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Introduction

In the aftermath of the attacks on the World Trade Center and the Pentagon, attention was focused on the failings of the private firms charged with securing America's aviation system. The low quality of airport security – a fact long known to frequent travelers in the United States – was suddenly an urgent concern. The Bush Administration quickly suggested that the government might assume responsibility for screening passengers and baggage, a function then performed by low-paid employees of private security firms hired by individual airlines (Schneider and Nakashima 2001).

This development was quite striking inasmuch as President George W. Bush followed in the tradition of Ronald Reagan, calling for a smaller federal government and increased responsibility for the private sector. What was not surprising, however, was that the general suggestion was soon followed by the proposal that a government corporation be created to handle the weighty task of hiring, training and managing the personnel charged with preventing another September 11.

Government corporations are a type of "hybrid" organization. The appeal of hybrids, entities that combine characteristics of public- and private-sector organizations, lies in the belief that they combine the best of both worlds: public accountability and private efficiency. Indeed, the General Accounting Office (GAO) expert testifying before Congress regarding his agency's survey of possible structures of the new security agency noted the general view "that the screening performance and accountability would improve under a government corporation" and such an entity would be "more flexible and less bureaucratic than a federal agency" (GAO 2001).

For reasons too numerous to catalog here, the Transportation Security Administration was not created as a government corporation (Schneider

2002). Still, the episode gives an indication of the prominence of hybrid organizations in contemporary governance and the need to better understand these peculiar entities frequently called upon to carry out public functions.

Created by governments to address public policy needs, hybrids resemble private companies in form and function. Many hybrids are privately owned, profit-seeking businesses. They generally charge fees for the services they provide, allowing them to cover the cost of their operations. And they are exempt from many of the laws and regulations that apply to government agencies, giving them flexibility as they pursue organizational objectives.

Hybrids are not commonly referred to as a *class* of institutions because each is unique in terms of history, purpose and organization. Still, many are familiar fixtures. In the United States, for example, the Federal Deposit Insurance Corporation (FDIC), the Port Authority of New York and New Jersey, and the Tennessee Valley Authority (TVA) are known to many people. At the very least, their names are familiar.

Hybrids are perhaps more common outside the United States. In Commonwealth countries, the peculiar class of organizations dubbed "quangos" perform a dizzying array of functions. Public enterprises, companies that are owned all or in part by government, are relatives of American hybrids that are common around the globe. There is even a mysterious class of transnational hybrid organizations such as the World Bank and International Monetary Fund that are publicly financed by multiple nations yet run as semi-private entities.

For every hybrid that is somewhat familiar, there are many more that operate in the shadows, carrying out mundane functions such as power generation, school construction and the management of our railroads. If the obscurity of most hybrids creates the impression that these institutions are marginal in the scheme of US government, that impression is misleading:

- Hybrids are big; the combined liability of federal hybrids (i.e., the amount of money guaranteed by hybrid organizations) exceeds $2 trillion, more than the entire federal budget for this (or any) year.
- Hybrids are numerous; there are more than fifty federal hybrids and hundreds more in state and local government.
- Hybrids are vital; hybrids perform critical functions, ranging from financing home purchases to operating metropolitan transit systems to disposing of weapons-grade uranium.

In short, hybrids touch the lives of virtually every American. Despite the lack of popular or scholarly attention quasi-government is critical, and in the coming years it is likely to grow in importance. To borrow the words Arthur Miller penned for Linda Loman, attention must be paid.

Why are hybrids of interest?

Although hybrid organizations are not new, they are increasingly common features of the governmental landscape. Their proliferation can be explained by several factors. First, proponents of quasi-government promise greater effectiveness than traditional government agencies at lower cost to taxpayers. Second, at a time when all things governmental are regarded with suspicion and the triumph of capitalism is widely celebrated, hybrids are appealing precisely because they seem more "businesslike" than a typical government program. Third, the desire to trim the budgets of government at all levels has led policy-makers to seek out alternatives that will ease the burden on public appropriations.

