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Lawrence W. Reed's

PRIVATIZATION

Pros and Cons for The Bahamas

Once a service is privatized accountability is almost instantaneous

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Ideas make all the difference in the world. In fact, as the old saying goes, they rule the world! Victor Hugo, the great French author, once said "Nothing is as powerful as an idea whose time has come." I think he's also credited with the statement, "Ideas are more powerful than all the armies of the world."

For much of the 20th Century, trends in both ideas and the public policies that resulted from them were marching in directions unfriendly to liberty the world over. Statism — the notion that society's needs and problems are best addressed by politics and the political process — dominated public discussion. Respect for personal liberties, private property, and freedom of commerce in open, competitive markets fell victim to the state's false but alluring vow of economic security. Governments grew immensely — commanding ever-greater portions of personal income, regulating and even nationalizing businesses, making public burdens of millions of people.

Those who supported the free market suffered in number but not in spirit or persistence. Some of the greatest critiques of the interventionist state ever written were penned as the state approached the zenith of its influence. Mises' Socialism in the 1920s and Hayek's The Road to Serfdom in the 1940s stand as two of the very best examples. For the free market to prevail, however, its friends would sooner or later have to devise a strategy for actually dismantling socialism. Theoretical critiques, though essential to winning the intellectual battle, would have to be supplemented by practical methods of taking what was "public" and making it "private." What had been "socialized" would have to be "privatized."

By the 1970s, the bitter harvest of statism was everywhere apparent: in bloated, overbearing bureaucracies, in crushing tax burdens, and in frightening burdens of debts and deficits. Public officials and private citizens alike began to look for answers. The case for freedom and free markets began to win the battle among intellectuals. Increasing numbers among the general public followed suit, electing public officials committed to stuffing the statist genie back into its bottle. The time for privatization had arrived.

This is an earlier, 1997 version of the speech delivered in February 2008 for the Nassau Institute by Mr. Reed.
As the reader will note, the message is as timely as ever.

A definition is in order. Privatization, in its broadest sense, is the transfer of assets or services from the tax-supported and politicized public sector to the entrepreneurial initiative and competitive markets of the private sector. The superiority of the latter is now approaching the status of undisputed, conventional wisdom: the private sector exacts a toll from the inefficient for their poor performance, compels the service provider or asset owner to concern himself with the wishes of customers, and spurs a dynamic, never-ending pursuit of excellence — all without any of the political baggage that haunts the public sector as elements of its very nature.

In an interdependent world getting smaller through the speed of transportation and communications, no community of people can compete successfully without ridding itself of costly public enterprises and liberating the entrepreneurial spirit. Recognition of that fact is at the root of today's dramatic privatization revolution — from Moscow to Manila to my hometown of Midland, Michigan.

The theory is simple, but grounded in profound truths about the nature of humans and their response to incentives and disincentives. Tie up the performance of a task with red tape, bureaucracy, and politics within a system that is guaranteed to exist regardless of outcome, and the result is usually mediocrity at great expense. Infuse competition, accountability, and the fear of losing a valued customer into the task and mediocrity becomes the exception, excellence the rule.

Sometimes these lessons must be learned the hard way. Here's an example that proves that point: Before the break-up of the Soviet Union, any foreigner traveling there had to go through state-run tourist bureaus for permission to enter, itineraries, and guides. Since the break-up, many of the 15 former Soviet republics have permitted private tour companies to emerge and some of those companies have even been started by the very bureaucrats who used to work for the state.

In Ukraine, former state employees formed their own private tour company. According to a speaker I heard a few years ago, one of the first brochures they put together was aimed at attracting English-speaking foreigners to come in groups and tour — of all places! — Chernobyl, the site of the 1986 nuclear disaster. The brochure proudly announced that the tour included the city of Chernobyl, a visit to the concrete sarcophagus that envelopes the old reactor, a trip to a nearby radioactive waste dump, and a quick stop at a nearby town populated by radiation-exposed workers whose motto is, “Life is Good . . . But Too Short.”

The brochure also stated that the tour begins and ends with a Geiger counter check of tourists. Anyone needing treatment afterward for radiation exposure, it promised, will receive it “at no extra charge.”

Now, I don’t know for sure how this entrepreneurial venture turned out, but my guess is that this new company learned a lesson or two about pleasing the customer. Unlike working for a socialized enterprise, merely hanging out a sign or printing up a brochure does not guarantee revenue or your job in a free market. That’s a great strength of the free market itself — indeed, it’s the main reason why free markets in America have fed, clothed and housed more people at higher levels than any socialized economy anywhere could even promise.

