Reform of Public Service Delivery in China:
Are There Lessons from the United States?

Presented at a Conference on Public Sector Unit Reform
Sponsored by
The Government of the People's Republic of China and
The World Bank

Published as
中┌ 公共服┌ 部┌ 的改革：能┌ 美┌ ┌ 到些什┌
Comparative Studies, Beijing, Vol. 12, 2004

March 23, 2004

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Greetings. It is a pleasure to prepare this paper to provide insight about the delivery of public services, especially in health, education, and research, in the United States. Five years ago I had the opportunity to participate in a conference in China on restructuring state-owned enterprises. Since then it has been impressive to watch China working actively to address the difficult issues involved in that transformation. It is therefore with great interest that I look forward to following future developments in public service unit reform as well.

It is my understanding that reform of public service units involves the creation of a vision and a strategy for allocating public service functions across levels of government and to nonprofit organizations and enterprises.

This review of the experiences of the United States will proceed as follows:

- Section I will provide a brief sketch of some of the historical and legal framework in the United States that shapes the institutions of government – federal, state, and local – that provide public services. This is important so that we have a common understanding of the peculiar federal system of the United States and the reasons why the U.S. quite naturally leaves the states with prime responsibility for the delivery of important public services.
- Section II will provide some basic statistics that show the significant extent that support for the delivery of many, if not most, public services is concentrated at the state and local level rather than at the federal (i.e., national) level of government. This section also will discuss the characteristics of what Professor Lester Salamon calls "third-party government." This is the provision of public services, funded by our federal government, through a variety of third parties in the United States, including nonprofit and for-profit organizations as well as state and local governments.[1] The point here is that recent changes in the extent that responsibility for public services is transferred to other levels of government or to other third parties are not major, in terms of the historical context.
- Section III will present the differences between the government department and agency, on the one hand, and the nongovernmental institutions that carry out public purposes. *Please be cautions about definitions: the United States differs from other OECD countries in the meaning of the term "agency." In the U.S. context, an agency is an integral part of the United States government, similar to a government department, but generally smaller*.

[1]Lester M. Salamon, ed., *The Tools of Government: A Guide to the New Governance*, Oxford University Press, 2002.

- Section IV will present brief cases to illustrate some current experiences of the federal government in supporting delivery of public services by either (1) other levels of government or (2) non-governmental organizations. The conclusion to this paper – whether some of the principles and approaches used in the United States might be usefully adapted to the Chinese context – is up to you. I look forward to the opportunity for us to engage in a discussion that may shed some light on that question.

I. The Historical and Legal Framework of Public Service Delivery in the United States

This historical and legal review is important because it shows how the devolution of public service delivery is an integral and a long-standing feature of the federal structure of the United States. Thus, the Reagan Administration's use of block grants to devolve functions to state and local governments, and the more recent block granting of Temporary Assistance to Needy Families, fits within a historical pattern of delivery of public services by state and local governments. Similarly, the Bush Administration's outsourcing initiative and earlier efforts at privatization of federal government functions fit within historical patterns. In other words, current changes in the means of providing public services do not represent major change, when viewed within the general outlines of the historical context.

It is useful to start with some historical features that help to shape the framework for the United States government, for relations among the federal and state governments, and for relations between government and the private sector. The most important historical factor is that the United States began as a colony of Great Britain. This gave us certain advantages: we began our system of government on the basis of the British legal tradition. That tradition includes the long struggle between Parliament and the British King which the Parliament eventually won, especially because of Parliament's claim to the "power of the purse," i.e., the right of the people's elected representatives to decide when and how to tax and spend. Our Constitution today gives the Congress the paramount (albeit not complete) authority over taxation and appropriations to pay for public services, and over the allocation of those expenditures.

Moreover, a reader of the Constitution would find that the Constitution expressly empowers the Congress (not the President) to lay and collect taxes, regulate commerce, coin money, and establish post offices and roads. This again reflects the British tradition, but with the important change that, in contrast to the British system, the President of the United States is elected separately from the Congress and the Executive is a distinct and separate branch of government. Over time, of course, and especially with institution of the budget process in the Twentieth Century, the President has acquired increased influence over taxation and spending.

Being a colonial subject also included disadvantages that need not be spelled out in this forum. We were on the receiving end of a very efficient imperial system and thus saw that efficiency of government must be balanced against other more important considerations such as legitimacy. As a consequence, our Constitution is structured to create an asymmetry between government and the private sector. Government may do only those things that are spelled out in the Constitution and in law enacted pursuant to the Constitution; by contrast the private sector may engage in all activities except where these are prohibited by law. The Constitution also includes a number of constraints and restrictions on the scope and nature of permitted government activity.

This constitutional asymmetry between government and the private sector has important consequences for relations between the two sectors. When the private sector falters, as in the Great Depression of the 1930s, or when there is an external crisis, as in World War II, there is popular support for an increase in the strength and scope of government. By contrast, when the private sector flourishes, as in the 1990s, then there is popular support for curtailing the extent of government.[2] This reflects a cycle of increasing and decreasing public support for public services. It also creates a change in the mix of public services that government is expected to provide, again according to changes in political support. On the other hand, when seen as a percent of GDP, the size of federal government receipts and outlays changes within a generally modest range, regardless of the Administration in power.[3]

Thus, the emphasis of the Bush Administration on outsourcing of federal activities represents a continuation of the swing away from the high degree of federal employment in the years of the Great Depression and World War II. On the other hand, the recent emphasis on homeland security has resulted in a contrary movement, which includes the creation of a new organization, the Transportation Security Administration, which is staffed by federal officials who are taking the place of private contractors who performed demonstrably poorly before September 11.

