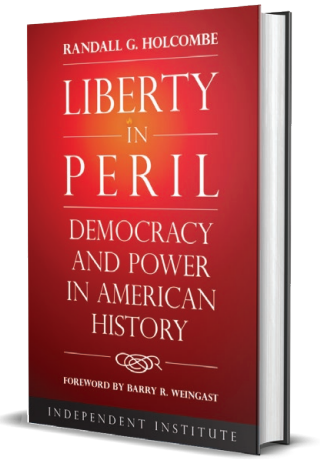
SUBSCRIBE NOW AND RECEIVE A FREE BOOK!

"***The Independent Review*** does not accept pronouncements of government officials nor the conventional wisdom at face value."
—**JOHN R. MACARTHUR**, Publisher, *Harper's*

"***The Independent Review*** is excellent."
—**GARY BECKER**, Nobel Laureate in Economic Sciences

Subscribe to ***The Independent Review*** and receive a free book of your choice such as ***Liberty in Peril: Democracy and Power in American History***, by Randall G. Holcombe.



Thought-provoking and educational, ***The Independent Review*** is blazing the way toward informed debate. This quarterly journal offers leading-edge insights on today's most critical issues in economics, healthcare, education, the environment, energy, defense, law, history, political science, philosophy, and sociology.

Student? Educator? Journalist? Business or civic leader? Engaged citizen? This journal is for YOU!

Order today for more *FREE* book options

SUBSCRIBE

The Independent Review is now available digitally on mobile devices and tablets via the Apple/Android App Stores and Magzter. Subscriptions and single issues start at $2.99. **Learn More.**

Download on the App Store | GET IT ON Google Play | Available on MAGZTER

INDEPENDENT INSTITUTE, 100 SWAN WAY, OAKLAND, CA 94621 • 1 (800) 927-8733 • ORDERS@INDEPENDENT.ORG

Holding "Governance" Accountable

Third-Party Government in a Limited State

SHEILA SUESS KENNEDY

Public-administration scholars and schools of public affairs increasingly use the term *governance* to describe the processes they study and teach. *Governance*, rather than the older word *government,* is thought to be a more accurate descriptor of the reality of contemporary state structures, where an ever-increasing percentage of the state's work is outsourced to for-profit, nonprofit, and faith-based organizations.

The reasons for this growth in "government by proxy" are varied, but all are rooted in a distrust of government and an often-reflexive preference for markets or civil society. Those who hold that reflexive preference fail to recognize that contracting out is not "privatization," properly understood; that is, the choice of private surrogates to deliver services on behalf of government agencies obscures but does not alter the fact that government is choosing, directing, and paying for those services. (Reflexive opponents of contracting, however, fail to recognize that often the choice of a private intermediary will provide needed flexibility or expertise.) Whatever the merits of these opposing ideological positions, my objective in this article is to suggest that before policymakers and public managers accept third-party government as a

Sheila Suess Kennedy is an associate professor of law and public policy in the School of Public and Environmental Affairs at Indiana University/Purdue University, Indianapolis.

The Independent Review, v. XI, n. 1, Summer 2006, ISSN 1086–1653, Copyright © 2006, pp. 67–77.

fait accompli, to be reconceptualized and relabeled accordingly, those concerned with constitutional principles grounded in a conception of limited government think long and hard about the implications of these practices—not just for public administration, but for the very notion of a limited state.

Scholars and practitioners have focused significant attention on the fiscal and political accountability implications of outsourcing, but with few exceptions they have paid little attention to the growing disconnect between the new "governance" paradigm and the basic constitutional norms that have structured U.S. government and public management for two hundred years. Although the literature on privatization and the "reinvention" movement is copious, it has dealt almost exclusively with the management challenges and fiscal accountability issues raised by contracting. More recently, serious scholarly attention has turned to the effects of outsourcing on government's nonprofit partners and to concerns about the transformation of organizations within the voluntary sector that results from their increasing dependence on government dollars. Public-administration and political theory scholars have paid little attention to the constitutional implications of government by proxy, however, and that neglect is troubling because these issues are foundational. Public administration is grounded in constitutional values; political efforts to keep government responsible and accountable—politically, fiscally, and constitutionally—depend on the ability to *identify* government and to recognize when the state has acted. "Governance" may be robbing citizens of the ability to make that crucial threshold identification.

