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*Last Updated: 1/26/2024*

MEMORANDUM

COUNCIL OF ECONOMIC ADVISERS

March 27, 1986

TO MEMBERS OF THE WORKING GROUP ON PRIVATIZATION

FROM: THOMAS G. MOORE, CHAIRMAN  
WORKING GROUP ON PRIVATIZATION

SUBJECT: Draft of Paper for DPC

Attached is a revised draft of our proposed paper for next Wednesday's DPC meeting. I would like to have any comments on this by COB 3/28 so that we can send the paper along to the DPC on Monday.

DRAFT

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MEMORANDUM FOR THE DOMESTIC POLICY COUNCIL

FROM: THOMAS G. MOORE, Chairman  
Working Group on Privatization

Issue: What strategies should the Administration use to develop and implement privatization initiatives?

Background:

In 1981, the President promised "to limit government to its proper role and make it the servant, not the master, of the people". The President called for a re-evaluation of past decisions that have created a bloated and ever-expanding Federal government. The Director of OMB recently articulated a set of management decision rules which were used to formulate the FY 87 budget, and which focus on achieving effective government within a balanced budget. The decision rules question whether each current government function should in fact be performed by the Federal government. If there is no reason why the Federal government should provide a particular service, a decision is made as to whether the function should be terminated, transferred to another level of government, or moved into the private sector.

The FY 87 budget supports the President's priority of turning over to the private sector those functions now being performed by government which could be more efficiently and effectively carried out by non-governmental organizations. Implementation of these initiatives and other similar

privatization actions will strengthen the private sector of our economy, and allow the Federal government to more directly focus its limited resources on the tasks and activities best accomplished by governmental action. However, full implementation of new or previously identified privatization initiatives requires a coordinated inter-agency strategy that allows the Administration to assess the broad economic and political implications of privatizing each identified area. The strategy must provide an organizational structure that leads to effective execution of each privatization initiative despite natural resistance from affected interest groups.

Discussion:

In its broadest sense, privatization is a process for transferring the governmental production of goods and services to the private sector. While the specific approach will vary from case to case, there are three primary means of privatizing government activities:

- \* Contracting out
- \* Asset sales to the private sector
- \* Curtailing government provided services and allowing the private sector to determine how much and what type of service will be supplied.

Current Administration policy provides examples of each of these privatization activities: the A-76 program aims to reduce costs through contracting out; asset sales have been

proposed for Conrail, Power Marketing Authorities, and other agencies; the proposals for ending Amtrak subsidies and phasing out crop insurance subsidies are examples of the last method of privatization.

Privatization improves economic performance in several ways. The economy gains from the efficiency improvement that comes with private ownership and management and the removal of distorting subsidies. Government expenditures decline due to cost savings and termination of subsidy programs. Finally, privatization reduces the monopoly restraints that often accompany government production.

These economic gains have led several other countries to pursue policies of privatization. Over the past few years Great Britain has transferred \$28 billion of assets to the private sector including British Telecom and Britoil. In the United States at the local level, many governments have contracted out for the provision of municipal services. The cessation of federal grants for waste-water facilities has led to private firms building and operating these facilities for municipalities. At the federal level, the A-76 program, the Conrail proposal, the creation of markets in airport landing and take-off slots, FCC proposals to auction the radio spectrum, and demonstration programs to sell public housing units to current occupants can all be considered privatization initiatives.

Current Privatization Candidates:

The budget process has led to specific privatization proposals in the 1987 budget (see attachment). Some of these proposals involve ending subsidies or instituting voucher systems. Other proposals initiate sale of government assets to the private sector. In addition, the working group has generated other privatization possibilities. The specific privatization candidates currently being considered by the Working Group are:

1. Student Loan Marketing Association (Sallie Mae). A subgroup (with representatives from Departments of Education and Treasury, OMB and CEA) is considering the role played by Sallie Mae and the advisability of eliminating its remaining federal connections. Sallie Mae creates a secondary market for student loans and is privately owned. It does, however, enjoy special status which, among other things, exempts their earnings from state and local income tax, exempts their securities from SEC registration, and eliminates restrictions on investment in their securities by depository institutions. Privatization would terminate these special conditions and also eliminate restrictions on Sallie Mae's business activities.