One other historical factor worthy of mention here is the fact that the colonies, and later the states, preceded the formation of the national government of the United States. Thus there always has been strong support for retaining the authority of the states to make their own decisions concerning the delivery of public services. The states have used a variety of organizational forms for the delivery of public services. One of the more interesting is the public utility, which in the past provided a range of services – sometimes including electricity, water, and telephone services – under a system of regulation of either publicly or privately owned monopolies. The regulation of public utilities has diminished in recent years in an effort to introduce greater competition. Section II, below, shows how the bulk of domestic public services in the United States are supported financially from the state and local level rather than from the national government. In addition, the delivery of

[2] An excellent overview of these cycles of government is found in Richard J. Stillman II, *Preface to Public Administration*, second edition, Chatelaine Press, 1998.
[3] Here, a good source of statistical information is, *Budget of the United States Government: Historical Tables* (various years).

domestic public services (as contrasted to the financial support for those services) is even more concentrated at the state and local levels.[4]

II. Support for Public Services at the National, State, and Local Levels

The Allocation of Public Service Responsibilities Among the Three Levels of Government

Please note that the following figures all are intended to give a general concept of the allocation of support and delivery of public services at the three levels of government. They are not intended to provide definitive statistical analysis.[5]

The extent that public services are provided by the federal (i.e., national) government, compared to state and local governments, can be seen in a variety of statistics. Consider first, the allocation of employees and payroll spending across the three levels of government:

Table 1
Governmental Employment and Payrolls (2001)

Level of Government	Proportion of Governmental Employment	Proportion of Government Payrolls
Federal Government	**12.9%**	**18.7%**
State Government	**23.8%**	**23.3%**
Local Government	**63.3%**	**57.9%**

Source: U.S. Census Bureau, *Statistical Abstract, 2003*

Table 1 shows that local governments employ the lion's share of government employees, followed by state governments and then the federal government. In part, of course, this reflects that there is one federal government, but there are 50 different state governments, and thousands of local governments.

Another important measure is the extent of financial support for public services, whether these are delivered directly or by another level of government. Table 2 compares the consumption and investment expenditures of the national government to those of the state and local governments:

[4] One other issue, not particularly important here, is that the states have paramount legal authority over their localities. The states differ from one another in the extent that taxation and spending for particular public services are carried out at the state or local level.
[5] For further information see, the Bureau of the Census, *Statistical Abstract of the United States* (current year), and the statistical information provided in the appendix to, Council of Economic Advisors, *Economic Report of the President* (current year). To find these and other government reports and documents, a search engine is available at www.FirstGov.gov.

Table 2
Government Consumption and Investment Expenditures (2002)

Level of Government	Dollars	Percent Distribution
Federal Government	**$ 693.7 billion**	**35%**
State and Local Government	**$1.28 billion**	**65%**

Source: U.S. Census Bureau, *Statistical Abstract, 2003*

In other words, the federal government is only about one-half as large, in terms of expenditures, as are the combined state and local governments. The federal share of domestic expenditures is even less because so much of federal expenditures go to defense. On the other hand, the federal government funds some of the public services that are delivered by state and local governments and that are included in this table. Federal grants constitute 15 percent of state and local revenues.

The paramount role of state and local governments is seen in many public service sectors. In declining order, state and local spending is allocated to education (both higher education and primary/secondary education), public welfare, health and hospitals, highways, police protection, and corrections. Take higher education first:

Table 3
Current Fund Revenue of Public Higher Education Institutions (1999-2000)

Level of Government	Percent Contribution
Federal Government	**10.8%**
State Government	**35.8%**
Local Government	**3.8%**

Source: U.S. National Center for Education Statistics, *Digest of Education Statistics*

Note that government support for public higher education amounts to slightly less than half of all revenues. Other sources of revenue include sales and services, tuition, and private gifts and grants. Note also that these figures are for public degree-granting institutions, i.e., mostly state colleges, state universities, and community colleges. The point here is that, in support for public higher education, the federal government provides much less direct support than do states and localities. The federal government does provide student loans and grants, but these are not counted here because those payments go to students rather than to the institutions of higher education.

Primary and secondary education is supported even more disproportionately by states and localities rather than the federal government:

Table 4
Percentage Distribution of Revenues for Public Elementary and Secondary Schools (1999-2000)

Level of Government	Percent Contribution
Federal Government	7.3%
State Government	49.5%
Local Government	43.2%

Source: U.S. National Center for Education Statistics, *Digest of Education Statistics*

Indeed, the nature of federal involvement in public elementary and secondary education is largely limited to special initiatives, such as support for disabled students and the recent Bush Administration effort at measuring and encouraging school performance. By contrast, the states and localities provide the basic support for education.

By contrast, federal support for healthcare is much greater than the level of state and local support:

Table 5
Government Expenditures for Health Services and Supplies (2001)

Level of Government	Hospitals	Physicians and Clinical Services	Public Health	Total
Federal Government	80%	82%	11.5%	70%
State and Local Government	20%	18%	88.5%	30%

Source: U.S. Census Bureau, *Statistical Abstract, 2003*

However, it is important to note that almost 40 percent of total federal health spending comes from the Medicare program for the elderly. This involves making federal payments directly to physicians and hospitals rather than the delivery of public services by government. Conceptually, Medicare might be considered to be the largest U.S. national voucher program. It is not a public service that is delivered directly by government.

