

PRIVATIZATION AND PUBLIC-PRIVATE PARTNERSHIPS¹

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Adopting market principles in government activities is an important feature of the new public management, and privatization is one of its principal elements. The definition of privatization is rather muddled, however, as there are numerous definitions, each one focusing on only one narrow aspect or managerial technique.

Defining Privatization

What follows is a lengthy list of usages of this and related terms. (1) In countries with many state-owned enterprises, including many developing countries, post-socialist countries, and countries in Western Europe, privatization is the transfer of enterprise ownership—in whole or in part—from the state to private hands. This is also called denationalization and “destatization.” (2) While there is general agreement that the sale of government enterprises represents privatization, there is less unanimity about defining the sale of other government assets, such as land and buildings, as examples of privatization. Such divestments are viewed here as privatizations. (3) In the United States, which has relatively few state-owned enterprises, the term “privatization” is commonly applied to the act of contracting for public services. Others, however, reject this nomenclature and call the practice outsourcing, a common practice that is found entirely within the private sector as well, for example, when one company contracts with another for a specific service or function, such as operating the company cafeteria or warehouse. Some consider contracting to be a form of decentralization, but this seems unhelpful and unnecessarily confusing. (4) “Competitive sourcing” refers to competition between public employees and private contractors; some call this “managed competition.” If a contractor wins, it is called privatization or contracting out. If the public employees win, it is obviously not privatization; sometimes it is called “contracting in.” (5) Confusingly, in the financial world the term privatization can refer to the act of transforming a company from one whose shares are listed on a stock exchange and can be bought by members of the general public to one that is no longer listed or publicly traded because it has been bought by a private group. (6) When a government agency is forced to operate in a market environment, for example, raising funds in capital markets and selling its services to willing buyers, this is best called “marketization,” not privatization. (7) The transformation of a public agency into an independent authority or government corporation, such as the U.S. Postal Service, is sometimes called privatization, but “commercialization” is a better word. (8) The term “public-private partnership” is particularly malleable as a form of privatization. It is defined broadly as an arrangement in which a government and a private entity, for-profit or nonprofit, jointly perform or undertake a traditionally public activity. It is defined narrowly as a complex relationship—often involving at least one government unit and a consortium of private firms—created to build large, capital-intensive, long-lived public infrastructure, such as a highway, airport, public building, or water system, or to undertake a major civic redevelopment project. Private capital and management of the design, construction and long-term operation of the infrastructure is characteristic of such projects, along with eventual public ownership. Despite its ambiguity, “public-private partnership” is sometimes a useful phrase because it avoids the inflammatory effect of “privatization” on those ideologically opposed. (9) There is also a whimsical ninth definition that

is simply too delicious to pass up: Janusz Lewandowski, post-Communist Poland's first privatization minister ("Minister of Ownership Transformation," to be exact) defined privatization in his country as "the sale of enterprises that no one owns, and whose value no one knows, to people who have no money."

We attempt here to clarify the confusing picture and offer a general definition that captures the broad essence of the practice and leads to various implementation techniques. Fundamentally, privatization is much more than a financial or managerial action; it is a philosophical position concerning the roles and the relationships of society's private institutions and government. Society's principal private institutions are the market, voluntary nonprofit associations of all kinds (civil society), and the family. *Privatization is the act of reducing the role of government or increasing the role of the private institutions of society in satisfying people's needs; it means relying more on the private sector and less on government.*

Both the public and private sectors play important roles in privatization, and it is increasingly common to refer to "public-private partnerships," a less contentious term—despite its indistinct boundaries—than "privatization," as noted above. The fundamental, philosophical view of privatization noted above brings forth strong ideological opposition and distracts from privatization as a pragmatic tool to improve government performance and societal functioning.

Some opponents still regard privatization as a simplistic call to cut back government and regress to a Darwinian state where only the fittest survive and the poor and sick are left to cope as best they can. This is a serious misunderstanding of the concept. Privatization can be at least as compassionate as the welfare state; properly implemented, it offers even more for the less fortunate among us.

Advocates of privatization do not deny the need for government, preferably an effective one; they are not anarchists. Government intervention in society and the economy in various forms and to varying degrees is necessary. The classical reasons are to supply risk capital when massive investments are needed in uncharted areas; to establish rules for an increasingly interactive, urbanized nation where people get in each other's way; to plan for and provide, directly or indirectly, services deemed necessary and to subsidize them if unaided market forces cannot satisfy society's need; to handle external costs that otherwise desirable activities impose on others; and to regulate natural monopolies.

The remainder of this paper presents a dynamic analysis, describing how to change from an arrangement that relies heavily on government to one that relies relatively more on the private sector. Drawing on earlier work, this section presents a simple classification taxonomy that encompasses three broad methods that result in privatizing government-run services and functions and government-owned enterprises and assets²: (1) delegation, where government retains responsibility and oversight but uses the private sector for service delivery, for example, by contracting for services, or outsourcing; (2) divestment, where government relinquishes responsibility; and (3) displacement, where the private sector grows and displaces a government activity.³ Each of these incorporates several specific approaches that are identified in Table 1 and discussed in turn.

