ALTERNATIVES TO PRIVATIZATION:

AN EXAMINATION OF THE CORPORATE DEVICE IN MUNICIPAL WATER UTILITY OPERATIONS

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This brief working paper is a very preliminary examination of the use of the corporate device, specifically the use of public authorities, as an alternative to both traditional government bureaus or departments and to privatization in the delivery of municipal water services. The data collection required for the final version of this paper, using the resources of the American Water Works Association, is on going and not yet complete. One example of the corporate device in municipal water operations, that of the Denver Colorado Board of Water Commissioners, will be used to illustrate the conceptual basis of the paper. It is the author’s intent to more fully elaborate on the organizational state of the water industry in future drafts of this paper.

Writing in 1988 on the limits of the public and private sectors, Barry Bozeman noted that “Public administration can make its contribution to sector and organizational allocation decisions by providing serious institutionally-based, organization theory-informed research as to what structures seem to perform well for particular sets of public problems. This need not imply an exclusive concern with technical efficiency” (Bozeman, 1988, P. 673). Much of the argument for private service delivery does, however, have an economic rationale at its core (Morgan and England, 1988; Blanchard, Hinnant, and Wong, 1998). The basic requirement appears to be which sector provides the service in the most cost-effective manner while ensuring the public that the service is environmentally sound, inclusive of the entire community and ethical (Greenough, et. al., 1999, P. 45). The original impetus for examining the relationship between public versus private service delivery in this paper came from the interesting case of “reverse privatization” that occurred in the creation of the Denver Board of Water Commissioners. The case is briefly detailed below.
Water, or the lack of it, has always been a problem in Denver, ever since the first cabins appeared in 1859 near the confluence of Cherry Creek and the South Platte River. The small town of Denver was nearly swept away in 1864 flood waters, although the usual state of affairs for the settlers was a continual search for water to augment the mere 12 to 13 inches of precipitation annually in the semi-arid region. Rivers, ditches and wells sufficed until the first private water company began service in 1872.

For almost the next half century water was provided to the growing city of Denver by private water companies. At one time during this half-century there were eleven private water companies competing for business and several went bankrupt. In some areas there were three separate water companies running their water mains down the same street and competing for individual customers. When a water main broke there would occasionally be chaos since it was almost impossible to determine which of the mains was leaking and which company was responsible for the repairs. Eventually, the Denver Union Water Company managed to consolidate its grip on most of the Denver service area, but citizens and political leaders were not satisfied with their lack of control over the water future of Denver. In 1918, Denver citizens voted to issue bonds to obtain funds to purchase the private company’s water system. They also voted for a management plan placing control of the system under an independent, non-partisan board of five water commissioners. The Denver Union Water Company was purchased for 14 million dollars by the City and County of Denver on November 1, 1918 (Miller, 1971).

The creation of the Denver Water Board ended years of litigation over water rates charged by the private water companies and many other water-related issues that made their way to the courts. An editorial in the Denver Municipal Facts following the election, hailed the end of “thirty years of civic strife” (1918). James Cox in his history of water supply in Denver noted that:

“The framers of the Charter Amendment creating the Denver Water Board were painfully aware of the influence that the Denver Union Water Company had exercised in city government and they were determined to create an agency that would be removed, as far as possible from politics. By creating a board, rather than a department, directly responsible to the mayor, it was hoped that the influence of the mayor upon board policies would be reduced. Although the mayor was granted the authority to appoint board members, he was not given specific removal power. Also, the terms of commissioners were for a longer period than that of the mayor, requiring the mayor to serve more than one term of office in order to appoint a majority of the board members. The council was not given a role in the appointment of commissioners, and as a consequence was also hindered in exercising direct influence on the board. The Denver Water Board succeeded in maintaining its independence from the
city administration and city council. Even though some mayors have been able to appoint a majority of the board members, they have not found it possible to exercise any considerable control or direction over the decisions of the Board “(Cox, 1967, P. 96).

The creation and use of public authorities, such as the Denver Board of Water Commissioners, is certainly not a new phenomenon in American history. In fact, public authorities or government corporations have been in use almost from the beginning of the republic. In his influential 1983 article Jameson Doig uses the term “public authority” to refer to “those organizations, created by local, state, or national statutes, which are partially independent of elected officials in their formal structure and in their gathering and use of funds. That is, the authorities are supervised by multiheaded boards; and rather than obtaining their funds through appropriations by legislative bodies, they rely substantially on fees obtained from the direct users of their facilities. These agencies are wholly owned by government, but they have independent corporate status (including, generally, the right to own property and the right to sue and be sued); and they have the power to raise funds from private money markets.” (Doig, 1983, P. 294).