Opponents of Sallie Mae privatization are likely to be those who fear that the private market will not continue to make a secondary market in student loans. Private firms now compete only to a limited degree with Sallie Mae. However,

private activity could expand as the special advantages of Sallie Mae are phased out. There could also be significant opposition from other government sponsored agencies concerned about the impact of similar proposals on their financial viability. Finally, a major issue being considered is how to treat Sallie Mae's current \$5 billion floating rate debt held by the U.S. Treasury.

2. Overseas Private Investment Corporation (OPIC). OPIC provides insurance to firms investing abroad at rates that appear to be concessionary. At present, there are private companies in competition with OPIC that insure private investments against expropriation, and to a somewhat more limited degree, also offer insurance against war risk and nonconvertibility of currency. Some opposition to privatization comes from the National Association of Manufacturers whose members benefit from the relatively low-cost insurance.

3. United States Postal System. A subgroup will look at ways to increase competition in the Postal Service. Measures which could be considered include: increasing the use of private contractors; allowing charitable groups access to letterboxes for the delivery of their own mail; and, expanding the current "urgent letter" exemption to the private express statutes. Increased contracting out and expanded exemptions to the private express statutes can be accomplished by rule making

by the Board of Governors of the USPS. Legislation is needed to expand access to letterboxes. All these options are likely to be opposed by the Postal Workers' Unions.

4. Department of Energy Initiatives. The 1987 budget calls for selling power marketing authorities and the naval petroleum reserves. The Department of Energy is also looking at privatizing the Great Plains Coal Gasification project and the advanced enrichment technology (AVLIS). DOE is also considering options for the closed gas centrifuge plant in Portsmouth, Ohio. At present, DOE is establishing an in-house task force to marshal its expertise to develop the information necessary to support successful privatization efforts.

Strategies:

Successful execution of the Administration's privatization policy requires careful management from initial concept generation all the way through to the implementation stage. The privatization strategy adopted by the Administration must consider: interagency coordination; innovative approaches that deal with the natural resistance of the affected interest groups; and formulation of priorities among the various privatization candidates.



1. Interagency Coordination. OMB will continue to develop privatization initiatives through the budget process and the Working Group will identify additional candidates.

Coordination between OMB and the Working Group on the selection of privatization candidates is desirable.

At the design and implementation phase of privatization, the Working Group needs to draw upon the expertise of affected agencies. While most privatization efforts affect a wide range of interest groups and involve a number of government agencies, there is usually one agency with primary responsibility for the targeted activity. Inevitably those agencies most involved in a particular activity will need to organize within their agency to develop necessary information and specific proposals for privatization. These departmental efforts are important to the generation of information and sensible options and can serve as valuable input to the Working Group. Broad based policy issues and the political and economic implications of specific actions can then be addressed by the Working Group and fashioned into specific options for the DPC.

2. Innovative Approaches for Dealing with Affected Groups.

The major obstacles to privatization come from groups that now benefit from the direct and indirect subsidies associated with the government provision of goods and services. Often, the only way in which to make privatization politically feasible is to compensate or to provide assurance of service to current beneficiaries. This can be accomplished in a variety of ways. In Great Britain, for example, this involved selling shares in privatized corporations to affected workers at below market rates. The explicit recognition of the subsidies that comes with sale at below market rates or other direct compensation leaves the Administration open to criticism from those who will claim we are "giving away" public assets and benefits. Nevertheless, the working group feels that in developing privatization strategies we should recognize that realizing top dollar from privatization efforts, while desirable, may not always be politically feasible. Of course, in implementing a proposal, consideration must be given to the objective of benefitting the federal taxpayer.

