All around the world, government services and enterprises are being shifted into the private sector via a phenomenon known as *privatization.* In Britain, nationalized industries such as British Airways and Jaguar have been returned to investor-ownership via stock offerings. Similarly, in Chile, hundreds of firms nationalized by the Allende government have been returned to private ownership.

But privatization goes further than simply returning once-private firms to the business sector. Margaret Thatcher's government privatized over 1.5 million council houses – public housing units which were created by the public sector. It also privatized the major airports, the gas utility, and the telephone system – all of which had always been in the public sector. Likewise, the Japanese government is privatizing Nippon Telephone and Japan National Railways, which have been fixtures of the public sector. So in a very real sense, privatization is actually dismantling big government, not merely correcting the excesses of socialist regimes.

The Move Toward Privatization

Privatization was first identified as a phenomenon in the mid-1970s in the United States when the trend of municipal governments to purchase service from private firms under contract was discussed in *Reason* magazine. This ultimately led to the creation of the Local Government Center by Mark Frazier and Robert Poole in 1976 – the first think-tank devoted to researching privatization. In the late 1970s, LGC's materials came to the attention of Ronald Reagan's speech-writers, several of whom went on to hold White House domestic policy positions and promote privatization within his administration. Also in 1977-79, LGC privatization materials began being used by British local council members John Blundell and Michael Forsythe. This lead to a wave of local-service contracting-out which began at Wandsworth. Inspired by these developments, Eamonn Butler and Madsen Pirie set up the Adam Smith Institute in London in 1979. They began extending privatization concepts to state-owned enterprises, and their ideas soon began to influence a newly-elected Margaret Thatcher.

Privatization can take several different forms. A government function can be partially privatized if some aspects of it are shifted away from state control. For example, if a service formerly financed by taxation is shifted onto a user-fee basis (whereby only those who use the service pay, and in proportion to their use), we can accurately say that the *financing* of the service has been privatized. On the other hand, if a city service such as street-sweeping was formerly offered directly by the city government (and paid for by taxes) but is now offered by a private firm, selected competitively for a two-year contract, we can say that the *delivery* of the service has been privatized.

Full privatization, then, involves the transfer of both the financing and production to the private sector. At the municipal level, this can mean either the withdrawal of government from the field, letting private firms take over (as in, say, ambulance service or garbage collection) or the sale of the government operation to private owners (for example, a municipal hospital, sewage-treatment plant, or transit system). At the national level, full privatization generally means the divestiture of an enterprise or asset to private owners.

Why Privatization?

Why did privatization develop in the late '70s and become a worldwide phenomenon in the '80s? The fundamental reason is that people began to conclude that government had simply gotten too big, bureaucratic, and inefficient. The waves of local privatization in the United States were triggered by the tax revolt at the state level, typified by citizen-initiated tax-cut measures such as Proposition 13 in California (1978) and Proposition 2½ in Massachusetts (1980). With their tax revenues limited, state and local governments were forced to look for less costly ways of delivering needed services – and privatization met that need. Although England did not have a tax revolt as such, its local government costs were so high, even compared with other European welfare states, that once privatization slashed costs in Wandsworth, people in other cities and towns demanded similar economies.

Why does privatization lead to lower costs and more efficient operations? The fundamental reason is the difference in incentives between public and private sectors. A tax-funded government agency differs profoundly from a business. The former has a legally-guaranteed monopoly on its services (e.g., picking up a city's garbage). It is guaranteed its revenues, regardless of performance. And its workers are protected both by unionization and by a civil service system which virtually guarantees continued employment and pay increases, regardless of performance. In sharp contrast, a private firm in a competitive market must win over its customers by offering them a superior combination of performance and price. If it fails to deliver adequately, its customers can go elsewhere. Like the prospect of being hanged, the prospect of losing one's customers tends to concentrate the mind. Private firms producing public services – even firms which competitively win exclusive contracts for a number of years – therefore operate far more efficiently than government monopolies.

This may sound fine in theory, but what about the evidence? After all, public-employee union critics make the charge that privatization must lead to *higher* costs, since a private firm will have all the same expenses as the public agency it replaces – plus the added costs of advertising and profits.

