

Privatization, Government, and Economics

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While the duty of a democratic government is to represent the popular will, the management of resources within its control presents a particularly vexing challenge. Taken at its root, the problem boils down to the fact that while every citizen is part owner of a public resource, no single entity definitively controls it. Determining who is granted license to utilize and further develop a resource in a fair and equal manner is a problem that has fueled the refinement of numerous governing philosophies.

Generally, resource distribution occurs in a manner consistent with a nation's economic policy. In the United States, the laissez-faire principle allows the invisible hand of the market to determine the allocation of various resources, as well as which entities gain control of them. In the socialist countries of Western Europe, governments continue to retain more control over public goods and services. And in the Far East, Marxist-derivative systems assure that almost all public resources remain in control of their governments.

Drawing a comparison between the relative strength of the various global economies and the freedom with which their resources are allocated tends to show a strong positive correlation¹. That is, the more free an economy, the stronger and more prosperous it tends to be according to conventional measures², such as the Gross Domestic Product. This result confirms a fundamental principle of economics: that the dynamic allocation of limited resources results in production at the highest efficiency attainable. However, the GDP is inaccurate insofar as it ignores those goods and services to which it cannot assign a value. For instance, an abundance of clean, healthy air does not contribute to the GDP, whereas a prescription charge for asthma medication

¹ *Economic Freedom, Prosperity, and Equality: A Survey*, Cato Institute Journal Vol. 17, No. 2
<http://www.cato.org/pubs/journal/cj17n2-1.html>

² *An Inquiry into the Nature and Causes of the Wealth of Nations*, Adam Smith, 1776

is factored in. Therefore, a major caveat to the theory of measurable prosperity is the requirement that the products being measured have tangible value.

Recently, however, proponents of the laissez-faire model have attempted to correlate their predictions of greater efficiency and lower cost to the privatization of public goods and services that have relatively *intangible* value. Education, health care, and public transportation do not produce easily quantifiable value and were not originally intended to produce surplus profits from their users. By subsidizing certain public services, the government is able to keep them affordable for the majority of users. While governments are reluctant to increase usage fees for services, the costs of these services have increased in recent years such that they now comprise a significant portion of municipal budgets. Privatization is seen as a means of reducing cost and improving the accountability of the service providers. This reasoning does not stand up to careful examination.

First of all, a private corporation is not likely to offer its services for an amount less than the previously allocated tax revenues. Or, if it does accept less in tax revenues, it may directly recoup its costs from its users. This introduces a source of potential inequality in the distribution of services to the population. In particular, people who relied on the shared costs of government-provided services may be unable to pay the out of pocket costs demanded by privatized entities. For instance, while the privatization of the water utilities in Great Britain in 1989 led to improved water quality, the costs of implementing the system caused water prices to double in 7 years. As a result, many British citizens lost their ability to pay for a sanitary water supply³. Indeed, while divesting a public service may eliminate certain government expenditures, the aggregate cost to the end user may increase well beyond the government's savings.

³ *Privatizing Water Supply and Sewage Treatment: How Far Should We Go?*
Journal des Economistes et des Etudes Humaines, Volume 8, Number 4, December 1998, pp.441-454
<http://www.environmentprobe.org/enviroprobe/pubs/ev541.htm>

Secondly, because it is driven by the need to maximize profitability, a private corporation will seek to minimize its costs as aggressively as possible. With a fixed revenue stream and other factors held constant, the only way to increase profit is to reduce costs and expenditures. Thus, the minimization of expenses may come at the provision of lower-quality goods or services as well as the avoidance of meeting standards. It must be remembered that prior to the passage of child-labor mandates and a public education system, the market itself did not strive to create a system of its own to educate and further develop its unskilled workers. Also, prior to the creation of water and air quality standards, industries minimized their expenses by releasing untreated effluent into the water table and atmosphere. Given the opportunity, and a past history, private industry has often acted solely in the interests of the market, and counter to the best interests of the people.

