OUTLINE
Privatization: Some Theoretical Considerations

Much of this material comes from "The Meaning of Privatization," by Paul Starr (Yale Law and Policy Review, 1988), but I have added other material and observations. Starr's material is over 20 years old. Also, Starr admits that he distrusts privatization, and that bias underlies his essay, as it does all the study materials I looked at. This is not surprising; we wouldn't be undertaking this study if we didn't think privatization deserved more scrutiny.

1. What do we mean by "public" and "private"?

Sometimes "public" means open as opposed to closed – a public place, public behavior, published work as opposed to private homes or diaries.

Sometimes "public" means "common," but not necessarily governmental – public opinion, public interest. So it may be in the public interest to support a right to privacy.

An economist views the marketplace as private, not controlled by the state. Social scientists view the marketplace as public because anyone can participate in it. Some companies are privately held, but others are public in the sense that anyone can invest in and profit from them. So we have public corporations in the private sector.

So divisions between public and private spheres are not well-defined. And there has historically been some tension between them, at least since the Enlightenment, with its respect for the value of the individual.

2. Some historical context on the role of government and on the public versus the private realm

From the founding of the U.S., we have been trying to determine the proper role of government in a growing number of realms:

- National defense
- Ensuring justice under the law
- Public health
- Education
- Public safety
- Social welfare
- Environmental protection

The Preamble to the Constitution says that the People want to form a more perfect union, establish justice, insure domestic tranquility, provide for the common defense, promote the general welfare, and secure the blessings of liberty. This seems to give the government a wide range of responsibilities.

But almost immediately, the new states called for the addition of the Bill of Rights, which limited the powers of the new government with regard to religion, speech, a free press, a right to assemble and to petition the government for redress of grievances, as well as the right to be secure in their persons, houses, papers, and effects.

So religious and moral belief and practice and economic activity that was formerly regulated by the state (in Europe) became increasingly privatized in this country; meanwhile, the U.S. committed to public law and public political discussion. Citizens expect their government to be public not only in its ends but in its processes. They expect it to be transparent.

In the 19th century, cities became classified as agencies of the state, while business corporations came to be treated as individuals. This is the basis of the contemporary legal distinction between the public and private sectors.

Some historians argue that since the 18th century, society has seen a decline of public culture and sociability, and that has increased as modern households have acquired larger homes, private cars, televisions, and other resources as alternatives to public facilities and public spaces. Starr argues that privatization involves a withdrawal of involvement in civic concerns, and extrapolates from that to privatization as a withdrawal of assets, functions, or institutions. It is worth noting, though, that some institutions – churches, for example – have always been private in this country, and that engagement in society takes place in many ways that are not "civic" in the sense of "related to citizenship."

Starr doesn't refer specifically to the public trust doctrine: the principle that certain resources are preserved for public use, and that the government is required to maintain them for the public's reasonable use. This is a major issue in California when it comes to resources such as water, clean air, or endangered species. Ongoing private sector pressures on public trust resources are not part of Starr's discussion.

3. Some historical context on economic theory

We see a kind of pendulum effect here. The idea that individuals working for private gain serve the larger social order goes back to 18th century economist Adam Smith (which Starr doesn't mention). Smith's *Wealth of Nations* underlies free enterprise and capitalism.

The 19th century saw increasingly abusive business and industrial practices, leading to anti-trust and labor laws. High inflation and banking failures led to the creation of the Federal Reserve (a central but not a government bank) in 1913. During the Progressive Era of the early 20th century, the U.S. subjected industry to systematic government regulation, a approach that continued through the Great Depression.

After WWII, the dominant economic theory was that of John Maynard Keynes. Keynes believed that to break a depression, the government needed to stimulate demand by getting money into the hands of consumers. This demand would stimulate business.

In the 1970s, private sector leaders began to assert that high tax rates and government regulation were inhibiting free trade, which was becoming increasingly global. This is when the term "privatization" began to be widely used.

