An overview of the privatization debate*

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Privatization is not a new concept. In 1968, Peter Drucker suggested that government should spend more time governing and less time providing and that the public sector should either purchase services from the private sector, or simply stop producing.1 It can also be argued, however, that in recent years the intensity of pressures on government to solve complex problems without infusing new monies has stirred the sea of public policy debate and swept an undercurrent of privatization to the surface as an attractive policy option.

Debate surrounding the issue of privatization has essentially been waged in terms of whether public or private enterprise is better. We cannot resolve the privatization debate in its present form; we must extend it beyond its predominantly simplistic ideological dimensions by recognizing that both public and private enterprise can contribute positively to the goal of effective service delivery. The premise is that conventional ideological perspectives fall short of providing a meaningful framework within which sound decisions surrounding the use of privatization as policy option can be made.

Dimensions

Privatization defined

In its narrowest sense, privatization encompasses the whole or partial sale of state-owned companies to private investors. This narrow view is consistent with the 1983 debut of the word privatization in Webster’s Dictionary, where it was defined as “the process of changing from public to private control or ownership.” Interestingly, this definition remains essentially unchanged after a decade and a half of exposure to and experimentation with various forms of privatization.

A number of authors take a broad view in defining privatization. Martin, for instance, suggests that it is “a change in the role, responsibilities, priorities and authority of the state,” rather than simply a change of ownership.2 Donahue proposes that the word privatization can signify something as broad as shrinking the welfare state while promoting self-help and volunteerism.3 Such broad definitions underscore the need for continued evolution of the public sector as it faces increasingly complex challenges in today’s environment.

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Some definitions, such as that proposed by Kent, focus on the economic dimensions of privatization while largely ignoring its corresponding political aspects. Kent suggests that “privatization refers to the transfer of functions previously performed exclusively by government at zero or below full-cost prices to the private sector at prices that clear the market and reflect the full costs of production.” Donahue’s offered definition, namely, “the practice of delegating public duties to private organizations,” serves to highlight the cogent issue of government accountability as it relates to the use of privatization as a policy instrument.

Kolderie identifies two different concepts that are often confused when talking about privatization. The first concept, “provision,” is the policy decision to actually provide a good or service. The second, “production,” is the administrative action to produce that good or service. Such conceptualization is helpful, as it shows that government may elect to privatize either service provision or production, or both. It also provides a useful framework within which to review and understand the various forms of privatization that have been adopted in Canada and internationally.

The question of what to privatize
Just as there are widely disparate definitions of privatization, so there is much room for different constituencies to arrive at varying conclusions about what functions can and should be privatized.

Some authors propose that steering functions, including policy and regulatory activities, must be fulfilled by government. Without an overall public process of governance, these writers emphasize that society would have no mechanisms by which to make collective decisions and no means by which to set the rules of the marketplace. Similarly, they argue that many compliance functions should remain in government hands. It has been suggested that the more sensitive and risk-laden the function, the more likely that the citizenry will want it to be operated by government. Policing, prisons, income tax and the courts may be seen to fall under this umbrella.

At the same time, it has been proposed that certain functions can be left entirely to the market. Osborne and Plastrik identify three critical preconditions for making this decision. First, the market must be able to provide them. Second, such functions must provide truly “private goods” in that they primarily benefit individuals or groups, as opposed to society as a whole. Third, there must be no concerns about the equity of or universal access to the goods and services these functions provide.

Other authors adopt a narrow perspective in decision making. Waters, for example, suggests that the question about what to privatize is simply a question of efficiency. Specifically, he argues that if the competitive private sector can produce a desired output at lower cost to society than the state sector, then privatization should occur. Waters’ focus on economic considerations at the exclusion of political considerations, however, can be disputed as too simplistic for responsible policy decision making. The perspective adopted by Mitchell and Sutherland underscores the inherent political dimension of policy decision making. In discussing health care and education, the authors emphasize that “such issues themselves are not determined by the marketplace nor are they appropriately defined by the concepts and values of the marketplace. Rather, they are the province of politicians working within a framework of political responsibility and corresponding accountability.”

Forms of privatization
The past decade has witnessed the emergence of an almost infinite variety of new organization forms and delivery methodologies, with varying mixes of “publicness” and “privateness.”

Thomas and Wilkins point out that a number of these new forms and approaches straddle whatever boundary remains between the public and private sectors. The authors identify privatization as but one point on a continuum of alternative delivery mechanisms, beginning with government line departments and progressing through semi-autonomous agencies, different types of Crown Corporations, Special Operating Agencies, mixed enterprises involving public and private participation, and government-owned/contractor-operated organizations.

