



## **PRIVATIZATION: THE PUBLIC POLICY DEBATE**

### **Executive Summary**

The purpose of this article is to provide a description of the evolution of the public policy known as “Privatization.” Privatization is a movement to deregulate private industry and transfer many government services, assets and functions to the private sector.

#### **Claims and Concerns**

Those promoting privatization claim that:

- the private sector can provide increased efficiency, better quality and more innovation in services than the government;
- a smaller government will reduce costs to the taxpayer; and
- less regulation will provide a better environment for business, thus creating more jobs.

Those concerned about privatization suggest the following.

- Profits: The mandate to make a profit will endanger public safety and reduce services available to the general public.
- Costs: There will be increased costs to consumers.
- Transparency and Accountability: Private companies will lack transparency, adequate oversight and accountability.
- Corruption: There will be increased corruption between government and for-profit, private companies.
- National Defense: Privatizing sectors such as ports, utilities and defense can result in foreign control and will put the country at risk in the event of war.
- Inequality: The scale of privatized programs will result in chronic high unemployment, low wages and abusive labor practices, leading to growing inequality between the wealthy and poor.

#### **Larger than the United States**

The privatization movement is an international movement. Outside the United States, prominent divestitures of government assets have included Russia’s natural gas (Gazprom), Bolivia's municipal water system in Cochabamba and the United Kingdom's British Rail. Inside the United States, privatization has taken the form of deregulation, e.g., the deregulation of the financial services industry; redistribution of the taxes “burden,” e.g., efforts to reduce individual

## Privatization: The Public Policy Debate

taxes on capital gains and inheritances, and reductions of corporate taxes; and privatization, the shifting of government programs to the private sector, e.g., the prisons and highways.

### History

In the 1970s, disillusioned with the Progressive Era vision, leadership in the increasingly global private sector became more active, asserting that burgeoning tax rates and government regulations of industry were inhibiting free trade. Efforts were launched to dismantle many Progressive programs such as restrictions on financial lending, elimination of worker's compensation, elimination of control over food and environmental safety, and a revamping of the tax system by eliminating progressive taxes and replacing it with a flat tax.

### Competing Theories

Milton Friedman: The intellectual inspiration behind the public policies to privatize in the United States has come from the Public Choice and Property Rights schools of thought. Prominent leaders advocating these theories include Milton Friedman, the Chicago School of Economics, and Fredrick Von Hayek whose book, *Road to Serfdom*, warned of the growing welfare state. The basic assumptions include:

- Democratic political systems have inherent tendencies toward government growth and excessive budgets.
- Expenditure growth is due to self-interested coalitions of voters, politicians, and bureaucrats.
- Public enterprises necessarily perform less efficiently than private enterprises.
- The more individuals stand to gain from tending to their property, the better it will be tended.

John Maynard Keynes: The dominant economic theory after WWII was that of John Maynard Keynes. Keynes believed that to break a depression, the government needed to stimulate demand. It was necessary to get money into the hands of consumers to jumpstart growth. Businesses would not borrow and build if no demand was in sight, no matter how low the interest rates might go. Keynesian theories were later refuted by economist Milton Friedman and this dispute is at the core of the ongoing debate regarding how to break the current recession/depression.

### Privatization in Practice

The key strategies as to how to downsize government and transfer programs to the private sector are described as:

- Privatization by attrition  
Cessation of public programs and disengagement of government from specific kinds of responsibilities. Example might be the U.S. postal system.

## Privatization: The Public Policy Debate

- **Transfer of assets**  
Direct sale or lease of public land, infrastructure, and enterprises. Examples might be federal and state parks, state-owned liquor stores and the proposed privatization of public libraries.
- **Contracting out (public/private partnerships) or vouchers**  
Instead of directly producing some service, the government may finance private services, for example through contracting out or vouchers. Examples might be charter schools, prisons.
- **Deregulation**  
Deregulation of entry into activities previously treated as public monopolies. Examples might be utilities, water, waste management, air traffic control and ports.

### **Role of Government**

The public agenda of privatization requires a close examination of the proper relationship between government, business and civil society. What should the role of government be in protecting the environment, helping the poor, defending the nation, providing justice, ensuring democracy, protecting public health, ensuring public safety, providing education, promoting a thriving economy, and ensuring safe work environments and a living wage? Our country must seek a pragmatic balance between social and economic returns.