Milton Friedman and the Chicago School of Economics believed that

- Democratic political systems tend toward government growth and high budgets
- Expenditure growth is due to self-interested coalition of voters, politicians, and bureaucrats
- Public enterprises perform less efficiently than private enterprises
- The more individuals gain from tending their own property, the better it will be tended

4. Shifting from public to private

(Note: shifts from private to public – i.e. nationalizing industry – haven't happened in this country.)

Starr says privatization has come to mean 1) any shift of activities or functions from the state to the private sector, and, specifically, 2) any shift of the production of goods and services from public to private.

He includes in the private sector both commercial firms and private nonprofit corporations or voluntary associations.

Starr notes that sometimes shifts from publicly to privately produced services occur not as a result of deliberate government policy but because government is not able to satisfy demand. (In socialist countries, this leads to underground economies.)

Privatization can refer to either production or consumption. For example, "privatization of transportation" might mean conversion of an urban bus system from public to private ownership, or it might mean a shift in ridership from buses to private cars.

Starr identifies four types of government policies that bring about a shift to privatization:

- Cessation or restriction of public programs or activities (privatization by attrition)
- Transfers of public assets to private ownership
- Financing of private services (contracting out)
- Deregulation of entry into activities that were previously public monopolies

Privatization may dilute government control and accountability without eliminating them. "Liberalization" refers to a reduction in government control, encouraging greater competition. It doesn't necessarily mean a complete transfer of ownership. And "private" doesn't necessarily mean "more competitive."

Also, privatization doesn't necessarily mean a reliance on commercial markets. Production of goods or services can be transferred to individuals or nonprofits as well as to small businesses or to large-scale corporations.

5. Economic models based on efficiency

a. Privatization as a reassignment of property rights

"The more individuals stand to gain from tending to their property, the better it will be tended." The more diluted their property rights, the less motivation they will have for using property under their control efficiently. For corporations, this theory says that the market will prompt managers to be efficient for the benefit of shareholders (in the form of profits).

The marketplace focuses attention on short-term profits and shareholder dividends, so there doesn't seem to be much incentive for private managers to manage for the long-term.

Public ownership, in this view, leads to what Garrett Hardin in a famous 1968 essay called "The Tragedy of the Commons." Individuals, acting out of rational self-interest, abuse and ultimately destroy the commons but take care of their own private property.

Are people capable of recognizing a collective self-interest apart from their own? Voters sometimes do that. Also, 2009 Nobel prize-winning economist Elinor Ostrom has shown how humans in various parts of the world interact with ecosystems to maintain long-term sustainable resource yields. People do not always destroy a commons.

b. Privatization as a relocation of economic functions

Some economists who don't believe that the public sector is necessarily inefficient still favor privatization when it creates competition in conditions when markets are likely to be <u>more</u> efficient. When markets don't work, some form of public ownership or regulation is justified. When neither private nor public ownership works, nonprofits may be the most efficient alternative.

6. Social models

a. Privatization as community empowerment

Some arguments for privatization focus not on efficiency but on strengthening communities by empowering voluntary associations, community organizations, churches, and self-help groups that mediate between individuals and society's large, alienating institutions. The objective is not to expand the domain of markets and profit but to strengthen local, small-scale forms of social provision. Starr argues that non-profit community organizations have often depended on government subsidies and that community empowerment is more likely to come from more government intervention than from privatization.

b. Privatization as a reduction of government overload

Advocates of this position hope to decrease employee claims on the public treasury and taxes; they may even sell enterprises to their workers. They want to increase the proportion of the population that owns shares of stock and privatize assets such as public housing and Social Security trust funds. The theory is that this may change people's frame of social and political thought.

7. Conditions handicapping the public sector

American public institutions are handicapped. "American public institutions at all levels of government suffer from rampant credentialism and proceduralism [red tape] that hamper the ability of managers to hire and fire, reward, and motivate their subordinates. . . . [P]ublic organizations also do not respond quickly to change" (new technologies, consumer demands). Long lead times required by the appropriations process may prevent agencies form adapting quickly.

Also, Starr notes that "We commonly limit public services to a functional minimum and thereby guarantee that people will consider the private alternative a step up." So people who can afford a private alternative are increasingly likely to choose it.

Not mentioned by Starr in 1988: a recession economy that strips the public sector of tax revenues.