1 INTRODUCTION AND OVERVIEW – WHY OUTSOURCING THREATENS DEMOCRACY

A. CONCERNS OF THIS BOOK

The government exercises sovereign powers. When those powers are delegated to outsiders, the capacity to govern is undermined. A government appointment creates a public servant who, whether through the oath, the security clearance, the desire to achieve public goals, or the psychic income of service, is different from those in the private sector. The office itself is honored. This is why many in our democratic system live in a dual reality, decrying the president, whether it be Bush or Clinton, Reagan or Roosevelt, but respecting the presidency, the office of George Washington, the first among the heroes of our Republic. Those offices that fall under the president deserve similar respect. Anyone who has served in government, from a buck private to a cabinet official, knows this feeling. And they also know that the public and private sectors have different boundaries. Outsourcing tests these boundaries. By doing so, it pushes government to justify delegations of public power to private hands.

One of the challenges of this book is to show exactly when public power has been transferred. By way of introduction, consider one statistic – security clearances. These are key indicators of public responsibility, reflecting the exercise of important duties and realized only after careful investigations by federal officials. Currently over eight hundred thousand contractors have security clearances at eleven thousand government facilities.¹ That may be more than exist on the civilian side of government. It certainly forces us to ask what it is these people do
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for government and whether it is something that government should be doing for itself.

After many years of infatuation with the idea of privatization, the potential downsides of privatizing or contracting out government functions are being examined. The perceived threat is to democratic principles of accountability and process in what has been a largely unexamined shift from public to private governance. On both a national and global stage, a “democracy deficit” may be emerging. This book explores privatization and “outsourcing” and sets itself against delegating the “sovereign” powers of government to private contractors. The premises of this argument incorporate constitutional, statutory, administrative, and contractual sources. The argument builds on existing work in delegation theory and transactions cost analysis and contributes new ways of looking at constitutional provisions and bureaucratic behavior. Its conclusions should be of broad academic and public interest.

To date, strong public reactions against outsourcing sovereignty have been hard to locate. But that is changing. The recent exposé of shabby treatment and poor living conditions for wounded soldiers at Walter Reed Army Medical Center forced the resignation of the Secretary of the Army, Francis Harvey. Private contracting of support personnel and maintenance workers, something Harvey (a former G.E. executive) encouraged, led to a reduction in force from 300 to 60 in 2006. The House committee investigating the Walter Reed situation focused directly on the impact of outsourcing upon the performance of government functions.

In Iraq the implications of a “private military” have also been subjected to scrutiny. Ted Koppel, no isolated scholar, wrote in the op-ed pages of the New York Times about the “seductive . . . notion of a mercenary army.” The emergence of a private military is one consequence of the privatization movement. Koppel suggested the “inevitable” next step – a defensive military force paid for by energy corporations, such as Exxon Mobil, to be deployed in countries where their interests need to be protected. He then quoted officials at Blackwater USA, a leading provider of such services: Provide a battalion or two of troops to protect oil fields in Nigeria, they responded, no problem. They are ready to take on the “Darfur account.” The idea of conducting foreign policy
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by contract – the idea that such a duty can be delegated in the first place – is certainly an arresting one.

Noting that the Pentagon was reluctant to have private armies outside its chain of command, Koppel mentioned issues of loyalty and accountability. But Blackwater’s representatives did not flinch. “We are accountable. We are transparent.” After all, they said, “If we were against the U.S. government’s interests we would never get another contract.”9 Surely, this candid expression of economic interest from Blackwater and the many other private firms performing military work (which includes familiar names such as Halliburton and its subsidiary Kellogg, Brown & Root) satisfies stockholders’ wishes. But it is not only stockholders whose interests must be served – it is citizens’ interests as well. Blackwater and friends do not have the last word on whether they are doing too much, or whether they are transparent or accountable. This is where the government comes in.

Koppel, in terms Jonathan Swift would admire, next encouraged debate on the merits of mercenary regimes. And debate he got. Six days later, a remarkable series of letters appeared in the Times that raised many of the policy points this book will explore. Some said as a “democratic nation,” sensitive to “fueling serious human rights abuses,” the “frightening prospect” of mercenaries conducting our foreign intervention is not what America is all about.10 One writer suggested, if the all volunteer army cannot staff the war in Iraq (or elsewhere), necessitating the use of private forces, perhaps that signals a vote against the war.11 Yet another writer urged congressional oversight of private military contractors and called for the restoration of compulsory military service as an obligation of citizenship and patriotism. All of the letters decried Koppel’s “dubious cause.”12 By doing so, the writers joined the issue publicly,13 which surely is what Koppel was hoping for.

