



# Cato Handbook for Policymakers

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## 6. Privatization

### **Congress should**

- end subsidies to passenger rail and privatize Amtrak, which would allow the company to innovate, invest, and terminate unprofitable routes;
- privatize the U.S. Postal Service and repeal restrictions on competitive mail delivery;
- privatize the air traffic control system;
- help privatize the nation's airports, while ending federal subsidies;
- help privatize the nation's seaports;
- privatize federal electricity utilities, including the Tennessee Valley Authority and the Power Marketing Administrations;
- privatize portions of the Army Corps of Engineers, such as hydroelectric dams, and transfer the remaining civilian activities to state governments; and
- sell excess federal assets, including buildings, land, and inventory.

In recent decades, governments on every continent have sold state-owned assets, such as airports, railroads, and energy utilities. The privatization revolution has overthrown the belief widely held in the 20th century that governments should own the most important industries in the economy. Privatization has generally led to reduced costs, higher-quality services, and increased innovation in formerly moribund government industries.

The presumption that government should own industry was challenged in the 1980s by British Prime Minister Margaret Thatcher and by President Ronald Reagan, who established a Commission on Privatization. But while Thatcher made enormous reforms in Britain, only a few major federal assets have been privatized in this country. Conrail, a freight railroad, was

privatized in 1987 for \$1.7 billion. The Alaska Power Administration was privatized in 1996. The federal helium reserve was privatized in 1996 for \$1.8 billion. The Elk Hills Petroleum Reserve was sold in 1997 for \$3.7 billion. The U.S. Enrichment Corporation, which provides enriched uranium to the nuclear industry, was privatized in 1998 for \$3.1 billion.

There remain many federal assets that should be privatized, including businesses such as Amtrak and infrastructure such as the air traffic control system. The government also holds billions of dollars of real estate that should be sold off. The benefits to the federal budget of privatization would be modest, but the benefits to the economy would be large as newly private businesses would improve their performance and innovate.

The Office of Management and Budget has calculated that about half of all federal employees perform tasks that are not “inherently governmental.” The Bush administration attempted to contract some of those activities to outside vendors, but such “competitive sourcing” is not privatization. Privatization makes an activity entirely private, with the effect of getting spending completely off the government’s books, allowing for greater innovation, and preventing corruption, which is a serious pitfall of government contracting.

Privatization of federal assets makes sense for many reasons. First, sales of federal assets would cut the budget deficit. Second, privatization would reduce the responsibilities of the government so that policymakers could better focus on their core responsibilities, such as national security. Third, there is vast foreign privatization experience that could be drawn on in pursuing U.S. reforms. Fourth, privatization would spur economic growth by opening new markets to entrepreneurs. For example, repeal of the postal monopoly could bring major innovation to the mail industry, just as the 1980s’ breakup of AT&T brought innovation to the telecommunications industry.

Some policymakers think that certain activities, such as air traffic control, are “too important” to leave to the private sector. But the reality is just the opposite. The government has shown itself to be a failure at providing efficiency and high quality in services such as air traffic control. Such industries are too important to miss out on the innovations that private entrepreneurs could bring to them.

## **Stand-Alone Businesses**

The federal government operates numerous business enterprises that should be converted into publicly traded corporations, including the U.S. Postal Service, Amtrak, and a number of electric utilities.