Table 1. Forms of Privatization	
Delegation	Contract Public-private competition Franchise Public-private partnership Grant, loan, favored tax status, etc. Voucher Mandate
Divestment	Sale Free transfer Liquidation
Displacement	Default Withdrawal (load shedding) Voluntary Action (voluntarism) Deregulation

Source: E.S. Savas, Privatization and Public-Private Partnerships (New York: CQ Press, 2000), Table 5.2.

Delegation

The first broad privatization strategy discussed here is delegation, which calls for a positive act by government. Sometimes called partial privatization, delegation requires a continuing, active role for government, which retains responsibility for the function while delegating the actual production activity to the private sector. The “tools of governance”⁴ most suitable for delegation are contracts, public-private competition, franchises, public-private partnerships, subsidies—by grants or vouchers for example—and mandates.

By Contract. Government can privatize an activity by contracting with a private organization, for-profit or nonprofit, to perform the work. Increasingly this is referred to as competitive sourcing, the term used in President Bush’s 2001 Management Agenda.⁵ This is the most common form of privatization in the United States, used by federal, state, and local governments, and the most direct form of delegation. (The most common form of privatization elsewhere is divestment, because of more statist economies and the correspondingly larger number of state-owned enterprises.)

Privatization by contract is not new in America. Queen Isabella of Spain outsourced exploration of the Western Ocean to an Italian contractor in 1492. The British contracted for Hessian mercenaries to fight in America’s War of Independence. Contractors were cleaning the streets of New York by 1676. The fledgling United States contracted out mail service in the 1790s. What is new—since the 1970s—is contracting with private firms in a deliberate effort to introduce competition and thereby reduce the cost of ongoing government activities that public employees currently provide directly. Accordingly, competitive contracting (“tendering”) is compulsory for selected local government services in Britain.

But contracting is surprisingly complex and accordingly deserves more space here than other forms of delegation. To simplify Williamson's crucial analysis,⁶ functions can be carried out externally through markets or internally through vertically integrated hierarchical organizations (firms or governments). Both incur costs. Markets incur transaction costs (see below); hierarchies incur costs due to the chain of goal-displacing principal-agent links (see below) between the top and bottom of the hierarchy and to limitations of human understanding and competence; together these lead to nonmarket failure.⁷ Leaders have to gauge the costs of each approach to decide whether to use markets and explicit external contracts or their own hierarchy and implicit internal contracts.

It is useful to distinguish between the purchase of goods and the purchase of services. Local governments, for example, buy all sorts of goods: potatoes (for schools and hospitals), underwear (for prisoners), chalk, chairs, sand, buses, trees, and thousands of other items. Procurement is fairly straightforward for such goods but much more complex for other goods such as computers and computer networks, an issue that Kelman has studied at length.⁸

Purchase of services is more complicated. It is used for direct services, support services, and for services delivered to third-party clients. Local governments purchase (outsource) direct services such as solid-waste collection, street repair, street cleaning, snow removal, and tree maintenance. The average American city contracts out almost a quarter of its common municipal services to the private sector.⁹ The average American state contracts out 14 percent of its activities,¹⁰ including the operation of some prisons.

Government agencies at all levels contract for support services such as data processing, loan processing, architecture and civil engineering, training, audio-visual services, food services, reference checking and testing of job applicants, employee medical examinations, claims processing, mail and file services, libraries, laundry and dry cleaning, facilities maintenance, warehousing, transportation, and vehicle maintenance.

Services purchased from organizations (often nonprofit) for delivery to third-party clients commonly include programs such as family counseling, employment training, senior citizen day-care, "meals on wheels," foster care, adoption programs, drug counseling, and shelters for the homeless and for victims of spousal abuse. Purchase of such services poses different problems than other forms of contracting.¹¹

Contracting presents the ever-present, principal-agent problem: Is the agent, the contractor, pursuing the principal's (government's) goals or his own? Moreover, market imperfections may override government imperfections or vice versa. Transaction costs can be high enough to forestall contracting attempts—establishing the requirements, designing the proposal or bidding process and the contract instrument itself, assuring that there is a truly competitive market, defining and choosing the best bid, overcoming political and public opposition, dealing effectively with affected employees, working with the contractor both cooperatively and at arms length simultaneously, monitoring the work, evaluating the results, and determining whether to renew or terminate upon contract completion.