*Nora Leech*

## **PRIVATIZATION: THE PUBLIC POLICY DEBATE**

By Nora Leech

### **What Is the Role of Government?**

The purpose of this article is to provide a description of the evolution of the public policy known as “Privatization.” Privatization is a movement to deregulate private industry and transfer many government services, assets and functions to the private sector. We, as citizens of the United States, have been experiencing the growing effects of the privatization movement since the 1980s. Privatization efforts have been tried (with varying degrees of success) on federal, state and local levels. Federal efforts include Social Security/Medicare, student loans, military services and interstate highways. On the state and local level, agencies responsible for social services, transportation, mental health and public health care, corrections, and education have all seen remarkable increases in privatization activities since 1988.<sup>1</sup> On a local city and neighborhood level, efforts are prominent to privatize public libraries, parks, court services and roads/bridges.

The pace of the movement to privatize has escalated since 2008. The current economic recession and the trend in government over the years to reduce taxes have increased government budget deficits. The current recession (the largest since the Great Depression) is resulting in business failures, high unemployment, and a loss of tax revenues for federal, state and local governments. Whether the current financial situation is directly related to the deregulation of the financial services sector is the subject of great debate. Regardless of the causes, the revenue losses have added to the drive to downsize government by privatizing functions, services and assets. Although saving money through greater efficiencies may appear to be the primary reason for such a push to downsize government at this moment, there are other forces and philosophies behind the move to privatize that have been active since the early 1970s and have gained significant momentum since the 1980s.

This is a good time to take measure of privatization’s impact on our citizenry: what is working and what is not. The United States has more than 30 years of privatization efforts to evaluate. It is important to think about the lessons learned within the greater framework of this public policy debate.

### **The Idea**

Milton Friedman, the Chicago School of Economics, stated the goals of privatization as a public policy agenda to reduce the size of government, deregulate business and reduce taxes<sup>2</sup>.

### Claims and Concerns

Those promoting privatization of government services, assets and functions claim that the private sector will provide increased efficiency, better quality and innovation in services. Proponents claim privatized services will provide a cost savings to those being served (public consumers of the services) as well as to the government no longer responsible for providing the services or maintaining the assets. Many suggest that the government has overextended itself into sectors

## Privatization: The Public Policy Debate

that could well be covered by private, for-profit companies. Some claim that privatizing government programs like interstate highways, trains or the postal service will mean that large expenses will be taken off the government books, thus providing relief to taxpayers. Advocates believe that private firms have better incentives to control costs and respond more effectively to competition.

Those concerned with the public policy of privatization say that the private sector mandate to make a profit can endanger public safety and reduce services available to the general public (particularly in poor and rural areas). They are concerned that there will be increased costs to consumers through fees and tolls and increased costs to government through poorly written contracts. They are concerned that the private sector will increase profit margins and include expenses like high executive salaries and corporate debt loads (interest on debt) that consumers and tax payers will have to pick up. There is also a concern that private companies will lack transparency, adequate oversight and accountability. How do individuals complain to a corporation if they feel abused by high prices when there are no or limited alternatives? There is a fear of increased corruption between government and for-profit private companies as the lines between government and business professionals become blurred. There also is a concern that privatizing strategic sectors such as ports, utilities and defense to foreign-controlled multinational corporations will put the country at risk in the event of war. There is concern that the strategy to privatize large sectors of government services and functions will result in chronic high unemployment, low wages and abusive labor practices, especially during economic downturns. There is also a concern that the privatization policies will result in growing inequality between the wealthy and poor, thereby losing the revered American middleclass.

### **Larger than the United States**

The privatization movement is an international movement. David Linowes, chair of the 1987 President's Commission on Privatization, explains that outside the United States, it is known as the privatization movement and involves outright divestiture of government properties. In the United States, it has meant deregulation and tax reduction.<sup>3</sup>

#### Outside the United States

Countries with significant state corporations are encouraged to divest these businesses to the private sector. Prominent divestitures in the news have included Russia's natural gas (Gazprom), Bolivia's municipal water system in Cochabamba and the United Kingdom's British Rail. As an incentive, lenders have been known to require that governments reduce the size of the public sector through privatization and deregulate industries engaged in international trade as conditions for loans<sup>4</sup>.

#### In the United States

The deregulation of the financial services industry would be a notable example in the news<sup>4</sup> and examples of tax reductions would be the significant reductions in corporate taxes over the last 20 years, as well as efforts to reduce individual taxes on capital gains and inheritances. Linowes states that the tax reductions of the 1980s were intended to reduce the government influence over private sector activity.

## Privatization: The Public Policy Debate

However with today's financial downturn, the focus in the United States is increasingly on downsizing government by privatization of assets, services and functions. The loss of taxes from the economic downturn and from tax cuts are jointly adding to the deficit imbalance which is creating a political crisis. Current recommendations under consideration for privatization include roads, bridges, prisons, schools, parks, health, tax collections, postal service, Amtrak, social welfare services, public health services and Worker's Compensation, to name a few. In the United States, pressure is coming from international lenders, most recently via bond rating companies threatening to downgrade U.S. bonds. A lower bond rating generally requires paying higher interest rates to lenders. This, in turn, should increase the government deficit unless taxes can be raised or cuts can be made in other areas.