- **Postal services.** The mammoth 685,000-person U.S. Postal Service is facing declining mail volume and rising costs. The way ahead is to privatize the USPS and repeal the company's legal monopoly over first-class mail. Reforms in other countries show that there is no good reason for the current mail monopoly. Since 1998, New Zealand's postal market has been open to private competition, with the result that postage rates have fallen and labor productivity at New Zealand Post has risen. Germany's Deutsche Post was partly privatized in 2000, and the company has improved productivity and expanded into new businesses. Postal services have also been privatized or opened to competition in Belgium, Britain, Denmark, Finland, the Netherlands, and Sweden. Japan is moving ahead with postal service privatization, and the European Union is planning to open postal services to competition in all its 27 member nations.
- **Passenger rail.** Subsidies to Amtrak were supposed to be temporary after it was created in 1970. That has not occurred, and Amtrak has provided second-rate rail service for more than 30 years while consuming more than \$30 billion in federal subsidies. It has a poor on-time record, and its infrastructure is in bad shape. Reforms elsewhere show that private passenger rail can work. Full or partial rail privatization has occurred in Argentina, Australia, Britain, Germany, Japan, New Zealand, and other countries. Privatization would allow Amtrak greater flexibility in its finances, its capital budget, and the operation of its services—free from costly meddling by Congress.
- **Electric utilities.** The U.S. electricity industry is dominated by publicly traded corporations. However, the federal government owns the huge Tennessee Valley Authority and four Power Marketing Administrations, which sell power in 33 states. These government power companies have become an anachronism as utility privatization has been pursued across the globe. TVA and PMA privatization would eliminate artificially low power rates that cause overconsumption and would increase efficiency in utility operations and capital investment. President Bill Clinton proposed to sell off the four PMAs in his 1996 budget. It is time to dust off those plans and move ahead with reform.

## **Infrastructure**

Before the 20th century, transportation infrastructure was often financed and built by the private sector. For example, there were more than 2,000 companies that built private toll roads in America in the 18th and 19th

centuries. Most of those roads were put out of business by the spread of the railroads. Then, during the 20th century, roads and other infrastructure came to be thought of as government activities. By the 1980s, that started to change, and governments around the world began selling off airports, highways, bridges, and other facilities.

Any service that can be supported by consumer fees can be privatized. A big advantage of privatized airports, air traffic control, highways, and other activities is that private companies can freely tap debt and equity markets for capital expansion to meet rising demand. By contrast, modernization of government infrastructure is subject to the politics and uncertainties of government budgeting processes. As a consequence, government infrastructure is often old, congested, and poorly maintained.

- **Air traffic control.** The Federal Aviation Administration has been mismanaged for decades and provides Americans with second-rate air traffic control. The FAA has struggled to expand capacity and modernize its technology, and its upgrade efforts have often fallen behind schedule and gone over budget. For example, the Government Accountability Office found one FAA technology upgrade project that was started in 1983 and was to be completed by 1996 for \$2.5 billion, but the project was years late and ended up costing \$7.6 billion. The GAO has had the FAA on its watch list of wasteful “high-risk” agencies for years. Air traffic control (ATC) is far too important for such government mismanagement and should be privatized.

The good news is that a number of countries have privatized their ATC and provide good models for U.S. reforms. Canada privatized its ATC system in 1996. It set up a private, nonprofit ATC corporation, Nav Canada, which is self-supporting from charges on aviation users. The Canadian system has received high marks for sound finances, solid management, and investment in new technologies.

- **Highways.** A number of states are moving ahead with privately financed and operated highways. The Dulles Greenway in Northern Virginia is a 14-mile private highway opened in 1995 that was financed by private bond and equity issues. In the same region, Fluor-Transurban is building and mainly funding high-occupancy toll lanes on a 14-mile stretch of the Capital Beltway. Drivers will pay to use the lanes with electronic tolling, which will recoup the company’s roughly \$1 billion investment. Fluor-Transurban is also financing and building toll lanes running south from Washington along Interstate 95.



Similar private highway projects have been completed, or are being pursued, in California, Maryland, Minnesota, North Carolina, South Carolina, and Texas. Private-sector highway funding and operation can help pave the way toward reducing the nation's traffic congestion.

