

# Government Competition with Private Enterprise

LRC Staff:  
Randy Bacon  
Sharon Schneider

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**M E M O R A N D U M**

TO: Vic Hellard, Jr., Director

FROM: Randy Bacon/Sharon Schneider

DATE: July 1, 1986

SUBJECT: Government Competition with Private Enterprise

Resolutions HR 50 and SR 59, which passed during the 1984 session of the General Assembly, directed the Legislative Research Commission through the Small Business Task Force, to identify governmental activities which may be in competition with private enterprise and study the desirability of contracting out government services to the private sector. These resolutions reflected a continuing and growing concern among members of the General Assembly and within the Kentucky business community about the issue of government competition with private enterprise.

This memorandum examines this subject from several perspectives. It examines such competition generally, surveys action taken in other states as well as at the Federal level, describes the efforts of the Task Force on Small Business during the 1984-85 Interim, and addresses prospects for legislative action in this area.

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any goods otherwise available from private enterprise in the community was defeated in the Senate. A bill introduced in the House which would have established a private enterprise review commission to study government competition with private enterprise never got out of committee. Legislation has been enacted which directs a task force to study the issue.

#### Louisiana

In 1984, legislation was introduced in Louisiana which would have prohibited the government from providing goods and services offered by private enterprise, but the bill failed to pass.

#### South Dakota

Legislation was passed in South Dakota in 1984 which established the Private Enterprise Review Commission, but no funds were appropriated. In 1985, legislation was introduced which would have appropriated funds and extended the Commission, but this failed to pass.

#### Tennessee

In 1984, Tennessee legislation was introduced which would have restricted government and tax-exempt corporations from competing with private businesses. The bill would have also established a private enterprise review commission, but the legislation failed to pass.

#### Washington

Legislation was introduced in Washington in 1985 to establish the Fair Competition Review Commission, but it did not pass out of the committee. Hearings were held in November and December of 1985 to study the unfair competition issue.

#### California

Legislation restricting unfair competition was introduced in California in 1985, but was left pending in committee. Legislation is anticipated during the 1986 Session.

#### Missouri and Oregon

Bills concerning government and nonprofit competition with the private sector were introduced in Missouri and Oregon in 1985.

## Florida and Ohio

No legislative action has been taken in Florida or Ohio, but bills addressing the issue of government competition were expected to be introduced in their 1986 Sessions.

## Georgia

In 1985, a Georgia Senate Resolution established the Joint Small Businesses in Georgia Study Committee to study the issue and make legislative recommendations by December, 1985.

## Iowa

No legislative action has been taken in Iowa, but the Governor's Advisory Council on Small Business has been reviewing the issue of government procurement.

## Michigan

Legislation has been enacted in Michigan to direct the Department of Management and Budget to study all state departments to determine whether their activities unnecessarily duplicate the activities of nongovernment businesses.

## Nebraska

In 1984, legislation was enacted in Nebraska to study the retail sales of computer equipment by the University of Nebraska.

## New York

The Small Business Subcommittee of the New York Senate Committee on Commerce and Economic Development has completed a study on unfair competition and will make legislative recommendations for the 1986 Session.

## Pennsylvania

In 1984, a House Resolution was passed in Pennsylvania to direct the State Government Commission to form a task force to study ways the government can reduce competition with the private sector. In December 1985, House Resolution 201 called for a bipartisan study of business ventures by such tax-exempt organizations as universities and hospitals.

## Wisconsin

The Joint Audit Committee of the Wisconsin legislature is investigating the state's competition with private businesses and will make legislative recommendations.

## Maine

Legislation has been introduced in Maine to establish a commission to study government competition with private enterprise.

## Virginia

In Virginia, the Governor's Advisory Council on Small Business has recommended that a study be done on this issue. A task force of business representatives has also been formed to make legislative recommendations.

## Montana

A resolution requesting a study to identify government activities which compete with the private sector in Montana was introduced, but did not pass the Senate.

## Alabama, Arkansas, Delaware, Massachusetts, and New Jersey

No legislation is being considered in Alabama, Arkansas, Delaware, Massachusetts or New Jersey, but business representatives are concerned over the issue and would like to see legislative measures taken.