Kent discusses four different forms of privatization. First, a government enterprise may be sold in
whole or in part to private investors. Interestingly, the author cites a number of examples in which enterprises that were losing operations under government ownership became profitable after being sold to their employees. Second, government may contract with the private sector to provide various public services. Third, government may charge user fees – that is, private payment, to recover the cost of publicly provided services. Fourth, government may provide vouchers to consumers towards the purchase of goods or services from private providers – in other words, public funding of private services.

Several authors observe that, while it is true that occasionally an entire activity or entity within government is transferred or divested to the private sector, privatization is typically considered to have occurred when the provision of a public good or service is assigned, normally by contract to a third party. Tittenbrun cites another form of privatization that occurs without a transfer of ownership of assets. Specifically, liberalization or deregulation is regarded as the abolition or restriction of controls on entry, outputs, prices, profits and markets in the public sector. Other authors emphasize that it should not be assumed that privatization always involves substituting for-profit firms for government organizations as service providers. They point out that the private sector also encompasses non-profit agencies, self-help groups and volunteers, and suggest that the type of private entity that will best provide a specific service depends on many factors, including the nature and demand for the service, incomes of intended beneficiaries and the regulatory environment.

The literature also discusses competition of private industry with public enterprise as an alternative form of privatization. In this form, one of the more creative and promising approaches to contracting services is to allow public sector agencies and/or unions to bid along with private firms. Last, but certainly not least important, it can be argued that another form of privatization is one in which public enterprise remains the primary service producer and provider, but incorporates a more entrepreneurial approach towards the goal of efficient and effective service delivery.

An overview of the arguments

The case for privatization

Privatization advocates point out that in the free marketplace, the consumer can turn to another provider if dissatisfied with quality or price. They emphasize that the market is structured to accommodate consumer preference and choice; the political process is not.

Further, they suggest that privatization opens new opportunities for entrepreneurial innovation. I will argue that emerging new organizational forms and delivery methodologies open the same opportunities for entrepreneurial spirit as more traditional forms of privatization.

"Free-marketers" suggest that the structure of incentives within the public sector, as compared to the private sector, force employees to behave differently. Extreme viewpoints are tabled by several authors. Kent, for instance, proposes that bureaucrats not facing competition are motivated primarily by the desire to expand their agencies' budgets and workforces, rather than by the desire to satisfy consumer needs or to lower costs. Drucker argues that factors that impede innovation in a public sector organization are both inherent in it and inseparable from it. Lovik contends that bureaucrats, unlike their private sector counterparts, do not seek out mutually beneficial exchanges with consumers, but rather, seek incentives from elected officials, who frequently view public interest through the lens of personal interest. Lovik's position may be readily countered by pointing out that business owners in the private sector, as much as or more so than politicians, view the world through a lens of personal interest. Exaggerated charges such as these are made in the absence of any convincing supporting evidence. That being said, however, the need for and importance of reviewing traditional government organizational structure and incentive systems cannot be discounted.

The proponents of user fees as a form of privatization point out that government typically provides services at less than full cost, even to those who can pay, thereby resulting in overuse and general misallocation of public resources. Kent, for instance, suggests that cities should charge user fees for special
services including additional police patrols, building inspection and other regulatory functions. Notwithstanding the merits of user fees in some areas of public policy, Kent’s viewpoint on special services seems short-sighted. Specifically, some of the very areas in greatest need of such services comprise disadvantaged people who would be unable to pay for them.

Some authors take a more balanced case-specific perspective in supporting the concept of privatization. Fitzgerald, for instance, suggests that selling assets may afford governments potentially large one-time capital gains, which may in fact be the sole impetus for debt-ridden jurisdictions to experiment with load-shedding. Wright and Rodal argue that engaging private sector resources in service delivery has the potential to free up and focus government resources on core aspects of governance, including policy development and analysis. Martin legitimately points out that the short-term time horizons that concern politicians are not consistent with the long-term planning required in building successful businesses. Kolderie, as cited by Fitzgerald, argues that privatization reduces neither the concept of community nor the sense of public purpose of a particular program, and puts forth the view that only government can reduce social commitment as a matter of policy. At the same time, he acknowledges that there is no inherent virtue in the service producer or provider being private.

The case against privatization

The notion of efficiency is central to the privatization debate. Specifically, it serves to underscore the fact that the decision to use any policy instrument, including privatization, has both economic and political components. In this regard, McLaren points out that while parliamentary democracy is not necessarily efficient, it was never intended to be. The author argues that there is more to efficiency in a democratic system than merely doing things as inexpensively as possible, and that public policy solutions must provide evidence that additional “non-quantifiable” considerations beyond simple administrative efficiency have been considered. McFetridge (as cited by Tupper and Doern) concurs that while the commercial efficiency of state organizations may sometimes be inferior to that of private sector firms, their institutional characteristics may make them superior to the private sector in the delivery of services to citizens.