When it’s done properly and with care, privatization harnesses the powerful market forces of competition, accountability and incentive. It means that government officials don’t have to be hemmed in by an indifferent bureaucracy; instead, they can “shop around,” as other consumers do, for the best available buys. State and local governments have routinely experienced cost savings of from 10 to 40 percent through privatization, and often with accompanying improvements in the way an asset is managed or a service is delivered. When and where assets and services can be left entirely in private hands from the very start, with the middleman of government absent altogether, even greater efficiencies are possible.

The most common form of it — contracting out to private firms — has become more than just a trend. With decades of experience, it has become something of a science at the local level in America. We now know what it takes to make this work: open, competitive bidding for contracts that are subject to periodic renewal; careful writing of the contract terms to incorporate clear language and appropriate safeguards; and effective monitoring of performance to ensure the contract is being carried out as expected, to name a few of the requirements.

Commercialization is another form. That happens when a unit of government simply says, “We’re no longer going to do this work with our own workforce. We’re not going to contract it out either. We're simply going to get out of this business altogether. The customers we used to serve can take care of the job themselves by contracting with the private provider of their individual choice."

This is how, for instance, cities across America like Traverse City, Michigan, have pulled out of the garbage business. The citizens themselves shop amongst several private, competitive firms that specialize in picking up and properly disposing of garbage. No middleman, no taxes, no boring city council meetings to sweat through in order to register a complaint. You hire the service and if you're not happy, you fire it and hire a different one. This form of privatization tends to enhance both our liberties and our pocketbooks if it's done right. Other forms of privatization include:

- the outright gift or sale by government of a physical asset (a piece of equipment or a building, perhaps) to a private entity;

- the issuance of "vouchers" which can be redeemed in the marketplace, instead of direct public provision of a service, giving recipients choices where they had none before;

- the sale of stock in a newly privatized company that was formerly state-owned;

- the ending of subsidies and all the red tape and regulations that came with them, liberating an industry to produce "for the market" and not for the government. (New Zealand accomplished this with agriculture a decade ago; farmers there are no longer wards of the state and are doing quite well, thank you).

Each of these forms, of course, has its pros and cons. But let there be no mistake about this fact: privatization in its various forms has now become nothing less than a revolution in governance all over the world. It is happening at a feverish pace, and the more it is done, the more we are learning about how to do it right.

Former British Prime Minister Margaret Thatcher taught us much about how to privatize. During her tenure, she sold off seven major commercial airports, including Heathrow, Gatwick, Aberdeen and Stansted — in a careful, studied and public way that maximized popular support for the move. More than two million citizens bought

1.4 billion shares of stock in the airport privatization effort.

Moreover, Thatcher sold a million units of public housing by offering them to the tenants at well below market value. The tenants who previously complained about the indifference of distant, bureaucratic management became the owners and managers themselves. With pride of ownership working its wonders, whole neighborhoods were subsequently transformed — broken windows were replaced, broken screen doors were repaired, gardens sprouted where litter once marred the landscape. The British treasury was relieved of the burden of throwing huge subsidies down the rat hole of public housing. The experience bears testimony to a time-honored principle of human action: what you own, you take care of; what nobody or "everybody" owns falls into disrepair.

Many state-owned companies were privatized under Thatcher — the huge and ubiquitous British Telecom being the foremost example. To encourage the public employees to be supportive, Thatcher offered them first crack at the sale of stock. They could buy the stock at discounts from what shares were expected to fetch later in the open market. The result: Public employees made money and became prideful part owners of new, private firms; the general public enjoyed better services; the British economy became more competitive; and taxpayers saved a bundle of money.

In the space of a decade, Margaret Thatcher sold off $40 billion in state enterprises. The number of British households owning stock rose from 2 million to 12 million. And about three-quarters of a million government employees were transferred from public to private payrolls. Once the post-war "sick man of Europe," Britain came to life again.

In a few places around the world, privatization is occurring because the enlightened leaders in power are motivated by ideology. They have read the works of Mises, Hayek, Friedman, and other great minds of free market economics. They know that free markets work and socialism does not. Prime Minister Vaclav Klaus of the Czech Republic is one such leader, and he has been shedding state assets and services at an impressive pace.

In most places, however, privatization is occurring for more pragmatic reasons. Countries, states, provinces or communities have hit the "tax wall," meaning they have no more room to raise taxes. Doing so would either violate some constitutional or statutory limit, or send people and businesses packing for friendlier climes. In other cases, government simply has not kept pace with technology and productivity advances and must rely upon private enterprise to put its unique expertise to work. So, for pragmatic reasons, hard-pressed politicians are exercising the best or only option they have — they privatize.

