cycle, as the British and Canadians do. An annual or biennial budget cycle is usually too short, and a 12–year cycle, like the Texas sunset review process, is disconnected from the agencies' planning horizon.

6. Reduce the natural defensiveness of organizations being reviewed by asking them to begin with a self-assessment.

In Arizona, the review begins with a self-assessment of the program by its agency. "This gets the people in the agencies involved, which puts them in a less defensive posture," says Ted Ferris, former director of the Joint Legislative Budget Committee staff, which evaluates the assessments. The next stage is performed by outside offices, to give the review some real discipline.

pp. II/89-93

This is similar to the method Canada used for its Program Review. In the U.K., agency managers and employees also have opportunities to give their views to the departmental reviewers. This kind of involvement is crucial in creating a mentality of self-examination within the agencies. "The greatest benefit of the self-assessment is that by responding to a series of questions about their history, performance, and management, staff figure out for themselves what is working and what needs to be fixed in their programs," says Rebecka Derr, the strategic management analyst in the Arizona Governor's Office of Strategic Planning and Budgeting.

> *In fact, by the time we get the self-assessment, most programs have already started to take corrective action on identified problem areas.*
>
> *Untold numbers of hours go into these reports, and at first, most of these programs are not real thrilled to be part of the process. But without question, every program that has gone through a review has revealed to the budget office staff that this is one of the best processes they have been through. In fact, positive comments by programs that have undergone a PAR have resulted in agencies adopting the PAR self-assessment to informally evaluate their programs on their own.*

7. Don't underestimate the time and capacity required to do periodic options reviews.

As Derr points out, serious reviews take an enormous commitment of time and energy. In the U.K., reviews are supposed to take about nine months. Initially, they were to be done every three years. But with elected ministers sometimes pushing for privatization, civil servants often disagreeing, and Treasury Department officials sometimes challenging the reviews' conclusions, the process bogged down. By 1994, some reviews were taking two years or more. The government finally decided to extend its timetable from every three years to every five.

8. If you don't have enough staff capacity, contract out pieces of the review.
The TPR often contracted with consulting firms or academic experts to review particular functions or programs if the comptroller's staff did not have the time or expertise required. Generally this worked well, says Mary Buckley. But "it was critical that someone stayed on top of the consultants, so you didn't get recommendations that weren't useful near the end, when you didn't have time to get them fixed. You have to monitor the consultant; you have to stay in touch."

RESOURCE ON PERIODIC OPTIONS REVIEWS

United Kingdom. Cabinet Office. *Guidance on Agency Reviews,* December 1995. A brief document laying out basic guidelines for an agency review in the U.K.

ASSET SALES

***Asset Sales* move government assets, such as publicly owned businesses, corporations and pieces of physical infrastructure (airports, dams, railroads) to private ownership. In most countries this is synonymous with the word *privatization*, although in the U.S. that term is also used to describe contracting out.**

By 1995, roughly 100 countries had programs to divest their public enterprises, according to the Reason Foundation, a nonprofit advocate of privatization. Some 16,000 state-owned enterprises had been sold in the previous decade; estimates of their value range from $388 billion to $445 billion. Though Latin American and Asian nations led the early charge, these numbers were boosted by sales in formerly communist nations, where government-owned businesses had accounted for the vast majority of economic activity.

Sales have included anything under the sun that might attract a profit-seeking buyer, including airlines, airports, telephone companies, oil companies, ports, sewage treatment plants, water systems, toll roads, bridges, tunnels, prisons, off-track betting operations, hospitals, convention halls, stadiums, parking garages, electric and gas utilities, waste-to-energy plants, telecommunications systems, and dams. In December 1994, Australia conducted the world's first stock-market sale of shares in a toll road. In 1995, New York City initiated the sale of its radio and television stations. In 1997, the U.S. government sold its 17,000–acre oil and gas reserve in California for $3.65 billion, the largest price ever paid for a public asset in the U.S. And in 1998, the *Wall Street Journal* reported that competition by firms around the globe to acquire and construct the infrastructure for water systems was the new frontier of privatization.

