MARKET-BASED GOVERNANCE

Supply Side, Demand Side, Upside, and Downside

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John D. Donahue and **Joseph S. Nye Jr.**
Editors

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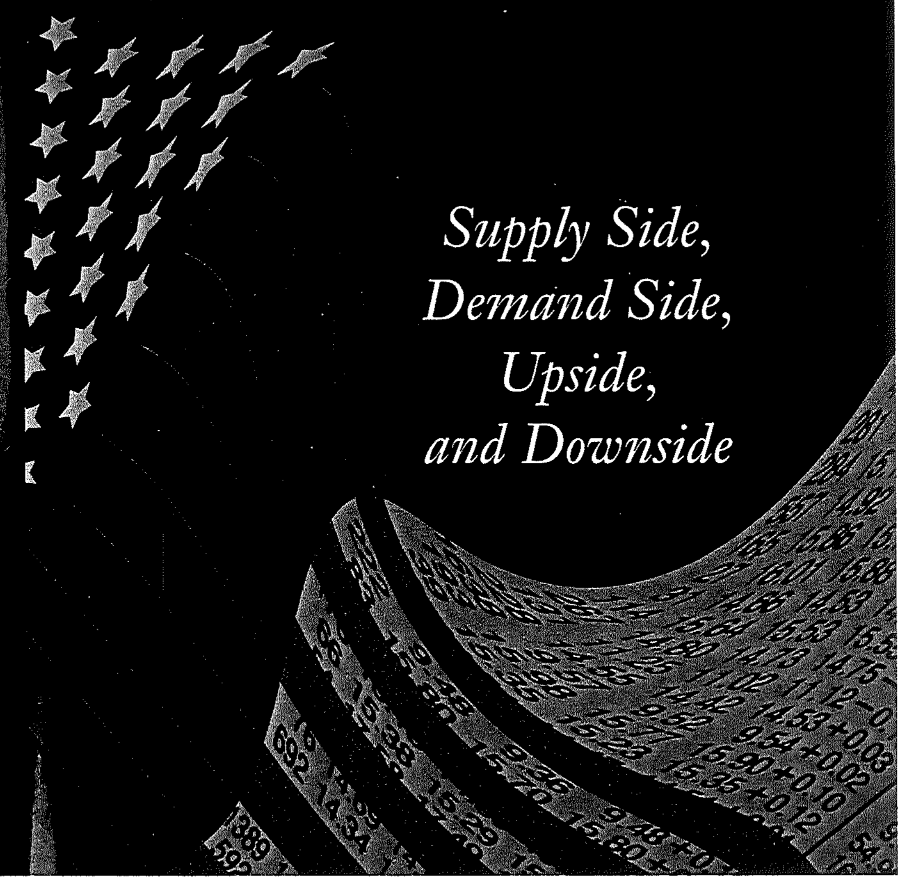

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MARK H. MOORE

Privatizing Public Management

PUBLIC ENTHUSIASM FOR the ideas of privatization and marketization has had a profound impact on the way America thinks about the proper scope of government. By the *scope* of government, I mean the set of purposes that citizens have asked the government to assume responsibility for achieving. Those who embrace the ideas of privatization and marketization often say, for example, that government should interfere as little as possible with the natural workings of a private economy, or they say that government should stick to its "core competencies" and resist being dragged into areas in which it cannot perform well. These are claims about the proper reach of government in society.

The ideas of privatization and marketization have also had an important impact, however, on how Americans think about the means government relies upon to achieve its mandated ends as well as the ends themselves. For example, governments are urged to take advantage of market-like mechanisms to help them achieve their objectives; to take maximum advantage of private enterprise in the pursuit of public goals; and to run public organizations in more business-like ways.

The current popularity for the business model of government signals another important belief about privatization and marketization: the idea that management ideas from the private sector can make an important

contribution to the way that public bureaucracies are managed. Government organizations, for example, are now expected to focus on "customer service" and to develop measurable "bottom lines" to enhance their accountability to citizens and motivate their efforts on improving performance. It is also thought that government would become more efficient if it made less and bought more—that is, if government contracted its work out to efficient private sector enterprises rather than continuing to rely on rigid, inefficient government bureaucracies.[1] These three notions—customer service, the bottom line, and contracting out—are at the heart of the privatization model of public management.

Improving Customer Service

Of all the ideas about the model of private sector management in government, the one that has probably had the broadest and most subtle impact has been the notion that government as a whole could best be conceptualized as a large "service enterprise" that lives or dies on the quality of service it provides to its customers. Just as the private sector had to learn that it could not take customer loyalty for granted, so the government has to give up the arrogance that goes along with bureaucratic power and work harder to ensure that citizens' encounters with their government are convenient and satisfying. Just as the private sector had to learn to be highly responsive to changing and heterogeneous customer demands, so the public sector needs to abandon its rigid, autocratic bureaucracy in favor of a corps of flexible civil servants who want nothing more than to be of help to citizens who contact them for assistance. This idea is considered so self-evidently meritorious that the administrations of both Bill Clinton and George W. Bush have based their management agendas on the concept of customer service.

There is much to commend this particular idea. Anyone who has had a government window snapped shut in her face, or has waited in a long line to be told that he lacked the appropriate documentation for some privilege he sought, can immediately understand the virtue of better treatment. To the extent that the focus on customer service has caused government organizations to make themselves more respectful and more conveniently accessible, all Americans can be grateful for the result. Yet the idea that the individual citizens with whom government interacts should be treated as customers has some deeply problematic aspects. To understand the problem, it is important to look closely at the idea of "customer" in the private sector and see how it carries over into the world of the public sector.