This exchange helps to establish the theme of this book: “Outsourcing sovereignty” occurs when the idea of privatization is carried too far. In an era of national and global privatization, the temptations are great to expand it to include governmental functions inherent in sovereignty.

The New York Times recently published a series of articles that label contractors as the “Fourth Branch” of government.14 That term, coined in the 1930s to describe the independent agencies of government,15 has now been appropriated to cover private contractors. If
the fourth branch was “headless” when composed of independent agencies, think how more so it can be when it consists of private contractors performing government services.

Privatization demonstrates efficiency principles that can improve government performance. But when privatization encourages the outsourcing of political decisions, it exceeds its limits. John Donahue reminds us that democracy is not defined by efficiency alone. Accountability is a countervailing principle of democracy. It may but need not be efficient. Indeed, as the Supreme Court has recognized, the Constitution is sometimes intentionally “inefficient.” Of course, efficiency and accountability need not be in opposition – they can and do coexist. But when efficiency dominates – as is the case with outsourcing important aspects of public sector decision making – it clashes with accountability and undermines democratic values.

Moreover, although a dramatic example, the private military is in no way the exclusive setting for this problem. The urge to outsource affects many government programs, civilian as well as military. Recently, the Internal Revenue Service (IRS) decided to outsource delinquent tax collections to the private sector. The evidence was that the IRS could have done this important job itself more efficiently. Outsourcing in the face of both accountability and efficiency objections is inexplicable. It amounts to, in Paul Krugman words, “a retreat from modern principles of government.”

Outsourcing failures have been highlighted recently in the Coast Guard’s decision to turn over to Lockheed Martin and Grumman the responsibility to manage its $17 billion fleet modernization program. The costs of this program now exceed $24 billion and the structural weaknesses in completed ships are rendering them unseaworthy. Many auditors and retired Coast Guard officials fault the privatization model, which “allowed the contractors at times to put their interests ahead of the Guard’s.” This compulsion to delegate government responsibilities has earned President Bush the title of “Outsourcer in Chief.”

In both the IRS and Coast Guard examples, the outsourcing of management functions that are best performed in house undermines government performance in two ways: By utilizing second-best performers and by weakening or atrophying government’s power to perform these functions in the future. Government managers cease to exist when they are not put to good use.
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Some agencies, such as the Department of Defense (DOD), the Department of Energy (DOE), and the Department of Homeland Security (DHS), are outsourcing engines. The national security, public infrastructure, disaster relief, and border control missions these agencies perform are honeycombed with private contracts. And other agencies of government, when faced with personnel constraints or because of political preferences, increasingly turn to contractors to do policy formulation and implementation. The question becomes: Who is really in charge of government policy making? It is the burden of this book to show (1) that important work – labeled “significant” or “inherent” – is being contracted out to the detriment of democratic policy making; and (2) that this trend can be moderated, if not reversed, by feasible changes in the way government operates. When the public, “We the People” under the Constitution, call this a “dubious cause,” as one of Ted Koppel’s responders put it, we are commanded to listen.

The “era of privatization” has unintended costs as well as intended benefits. Outsourcing can lead to corruption of our bureaucracy, at least of its politically appointed members. Political officials, who are appointed for short periods and enter service through the famous revolving door, sometimes utilize outsourcing both as a means of getting results and as a way of preserving later career opportunities.

Homeland Security seems to be the paradigm case. This multibillion-dollar agency, formed virtually overnight to meet a national security preparedness challenge, has been struggling to perform its complicated mission. More than two-thirds of the Department’s most senior executives, including its first Secretary, Tom Ridge, have moved to private positions, some with companies who receive lucrative contracts from the agency. These companies are doing outsourced government work. Asa Hutchinson, a former undersecretary who ran for governor of Arkansas, allegedly had numerous private relationships with these companies, including one that sold him stock (Fortress America Acquisitions) that IPOed for a potentially generous return. In the words of one critic, DHS itself seems to have become an IPO and “[e]veryone wants a piece of it.” Ethics rules control these activities to some degree, although they too seem to have been reduced in effectiveness.

