EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE DIRECTOR

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MEMORANDUM FOR HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES

FROM: Alice M. Rivlin AMR

SUBJECT Government Corporations

The drive to create a government that works better and costs less has generated increased interest in the creation of new entities. For example, the Administration has supported the transformation of agencies that have a clear measure of performance into "Performance-Based Organizations" with flexibility, where necessary, in human resources management, budget, procurement, and other administrative functions. Such organizations will generally continue to operate within their present agency and will be led by executives operating under term, performance-based contracts. You will hear more about these organizations in the year ahead.

The use of a more traditional government corporation may be indicated when an entity is revenue producing and potentially self-sustaining, and involves a large number of business-type transactions with the public. Such revenue producing and self-sustaining enterprises, to operate most effectively and efficiently, may need, in lieu of normal input controls, a different form of fiscal and program accountability adapted to their unique requirements.

The concept of a government corporation has been applied inconsistently in the past. Some entities are government corporations without being designated as such. Other entities are called government corporations without having many of the essential characteristics. Many "revolving funds" have similar characteristics regardless of whether they are designated as "government corporations." The challenge involved in designing government corporations is to the balance need for autonomy and flexibility with the need for accountability and oversight. If the decision is made to create a government corporation, the goal should be to provide an operational structure that allows Federal entities to carry out their functions in the most effective and efficient manner, and in a way that maintains accountability to decision makers.

The attached *"Specifications for Creating Government Corporations"* provide a set of issues and presumptions to be considered when analyzing whether programs would benefit from the operating and financial flexibility and other normal attributes of a government corporation. Though the specifications provide an overall analytic framework, the suitability and form of alternative forms of fiscal and performance accountability should be considered on a case-by-case basis to meet the specific needs of the entity.

Attachment

SPECIFICATIONS FOR CREATING GOVERNMENT CORPORATIONS
December, 1995

I. Purpose

A. This outline provides an analytic framework of policy presumptions and questions to be asked when an agency or function proposes to form a government corporation.

B. The analytic framework should be used when a public businesslike function, which requests to become a government corporation, asserts a *prima facie* case that it cannot operate more effectively or more efficiently without changing its organizational structure.

C. Though the specifications provide an overall analytic framework, the suitability and form of alternative models of fiscal and programmatic accountability must be considered on a case-by-case basis to meet the specific needs of the entity.

II. Introduction

A. The Administration considers it important to transform agencies or operations that have a clear measure of performance into "performance-based organizations," and those that are self-supporting (or potentially so) through their own revenues into government corporations. [1]

B. The goal is to provide an operational structure that allows Federal

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1 The President's Management Council is looking at the concept and opportunity to transform agencies that have a clear measure of performance into "performance-based organizations." The Administration will consider providing performance based organizations flexibility to adopt different forms of fiscal and program accountability, where necessary to operate most effectively and efficiently. That might mean, for example, alternative systems for human resources management, budget, procurement, and other administrative functions, in lieu of current "input" controls. A major difference from a corporation (which should be revenue producing and self-sustaining) would be that a performance-base organization would be headed by an executive employed under a 5-year performance contract.

entities to carry out their functions in the most effective and efficient manner, and in a way that maintains accountability to decision makers, while minimizing Federal exposure to loss.

C. A first-order question is to determine whether the Government should perform this function at all. [2]

D. The Federal Government should limit or focus its operations to those functions:

1. Not performed by the private sector;
2. More appropriately performed by government;
3. That continue to demonstrate that performance by government is in the best interests of the taxpayer; and
4. So necessary to the national welfare that continuation of a core capacity must be assured even though the function also may be performed by the private sector.

E. The possibility should be considered of moving operations (in whole or in part) that can sell goods or services on a self-sustaining basis into the private sector.

F. If a public purpose discourages privatization, it should be recognized that creating a government corporation under the Government Corporation Control Act does not, by itself, guarantee efficiency or accountability.

G. It should be also recognized that the concept of a government corporation has been applied inconsistently in the past. Some entities are government corporations without being designated as such. Other entities are called government corporations without having

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[2] This is not a rhetorical question. In keeping with the Administration's reinvention effort and the current budgetary realities, the Government should perform a function only if it involves an important public purpose that Government can best serve.

many of the essential characteristics.[3] Many "revolving funds" have some similar characteristics regardless of whether they are designated as "government corporations." A few entities classified as government corporations under the Government Corporation Control Act are not part of the Federal Government.

III. First Step in the Analysis - Is this a businesslike enterprise?

A. If the answers to the following questions are negative, the entity should be dropped from further consideration under this analytic framework. If the answers to the questions are affirmative, the businesslike entity should next be considered for privatization. In cases where the answers are mixed, judgements should be made on a case-by-case basis.

B. Is this an operation that is, or could be, predominantly of a businesslike character -- that is, does it act like a private business or what we would think of as a private corporation?

1. Does the enterprise deal with the public as a businessman, insurer, or banker, and not as a sovereign?
2. Is its primary purpose to sell goods and services to the public (rather than regulate, make grants, or provide goods and services to the public without a price)?
3. Does it have customers (*i.e.*, individuals or organizations who freely choose to purchase the product or service)?
4. Is it, or could it be, substantially self-financing (*i.e.*, does the income generated from selling the product or service cover operating expenses and the cost of capital)?
5. Is there likely to be continued demand for its goods and services over a long period?

IV. Second step in the analysis - Why not privatize?

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[3] The Department of Defense has some nonappropriated fund activities, such as the Army and Air Force Exchange Service, that also have characteristics of government corporations.

A. If the answers to questions B, C, D, and E below are negative, the businesslike enterprise should become a private corporation with no Federal control or backing. (In the event the entity is privatized, provision should be made for the entity to reimburse the Government for its investment in the enterprise in accordance with Federal financial policies.) If the answers are in the affirmative, move to the next step of the analysis.

B. Are there good and sound reasons this entity cannot compete in the private sector? (For example, if the private sector does not produce these or similar services, would that still be the case if Government intervention is removed?)

C. Are there market impediments that could make privatization inappropriate?

1. Absence or imperfection of a viable market?
2. Need to protect or continue service to "unprofitable" segment of market (*i.e.*, would there be an inclination to service less than the entire market, or need for/desirability for cross-subsidization)?
3. Regulatory/safety or other public function that is intrinsic to the entity's operation and cannot be separated from its commercial aspects and carried out by a separate governmental entity? [4]

D. Does the entity serve primarily public policy as opposed to private purposes?

E. If it failed, would the Government feel obliged to bail-out the entity to maintain the provision of a public policy or for some other reasons?

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4 Regulatory functions are not normal, businesslike activities, since they involve the exercise of inherently governmental (sovereign) powers. Consequently, regulatory functions should be separated from the entity's businesslike functions and carried out by a separate governmental entity.

V. <u>Third step in the analysis - Should the entity become a government corporation?</u>

A. The legal and financial powers of a corporation do <u>not</u> themselves justify the corporate form; they are a means, not an end in and of themselves.

B. While a governmental corporation by itself does not guarantee efficiency or accountability, neither does a traditional agency. However, the fiscal and performance demanded of a self-sustaining entity often leads to the development of a "competitive tone" that may be absent in other agencies.

C. The businesslike enterprise should make a "presentation" to OMB that explains the benefit of incorporating the operation, addresses the need for each element or feature of incorporation, justifies the removal of each statutory constraint, and explains why alternatives are not an equal (if not superior) way to achieve more efficient or effective operations.

D. Key factors agencies should consider in such analysis are whether the enterprise:

1. Is sufficiently businesslike,
2. Cannot privatize immediately, and
3. Would function better as a corporation than under other alternatives (e.g., removing specific constraints, financing and operating as a franchising or revolving fund, or using service contracts).

E. These questions are intended to insure that appropriate analysis and consideration are given to the most obvious, relevant, and practical alternatives to becoming a government corporation.

F. Assuming an entity's operations are needed and are sufficiently businesslike (first step in the analysis) and not suitable for immediate privatization (second step in the analysis), and the entity makes a compelling programmatic presentation, there are two primary reasons to form a corporation:

1. As a transitional state, pending private ownership, or
2. When the programmatic or fiscal performance of the entity would benefit from the distinct legal identity accompanying incorporation.

VI. Mandatory disclosure and control.

Government corporations should be subject to the provisions of the Government Corporation Control Act (31 USC 91). [5]

VII. Autonomy and flexibility.

A. A government corporation should not be established merely as a convenient way to escape legitimate discipline and proper executive controls.

B. However, revenue-producing and self-sustaining corporations are different from agencies financed primarily with annual appropriations and often cannot function effectively if subject to controls designed for programs financed by annual appropriations. In such circumstances, alternative systems of control and accountability should be considered, adapted to the entity's unique requirements.

C. The Administration will consider providing corporations flexibility in human resources management, budget, procurement, and other administrative functions.

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5 The Government Corporation Control Act provides specialized budgetary reporting requirements, which are in addition to the reporting required of other Federal entities. Specifically, GCCA requires wholly-owned government corporations to prepare and submit business-type budgets to the President each year. The Act also imposes certain audit and reporting requirements on both wholly-owned and mixed-ownership government corporations.

D. To the extent an entity proposes exemptions or flexibility from controls designed for programs financed by annual appropriations, it should describe in detail its proposed alternative management systems (e.g., human resources management, budget, procurement, and other administrative functions) in terms of its programmatic goals, addressing how these alternative systems will improve efficiency and performance.

VIII. Corporate "bottom line."

A. Government corporations should be accountable for results that focus on programmatic outputs and outcomes. [6]

B. The corporation should be formed with a "charter" that spells out the scope of its activities to assure that government corporations are established and conduct their operations so as to be fully accountable for their financial soundness and programmatic activities. Corporations should be created with strategic goals and defined objectives (what the corporation should do) that will enable the Secretary and the Congress to judge how well the corporation is performing, including:

1. Program measures,
2. Financial measures, and
3. Specific actions if goals are not met.

C. The Secretary (and OMB) should focus on strategic priorities rather than intervention in a corporation's day-to-day operations.

IX. Other standards for a businesslike entity that propose to become a government corporation.

A. Generally-applicable laws. A corporation which seeks exemption from generally-applicable statutory requirements must make a

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[6] Consistent with the Government Performance and Results Act, results should, to the extent appropriate, focus on *outcomes*.

specific case, tied to the nature of its business. Absent specific, compelling reasons, a government corporation will be subject to generally applicable statutes.

B. Budget and Credit Standards.

1. Budget requirements in Title 31. All government corporations should be included in the Federal Budget.
    (a) The President and the public need to be assured that a government corporation is:
        (i) Fiscally sound and viable (*e.g.*, that the corporation is presently, and is expected to remain, self-sustaining), and
        (ii) Not deviating from its public purpose (*i.e.*, the public purpose is being fulfilled).
    (b) Publication of the President's Budget and the management report required by the CFO Act (which includes a Corporation's financial statements, auditor's report and statement by the head of the agency on the corporation's internal accounting and administrative control systems) give the Congress as well as the public the opportunity to review the operation of government corporations.
    (c) The President has the same authority to review a government corporation as he does any other government entity.
    (d) In choosing to exercise his authority, the President can stipulate the timing and format of budgetary submissions, and compel financial reporting.
    (e) In practice, the application of budget requirements to a government corporation will differ depending upon whether OMB determines each year whether the corporation is:
        (i) Clearly operating on a <u>self-sustaining</u> basis (e.g., revenues meet or exceed expenses) and consistently with its charter -- in which case, it will not be subject to further OMB budget

review.[7]

(ii) Not-self-sustaining (e.g., those which require appropriations as a one-time, or regular event, including appropriations for subsidy costs of credit) or is not operating consistently with its charter -- in which case, it will be subject to full OMB budget review, modification, approval, and apportionment.

2. Credit Reform. All government corporations that make direct loans or guarantee loans should be subject to the budget and accounting requirements of the Federal Credit Reform Act of 1990 (Title V of the Congressional Budget Act of 1974). [8] The estimated long-term cost to the Government of credit extended (as defined by the Act) must be estimated and an appropriation of the cost, if any, must be provided from the Congress or from retained earnings of the corporation before any direct loans or loan guarantees can be made.

C. Operating flexiblities.

1. Personnel rules. Consideration should be given to granting corporations flexibility from personnel rules (if, for example they need to quickly adjust to changing workforce requirements, or need to define jobs more broadly, or have more pay setting flexibility). However, employees of government corporations remain government employees even if exempt by law from certain provisions of title 5. [9]

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7 For example, the intent of apportionment is to prevent the over-obligation of appropriated funds and is thus inappropriate for self-financed corporations.

8 Government corporations engaged in direct loan and loan guarantee activities are subject to Credit Reform.

9 In particular, because corporation employees are employees of the executive branch, they are subject to the criminal conflict of interest statutes at title 18 of the U.S. Code. Exemptions from title 18 should be considered only in a very unusual case where the business of the corporation could not be conducted within the restrictions of title 18. Employees engaged in privatization initiatives should be

2. FTE limitations. As a general matter, employees of government corporations are Federal employees and are subject to the Federal Workforce Restructuring Act and OMB Circular A-76.
   (a) In general, a corporation that has defined business requirements or can demonstrate business conditions (*e.g.*, seasonal or surge workloads) or other requirements for FTE, and the funds to finance them, will be provided FTE levels needed for businesslike operations.
3. Employee benefits and pay limits in Title 5. Government corporations should not be exempt from limitations on employee benefits and pay. The top salary should not exceed that of Executive Level I. However, exemptions may be appropriate for government corporations:
   (a) If necessary to keep or recruit select personnel with unique technical background and skills (due to competitive pressures from the private sector). (If exceptions are sought for large numbers of personnel, it is appropriate to reexamine whether the corporation operates sufficiently like a private entity that it should be privatized.)
   (b) To facilitate moving the corporation into the private sector (*e.g.*, if it is expressly understood that this corporation is moving toward privatization).
4. Procurement rules. Consideration should be given to granting corporations flexibility to procure more efficiently or effectively (if, for example, they are having difficulty in obtaining necessary goods and services pursuant to existing procurement rules).

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made aware that the restrictions of the conflict of interest statutes in title 18 of the U.S. Code and the Standards of Ethical Conduct for Employees of the Executive Branch (5 C.F.R. 2635) continue to apply to them as Federal Employees. In some cases, these restrictions may have the effect of limiting the involvement of employees in certain types of privatization activities. In such cases, employees should consult an ethics official for specific advice.

C. Placement and structure.

1. Government corporations are executive agencies subject to Title 31.
2. Government corporations should remain under the head of an existing department or agency (rather than established as an independent executive agency) to ensure coordination with common programmatic missions or activities, and general supervision. [10]
3. All government corporations should receive and be responsive to policy instruction from the President and/or agency head, though such policy coordination and oversight would not, in general, extend to day-to-day operational control and direction.
4. In accordance with the Government Corporation Control Act, government corporations cannot create a subsidiary without approval of Congress. A subsidiary of a government corporation should be subject to the same budget controls as the parent corporation, and should not be in a position, by itself, to increase the Government's exposure to loss.
5. While there should be no provision for a governing Board of Directors, it may be useful to have an advisory board if input from business advisors on business operations is desired.

D. Financing: Permanent authority to use collections instead of requesting annual appropriations.

1. This is generally appropriate for businesslike activities, and hence government corporations.
2. Revenues should be sufficient to cover all costs, including the full cost of employees' pensions and other benefits, interest and depreciation on capital utilized by the corporation, repayment of debt, etc.
3. If the proposed government corporation will be selling a

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10 While legally "separate" and distinct, government corporations should still remain under the policy supervision and oversight of a Cabinet Secretary and Deputy.

Government asset, it should pay the Treasury for the asset and build this cost into its prices.

4. Except for funds deposited in credit financing accounts, which are subject to Section IX.B.2, funds should be deposited with the Treasurer of the United States or a Federal Reserve Bank or bank approved by the Secretary of the Treasury as provided by the Government Corporation Control Act. Funds deposited in the Treasury may be withdrawn only pursuant to an appropriation.
5. Interest on balances should be credited to the government corporation.

E. Borrowing.

1. Limitations on borrowing:
   (a) Outstandings at any one time limited by law.
   (b) Only from Treasury. (Should not say that its debt is not guaranteed by the Federal Government since all government corporation debt is Federal debt.)
   (c) Subject to Treasury approval of terms and conditions.
   (d) Stock not to be issued to Treasury in lieu of Borrowing from Treasury. If stock is needed to sell the corporation, it can be created at the time of sale.
   (e) Lease-purchase transactions, being equivalent to borrowing, scores as indicated under standard budget scoring rules, see Section IX.B.2.
2. Use of borrowed funds:
   (a) For start-up costs.
   (b) For expansion of capital investment.
   (c) Not for operating expenses, except (subject to OMB approval) for specific, emergency cash-flow requirements.[11]

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11 Cash-flow problems may be an indication that a corporation is not self-sustaining. This provision is intended to enable corporations to respond to short-term, cash-flow deficiencies, not provide permanent access to additional capital.

F. Financial management.

1. A government corporation should always be subject to Federal accounting standards. (If a corporation is in a transitional stage pending privatization, it can elect to also use standards of the Financial Accounting Standards Board.)
2. A corporation should have a Chief Financial Officer (CFO).
3. A government corporation should produce an annual audited financial statement pursuant to the CFOs Act.
4. To the extent the corporation engages in profitable lines of business, the nature and amounts of earned surplus should be revealed in the financial statements (lines of business analysis).
5. For corporations with fewer than 20 FTE involved in audits and investigations, the Inspector General (IG) function should be performed by the IG for the Department or agency under which they are located. Corporations with more 20 or more FTE can consider creating their own IG if that can be demonstrated to be the more effective way to operate.

H. Periodic reauthorization.

1. A corporation should be subject to reauthorization not less often than every five years.
2. Reauthorization should be an opportunity to:
   (a) See how the corporation has performed (including a review of published performance measures) and
   (b) Consider privatization.
3. The corporation should be asked to make a formal presentation to OMB reviewing its business operations and programmatic performance, particularly in terms of its charter and other requirements, and against these standards.

Government-Sponsored Enterprises (GSE)

For information -- while not the subject of this outline, government sponsored enterprises (GSEs) are a related type of business entity:

A. Broadly defined, a GSE is a private corporation chartered by the Federal Government to achieve public purposes that has nongovernmental status and is excluded from the Federal Budget.

B. As a general matter, GSEs occur infrequently, and are limited to being a privately owned, federally chartered financial institution that has nationwide operations and specialized lending powers and that benefits from an implicit federal guarantee that enhances its ability to borrow and from other ties to the Federal Government.

C. GSEs were created because wholly private financial institutions were believed to be incapable of providing an adequate supply of loanable funds at all times and to all regions of the nation for specified types of borrowers.

D. A fundamental policy judgement about a GSE is whether the achievement of its public purpose is worth the amount of risk that the government must accept.

E. GSEs should have a Federal overseer created in law, with a regulatory regime that establishes and monitors performance of their mission and ensures that the entity is operating in a sound manner that minimizes risk to the government while enabling it to accomplish its mission.

F. GSEs should only be created with a clearly articulated "exit strategy" and an express sunset date in their charter.

G. A GSE could be fully privatized when the:

1. Assigned functions themselves are no longer necessary or appropriate for Federal involvement.
2. Business conditions which prompted its creation have changed (i.e., the special privileges bestowed upon them are no longer necessary to perform the functions for which they were created), or
3. A GSE is no longer the most efficient way to achieve the public purpose.

Government corporations in the budget: [12]

- Commodity Credit Corporation
- Community Development Financial Institutions Fund
- Corporation for National and Community Service
- Export-Import Bank of the United States
- Farm Credit Insurance Corporation
- Federal Crop Insurance Corporation
- Federal Deposit Insurance Corporation
- Federal Financing Bank
- Federal Housing Administration
- Federal Prison Industries (UNICOR)
- Government National Mortgage Association
- Legal Services Corporation
- National Credit Union Administration Central Liquidity Facility
- Overseas Private Investment Corporation
- Pennsylvania Avenue Development Corporation
- Pension Benefit Guaranty Corporation
- Resolution Trust Corporation (RTC)
- Rural Telephone Bank
- Saint Lawrence Seaway Development Corporation
- Tennessee Valley Authority (TVA)
- United States Enrichment Corporation

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12 A 1995 Congressional Research Service (CRS) report "Managing The Public's Business: Federal Government Corporations" acknowledges that "There is at present no universally accepted definition of what constitutes a government corporation, hence there are several listings of government corporations, each different and based upon the definition employed by the compiler." (page xii).

This listing identifies the 21 government corporations in the Budget; the following list identifies two others which are not. CRS also identifies 23 government corporations, but their listing differs in four respects, by including the Securities Investor Protection Corporation and the United States Postal Service, but not the Farm Credit Insurance Corporation or the Federal Housing Administration.

Government corporations that are <u>not</u> in the budget:

- -- Corporation for Public Broadcasting
- -- National Railroad Passenger Corporation (AMTRAK)

Proposed government corporations:

- -- Air Traffic Corporation
- -- Bonneville Power Authority
- -- Federal Housing Corporation (FHC)
- -- U.S. Petroleum Corporation for NPR
- -- Patent and Trademark Office (PTO)
- -- Presidio Trust

Government-Sponsored Enterprises:

- -- College Construction Loan Insurance Corporation ("Connie Lee")
- -- Student Loan Marketing Association ("Sallie Mae")
- -- Federal National Mortgage Association ("Fannie Mae")
- -- Financing Corporation (FICO) [13]
- -- Federal Home Loan Mortgage Corporation ("Freddie Mac")
- -- Federal Agricultural Mortgage Association ("Farmer Mac")
- -- Farm Credit System institutions (Banks for Cooperatives, and Farm Credit Banks)
- -- Federal Home Loan Banks System institutions (FHLBs)

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[13] Does not meet the definition of a GSE as defined in Appendix I.

-- Resolution Funding Corporation (REFCORP) [14]

[14] Does not meet the definition of a GSE as defined in Appendix I.