Various other political and economic arguments are advanced in the case against privatization. Some authors contend that once a public function is privatized, there is no longer responsible political control of that function. It may be argued, however, that the assignment of public functions to third parties does not eliminate, or even diminish, the requirements of government management; it simply changes the nature of this management. Other writers point out the advantages of public services in terms of sharing both responsibilities and costs collectively within society. Downs and Larkey discuss three essential differences between the public and the private sector, namely – the nature of public sector goals, the limitations on executive authority in government and compressed political time horizons. In their view, these differences are not “transient products of poor management practices on the part of public sector decision-makers,” but rather, reflect fundamental political and institutional variations that cannot or should not be lightly dismissed. Given such primary variations, it can be argued that caution and common sense must be exercised in attempting to transport management and organizational practices from one sector to the other.

The notion that privatization necessarily “shrinks” the size of government, as measured in financial terms, is disputed by some authors. These writers take the position that privatization does not necessarily guarantee lower costs and may, in fact, result in increased prices to consumers. In particular, they point out that if contracting out arrangements simply involve the substitution of a private monopoly for a government one, little has been accomplished. Thomas points out that the assumption that contracting out service delivery to the private sector reduces management challenges and increases accountability has “proven to be naive and unfounded in many instances.”

The empirical evidence

While available empirical evidence on the privatization of public services clearly supports mixed conclusions, observers have not been reluctant to interpret the evidence as they see fit. Numerous authors cite studies
that find significant cost and performance advantages in privatization. Some authors conclude that any generalized empirical claim that the performance of public enterprise is intrinsically inferior to that of private seems unwarranted and cite a number of cases where public ownership in fact performs better in terms of productive efficiency. Still others cite no finding of public sector inferiority but emphasize that empirical studies do not demonstrate any inherent or decisive superiority of public enterprise performance.

Conflicting results may be attributed to a number of factors. First, empirical studies use different methodologies and divergent performance measures, some of which, when taken independently, may be misleading. Borins and Boothman emphasize that each type of efficiency measure incorporates “significant problems of calculation or has serious limitations in explanatory power.” The authors state that profitability is the least appropriate type of measurement since it is simply “not in accord with the designated social role of a public enterprise.” Second, investigations utilize competing definitions of efficiency and review different organizations and industries at various periods of economic and political development. Third, studies often fail to control for a variety of other variables, including differences in accounting practices, service conditions, competitive environments, and fluctuating economic and political conditions, all of which will affect conclusions regarding the efficiency of public or private provision of services. Savas points out that evidence is often based on relatively simple statistical computations, in which it is often erroneously assumed that all other variations are cancelled and that the only variable being observed is one of public or private operation. A number of authors conclude that it is seldom, if ever, possible to compare like with like and to control for exogenous factors. Fourth, and perhaps most important, empirical reviews tend to proceed from divergent ideological assumptions that inevitably lead to opposing conclusions.

The question of whether public or private provision of service is better is, in itself, inappropriate. In the words of Osborne and Gaebler, “business does some things better than government but government does some things better than business.” The authors point out that the public sector tends to be better at policy management, regulatory activities, ensuring equity and social cohesion. At the same time, they feel that the private sector tends to be better at “performing economic tasks, innovating, replicating successful experiments, adapting to rapid change, and abandoning unsuccessful or obsolete activities.”

The finding by Kay and Bishop (as reported by Martin) that changing organizational culture and management methods, rather than changing ownership, is the decisive influence on organizational effectiveness is instructive. It suggests a need to think about and pursue new ways of delivering public programs and services in a manner that strikes a balance between financial efficiency and democratic responsiveness.

Conclusion

Key concepts and terminology surrounding the notion of privatization are reflective of diametrically opposed ideological perspectives. The imprecision of the word privatization and its constituent elements has generated uncertainty and controversy about its proper place and usefulness as a policy instrument.

Arguments for and against the use of privatization as a policy tool are hurled back and forth across a vast ideological divide. These arguments tend to focus on the economic dimensions of privatization while largely ignoring the broader constellation of political and social dimensions that are inherent in responsible policy decision making. A review of mixed empirical evidence reveals the complexity of attempting to evaluate and compare the relative performance of public and private enterprise, particularly given that such studies tend to proceed from divergent ideological assumptions.

New organizational models for service delivery are emerging, in forms that represent various blends that seek to combine the best features of public and private sectors in their structure and operation. Within this context, privatization may be seen as a potential choice from among a range of complex policy instruments, whose design and introduction must be thoughtfully balanced with other policy alternatives towards best meeting identified societal needs.
Notes