Definitions, p. II/140

Asset sales usually involve the service functions of government—unloading either "hard" assets, such as physical infrastructure, or "business" assets, such as a steel company or electric utility. In general, this tool doesn't work for eliminating policymaking, regulatory, or compliance functions, since these don't normally have commercial value. In some cases, however, a regulatory or compliance organization sells an asset, such as its database or information technology operation, and then contracts with the buyer for services.

As E. S. Savas points out, governments can also give away assets to employees, the public, or customers. They can abandon them as well, by simply getting out of a business. Usually, though, governments sell their assets; like private investors, they seek to recoup the cost of developing them. The sale may be to a private buyer, by auction, sealed bid, or negotiation; to the public, by sale of shares; to government managers or employees; or to users or customers.

Why Sell?

In the U.K., when Margaret Thatcher kicked off the global trend toward asset sales, she firmly believed that the government's extensive ownership of enterprises was ruining the economy and had to be reversed. "The state should not be in business," she wrote.

> *State ownership effectively removes—or at least radically reduces—the threat of bankruptcy which is a discipline on privately owned firms. Investment in state-owned industries is regarded as just another call on the Exchequer, competing for money with schools or roads. As a result, decisions about investment are made according to criteria quite different from those which would apply to a business in the private sector.*

A second purpose of asset sales is to get the government out of activities that the private market can perform better. Though public enterprises sometimes perform as well or better than private ones, businesses often have advantages. As Wilbur Ross, senior managing director of Rothschild, Inc., points out, private companies tend to have fewer high-paid managers, they can more readily adopt labor-saving technology, they often enjoy economies of scale, they are unencumbered by the procurement and personnel procedures of government, and they are more effective at marketing and collecting receivables. As a result, shifting businesses into private markets tends to result in lower costs to consumers. “We know of no privatized entity in the entire world whose costs were higher after privatization than before it,” Ross says. “Hundreds lowered their costs dramatically, with reductions of 20 percent to 40 percent not at all unusual.”

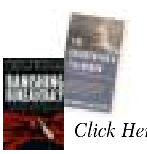
As consumers benefit, so typically do taxpayers, because selling public assets not only earns revenues, it often eliminates money-losing operations. It also frees up resources and people for other, more essential public work. In the early 1990s, for instance, Mexico’s finance minister calculated that what it cost the Mexican government to upgrade the fleet of its national airline, which served only 2 percent of the Mexican people, could have been used to pave more than half of the country’s unpaved roads.

Perhaps the most important reason to sell assets, in this era of global markets, is to increase the competitiveness of a nation’s economy. Asset sales can unleash substantial business investment and innovation, since private owners have more incentives to invest and innovate than public officials do. According to Per Westburg, then Sweden’s minister of industry and commerce, when Sweden decided in the early 1990s to put 35 state-owned businesses on the market, one of its goals was to make the firms more competitive.

Asset sales also affect a country’s economy by spreading the ownership of economic assets. When the sale is to a company or a single bidder, this impact is not necessarily substantial. But some reinventors, including Thatcher, have insisted that some public assets be sold to the public through stock sales. “Privatization was not for the fat cats,” explains Geoffrey Bell, a prominent British businessman. “It was absolutely made clear to the merchant banks that distribution of the shares of U.K. companies that were privatized had to go to the small investor.” This brought “a whole new range of investors” into company ownership, Bell says, and had a political benefit as well: “If we have a change in government . . . then you’re not going to get a renationalization of those companies that were made private. Why? Because people like having shares.” In 1986, more than 4.5 million individuals applied for shares in British Gas.

Does It Work?

Asset sales have a strong track record of producing the expected benefits. There are many well-known success stories, such as British Airways, once a chronic money loser under government ownership but now a world-class airline. An authoritative study by the World Bank in 1992 that examined 12 sales of government assets in the U.K., Malaysia, Mexico, and Chile found that 11 of the



privatized firms became more efficient. As a result, their shareholders made more money. In addition, workers were offered opportunities to buy stock at discounted prices and to receive severance payments. And in some cases, the new private companies increased employment. In the Mexican auto parts industry, for instance, privatized companies increased employment by 30 percent.

Government assets can be sold, and their activities thus left to markets to perform, when three conditions are met:

1. They are commercially feasible, and therefore the market can provide them. This requires that buyers will purchase their goods and services and nonpayers can be excluded from enjoying them.
2. They are "private goods" that mainly benefit individuals or groups of individuals, rather than society as a whole.
3. There is no requirement in the community that everyone have access to them.