Finally, accountability is *the* legitimizing factor in broadening the appeal of privatization. The need for excellently designed and stringently enforced regulation is an important component of privatization theory. Although a public resource may be ceded to private management, an appropriate system of checks-and-balances must be implemented to assure taxpayers that a service provider is operating in a manner consistent with the best practices available. The transactions of a privately operated service must also be kept at the same level of transparency to scrutiny as public records. Attaining this transparency may prove difficult, however, since privately held corporations are not generally accountable to the public.

The nature of business in its present, relatively unregulated state is highly incompatible with that of public service. Where one model seeks a profit for production by pursuing the lowest costs, the other model attempts to meet the needs of a citizenry without regard for profit or cost. Although efficiency tends to be higher in the former and lower in the latter, the fact of the matter

remains that in a privatized system, an entity may be able to generate excess revenue/profit from a publicly generated tax base, while possibly providing a less-equivalent service.

While it may appear that allowing privatization into the public service marketplace runs counter to the very ideals of that marketplace, it is vital to realize that the underlying need for the restructuring of public services exists regardless of the controversy surrounding proposed solutions. Privatization presents itself as one option, although other options such as governmental streamlining and reform are also valid. Ultimately, the goal of laissez-faire proponents is to force the government to respond more dynamically to the needs of its users.

How does the introduction of privatization change the existing public services model? The major selling point of privatization is its ability to offer greater choices to the citizenry by eliminating the single-source supply model of government. The hope is that by creating more choices, competition may be fostered where necessary. However, as a precondition to privatization, the present condition of the public services marketplace must be examined. Whether or not a marketplace should be opened up to competition depends on the number of incumbent service providers. If a service is currently provided by a single *public* entity, then the privatization of that entity would result in an instant monopoly by a single *private* entity⁴. It is immediately noted that many of the services under consideration for privatization fit the above scenario. The sanctioned creation of monopolies or oligarchic systems must not be allowed, due to the fact that there is little incentive for monopolies to innovate and improve efficiency. On balance, trading one monopoly for another would not offer end users any positive benefit⁵.

⁴ *Privatization and the Globalization of Energy Markets, Chapter 4: Russia*, U.S. Department of Energy Report <http://www.eia.doe.gov/emeu/pgem/ch4a.html>

⁵ *An Alternative Proposal for Philadelphia: A privatized school monopoly is no better than a government school monopoly*, Mackinac Center for Public Policy, December 2001, <http://www.mackinac.org/article.asp?ID=3878>

What is needed to replace a single supplier market is a multitude of competing suppliers from both the governmental and private sectors. In the case of education, the creation of varied charter schools might offer parents and students the opportunity to choose the school most closely fitting their needs. An increase in schooling options would raise the amount of academic competition in a district, which would be a positive outcome. In this case, the dismantling of an existing state-operated monopoly would generate beneficial results for the taxpayer.

Under other conditions, however, multiple suppliers can also be highly impractical, suggesting that consolidation might be a better answer. In the health care arena, the creation of multiple private insurance companies has resulted in the segmentation of health care providers and tremendous inefficiencies in the billing process. While the public health services of Western Europe and Canada may not be stellar examples⁶, the benefits of a single-payer system with primary health insurance guaranteed by the government are evident.^{7,8} Just as privatization is suggested in cases of poor public service performance, nationalization might be considered a valid option in instances where privately operated services perform poorly. It may be beneficial to consider solutions that go against the unidirectional ‘flow’ of progress.

Thus, the decision between government and market influence should be careful to consider a broad array of factors. Simply throwing identical quantities of money at alternative privatized solutions to a public need would produce roughly equivalent results. However, if carefully crafted and independently monitored privatization efforts are implemented in sectors that demonstrate significant potential benefit, the end results might outshine the initial uncertainties.

⁶ *The Structural Problems of Single-Payer Systems: Rationed Care*, Health Care News, August 2001
<http://www.heartland.org/health/aug01/structure.htm>

⁷ *Canada's Single Payer Health Care System - It's Worth a Look*, Bruce Robinson, Boulder Community Network
<http://bcn.boulder.co.us/health/healthwatch/canada.html>

⁸ *Physicians for a National Health Program Statement*, http://www.pnhp.org/publications/single_payer3_27_00.htm