The evidence shows overwhelmingly that the theory, rather than the unions' claim, is correct. Every controlled study comparing public versus private service delivery shows lower costs (for a given level of performance) for private enterprise. This includes nationwide studies of garbage collection in the United States (1976) and Canada (1985); of fire protection (1976, Arizona); public-works services such as street sweeping, pavement patching, and traffic signal repair (1984, Southern California); transit services (1986, US); school bus transportation (1984, Indiana); airlines (1977, Australia); naval ship repair (1978, US), and many others. In these statistically valid studies, the cost of government services is typically 30-40% to as much as 100% higher than private services.

At the national level, in developed countries such as England, France, and Japan, privatization of state-owned enterprises has proceeded from a mixture of ideological and fiscal motives. Conservative political leaders in those countries concluded that the public sector had grown far too large and costly to operate (given that most state-owned industries operate at a loss). Economic analysis, much of it by libertarian Public-Choice economists, had persuaded them that political factors would usually force state enterprises to operate in wasteful, non-businesslike ways over the long run (e.g., by preserving obsolete jobs for political reasons). Thus, rather than try to reform those industries, it would be far better to get rid of them altogether.

What has made privatization far more attractive, however, even to socialists such as Spain's prime minister Felipe Gonzalez and David Lange's Labor government in New Zealand, was the realization that large one-time cash infusions would be possible from the sale of these industries. To be sure, there is little market for shares in a large loss-maker such as British Coal or Japan National Railways. But if a new management team can be brought in and given a free hand to slash costs and rationalize operations prior to privatization (as in the case of British Airways, Jaguar, and Rolls-Royce), the market value of the company can be quite significant. As of the end of 1988, the British government had realized over $40 billion in one-time revenues from privatization of council houses and state industries. The New Zealand government realized over $14 billion from its privatizations, and the Japanese government over $100 billion just from Nippon Telephone and Japan Air Lines. These are revenues which help to reduce budget deficits without tax increases.

By 1989 the idea of privatization had been embraced by many other countries. The Canadian government sold off its two aircraft firms (DeHavilland and Canadair) and Air Canada. Bangladesh has sold its textile mills and banking industry. Malaysia and Singapore sold portions of their state airlines. Turkey has privatized the Bosporus bridge and is planning to sell off its airline and other state industries. Argentina, Brazil, Chile, and Mexico have begun to sell numerous state-owned industries, as a way of coping with their foreign debt problems. Since such sales reduce government expenditures (to cover operating losses) while also bringing in one-time cash receipts, the US. Agency for International Development, the World Bank, and the various international development banks have all endorsed privatization as an important part of debt-reduction strategies.

In short, the privatization revolution is sweeping the world. As production and services are shifted from inefficient state monopolies to competitive private enterprises, consumers gain greatly from more responsive providers offering lower-priced goods and services. And taxpayers win big – thanks to a shrinking of the size and cost of government.

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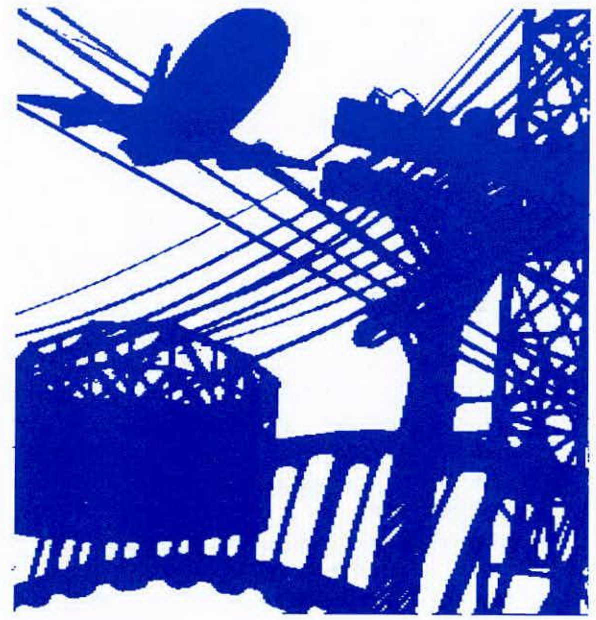

by Robert Poole, Jr.

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