Customers in the Private Sector

The idea of a "customer" in a market has at least three important connotations. The first is that a customer has a particular location in the "value chain" that constitutes the productive processes of an enterprise. Customers are encountered in individual transactions at the business end of the organization, where the rubber meets the road, so to speak. They are the ones who get the specific product or service that the organization supplies.[2]

The second is that the customer is also the person who pays for the product or service and, in so doing, provides the financial wherewithal for the organization to carry on. At the outset, of course, before an organization is actually producing products and services, it secures resources through capital financing. That capital financing, however, will only last for a while. In the end, financial sustainability and organizational survival depend on actual customers who are willing to pay for the product or service being offered and at prices and in quantities that will more than cover the costs of producing the products and services.

The third and least commonly acknowledged but perhaps most important idea about a customer in the private sector is that it is the customer's satisfaction that provides the ultimate justification for the private firm's existence. It is tempting for someone who has been operating in the public sector, coping with problems such as the relief of hunger or the care of the handicapped, to look at the products and services produced by the private sector with a certain disdain. What, they might ask, is the value of producing such useless things as lemon-scented furniture polish or hula hoops when there are so many other urgent problems in the world? Compared with the importance of the products and services the public sector provides, where is the value in such trivial products?

Yet private sector managers have a pretty convincing answer to this question. They simply note that such things are presumed to be valuable because individual customers are willing to take hard-earned money out of their pockets and plunk it down on the counter to buy them. In doing so, customers are giving fairly incontrovertible evidence that they value these products and services and, furthermore, that they value them at a price in excess of the cost of production. To the extent that society as a whole thinks

it is socially valuable to organize itself to satisfy individual consumer desires, then, one can say that a certain kind of public value is being created by the production of lemon-scented furniture polish and hula hoops. It is this kind of reasoning that provides the social justification for the spread of markets and that makes the enhancement of customer satisfaction an important normative as well as instrumental goal of private sector organizations.

Customers in the Public Sector

These three ideas associated with the idea of "customer" in the private sector point to quite different actors when the "customer" is transferred to the public sector, and there is no actor who combines all three qualities. In the first sense, as the individuals who receive the product or service an organization is producing, it is clear who the customers of government are: in a school system, it is the student (or perhaps the parents); in the health-care system, the patient; in the employment training sector, the unemployed worker hoping to learn skills; in the welfare sector, the unsupported mother seeking financial help in caring for herself and her children. These people all resemble customers in the private sector in that they receive the products or services delivered by public sector enterprises. They also, for the most part, seem both to benefit from and to like the service they receive.

As the individuals who occupy the position at the tail end of the production process, and appear as beneficiaries, however, the "customers" of government may lack some other important characteristics of customers in the private sector. Most important, perhaps, these individuals typically do not pay the full cost of the product or service they receive. (If they did, the enterprise would not have to be publicly supported in any way.) Typically, the public as a whole is subsidizing the cost of these services with tax dollars.[3]

If it is the public as a whole, rather than those who directly receive government services, that pays for the delivery of those services, then an important question arises as to whose satisfaction constitutes the normative justification for the enterprise. One can argue, of course, that the point of a government enterprise is to make its clients happy—to make sure that students like school, that patients feel well cared for in hospitals, that the jobless find their training programs inspiring and helpful, that welfare recipients feel that they are treated with dignity and compassion. It is quite possible that the public that is paying for the service would agree with this idea; given the opportunity, they might write into the mission statement of the organization that their aim includes the important goal of making its clients happy in addition to any other goals it might have. In this case, the potential tension between the ambitions of the collective and the satisfaction of the individual clients would be resolved decisively in favor of satisfying the clients.

The public often has other goals, however, in addition to satisfying clients. For example, in schools, society has the goal of educating children, not just pleasing them. It wants the children to learn to read and write, whether or not the children or their parents share this goal. Similarly, in health-care settings, the quality of the care is not judged simply by whether the rooms are comfortable and the staff treats the patients politely (the service shell that could be wrapped around low-quality medical care to make it feel good to the patients); quality care is also judged in terms of whether it achieves the socially (and individually) desired result of restoring health. Given the importance of the second goal, the public may quite appropriately deliver high-quality medical service stripped of its attractive wrapper of customer service. In the context of job training and welfare programs, it is also true that society has ambitions for these clients that differ to some degree from merely satisfying their desires. We want the poorly skilled to learn trades and get jobs, not just to enjoy themselves; and we want welfare recipients to find ways to reduce their dependency on the state.

Indeed, the fact that society has interests in such programs beyond the satisfaction of the clients is clear in the ways in which such programs are evaluated. If the clients of government programs had the same normative importance in the public sector that customers have in the private sector, government programs could be evaluated simply by asking the clients whether they valued the services they had received. If they said yes, and claimed that they would have been willing to pay at least as much as the cost of providing the service to them, then the program could be presumed valuable. That is not generally how government evaluates social programs, however. Instead, government tries to determine whether the program achieved the outcomes that society had in mind when it launched the program. Did children learn to read and write? Did patients' health improve? Have the unemployed found jobs? Have welfare recipients been able to care for their children and gain economic independence? If these social goals (in technical language, social, rather than individual, "utility functions") are achieved at a reasonable cost, the program is considered to have been socially valuable, and if the social goals are not met, the program is deemed a failure—regardless of client satisfaction.