Assets sales are not without controversy, however. Sometimes people object because they believe the public interest will be jeopardized if a government business is made private. For instance, efforts to privatize postal services in the U.K., New Zealand, and elsewhere are routinely opposed for fear that they will lead to the end of service to rural areas. Other objections are motivated purely by self-interest: for example, legislators may fear the loss of power over government resources, or public employees may fear the loss of their jobs. Privatization of enormous government businesses in New Zealand, Argentina, and the former East Germany led to massive unemployment when the new companies cut jobs to become competitive. When Germany's Treuhandstalt, an organization created to handle the massive privatization effort, began to sell thousands of government businesses, it triggered widespread social unrest. Detlev Rohwedder, its director, was assassinated. (As explained elsewhere in this book, there are many ways to mitigate the unemployment problem, and reinventors should use them whenever possible.)

pp. II/88-89, III/65

Sometimes assets sales do go wrong, due to mistakes in the sales process, misjudgment of market conditions, corruption, or other problems. These problems are discussed in the following section.

Selling Assets: Lessons Learned

1. Make sure you have the stomach to withstand political controversy.

"No one should underestimate the extent to which political will, commitment, and single-mindedness was needed to implement the British privatization program," says Brian Pomeroy, a partner in Touche Ross U.K. "There was considerable risk-resistance by the industries that were to be privatized; considerable resistance initially on the part of employees and the labor force; and even within government there were considerable tensions and differences as to how individual enterprises should be privatized."

This is how asset sales often play out politically. Therefore, political leaders must anticipate the opposition and figure out how to deal with it. They must believe that whatever the controversies in the short term, there will be a payoff for consumers, investors, the public interest—and perhaps also employees—once the asset has been sold.

2. *Prepare the assets for sale.*

A great many government-owned businesses aren't performing well enough to attract a good price; in financial terms, they are underperforming assets. This doesn't necessarily scare away bidders, since some buyers look to buy low and then turn the business around. But in some cases it may chill the market for the asset. Either way, the government's potential for revenues is reduced.

See Banishing Bureaucracy pp. II/2-10

pp. III/42-43

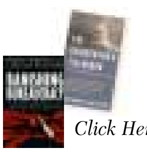
The key to getting full value for an asset is to get it in shape for the sale. In New Zealand, the government first "corporatized" a number of state-owned enterprises, forcing them to operate in competitive markets without subsidies; then, when they had demonstrated business viability, it put them up for sale. Using this tactic gives public enterprises as much exposure to the commercial market as possible without actually changing their ownership. It encourages them to strengthen their management teams, introduce new working practices, change their capital structures, and provide clear, accurate accounting information, using business standards such as accrual accounting. It also creates the track record necessary to justify a decent price.

If your government-owned entity is losing money, turn it around before you sell it, if at all possible. Another option is to sell only the profitable parts of the entity, advises Rothschild's Wilbur Ross. The rest can be sold later, after you have turned it around.

3. *Ensure private competition for the asset.*

A basic rule is that competition among potential buyers will get you a better price. The World Bank's Mary Shirley provides an example: "The price offered for a steel mill in a Latin American country went from about $5 million to $33 million—well above the minimum asking price—thanks just to the threat of competition."

When selling a public business that has enjoyed monopoly status, it may be necessary to break the asset up into multiple businesses, the way a judge split AT&T into the "Baby Bells" in the U.S. The British, for instance, split Na-



tional Bus into more than 60 separate businesses before putting them up for sale, to stimulate competition among bus operators.

If potential bidders are scarce, consider letting public managers or public employees in on the bidding.

4. *Get the regulatory framework right.*

Some asset sales involve government monopolies, such as telecommunications systems or railroads, for which no regulatory framework exists. In such cases you will have to develop one, to promote competition and protect consumers. Designing such frameworks is complex work that requires knowledge of specific markets and business practices within those markets. At the heart of any framework is some sort of regulatory body, with the power to monitor business activities and change the pertinent regulations. In creating the regulatory framework, however, you don't have to buy in to the bureaucratic model. There is now ample experience to draw on with postbureaucratic regulatory and compliance models.

pp. IV/97-101

In addition to rules, the framework you develop may need to include public subsidies to ensure desired levels of service or universal access to services. You can directly subsidize businesses, in the form of grants or tax incentives, or consumers, in the form of vouchers or tax breaks.