The Constitutional Bases of Public Administration

Woodrow Wilson wrote that "it is getting to be harder to *run* a constitution than to frame one" (Rohr 1986, 1, emphasis in original). `Wilson meant to call attention to the importance of constitutional values for questions of administrative legitimacy and to the dangers of forgetting that critical link under the pressures of day-to-day management challenges.

John Rohr, David Rosenbloom, and other public-administration scholars have emphasized the normative role played by the constitution. In the introduction to *Constitutional Competence for Public Managers,* Rohr writes: "[W]e are witnessing the gradual reintegration of constitutionalism and public administration. I say *re*integration because of the obvious connection between public administration and constitutionalism in *The Federalist Papers.* So integral was administration to the intent of the framers that the authors of *The Federalist Papers* made more frequent use of the word *administration* and its cognates [than] they did of the words *Congress, President* or *Supreme Court*" (Rosenbloom, Carroll, and Carroll 2000, xiii). The book itself makes explicit the connection between "public values" and the "daily decisions and operations of public managers" (xvi).

Political theorists and public administrators alike emphasize the importance of legitimacy, defined as operational rules rooted in constitutional norms, to public

administration. As Michael Spicer has noted, "in the absence of consensus surrounding the role of government, bureaucracy becomes increasingly seen simply as a tool by which some groups gain benefits and privileges at the expense of others" (1995, 4). A legitimate exercise of authority, no matter how coercive, is different from the exercise of raw power unrestrained by adherence to codes of normative values, and it is seen differently by members of the polity. That difference is especially critical to those on the "front lines" of state and local government, who must make and implement policies that are anything but abstract to the citizens they affect.

The importance of tying public-administration practices to constitutional values springs from the central question of both political philosophy and public administration: What is the role of the state, and how should that role be managed? What convictions should animate public service, and how should that service be defined? The U.S. Constitution incorporates specific understandings of human nature, the role of the state, and natural rights. Those understandings led the Founders to limit the power of the state sharply. The original American concept of liberty was framed in the negative: liberty was seen as an individual's right to be free from state control, subject only to the equal rights of others.

To limit government, however, one must first define it. Increasingly, such definition is problematic. D.D. Raphael (1990) has summarized the contemporary idea of the state by defining it as "an association having universal compulsory jurisdiction within territorial boundaries" (qtd. in Kennedy 2001, 205). The two elements of that definition—territoriality and a monopoly on the right to use certain types of force or power—are arguably integral to popular understanding of the concept of statehood or government. Both are undergoing redefinition.

That redefinition cannot be attributed solely to the growth of contracting out, of course. In industrialized nations, and perhaps elsewhere, the growth of the global economy and the worldwide penetration by the Internet are increasingly challenging traditional notions of territorial jurisdiction. In the United States, the steady expansion of government since the New Deal has already required us to rethink the relationship between government power and fundamental rights. (As previously noted, in the American system, rights were traditionally defined as limitations on the coercive power of the state; today, lawyers and political philosophers speak of both negative and positive liberties and debate the propriety and nature of affirmative "entitlements.") More recently, the advent of widespread contracting, with a growing number of services provided and paid for by government but being delivered by contractors, has raised a host of new questions: Are partnerships with businesses and nonprofit organizations creating a new definition of government? Is "privatization" (understood as government contracting) extending, rather than shrinking, the state? Does the substitution of an independent contractor for an employee equate to a reduction in the scope of government, as proponents apparently believe? Or does the substitution operate instead to shift the locus but not the scope of government activity (Kettl 1993; Smith and Lipsky 1993) and thereby blur the boundaries between public and private, making it ever more difficult to

decide where "public" stops and "private" begins? If we are altering traditional definitions of *public* and *private* by virtue of these new "governance" relationships, turning for-profit and nonprofit organizations into unrecognized arms of the state, how does that alteration affect a constitutional system that depends on the distinction between public and private to serve as a fundamental safeguard of private rights? Finally, if the constitutional system is being altered, what are the implications for political theory and public management?

State Action and Constitutional Accountability

However we understand government, a central tenet of democratic regimes is that the state must be accountable to its citizens. Contracting out complicates accountability in a number of ways (Gilmour and Jensen 1998). Smith and Lipsky (1993) were among the first to explore some of the issues for the nonprofit sector inherent in the transfer of state power to private providers; more recently, legal scholars have considered the issues of constitutional accountability raised by the emergence of what some now call "third-party government" (Minow 1999; Kennedy 2001; Metzger 2003).