This is not to say that client satisfaction is unimportant or entirely irrelevant. As noted above, authorization of a particular program might have included the mandate that the program should satisfy its clients. Indeed, the appropriateness of requiring government to pay attention to some aspects of individual citizen satisfaction has long been recognized and is the basis for granting the individual certain constitutional rights. These continue to have significant force in shaping the kind of services government provides in the domains of education, mental health, juvenile corrections, and so on. To the extent that such goals are present in the authorization for a government program, either as expressed aspiration for the program or as constitutional rights, the collective has enshrined concern for the welfare of individual clients as an important goal of a policy or program.

Even if the goal of satisfying clients (or protecting their rights) is not written into the policy instructions that guide public managers, however, government might still be interested in producing client satisfaction as a means to social ends rather than an end in itself. That is, in organizing a school, or a hospital, or a training program, or a welfare program to achieve social goals other than client satisfaction, the collective, or the managers who act in their name, might decide that the social goals can only, or can best, be achieved if the program is operated in ways that made the clients happy. They could decide, for example, that it is important to students' learning that they like school, not merely endure it. They could decide that it is consistent with the aim of helping welfare recipients to get off the dole to treat them with dignity and respect. Thus client satisfaction can be viewed as an important way of efficiently and effectively accomplishing the socially desired result.

Whether the collective views client satisfaction as an end or a means, however, what is important here is that the collective gets to decide on how it will value individual client satisfaction in its collectively financed enterprises. The collective's preferences count because it is the choice of the collective to tax and regulate themselves to produce the desired social result that established the public program. That choice may have given more or less standing to the satisfaction of individual clients as an object of public value.

The Delivery of Obligations

Government is not only in the business of providing services to clients. It is also in the business of imposing obligations on individual citizens. This is most obvious in law enforcement organizations. Do people serving time in prison or arrested for a crime think of themselves as receiving a service? Would society as a whole think that the point of corrections departments and police departments is to make their clients happy?

Similar issues arise in regulatory agencies designed to keep the air and water clean or the workplace safe. Here, too, the clients of the organizations are typically firms that may receive some technical advice from the government in learning how to reduce the pollution or workplace hazards created by their production practices but also often find themselves faced with obligations to change those practices. These issues arise in tax-collecting agencies, as well. Taxpayers may receive the help of the organization in understanding exactly what they owe in taxes, but ultimately they face obligations to pay up on pain of civil and criminal sanctions if they fail to comply.

Authority As an Asset

What is interesting about these situations is not only that clients are receiving obligations from the government, rather than services, but also that the government is deploying a particular asset, one that private sector firms typically cannot deploy: in these cases, the government is using its authority, rather than its money, to accomplish social purposes. To many, it seems odd to think of authority as an asset for the government. For one thing, legitimate authority lacks a physical form. We can see the effects of authority when it is exercised—we note when the tax collector has cashed our check, we are clear about the moment when the policeman demands that we drive more slowly or stand still to answer questions, we can see the regulatory inspector shut down a polluting firm. However, we cannot see and count the stock of authority that the state has at its disposal; we can only see the flow of authority as it is used.

Similarly, it is not clear that authority can be used up and consumed like other assets. The legitimacy of the state's authority can wear thin with use. Indeed, it might wear out particularly quickly with frequent abuses of authority. It is likely that as the state's legitimacy ebbs, it may have to use more physical coercion to achieve the same compliance with its rules that it once got when it enjoyed greater legitimacy. This suggests that authority can, in some important sense, get used up. The effective authority of the state can also increase with the use of it. Indeed, that is the whole idea of deterrence: that the authority of the state can be used in ways that magnify its effect. In these respects, authority is unlike other kinds of physical or economic assets.

Finally, authority is not usually thought of as achieving a result nor as justifiable based on its utility in producing a particular result. In the common conception, the use of authority should be guided by ideas of justice: of what individuals owe to one another and of what the state can expect and demand of individual citizens as a matter of principle. Authority is not to be dragged out any time it is useful. There has to be some idea that it is right to use authority, that the person who feels the obligation can understand the reason for it, as well as understanding its usefulness.

These important observations tend to undermine any simple claim that it would be possible to think of authority as an asset of government. Yet it is also important to recognize that authority is, in fact, an important asset to government in at least two significant senses. First, authority can be used interchangeably with money to achieve some desired social results. If an important goal of government is to provide for the common defense, for example, then the collective can achieve that result in either of two ways: it can raise money and offer to pay people to serve in the military, or it can institute a draft. The first method uses state money to accomplish the goal; the second uses state authority. If it wants to clean up the air and water, it can do so by offering to pay polluting firms for the costs of cleaning up or by compelling the firms to stop dumping pollutants in the air and water through the use of regulation. Again, it can use either money or authority to accomplish the job it has been assigned to do.

Authority might also be similar to money in the sense that society is as interested in economizing on its use as it is in economizing on the use of tax dollars. Generally speaking, public enterprises depend on both money and authority to achieve their purposes. Both are taken from private individuals to achieve public purposes. The money is taken from private consumption, the authority is taken from private liberty. Because liberty is highly valued in our society, it is reasonable to suppose that citizens would prefer that the least possible authority be used in accomplishing a particular purpose, on the premise that it is better to induce people to contribute to public purposes than to force them to do so. When force becomes necessary, we might want it to be used legitimately and appropriately.

The use of force differs from the use of public money in important ways, however, not the least of which is the normative framework used to evaluate it. In judging the use of public funds, we are usually primarily interested in how efficiently and effectively the funds have been used. This is a concern with the use of authority, as well. But in an evaluation of the use of authority, the focus often is on how justly or fairly, rather than how efficiently, the authority was used. We want to be sure that individuals were treated justly, that they "got what they deserved," and that their rights were protected. In short, the use of authority to accomplish goals invokes important concerns about equity and fairness as well as efficiency and effectiveness.