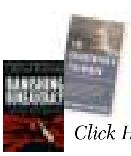
5. *Protect the public interest.*

When the British sold Rolls Royce and British Aerospace to private investors, they limited ownership in them by foreign investors, because both companies were deemed important to the national defense. There are several reasons to maintain public values and limited control over an asset after it is sold: national security, the desire to ensure certain service levels or standards, the desire to give former public managers time to adjust to the private sector, and the need to prevent the embarrassment caused by quick resales of the asset for high profit. "The task," observes Wilbur Ross, "is to balance government's need to protect the citizenry on the one hand, and the entrepreneurs' premiums for freedom of action on the other."

pp. II/112

Other ways for the government to exercise postsale influence include:

- Maintaining partial government ownership of the asset, with veto power over certain major decisions.
- Retaining control over a number of board seats, and requiring a super-majority vote of the board on important issues.
- Executing a long-term performance contract between the government and the buyer, with provisions spelling out behaviors required by the government.



- And selling only a "limited duration franchise" to use the asset, renewable only if the government so desires.

6. *Make employees winners.*

See *Banishing Bureaucracy* pp. III/18-20

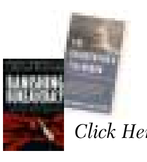
Perhaps the most common barrier to selling public assets is resistance from public employees and their unions. As noted earlier in this chapter and in *Banishing Bureaucracy,* one important solution to this problem is to manage the transition to private status humanely.

But you can do even more: you can make employees winners. The British did this several times by letting employees purchase discounted shares in businesses that were being privatized, so they would have a financial stake in the success of the private companies. According to Robert Poole, president of the Reason Foundation, "earmarking for workers and managers a meaningful fraction (e.g., 10 percent or more) of the shares in a firm being privatized has become routine around the world, especially for large firms and especially for those which are labor-intensive."

Some governments have also sold public businesses to public employees—a public sector version of the employee buyouts seen in the private sector. Both Canada and the U.S. have approved employee-takeover policies. The first U.S. agency to try this was the Office of Federal Investigations, the unit that investigates the personal histories of applicants for federal jobs. In August 1996, USIS, Inc., incorporated and hired nearly 700 former employees of the federal office the day after they were voluntarily separated from federal service. They became employee-owners, just like the millions of employee-owners of thousands of companies in the U.S., including Avis and United Airlines. USIS matched their federal base salaries and gave them comparable health benefits and leave entitlements. Its revenues quickly climbed, and the case backlog it inherited from the government was eliminated.

Other methods for managing the transition include:

- Buying out employees who are no longer needed, by offering them lump-sum payments to leave their jobs.
- Offering early retirement incentives.
- Limiting employment cuts to attrition and retirement.
- Paying the remaining staff a bonus for taking on an increased workload.
- Encouraging the employees' union to set up a new local as the bargaining agent for the private company, and requiring the buyer to recognize it and accept a prenegotiated contract.



7. Use expert help.

Assets sales are not for amateurs. Few people in government have much experience in this field. You will need advice about financial and legal matters, such as setting a value on the assets and structuring sales agreements, and expertise about the businesses and markets in question. You can buy this knowledge from the private sector, where asset sales are a well-understood business tool.

8. Use a savvy champion inside government to manage the sale.

Outside experts can only do part of the job. You also need at least one savvy insider—a top manager or political appointee—to guide each sale through the government's unavoidable administrative processes and the likely political minefields. In short, you need a committed champion who can drive the process and close the deal. The champion should create a detailed work plan that lays out every step, a timetable, and strategies for dealing with the political dynamics.

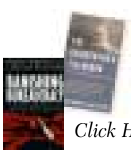
9. Create incentives for your public organizations to sell their assets.

