

When Government Isn't Exactly Government

Jonathan G. S. Koppell. 2003. *The Politics of Quasi-Government: Hybrid Organizations and the Dynamics of Bureaucratic Control*.

Cambridge, England: Cambridge University Press. 254 pp.

This book by Jonathan Koppell, Assistant Professor at the Yale School of Management, is a welcome addition to the growing literature on the government's increasing delegation of public responsibilities to organizations outside of the formal government structure. Koppell calls these organizations, which are structurally distinct from departments and agencies of government, "hybrids." In other words, they embody characteristics of both the public and private sectors.

Koppell focuses his analysis on two kinds of examples—(1) government sponsored enterprises (GSEs), particularly Fannie Mae and Freddie Mac, and (2) government backed international venture capital fund programs—to show the difficulty of assuring control and accountability of these hybrid organizations.

The quite different structures of these two types of hybrid highlight a problem with any attempt to analyze them: the major kinds of hybrid differ from one another and have different requirements for effective regulation. Policymakers, especially in Congress, tend not to appreciate the structural nature of each type of hybrid and are slow to recognize, much less to apply, the regulatory framework that is needed to improve accountability. In his next book, Koppell might want to attempt to create a typology of the variety of hybrid organizations and the most appropriate framework for promoting the accountability of each major type.

Proper typology is critical to reforming the regulation of hybrid organizations. To illustrate this important truth, it is worth recounting the process of reform of the accountability framework for GSEs since the late 1980s. By that time many different congressional committees had enacted laws creating government-sponsored enterprises. These included the House and Senate agriculture committees (which oversee the Farm Credit System and Farmer Mac), the education committees (Sallie Mae), the banking committees (the Federal Home Loan Bank System), and the housing subcommittees of the banking committees (Fannie Mae and Freddie Mac).

Each House and Senate committee viewed its own GSEs as unique institutions that fitted into a range of departments, agencies, and other organizations authorized by laws within its particular committee jurisdiction. There was a general lack of recognition of the GSE as a distinct organizational type. The problem was compounded by the lack of authority over GSEs by a committee of general jurisdiction, such as the House and Senate governmental affairs committees, and by the lack of a central unit within the Office of Management and Budget to oversee the GSEs. Without a typology to define them, GSEs remained generally unaccountable either to the Congress or to the Executive Branch.

The late Harold Seidman, who was the nation's foremost authority on government organization, and to whom Koppell dedicates his book, had adopted a broad definition of the term, "government sponsored enterprise," and that definition came into general use. To reform regulation of GSEs required that the term be given more focus. That way the GSEs

DOI: 10.1093/jopart/muh027

Journal of Public Administration Research and Theory, Vol. 14, no. 3

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authorized by the various congressional committees would be seen as having a common organizational and financial structure. The reformers simply borrowed the term “GSE” and gave it a new and more precise meaning (Congressional Budget Office 1991, 2).

With the proper typology in place, the structure of the GSEs could be analyzed to design the appropriate regulatory framework. It turns out that GSEs resemble banks and thrift institutions in their organizational and financial characteristics. Regulation of safety and soundness of GSEs thus should resemble the regulation of these financial institutions (Stanton 1991). Regulation of the public benefits provided by GSEs requires a somewhat different approach from regulation of the activities of banks and thrifts, but—in the aftermath of the savings and loan debacle and the financial failure of the oldest GSE, the Farm Credit System—the reformers concentrated first on safety-and-soundness.

Once the analytics were clear, the reformers needed political support. The common definition of GSEs and the need to oversee all of them in a comparable manner meant that the most effective support would come from a congressional committee that had broad general jurisdiction rather than from one of the committees that had authorized its own GSE.

The powerful House Ways and Means Committee lent its support to reform. Besides its jurisdiction over taxes, Ways and Means also has responsibility over the public debt. The definition of a GSE as a specialized federally chartered financial institution that borrows on the basis of the perception of an implied government guarantee was one that fit well within the committee’s jurisdiction. Senior committee members Jake Pickle (D-TX) and Bill Gradison (R-OH) took a personal interest in GSE reform and led the committee in holding a number of important hearings.

The involvement of the committee, and the implicit threat that Ways and Means might assert jurisdiction over regulation of all of the GSEs, spurred interest of the individual congressional authorizing committees in improving the regulation of GSEs. The Senate Banking Committee, the House and Senate Budget Committees, and a subcommittee of the Senate Governmental Affairs Committee also took leadership roles.

The GSEs and their authorizing committees were influential enough to prevent creation of a central regulator for all of the GSEs. But they had to acquiesce in the enactment of several pieces of legislation that strengthened safety-and-soundness supervision of each individual GSE. In 1992 the Congress created a new financial regulator, the Office of Federal Housing Enterprise Oversight (OFHEO), to oversee the largest and most powerful GSEs, Fannie Mae, and Freddie Mac.

As Koppell observes (106–114), OFHEO’s organization and powers fell short of the reformers’ goals. He points out (167) that Fannie Mae and Freddie Mac have a tremendous amount of influence. Given the disparity in political power between the GSEs and the reformers, OFHEO’s creation was a significant accomplishment.

This became particularly apparent last year when Freddie Mac displayed serious management and accounting problems. An OFHEO special examination report found that “Weaknesses in the staffing, skills, and resources in the Corporate Accounting Department of the Enterprise led to weak or nonexistent accounting policies, an over reliance on the external auditor, weak accounting controls, and an over reliance on manual systems. . . . [T]hose weaknesses effectively increased the systemic risk posed by the Enterprise” (Office of Federal Housing Enterprise Oversight 2003, iv). OFHEO is now examining Fannie Mae to determine whether there are significant infirmities in that GSE as well.

Both the Federal Reserve Board and the Bush Administration have taken notice of the financial risk posed by the two GSEs and by the third housing GSE, the Federal Home Loan Bank System. The Administration is making a concerted effort to strengthen the regulatory framework both for safety-and-soundness supervision and with respect to the affordable housing goals that Fannie Mae and Freddie Mac are supposed to meet as a part of their public responsibilities. Despite receiving substantial public benefits, the two GSEs lag other institutions in the mortgage market in meeting the needs of disadvantaged minorities and low-income people and communities.

There is an argument that the GSEs have outlived their original usefulness as instruments of government policy (Stanton 2002). One GSE, Sallie Mae, has sought and received authority to give up its government sponsorship. Recently, the American Enterprise Institute convened a group of academics and financial experts to explore the mechanics of removing government sponsorship from several other GSEs as well. But given the GSEs' substantial political influence, it may not be easy to remove government sponsorship. As Koppell warns (121), "Designers of future hybrids should not be surprised if hybrid organizations acquire unusual political influence due to their unique combination of public- and private-sector advantages."

In the interim, what is to be done about GSEs and other hybrid organizations? One needed step is to recreate the capacity that once existed in the Executive Office of the President to design and monitor the organization and management of both governmental and quasi-governmental entities (e.g., Moe 2004). A second step would be to increase the authority of the congressional governmental affairs committees to oversee all quasi-governmental organizations. In the meantime, following the excellent example of the Canadian Auditor General (e.g., 2002), the U.S. General Accounting Office might undertake a systematic review of the major types of hybrid organizations in the United States and the nature of the supervision that is needed to enhance their public benefits and reduce potential public costs.

The lesson of *The Politics of Quasi-Government* is that it is time for government to increase its capacity to deal with hybrid organizations. That is especially true if, as Jonathan Koppell expects (185), quasi-government will become even more significant in coming years.

Thomas H. Stanton
Johns Hopkins University

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