Most of the money that government uses to accomplish collectively defined purposes is raised through taxes—that is, through the use of collectively owned authority. If it is true that the money government uses to accomplish its purposes relies on authority, then it seems reasonable to suppose that some of the special concerns that attach to the use of authority would also attach to the use of government tax dollars. Like authority itself, money raised through the use of authority has to be spent not only economically but also fairly. This follows as a natural consequence of viewing authority as a collectively owned asset that can be used only for the benefit of all and of recognizing that government money is raised through the use of authority. Government cannot spend money for efficiency reasons alone; it must spend it fairly to produce certain kinds of equity as well.

Insofar as government is concerned about producing equity in the pursuit of substantive objectives as well as the substantive objectives themselves, then what it means to be a customer of government is again transformed. Equity brings in some notion of individual entitlement or desert as well as a notion of socially recognized need or individual ability to pay as characteristics that guide the flow of governmental activity to particular individuals. To the extent that government programs are designed to produce equity—that is, to give to individuals what the collective has entitled them to receive rather than what they need, want, or are willing to pay for—collectively defined goals, once again, trump individual desires. Here, however, the social goals include justice and fairness (as it has been collectively defined) rather than simply the efficient production of goods and services or the achievement of desired social outcomes.

In sum, the idea of a customer translates rather badly into the world of public sector production and management. Those whom government agencies meet as individual clients at the tail end of their production processes do not pay for the service. Nor does their satisfaction constitute the important justification of the enterprise. The welfare of the clients can be counted as important and socially valuable if the collective has so stated or if it turns out to be an effective means of achieving desired social results. One cannot assume at the outset, however, that the point of the exercise is to satisfy the clients.

Furthermore, both in circumstances in which society is providing services to clients and those in which they are bringing obligations to bear, public sector enterprises must be able to show that they operate fairly as well as efficiently and effectively. This follows from the fact that government authority is nearly always being used in some way when the government takes action on behalf of collectively defined ambitions, and, as a normative principle in a democratic society, government authority has to be used fairly as well as economically and effectively. Because fairness is not simply a property of the subjective experience of the client but is also a socially defined quality both in individual transactions and in the aggregate operations of a public sector entity, the overall social value produced by a public organization departs even further from individual valuations of what the organization produces. Government enterprises are in the business of achieving collectively defined goals with the least and fairest possible uses of the money and authority of the state. They are not in the business of satisfying customers.

Defining the Public Sector's Bottom Line

A second important managerial idea brought to the public sector from the world of private sector management is that government managers should create a functional equivalent to the private sector's famed "bottom line." The basic assumptions are that this will help public sector agencies become more accountable to their citizen-owners; force them to think carefully and concretely about what they really mean to accomplish; and improve performance in the organization's operations. As with the idea of "customer service," the idea that government agencies should create bottom lines for themselves is considered so self-evidently sensible that legislatures throughout the country have passed legislation mandating the development of "performance measurement systems" that can reveal the value produced by public organizations as reliably as private sector financial measures reveal the value they have been able to produce.

Again, there is much to recommend this idea—more, I think, than the idea that government should focus on customer service. Indeed, I count myself one of the most ardent supporters of the notion that government should make major efforts to improve the measurement of its performance. Developing and relying on such measures is, in my opinion, probably the single most important thing that can be done to improve the performance of public sector organizations.

Yet, once again, we must be careful in transporting an important private sector idea into the public sector environment. The difficulties in translating the concept of a "customer" both signals and helps us to understand the ways in which it is necessary to reconstruct the simple idea of business's "bottom line" in a useful form in the public sector. To see why this is so, it is necessary to understand what the "bottom line" is in the private sector and why it has the power it seems to have in producing improved performance in private sector organizations.

The Bottom Line in the Private Sector

The "bottom line" in the private sector is a financial measure. Specifically, it measures the relationship between the revenues a firm earns by selling its products and services to willing customers, on one hand, and the costs of producing those products and services, on the other. If revenues exceed costs, we say that the enterprise is profitable.

The fact that a firm is profitable means a lot. As a practical matter, it means that its investors can be paid and its managers and employees can anticipate continued employment. The fact that a private firm makes a profit also means, however, that it is plausible to assume that the firm has created value. This follows from accepting two important ideas: first, that the customers' valuations of the organization's outputs were recorded with some precision through their voluntary choice to buy them at a particular price; second, that the real social costs of producing the goods and services were accurately reflected in the prices that the firm had to pay for the materials, labor, and capital it used to create the products and services. If consumers valued the product at more than the cost of producing it, then arguably value has been created by the firm's operations.

The financial bottom line is a relatively clear and objective way of summarizing and assessing the net value that a firm produces. Because it is so clear and so objective, simple reporting of the facts tends to end arguments about whether the firm has been successful. Consequently, instead of arguing endlessly about what constitutes good performance, the firm can focus its attention on producing results. That makes the firm much more disciplined and focused.

For the bottom line to carry behavioral power, the information on which it is based must be relatively inexpensive for a firm to gather and

must come in quickly and continuously. A private sector firm can understand its costs simply by keeping track of its expenditures. (This is routine cost accounting.) It can understand the value it produces simply by keeping track of its revenues. (This is routine financial management.) The firm does not have to spend time and effort going outside the boundaries of the organization to find out how the customer actually used the product and whether it really did improve the customer's quality of life in some way. Nor does it have to wait to see what effect the product or service has had on the customer. All the relevant information about value is present as the cash crosses the counter.