The federal share of health spending has increased since these statistics were tabulated. The Medicare program has just been expanded to include federal payments for prescription drugs, and federal spending for public health, largely in the form of grants to states and localities, has expanded following the need for stepped-up homeland security in the aftermath of September 11.

The United States spends considerable amounts on correctional facilities, i.e., jails and prisons. States and localities support the large bulk of this spending, which is one of their most expensive public services:

Table 6
State and Federal Correctional Facilities (2000)

Level of Government	Proportionate Number of Staff	Proportionate Number of Inmates
Federal Government	**7.6%**	**8.5%**
State and Local Government	**92.4%**	**91.5%**

Source: U.S. Census Bureau, *Statistical Abstract, 2003*

Another important public service, involving research and development (R&D) expenditures, is heavily supported by the federal government. However, almost two-thirds (65.4 percent) of R&D spending comes from private industry. The federal government funds about 28 percent of all research and development, and universities, nonprofits, and other sources (presumably including state and local governments) fund the remainder.

Comparing Direct Government With Third-Party Government

In contrast to the readily available numbers concerning the allocation of resources among the three levels of government, statistics concerning other forms of third-party government are not easy to calculate. However, some general statistics are illuminating. While the United States government has a workforce of some 2 million employees, there are an estimated 8 million people who work for the federal government on the basis of grants and contracts.[6] These 8 million people are largely in the private sector, working as contractors under the direction of federal government employees. In other words, the Bush Administration's current interest in outsourcing of federal functions addresses a transformation that has already taken place to a large extent.

Professor Lester Salamon has compiled another set of statistics that compares what he calls direct government with third-party government. In 1998-1999, direct government expenditures included $ 187 billion in provision of goods and services and $ 550 billion in funding of income support (such as Social Security). By contrast, federal spending on third-party government that year included $ 199 billion of contracting, $ 286 billion of grants (to state and local governments and to individuals), and $ 251 billion of vouchers.

In the early 1980s, Professor Salamon studied sixteen communities and the share of government-financed human services that were being delivered by private nonprofit and for-profit organizations. These services included social services, employment and training services, housing and community development, health, and arts and culture. Salamon found that government delivered 39 percent of these services directly, 42 percent through nonprofit organizations, and 19 percent through for-profit organizations.

[6] Paul Light, *The True Size of Government*, Brookings Institution Press, 1999, cited in Dan Guttman, "Contracting United States Government Work: Organizational and Constitutional Models," *Public Organization Review*, Vol. 3, pp. 281-299, 2003. The figure on number of contractor employees represents a general approximation.

As he concludes, "the majority of government-financed human services available at the local level was already being delivered by private non-profit and for-profit organizations …and this was well before the advocates of 'privatization,' 'contracting out," and reinventing government' had proposed it."[7]

III. Organizational Forms: The Government Department or Agency Compared to the Nongovernmental Organization that Carries Out Public Purposes

The Government Department or Agency

Governmental bodies include institutions that are owned by the government and controlled by government officials. Following the constitutional requirement that the duty of the Executive Branch is to see that the laws are faithfully executed, government departments and agencies operate within an institutional framework that is determined by law. Governmental organizations have distinctive attributes that contrast with those of private institutions: (1) they are established by law and are authorized to perform only those functions that are permitted by the terms of that law; (2) they are staffed by people who are appointed according to law to offices or positions that are authorized by law; (3) they are subject to a large number of prescriptive controls upon procurement, contracting, and issuance of regulations, for example, that tend to prescribe procedures and inputs rather than performance and outputs of a governmental process, and (4) they are funded through a budget process that is authorized by law. In short, governmental bodies are created by law and depend upon the terms of law to determine their capacity, accountability and activities.

The governmental organization is staffed by a combination of political appointees and civil servants. It operates under laws that specify their duties, position in the governmental hierarchy, remuneration, and tenure. The law may also specify procedures with respect to hiring, promotion or demotion, and firing of government employees.

The level of budget resources and limitations upon the allocation of such resources are some of the most important factors affecting the performance of a governmental organization. With sufficient money, a governmental body can hire contractors, ranging from particular individuals to entire companies, to carry out public purposes for the governmental institution. Again, applicable law will determine the extent that such contractors are free to adopt more flexible private-sector practices for staffing, procurement, and so forth. In the United States at least, the government may shape the practices of contractors in a few ways that resemble those of the government itself, with contractual limitations upon remuneration, hiring practices, and conditions in the workplace, for example. Applicable law determines the extent that the work of a private contractor can substitute for that of a governmental official. While there is a generally

[7] *The Tools of Government*, p. 3.

accepted principle that so-called “inherently governmental” functions may not be delegated to a contractor, this term has not been well defined.[8]

Limitations upon the allocation of budgeted resources can be significant for a governmental body. The government's annual budget and annual appropriations laws may allocate resources (both staffing levels and money) with great specificity. The government department or agency or program may find that the budget process imposes significant rigidity upon its activities and greatly limits its ability to adapt to evolving needs and changing public purposes. This is because of the tendency of the budget process to apply each year's allocation in terms of modifying the baseline of the allocations the year before. Even an Administration such as the Reagan Administration, which seeks to make drastic changes in the allocation of budget resources, may be reduced to attempting incremental changes. Constituency pressures can make it hard, if not impossible, for the government completely to terminate many existing governmental activities.