Public authorities have, according to Walsh (1978) enjoyed the support of groups from nearly the entire political spectrum, generally because they are regarded as business rather than as political enterprises. Politicians and the general public at large tend to associate business enterprises with efficiency and competence whereas standard government departments are frequently viewed as inefficient, wasteful, and poorly managed. Public authorities can provide a relatively independent base of operations for entrepreneurs in the public sector and give these entrepreneurs administrative power that is greater than that usually found within the standard departments and bureaus of government.

A SEARCH FOR COMMON CHARACTERISTICS

There are more than 6,000 state and local public authorities in the United States (Mitchell, 1990) which makes it difficult to say with certainty that they all share a single set of characteristics. Most state and local public authorities do enjoy a legal, financial, and administrative autonomy that regular government agencies lack. Common characteristics of public authorities can be examined using these three forms of autonomy as a guide.

Legal autonomy involves separate corporate status in law with the freedom to sue and be sued. Authorities are not usually covered by the tax and expenditure limitations imposed
on state and local governments. Essentially, authorities are created by a public statute that defines their powers, but they are corporations without stockholders and political jurisdictions without voters or taxpayers. Generally, authorities do not have the power to tax, but they do have the ability to raise money from private money markets and have access to tax-exempt bond markets. Many authorities have the power of eminent domain and the power of condemnation, the discretion to establish rates and charges, as well as exemption from property or corporate taxes. Additionally, state and local public authorities are generally not subject to regulatory commission oversight (Foster, 1997; Mitchell, 1992; Walsh, 1978).

Public authorities do not levy taxes. Financial autonomy is achieved due to the fact that most public authorities are self-supporting, and are able to retain their own earnings. Public authorities raise most of their revenues through user fees, grants, and private revenue bonds. Doig (1983) notes that the independence of public authorities is largely a result of their reliance on fees obtained from users of their facilities. Public authorities do tend to provide services that are divisible and chargeable, such as toll roads, bridges, tunnels, and seaports. Public authorities also commonly have the power to offer tax-free proceeds on investment in their revenue bonds (Foster, 1997; Mitchell, 1992). This enables authorities to act as providers of large-scale capital projects that might not be funded under a pay-as-you-go system. Most state and local public authorities remain free from budgetary review or controls, determine their own expenditure priorities, and can retain excess earnings, even if they were initially or are currently subsidized. Public authorities typically employ business-type budgets and accounting systems (Tierney, 1984; Leigland, 1994).

Administrative autonomy usually includes freedom from many of the management controls to which standard government agencies must conform. Public authorities generally create their own personnel and pay systems and are not subject to the civil service systems of the parent governments. Personnel policies of public authorities commonly allow for competitive recruitment and hiring of high caliber employees and for swift termination of poor performers. Authorities are also not usually subject to the central budget administration of the parent governments and are not subject to audits by government auditing agencies. Government regulations on contracting, purchasing and price setting do not normally apply to public authorities (Walsh, 1978; Foster, 1997). Interestingly, controls placed on government departments and freedom or exemption from these same controls for public authorities were generally said to be for the same reason, which is to provide buffers against special interests and to promote efficiency.

Public authorities may be exempted from portions of state enacted freedom of information acts allowing for confidentiality relating to business activities. Authorities generally operate under appointed rather than elected boards that are composed of part-time,
business-dominated directors and have full-time managers who do not answer directly to any elected officials and who tend to rely heavily on private consultants (Mitchell, 1992). One other important attribute of most public authorities is functional specialization. General-purpose governments, as their name implies, provide a range of public services, whereas public authorities perform a single or a very limited number of specified functions or services.

The common characteristics discussed above are typical of the large majority of the thousands of state and local public authorities in the United States. The suitability of public authorities as an organizational device for municipal water utilities will be examined in the next section.

ANALYSIS AND DISCUSSION

Luther Gulick, writing in 1947, suggested a set of conditions that should be met before using the public authority device in place of a line agency (reported by Doig, 1983). These conditions included situations where the stability of management policy and long term contracts are essential; where the service does not require “daily integration” with other government activities; and where the service depends on a high degree of reliance on imaginative enterprise and commercial elasticity (P. 304). These conditions could be viewed as in substantial alignment with the purpose and mission of many, if not most, municipal water utilities. On the other hand, conditions which would argue against the use of an authority (Walsh, 1978) include situations where goals, not appropriately measured by new physical construction, are important and where programs should be determined in a context of coordination and compromise with input from citizen groups. These conditions might argue against the use of authorities for municipal water utility operations in cases where there is a need to develop new, controversial sources for water or to construct new water storage options involving dams and reservoirs. It should also be noted that such conditions do not appear to favor the privatization of municipal water operations either.