### III. Activity at the Federal Level

Contracting is not a new issue for the federal government, which has been using the services of the private sector in varying degrees since the time of the American Revolution. President Eisenhower, in his 1954 budget address, began a new trend in government, known as the "contract state," with these words: "This new budget marks the beginning of a movement to shift...to private enterprise federal activities which can be more appropriately and more efficiently carried on in that way."<sup>3</sup> In 1966, OMB Circular A-76 provided the guidelines for government contracting industrial and commercial goods and services. In 1979, a revised OMB Circular A-76 reaffirmed the government's general policy of reliance on the private sector.

Government's business is not to be in business. Where private sources are available, they should be looked to first to provide the commercial or industrial goods and services needed by the Government to act on the public's behalf....In a democratic free enterprise economic system, the Government should not compete with its own citizens. The private enterprise system characterized by individual freedom and initiative is the primary source of national economic strength.<sup>4</sup>

The basic criticism of this procurement policy has been its implementation, or rather in the perception of many, its lack of implementation.

Recently, it has been suggested that this policy be made law. In 1981, Senator S.I. Hayakawa of California led the hearings before the Subcommittee on Advocacy and the Future of Small Business of the United States Senate Committee on Small Business to determine the extent to which the Federal government competed with the small business sector.

In 1983, Senator Warren Rudman of New Hampshire introduced in Congress the Freedom from Government Competition Act, a bill which would have made reliance on the private sector a federal statutory requirement. Hearings were held in 1984, but the bill never came to a vote.

Currently, a similar legislative initiative has been introduced in Congress by Representatives Robert F. Sada of Oregon and Charles Stenholm of Texas. H.R. 3387 would

require the Federal Government to enter into contracts with the private sector for procurement of property and services needed by the Federal Government when any cost comparison demonstrates that the cost of such procurement from private sector sources is lower than the cost of providing such property or services by the Government, and to establish in the procurement policy of the Federal Government a greater reliance on private sector sources to provide property and services needed by the Federal Government.<sup>5</sup>

If this legislation were passed by Congress, the government would be required to make greater use of the private sector.

The Reagan Administration has an active policy of encouraging privatization. It has encouraged state and local

governments to turn over services to private contractors and has proposed the sale of various federally-owned assets to private enterprise.

Conrail was recently sold through the U.S. Department of Transportation, and President Reagan recommends that such enterprises as Amtrack, the Bonneville Power Administration, and the Naval Petroleum Reserve should also be sold to the private sector. In addition, the Grace Commission recommended sale of Dulles and National Airports in Washington, military commissaries, and even part of the Coast Guard as money saving steps. Budget Director James Miller has also suggested selling the Postal Service, traffic-control units in small airports and the Federal Housing Administration.

These efforts at the federal level toward an active policy of privatization have been the subject, of course, of great controversy.

#### IV. Kentucky Legislative Initiatives

The interest among members of the Kentucky General Assembly in taking legislative action on the issue of government competition with private enterprise dates at least as far back as the 1976 Session. The following pages give some of this legislative history, stressing the efforts of the Task Force on Small Business during the 1984-85 Interim.

##### Legislative History

During the 1984 Session of the General Assembly, Senator David Karem introduced Senate Bill 301, which would have restricted state agencies or institutions, with certain exceptions, from engaging in activities in competition with private enterprise. This bill was not discussed nor voted on in committee and therefore never came to the Senate floor for a vote.

With the exception of 1982, a bill similar to 1984 SB 301 has been introduced in every regular session of the General Assembly since 1976. In 1976 SB 328, introduced by Senator Danny Yocom, reached the Senate floor but was defeated by a vote of 16 to 18. In 1978 House Bill 469, with thirty sponsors, passed the House of Representatives 45 to 9. House Bill 108 and Senate Bill 319, introduced in 1980, were not voted on in their respective chambers.