Some governmental organizations and programs, when backed by powerful constituencies, may continue to draw resources long after their nominal public purposes have been achieved or otherwise have declined in public priority compared to other potential public uses of scarce resources. Indeed, the presence of a government subsidy can increase the number and strength of constituents of a program, thereby increasing the strength of an "iron triangle" and locking the government into a pattern that can become very costly. This is true of some agricultural programs in the United States, for example.

This context can make it difficult to assure the accountability of a governmental institution to serve its public purposes. The first question, of course, is to whom the governmental body or program should be accountable. The federal department or agency is directly accountable both to the Congress and, unless the agency is a so-called independent agency, to the President of the United States and the officials to whom he delegates responsibility. Departments and agencies also tend to be accountable to a few actors to a great extent, such as their congressional appropriations subcommittees, often informally rather than formally.

The government lacks the mechanisms of the marketplace that can systematically restructure or remove failing entities, e.g., through the process of bankruptcy, and reallocate their resources to higher priority activities. Instead, governmental bodies and programs tend to exhibit significant inertia and may continue to exist even when they have been deprived of the capacity to perform effectively. This deprivation can take a variety of forms. The Congress or an Administration may seek to apply cross-the-board cuts in budget resources that restrict program and agency budgets. Or rising costs can reduce the real value of governmental resources that have been allocated to a program. Also, spending restrictions may deprive agencies of the systems they need to function effectively.

[8] For an excellent review of the state of contracting in the United States, see, Dan Guttman, “Governance by Contract: Constitutional Visions; Time for Reflection and Choice,” Public Contract Law Journal, Vol. 33, Issue 2 (Forthcoming 2004).

Constrained budget resources can interact with staffing issues to reduce the capacity of government bodies yet further. Thus, limitations upon remuneration of government workers may drive out especially those highly skilled individuals who have access to more appropriate levels of compensation in the private sector. Inflation can interact with statutory pay ceilings to accomplish the same dysfunctional result. The result of all of these factors may be a governmental body or program that continues to exist but that lacks the essential capacity to accomplish its designated public purposes. This is the phenomenon known to students of public administration as "hollow government."

One kind of government agency deserves special attention. The U.S. government corporation is an organizational form that can be quite helpful in supporting the operations of an agency that provides business-type services. President Harry Truman, in his 1948 budget message, stated the criteria for creating a government corporation:

> “Experience indicates that the corporate form of organization is peculiarly adapted to the administration of government programs which are predominately of a commercial character - those which are revenue producing, are at least potentially self-sustaining and involve a large number of business-type transactions with the public. In their business operations such programs require greater flexibility than the customary type of appropriations budget ordinarily permits.”

The essence of the government corporation is its ability to keep its accounts and manage its affairs on a businesslike basis. In other words, a government corporation that is financially self-sustaining does not need annual appropriations; it funds itself instead from revenues that it generates from its activities. The United States Postal Service sells mail delivery services, the Tennessee Valley Authority sells power, and the Government National Mortgage Association (Ginnie Mae) charges a fee for guaranteeing mortgage-backed securities.

Some government corporations, such as the Federal Deposit Insurance Corporation (FDIC) and the Tennessee Valley Authority, benefit from considerable autonomy. Other government corporations, such as Ginnie Mae, the Pension Benefit Guaranty Corporation, and the St. Lawrence Seaway Development Corporation, have less autonomy in their operations. Even these less autonomous corporations benefit from some management flexibilities that noncorporate government agencies would envy. When a government corporation is appropriate for the intended mission, the organization is able to develop an institutional culture that can be quite businesslike. On the other hand, maintenance of accountability is very important, as the experiences of the Tennessee Valley Authority have shown.

The Private Instrumentality of Government

The instrumentality of government is an organizational category that includes a variety of nongovernmental organizations that carry out public purposes as defined by law. The instrumentality is an important category for organizational design because efforts to privatize government functions can involve creation of an instrumentality, or use of an existing organization as an instrumentality, to carry out purposes that previously were carried out by a government agency.

Private instrumentalities of the federal government are privately owned and managed. As with government organizations, the features of private instrumentalities involve their capacity to carry out public purposes, their accountability for carrying out those purposes, and the life cycle of the organization. Like government, and unlike ordinary private firms, private government instrumentalities are permitted to engage only in those activities that are authorized by their enabling legislation. Figure 1, below, summarizes some of the distinctions among government agencies, government instrumentalities, and completely private companies. The distinctions are not always sharply drawn because the law creates many hybrid organizations that resist easy categorization.

For purposes of clarity, one should hasten to add that the typical private firm that contracts with government does not become an instrumentality merely because of the contractual relationship with a government agency. Rather, an instrumentality is a private company or cooperative or nonprofit that is authorized by federal law or whose activities federal law directs so that it serves public purposes.

Federal instrumentalities tend to be prevalent in the financial sector. They include Federal Reserve Banks, the Securities Investor Protection Corporation, government sponsored enterprises, and commercial banks.[9] Nonfinancial instrumentalities have included the Communications Satellite Corporation and some nonprofits such as the Corporation for Public Broadcasting, the Legal Services Corporation, the American National Red Cross and the National Park Foundation. Again, the importance of instrumentalities is that they represent an important organizational alternative to carrying out public purposes through a government department or agency.