Private sector firms get a huge amount of information about their performance from their financial management systems. They know their costs. They know their revenues. They can interpret their revenues as a reliable expression of the value of their output. They can directly compare revenues to costs, and they can do so for a wide variety of products they produce. In all these ways, the bottom line is truly a powerful idea in the private sector. It would be terrific if the public sector could have something comparable.

A Bottom Line for the Public Sector

As in the case of "customer service," however, the idea of a bottom line has to make a somewhat tortuous journey as is crosses from the private to the public sector. The identification of the economic and financial costs of producing governmental output remains pretty much intact as it crosses from the private to the public sector. In principle, it should be no more difficult for public sector managers to discover their costs than for private sector managers. After all, government managers pay prices for factors of production just as private firms do. Those costs register in expenses the organization makes. All they need do to understand their costs is to apply the elementary principles of cost accounting.

The problem arises, however, when government managers try to capture the information contained in the second part of the bottom line—namely, the "revenue" number. Government agencies have financial revenues, of course. They need money to buy the materials, pay the salaries, and maintain the buildings in which they carry out their operations. Some of these revenues might even be earned by charging clients fees for particular products and services. For the most part, however, the financial revenues used by government agencies do not come from the sale of products and services to willing customers. They come instead from taxes imposed on the general population to support a collectively decided purpose.

This fact has three important consequences for public managers. First, it changes our ideas about who determines the value of the output of the public agency. If customers are not spending their money to buy government's products and services, then how is the value of those products and services to be determined? The answer is that it is the collective, acting through the (admittedly clumsy) machinery of representative government, that is assigning value to public sector output. It is the purposes set out in policy mandates and organizational missions, authorized and approved by legislatures and refined in executive branch policymaking—not the clients—that define the value produced by public sector organizations.

Second, if the public sector is earning its revenues not by selling products and services to customers but instead by achieving social purposes and goals that have been established by a collective process, then the metric used to define the value produced by the organization must change. The financial revenue measure does not serve the purpose, because this figure no longer has the meaning it has in the private sector. The financial revenue measure for government is a statement about the amount of money the collective has authorized to be spent on behalf of a particular purpose; it is not a record of the value that customers place on the output of the organization. The accurate measure of performance has to be, instead, some kind of social impact analysis that allows the collective to determine whether and to what extent the organization has succeeded in achieving the goals the collective has set for it. That analysis will typically be carried out by observing the effects a government program or policy has had on some objective social conditions: for example, whether drug use has been reduced, whether welfare clients have made the transition to work, whether an epidemic has been avoided through the use of immunization, and the like.[4]

Third, without revenues generated by the purchases of willing customers as a handy summary of the (gross) value produced by the organization, government managers will need more than a financial accounting system to measure the net value of their output. In fact, when they look at their financial statements and learn whether they have operated within budgeted revenues, they know nothing about the value of what it is they have produced. They know only whether they have stayed within the financial bounds of what the legislature was prepared to spend on a particular venture—whatever the results, and the value of those results, might be.

The fact that financial revenues do not measure the value of governmental output in the public sector is critical for the management of government agencies. Consider what an automobile manufacturer in the private sector would do if he could have all the cost information he wanted but knew nothing about the revenues he had earned from the sale of cars. It should be obvious that he would be in a lot of trouble. He would probably try to work his way out of trouble by doing many of the things that government managers try to do. He would conduct surveys to determine how much his customers liked the cars they bought. He would ask different kinds of engineers to set standards for what constituted a "good car" and see how closely his cars matched those standards. He might even try to find out how his cars were being used and whether they were improving the quality of individual and social life. The point is this: he would face serious challenges in determining the value of the cars he produced if he were denied information about how much customers had paid for his product.

As a practical matter we have only a few limited methods to use to gauge the value of public sector output. In the past, we have relied principally on such techniques as program evaluation, cost-effectiveness analysis, and benefit-cost analysis.[5] The difficulties have been sufficient to dash the hopes of many who thought that these techniques could fully compensate for the lack of a bottom line in government management. These techniques themselves have lacked the objectivity and simplicity of the bottom line.

There is a further problem, however. The techniques of policy and program evaluation have as their underlying unit of analysis a policy or a program. The private sector's financial balance sheet, in contrast, has as its underlying unit of analysis an organization. One might imagine that this is not a great problem—that one could easily construct some kind of crosswalk that would transform policy or program numbers to organizational numbers. This turns out to be not quite true, however. Many public policies, for example, rely on contributions from many different organizations. Similarly, many organizations consist of bundles of policies and programs that are spread across organizational subunits. Moreover, many of the policies and programs within an organization depend on contributions from other public organizations to achieve the desired results.

The most difficult problem, however, is probably that government organizations are more than the sum of the policies and programs in whose implementation they have a role. Certainly no one in the private sector would think that a private sector organization is simply the sum of its current product lines. A private sector organization has been constructed to develop synergies among its product lines. It has developed a brand and a reputation within particular markets that transcend particular products. It has information and strategic planning systems that allow it to search for and find higher-value uses of the organization's assets. It is this whole package that is valued in the market, not just the performance of the organization in its current product lines.

Consequently, the value of a public sector organization might not lie simply in the summation of the value of the policies and programs for which it is responsible or to which it is contributing some portion of the effort. Interestingly, the General Accounting Office once tried to develop a method for conducting an evaluation of cabinet-level organizations as a whole, viewed over time. It called the evaluations its "general management reviews." The aim was to go beyond its usual methods of evaluating organizations, which generally consisted of two different kinds of evaluations: an examination of the organization's administrative systems, to determine whether they were in good shape, and program evaluations and benefit-cost studies of particular programs within the organization's jurisdiction. Instead of the limited views provided by these methods, the General Accounting Office wanted a picture of the organization's performance as a whole over a five-to-ten-year period—the kind of information that private investors have about firms in the private sector. Significantly, this effort failed. It failed partly because of technical difficulties: it was difficult to develop measurement tools for doing this work. But it also failed because of lack of congressional support: it was hard to find someone in Congress who was really interested in organizational performance as opposed to policy impact or program accomplishment. It was hard for elected representatives of the people to think about the value of public sector enterprises as organizations as distinct from policies or programs.