In 1984, in contrast, the Senate passed Senate Resolution 59 and the House of Representatives passed House Resolution 50. These resolutions directed the Legislative Research Commission, through the Small Business Task Force, to identify governmental activities which may be in competition with private enterprise and study the desirability of contracting out government services to the private sector.





4. A consideration of fees charged in the private sector before setting fees at state park facilities.

While we do not wish to discourage appropriate development of our state park system, we think it is important to consider the private sector in the process of such developments.<sup>6</sup>

These policy statements accurately reflected the sentiments of the Task Force regarding the issue of government competition generally and contracting for service in particular. Commissioner Hudson responded favorably to these policy statements but noted in respect to item 3 that "...private management...should only occur when the total capital cost has been invested by the private sector."<sup>7</sup>

At the last several meetings of the Task Force during the 1984-85 Interim, several different drafts of legislation to restrict government competition with private enterprise were considered. The last two drafts drew features from Senator Karem's 1984 bill, the Arizona statutes, and the policy sentiments expressed in the letter to Commissioner Hudson. A motion at the December 16, 1985, meeting to prefile a particular draft with the expression that it should pass failed by a vote of 13 to 2. Prefiling required a positive vote by a majority of the committee. Since the Task Force had twenty-seven members, the measure failed by one vote.

House Bill 654, introduced by Representative Marshall Long during the 1986 regular session, is attached to this report. It contains most of the features considered by the committee at its December 16, 1985, meeting.

Although the 1986 Session of the General Assembly did not pass HB 654, the Task Force has committed itself to continuing action in this area. At its November 12, 1985, meeting a motion was made by Senator Danny Yocom and seconded by Representative Jim Yates that the first order of business for the Task Force during the 1986-87 Interim should be a continuation of its role of hearing and attempting to resolve complaints from the private sector about state government competition. The motion carried unanimously. The Labor and Industry Committee has also decided to study the issue during the present interim.

#### Summary

The sentiment of the committee seemed solidly behind the idea that competition was at times a problem and that sometimes intervening action was needed. They were somewhat ambivalent about whether this problem should be or could be resolved statutorily. However, the Task Force was pleased with their success in getting both the state Parks Department

and the State Fair Board to adjust their rates upward, and also their success in getting the Area Development Districts to agree in writing to restrict their computer services to local governments. The Task Force, therefore, as the measure adopted on November 12, 1985, indicates, clearly sees a role for itself as a forum to which small business can bring complaints, and as a problem solver in this area, on an ad hoc, case-by-case basis.

## V. Conclusions

There obviously are several areas in which Kentucky state government competes with private enterprise. The public school systems, for example, compete with private educational services from preschool through post-graduate programs. Public health facilities, from local health departments to university hospitals, are to various degrees in competition with physicians in private practice and with for-profit hospitals. State parks' marinas and campgrounds compete head-to-head for the tourist dollar with their counterparts in the private sector. The state Transportation Cabinet is to some degree doing road repair and maintenance which could be performed through contract. Each of these activities has its own history. In some instances, state services have preceded private services and, as in the case of tourism, stimulated private sector development.

Most of the examples above are not areas in which Kentucky government has opted to contract with private enterprise for the provision of services, although there are exceptions. For instance, (1) in light of recent decisions at Paintsville and Taylorsville lakes, the Department of Parks seems to be moving toward a policy of contracting for marina services; (2) while the state has previously contracted with private providers, such as Exception, for health services on a limited scale, the decision to provide the management of the University of Louisville's teaching hospital through the Humana Corporation was a major step toward privatization; and (3) during Governor Brown's administration several contracts for right-of-way mowing, maintenance, and aerial photography were let, services all traditionally provided in-house.

In the final analysis, there are almost no services or goods provided by governmental agencies which are not also being offered in the private sector. Garbage collection, water and sewage treatment, printing, police and security services, fire protection, prison industries, personnel services, testing (written or laboratory), mapping, dining and cafeteria services, golf courses and other recreational services all could be provided through contract rather than directly. In fact, in many cities and states they are. However, this report has focused primarily on the specific instances of competition cited by businesses during the public hearings, rather than examining in detail all the potential areas of competition.