There are legitimate reasons for concern that the growth of this "quasi-government" is continuing unchecked. Collectively, hybrids embody an alternative relationship between elected officials and public bureaucracies – or, to use the language of economics, principals and agents. Many tools traditionally utilized by principals to control their agents are not part of quasi-government (Smith 1975, Musolf and Seidman 1980, Moe and Stanton 1989). For example, the leaders of many federal hybrids are not appointed by the President but elected by stockholders. Other hybrids are exempt from the yearly appropriations process through which Congress exercises its oversight function. These constraints on government agencies often were put in place, however, to ensure due process, fairness, equity and other values related to proper public administration in democratic regimes (Kaufman 1977).

As a result, critics of quasi-government claim that hybrids are simply beyond the control of elected officials, and, by extension, the public. In the rush to move government expenditures off-budget and bring "market efficiency" into the public sector, policy responsibilities have been delegated to hybrids with little consideration of the potential *political* costs. Thus critical questions have gone unanswered – even unasked.

Do we sacrifice popular sovereignty by granting public authority to semi-private institutions? Is the quasi-government accountable to the public? Are hybrids beyond the control of our elected representatives? These are the central questions of this book.

Accountability and control are core considerations of political science. An "unaccountable" government, insulated from the public and their elected representatives, threatens the very legitimacy of a democratic political system (Krislov and Rosenbloom 1981, Gruber 1987). In light of the swelling ranks of hybrid organizations – and their latent threat to democratic accountability – this study is long overdue.

It is crucial to note that this book is not based upon the assumption that hybrid organizations are inherently more difficult to control or less accountable than government agencies. On the contrary, the purpose of this volume is to determine if, when and why that is the case. Proponents of the hybrid model argue that freedom from the bureaucratic "red tape" that ensnares government agencies endows hybrid organizations with the flexibility necessary for success. The purpose of this book is to fill in the other side of the ledger.

Learning from hybrids

There is an additional benefit to studying political control of hybrid organizations. It yields tremendous insight into the nature of control over traditional government agencies. Like Oliver Sacks' studies of abnormal psychology that provide understanding of normal brain physiology (Sacks 1987), this book highlights the function of structural features of government agencies by revealing the consequences of their absence from hybrid organizations. This study of hybrids revealed that the absence of some features does result in loss of control. However, the absence of other features seems *not* to diminish organizational accountability.

Thus attention is focused on an aspect of the "principal-agent" relationship frequently overlooked in the bureaucratic control literature. Typically studies of bureaucratic control evaluate the relative influence of various principals: Congress, the President, the courts, interest groups. Rarely are variations in the structure of *agents* even considered. By comparing hybrids and traditional agencies in three policy domains, this study is designed to accomplish just that objective.

To understand the dynamics of quasi-government and evaluate the consequences of variation in agent structure for bureaucratic control, American federal hybrids and traditional government agencies were compared in three policy areas: export promotion, housing and international market development. In each area, explicit principal preferences were identified and the performance of the organizations was examined to determine the extent to which the different types of agents satisfied these preferences. The design and theoretical implications of this research are addressed at greater length in the second chapter.

The strange world of the federal quasi-government

The United States Constitution is quite vague regarding the structure of the executive branch of the federal government. Article I, section 8 states simply that Congress has the power "To make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this Constitution in the government of the United

States, or in any department or officer thereof." This vagueness has permitted the executive branch to adapt to changing demands with countless innovations, variations and mutations. Indeed, experiments in administrative structure are an American tradition. *McCulloch* v. *Maryland*, one of the cornerstone cases that defined the Supreme Court's power, considered the legitimacy of a novel organization, the Bank of the United States (Stanton 1994). The Bank was just the first in a line of seemingly unprecedented public institutions.

The most familiar bureaucratic form is the executive department. In the early days of the Republic, departments were few and small. The Departments of State, Treasury and War conducted the business of the federal government until 1849. The spirit of experimentation with organizational form was alive and well at this time. One of the most peculiar American governmental entities, the Smithsonian Institution, was created in 1846 following years of congressional deliberation. Established with the gift of James Smithson, the Institution is governed by a committee that includes the Vice-President, the Chief Justice of the Supreme Court, and Members of Congress appointed by the Speaker. Not only is this structure likely unconstitutional, it remains unique even by today's standards.