3. Priorities. The privatization candidates differ greatly in terms of the difficulty of fashioning feasible proposals. Some early success in its privatization efforts would demonstrate the Administration's commitment to and the feasibility of privatization. Such successes would create an environment that will make later efforts at privatization easier. Further, the

experience gained will help with the more complicated privatization initiatives. To demonstrate such success we need to pursue first a few proposals that will provide gains to the economy, but that are structured to engender little opposition.

Recommendation: The working group recommends that in a 60 - 90 day period specific proposals for a few FY 1987 budget privatization initiatives be brought back for DPC consideration. The assessment of the working group is that proposals for OPIC, the Naval Petroleum Reserves, and one of the smaller PMA's can be developed in a relatively short time-frame. Work on developing other proposals will continue and will result in proposals at a later time. Nevertheless, the working group feels that in order to establish early successes our efforts now be concentrated on these candidates.

We also recommend that the Working Group continue to explore further the possibilities for privatizing Sallie Mae, and measures for increasing the private sector role in mail delivery. Any privatization proposals for Sallie Mae or other financial institutions will be cleared through the EPC's Credit Policy Working Group before being brought to the DPC. The Working Group will report back to the DPC on its recommendations in these areas at a later date.

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EXECUTIVE OFFICE OF THE PRESIDENT  
COUNCIL OF ECONOMIC ADVISERS  
WASHINGTON, D.C. 20500

March 31, 1986

MEMORANDUM FOR THE DOMESTIC POLICY COUNCIL

FROM: THOMAS G. MOORE, Chairman  
Working Group on Privatization

*Thomas G. Moore*

Issue: What actions should the Administration pursue to develop and implement privatization initiatives?

Background:

In 1981, the President promised "to limit government to its proper role and make it the servant, not the master, of the people". The President called for a re-evaluation of past decisions that have created a bloated and ever-expanding Federal government. The Director of OMB recently articulated a set of management decision rules which were used to formulate the FY 87 budget, and which focus on achieving effective government within a balanced budget. The decision rules question whether each current government activity should in fact be performed by the Federal government. If there is no reason why the Federal government should provide a particular service, a decision is made as to whether the activity should be terminated, transferred to another level of government, or moved into the private sector.

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2. Overseas Private Investment Corporation (OPIC). The FY 1987 budget calls for the privatization of OPIC. A subgroup has been formed to develop specific proposals. OPIC provides insurance to firms investing abroad at rates that appear to be concessionary. At present, there are private companies in competition with OPIC that insure private investments against expropriation, and to a somewhat more limited degree, also offer insurance against war risk and nonconvertibility of currency. Some opposition to privatization comes from the business community whose members benefit from the relatively low-cost insurance. (This issue will also be referred to the EPC for consideration.)

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Strategies:

Successful execution of the Administration's privatization policy requires careful management from initial concept generation through to the final implementation stage. The privatization strategy adopted by the Administration should consider: interagency coordination; innovative approaches that deal with the natural resistance of the affected interest groups; and formulation of priorities among the various privatization candidates.

1. Interagency Coordination. OMB will continue to work with Departments and Agencies to develop privatization initiatives through the budget process. The Working Group will also identify and propose additional candidates for privatization, and will coordinate its efforts with OMB and the affected Departments and Agencies. At the design and implementation phases of privatization, the Working Group will provide coordination, guidance and advice on specific initiatives and will draw upon the expertise of the affected agencies to address policy issues requiring DPC decisions.

While most privatization efforts affect a wide range of interest groups and involve a number of government agencies, one agency usually has primary responsibility for the targeted activity. Those agencies will need to organize internally to develop necessary information and possible options and action plans for privatization. These departmental efforts will be valuable as input to the Working Group. Broad based policy issues and the political and economic implications of specific

actions will then be addressed by the Working Group which will develop options for DPC review and decision.

2. Innovative Approaches for Dealing with Affected Groups.

The major obstacles to privatization come from groups that now benefit from the direct and indirect subsidies associated with Federal government provision of goods and services. Often, the only way to make privatization politically feasible is to compensate or provide assurance of service to current beneficiaries. This can be accomplished in a variety of ways. In Great Britain, for example, shares in privatized corporations were sold to affected workers at below market rates. The explicit recognition of the subsidies associated with sale at below market rates or other direct compensation exposes the Administration to criticism from those who will claim we are "giving away" public assets and benefits. Nevertheless, the Working Group feels that specific privatization strategies should recognize that realizing top dollar from privatization actions, while desirable, may not always be achievable given the need to build a supportive political constituency within affected interest groups. Of course, in implementing a proposal, consideration must also be given to protecting and benefitting Federal taxpayers.

3. Priorities. The difficulty of fashioning feasible proposals differs greatly between privatization candidates. Some early success would demonstrate the Administration's commitment to privatization and the feasibility of the privatization concept. Such successes would also create an environment that may make later privatization efforts easier. Further, the experience gained will be important to successful implementation of more complicated privatization initiatives. To demonstrate such success, priority effort should be given to pursuing a few less difficult proposals that will provide gains to the economy, but which are structured to engender relatively little opposition.

Recommendation. The Working Group recommends that the Domestic Policy Council support the following actions:

- o To establish early successes, effort over the next 60-90 days should be directed towards developing specific privatization action plans for OPIC, the Naval Petroleum Reserves, and one of the smaller Power Marketing Authorities.
- o The Working Group should continue to explore the possibilities for privatizing Sallie Mae, and measures for increasing the private sector role in mail delivery.
- o Work on FY 1987 budget initiatives and other actions proposed above should continue and result in specific proposals at a later time.

- o Specific privatization proposals for Sallie Mae or other financial institutions should be referred to the EPC through its Federal Credit Policy Working Group.
- o Privatization initiatives should continue to be developed through the budget process by the Departments and Agencies in cooperation with OMB. The Working Group should serve as an additional catalyst for privatization proposals.
- o Privatization action plans should be structured to gain the optimum benefit for the taxpayers while developing support within affected interest groups. The Working Group should take the lead in proposing and developing innovative approaches to deal with the issue of direct and indirect compensation to current beneficiaries.
- o The Working Group should periodically report progress to the Council and should continue to develop options for policy issues which may arise during the execution of privatization initiatives.

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*Rescheduled  
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- \* Curtailing government provided services and allowing the private sector to determine if the service will be supplied and, if so, how much and what type of service will be provided.

Current Administration policy provides examples of each of these privatization activities: the A-76 program aims to reduce costs through contracting out; asset sales have been proposed for Conrail, Power Marketing Authorities, and other agencies; the proposals for ending Amtrak subsidies and phasing out crop insurance subsidies are examples of the last method of privatization.

Privatization improves economic performance in several ways. The economy gains from the efficiency improvement that comes with private ownership and management and the removal of distorting subsidies. Government expenditures decline due to cost savings and termination of subsidy programs. Finally, privatization reduces the monopoly restraints that often accompany government production.

These economic gains have led several other countries to pursue policies of privatization. Over the past few years Great Britain has transferred \$28 billion of assets to the private sector including British Telecom and Britoil. In the United States at the local level, many governments have contracted out for the provision of municipal services. The cessation of federal grants for waste-water facilities has led to private firms building and operating these facilities for municipalities. At the federal level, the A-76 program, the Conrail proposal, the creation of markets in airport landing and take-off slots, FCC proposals to auction the radio spectrum, and demonstration programs to sell public housing units to current occupants can all be considered privatization initiatives.



Current Privatization Candidates:

The budget process has led to specific privatization proposals in the 1987 budget (see attachment). Some of these proposals involve ending subsidies or instituting voucher systems. Other proposals initiate sale of government assets to the private sector. In addition, the working group has generated other privatization possibilities. The specific privatization candidates currently being considered by the Working Group are:

1. Student Loan Marketing Association (Sallie Mae). A subgroup (with representatives from Departments of Education and Treasury, OMB and CEA) is considering the role played by Sallie Mae and the advisability of eliminating its remaining federal connections. (This issue will ultimately be referred to the EPC for consideration).

Sallie Mae creates a secondary market for student loans and is privately owned. It does, however, enjoy special status which, among other things, exempts their earnings from state and local income tax, exempts their securities from SEC registration, and eliminates restrictions on investment in their securities by depository institutions. Privatization would terminate these special conditions and also eliminate restrictions on Sallie Mae's business activities.

Opponents of Sallie Mae privatization are likely to be those who fear that the private market will not continue to make a secondary market in student loans. Private firms now compete only to a limited degree with Sallie Mae. However, private activity could expand as the special advantages of Sallie Mae are phased out. There could also be significant opposition from other government sponsored enterprises concerned about the impact of similar proposals on their financial viability. Finally, a major issue being considered is how to treat Sallie Mae's current \$5 billion floating rate debt held by the U.S. Treasury on which repayment will begin in 1986.

2. Overseas Private Investment Corporation (OPIC). The FY 1987 budget calls for the privatization of OPIC. A subgroup has been formed to develop specific proposals. OPIC provides insurance to firms investing abroad at rates that appear to be concessionary. At present, there are private companies in competition with OPIC that insure private investments against expropriation, and to a somewhat more limited degree, also offer insurance against war risk and nonconvertibility of currency. Some opposition to privatization comes from the business community whose members benefit from the relatively low-cost insurance. (This issue will also be referred to the EPC for consideration.)

3. United States Postal System. A subgroup will look at ways to increase competition in the Postal Service. Measures which could be considered include: increasing the use of private contractors; allowing charitable groups access to letterboxes for the delivery of their own mail; and, expanding the current "urgent letter" exemption to the private express statutes. Increased contracting out and expanded exemptions to the private express statutes can be accomplished by rule making by the Board of Governors of the USPS. Legislation is needed to expand access to letterboxes. All these options are likely to be opposed by the Postal Workers' Unions.

4. Department of Energy Initiatives. The 1987 budget calls for selling power marketing authorities and the naval petroleum reserves. The Department of Energy is also looking at privatizing the Great Plains Coal Gasification project and the advanced enrichment technology (AVLIS). DOE is also considering options for the closed gas centrifuge plant in Portsmouth, Ohio. At present, DOE is establishing an in-house task force to marshal its expertise to develop the information necessary to support successful privatization efforts.

Strategies:

Successful execution of the Administration's privatization policy requires careful management from initial concept generation through to the final implementation stage. The privatization strategy adopted by the Administration should consider: interagency coordination; innovative approaches that deal with the natural resistance of the affected interest groups; and formulation of priorities among the various privatization candidates.

1. Interagency Coordination. OMB will continue to work with Departments and Agencies to develop privatization initiatives through the budget process. The Working Group will also identify and propose additional candidates for privatization, and will coordinate its efforts with OMB and the affected Departments and Agencies. At the design and implementation phases of privatization, the Working Group will provide coordination, guidance and advice on specific initiatives and will draw upon the expertise of the affected agencies to address policy issues requiring DPC decisions.

While most privatization efforts affect a wide range of interest groups and involve a number of government agencies, one agency usually has primary responsibility for the targeted activity. Those agencies will need to organize internally to develop necessary information and possible options and action plans for privatization. These departmental efforts will be valuable as input to the Working Group. Broad based policy issues and the political and economic implications of specific

actions will then be addressed by the Working Group which will develop options for DPC review and decision.

2. Innovative Approaches for Dealing with Affected Groups.

The major obstacles to privatization come from groups that now benefit from the direct and indirect subsidies associated with Federal government provision of goods and services. Often, the only way to make privatization politically feasible is to compensate or provide assurance of service to current beneficiaries. This can be accomplished in a variety of ways. In Great Britain, for example, shares in privatized corporations were sold to affected workers at below market rates. The explicit recognition of the subsidies associated with sale at below market rates or other direct compensation exposes the Administration to criticism from those who will claim we are "giving away" public assets and benefits. Nevertheless, the Working Group feels that specific privatization strategies should recognize that realizing top dollar from privatization actions, while desirable, may not always be achievable given the need to build a supportive political constituency within affected interest groups. Of course, in implementing a proposal, consideration must also be given to protecting and benefitting Federal taxpayers.