These activities reflect chronic problems with DHS itself – problems that aggressive privatization exacerbates. In agencies with big
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budgets such as the DHS, in which the players are inexperienced and the programs are new, officials have enormous opportunities to benefit from the outsourcing process. But outsourcing also causes demoralization costs. Civil servants may be bypassed by outsourcing decisions and their purpose and commitment are frustrated. Given the aging of our bureaucracy and difficulty in finding qualified replacements, maintaining significant functions in-house is crucial to the preservation of our civil service. The Wall Street Journal puts it provocatively; Is government “outsourcing its brain?”

B. PERSPECTIVES AND PLAN

This book will explore public sector privatization, explain its roots, internal logic, and self-perpetuating nature, and propose ways to control it in the future. The perspective is not antiprivatization. The author has long favored deregulation and the values of efficiency, and does not see government as the solution to all public problems. But it is surely the solution to some of them. The continued outsourcing of government functions has reached the point where limits on it must be addressed. There seems to be no consistent standard applied when the choice to privatize or retain government functions arises. To avoid making outsourcing the default alternative, it should be checked by public law limits. These limits must be fixed for our democracy to work.

The relationship of government to the private sector is very much in flux these days. The pressures to outsource more and more government functions are occurring at the same time as the federal bureaucracy is shrinking in alarming proportion to its oversight responsibilities, and in relationship to the size of government itself. In these circumstances, the number of private contractors doing the work of government will inevitably accelerate to the limits of federal employees available to supervise them; and may be beyond. Contractor oversight of contractors has become a routine proposition. The Government Accountability Office (GAO) now hires contractors to review contractors who have been suspended or barred for poor performance. The surveillance of privatized activities is more difficult to achieve because of the reduction in key government personnel. A disequilibrium is occurring between
those in government who should oversee and those in the private sector who need to be overseen. Accountability is lacking.  

The gap is a by-product of two converging forces: the deregulation movement, which renders many government regulatory programs unnecessary, and the privatization movement, which transfers government activities to the private sector. Deregulation challenges the economic role of government over the economy. It seeks to end programs that are inefficient or counterproductive. Even after its many successes, however, “the prevailing view still holds that government regulation is overzealous and needs to be reined in.” This view is not equally shared by the public or the academy, but it often drives decisions at the White House, in Congress, and even before the courts. There is no need to challenge deregulation; the need is for government officials to make all significant decisions, whether they be regulatory or deregulatory in character.

Privatization’s role is different from deregulation. It accepts the need for a government activity but sees advantages in shifting its operation to private hands. In the United States, at least, privatization, unlike deregulation, is concerned less with the amount of government expenditures than with where to place responsibility for the activity. The size of government, viewed as a percentage of the Gross Domestic Product, could well grow in a privatized environment, as it has during the Bush administration. But privatization and deregulation do share a belief that the market will improve the services provided by a monopolistic bureaucracy. A cornerstone of the reinventing government movement of the Clinton–Gore administration, this commitment has become ideological under the Bush administration.

President Bush’s vision of an “ownership society” tries to build public support for reducing the size of government across the board. It has been used prominently to advocate private accounts as an alternative to Social Security, but it also has become a code word that signals more generally the private sector’s role in the provision of traditional government services. Privatization, in this view, is a way to pass ownership of government on to the people, or at least some of the people.

But stating a preference for private over public solutions, as the term ownership society suggests, has unintended consequences. Government has been contracting out some of its services since the post–World War II period, but its acceleration to the limits of accountability is a...
relatively recent phenomenon. The view that private enterprise provides a superior organizing principle to government monopoly puts the public sector on the defensive. It fuels the debate over whether Social Security should remain a public function or whether health care should become one. Indeed a central question arising from the privatization movement is whether the term “public sector” continues to be a viable social concept. Stated alternatively, is the public-private distinction, which has been reflected in law and political theory from the earliest times, still meaningful in an era of transcendent privatization? And if not, what replaces it?

This book explores the relationship of public law to privatization. Chapter 4 elaborates on the public-private distinction and asks whether the values of responsibility and accountability behind the distinction still resonate. Accepting privatization, it is argued, need not be the end of public law; instead, public law limitations should be reformulated to restrict the outsourcing of significant government functions as a way to preserve democracy.