One might conclude from the foregoing that the only way to develop a bottom line for government is to somehow improve our methods of program evaluation and benefit-cost analysis. That might be true. The difficulty, however, is that such program evaluations are expensive to conduct, and only a few of any agency's organizations will be subject to serious evaluations in any given year. Moreover, by the time the information from such studies becomes available, the program has already been operating long enough to produce the effects that originally justified it. That means that it is hard to use this information in the short run to hold managers accountable for performance in real time as they are making decisions and spending resources.

The implication of these observations is that the public sector is currently stuck with two inadequate systems for measuring its performance. Its financial system, unlike the financial systems in private sector firms, cannot tell the agency much about the net value of what it is producing because it lacks the important piece of information that comes from individuals' directly valuing the products and services (and obligations) it delivers. On the other hand, program evaluations and benefit-cost analyses cannot be done comprehensively enough or quickly enough to make them useful to management in running organizations.

One possible answer to this dilemma would be to rely more on customer surveys of government clients. That is the line recommended by those who favor focusing on customer satisfaction. Such surveys might well be useful—even surveys of those who receive obligations from the government. The value of the information that comes in from customer surveys will be inadequate, however, for the reason noted above: namely, that the government is interested in more than customer satisfaction. It is also interested in knowing whether collectively valued results, encoded in policy mandates and mission statements, have been achieved, regardless of the satisfaction of the clientele.

A better answer might go something like this: First, government managers need to have detailed negotiations with their elected overseers about what constitutes value-creating performance and the terms to which they will be held accountable. Second, government managers need to construct and maintain measurement and reporting systems that make their operations transparent to their overseers on the dimensions of performance that concern them.

In all likelihood, this process would generate the need to collect information about many different dimensions of government performance. It would also put pressure on government to measure not only outcomes but also processes and activities. In evaluating the performance of a welfare program, for example, some overseers would be primarily interested in how well the clients were treated and whether their dignity and privacy had been respected. Some would be interested in determining whether the program had been successful in helping them make the shift to gainful employment. Others would be interested in the amount of money that had been lost to fraud. Still others would be interested only in the overall cost of the program.

To some, the idea of multiple measures of government performance, and measures that would cover not only outcomes but also outputs, processes, and activities, violates important ideas about how government programs should be evaluated. Instead, they feel, evaluations of government should focus on outcomes only, not outputs and processes, and should yield a single measure, equivalent to the bottom line of the private sector. Policymakers looking at multiple measures of performance will have to face the problem of how to add all the measures together to decide whether the program is valuable, all things considered; it will not be possible to isolate output and process to determine their effect on the achievement of desired results.

These objections are all valid: it is difficult to establish on an "objective basis" the (net) value of what government is doing. On the other hand, some real benefits are associated with constructing a scheme that has multiple measures covering costs, processes, and outputs as well as outcomes.

First, American citizens are interested in costs as well as in outcomes. Indeed, it is important to remember that the bottom line is a multiple measure: it includes both revenues and costs. It is converted into a single number only through a function that relates revenues to costs. In the public sector as well as in the private, we are not simply interested in maximizing the value of the output independent of cost; we are interested in maximizing the difference between the values of the resources used and the output generated.

Second, American citizens often place a value on the way government operates as well as the results it produces: we want to know that the government has distributed its resources according to some agreed-upon notion of desert, as well as need; and that it operates fairly and properly in its encounters with citizens, as well as producing outcomes. Third, those who authorize public activity often do so for different reasons, or they emphasize some values in a public policy decision over others. If authorizer A values effects x and y, and authorizer B values effects y and z, A and B can probably make a deal to authorize the policy, but they will evaluate the impact of the policy in different terms and will want different kinds of information about what the policy is producing. For all these reasons, multiple measures seem better than single measures; and measures that focus on costs, activities, outputs, and outcomes more useful than measures that focus only on outcomes.

Interestingly, this conclusion about what is necessary and desirable in the measurement of public sector performance is increasingly being embraced by private sector companies as well. The most sophisticated private sector companies are relying less exclusively on financial measures to guide their decisions and operations than they once did. They are, instead, increasingly employing a "balanced scorecard" that uses multiple measures distributed across the "value chain"—leading from fungible resources to concrete outputs, evaluated by customers not only in the short run, at the time of purchase, but also over the long run, as they maintain or abandon a relationship with the company. In this respect, the private sector is moving by choice toward a process that government must of necessity embrace because its financial scorecard gives it inadequate information.

Contracting Out

A third influential idea about public management that derives from market ideas is the notion that government should contract out more of its activities to nongovernmental producers. Again, there is much that is useful in this suggestion. It emphasizes the important difference between deciding that some goal is worth public financing and selecting public bureaucracies and government employees as the best way to produce it. It reminds us that the public might agree collectively on an important goal, and agree to tax and regulate itself to produce that result, but decide to use the money so raised to pay some nongovernmental agency to achieve that result.