Hult and Walcott (1990) point out that a hierarchical form of governance structure is appropriate for decision-making settings where there is consensus concerning the goals and objectives of the organization and where there is certainty about the methods or technology to employ to accomplish these goals. When ends and means are certain, Hult and Walcott argue, decision-making can, in principle, be fully programmed, and thus a hierarchical form of organization structure is appropriate (P. 75). Much of the day-to-day work of functionally specialized public authorities, such as producing water, maintaining toll roads, or solid waste collection, can be handled quite efficiently and effectively through
programmed routines and standard operating procedures.

Creating an independent public authority to accomplish uncertain goals using uncertain methods makes public accountability that much more difficult to attain. As Tierney (1984) points out, “government corporations whose goals are multiple and contradictory can be expected to do a poorer job of meeting public expectations than a corporation whose objectives are less diffused. Government corporations are like traditional government agencies (and unlike private businesses) in that their goals are set not by the organization themselves, but by persons outside the organization” (P. 90). In the case of municipal water utilities, however, there is generally consensus concerning goals and objectives. Most frequently the goals involve the provision of an adequate supply of clean, safe water at a reasonable cost to consumers. Also, there is generally certainty about the methods and technology needed to produce potable water. In municipal operations or functions, where there is a high degree of certainty involving both ends and means, there is a greater likelihood that the function will be an appropriate candidate for either a public authority form of structure or for private sector operation of the function.

The political independence of public authorities may be an advantage of this organizational device, but independence may result in accountability concerns. Most government departments are held accountable for process not results. In fact, Behn (1998) points out that accountability for results in government cannot work similarly to accountability for process because process is different from results (P. 153). Specifically, the politics of process are different from the politics of results. Behn elaborates on this premise noting that:

“Clarifying objectives is managerially sound but politically irrational. For in clarifying objectives, the politician must choose from among competing constituencies and conflicting values. From experience, elected officials have learned that they can win more praise, support, and votes by being fuzzy about what results it will produce by when than by being clear” (Behn, 1998, P. 153-154).

Public authorities are, by design, exempt from many of the regulations that promote process accountability. In fact, public authorities may be used to circumvent process controls such as personnel ceilings and oversight by regulatory agencies (Musolf and Seidman, 1980; Moe and Stanton, 1989). As Seidman points out, “laws applicable to government are intended to prevent abuse of power and to assure fairness and openness in the administration of laws” (Seidman, 1989, P. 77). And yet, if Behn is correct, it will be difficult at best to replace accountability for process with accountability for results. It seems, however, logical to assume that accountability will be more difficult to attain when government operations are privatized and the contractual document becomes the primary
or only vehicle to assure accountability both for process and results. As Gilmour and Jensen point out, “When public functions are delegated to private actors and are allowed to be transformed into ‘private’ actions, public accountability is inevitably lost” (1998, P. 249).

The financial flexibility and minimal reporting requirements characteristic of public authorities creates an inherent risk of abuse or misuse of public funds. The creation of public authorities places important governmental functions outside the reach of traditional governmental budgetary and other controls. As Lester Salamon notes, “this can contribute to short-term efficiencies, but it can also pose a significant long-term threat to accountability and democratic control. Under these circumstances, resort to the government corporation tool should be pursued with caution” (Salamon, 1989, P. 20). I would argue that the risk of abuse or misuse is further compounded when government functions are privatized.

Public authorities may be created initially, at least in part, to serve political ends. The creation of public authorities may provide an opportunity to take a significant number of employees "off the books," thus reducing the number of civil servants working in direct departments of state and municipal governments. This “slight of hand” method for “reducing” the size of government can be a definite advantage for politicians given the current political climate. Privatization can, of course, be used to accomplish these same political ends. In the case of the Denver Board of Water Commissioners, the initial impetus for creating the non-partisan Board was to take “politics” out of the collection, treatment, and delivery of water and at the same time to maintain a degree of governmental control over this very important natural resource.

Exemption from complex and restrictive civil service rules and policies provides public authorities with the means to be more efficient and perhaps more effective in matters of personnel management. Potential employees can be hired rapidly and provided with incentive packages not normally found in line agencies. There are no civil service protections for "at will" or discretionary employees which puts the public authority on the same footing as private sector organizations, at least in those cases where public authorities have not developed their own civil service systems. In fact, public authorities are often free to develop performance-based management systems normally associated with private business practice.

Public authorities are often exempt from other regulations that impede rapid decision-making. They may be exempt from certain procurement requirements and from requirements for coordination with other state or municipal agencies. These exemptions give public authorities the ability to operate on more of an equal footing with private
businesses. Standard line agencies do not always have the ability to react quickly to short notice opportunities. Obviously, public authorities enjoy a freedom from constraints not found with traditional government departments.