The correct analysis of this issue will probably show the existence of a dynamic and ever-changing relationship between the private and public sectors. A correct response to the issue will, therefore, probably call for a flexible, dynamic process to ease, from time to time, the tension which builds up between the two sectors.

There is now no statewide policy on or focal point for evaluating where state government is appropriately or inappropriately in competition with the private sector. Government policy in this area has tended to vary from administration to administration, from legislature to legislature and from service to service.<sup>8</sup> Judging from the response of the business community at the Task Force's hearings, government competition, while a burning issue to several businesses, is probably not perceived as a major problem by the Kentucky business community in general.

One possible response to this issue is to pass legislation which would attempt to define where the legislature wishes to prohibit government competition altogether and where it wishes to carefully restrict state service delivery. For instance, as was voiced during the hearings, there may be a time and place for the state to restrict its building, expansion, and management of new and existing park lodges, swimming pools and campgrounds. However, in lieu of direct state provision, the private investor could through contract or lease develop and operate these same kinds of facilities within our park system. These ideas are expressed legislatively in HB 654, which is attached to this report.

Many of the prospects and pressures for change involve unknown quantities: (1) If there is, in fact, a trend toward privatization at the federal level, the trend may gather momentum if federal deficits are reduced and taxes are not substantially increased. In that scenario, the federal government will probably cut existing public services or find ways of delivering services for less money. (2) Kentucky's state and local governments also face taxing and revenue constraints, which might increase the appeal of privatization as a means of reducing public service costs. If substantial federal aid cutbacks do occur, Kentucky's state and local governments will probably consider privatization more closely. (3) Decentralization of governmental services nationally and locally may make federal, state and local governments more innovative as arrangers and not necessarily providers of service. In all three cases there is the hope on the part of those who advocate privatization that it will increase productivity and cut back management costs in government.

Regardless of the unknowns, the Task Force on Small Business has committed itself to address this issue during the 1986-87 Interim, at least on an ad hoc basis. As a result,

businesses in Kentucky will continue to have an instrument through which to voice their concerns regarding government competition with private enterprise.

## Notes

<sup>1</sup>U.S. Small Business Administration, Government Competition: A Threat to Small Business (Washington: Government Printing Office, 1980) p. iii.

<sup>2</sup>Kathleen Burch, Unfair Competition in the States (Washington: Business Coalition for Fair Competition, 1985) pp. 21-29.

<sup>3</sup>John D. Hanrahan, Government by Contract (New York & London: W. W. Norton & Company, 1983) p. 84.

<sup>4</sup>Revised OMB Circular A-76 in U.S. Small Business Administration, Government Competition: A Threat to Small Business (Washington: U.S. Government Printing Office, 1980) Appendix VIII.

<sup>5</sup>U.S. Congress. H.R. 3357, 99th Congress, 1st Session, 1985.

<sup>6</sup>Letter from Senator Fred Bradley, Co-Chairman, Task Force on Small Business, to June Hudson, Commissioner, Department of Parks, Frankfort, KY, November 11, 1985.

<sup>7</sup>Letter from Commissioner June Hudson to Senator Fred Bradley, Frankfort, KY, November 14, 1985.

<sup>8</sup>Two examples of recent interest in contracting with the private sector for provision of public services in Kentucky are (1) the Humana Corporation's management of the University of Louisville's hospital and (2) U.S. Corrections' provision of residential services for Kentucky's Corrections Cabinet.

# IN HOUSE

REGULAR SESSION 1986

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HOUSE BILL NO. 654

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THURSDAY, FEBRUARY 13, 1986

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Representative Marshall Long introduced the following bill which was ordered to be printed.

AN ACT relating to activities in competition with private enterprise.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

1 SECTION 1. A NEW SECTION OF KRS CHAPTER 12 IS  
2 CREATED TO READ AS FOLLOWS:

3 (1) As used in this Act, an "activity in competition  
4 with private enterprise" means an activity which:

5 (a) Is undertaken by a state agency, institution, or  
6 political subdivision that is supported in whole or in  
7 part from any state revenues; and

8 (b) Can be performed by an existing private  
9 enterprise situated within the Commonwealth of Kentucky.