Private instrumentalities fall into three basic organizational types: (1) the investor-owned for-profit company, (2) the cooperative, and (3) the nonprofit organization. Examples would be commercial banks, the Farm Credit System, and the American National Red Cross, respectively.

Each organizational type has strengths and limitations. Profit-seeking investor owned companies are subject to the discipline and incentives of a financial bottom line by which to measure success. The advantages of using an investor-owned firm to carry out public purposes relate to their ability to use resources efficiently in search of profits. When necessary to achieve profitability, private firms can invest in high quality personnel and

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[9] See, e.g., Thomas H. Stanton, *Government-Sponsored Enterprises: Mercantilist Companies in the Modern World,* AEI Press, 2002.

systems that may be far more productive than those found in government. A disadvantage of using profit-seeking companies is the principal-agent problem and the need to deal with the divergent interests of private owners vis-à-vis the government's interests in promoting service for public purposes.

The distinguishing design feature of the cooperative is that it is owned and controlled by the people or institutions that use its services. That means that the benefits of a cooperative organization flow to its members, in the form of services and, generally to a lesser extent, as dividends. To coin a phrase, investor-owners of a private company want to create a racehorse – to perform well and return dividends to the shareholders. By contrast, the owners of a cooperative want to create a milk cow – to pass through benefits to the owners, even at the cost of its own performance in the marketplace. In particular, cooperatives are unlikely to compete with their user-owners.

These unusual characteristics make the cooperative a distinctive instrument for carrying out public purposes. To the extent that government provides a subsidy through a cooperative, those subsidy benefits will flow through to the member-owners. On the one hand, this makes it possible to use the cooperative to target selected constituencies, e.g., farmers, rural communities, or certain kinds of financial institutions. On the other hand, targeting of benefits to the neediest constituents can be difficult; some cooperative organizations may end up serving primarily their strongest members, i.e., those that are the most affluent and influential, with their government-supported benefits.

Nonprofit organizations are a distinct organizational type. Nonprofit instrumentalities vary considerably in size and purpose. The common elements of all nonprofit organizations are (1) tax exempt status under the Internal Revenue Code, and (2) the absence of shareholders or other owners of the organization.[10] Not all nonprofits are government instrumentalities; the distinction again rests on whether the organization is carrying out activities that are deemed to involve a public purpose.

Unlike investor-owned companies or cooperatives, nonprofits do not have shareholders. This plays a role in the behavior of nonprofits. On the one hand, the absence of investors means that nonprofits can save money that otherwise would be paid as returns to shareholders. On the other hand, the absence of shareholder returns may make it difficult for nonprofits to raise capital needed to assure the financing of the organization's objectives. Indeed, many nonprofits have established for-profit affiliates to provide a source of income beyond donations and the remuneration from services provided. Like government agencies, nonprofit organizations can be torn between trying to do good and trying to do well enough to survive and grow.

In terms of capacity and flexibility, nonprofit organizations sometimes may lag their investor-owned counterparts. Thus, many nonprofit hospitals or health insurance plans justify their conversion to for-profit status on grounds that they need the greater access to

[10] One useful overview of nonprofits is, Boris, Elizabeth T. and C. Eugene Steuerle. 1999. *Nonprofits & Government*, Washington, DC: Urban Institute Press.

the capital markets that is available to private firms, and also that they need to be able to pay greater compensation to highly skilled professionals than is possible in a nonprofit organization.

The activities of nonprofits, and categories of nonprofits such as charities and foundations, are restricted by the terms of their preferred status under the income tax laws. To the extent that a nonprofit organization such as the American National Red Cross or a nonprofit hospital or health insurance company is considered to have a public purpose, it is supposed to use its special benefits to lower costs and permit access to services that otherwise might not be available on affordable terms. Some nonprofit instrumentalities, such as the Corporation for Public Broadcasting and the Legal Services Corporation, receive federal appropriations to carry out their work.

As might be expected, given the quite different legal frameworks of government and private organizations, the questions for private instrumentalities are quite different from those for government departments or agencies. Government agencies frequently seek added managerial flexibility and organizational capacity to carry out their programs. By contrast, private organizations that carry out public purposes often possess capacity, and the questions tend to focus more on promoting accountability to carrying out their public purposes. As Harold Seidman warns, "Intermingling of public and private purposes in a profit making corporation almost inevitably means subordination of public responsibilities to corporate goals. We run the danger of creating a system in which we privatize profits and socialize losses."[11]

Any instrumentality, whether for-profit, cooperative, or nonprofit, must be designed with careful attention to accountability if it is to succeed in serving its public purposes. The government tends to have two interests in the instrumentalities that it uses to carry out public purposes: (1) to assure that high-priority public purposes are carried out, and (2) to assure that the organization operates in a prudent financial manner. The latter issue is especially important for depository institutions and government-sponsored enterprises (GSEs) because of the government backing of insured deposits and the perception of government backing for GSE obligations.

Under applicable legislation, government can has a number of ways to try to assure that instrumentalities serve public purposes. These include provisions that limit the scope of authorized powers of that an instrumentality may carry out, governance or organizational requirements, and government oversight of the activities that instrumentalities carry out under their enabling legislation. Some of these approaches, such as the supervision of safety and soundness of banks, seem to work fairly well; others, such as the government's power to appoint directors of some private instrumentalities, add little if anything to the accountability of the organization to serving its public purposes.

[11] Harold Seidman, *Politics, Position and Power: The Dynamics of Federal Organization*, fifth edition, New York, NY, Oxford University Press, 1998, p. 213.