The most widely cited reason for the decision to privatize a particular service or function is that it will cost the government less to deliver a service if it is contracted out to a private or non-profit organization (Lawther, 1996). Typical sources of cost savings, such as freedom from restrictive personnel and budget rules, have already been discussed in previous paragraphs with the intent to show that the advantages of privatization may be minimal when compared to the use of public authorities. One other cost saving of privatization cited in the literature is economies of scale. Ferris and Graddy (1986) point out that when a large portion of the cost involved in providing a service is in equipment and materials, than large scale producers buying large amounts of equipment and materials may have more bargaining power over the costs involved than small scale producers. Additionally, as Rehfuss (1989) points out, a private vendor serving a wider geographical area including several municipalities will normally have costs that are significantly lower than any one single municipality. Arguments for the cost savings involved with economies of scale have merit. However, in the case of many public authorities, such as the Denver Water Board, they are already regional in scope and serving many municipalities. The majority of the suburban population surrounding Denver, for example, is served by the Denver Water Board through contractual arrangements, thus providing the economies of scale necessary to operate a major reservoir and water treatment/delivery system. There are many other examples of regional public authorities that have been set up by cooperating municipalities with economies of scale playing an important role in the decision making process to establish the public authority. It seems unlikely therefore, that privatization can provide any significant advantage over the use of public authorities in terms of economies of scale cost savings.

SOME CONCLUDING REMARKS

The most significant question regarding public authorities is whether the corporate device is a viable alternative to the privatization of government functions. Certainly some authors have advocated putting public services where they can best be accomplished, whether by government, the private sector, or non-profit agencies (Cohen and Eimicke 1996; Chi 1998). The use of public authorities provides tremendous flexibility for governments, primarily due to public authority exemptions from certain laws, policies and debt ceilings. This flexibility may translate into an ability to compete on an equal footing with the private sector as decisions are made concerning which sector should provide a given service.
The relationship between public and private sectors in the United States has changed and continues to evolve. Services that were never considered for privatization just a few short years ago are now being considered as possible privatization opportunities. Among the management trends that have influenced the movement to privatization have been the “search for excellence” which has taught companies and public organizations to focus on core businesses, and “reinventing government” which taught that the public sector could be run like a business (Greenough, et. al., 1999; Williams, 2000). The basic requirement appears to be that the desired service be provided in the most cost-effective manner while ensuring that the service is environmentally sound and inclusive of the entire community. The public must be aware, however, that a distinctive feature of third-party government arrangements, such as privatization, is the sharing of a basic governmental function: the exercise of discretion over the use of public authority and the spending of public funds (Salamon, 1989). Privatization places a very large share of the discretionary authority involved in the operation of public programs or functions into the hands of nonpublic, third party implementers.

This preliminary examination of the use of public authorities as an organizational device to provide municipal water operations appears to demonstrate, in theory at least, that authorities could and should be as efficient as private provision of this function. A key advantage to the use of public authorities, as opposed to privatization, is the degree of control, albeit somewhat limited, that governments can exercise over water policy and operations. The use of a public authority to provide water services has one important, but controversial advantage over the use of standard government departments. Public authorities are more likely to provide the appropriate levels of on-going water system maintenance and needed system upgrades. Based on limited research to date, it appears that at least some municipal governments treat water operations as a “cash cow” to provide moneys for purposes other than water operations and maintenance. This can result in “deferred maintenance” of the water system with the “bill” for system upgrades and water main replacements coming due for rate payers years later.

Natural monopolies, such as water utilities, present difficult challenges for governments in terms of efficient operation in a non-competitive environment and privatization has been viewed as a potential method for introducing efficiency. In a situation where a private company is only producing a product or service and where the government must provide the funding for the product or service because it would not otherwise be profitable, then the product or service will still be produced in a "monopoly" environment. In regard to water, there clearly is a market, but other conditions such as infrastructure development and operation, as the case of the Denver Board of Water Commissioners illustrates, make competition for customers less than feasible. Research on privatization (Kolderie, 1986; Donahue, 1989) demonstrates that a competitive versus a non-competitive environment is
more important as a determinant of efficient operation then the issue of public versus private. The issues surrounding the use of alternative service delivery systems are, according to Morgan and England, complex and the full implications concerning the use of various service delivery arrangements remain elusive. They do note that, “Efficiency remains a laudable goal, but not to the exclusion of other equally fundamental principles – constitutional protections, equity, citizenship, and community. Only through continued analysis and discourse can we hope to establish service delivery arrangements that minimize adverse tradeoffs and that further both democracy and efficiency” (Morgan and England, 1988, P. 986). The question that this paper has attempted to address, at least in part, is whether the public authority organization device provides the right “mix” of democratic structure and efficiency.

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