One traditional way to enforce government accountability is through the courts. But just as a lack of transparency in contracting relationships can impede political accountability, the failure of state-action jurisprudence to keep pace with the political reality of government contracting—the inability of current legal theory to identify government action for purposes of assessing government responsibility—has significantly undermined constitutional accountability. Because we rely on our understanding of the state-action doctrine to know when we may ask the courts to restrain government agencies, we are now in danger of losing an important constitutional check on the exercise of government power. Lack of comprehensible rules defining the actions we may legally attribute to the state undermines the efficacy of constitutional litigation. If we are unable to see the boundaries of government's legal responsibilities, our ability to fashion appropriate political remedies will also be compromised.

To understand the problem's dimensions and its importance to public administrators, it is necessary to engage in a brief review of the genesis and history of the state-action doctrine. *State action* was first defined by the Supreme Court in 1883, in the *Civil Rights Cases* (109 U.S. 3 [1883]). Ratification of the Fourteenth Amendment had prohibited states from denying the "privileges and immunities" of citizenship to persons otherwise entitled to them. In stating the scope of that prohibition, the Court declared: "The Fourteenth Amendment expresses prohibitions (and consequently implies corresponding positive immunities), limiting State action only, including in such action, however, action by all State agencies, executive, legislative, and judicial, of whatever degree. . . . Individual invasion of individual rights is not the subject-matter of the amendment" (3). Recently restating the doctrine, the Court declared: "[E]mbedded within our Fourteenth Amendment jurisprudence is a dichotomy between state action, which is subject to strict scrutiny under the Amendment's Due Process Clause, and private conduct, against which the Amendment affords no shield,

no matter how unfair that conduct may be" (*National Collegiate Athletic Association v. Tarkanian,* 488 U.S. 179 [1988], 191). The Court has thus established a distinction between invasions of rights that are constitutionally forbidden ("public" invasions) and those that are not ("private" invasions), a distinction that rests on the actor's identity. As one legal scholar has noted, "a central premise of U.S. constitutional law is that the Constitution imposes limits on the actions that governments can take." The corollary premise is that "the rules governing private actors should be politically, rather than constitutionally, determined" (Metzger 2003, 1373).

The Bill of Rights was initially designed to limit the federal government's reach; the Fourteenth Amendment later extended those limitations to bar similar actions by the states. Over the years, by the process known as "selective incorporation," most of the provisions of the original eight amendments have been held to apply to state and local government units as well as to the federal government (*Twining v. New Jersey,* 211 U.S. 78 [1908]; *Palko v. Connecticut,* 302 U.S. 319 [1937]; *Adamson v. California,* 322 U.S. 46 [1947]; Berger 1977; Ely 1980). Still, the citizen's protection is against the public actor only. Discriminatory acts, denials of due process, or restrictions on speech by private parties are constitutional; indeed, they are entirely legal unless prohibited by legislation such as the Civil Rights Act of 1964 or the Americans with Disabilities Act.

This distinction between public and private acts loses clarity in a number of contexts; indeed, it has been referred to as a "conceptual truth" (Stone et al. 1986, 1467). Accordingly, the Court has been obliged to develop rules that allow certain private acts to be attributed to government. As Robert Gilmour and Laura Jensen have noted, "When the relationship between government and citizen becomes more complex than that between a mere commodity or service provider and its customers, more than marketplace efficiency is required to hold the government and its proxies and surrogates accountable for their exercise of authority on behalf of the state" (1998, 247).

Acknowledging the need for such rules and actually fashioning them have proved, however, to be very different matters. As one commentator has wryly noted, the Court's "sifting" and "weighing" in state-action cases "differs from Justice Stewart's famous 'I know it when I see it' standard for judging obscenity mainly in the comparative precision of the latter" (Brest 1982, 1296). On the one hand, the mere fact that a regulatory agency exercises oversight of a licensee and has thus implicitly approved the licensee conduct at issue has been held insufficient to attribute an action to the state (*Jackson v. Metropolitan,* 419 U.S. 345 [1974]). On the other hand, where government intentionally funds an unconstitutional program conducted by private actors, the Courts have generally found state action (*Norwood v. Harrison,* 413 U.S. 455 [1973]).