Let's bring this closer to home and focus now on the United States exclusively. At the federal level, little has been privatized but much could be. The power of entrenched bureaucracy and special interests that support the status quo is greater in Washington, as a rule, than it is at the state or local level. Proposals to privatize everything from Social Security to federal lands to the Post Office are now on the table, but they probably await a friendlier White House.

Incidentally, the Post Office is already undergoing a kind of market-driven, involuntary and unplanned privatization. Every time you use a private overnight mail service, a fax machine, or electronic computer mail to send a message you might ten years ago have sent via "snail mail," you are personally privatizing the U. S. Postal Service.

At the state level, there's much more going on. States are privatizing utilities, prison management, data processing, child foster care, and a long list of other items. Michigan under the enlightened leadership of Governor John Engler, I am proud to note, set a record in 1995 for the largest sale of an asset (in dollar terms) in the history of the 50 states. The state removed itself entirely from the worker's compensation insurance business when it sold the Accident Fund of Michigan and reaped $255 million in the process.

It is, however, at the local level of government — counties and cities and schools — where the privatization revolution is taking flight. You name it — just about any asset or service that a local government owns or provides has been privatized somewhere, in some manner, partially or wholly. That includes fire protection, certain elements of police protection, wastewater treatment, street lighting, tree trimming, snow removal, parking structures, railroads, hospitals, jails, and even cemeteries.

Mayor Steve Goldsmith of Indianapolis is one of the leaders in municipal privatization. According to Reason Foundation experts William Eggers and John O'Leary, in their new book titled Revolution at the Roots, Goldsmith has subjected more than 60 city services to competitive bidding and other forms of privatization. City employees have been given the opportunity to reorganize and enter the bidding too, in competition with private firms, and have won back the right to perform certain services. A funny thing happens when public employees have to directly compete: they discover that they really don't need as many supervisors, make-work rules, and coffee breaks.

Goldsmith has put almost everything Indianapolis does on the list for possible privatization. His motto is enough to make an entrepreneur out of many foot-dragging bureaucrats: "Sacred cows," he says, "make the best burgers." Indianapolis is now one of the best-run cities in the country, lean and mean and clean.

Governments don't always have to privatize to get their work done more efficiently. Sometimes, all they have to do is tell the world they're just thinking about it. That's the lesson from Flint, Michigan, where Mayor Woodrow Stanley can take credit for saving city residents a quarter of their annual $6.2 million garbage collection bill.

Here's the Flint story: For months, Mayor Stanley made it plain to the city that garbage collection was costing too much money. He finally did something about it in early 1994. He solicited bids from five private companies and the numbers confirmed his suspicions. The combination of a private firm handling garbage, compost, bulk items, and trash bins and the city taking care of leaf pickup and special clean-ups would cut the city's total cost by a whopping $2 million!

Flint's city employee unions then knew the mayor was serious. They scrambled to be competitive and offered to shave about $1.4 million from the garbage budget. They proposed increasing the number of stops on each route from 665 to 775, reducing the number of shifts from two to one, cutting the sanitation staff from 47 workers to 35, picking up bulk items along with regular garbage instead of doing that on overtime, and requiring workers — get ready for this — to work a full eight-hour day instead of going home early as they often had done in the past! These concessions were sufficient to convince the mayor and city council, at least for the time being, to keep garbage collection in-house. Nothing more than a reality check and residents saved $1.4 million!

So, there's a case where just going through the motions of privatization was enough to save a small fortune. Mayor Stanley told the Flint Journal, "If I were just some weak-kneed kind of namby-pamby politician, I wouldn't have touched this privatization issue with a 10-foot pole. Political leaders who aren't willing to take risks don't deserve to be in office."

Considering the privatization option, whether or not the final decision is to actually do it, is nothing less than good stewardship of the public purse. Thinking seriously about it prompts officials to open their minds and think about government services in ways they never pondered before. It forces them to find out, for instance, how much it is actually costing them to provide those services.

Most people don't realize that governments keep their financial books in what can only be described as a state of confusion. Rarely are all the appropriate costs of an activity or department actually charged to it. For example, a county sheriff in Michigan once boasted that he could house prisoners for a mere $17 a day, but a few follow-up questions revealed many things he wasn't counting because "some other department" took care of them — costly items such as custodial work to keep the jail clean and the pension obligations payable to jail employees.

At the Mackinac Center for Public Policy we discovered this important truth when we examined the custodial costs in a half-dozen public school districts around Michigan's capital city of Lansing. None of the districts had ever computed their custodial costs in a fashion that would allow them to gauge just how high they really were. We ran the numbers ourselves and discovered that the least costly district was spending 50 percent more than private firms would charge to do comparable work. The costliest district was spending three to four times more to get the job done! That one district, if it privatized the work, would save more than a million dollars a year in custodial bills alone — enough to hire 20 teachers at $50,000 each, or buy 500 computers for $2,500 apiece, or pay for 30,000 textbooks at $33 a book.