### History

The Chair of President Reagan's Privatization Commission provides some background. "The Privatization movement was developed mainly in reaction to the Progressive movement of the early Twentieth Century. In the Progressive Era, while other nations were most likely to nationalize an industry, the United States was more likely to subject the industry to systematic government regulations."<sup>5</sup>

In the 1970s, disillusioned with the Progressive Era vision, leadership in the increasingly global private sector became more active, asserting that burgeoning tax rates and government regulations of industry were inhibiting free trade. Leaders expressed their skepticism about a "planned market" where the government plays a prominent role regulating businesses. They agreed with economist Milton Friedman's broader philosophical view, that free markets were the solution to many problems – health care, product safety, banking failures and financial speculation. Linowes reminds us that the Progressive movement policies were themselves a reaction against the Social Darwinism (survival of the fittest) and *laissez-faire*, free market theories prevalent in the late 19th century.

Though many large corporations and leading financial institutions may advocate a return to *laissez-faire*, free market policies, there are other perspectives on the unregulated boom/bust economies of the late 1800s. It was a time of great instability. There were multiple economic depressions including the panic of 1893, where millions of Americans lost their life savings and homes due to bank failures and foreclosures. These were times of corruption in government witnessed by the railroad scandals and banking failures. These were times of unacceptable labor conditions where men in the steel mills worked 12 hours a day, seven days a week, 363 days a year; where workers maimed at work were dismissed with no compensation for themselves or their families; and where children put in 12-hour days in textile factories and coal mines under appalling work conditions. These were times when diseases – malaria, cholera and TB – were common due to government inaction, and times of unsafe food due to unregulated food industries. And these were times of massive business failures and unemployment.<sup>6</sup>

These unstable times were followed by the catastrophic events of World War I, the Great Depression and World War II.

At the onset of these troubled times, those advocating progressive policies began to create a much stronger role for government in the well-being of its citizens by regulating business and the

economy. To protect the aged, Social Security was initiated. To protect the public health, businesses were regulated (a prime example was the meatpacking industry that disgorged offal upstream of major cities). Public education was strengthened to provide an informed citizenry and a productive workforce. Programs were established to protect labor, such as workers' compensation, and laws were passed to limit the workday and provide a minimum wage. Additionally, programs were created to help the unemployed in economic downturns.

High inflation and the banking failures in the late 1800s and early 1900s led to the creation of the Federal Reserve in 1913. Although called the Federal Reserve, the new central bank (not a government bank) was an association of private bankers with limited government input. It had the power to minimize inflation by managing the amount of currency in circulation. But banks continued to fail as depositors withdrew their savings and the country fell into the Great Depression. In 1933, President Franklin Delano Roosevelt created the Federal Deposit Insurance Commission (FDIC) to encourage depositors to trust banks. Along with the ability to control inflation, the Federal Reserve was challenged by the U.S. government to maintain "full employment," aware that policies to limit inflation carried the risk of high unemployment.<sup>7</sup>

In the 1980s, however, advocates for *laissez faire*, free market policies were growing increasingly influential. In September 1987, the President's Commission on Privatization was created. The Commission's purpose was "to review the appropriate division of responsibilities between the federal government and the private sector and to identify those government programs that are not 'properly' the responsibility of the federal government or that can be performed more efficiently by the private sector." The Commission in 1988 recommended a broad spectrum of government activities that could be transferred to the private sector. These included low-income housing, housing finance (Fannie Mae and Freddie Mac), federal loan programs, air traffic control, educational choice (voucher programs and charter schools), U.S. Postal service, military commissaries, prisons, federal asset sales such as Amtrak and the Naval Petroleum Reserves, Medicare, international development programs, and urban mass transit.<sup>8</sup>

### **Theories Supporting Privatization**

Yale Law Professor Paul Starr explains that the normative theories, justifying privatization as a direction for public policy, have drawn their inspiration from several different schools of thought on what constitutes a "good society."<sup>9</sup>

#### **"Property Rights" and "Public Choice"**

The intellectual inspiration behind contemporary privatization in the United States has come from the "Public Choice" and "Property Rights" schools of thought. Prominent leaders advocating these theories include Milton Friedman of the Chicago School of Economics and Fredrick Von Hayek, whose book, *Road to Serfdom*, warned of the growing welfare state.

Starr's basic assumptions include:

- Democratic political systems have inherent tendencies toward government growth and excessive budgets.

## Privatization: The Public Policy Debate

- Expenditure growth is due to self-interested coalitions of voters, politicians and bureaucrats.
- Public enterprises necessarily perform less efficiently than private enterprises.