As many have noted, current state-action jurisprudence is incoherent; the Court has struggled with cases presenting different factual situations, and the major casualty has been the very predictability that the law is expected to provide. Worse, in an increasing number of situations, government contracting can provide a handy mechanism for evasion of the limits imposed by the Bill of Rights. As the dissent in one case noted, "the State can shield its legislation affecting property interests from due

process scrutiny by delegating authority to private partners" (*Flagg Bros. v. Brooks,* 436 U.S. 149 [1978], 153).

Blum v. Yaretsky (457 U.S. 991 [1983]) is an excellent example of the inadequacies of current state-action doctrine. The case involved an alleged violation of due process arising out of involuntary discharges and transfers of Medicaid patients in a nursing home. Chief Justice William Rhenquist, writing for the Court, declined to find state action on the grounds that "a state normally can be held responsible for a private decision only when it has exercised coercive power or has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the State" (1012).

Acknowledging that more than 90 percent (perhaps as many as 99 percent) of the patients in the facility were Medicaid patients and that the nursing home was subject to pervasive governmental regulation, the Rhenquist majority nevertheless held "[t]hat programs undertaken by the State result in substantial funding of the activities of a private entity is no more persuasive than the fact of regulation of such an entity in demonstrating that the State is responsible for decisions made by the entity in the course of its business" (1004).

In dissent, Justice Brennan underscored the superficiality of this analysis: "[N]ot only has the state established the treatment levels and utilization review in order to further its own fiscal goals, but . . . the State [has] set forth precisely the standards upon which the level-of-care decisions are to be made, and has delegated administration of the program to the nursing home operators, rather than assume the burden of administering the program itself" (1013).

Rendell-Baker v. Kohn (457 U.S. 830 [1982]) raised similar concerns. This case involved a private school for "problem children" referred to it by state officials. Nearly all of the school's funding came from the state, the facility was heavily supervised and regulated by the state, and almost all its students were sent by the state. Nevertheless, the Court declined to find state action, holding that "the school's fiscal relationship with the State is not different from that of many contractors performing services for the government" (843). Critics of current state-action jurisprudence would agree—and they would point out that this lack of difference is precisely where the problem lies.

The inequities extend beyond service recipients to differential treatment of employees. In *Richardson v. McKnight* (117 S.Ct. 2100 [1997]), the Court declined to find that private prison guards were entitled to qualified immunity, even though such immunity clearly would have been available to them had the state employed them directly. Lower courts, in contrast, have not hesitated to find state action in private prison and institutional detention cases (*Blumel v. Mylander,* 919 F. Supp. 423 [M.D. Fla.1996]), often noting that the power to deprive an individual of liberty is a quintessentially governmental power (*Plain v. Flicker,* 245 F. Supp. 898 [D.N.J. 1986]). This line of reasoning is persuasive but difficult to reconcile with *Richardson* or with cases such as *Wade v. Byles* (83 F.3d 902 [7th Cir. 1996]), where

a private company providing security to a public-housing project was held not to be a public actor even though the guards had authority to carry guns, arrest people, and use deadly force.

Complicating matters even further is the reviewing courts' tendency to apply different standards of analysis, depending on the nature of the constitutional right involved, generally without articulating the basis for those differences. Commentators have noted that in cases involving racial discrimination or religious liberties, the Supreme Court has been much more willing to find—or assume—state action. (Finding a violation of the Establishment Clause requires the presence of state action, whether that requirement is articulated or not, because a private party cannot violate the Constitution.)

Discussion

If state-action jurisprudence is so complicated that lawyers often disagree on the presence or absence of governmental liability for particular actions, how can state and local managers avoid outsourcing practices that are likely to embroil them in litigation? How can citizens or corporations doing business with government agencies know when the state has acted unconstitutionally? How *should* the concept of state action be understood? Or, more broadly, when should citizens hold the state responsible for actions taken by a contractor? What form would a coherent jurisprudence capable of providing direction to public managers and accountability to citizens take? How might we safeguard constitutional accountability without sacrificing the administrative flexibility necessary to manage today's third-party government?

These questions require two kinds of responses: political and legal.