The Civil War and territorial expansion prompted more conventional government growth. Offices and personnel were added and new departments created (Interior in 1849, Justice in 1870, Agriculture in 1889). Even with this major expansion, the size of the federal government did not approach the current scale until well into the twentieth century.

World War I prompted the next wave of expansion. Mobilization led to the creation of a set of institutions intended to prepare the United States quickly for war. The Emergency Fleet Corporation, US Grain Corporation and War Finance Corporation were set up as government corporations to allow them to act more quickly than government agencies (Pritchett 1946a). After the war they were phased out, their assets sold, their operations halted. These organizations were ancestors of modern American hybrids in the sense that they operated as independent entities carrying out functions that resembled private-sector organizations (e.g., overseeing the construction of vessels and housing for workers).

This set the pattern for government expansion during the New Deal and World War II. Faced with the Depression and a need for military mobilization, Roosevelt and Congress created a familiar alphabet soup of entities, including several hybrids that still operate today – the Export-Import Bank (ExIm), Tennessee Valley Authority and Federal Crop Insurance Corporation – as well as several agencies that were later "hybridized," partially or completely sold to private parties. The government did not shrink following World War II as it did in the wake of World War I. Fear of a renewed Depression kept agencies in place; sustained economic expansion through the 1950s tempered the need to cut government spending.

Indeed, the growth of the federal government in this period nearly kept pace with that of the previous decade. This expansion slowed dramatically by the end of the 1960s. Debt from the "Great Society" programs and the Vietnam War as well as the financial crises of the 1970s limited the federal government's ability to address policy problems with direct expenditures. This helps account for the creation of numerous hybrids in the late 1970s and 1980s, including the Rural Telephone Bank, the Pension Benefit Guaranty Corporation, the Legal Services Corporation and others.

Budget constraints and rules have always been a significant factor in the explanation for the growth of American quasi-government. The transformation of the Federal National Mortgage Association ("Fannie Mae") from a government agency to a government corporation to a privately-owned government-sponsored enterprise, for example, can be directly attributed to revisions in budget rules. Designated a government corporation to escape inclusion in the budget, Fannie Mae was restructured again when government corporations went from "off-budget" to "on-budget" status. This necessitated another change in Fannie Mae – this time it became a government-sponsored enterprise – to get it back off-budget (interview 112, Tierney 1984, 79).

In recent years, efforts to trim the federal budget sustained the appeal of the hybrid form generally and increased interest in selling government-owned organizations to investors. For example, the Student Loan Marketing Association – an entity that performs a function for student loans similar to that performed by Fannie Mae for home loans – is being "fully privatized" (Crenshaw 1997). This will raise money for the Treasury and move debt off-budget. It has been suggested that other agencies should be "hybridized" or sold for similar reasons.

There are other rationales for creating hybrids. At the state and local levels, hybrids are utilized as instruments to overcome a wide range of obstacles faced by traditional public bureaucracies. New York State's public authorities, for example, are known for pioneering the "moral obligation" bond as a means of circumventing limitations on state government borrowing. This created not a legal obligation of payment, as prohibited by the borrowing limits applied to government agencies, but a moral obligation that investors accepted with a wink (Sharkansky 1979). Other authorities have been designed to straddle multiple jurisdictions (e.g., the Port Authority of New York and New Jersey) or enable their leaders to operate free of constraints created by state laws and regulations.

Outside the United States, there are hybrid organizations with origins similar to those of American quasi-governmental entities. The most commonly utilized label for such organizations is "quangos." Quangos (which are discussed at greater length later in this chapter) are generally associated with Commonwealth nations. Many quangos began their existence as government bureaus but underwent a transformation at some point for fiscal or ideological reasons.