10 (2) Except as otherwise provided in this Act, and  
11 notwithstanding any other provisions of law, it shall be  
12 the policy of the Commonwealth that no state agency,  
13 institution, or political subdivision supported in whole  
14 or part by any state revenues shall engage in any activity  
15 which is in competition with private enterprise unless the  
16 agency, institution or political subdivision can  
17 demonstrate that there is an overriding or compelling  
18 public interest served by the Commonwealth's provision of  
19 the service. Examples of activities provided by the  
20 Commonwealth which may carry an overriding or compelling



1 public interest include certain aspects of the criminal  
2 justice system; educational services of various kinds;  
3 certain services provided by the state parks department;  
4 activities and services provided by the state fair board;  
5 services provided by the department for the blind;  
6 programs of the Kentucky development finance authority;  
7 and health services such as those provided by state owned  
8 or operated hospitals.

9 (3) The secretary of the public protection and  
10 regulation cabinet shall determine, upon petition by any  
11 person directly affected by competition with a state  
12 agency, institution, or political subdivision whether said  
13 agency, institution, or political subdivision is in  
14 competition with private enterprise.

15 (4) If, after a hearing at which all parties have  
16 been afforded an opportunity to present evidence, the  
17 secretary finds that the agency, institution, or political  
18 subdivision is engaged in an activity in competition with  
19 private enterprise, he shall direct the agency,  
20 institution, or political subdivision to terminate the  
21 activity unless he also finds that:

22 (a) Cessation of the activity by the agency,  
23 institution, or political subdivision will create a bona  
24 fide emergency;

25 (b) The cost of the service from private enterprise  
26 will be substantially greater;

1           (c) Private enterprise cannot adequately provide the  
2 needed service; or

3           (d) Cessation of the activity will cause irreparable  
4 harm or loss of substantial invested funds to the  
5 Commonwealth.

6           (5) The secretary shall submit his decision along  
7 with written findings within twenty (20) days regarding  
8 his decision to authorize or terminate the activity of the  
9 agency or institution and shall make available copies to  
10 all parties in interest.

11           (6) An appeal from an order of the secretary of  
12 public protection and regulation may be taken to the  
13 circuit court where the petitioner does business or to the  
14 Franklin circuit court. Such appeal shall not be de novo.  
15 The petitioner, if unsuccessful, shall pay the costs of  
16 the hearing and appeal, incurred by the Commonwealth, if  
17 any, including reasonable attorney's fees.

18           (7) Activities of a state agency, institution, or  
19 political subdivision which were undertaken prior to, and  
20 are in operation on July 15, 1986, and which are found  
21 under this Act to be in competition with private  
22 enterprise and ordered terminated, may continue until the  
23 expiration date of any contract which would be adversely  
24 affected by the cessation of the activity.

25           (8) If a state agency, institution, or political  
26 subdivision of the Commonwealth demonstrates an overriding

1 or compelling public interest for the provision of any  
2 activity in competition with private enterprise, it  
3 nevertheless shall be the policy of the Commonwealth to  
4 contract with the private sector for the provision of that  
5 activity insofar as feasible and in the public interest.

6 (9) If a state agency, institution, or political  
7 subdivision is authorized to engage in an activity in  
8 competition with private enterprise, it shall be the  
9 policy of the Commonwealth to set a fee or charge a price  
10 for such activity which shall include consideration of:

11 (a) The fair market value of that activity; and

12 (b) The actual costs incurred in engaging in the  
13 activity, including the costs and value of labor, real  
14 estate, equipment, overhead, and other related expenses.

15 Insofar as appropriate or deemed expedient in order to  
16 serve the public interest, fees or prices charged for  
17 public activities shall reflect the fair market value or  
18 the actual costs incurred.

19 (10) No later than September 1 of each odd numbered  
20 year, the secretary shall submit a report on government  
21 competition with private enterprise to the legislative  
22 research commission and the governor. The report shall  
23 include recommendations concerning whether the competitive  
24 government activities identified and reviewed by the  
25 secretary should be continued.