Politically, we need to revisit the first questions of political theory: What should government do? What should government refrain from doing, and why? It is a libertarian truism that the existence of a problem is not a warrant for government action. There are many problems that government is uniquely able to handle, and many other areas where government efforts to ameliorate problems simply create worse ones. We need a reinvigorated civic discussion about what those categories are and the principled bases of the decisions involved. If government does not belong in a particular activity, that activity should be genuinely privatized: government should get out of it entirely. If the activity is something that government should do, citizens should be prepared to spend the time, energy, and money to ensure that it is done well.

Assuming that a particular task is properly governmental, the next question is: "Which government?" Zoning decisions are obviously local; national defense is a federal responsibility; environmental issues may be handled best at a supranational level. Citizens will differ over the appropriate jurisdiction; whatever the ultimate decision, lines of responsibility should be clear.

Once a specific government agency has been charged with a responsibility, the question becomes one of delivery. Is this job handled best by employees or

by contractors? If the latter is the case, what mechanisms will we need to ensure accountability for both program results and constitutional compliance? Only after we have gone through this political analysis is it appropriate to ask what the legal rules should be and what form state-action jurisprudence should take.

Certain characteristics of the relationship between government and private entities will always be relevant to the inquiry into whether an action can fairly be attributed to the state. Those characteristics include the existence, nature, and extent of government funding; the nature and extent of government control of the activity in question; the extent to which government has authorized a contractor to exercise government powers; and a functional (holistic) analysis. All can be used to determine the presence or absence of state action, and none requires a paradigm shift in either public-administrative practices or the law in this area.

Money

Where government money passes to a presumptively private entity, a threshold inquiry should be whether the transaction is a purchase of goods or services, which should not constitute state action, and other types of funding, which may. Purchase involves a product or service that is generally available and relatively standardized, where production of the good or performance of the service is substantially, if not entirely, controlled by the vendor. When the state goes into the market looking for computer support or engineering services, for accountants to perform an audit, for asphalt to use in paving projects, or for other widely traded goods and services, it is relatively clear that it is simply making a purchase. Even where the transaction is apparently a purchase of services, however, a significant long-term relationship between a contractor and government, where the government's business constitutes a majority of the contractor's income, should be held to raise a rebuttable presumption of state action. When a single "customer" accounts for most of a contractor's income, that customer clearly has the power to dictate behavior. The existence of that leverage justifies raising the presumption, which can be rebutted by evidence that no delegation of governmental authority in fact occurred.

Control

Where government has the authority to control the manner in which work is done, it should be held accountable for the results, without requiring a finding of explicit authorization of the disputed act. This rule is consistent with the Court's current articulation of the law, if not its practice. Mere regulation should continue to be insufficient, but something less than direct control should implicate the state. Where a regulatory scheme substantially limits the options available to the private entity, where it prescribes the goals and limits the acceptable methods for achieving them, the state should bear responsibility for the results. Courts might helpfully draw analogies with

existing tests to determine whether a worker is an employee or an independent contractor; many of the same considerations are relevant.

Agency

When the state authorizes a private entity to act on its behalf, it creates an agency relationship. When the agent is authorized to exercise powers that are essentially, even if not exclusively, governmental, we are justified in finding that government has acted through that agent. Whether we justify the finding by reworking state-action doctrine or, as Metzger has suggested, by finding that the state has delegated a governmental power, is for lawyers and jurists to determine; the important issue is to reach a result that accords with the reality of the relationship involved. The law of agency and partnership can be particularly helpful and relevant here, and it is curious that those principles have not yet been applied, even by analogy. When government cloaks a contractor in real or apparent authority to act on its behalf, the ensuing actions should be deemed governmental.

Function

Each of these inquiries is an attempt to determine whether a private entity is acting as a proxy for government under the facts of the case. If the contractual relationship involved has replaced government employees who were previously providing the service, common sense suggests that the contractor is a government proxy. Where government is responsible for delivery of the service, there should be at least a rebuttable presumption of state action. The issue is not whether the activity is one that only government does or has ever done or should do. The issue is whether government is *actually* "*doing*" *the activity in question*.[1] Where government undertakes an activity, funds it, authorizes a contractor to act on its behalf, and effectively dictates the manner in which it is done, that activity should fairly be attributed to government.