Private sector advisers will build incentives for performance into their fee structures. But you should consider ways to provide incentives to your government sales team as well. When Canada set up a privatization process in the mid–1980s, its leaders decided that no revenues from sales could go to departments or crown corporations, so ministers and managers lost interest in the process. The U.K., by contrast, allows its departments to capture some of the financial rewards of what they sell—so they have been fairly aggressive about selling assets. The principle is the same one that makes shared savings and gainsharing so powerful: if you share cost savings or revenue increases with organizations or employees, they are far more likely to produce them.

pp. III/127-134

Pitfalls to Avoid

Avoid quick-profit embarrassment. "Woe to the public official who privatizes something only to have the buyer flip it quickly at a large profit," observes Rothschild's Wilbur Ross. The best protection against this danger is to get a fair price for the asset you are selling. If you can't be sure of that, one remedy is to sell only part of the equity in the business initially, then sell more later to capture any increases in value. You can also include in the sales agreement a provision giving the government part of any future profits or revenues from the resale of the asset. And as Ross points out, you can prohibit resale of the asset for a specified period of time, or require government approval within the first few years after the sale. Finally, the government can offer shares in the privatized business to employees and citizens, so if the value goes way up, they will benefit.



Avoid selling to monopolies. Selling public assets to a monopoly is often a mistake, because it jeopardizes service improvements. Mexico, for instance, sold its telephone system to a monopoly, which didn't act quickly to improve service. In 1996, the British government sold the tracks of its national railway system to a private monopoly, Railtrack, which then charged fees to private rail service operators using the tracks. Railtrack began to generate substantial profits, and the value of its stock soared. But so did customer complaints about the quality of rail service. In mid–1998, they rose 39 percent in a three-month period, while complaints about late trains jumped by 88 percent. Under fire, newly private railway operators, who operate rail lines on franchises, complained that Railtrack's exorbitant access fees were keeping them from ex-

RESOURCES ON ASSET SALES

Robert W. Poole Jr. *A Federal Privatization Agenda.* Los Angeles: Reason Foundation, 1995. Available for $2.50 from the Reason Foundation, this testimony before the U.S. Senate reviews federal assets that could be sold.

The Reason Foundation (www.reason.org). A national public policy research organization in Los Angeles that focuses on privatization. Its website contains a myriad of useful papers, from how-to guides to studies of privatization in particular sectors (railroads, airports, water systems, and so on) and comprehensive reviews of the status of privatization around the world. Telephone: (310) 391–2245.

Wilbur L. Ross Jr. "Privatization: An Important Tool for Government." Unpublished manuscript. An excellent summary of practical, how-to knowledge from a veteran of asset sales, the senior managing director of Rothschild, Inc., in New York City. Available from Ross at 212-403-3500.

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United Kingdom. Her Majesty's Treasury. *Privatization—Sharing the U.K. Experience.* London: Her Majesty's Treasury. An excellent brief summary of key lessons in asset sales, with examples from the British experience. Available from the Public Enquiries Unit, Room 110/2, Treasury Chambers, Parliament St., London SW1P3A6. Phone: 0171 270 4558. Fax: 0171 270 5244.

panding service capacity.

Some services are natural monopolies. But many former monopoly industries, including telecommunications and electric utilities, are rapidly becoming competitive. If faced with a monopoly situation, you can sometimes deregulate the industry, allow competition, and then sell the asset. If you must maintain monopoly status, you should regulate the new business, as discussed previously, while also examining ways to create a competitive marketplace. Sometimes it makes more sense to sell the monopoly to its users; an example would be the conversion of a public utility into a user-owned cooperative. In the U.K., for example, it might have made sense to sell the rail tracks to a cooperative made up of the private operators of rail lines. In such cases, if the monopoly charges too much, its users get the money back in profits, because they own it.

p. II/108

Avoid ineffective buyers. When selling government assets, it pays to look carefully at the experience and financial strength of the bidders. Don't sell to inexperienced, capital-thin buyers. Mexico has had serious problems with this. It sold government banks to Mexican investors who didn't have deep enough pockets when a financial crisis hit in December 1994. It also sold two airlines to owners with little experience and insufficient capital; within a few years, they were on the brink of bankruptcy. Mexico's program for private road construction flopped when the highway builders set tolls so high that few working people could afford to pay. In 1997, the government announced a $7.5 billion bailout to renationalize 23 of the private highways and two of the bridges.

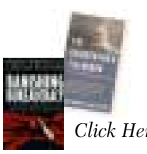
Avoid fraud. As in any business deal, greed may be a factor. If you detect a problem, immediately stop the sale. Openness and transparency are important in any privatization process, and due diligence—that is, careful examination of potential buyers—is critical. A watchdog organization should be appointed to oversee all sales and investigate any hints or charges of corruption.

QUASI-PRIVATIZATION METHODS

***Quasi-Privatization Methods* let the private sector lease or build physical assets, such as prisons, hospitals, and highways, and use them to deliver services governments want. The asset may be owned by government or may shift to public ownership at a specified future date.**

Although asset sales have become an enormously popular tool with reinventors, governments have other ways of getting value out of their physical assets short of selling them off. Quasi-privatization methods can save governments money, end construction cost overruns and delays, and improve public service delivery.

Public organizations can *lease* their assets to businesses—giving them permission to use the assets under certain conditions. The asset remains publicly



owned, preserving it for future generations. In 1994, for example, Australia's national government offered 50–year leases on all 23 of its major airports—allowing private operation but ensuring their preservation as airports. Austin, Texas, leased its hospital to a health care business for 30 years. Such lease agreements usually involve long terms, because this makes the business opportunity more attractive. They specify what services the private entity must provide and at what levels.

A variation of the lease is a *joint operating agreement,* in which the public organization also retains the power to appoint part of the board of directors of the company that will use the asset. When Oklahoma transferred operation of its teaching hospitals to a private company in 1998, it created a joint venture—and appointed half of the directors. The state-appointed directors had the right to unilaterally fire the CEO if he did not maintain a certain level of spending on operations.

Increasingly, governments also create *incentives for private firms to build assets that provide public services.* Usually the incentive is a long-term government contract to use the asset to provide public services. In Australia, for example, the state of Victoria signed 20–year contracts for three new privately owned and operated prisons. Another incentive is access to a unique market opportunity. California leased the right of way in the median of the Riverside Freeway to a private company to build a toll road, called "91 Express Lanes." More than 90,000 motorists pay to use the road every week, which relieves congestion on the freeway.

If the government wants such an asset to convert to public ownership at some point, it can negotiate a *build-operate-transfer agreement.* This gives a business the right to build and operate an asset but ensures that it will at some point become a public asset.

In the U.K., the Private Finance Initiative (PFI), launched by the Conservative Party but continued by the Labor Party, had by 1999 stimulated the private sector to construct and maintain ownership of an estimated $18 billion in assets the government wanted built. The PFI encourages the private sector to design, build, finance, own, and operate assets necessary to provide services the government desires. The government never owns the assets; instead, it uses the incentive of a long-term contract for services to convince businesses to build and operate them. A PFI contract, which typically spans 15 to 25 years, covers what normally would involve three separate contracts—for design, construction, and operations. This method has been used to create rolling stock for the London Underground, a national insurance records system, a new hospital wing and patient hotel, a rail link, a bridge, an armory, prisons, roads, and schools.

Normally, the government gives the private sector great latitude to get the job done. The PFI involves "the art of defining the end without specifying the means," says Adrian Montague, chief executive of a U.K. Treasury Department task force. When it comes to asset building, he explains, government should "ask, 'What is to be provided?' not 'How is it to be provided?'"

A benefit of this approach, according to Treasury Department officials, is that private sector partners have much stronger incentives than government managers to invest carefully and manage efficiently. Because their own money is at stake, they try to manage the asset productively after they build it. In addition, they get paid by the government only if the asset performs to specified levels.

The U.K. Treasury Department was so enamored of the tool that in 1996 it required all proposals for public capital projects to be examined for their PFI potential.

Negotiating Quasi-Privatization Agreements: Lessons Learned

pp. II/ 108-110

Many asset sales lessons pertain to quasi-privatization as well, particularly the need to protect the public interest in the arrangement and to avoid the common pitfalls of dealing with the private market. In addition, the somewhat different nature of quasi-privatization leads to several other lessons:

1. Negotiate performance-based service contracts.

Governments that make use of quasi-privatization usually end up contracting for services from the businesses that operate the assets developed. To ensure quality services, they should include performance incentives in their contracts with these businesses. When the Victoria, Australia, government signed long-term contracts for private prisons, for example, it tied a portion of future payments to performance indicators such as escapes, deaths in custody, and assaults on inmates and staff.

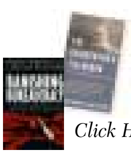
pp. III/74-78

2. Ensure that private companies maintain or—better yet—increase current government service levels.

Typically, elected officials and others are nervous that private companies operating public assets will try to increase their profits by reducing services or investments in the upkeep of the asset. To reassure them, negotiate contracts that call for increases in service and investment levels.

3. Share the financial risks with private operators.

It takes money to build an asset, which means there is always a risk of not recovering financial outlays or not making a profit on the investment. When the quasi-privatization agreement is negotiated, therefore, it is essential to be clear about which party bears which risks. "Risks should be allocated to the party best able to manage them," advises Adrian Montague. In particular, he says, businesses should take the risk of securing planning permission, design-



ing and constructing the asset efficiently and effectively, operating the asset properly, and obtaining project financing. Governments should share with businesses the risk of insufficient service demand.

RESOURCE ON QUASI-PRIVATIZATION METHODS

United Kingdom. Her Majesty's Treasury. Web site on the Private Finance Initiative: www.treasury-projects-taskforce.gov.uk. This site contains a variety of resources, including papers that describe the initiative, evaluate it, provide examples, and give readers a step-by-step guide to implementing a PFI project.

Questions People Ask About Clearing the Decks

Q: Which activities can be privatized—left to the market—and which cannot?

Functions can be left entirely to the market:

- If the market can provide them. If buyers will purchase them and nonpayers can be excluded from enjoying them, then private producers will supply them.
- If they primarily benefit individuals or groups of individuals, rather than society as a whole (if they are "private goods").
- If the community does not care whether everyone has access to them—if there is no concern about equity or universal access.

If all three of these conditions are met, the activity can be left to the market. In such cases the public sector may have to regulate the activities and enforce compliance with regulations, but it does not need to pay for or operate them.

Within these guidelines, there is much room for different communities to come to different judgments, of course. Some democracies leave ownership of railroads in private hands because they primarily benefit individual interests and voters do not feel every citizen should have access to rail transportation, for example. Others choose to subsidize rail transportation because they want to reduce highway congestion and air pollution, which are in the collective interest. Similarly, some democracies find it unacceptable that some people cannot afford basic housing, so they subsidize it. Others do not.

Q: Is there a core public sector that should always be operated by public organizations? Are there public functions that should never be carried out by private organizations?

Most steering functions—policy and regulatory activities—must be carried out by government. And many compliance functions normally remain in public hands, because the public is not comfortable with letting private organizations carry out functions such as those involving the courts, the police, and tax collection.

There are examples of private provision of all three of these functions: 30 Swiss towns and villages have contracted with a private company to operate their police forces; judicial functions such as dispute resolution are performed by private parties, and San Francisco uses Community Boards to resolve neighborhood disputes; and many governments use private firms to collect taxes. But in most communities, mixing these activities with for-profit organizations—or even nonprofits—makes people nervous.

The more sensitive and risky the function, the more likely it is that the public will want to see it operated by government employees. If it involves significant violence (as in police functions and high-security prisons), sensitive privacy issues (as in the administration of personal income tax collection), due process rights, or an absolute necessity of fair and equal treatment (as in the courts), citizens generally prefer to have public employees perform the function.

Though mercenary armies were common in the past, today most nations also insist that those who fight their wars and oversee their intelligence operations are public employees. Again, however, there are exceptions. During the Gulf War, the Joint Defense Facility at Nunungar, Australia, tracked SCUD missile launches by satellite and conveyed information to Patriot missile batteries in the Middle East. Those who monitored the launches worked for Serco Australia, a subsidiary of a British company.

To our knowledge, all other functions can easily be operated by private organizations, when funded by government. Private companies run fire departments, operate the American space shuttle, manage low-security prisons, and handle nuclear fuel.

Notes

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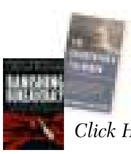

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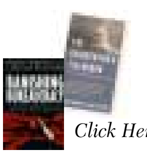

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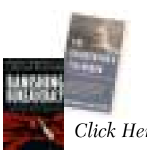

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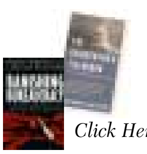

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