When a cooperative is an instrument for providing public services, the issue of accountability to government is quite similar to the issues raised by investor-owned companies. If the government lacks the capacity to protect its own interests, then the cooperative will go its own way. At the time that the Farm Credit System failed in the mid-1980s, for example, in a period of ruinous agricultural conditions, the government had largely lost control over the safety and soundness of the system and its member financial institutions. In the aftermath of taxpayer assistance, the government restructured the cooperative's federal regulator to have powers comparable to those of a federal bank regulator.

The issue of accountability of nonprofits is complex. On the one hand, nonprofits may have a service ethos that allows them to serve less profitable people and public purposes than would be expected from a for-profit firm. On the other hand, some nonprofits (and Medicare contractors come to mind here) may require careful supervision to try to assure good performance and financial integrity, much as if they were investor-owned firms.

Some government agencies, especially in the Department of Defense, have improved the accountability of nonprofits by developing long-term relationships. Thus, federally funded research and development centers (FFRDCs) such as units of the RAND and MITRE Corporations operate under special long-term contracts that allow for an especially close relationship between the agency and its nonprofit partner.[12] Because of the long-term relationship, an agency traditionally was able to insist that the FFRDC dedicate itself primarily to the interests of the government. To the extent that an FFRDC has relationships, such as interlocking directors, with a private for-profit firm with a range of other clients and interests, its accountability to the government in this respect may diminish.

Once instrumentalities have become established, both the Executive Branch and the Congress can find it difficult to influence their activities, either with respect to serving new and evolving public priorities or with respect to reducing financial exposure from their activities. Because private instrumentalities can live or die according to the terms of their enabling legislation, they have an incentive to use resources to influence the Congress, their designated regulators, and others in government who might threaten their legal franchise or otherwise impose policies at variance with the interests of the private owners or, in the case of nonprofits, the managers.

Although this discussion has concerned federal government instrumentalities, it should be noted that state and local governments also may create instrumentalities to carry out public purposes. One major category is the public authority that may be structured as a government agency with attributes comparable to those of the wholly owned federal government corporation (discussed above), or else may be a private instrumentality, generally a nonprofit, that carries out funding activities, e.g., to fund highways or urban

[12] See, Ronald C. Moe, "The Emerging Federal Quasi Government: Issues of Management and Accountability," *Public Administration Review*, Vol. 61, No. 3, May/June 2001, pp. 290-312, at pp. 295-6; and U.S. General Accounting Office, *Federally Funded R&D Centers: Issues Relating to the Management of DOD-Sponsored Centers,* GAO/NSIAD-96-112 (August 1996).

development, or the actual delivery of public services, e.g., airports, electric, gas, and water services, and transit services. In the author's experience, the government-owned authority tends to manifest greater accountability but less capacity than the authority that is a private instrumentality.

This is a general conclusion that can be drawn about the distinction between U.S. government agencies and U.S. instrumentalities. With government agencies, including some government corporations, the primary design issues concern the need for capacity to carry out their public missions. With instrumentalities, capacity may be present, but the major design issues involve problems of achieving effective accountability and overcoming the principal-agent problems inherent in the use of nongovernmental organizations to carry out public purposes.

IV. Recent Experience of the Federal Government in Supporting Delivery of Public Services by either (1) Other Levels of Government or (2) Non-governmental Organizations

The U.S. federal government has been increasing both the amount of devolution to state and local governments and the amount of privatization of federal activities. Four examples are useful to illustrate these trends. One example, of increased devolution, is the program for Temporary Assistance for Needy Families (TANF). TANF was enacted in 1996 to transform a federal entitlement program into a block grant that gave states much more discretion than before in allocating welfare payments among forms of assistance and recipients. Two other examples illustrate different ways that the federal government utilizes third parties to deliver public services. These are the grants for scientific research of the National Science Foundation, and the quite new prescription drug benefit authorized in the Medicare Modernization Act of 2003. Finally, all such programs are taking place in the context of the Bush Administration's Competitive Sourcing initiative to promote outsourcing of commercial-type activities that are currently performed by federal employees.

Welfare Reform: Temporary Assistance for Needy Families

Temporary Assistance for Needy Families (TANF) was a Clinton Administration initiative that ended earlier entitlement programs to provide welfare and job opportunity funding for needy people and families. Under an entitlement, the federal government is committed to pay the benefits provided by law to all recipients who meet the statutory criteria. Under the welfare entitlement programs, the states administered the benefits subject to regulation and supervision from the federal government.

TANF converted the entitlements into a block grant to the states. The federal government thereby transferred some financial risk to the states: in good times when the need for welfare assistance is lower, the states may be able to save money. However, in a recession, when state revenues may fall at the same time the need for welfare assistance increases, the states may not be able to support the same proportion of recipients who were supported under the earlier entitlement program.

The new program also transforms an earlier program of potentially long-term assistance into a program of temporary assistance. It does this by setting a requirement that, with few exceptions, recipients must work after two years on assistance, along with other requirements. The states must enforce the work requirements or face a reduction in the federal payment for their block grant. To prevent states from substituting the federal money for their own spending, states are subject to a so-called “maintenance of effort” requirement to maintain their own spending on welfare and related assistance.