Chapter 6 discusses long-standing practices that forbid the contracting-out of “inherent government functions.” These functions must be first understood and then preserved in the process of contracting-out. The privatization movement cannot ignore the limits that phrase implies. The application of both constitutional and statutory requirements, in particular the Take Care and Appointments Clauses and the Subdelegation Act, frame the analysis in Chapters 5 and 6. These provisions serve not only as grants of power to the Executive but also as limits on the exercise of those powers. The Constitution is largely about the delegation and sharing of powers among the three branches. The “fourth branch” (the administrative state, not the contractors) is central here, as contracting is largely done by the agencies.

The Office of Management and Budget’s (OMB’s) Circular A-76 process also helps to define the limits of the contracting-out process. The realities of current practice under this circular show how improvements can be made in the way that contracting-out is usually conducted by agencies. OMB’s role in contracting-out is crucial, and has the potential to preserve inherent functions in the hands of government officials.

Ultimately, the goal is to balance the two positives of the private and public sectors – efficiency and accountability – in ways that confirm
rather than threaten our legal and political traditions. Accountability emerges from constitutional principles, from legal standards, and from administrative practices. New formulations that embrace an invigorated conception of the public sector are also needed. Therefore, Chapters 7 and 8 ask: How can public service – the dreaded bureaucracy – be reorganized and reinvigorated to meet the challenges that privatized government presents? For years, the bureaucracy has been neglected and derided. But we have reached a point where it must be given a renewed life.

DHS and FEMA’s performance during Hurricane Katrina dramatically shows the dangers of excessive privatization. The proper balance between public and private solutions must be struck for mission-oriented agencies such as DHS to work effectively. Since 2001, government has been developing a new specialty in national security and disaster relief. These enormous responsibilities are the essence of inherently governmental; they cannot be shifted to the private sector. Yet contractors are expanding their roles in ways that make the shift increasingly inevitable. How did we get to the place where the proposition of who runs government admits of no easy answer?

C. THE IRAN–CONTRA ROOTS OF THE OUTSOURCING CONTROVERSY

Under the American system, Government is accountable to the people. The administration of President Bush and Vice President Cheney has perfected the art of contracting-out key functions of government. The preference for private solutions has combined with a penchant for secrecy that began at the outset of the administration when the vice president met privately with leaders of private oil companies to formulate an energy policy. Although the secrecy attempts ultimately succeeded, the policy itself has yet to be revealed, at least to the satisfaction of most observers. Cheney, of course, had deep ties to the energy community through his service as CEO of Halliburton which (with its subsidiary KBR) has become the major contractor for services in Iraq.

But the desire to outsource was not born with this administration. It was nurtured through several prior administrations, including Clinton
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and Bush I. It was the Reagan administration, however, that seems to have grasped most fully what privatization of policy making was all about. Indeed, the Iran–Contra Affair provides a virtual textbook in how to establish a private foreign and military policy shop.

1. The Relevance of Iran–Contra to Outsourcing Sovereignty

It is well to remember what Iran–Contra was all about. The plot was convoluted, but the goals were deceptively simple, and eerily familiar. In order to help release American hostages in Lebanon, the White House sold missiles purchased from Israel to the Iranian government of Ayatollah Khomeni and used the profits to fund the Contras in Nicaragua, who were trying to destroy the Sandinista government of Daniel Ortega. The plot was managed by Lt. Col. Oliver North in the White House basement on instructions from the National Security Advisor Robert McFarlane; it was made necessary by the fact that Congress, through the Boland Amendment, had forbidden the expenditure of federal funds for support of the Contras. President Reagan denied involvement or even knowledge of the “affair.” Given the fact that both houses were in Democrat hands, hearings were held and Reagan received a devastating blow to his administration.

There are many views of who should have been charged and convicted in the aftermath of this debacle. But one thing is clear: It was the most outrageously creative use of privatized resources ever deployed for government purposes. Colonel North secured over $30 million from Saudi Arabia and $10 million from private donors in addition to the profits made in the arms sales to Iran. When North’s operation threatened to draw public attention, Admiral Poindexter told North not to talk to anybody but him. Thus did the president ultimately secure the deniability necessary to save his office (and earn the title of “hands-off” president).

Appropriately the Iran–Contra Report had a section entitled “Privatization.” In it, the following statement appears:

The NSC staff turned to private parties and third countries to do the Government’s business. Funds denied by Congress were