There are also large numbers of hybrids with histories quite different from their American cousins. These organizations are often referred to as "state enterprises," "public enterprises" or "state-owned enterprises." Unlike American hybrids, these enterprises generally were founded as private companies. At some point, for reasons of market failure, national interest or political movement, the company or an entire industry was nationalized. That is, the government assumed ownership of all or part of a profit-seeking business. In developing countries, many public enterprises were founded with public capital and thus have been hybrid from their inception. These types of hybrids are quite different from those that have been discussed in the American context. They were not created – or hybridized – to deliver some public good in place of a government agency. As a result, the expectations for such entities, and the standards by which they are judged, are often quite different. The findings of this book are least relevant for this type of hybrid organization, as shall become clear in the ensuing pages.

There is an additional emerging class of hybrid that looms large on the horizon. These hybrids serve multiple nations and have literally global "jurisdictions." This diverse group of entities includes prominent institutions such as the World Bank and the International Monetary Fund. These organizations are financed by the governments of the world and/or returns on loans made to borrowing nations. Smaller, and far less visible, is the growing population of entities created to govern specific areas of international activity. Examples include the World Intellectual Property Organization and the Internet Corporation for Assigned Names and Numbers, and there are many other bodies with relatively narrow purposes. These entities look more like government agencies than many hybrids in that they perform traditional governmental functions rather than providing services for customers. Their transnational character and reliance on fees paid by client organizations (including governments) distinguish them from traditional agencies.

The ranks of all types of hybrid organizations are sure to continue swelling. Suggestions for new hybrids at all levels of government around the globe emerge frequently. In the United States, hybrid structures are deemed superior by some because the hybrid, unlike the government agency, must maintain financial discipline to survive in the market place. Thus traditional agencies are sometimes targeted for conversion into hybrids. Congress has considered, for example, "hybridization" (usually labeled "privatization" for its political appeal) of the Social Security Administration and the Air Traffic

Services of the Department of Transportation. These organizations could fund their own operations with fees paid by users for services and would provide a one-time boost to the Treasury with their sale.

In addition to the recent proposals for security-related hybrids, multiple new hybrid suggestions emerged from the Clinton Administration. "America's Private Investment Corporations" would have been a set of funds created to stimulate investment in underdeveloped American communities; the proposal was dropped by Clinton's successor (Markoff 1999). "Kiddie Mac," a proposed government-sponsored enterprise, would have financed construction of childcare facilities (Scherer 1999). One hybrid that *was* created under Clinton was In-Q-It (later renamed In-Q-Tee), a CIA-backed technology venture capital fund (Henry 2002).

In search of an analytic framework

Despite their popularity and importance, hybrids have not received much attention. Improbable as it may seem, in fact, no one knows just how many federal hybrids exist. This is a function of ambiguity, not secrecy. A General Accounting Office report on government corporations, a subset of hybrid organizations, relied upon organizations to characterize themselves (1995). That is, organizations were included in the report only if they considered themselves government corporations! The labels Congress attaches to organizations reveal little regarding the nature of the institution. Corporations are called agencies. Agencies are called foundations. Foundations are called corporations. The slipperiness of the labels calls to mind the conversation of Alice and Humpty-Dumpty in Lewis Carroll's *Through the Looking Glass:*

> "When *I* use a word," Humpty-Dumpty said, in rather a scornful tone, "it means just what I choose it to mean – neither more nor less."
>
> "The question is," said Alice, "whether you *can* make words mean so many different things."

The world of quasi-government would make Humpty-Dumpty beam. As a result, establishing order is an imposing task. Even the simple objective of determining what organizations to consider hybrids can be elusive.

One way to identify hybrids is to sort the entire universe of governmental institutions. Harold Seidman offers a system that, by his own admission, "makes no claim to scientific exactness" (Seidman and Gilmour 1986, 254). At the core of the federal government lie the *executive departments.* Those mentioned already have been joined by Commerce, Labor, Health and Human Services, Housing and Urban Development (HUD), Transportation, Energy, Education and Veterans Affairs (VA). The Executive Office of the President has grown to resemble a department encompassing several large agencies, most notably the Office of Management and Budget (OMB).