The states are allowed great flexibility in designing their programs. Except as expressly provided in the law, the federal government may not regulate the conduct of states in implementing the act. To reinforce this point, the legislation cut staffing for the responsible federal agency, the Administration for Children and Families of the Department of Health and Human Services, by 25 percent, thereby lessening the capacity of the federal agency to supervise the states, compared to the more intrusive role the federal government played under the former entitlement programs.

In organizational terms, the federal government uses a traditional agency, which is a part of a cabinet department, to provide limited oversight of state agencies that administer the federal block grant. The state agencies in turn often use local agencies to provide the services to recipients of TANF assistance, e.g., for providing employment training and making assistance payments to needy individuals and families. The states contract out an average of roughly ten percent of their service delivery – mostly education and training, job placement, and job-related support services – to nongovernmental organizations, including nonprofit organizations and some for-profit firms.

In terms of historical trends in the United States, TANF reflects recognition that state and local governments have become increasingly capable over the years. Because they are closer to their people than are federal officials, the federal government increasingly delegates authority to state governments in areas where the federal government formerly might have been more directive and prescriptive in establishing a regulatory framework to govern the spending of federal money.

Support for Scientific Research and Education: The Grant Programs of the National Science Foundation

The National Science Foundation (NSF) was established over fifty years ago. It is an unusual institution. With few exceptions, it does not conduct its own research. Instead it is a grant-making agency that supports research and education at U.S. colleges and universities. NSF currently funds about 55 percent of all federally funded basic research conducted at U.S. colleges and universities, not counting biomedical research that is funded by the National Institutes of Health. Thus, in fields such as mathematics, computer science, and the social sciences, NSF provides over half of all federal support for basic research at colleges and universities. NSF also provides almost thirty percent of the total federal support for science and mathematics education in the United States.

While grants (such as TANF) to state and local governments frequently rely on a formula to allocate money among the states and localities, NSF instead uses a competitive process to select and fund the most promising research proposals. The NSF uses a peer-review process, familiar from the scientific community, to sift proposals. NSF awards more than 10,000 new grants each year, out of some 40,000 submitted in 2002-3.

The National Science Foundation is an independent agency of the United States government (in the U.S. sense of that term). It is governed by a 24-member National Science Board, composed of leading scientists, engineers, and educators from across the country. Board members serve part-time and generally hold other distinguished positions. NSF itself is staffed with about 1,200 permanent employees, plus about 700 temporary employees who rotate into and out of NSF, generally from university science and engineering positions. The theory of these “rotators” is that they bring fresh views into the agency and a knowledge of leading-edge scientific and engineering research, to complement the institutional memory of the permanent employees.

In addition 10,000 members of the scientific community assist NSF by serving on proposal review panels, and staffing the NSF’s evaluation processes and more than 30,000 expert volunteers review the thousands of research proposals submitted each year. Each year, NSF recruits approximately 9,000 new participants to replenish and refresh the pool of scientific talent involved in the agency’s activities. As a recent study of the National Academy of Public Administration concludes, “NSF’s hybrid workforce is its most distinctive organizational characteristic. NSF’s success in bringing very specialized scientific expertise to support its merit review process is contemporary, as the work-force self-renewing and cost effective given its on-demand design. NSF’s novel approach to its workforce is principally a reflection of the science community’s culture.”
NSF employs a variety of accountability mechanisms. Among the most important are conflict-of-interest rules which preclude an NSF employee or volunteer from affecting, or appearing potentially to affect, the selection of grant proposals in which they may have a direct or indirect interest. These conflict-of-interest issues are policed both by NSF management and by the agency’s inspector general.

The NSF represents a way that a very small staff of permanent federal employees, supplemented by many more temporary, part-time, and volunteer people, can create a high performance organization that is widely recognized in government circles as carrying out its mission in an exemplary manner. The mission, moreover, is to fund research by outside organizations rather than to undertake the research directly in the agency.

The Medicare Prescription Drug Benefit

The Medicare program is the second-largest entitlement program in the United States. It operates similar to a large federal health insurance company, by paying claims submitted for covered healthcare procedures by providers such as physicians and hospitals. The Medicare program is administered by the Centers for Medicare and Medicaid Services (CMS), a small agency within the Department of Health and Human Services. Medicare serves about 35 million elderly beneficiaries.

For years, elderly groups have expressed concern that Medicare generally does not provide coverage for prescription drugs that the patient receives in a non-hospital setting. The Medicare Modernization Act of 2003, enacted last December, is an interesting example of third-party government. Some policymakers, and the pharmaceutical industry, while welcoming a federal prescription drug benefit for the elderly, feared that the government might use its market power to dictate prescription drug prices. The 2003 Act solves this problem by creating a structure that gives government subsidy payments, and the premiums paid by people who enroll in the plans for prescription drug coverage, to healthcare plans, including a new class of provider, the so-called Prescription Drug Plan (PDP). These healthcare plans may negotiate prices with pharmaceutical manufacturers, but the government may not. The government will conduct competitive procurements to obtain the services of PDPs and other eligible healthcare plans. The selected healthcare plans must take some financial risk when they offer their services competitively and seek to enroll Medicare beneficiaries in their drug plans. Because the entire concept is untested and it is not clear that private entities will emerge to provide drug benefits for the entire country, the government also will negotiate with companies to provide "fallback coverage" on a contract basis with the government. The prescription drug benefit is scheduled to be implemented only by 2006. This is a national experiment in organizational design that will be worth watching.