One reason for the tortured jurisprudence on state action has been the courts' reluctance to burden governmental units—and ultimately taxpayers—with liability for the actions of private contractors, but that concern is arguably misplaced. Government can protect tax dollars by contracts with hold-harmless or other indemnification provisions. Liability is a recognized cost of doing business, and the allocation of risk is a proper subject for contractual negotiation. Indeed, it might be argued that refusing to allow government to evade its constitutional responsibilities through contracting will force an explicit recognition and accommodation of the real costs of doing

1. As Gilmour and Jensen frame the issue, "Privatization in the United States is thus more likely to represent a change in form rather than function, i.e., the substitution of a 'private' contractor or other nongovernmental designee to act as a proxy for government officials and employees in performing public tasks under the aegis of governmental authority and paid from the public purse" (1998, 247).

business—including the assumption of potential liability risks. Such a result would benefit everyone: private contractors, public managers, and, most of all, citizens, who have a right to demand fiscal, political, and legal accountability from public servants and those they elect to office.

When government acts, it should be accountable. The instrument government chooses to perform the action should not alter that requirement. Whether government delivers drug counseling, job placement, or any other service through a state agency, a for-profit or nonprofit provider, or a faith-based organization, the program is state action—the empowerment of a third party to act for and on behalf of the state. Courts should recognize that reality and require adherence to constitutional standards—in the process providing state and local government actors with clear and welcome guidance.

Conclusion

The most obvious rules sometimes produce the most tortured applications. It is a truism of every high school and college government class that the Bill of Rights limits only the government, that a constitutional infringement must pertain to state action. However, by "reinventing" government, by sharing "governance" responsibilities with third parties and their subcontractors, we have created a mutant that is neither public nor private. The courts have encountered those mutations much as the blind men encountered the elephant: one finding a snake, one a wall, one a tree trunk. Unless we can come to grips with the whole animal, protean and evolving as it is, and refashion both our jurisprudence and our political theory to safeguard the distinction between public and private action—a distinction critical to the protection of constitutional liberties and the very idea of a limited state—constitutional accountability will be relegated to a quaint and dusty corner of public-management history.

References

Berger, R. 1977. *Government by Judiciary.* Indianapolis, Ind.: Liberty Fund.

Brest, Paul. 1982. State Action and Liberal Theory: A Casenote on *Flagg Bros. v. Brooks. University of Pennsylvania Law Review* 130, no. 6: 1296–330.

Ely, John. 1980. *Democracy and Distrust: A Theory of Judicial Review.* Cambridge, Mass.: Harvard University Press.

Gilmour, Robert, and Laura S. Jensen. 1998. Reinventing Government Accountability: Public Functions, Privatization, and the Meaning of State Action. *Public Affairs Review* 58, no.3: 247–58.

Kennedy, Sheila S. 2001. When Is Private Public? State Action in the Era of Privatization and Public–Private Partnerships. *George Mason University Civil Rights Law Journal* 11, no. 2 (spring): 203–23.

Kettl, Donald. 1993. *Sharing Power.* Washington, D.C.: Brookings Institution.

Metzger, Gillian. 2003. Privatization as Delegation. *Columbia Law Review* 103, no. 6 (October): 1367–502.

Minow, Martha. 1999. Choice or Commonality: Welfare and Schooling after the End of Welfare as We Knew It. *Duke Law Journal* 49: 493–559.

Raphael, D. D. 1990. *Problems of Political Philosophy*. Atlantic Highlands, N.J.: Humanities Press International.

Rohr, John A. 1986. *To Run a Constitution: The Legitimacy of the Administrative State*. Kansas: University of Kansas Press.

Rosenbloom, David H., James D. Carroll, and Jonathan D. Carroll. 2000. *Constitutional Competence for Public Managers*. Itasca, Ill.: F. E. Peacock.

Smith, Steven Rathgeb, and Michael Lipsky. 1993. *Nonprofits for Hire*. Cambridge, Mass.: Harvard University Press.

Spicer, Michael W. 1995. *The Founders, the Constitution, and Public Administration: A Conflict in Worldviews*. Washington, D.C.: Georgetown University Press.

Stone, Geoffrey, Louis M. Seidman, Cass R. Sunstein, and Mark V. Tushnet. 1986. *Constitutional Law*. New York: Little, Brown.