Closest to this core are a host of *independent agencies*, including the Environmental Protection Agency (EPA), the National Aeronautics and Space Administration, the Peace Corps and the Small Business Administration (SBA). Seidman cautions that *independence* means only that the agency is not part of an executive department, not that it is independent of the President or executive branch (1986, 254). There are numerous *institutes* (e.g., National Institute of Health) and *foundations* (e.g., National Science Foundation) associated with executive departments. *Commissions*, often created to perform regulatory functions, *are* independent and insulated from executive branch influence by virtue of statutorily required partisan balance in membership and lengthy terms not coinciding with presidential administration.

All of the entities mentioned so far are solidly governmental. They receive federal appropriations, are governed by presidential appointees, and are subject to federal rules and regulations. Seidman proposes three more categories for entities that are less traditional in character. *Government corporations*, such as the Federal Deposit Insurance Corporation and TVA, have a business-related purpose, produce revenue and conduct a large number of transactions with the public (GAO 1995). *Private institutions organized by the federal government to provide contractual services* include well-known research establishments like the Los Alamos National Laboratory and the Rand Corporation.

Then there are the leftovers. Seidman dubs this final category "*the Twilight Zone*." This remainder bin includes well-known organizations such as the Federal Reserve Banks, Fannie Mae and Amtrak. These entities were created by Congress but are privately owned (or partially owned by private parties). They are tied to the federal government by unique privileges, distinctive regulation and unusual appointment schemes.

The problem with Seidman's typology is its lack of an organizing principle. Many of the organizations in one category have much in common with institutions in other categories. For example, almost all the denizens of the Twilight Zone are as independent as, say, the Nuclear Regulatory Commission. No dominant characteristic orders the population. This implies a definition of hybrid organizations that would focus on what the organizations *are not* rather than what they *are*.

Perry and Rainey propose a typology incorporating *three* characteristics: ownership, funding and mode of control (1988). With three variables, this approach yields eight categories. One could consider organizations in categories two through eight (as numbered in table 1.1) to be hybrid organizations – although that is not indisputable.

Table 1.1 *Perry and Rainey's typology of institutions*

Category	Ownership	Funding	Control	Example
1. Bureau	Public	Public	Polyarchy	Bureau of Labor Statistics
2. Government corporation	Public	Private	Polyarchy	Pension Benefit Guaranty Corporation
3. Government-sponsored enterprise	Private	Public	Polyarchy	Fannie Mae
4. Regulated enterprise	Private	Private	Polyarchy	Private utilities
5. Governmental enterprise	Public	Public	Market	No known examples
6. State-owned enterprise	Public	Private	Market	Amtrak, Airbus
7. Government contractor	Private	Public	Market	Grumman
8. Private enterprise	Private	Private	Market	IBM

Note: This table is copied exactly as presented by Perry and Rainey (1988, table 2, 196) and does not reflect the author's view regarding proper characterizations of these institutions.

There are problems with this system. First, there are mixed ownership corporations in which the federal government shares ownership with private investors (e.g., Federal Home Loan Banks, Rural Telephone Bank). It is unclear how such institutions should be classified in Perry and Rainey's scheme. Second, many organizations receive funding from both appropriations and revenue income. Again it is unclear how such organizations should be classified.

A more serious concern, particularly with respect to the questions at the center of this book, is the "mode of social control" variable. The polyarchy/market distinction is quite slippery, as Perry and Rainey's examples reveal. Amtrak is offered as a "market" control entity while Fannie Mae is in the "polyarchy" category, meaning that it is subject to political control. While this may be true in some senses, it is far from straightforward. The requirement that Congress approve any labor agreement for Amtrak employees, for example, clearly conflicts with Perry and Rainey's classification of Amtrak as a market control organization (Woodward 1997). The executives of Fannie Mae, an organization classified as "polyarchy" in the control column, would blanch at the thought of such congressional intervention.