Presumably, the decision to contract out would be a good one if the nongovernmental organization were capable of achieving the desired results more efficiently, more effectively, and with more responsiveness to clients than the government bureaucracy that was the principal alternative. Because government bureaucracies are often thought of as expensive, rigid, indifferent to the quality of service they provide to clients, and slow to innovate, it is not hard to believe that public services could be delivered more effectively and responsively by private organizations.

The private sector firms with whom government might contract include both nonprofit and for-profit firms. Both kinds of firms are private in the sense that they are legally independent of government control. They are publicly accountable through their boards of directors, whose only obligations are to act in accordance with the broad principles of corporate accountability. Unlike public agencies, they are not directly accountable to elected public officials who can direct and control their operations.

Of course, to the extent that they sign a contract with a government agency to produce particular results, using particular means, both nonprofit and for-profit organizations become accountable to the government for that portion of their operation that is covered by the government contract. The difference is that some kind of boundary exists between the state, on one hand, and the nongovernmental organizations, on the other. The nongovernmental organizations are free to do what they want with that portion of their resources that does not come from government. They are also free to refuse to do business with government and to seek revenues from other sources, such as the sale of products and services to customers in private markets or the solicitation of charitable contributions.

This "independence" from government is potentially useful and important to both sides of the contractual agreement. It gives both the nonprofit and the for-profit organizations a bit of latitude and discretion in deciding how they will do their work, without government oversight over all of the details. For example, both for-profits and nonprofits are free to experiment with new methods for achieving public purposes in ways that would be difficult for public sector organizations to do. They can "gamble" on new processes, using their own resources in ways that government might find reckless and irresponsible. This gives the private organizations a greater capacity to innovate in the general methods to be used in curing illness or providing job training.

These private contractors also have some discretion in adapting the way they respond to heterogeneous client populations. If they have contracted with the government to produce outcomes, rather than to deliver services in a uniform way, they are free within the bounds of their contract to deliver different services to different individuals as is necessary to achieve the results. They are not necessarily bound, as a government bureaucracy might be, to treat all clients alike.

Nongovernmental organizations have this freedom to innovate and adapt to heterogeneous clients at least in part because their operations are not wholly accountable to politics and government but only in that part of their operations that is covered by the government contract. In contrast, a public bureaucracy would be entirely accountable to politics and government. As a result, when the government agency tried an innovation that failed, or when it responded differently to different cases, it would be vulnerable to charges of reckless incompetence and unfairness.

To many, the independence of the nongovernmental organizations (even when bounded by a contract with the government) is the problem, however, not the solution. They worry that, in the discretionary spaces left to the private contractor, the private contractor will make choices that would depart from the values and aims of the society and its surrogate, government, and that to that degree, some important public value will be lost. They worry, for example, that a for-profit firm contracted to provide job training programs will respond by recruiting the candidates who are easy to train and ignoring the others. Such conduct would be fully consistent with a public contract that paid the private firm for socially desired outcomes (for example, successful placements). It would also be consistent with the private firm's desire to maximize its profits because it would allow the for-profit firm to keep its costs low while achieving its contractually mandated results.

This conduct might not be consistent with the goal of the public, however, who might think it more publicly valuable to train the hard-core unemployed than those who were only temporarily unemployed. They might have this view on the prudential ground that training the hard-core unemployed would reduce future problems and government payments more than training those who might be able to improve their circumstances on their own and would not, in any case, be as significant a problem. Alternatively, they might have this view on the justice ground that the worst off are most deserving of assistance. In either case, the public would not have gotten what it valued from the private firm. Another common worry that applies more to contracting with nonprofit organizations is that such organizations might display favoritism toward clients with the same religious commitments or ethnic origins as those who initiated or sustained the nonprofit organization. The fear is that any discretion left to those who use government assets will end up being used for purposes that are important to those actors rather than for purposes that are important to the public.

There are only a limited number of ways of coping with this "agency" problem. One can try to write rules that reduce or guide discretion so that the agents can be held accountable for producing what the public wants; or one can rely on the judgment of the agents one hires to carry out the purposes. The first is, in many ways, the bureaucratic solution. The reason that government has so many rules is precisely because its demands for accountability are so high. The public wants to be sure that every scrap of public money and public authority it has granted to a public purpose is used efficiently, effectively, fairly, and justly to produce the desired results. The public quite rightly worries that if the people who spend the government's money and authority are given too much discretion, they will abuse it.

They will steal. They will become lazy. They will try out their own uninformed ideas about how to accomplish the assigned task. They will express their unreasonable prejudices. To control these problems of fraud, waste, and abuse, governments write detailed policies and procedures and enforce them through close supervision—all of which increase the costs and reduce the flexibility of government operations.

The second option, relying on the discretion of the agents one hires, might be realized in government operations if Americans could somehow trust the professionalism and commitment of government employees. There was a time when we did—when we thought that government employees were not mere bureaucrats but public servants professionally trained for their jobs and morally committed to pursuing public rather than their own individual purposes. Now, however, because Americans no longer trust their public officials and have found the limits of trying to control officials' behavior through rules and direct supervision, attention has shifted to a different kind of agent to pursue our public purposes—not a bureaucrat but a government contractor from the nonprofit or for-profit sector.

In terms of dependence on the discretion of the private contractor, there might be important reasons for the government to prefer contracting with a nonprofit rather than for-profit enterprise. A nonprofit organization, for example, does not seek to maximize a financial return for its owners. Its "capital" is charitable capital and does not demand payment for its use. Furthermore, a nonprofit organization can often add voluntarily contributed resources of money, time, and material to its production processes, thereby reducing the price it would have to charge the government to achieve the same result. Finally, one might suppose that many employees of nonprofit organizations work for love of the cause as well as their paychecks; this might imply not only that the nonprofit would be less expensive but also that it would be more reliable in the execution of its duties. These features, if true of nonprofit organizations, would give them a cost and quality advantage over for-profit firms.