3. Priorities. The difficulty of fashioning feasible proposals differs greatly between privatization candidates. Some early success would demonstrate the Administration's commitment to privatization and the feasibility of the privatization concept. Such successes would also create an environment that may make later privatization efforts easier. Further, the experience gained will be important to successful implementation of more complicated privatization initiatives. To demonstrate such success, priority effort should be given to pursuing a few less difficult proposals that will provide gains to the economy, but which are structured to engender relatively little opposition.

Recommendation. The Working Group recommends that the Domestic Policy Council support the following actions:

- o To establish early successes, effort over the next 60-90 days should be directed towards developing specific privatization action plans for OPIC, the Naval Petroleum Reserves, and one of the smaller Power Marketing Authorities.
- o The Working Group should continue to explore the possibilities for privatizing Sallie Mae, and measures for increasing the private sector role in mail delivery.
- o Work on FY 1987 budget initiatives and other actions proposed above should continue and result in specific proposals at a later time.

- o Specific privatization proposals for Sallie Mae or other financial institutions should be referred to the EPC through its Federal Credit Policy Working Group.
- o Privatization initiatives should continue to be developed through the budget process by the Departments and Agencies in cooperation with OMB. The Working Group should serve as an additional catalyst for privatization proposals.
- o Privatization action plans should be structured to gain the optimum benefit for the taxpayers while developing support within affected interest groups. The Working Group should take the lead in proposing and developing innovative approaches to deal with the issue of direct and indirect compensation to current beneficiaries.
- o The Working Group should periodically report progress to the Council and should continue to develop options for policy issues which may arise during the execution of privatization initiatives.

Attachment

List of Privatization Initiatives  
in the FY 1987 Budget

1. Power Marketing Administrations
2. Naval Petroleum Reserves
3. GSA Surplus Property Sales
4. Compensatory Education Vouchers
5. Housing Vouchers
6. Federal Housing Administration
7. Export-Import Bank Direct Loans
8. OPIC
9. Crop Insurance Subsidies
10. Amtrak Subsidy
11. Landsat Subsidy

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Domestic Policy Council  
April 2, 1986

ISSUE: What actions should the Administration pursue to develop and implement privatization initiatives.

METHODS

- Contracting out
- Asset sales
- Curtailing government provided services

GAINS FROM PRIVATIZATION

- Efficiency improvements
- Removal of distorting subsidies
- Decline in government expenditures due to cost savings and efficiency improvements — Budget savings is not the main motivation
- Removal of monopoly restraints

*Theory*  
*Evidence - Hydroelectric*

CURRENT CANDIDATES

- FY 1987 budget (see attachment to paper) - listed 11 - many are elementary subsidies
- Under consideration by Working Group - subject
  - Sallie Mae *Student Loan Guaranty Association*
  - OPIC *Overseas Private Investment Corp.*
  - USPS *Post office*
  - Department of Energy
    - PMA *Power Marketing Authority*
    - NPR *Nuclear Power Review*
    - Uranium Enrichment (Gas Centrifuge)

STRATEGIES

- Interagency coordination
  - Budget process and Working Group identify candidates
  - Working Group, relying on agency input, fashions options for DPC

*British Telecom*



- Innovative approaches
  - Dealing with current beneficiaries
- Priorities
  - Need for quick success to demonstrate Administration commitment and feasibility

RECOMMENDATION OF WORKING GROUP

- Next 60-90 days bring specific proposals for Naval Petroleum Reserves, and smaller Power Marketing Administration to DPC and for OPIC to EPC.
- Continue to explore possibilities for SALLIE MAE (for EPC approval) and USPS.
- Work on additional proposals and on FY 1987 budget initiatives should result in proposals at a later date.
- Privatization initiatives should continue to be developed by Agencies in cooperation with OMB, and by the Working Group.
- Working Group should take the lead in developing innovative approaches to deal with the issue of opposition from current beneficiaries.
- Working Group should periodically report to the Council on progress and continue to develop policy options for DPC consideration.

*Answer any questions*

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