The broader philosophical view is that government social programs and regulations, inflationary spending aside, were almost always detrimental to the efficient workings of an economy. In 1962, Milton Friedman, in his book, *Capitalism and Freedom*, provided an intellectual map for a reversal of the progressive policies of the nation. Friedman urged the U.S. government to eliminate Social Security, progressive income taxes, free public high schools, the minimum wage, housing and highway subsidies, and health care, even for the elderly, noting that an unregulated market place would take care of these problems. Friedman believed that if individuals were given the choice, free of government rules and regulations, of where to work, where to invest their retirement funds, where to send their children to school, where to buy their healthcare and where to rent or buy their homes, competition to supply the best goods or services would result in a greater number of cheaper and higher-quality options. He postulated that with reduced government and lower taxes, the poor would be better off, inequality would be minimized, and discrimination eliminated.

Friedman sought as well to discredit the Keynesian economic theories advocating government intervention to manage the economy during financial crises. Keynes had suggested that even if interest rates and prices fall, business may not invest because of lack of demand for their goods. Thus, he advocated for government spending to kickstart the process and stated that, with an expanding economy, the deficit resulting from the spending would quickly be replaced.<sup>10</sup>

### **Privatization in Practice**

Professor Starr describes four types of government policies intended to bring a shift from the public sector to the private sector: attrition, transfer of assets, contracting out, and deregulation.

- **Attrition**  
Attrition results from cessation of public programs and disengagement of government from specific kinds of responsibilities. Restriction of publicly produced services in availability or quality may lead to a shift by consumers toward privately-produced substitutes. Or, government may let the service run down by drastically reducing their budgets. An example might be the U.S. Postal Service.
- **Transfer of assets**  
Such transfer may occur with the direct sale or lease of public land, infrastructure and enterprises. Examples might be federal and state parks, state-owned liquor stores and the proposed privatization of public libraries.
- **Contracting out (public/private partnerships) or vouchers**  
Instead of directly producing some service, the government may finance private services, for example through contracting out or vouchers. Examples might be charter schools or prisons.

## Privatization: The Public Policy Debate

- **Deregulation**  
Deregulation may be the result of deregulating entry into activities previously treated as public monopolies. Examples might include utilities, water, waste management, air traffic control and ports.

These four policies vary in the degree to which they move ownership, finance and accountability out of the public sector. The spectrum runs from total privatization (as in government disengagement from some policy domain) to partial privatization (public/private partnerships or vouchers, such as for school or housing). In the case of partial privatization, the government may continue to finance but not operate services, or it may continue to own but not manage assets. Partial privatization may dilute government control and accountability without eliminating them. Examples might be detention centers for juveniles or welfare services.

### **What is the Role of Government?**

In rethinking the proper relationship of government, business and civil society, fundamental political and economic questions arise. What should the role of government be in protecting the environment, helping the poor, defending the nation, providing justice, ensuring democracy, protecting public health, ensuring public safety, providing education, promoting a thriving economy, ensuring safe work environments and a living wage. Our country must seek a pragmatic balance between social and economic returns.

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### **ENDNOTES**

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<sup>1</sup> “Privatization: Lessons Learned by State and Local Governments” Report to the Chairman, House Republican Task Force on Privatization, US General Accounting Office, March 1997.  
<http://www.gao.gov/archive/1997/gg97048.pdf>

<sup>2</sup> *Capitalism and Freedom*, Milton Friedman, University of Chicago Press, 1962.

<sup>3</sup> *Privatization, Toward More Effective Government*, produced by the President’s Commission on Privatization, Sept, 1987, Commission chair David Linowes (Editor).

<sup>4</sup> “Congress Passes wide-ranging Bill Easing Bank Laws” by Stephen Labaton, New York Times, Nov 05, 1999.  
<http://www.nytimes.com/1999/11/05/business/congress-passes-wide-ranging-bill-easing-bank-laws.html?pagewanted=all&src=pm>

<sup>5</sup> See endnote 3.

<sup>6</sup> *Age of Betrayal, The Triumph of Money in America, 1865-1900*, Jack Beatty, Vintage Books, 2008.

<sup>7</sup> *Age of Greed: Triumph of Finance and the Decline of America. 1970 to the Present*, Jeff Madrick, Knopf, May 31,

2011.

<sup>8</sup> See endnote 3

<sup>9</sup> “The Meaning of Privatization,” by Paul Starr, *Yale Law and Policy Review* 6 (1988): 6-41. This article also appears in Alfred Kahn and Sheila Kamerman, eds., *Privatization and the Welfare State* (Princeton University Press, 1989).

<sup>10</sup> “The Busts Keep Getting Bigger: Why?” A Review of Jeff Madrick’s *Age of Greed*. Reviewers: Paul Krugman and Robin Wells; *New York Review of Books*, July 14, 2011, p. 28.