Indeed, the reason to be concerned about using for-profit firms as contractors is precisely that their goal is to maximize financial returns. This means that they will treat the performance standards set by government as a constraint and will use any discretionary room that is left to them in the contractual arrangements to maximize their financial returns. Thus, unlike a nonprofit organization, which has less reason to try to maximize financial returns, the for-profit firm will shift residual value in the operations to the owners of the organization rather than either the clients or the employees.

Of course, nonprofit organizations have their own characteristic vulnerabilities as agents of public purposes. Some worry that nonprofit contractors may behave in discriminatory ways, others that the nonprofit will be so serious in the achievement of its mission that it will be indifferent to the costs, spending more on achieving results it deems valuable than on the results the public values.

To address these concerns, government could rely once again on the strategy of trying to control discretion through rules—in this case, by writing more detailed contracts. However, these contracts come increasingly to look like the dense structure of policies and rules that we formerly relied on to control bureaucrats. The thickly structured contract may take away the very flexibility that was the original goal in shifting from directly producing government operations to contracting them out. The only thing gained is a temporary moment of freedom before the inexorable demands for public accountability reassert themselves and make their claims felt through the contracts that structure the relations between government and the organizations it is relying on to achieve its results.

Even if the benefits of contracting out are less than first imagined in terms of increasing the innovativeness and flexibility of government operations, contracting out might still be the best available option because it would allow the public to take advantage of competitive pressures to force cost reductions and quality improvements. In principle, of course, a government could structure competition into its own internal operations. It could, for example, treat different schools or different precincts of a police department as "profit centers," allocating both budget and responsibility to those schools and precincts that were performing well and taking away budget and responsibility from those schools and precincts that were performing poorly. It does not really do this, however, and would probably be prevented from doing so by the existing structures of political accountability and control.

The easiest way to take advantage of competitive pressures would be to put government activities out to bid. This would be particularly effective if private suppliers of the services government wanted to produce already existed. The government has long used this principle in buying things such as paper, desks, pencils, real estate, automobiles, and even vehicle maintenance. It has also used this principle for decades in contracting for such core government functions as the building of advanced weapons systems. It is now increasingly using this idea in the social services sector, as well.

An important question in setting up such competitive systems, however, is whether government agencies would be allowed into the competition. In one version of this idea, what was previously produced directly by government is put up for bid, and only private suppliers can bid for the work. This is commonly called "privatization." In another version, the work is put out to bid, and private contractors are encouraged to apply, but government agencies are also invited to bid for the work. This is commonly called "marketization." These two systems—privatization and marketization—could be evaluated along several different criteria: Which system is likely to make the most effective use of competition to drive down costs or increase quantity and quality for any given expenditure? Which is "fairer"? Which is politically more feasible?

A little reflection reveals that the marketization option is to be preferred to the privatization option on all grounds. Once the commitment to the use of competition has been made, there is no reason to restrict that competition to private suppliers. If former government bureaucrats are able to form enterprises that can do the job more efficiently, effectively, and fairly than private firms, then it would be to the public's advantage to allow them to compete. This would have the additional virtue of being fairer to government employees, who would otherwise be arbitrarily excluded from employment opportunities. To give special preference to private firms might advance the principle that the government should not take business away from private suppliers, but it would do so at a cost to the public if the public providers were, in fact, better than the private suppliers.

The key to successfully contracting out government business is the ability to say clearly, concretely, and completely what it is that the government wants to produce: that is, to define the value that the public is trying to capture through any given operation. This is, as it always has been, where the trouble lies. It is difficult for a collective to reach agreement on the precise attributes of public value that it wants to see produced in a given part of the public sector. Defining social utility functions in ways that they can be written into contracts is tough conceptually, analytically, and technically—and politically. The political problem will arise not from disagreement about the desired direction of change but from the difficulty to clearly define the relative importance of different attributes of performance.

To the extent that weakness shows up in our collective ability to define what we are trying to accomplish, an important vulnerability is introduced into the contractual system. Sloppiness in the definition of purposes will allow the private agents—whether nonprofit or for-profit—to advance purposes, using public resources, that the public does not necessarily want. It will also prevent competitive pressure from doing the work it is supposed to do because it will focus competition on getting better at things that are not necessarily valuable. On the other hand, to the extent that what the public wants can be clearly articulated, it may not be necessary to go to a contracting system. It may be possible to measure the performance of public sector organizations and hold them accountable for achieving the goals set for them.

The real key to producing more of what the public wants is not necessarily to be found only in new forms of administration. It lies instead in figuring out how to help politics and public policymaking become clearer in characterizing what the American public has collectively decided to produce. If that cannot be done, then no amount of administrative tinkering will save us; our ability to produce what we want will be limited, no matter what we do. On the other hand, if the goals and values can be clearly articulated, then all the tasks of managing to produce the desired result become much easier. We will know how to measure the performance of public sector organizations. We will know how to structure the competition among government agencies, nonprofit suppliers, and for-profit firms to ensure that costs are low in the short run and that they go down over the long run through the creation and adoption of important innovations. The problem in government management continues to be the difficulty of organizing politics to give a clear mandate of what is to be produced. That problem cannot be solved by pretending that "customer satisfaction" can best determine what government services should be produced or that "contracting out" will yield reduction in costs and improvement in quality when we have not been able to articulate what we intended to produce in the first place.

Conclusions

In the end, the most valuable idea that comes from the private sector is that government management should aim at the production of value: