

# PERSPECTIVES

## On the Professions

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### "Privatization"

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The words "privatization" and "privatize" seem to be new, but their root is not. Both derive from the old Latin "prius," meaning "separate," "peculiar;" "of one only;" a root that gives "privy," "privet," and "privation;" as well as the more familiar (and, for our purposes, more important) "private:" Sometimes, to be private is not to have any special responsibilities (as in "private [soldier]" or "private citizen"). Sometimes the private is the opposite of what is (properly) open to public view or use (as in "private parts" or "private house"). Sometimes, however, the private is the opposite of the governmental (as in "private sector").

The privatization with which we shall be concerned here is of this latter sort, a turning over to private business of some activities government formerly performed.

One sign that "privatize" is new is the absence of any obvious term for its opposite. Both "nationalize" and "take for public purposes" refer to property rather than to governmental activity. "Socialize" (as in "socialized medicine") is closer, except that the term seems to have no use

apart from that one compound. (What, for example, is "socialized banking"?) Neither "politicize" nor "publicize" is even close. Though "deprivatize" may have a future, it certainly has no past.

That's surprising. After all, "deprivatization" seems to have been the trend in Europe (and its colonies) for a long time. For example, the US Constitution (Art. I, sec. 8, para. 11) empowers Congress to "grant letters of marque or reprisal," that is, licenses allowing an ordinary citizen, a "privateer," to send out his own ships to make war for profit by attacking the commercial vessels of the enemy. Today, we think this a job for publicly owned submarines and surface fleets. Why? Why shouldn't government leave even such activities to the private sector? History suggests some answers.

One reason government may take over what could be a private activity is that the private activity has a history of abuse. Machiavelli devotes Chapter XII of *The Prince* to explaining why government should not use private armies to make war (as many Italian states did in his time). According to Machiavelli, the profit motive made these armies "disunited, ambitious, without discipline, faithless, bold amongst friends, cowards amongst enemies." States are safer with their own armies, made up

predominantly of their own citizens. ("Mercenary;" our term for a privatized soldier, is still not a compliment.)

A second reason government may take over a private activity is necessity (a.k.a. "market failure"). For example, many cities now run a system of public transportation because the private companies that once did it went bankrupt. That too is why the federal government operates much of the country's long distance passenger service (AMTRAK).

A third reason government may take over what could be a private function is that the public believes government can do it better, whether more efficiently (by savings of scale), more fairly (by assuring that money will not be the sole determinate of service), or more honestly (by avoiding the bribery that would accompany giving out contracts to private firms).

Similar reasons once induced many large companies to do as much work as possible in-house. Today, many of these companies are "spinning off" in-house activities, "out-sourcing;" and otherwise "privatizing" what was already (strictly speaking) private. Perhaps "privatization" is not so much an attack on government as an adjustment to new facts making it hard for large organizations to do as much

efficiently as they used to.

Whether that is so or not, privatization seems to raise issues of justice and public policy, issues clearly relevant to the professions, especially public administration; hence, this issue of Perspectives.

We begin with a strong, but still modulated, defense of privatization of an activity most of us unthinkingly lump with war as among the activities that surely should remain governmental. John O'Leary argues that prisons can, and should, be privatized. Efficiency is the reason to do it; potential abuses, being preventable, are no reason not to do it.

Inge Fryklund, an official in Harold Washington's administration, reflects on her experience privatizing much of Chicago's parking program. Though her experience concerns a less controversial candidate for privatization, her conclusions are more modest than O'Leary's. Many of the costs of privatization (for example, the costs of preparing contracts) are easily overlooked; some efficiencies of privatization may defeat other policy objectives (for example, paying fair wages). Each proposed privatization should be considered on its own merits.

David Beam, Director of II T's Master of Public Administration Program, raises deep questions about what the "merits" are. While public administration has always sought to bring the efficiency of private business to government, it has always recognized that efficiency is not the primary determinant of what government should do. Government is, and ought to be, a different kind of undertaking from private

business. Beam then devotes much of his piece to pointing out some important differences. While some privatization makes sense, he concludes, the trend probably will not stand the test of time.

Martin Malin and Robert Ladenson provide a specific example of what Beam may have in mind. Over the last few decades much litigation has been privatized, that is, turned over to private arbitrators (for example, by contract between an employer and employee). These arbitrators must both find the facts and interpret relevant law. While the Supreme Court recently gave this trend its blessing, noting its considerable efficiency, Malin and Ladenson argue that the Court should only have blessed private fact-finding. Privatized interpretation defeats the law's ability to correct for market failure and to protect certain non-economic goods.

My apologies to CSEP's Director, Vivian Weil, for (once again) denying her space for the once-customary "At the Center."

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**"Private Involvement in Public Corrections Profits, Pros, Cons, and Convicts"**

John O'Leary, Reason Foundation, Los Angeles, California

One promising-if problematic-option for dealing with rising prison costs is privatization. In a range of activities from street sweeping to airport construction, the private sector has shown that savings of 20-50 percent can be

realized through competitive contracting. Yet the management of prisons raises ethical issues that street sweeping does not. Can the private sector play a role in corrections without jeopardizing the rights of inmates and the public? In some areas, such as prison construction or food provision, the answer must be a certain "Yes." In more sensitive areas, such as actual prison management, the answer would seem to be a more cautious "Yes:"

Increasingly, the issue is not one of merely academic interest. In the United States, over 77,000 inmates are housed in facilities operated by private corporations. That number has grown by 30 percent in the past year, and continues to rise. "The War on Drugs" has helped make corrections a growth industry. In 1977, there were 300,000 inmates in state and federal correctional facilities. By 1990, that number was 756,000. This dramatic increase has resulted in widespread overcrowding. By the end of 1989 state and federal facilities taken together were operating at an average 18-29 percent over capacity. In nine states, the entire prison system is under court order to reduce overcrowding. All but five states have at least one prison operating under court order or consent decree. The Federal Bureau of Prisons expects the number of federal inmates to double between 1990 and 1995.

Building prisons is not cheap. Construction costs range between \$60,000 and \$80,000 per inmate bed for high-security facilities. In addition, annual operation and maintenance costs are straining already overburdened budgets.

\Faced with these daunting

numbers, public officials have increasingly turned to the private sector to assist in corrections. In 1991, the Massachusetts Department of Corrections awarded a contract to provide food services at several state facilities to a private firm, at a cost savings estimated at \$600,000 annually. Other functions often contracted out include health services, inmate academic education, vocational training, and counseling.

Prison construction is another area in which the private sector can play a role. There are now more than a dozen private firms offering to finance prison construction projects, usually under a lease-purchase agreement. Under a lease-purchase agreement, a private firm will build a prison at its own expense, provided the state agrees to lease the facility for a specified period of time. Such arrangements are financially attractive for both the state and the firm. Free of bureaucratic regulations, private prison construction is faster and less expensive than public construction.

For most people, there is nothing objectionable about a private, profit making corporation providing such services. But, privatization advocates maintain that the responsibility of government is to provide all needed services in the most cost-effective manner possible; the public or private identity of the service provider is irrelevant. Taxpayers deserve to have the government procure the highest possible quality of service at the lowest possible cost.

What then about the actual management of a prison? One essential role of government is to

punish crime, a role which is and ought to remain unique to the state. While the state clearly must maintain responsibility for corrections, is there any reason that state employees, as opposed to private firms, should do the work?

The argument has been made that the profit motive of a private corrections firm would jeopardize the rights of inmates. Once a management contract had been awarded, this argument contends, the private firm would attempt to cut costs at the expense of the living conditions of inmates. The firm's objectives would take precedence over the public interest in fair inmate treatment, due process, education, vocational training, and rehabilitation. This argument cannot be dismissed lightly. The state has a compelling interest in assuring that its corrections objectives are met.

Through intelligent oversight, however, all these objectives can be achieved within the framework of a private facility. To be an acceptable option, private prison operation must be overseen by government employees charged with verifying that such facilities are managed in accordance with statute, regulation, and contract. Just as government agencies contracting for street sweeping verify the quality of the service provided, so too should public authorities contracting for prison management. Since privately operated facilities would continue to operate under the scrutiny of the judiciary, turning over the operation of a correctional facility is not tantamount to relinquishing oversight authority.

Some view the private-public debate as a choice between private management, with its undeniable

potential for fraud and abuse, and the "perfect" alternative of public operation. That is a mistake. Public operators can lack incentives to provide humane and high-quality inmate services. Many inmates now suffer under overcrowded conditions in public institutions. At least private operators have a profit guided interest coincident with the public interest-private operators are motivated to provide high-quality inmate services in order to secure additional contracts.

Where comparisons can be made, there is evidence that conditions in private facilities are superior: A higher proportion of private than public prisons have achieved American Correctional Association accreditation. In terms of seeking legal redress for ill-treatment, Professor Charles Thomas of the University of Florida points out that "the legal remedies of state inmates housed in private correctional facilities are more complete and expansive than those of state inmates housed in state facilities:" Issues concerning the use of prison labor are equally problematic for private and public operators.

The chief reason in favor of using the private sector-whether for prison support services or for management-is saving money. As in most areas, the innovation engendered in a competitive market results in significant savings over public monopolies. Because the true cost of public prison operation is often difficult to identify, few studies have been done to quantify the extent of savings. But Charles Logan of the National Institute of justice has estimated that the largest private prison operator saves the state 4-15 percent.

Savings are not, as a rule, achieved at the expense of prisoner well-being. Corrections is a highly labor-intensive operation. Private operators enjoy a cost of labor advantage because they pay the market rate, while public operators typically use unionized public employees whose wage and benefits are above the market rate. Private operators also use creative purchasing strategies to lower costs.

Given the limited resources available to government, using the private sector to stretch corrections expenditures has important ancillary public policy implications. Because of overcrowded prisons and a lack of funding, many criminals that justice and public safety indicate should be incarcerated are allowed to go free. Private prison operation can, by making more efficient use of scarce public resources, remove the availability of space from the list of considerations deciding whether to incarcerate a convicted criminal.

The successful use of private management in public corrections hinges on a contract that provides for an active government role in overseeing operations. Even in a privately managed prison, government retains the ultimate responsibility for the prisoner. Mechanisms exist to assure that private operators serve the interest of inmates and public. Evidence has shown that private service provision is more cost-effective than public. Through legislative, judicial, regulatory, and contractual means, stringent public oversight of private prison operators can and should be exercised.

Privately operated prisons can be an important component of the effort to provide humane, cost-effective corrections.

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**"Privatization: What I Did"**  
Inge Fryklund, J.D., Ph.D

In 1989, I became head of the Chicago Parking Program, responsible for creating a new system to manage 25,000 meters, 3.5 million tickets issued yearly, and all related adjudications, collections, and public service functions. Under its chaotic old system, Chicago had 17 million unpaid tickets worth \$420 million! I quickly concluded that Chicago lacked the resources and expertise to handle both the huge data bases and the information technology for on-line neighborhood service centers. This capability was in the private sector.

I began studying examples of privatization around the country to find out how private-public partnerships work, and why. The result for Chicago Parking was a privatization arrangement that saved money, resulted in better public service, was politically popular, and brought in about \$30 million in new revenue each year-while the city remained firmly in control of all operations.

Many examples of privatization around the country are disappointing or embarrassing. Why is success often elusive? The trick is to understand why privatization works. It is a mistake to have privatization as a goal. Privatization is a tool, a particular

means of accomplishing public ends. Like any other tool, privatization is effective in some circumstances, and worse than useless in others. Here are some of the considerations that I have found to be critical.

Usually, the chief rationale for privatization is saving money. But, consider a hypothetical case: In City A, municipal workers collect the garbage. Tax revenues cover employee salaries and benefits, garbage trucks and maintenance, and administration. In City B, garbage collection is contracted out. Payments to the contractor have to cover the costs of labor and equipment plus profit. These are the direct contract costs. There are also indirect costs incurred by the purchasing and law departments to draft, bid, and negotiate the contract, plus oversight for the life of the contract. Ronald Cease, an economist at the University of Chicago, won the 1991 Nobel Prize for his study of these "transaction costs:"

Transaction costs occur in both the public and the private sector, but are particularly burdensome in the public sector. A private business can do business with a handshake. Government must have a written bid document, advertise it, select a contractor using criteria specified in the bid package, and have a signed contract before payment. The government may also require minority and women-owned business participation, or local hiring, and have rules about the contractor's policy towards South Africa or Northern Ireland. While there may be excellent public policy reasons for each requirement, the economic fact is that they inevitably increase transaction costs (a fact rarely

considered when policy legislation is passed).

In comparing cities A and B, it would appear that the costs should be greater under privatization (City B) because of the transaction costs. Hence *Rule 1. Do not privatize (outsource) unless the expected gains exceed the transaction costs.* This leads to *Rule 2. Figure out how to measure both benefits and transaction costs.* In my experience, state and local governments do a poor job of cost accounting. The Sanitation Department in City B may show direct savings from privatization, but all the time spent by the law and purchasing departments does not appear in Sanitation's budget. Government cannot make informed decisions about privatization unless these costs are identified.

City B with its outsourced garbage collection may nonetheless be a winner even with fully allocated costs, because privatization, even of this simple substitution variety, can result in productivity gains:

1. Economies of Scale. If the contractor can spread costs over several buyers, or purchase supplies or equipment in quantity, direct costs should decrease. This is likely to benefit only small jurisdictions; larger cities are already buying in large volume.

2. Union Restrictions. Public sector output per employee may be low because union contracts require excess personnel. Until recently, Chicago used four-man garbage crews. That number is now three, but many cities use two or one. When confronting a powerful union is politically impossible for a city, it pays to

privatize and hire a company that uses two-man crews or has flexible work rules. The union issue is sidestepped. The productivity advantage of privatization therefore reflects the realpolitik of government-union relationships, rather than any intrinsic private sector advantage. The threat of contracting out (competition) may also encourage flexibility by public unions.

3. Public Sector Hiring and Firing. Firing a public employee for incompetence is difficult. If the worker is simply unwilling to go the extra mile, it is impossible. Private sector firing is easier, and privatization contracts often specify removal of employees at city request. What the contractor does with that employee (terminate, reassign) is the contractor's problem. Privatizing can thus give a public manager greater control over the workforce. Private employers can also hire more quickly. In the public sector, from the time a budgeted position is vacant, it can easily take four months to advertise, accept union bids, screen, interview, and hire. A quick response to changed conditions may be possible only by privatizing. While each of the public personnel rules was created to insure fairness in public employment, the net effect is to immobilize government. Privatization is a means around these rules.

While privatization is an attractive strategy for these purchasing, union, and personnel reasons, the implications should be addressed explicitly. Just as there are hidden transaction costs in public policy choices such as anti-apartheid laws, there are hidden policy choices implicit in privatization; unions may lose power, public-

employment be reduced, and other public policy choices be sidestepped. *Rule 3. Be alert to public policy implications of privatization.*

The efficiency gains from privatization are undeniable, but neither is the net gain all that large. Simple substitution of private for public workers is not going to save millions. This brings us to *Rule 4. The real benefits of privatization come from leveraging private sector resources and expertise.* This is particularly critical in the high tech area in which local governments are relatively new players. There are a number of leveraging strategies: Chicago used all of these in privatizing its parking system.

1. **Contract for Services, not Equipment.** Contracting for services (carefully specifying performance standards) reduces government's risks while providing access to leading-edge technology. A city is in no position to act as a systems integrator and generally lacks the expertise even to make intelligent purchasing decisions about advanced technology. Private sector firms specialize in this area. By leaving it to a computer systems company to deploy equipment as it sees fit in order to meet performance standards, the city can focus on goals and taxpayer service. By spreading the cost of high-priced and esoteric expertise across many other jobs, the contractor makes it possible for the city to obtain services and technical expertise that it could not afford in-house.

2. **Leveraging Private Sector Market Power.** AZ contractor may have market clout that the city lacks. For example, with just

one Sony optical disk storage device, Chicago would be a small customer of Sony. Fortunately, the equipment is owned by a contractor (EDS Corp.) which has contracted to provide imaging services for the Parking Program. EDS, a big customer of Sony, gets commensurate attention; so, problems are solved quickly without disruption of city operations. Privatization gives Chicago power to obtain a benefit that its own direct purchasing power could not.

### 3. Bundling Transaction Costs.

Any contract involves transaction costs. By putting many services under the umbrella of a single contract, it is possible to reduce the total transaction costs. For its parking program, Chicago needed tickets, forms, keypunching, computers, and data lines. If obtained separately each would have carried its own transaction costs. Instead, Chicago used a general contractor, EDS, which supplies the city with services (some of which include personnel), subcontracting as needed. In one fell swoop, Chicago eliminated many transaction costs, leveraged private sector expertise and market power for high tech equipment, and shifted most procurement and personnel issues into the private sector. With the large contract, it was even possible for EDS to subcontract economically meaningful chunks of business to meet the city's minority participation requirements.

Whether privatization is substitution or leveraging, always remember *Rule 5. Government can never contract away blame or responsibility.* Government will always be held accountable by the taxpayers. So, any privatization

contract must be drafted to insure that the government retains policy-making authority and accountability for all monies involved. Government cannot hand problems over to the private sector; it can only harness private resources as a means of serving public ends.

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### "The Challenge of Privatization"

Dr. David R. Bean, Public Administration, IIT

Public administration has borrowed managerial methods from business since public administration's origin. The first statement of its principles, written in 1887 by a young college professor, the future President Woodrow Wilson, even described "the field of [public] administration" as "a field of business." One might think, then, that "privatization" is simply the logical culmination of a century-old trend. Yet, in reality, it represents an historic change. "Privatization" is more than just another management technique. Privatization reflects a desire to turn back the course of history.

For many decades, government growth everywhere outpaced the private sector. This seemed inevitable. An advanced economy raises demands-for transportation routes, for example-and creates problems -like environmental pollution-that only government seems able to meet. Yet, privatization has recently enjoyed considerable success. The collapse of communist economies in the Soviet Union and eastern Europe and the creation of new

market based institutions has had counterparts in democratic socialist societies, including Thatcher's Britain, where some state-operated industries and holdings were sold to private owners.

Because the US never accepted "socialism" in a major way, there has been less for government to dispose of. Automobile companies, airlines, electricity, and so forth, have typically been in private hands. Yet, the same turning away from a government grown too costly and undisciplined occurred here in the 1970s and 1980s. The marks it left were deregulation, "zero-based" budgeting, "sunset" laws, deficit reduction targets, and all the other elements of "cutback management."

"Anything you can do, I can do better" is the theme-song of privatization's most ardent proponents, with "better" meaning one thing: "cheaper." As a respected expert in public finance declared to me, "I cannot see any reason why government should do anything the private sector can do less expensively." And that, to an economist, is nearly everything, because government is considered "monopolistic" and hence costly and exploitative, while business-presumably disciplined by a competitive marketplace-is forced to become ever more efficient.

One can challenge the claim that privatization always saves money, that competitive bidders will always be available, and so forth; many have done so. For example, some City of Chicago engineers claim that their department pays consultants as much as four times what it formerly cost to perform the same work in-house.

But this economic approach is too narrow. Cost is *not* the only issue pertinent to government. Questions of propriety and legitimacy are also involved. Indeed, in the historic essay quoted earlier, Wilson declared "It is the object of administrative study to discover, first, what government can properly do." (Discovering how "to do these proper things with the utmost efficiency and the least possible cost of either money or of energy" comes second.)

The primary question (what government can properly do) cannot be resolved in a day; resolving it is, very likely, a key task of each generation. But a way to begin is to reflect on not the more commonly-perceived similarities between business and governmental management, but their less-often-emphasized differences.

This, too, has a tradition. Sixty years ago, political scientist Wallace Sayre argued that surface similarities-say, the shared preoccupation with hiring, performance evaluations, and audits-were misleading. Public and private management are alike, he said, only "in all *unimportant* respects."

Choosing to have business, rather than government, deliver a public service ought to be a matter of consequence because the "cultures" of business and government grew out of different necessities: to beat out competitors, on the one hand, and to maintain popular support, on the other. These necessities are augmented by socialization. People in business and government generally differ on key issues because they have been

"indoctrinated" differently by work experience and formal education. For example:

**Attitude toward the Law.** In business, the bottom line is profit. In government, there is a different bottom line, less often noted: faithful execution of the laws. Wilson himself defined public administration as "detailed and systematic execution of public law." A charge to "take Care that the Laws be faithfully executed," directed at the president, is the principal reference to administration in the U9 Constitution.

Business, of course, should not and generally does not flagrantly disregard the law. Indeed, most business codes of ethics stipulate that employees should not "do anything unlawful or improper that will harm the organization." There is a difference, however, between an instruction to "faithfully execute" the law and one that says "don't break it." To choose business to operate a program, then, is to choose a mechanism where adherence to the popular will expressed through legislative action is not the principal objective.

**Public Interest Orientation.** Business is primarily concerned with the interests of its shareholders. Public administration, in contrast, has always been grounded in some conception of the general welfare.

Those in public life necessarily "rub up against more considerations" than those in business, as Paul Appleby noted, with the result that long concentration on business functions often leave a person ill-prepared for governmental roles:

"Without being venal, some thought their positions were simply a fortunate special privilege, like being the cousin of a purchasing agent. Others again had the fixed idea that the best possible way of promoting the public welfare would be to help private business and assumed accordingly that doing favors for private business was their simple governmental duty."

**Involvement in Politics.** Just as monks are expected to abstain from worldly pleasures, public servants are restricted in their political activity. A string of judicial decisions focused in Illinois, where this stricture was too often neglected, have now elevated it to Constitutional doctrine. Business, in contrast, considers political involvement a useful tool for enhancing its well-being; corporate PACs, in particular, have mushroomed since the mid-1970s. Not surprisingly, "politicization" has been a criticism of privatization activity; a recent *Chicago Tribune* series described state contracting for services as "the new era of patronage," preferred now that older forms are clearly unlawful.

**Openness and Confidentiality.** Government, by tradition augmented by recent open meeting and freedom of information laws, must be open to public inspection and participation -indeed, to intensive and often hostile journalistic scrutiny. Business, in contrast, is a private venture; internal operations may be considered a secret, likely to jeopardize corporate success if it falls into the hands of a competitor.

The flip side of openness is confidentiality. Government is

necessarily entrusted with information that it should not and cannot use in various ways: individual census records and tax return, for example. Business, on the other hand, considers information a strategic tool in the quest for corporate advantage. To choose business to provide a service, then, is to give information to an organization inclined to use everything it knows in the service of its economic objectives and to hide what it knows from public view.

These few examples do not exhaust the differences between business and government bearing on privatization. Others include the greater continuity of employment that marks the public service, as well as the strong "mission orientation" of many of its workers; the concern with "appearances" that is essential for those in public life; the enhanced stress on "process" and "fairness" in every aspect of governmental operations; and the greater need for clear lines of accountability, lines privatization often muddies. But the list is, I hope, long enough to prompt greater thought about privatization as a potentially troublesome, if also potentially useful, device.

Forecasting is perilous. But my bet is that, ten years from now, we will look back on the recent infatuation with privatization as a dead-end in the quest for more productive and trustworthy government. That's the bad news. The good news is that excesses by proponents of privatization could well produce serious debate about the primary task Woodrow Wilson set before us a century ago: reconsidering "what government can properly do." That would be good news, indeed.

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### **"The Privatization of Judges: Ethical Issues in Employment Arbitration"**

Robert F. Ladenson,  
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Recent years have seen a growing trend toward the privatization of activities and functions ordinarily associated with the public sector. Privatization generally occurs in connection with the providing of municipal services, such as transportation or garbage and waste removal. In addition, however, the trend toward privatization has expanded to include the administration of justice, an area many observers view as inherently public. Privatization in this area poses important ethical issues that remain insufficiently explored.

Litigation in a court of law is today characterized by procedural complexity, delay, and substantial expense. Dissatisfaction with the state of litigation has led to a growing alternative dispute resolution (ADR) movement. Arbitration is a major component. In the workplace, additional factors have spurred the growth of ADR. The steady decline of collective bargaining in the private sector during the past twenty years has been accompanied by a corresponding increase of legal constraints on employer actions both by new statutes and by judicial decisions expanding the range of common law causes of action employees may bring against an employer. These developments subject employers to potential costly

multiple causes of action litigated simultaneously in several forums. In an effort to duplicate many of the advantages found in arbitration under collective bargaining agreements, an increasing number of employers have established arbitration systems for resolving disputes in the non-unionized workplace.

The recent decision of the U.S. Supreme Court in *Gilmer v Interstate/ Johnson Lane Corp.* 111 S.Ct. 1647 (1991) appears to pave the way for privatization of justice in disputes between employers and employees involving an employee's legal rights under federal statutes relating to major areas of public concern such as race, sex, or age discrimination. In *Gilmer* the Court held that a securities broker who, as part of his registration application with the securities exchanges, agreed to arbitrate all claims arising out of his employment, was bound to arbitrate a claim arising under the Age Discrimination in Employment Act (ADEA). The Court held that the policy of the Federal Arbitration Act favoring enforcement of agreements to arbitrate compelled arbitration of Gilmer's ADEA claim. The Court refused to find within the ADEA a policy against compelling arbitration or otherwise waiving the right to litigate. This holding appears to apply, by implication, to other federal statutes protecting equal opportunity. The *Gilmer* decision has far reaching implications for protection of civil rights in the workplace.

Both those who hail and those who dread the growing ADR movement recognize a tension between efficient dispute resolution and publicly

accountable law making. ADR proponents, however, minimize the public justice concerns and maintain that without ADR's efficiency gains there will be no justice at all, only judicial and administrative gridlock. On the other hand, ADR opponents maintain that efficiency gains, if any, of ADR cannot justify the privatization of public justice, particularly in regard to interpreting the rights of individuals under Title VII of the 1964 Civil Rights Act.

The following example brings out the problem that troubles some commentators on the Supreme Court's *Gilmer* decision. Title VII makes it unlawful "to discriminate. . .with respect to. . . terms, conditions or privileges of employment, because of . . . race:" Imagine two competing insurance companies, Company One and Company Two, located in a metropolitan area with a high degree of racial segregation. Although each company hires sales representatives without regard to race, each concludes that a significant number of potential customers are more likely to purchase insurance from a sales representative who shares their race. Imagine too that both One and Two conclude that, although many potential customers regard the race of the sales representative as irrelevant, few are more likely to buy insurance from a sales representative of a different race. For this reason, both companies assign white sales representatives to their offices serving predominantly white areas and African-American sales representatives to their offices serving predominantly African-American areas.

Assume that companies One and

Two each face Title VII claims before different arbitrators, one of whom sustains the claim against Company One, and the other of whom rejects the claim against Company Two. These conflicting decisions, resulting from the arbitrators' different personal perspectives on Title VII, and their differing views on what constitutes racial discrimination, pose a deep problem. By enacting Title VII, Congress recognized that private markets do not prevent racial discrimination. For example, assume that both companies One and Two would prefer to assign their sales representatives without regard to race. Neither company acting alone, however, will do so because it runs a substantial risk of losing business to the other. When each acts alone the results are less than optimal. Each ends up with a racially segregated sales force it would prefer not to have. Because of this "prisoner's dilemma," a competitive market actually prevents an otherwise efficient solution to a problem of racial segregation. Title VII recognizes this imperfection in the private market and solves the prisoner's dilemma.

But Title VII does more. Assume that both companies wish to cooperate so that, vis-a-vis the other, neither will suffer a competitive disadvantage by integrating its force of sales representatives. Each still would have a motive not to integrate if each concluded, either separately or together, that an integrated sales force would produce a lower level of overall insurance sales (for example, because, for some extremely bigoted customers, the prospect of buying insurance from a representative of a different race would be so odious that they

prefer to spend their money on other financial products).

Title VII represents a public determination that the elimination of racial discrimination is so valuable that requiring employers to bear some of the costs of pursuing that goal is just. The extent of the costs that employers must bear is not specified in the statute. That issue is delegated to judges and administrative agencies to determine case by case. Under a system in which employment arbitrators make final and binding decisions in cases involving charges of discrimination brought under Title VII, there would be serious concern about whether those decisions adequately reflected the public justice values at the heart of the statute. For this reason, in our opinion, the conclusions of employment arbitrators concerning interpretation of the law must be subject to *de novo* judicial or administrative review. Judges must not view themselves as bound by an employment arbitrator's conclusions about how to interpret federal statutes. Only judges in judicial or administrative tribunals have the legitimacy, conferred by the legislature, to provide authoritative interpretations in this area.

If concerns of legitimacy mandate *de novo* judicial review of the decisions of employment arbitrators concerning interpretation of the law, what will happen to the advantages of employment arbitration from the standpoint of efficiency? These advantages, advocates of ADR contend, only accrue if the parties to a dispute must take the arbitrator's decision as final. Otherwise, say ADR advocates,

that decision simply becomes the initial step in a complex and costly litigation process.

We believe instead that *de novo* review of an employment arbitrator's conclusions of law would leave the efficiency advantages of employment arbitration largely unimpaired. According to our argument, *de novo* review is needed only for an employment arbitrator's conclusions of law. The approach of most employment arbitrators to the determination of factual issues does not raise the difficult issues concerning values of public justice that arise in connection with arbitral conclusions of law. There is no reason to subject an employment arbitrator's factual findings to judicial review beyond basic standards of fairness and impartiality.

Accordingly, we propose a dual standard of review of employment arbitration awards: broad deference to arbitral findings of fact, but *de novo* review of an employment arbitrator's legal conclusions. Most of the delay and expense of litigation may be attributed to the judicial system's formalistic procedures for factual inquiry. Were the facts undisputed, a lawsuit could be resolved quickly and cheaply. Furthermore, because most statutory employment discrimination claims are predominantly fact based, the availability of *de novo* review of arbitral interpretations of law will not significantly affect the overall finality of employment arbitration. It will provide, however, the legitimacy that otherwise would be lacking in the privatization of public justice in the workplace.

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## "Announcements"

**CALL FOR PAPERS:** *The European Business Ethics Network: Sixth Annual Conference*, September 15-17, 1993, Norwegian School of Management. While the conference theme will be "The Use of Consultancy Ethical Demands and Requirements;" contributions (including case studies) on any topic of business ethics will be considered. Deadline for submission: February 28. Contact: EBEN Conference Secretariat, Dr. Heidi van Weltzein Hoivik, Norwegian School of Management, PO. 580, N-1301 Sandvika, Norway.

**CONFERENCE:** *Teaching Ethics in Science and Engineering*, February 10-11, 1993, Boston, Massachusetts. Sessions include 'Authorship and Intellectual Property;' "Conflict of Interest;" "Privacy and Confidentiality;" and "Misconduct and Whistleblowing." Contact AAAS '93 Seminar, AAAS Meetings Office, 1333 H. St., NW, Washington, DC 20005.

*Total Integrity Management: Cultivating Ethical People-Building Ethical Organizations*, February 17-19, Long Beach, California. Contact: Delona Davis, Conference Coordinator, University Extension Services, California State University, Long Beach, 1250 Bellflower Blvd., Long Beach, CA 90840-8002 (ph. 310-985-8446).

The Center for the Study of Ethics

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