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Privatization and American Business

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He holds an M. A. in history from Slippery Rock State University, and he is the former chairman of the department of economics at Northwood University. In the past 10 years, he has authored over 750 newspaper columns, 300 radio commentaries, dozens of magazine articles, and four books, the most recent of which is *Private Cures for*



Public Ills

Mr. Reed's interests in political and economic affairs have taken him to 52 countries on six continents. While traveling with members of the Polish anti-communist underground some years ago, he was arrested and detained. Also from firsthand experience, he has reported on hyperinflation in South America, voodoo in Haiti, black markets in Russia, and rebel warfare in Nicaragua and Mozambique. ♣

Public policy expert Lawrence Reed describes a revolution-in-the-making that is happening around the world but that has received relatively little public attention: the privatization revolution. Millions of people are benefiting from the return of public services to the private sector—they are saving money and they are freer than ever.

Ideas make all the difference in the world. In fact, as the old saying goes, they *rule* the world. The great 19th-century French novelist Victor Hugo once said that “nothing is as powerful as an idea whose time has come.” For much of the 20th century, trends in ideas and the public policies they inspired 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, turning millions of people into public dependents.

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. Ludwig von Mises’ *Socialism* in the 1920s and F. A. 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 dismantling socialism. Theoretical critiques, though essential to winning the intellectual battle, would have to be supplemented by practical methods of taking what was made “public” and restoring its “private” state. In other words, 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 at least partially if not wholly committed to stuffing the statist genie back into its bottle. The time for privatization had arrived.

The Entrepreneurial Spirit

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 valued customers into the task, and mediocrity becomes the exception, excellence the rule.

Sometimes these lessons must be learned the hard way. Here is 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. Reportedly, 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 began and ended with a Geiger counter check. Anyone needing treatment afterward for radiation exposure would receive it “at no extra charge.”

Now, I don’t know how this entrepreneurial venture turned out, but my guess is that the company learned a lesson or two about pleasing the customer. In a free market, merely hanging out a sign or printing up a brochure does not guarantee revenue or jobs. That’s a great strength—indeed, it is the reason why free markets in America have fed, clothed, and housed more people and generated more prosperity than any socialized economy anywhere in the history of the world.

When it is handled 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 take advantage of the best available buys. State and local governments have routinely experienced cost savings of *10 to 40 percent* through privatization, often with significant improvements in the way an asset is managed or a service is delivered. When assets and services are left entirely in private hands from the very start and the government “middleman” is eliminated, even greater efficiencies are possible.

The most common form of privatization—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, including: 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.

Commercialization is another form of privati-

zation. That happens when a unit of government simply says, “We are no longer going to perform this work with our own workforce. We are not going to contract it out either. We are 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.”

Commercialization is how cities across America have pulled out of the garbage collection business. The citizens themselves choose one of several private, competitive firms that specialize in picking up and properly disposing of garbage. There are no middlemen, no taxes, no interminable city council meetings that must be endured if you wish to register a complaint. You hire the service and if you are not happy, you fire it and hire a different one. This form of privatization tends to enhance citizens’ liberties and spare their pocketbooks if it is 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” that 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 end of subsidies and the red tape and onerous regulations that inevitably accompany them, which then liberates the industry to produce “for the market” rather than for the government.

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.

Global Privatization

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. 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 tenants at prices that were well below market value. The tenants who previously complained about the indifference of distant, bureaucratic management became the new management. With pride of ownership working its wonders, whole neighborhoods were subsequently transformed—broken windows were replaced, torn screen doors were repaired, gardens sprouted where litter once marred the landscape. And the British treasury was relieved of the burden of throwing huge subsidies down the rat hole of public housing. The British experience with privatization 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 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 proud 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 free market ideas. They have read the works of Mises, Hayek, and other great defenders of the free market. They know that capitalism works 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 rate.

In most places, however, privatization is occurring for more pragmatic reasons. Countries, states, provinces, and 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. 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 hard-pressed politicians are forced to exercise the best or only option they have—privatization.

Privatization in the U.S.

Let us 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 interest groups 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 mail delivery are now on the table, but they undoubtedly await a more friendly White House.

Incidentally, the U.S. 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 mail to send a message that could be sent via “snail mail,” you are personally privatizing the system.

At the state level, there is much more dynamic activity. States are privatizing utilities, prison management, data processing, foster care, and a long list of other items.* Under the enlightened leadership of Governor John Engler, Michigan set a record in 1995 for the largest sale of an asset (in dollar terms) in U.S. history. The state removed itself entirely from the workers’ compensation insurance business when it sold the Accident Fund of Michigan, and it 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 having the greatest impact. You name it—just about any asset or service that a local government owns or provides has been privatized somewhere, in some manner. That includes fire protection, 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, authors of *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 they have won back the right to perform certain services. A funny thing happens when public employees have to compete: They discover that they really don’t need as many supervisors, make-work rules, and coffee breaks.

*Readers will inevitably be reminded of recent news stories reporting violence in private prison facilities in Texas. This is actually proof that the system works; state officials responded by pulling prisoners out when videotaped evidence of abuse was made public. They held the service providers immediately and directly accountable.

Goldsmith has put almost everything Indianapolis does on the list for possible privatization. His motto is enough to make an entrepreneur out of any bureaucrat: “Sacred cows,” he says, “make the best burgers.” Indianapolis is now one of the best-run cities in the country—lean, 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 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, 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: Privatization would cut the city’s total cost by a whopping \$2 million!

Flint’s city employee unions knew the mayor was serious. They scrambled to be competitive and offered to shave about \$1.4 million from the 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 saved \$1.4 million.

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 ten-foot pole. Political leaders who aren’t willing to take risks don’t deserve to be in office.” Considering the privatization option is nothing less than good stewardship. 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.

Privatization 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 and need its services. Governments that employ more people than necessary or that pay their employees more than the market will bear are not doing any favors for the citizens—including the poor—who are picking up the tab.

Privatization is an "enter-by-the-back-door" approach that is intended to destroy government. Mayor Goldsmith says that before he privatized city services, it was extremely difficult to resolve citizen complaints and to 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 this he and other officials are actually empowered. As Hillsdale College Professor of Economics Charles Van Eaton likes to point out, government can "shop around," just like an ordinary consumer, to find the best deals.

There are instances where privatization didn't work, so it shouldn't be implemented anywhere. I have yet to see a case where a failure was really an

indictment of privatization, such as noncompetitive bidding in smoke-filled back rooms, sloppy contract writing, or nonexistent monitoring of performance.

Privatization breeds special interests that lobby for more contracts and services from government, even when such activity is unwarranted. 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 make the right decisions when it comes to savings. It is true that when privatization generates lower costs, officials may have multiple options for realizing 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 government enterprise. Once again, this is 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 a moral imperative and it leaves us better served, freer, more responsible. ▲

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