The Congress considered creating a separate government agency from CMS to administer the new prescription drug benefit but instead wisely decided to create a new organizational unit within CMS to administer the new program. Once again, the federal government provides funds to support delivery of a public service, but uses third parties (here private companies) actually to deliver the service to the public.

Competitive Sourcing: A New Initiative to Encourage Competition With Civil Servants in Providing Public Services

The Bush Administration has begun implementing a new initiative that tries to create competition with federal employees who provide commercial-type services. Under the competitive sourcing initiative, agencies identify activities that they carry out that are commercial in nature and that are not exempt from outsourcing for a variety of reasons (e.g., a legal prohibition). The agencies then select the governmental positions (currently held by civil servants) that they wish to compete. They identify the work to be performed and then create a competition between the incumbent civil servants and outside firms that offer to do the work. The incumbent civil servants prepare a proposal to do the work that may include restructuring of work processes and other economy measures to make the proposal competitive. Then the government agency selects the winning bid, which can come either from the in-house government employees or from an outside contractor. The contracting process is to be renewed periodically, perhaps every five years.

Competitive sourcing is highly controversial. A number of congressional committees have enacted statutory prohibitions on applying competitive sourcing to agencies within their jurisdiction. So far, while a number of agencies have established extensive competitive sourcing plans, only a few thousand positions (out of about 2 million people in the federal civilian workforce) have actually been outsourced in this way. One problem has been the downsizing of government that occurred during the 1990s, under the precepts of the reinventing government initiative of the Clinton Administration, which was particularly targeted at many governmental agency support functions. Many agencies applied reinventing government principles and downsized their staffs that are responsible for contracting out governmental activities. One problem that competitive sourcing faces is that it requires skilled agency contract staffs to conduct the complex competition between the in-house employees and outside competitors. Many of the government agency contract staffs no longer possess the needed capacity.

The Bush Administration contends that outsourcing is not the goal of the competitive sourcing initiative. Rather, it is believed that the government would gain whether or not the in-house federal employees succeed in keeping their jobs. This is because, even if the in-house employees win, the pressure of competition will have caused them to restructure their processes and reduce the costs of their activities.

It is not clear whether competitive sourcing will remain a long-term program of the federal government or whether, similar to reinventing government, it will be of largely historical interest. The Clinton Administration's reinventing government initiative had sought to create contract-based agencies on a model familiar from New Zealand and other OECD countries. However, the initiative failed in its goals because of an unwillingness of the Congress and the Office of Management and Budget to forego their power over funding of government agencies through the traditional budget and appropriations processes. Another problem was the political split between the Democratic Clinton Administration and the Republican Congress. The few so-called performance-based organizations that the Congress authorized were achieved on a bipartisan basis. The most significant result of the reinventing government initiative was to reduce the number of government employees, which was a policy on which both parties could agree.

Conclusion

Is the U.S. experience of use to the Chinese effort to reform public service units? This background paper seeks to provide the basis for answering that question by showing the historical and legal context that has resulted in provision of many public services by state and local governments and by private organizations, even when the federal government funds the delivery of many of those services. As Lester Salamon's research and book, *The Tools of Government*, shows, the United States has long had a pattern of operation that involves provision of public services by third-party government. If the government of China seeks to devolve or contract out public service delivery, some of the tools of government used in the United States, and especially the government grant or the voucher, may be relevant to that effort.

Finally, one general lesson from the U.S. federal government bears emphasis: in the design of governmental organizations, the primary issues tend to involve the risk that an agency will lack sufficient capacity to carry out its public purposes. By contrast, the use of private instrumentalities often involves important issues of accountability and the risk that the organization will serve the interests of its owners or managers to an extent that may diverge from the public purposes that the organization is supposed to carry out.

Figure 1
Institutional Differences:
Government Agencies, Private Instrumentalities and Ordinary Private Companies

Government Agency	Private Instrumentality of Government	Ordinary Company
Political factors predominate; the market affects some government corporations	External environment includes the market, but political factors tend to dominate	External environment is more market-based than political
Subject to controls on resources that often include annual appropriations limits; a tendency exists to maintain agency functions despite inadequate resources or capacity	Stream of revenues and federal subsidies generates needed resources to build capacity	Stream of profits generates needed resources to build capacity
Accountable to multiple parts of government and, in varying degrees, to influential constituencies	Accountable to private owners (except for nonprofits); often regulated by government as well	Accountable to private owners
Some public disclosure; often less financial disclosure than is required for private firms	Financial disclosure (less than for the ordinary company) to private owners and possibly to government regulators	Financial disclosure to private owners; if a publicly held firm, also required public disclosures
Heavy controls on inputs (e.g., budget and staffing) and procedures; government corporations may have greater autonomy	Market-based external controls may be offset by federal subsidies; some regulatory controls	Market-based external controls based upon financial performance
Diffuse political pressures lead to serving multiple purposes that often may not be articulated	Mix of profit-oriented goals and regulated service; cooperatives serve their members	Profit-oriented goals often force focus upon particular activities, market segments and strategies
May stagnate over time, as public priorities change, without ceasing to exist	Some have government backing at start-up; sometimes may gain monopoly or market power; may stagnate over time; government backing, if present, can forestall easy exit	Life cycle: thrives or goes out of business; forced exit of failed firms

SOURCE: Thomas H. Stanton, *Moving toward More Capable Government: A Guide to Organizational Design*, the PricewaterhouseCoopers Endowment for the Business of Government, June 2002, available at http://www.businessofgovernment.org/main/winners/details/index.asp?GID=125