The teacher's union, which represents many custodial and food service workers in the schools, didn't appreciate our work. In the face of massive evidence that schools could indeed save money through privatization, the Michigan Education Association actually declared that it would oppose any privatization of any school support service by any school district! Now, you might ask, how can it be shown to the taxpaying public that the MEA's position is purely self-serving and inimical to the interests of the very children the union claims to be educating?

In thinking about this question at the Mackinac Center, it occurred to us one day that the MEA might not be practicing what it preaches. Surely, we thought, the union does not have its own full-time, fully unionized, in-house workforce providing every possible service at its own sprawling headquarters near Lansing. We checked it out and announced our findings in a press release headlined, "Mackinac Center Praises MEA For Cutting Edge Management Techniques."

Sure enough, we discovered that the teacher's union contracts out at its own headquarters with private firms for all of its own food service, custodial work, security, and mailing services and — in three out of four cases — with non-union firms! The hypocrisy of the union was not lost on the legislature, which eventually granted school districts much greater freedom to privatize support services without having to worry about opposition from the MEA. There is now a budding privatization revolution taking place in Michigan public schools as a result.

Examples of privatization are everywhere. Studies by the dozens verify its effectiveness. Articles and monographs are proliferating, advising officials of the pitfalls to avoid and the strategies that work. There is simply no denying that privatization is indeed a major trend now and that each new experience teaches us even more about how to maximize its benefits.

Objections to it, however, are still heard and sometimes loudly. I share with you here the most common ones, along with a brief response:

- It is anti-public employee. As the experience of innovative cities like Indianapolis proves, strategies can be devised that actually involve public employees in a positive way. But ultimately, we must remember that government does not exist for the benefit of those who work for it; it exists for the benefit of those who pay its bills or need its services. Governments that employ more people than necessary, or that pay their employees more than their market will bear, are not doing any favors for the citizens — including the poor — who are picking up the tab.

- It is a back-door way to hobble or destroy government. Mayor Goldsmith says that before he privatized city services, it was extremely difficult to resolve citizen complaints or get the bureaucracy to move on anything. Once a service is privatized, accountability is almost instantaneous. If performance suffers, the city can quickly cancel the contract. Because of that, says the mayor, government officials like him are actually empowered, not hobbled. As Hillsdale College economist Dr. Charles Van Eaton likes to point out, they can "shop around," just like ordinary consumers, and thereby find the best buys.

- There are instances where it didn't work, so we shouldn't do it anywhere. I have yet to see a case where a failure was really an indictment of privatization itself. Failures are almost always arguments for avoiding poor practices, such as noncompetitive bidding in smoke-filled backrooms, sloppy contract writing, or nonexistent monitoring of performance.

- It can breed special interests who will lobby for more contracts and services from government, even when that's not warranted. Public bureaucracies lobby for more government too. This is an argument for taxpayers and the press to be vigilant, not an argument against privatization.

- Government officials may not do the right thing with the savings. It's true that when privatization generates lower costs, officials may have multiple options for realizing the gain. They may choose to avoid raising taxes or actually cut them, passing the savings on to taxpayers. Or, they may simply take the savings and squander them on some other dubious enterprise of government. This is, again, an argument for vigilance, not against privatization.

All citizens who value freedom and the free markets that give life to that freedom should be encouraged by the privatization revolution. A better and leaner public sector is much more than a bipartisan, good government issue. It is an imperative that when accomplished will leave us a freer, more responsible, and better-served people.

About the Author

Lawrence W. Reed has been president of the Mackinac Center for Public Policy since its founding in 1988. The Center is a nonprofit, nonpartisan research and educational institute headquartered in Midland, Mich.

Reed holds degrees in economics and history from Grove City College and Slippery Rock State University in Pennsylvania, as well as an honorary doctorate in public administration from Central Michigan University. He taught economics at Northwood University from 1977 to 1984, serving as chair of the department from 1982 to 1984.

Reed is author of more than 1,000 columns and articles, which have appeared in dozens of newspapers, magazines and other publications, including The Wall Street Journal, Investor's Business Daily, Policy Review, The Detroit News and the Detroit Free Press. In addition, he has written or edited five books, and he has delivered more than 800 speeches, the venues including 40 states and 12 foreign countries. His interests in political and economic affairs have taken him as a freelance author to 67 countries on six continents since 1985.

He is both a member of the board of directors and a past president of the State Policy Network; chairman of the board of trustees of the Foundation for Economic Education in New York; and a regular columnist for FEE's monthly magazine, Ideas on Liberty.

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