- **Airports.** Nearly all major U.S. airports are owned by state and local governments, with the federal government subsidizing airport renovation and expansion. By contrast, airports have been fully or partly privatized in many foreign cities, including Athens, Auckland, Brussels, Copenhagen, Frankfurt, London, Melbourne, Naples, Rome, Sydney, and Vienna. Britain led the way with the 1987 privatization of British Airports Authority, which owns Heathrow and other airports. To proceed with reforms in the United States, Congress should take the lead because numerous federal roadblocks make cities hesitant to privatize. For example, government-owned airports can issue tax-exempt debt, which gives them a financial advantage over potential private airports.
- **Seaports.** Nearly all U.S. seaports are owned by state and local governments. Many operate below world standards because of inflexible union work rules and other factors. A Maritime Administration report in June 2005 noted that “American ports lag well behind other international transportation gateways such as Singapore and Rotterdam in terms of productivity.” Dozens of countries around the world have privatized their seaports. One Hong Kong company, Hutchinson Whampoa, owns 30 ports in 15 countries. In Britain, 19 ports were privatized in 1983 to form Associated British Ports. ABP and a subsidiary, UK Dredging, sell port and dredging services in the private marketplace. They earn a profit, pay taxes, and return dividends to shareholders. Two-thirds of British cargo goes through privatized ports, which are highly efficient. Because of the vital economic role played by seaports in international trade, this should be a high priority reform area in the United States.
- **Army Corps of Engineers.** The Corps of Engineers is a federal agency that builds and maintains infrastructure for ports and waterways. Most of the agency's \$5 billion annual budget goes toward dredging harbors and investing in locks and channels on rivers, such as the Mississippi. In addition, the corps is the largest owner of hydroelectric power plants in the country, manages 4,300 recreational areas, funds beach replenishment, and upgrades local water and sewer systems.

Congress has used the corps as a pork barrel spending machine for decades. Funds are earmarked for low-value projects in the districts of important members of Congress, while higher-value projects go unfunded. Further, the corps has a history of scandals, including the levee failures in New Orleans and bogus economic studies to justify expensive projects.

To solve these problems, the civilian activities of the corps should be transferred to state, local, or private ownership. A rough framework for reform would be to privatize port dredging, hydroelectric dams, beach replenishment, and other activities that could be supported by user fees and charges. Levees, municipal water and sewer projects, recreational areas, locks, and other waterway infrastructure could be transferred to state governments.

## Federal Assets

At the end of fiscal year 2007, the federal government held \$1.2 trillion in buildings and equipment, \$277 billion in inventory, \$919 billion in land, and \$392 billion in mineral rights. The federal government owns about one-fourth of the land in the United States.

Many government assets are neglected and abused, and would likely be better cared for in the private sector. It is common to see government property in poor shape, with public housing being perhaps the most infamous government eyesore. The GAO has found that “many assets are in an alarming state of deterioration” and the watchdog agency has put federal property holdings on its list of activities at high risk for waste.

The GAO also notes that the federal government has “many assets it does not need,” including billions of dollars worth of excess and vacant buildings. The federal government spends billions of dollars each year maintaining excess facilities of the Departments of Defense, Energy, and Veterans Affairs.

The solution is to sell federal assets that are excess to public needs and to better manage the smaller set of remaining holdings. For example, there are substantial maintenance backlogs on facilities of the Forest Service, Park Service, and Fish and Wildlife Service. The solution is not a larger maintenance budget, but trimming asset holdings to fit limited taxpayer resources. Another part of the solution is to scrap the Davis-Bacon rules, which require that artificially high wages be paid on federal contracts, including maintenance contracts.

Federal asset sales would help reduce the federal deficit and create budget room for improved maintenance of remaining assets. Perhaps more important, economic efficiency and growth would increase as underused assets were put into more productive private hands.

### **Suggested Readings**

Cato Institute. Downsizing the Federal Government website. [www.downsizinggovernment.org](http://www.downsizinggovernment.org).

Edwards, Chris. *Downsizing the Federal Government*. Washington: Cato Institute, 2005.

This book provides citations for most of the facts and data in this chapter.

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Vranich, Joseph, Cornelius Chapman, and Edward Hudgins. "A Plan to Liquidate Amtrak." Cato Institute Policy Analysis no. 425, February 8, 2002.

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