Government has to be a smart buyer, meaning knowing what to buy, deciding from whom to buy it, and then determining what it has bought; that is, preparing careful specifications as what is to be purchased, conducting a competitive procurement in a competitive market, and monitoring the contractor's performance.¹²

Kelman discusses these many issues in detail:¹³

- Candidate selection: services suitable for outsourcing;
- Source selection: sole source, limited competition, or open competition;
- Type of contract: fixed price or cost reimbursement; completion contract (performance contract) or best-effort contract;
- Contract for multiple provision: delivery order, task order, or indefinite-quantity procurement;
- Contract incentives and modifications, and resolution of claims and disputes;
- Criteria for evaluating bids;
- Degree of allowable official discretion;
- Nature and degree of oversight.

Contracting is likely to be better than direct, in-house provision under the following circumstances:

1. the more precisely a task or result can be specified in advance;
2. the more easily performance can be measured and evaluated;
3. the more competition there is among potential providers;
4. the less the activity is core to the agency's mission;
5. the more the demand for service varies over time;
6. the private providers can hire people with the needed skills more easily than government can;
7. the private providers have greater economies of scale in producing the service.¹⁴

Strong commitment from the top is needed to build the capacity for effective contracting because of the complexity and challenges of public contract management.

By Public-Private Competition. The goal of contracting is competition, not necessarily contracting with a private firm. Increasingly therefore, governments are encouraging their own workers to compete for contracts with private contractors. This is called "managed competition" or "competitive sourcing," and it has proven to be a powerful incentive for public agencies—under the threat of privatization—to improve their performance. "Competitive sourcing" gained prominence in President George W. Bush's *President's Management Agenda* and was an important thrust of his government reform effort. Both terms are somewhat confusing in that they seem to be contrasted with sole-source contracting rather than with giving public employees a chance to compete to retain their jobs. The term "managed competition" is used primarily in local government; this process became the standard approach in Indianapolis and in San Diego County, for example, for many municipal services. This term is unsatisfactory, however, because all competitions have to be managed; therefore the term "public-private competition" is preferred.

Public-private competition requires the creation of a level playing field so the in-house group can compete fairly with outside private contractors, and vice versa. Martin identifies many of the principal design features of a fair system; they are shown in Table 2.

Table 2. Designing a Level Playing Field for Public-Private Competition	
I.	Process design issues
	<ul style="list-style-type: none"> A. Public and private sectors should submit their bids in parallel, not in sequence. B. The public agency should have access to consultant help. C. An independent body should evaluate public-sector proposals and bids. D. The government purchaser and the government provider should be separate entities.
II.	Cost Issues
	<ul style="list-style-type: none"> A. Government should not mandate private-sector wages or benefits. B. Government should not establish a minimum savings threshold. C. Using “avoidable cost” in the cost calculation favors the public sector; using “fully allocated cost” favors the private sector. D. Transaction costs should be either excluded or included symmetrically, viz., included for the public sector when current delivery is private and for the private sector when current delivery is public. E. Contract administration and monitoring costs should be either excluded or included symmetrically, like transaction costs.
III.	Contract Administration
	<ul style="list-style-type: none"> A. If a contract is awarded to the public agency, the terms should be documented in a memorandum of understanding. B. The performance of the public or private contractor should be monitored. C. The contract terms for the public or private contractor should include a penalty for failure to perform, and the penalty should be imposed whenever justified.

Source: Adapted from Lawrence Martin, “Determining a Level Playing Field for Public-Private Competition,” presented at the Northeast Regional Conference of the American Society for Public Administration, New York, NY, October 29, 1999.

By Franchise. Franchising is another method of privatization. Under a franchise, government awards a private organization the right (often the exclusive right) to sell a service or a product to the public. The private firm usually pays the government a fee. Two forms of franchising exist. One involves the use of the public domain -- airwaves, air space, streets, underground space, etc. For example, broadcasters, airlines, bus and taxi companies, and utilities (electricity, gas, water, telephone) use the public domain in carrying out their commercial activities. This arrangement is usually called a concession. Infrastructure projects—water supply, wastewater treatment, highways, airports, and bridges—that are built, expanded, or

upgraded through public-private partnerships are franchises, usually in the form of concessions. The second form is a lease, where a private lessee uses tangible, government-owned property such as land or a building to engage in a commercial enterprise.

There is no sharp distinction between a lease and a concession. Some differentiate the two in that capital investments under a lease are made by the owner, the government, while under a concession they are made by the concession holder, the franchisee. This is important in some privatizations, but the distinction has little significance with respect to infrastructure privatization. This method was used, for example, to build public schools on public property where there is also enough adjacent space for a private commercial development. The latter generates the income to allow the developer to pay for the former.

By Public-Private Partnership. Infrastructure projects are increasingly being built through public-private partnerships (PPPs). Unlike the general use of this term as mentioned above, PPP in this sense refers to an arrangement where government states its need for capital-intensive, long-lived infrastructure and the desired facility is built using a complex combination of government and (mostly) private financing and then operated by a private entity under a long-term franchise, contract, or lease. The payments are usually spread over twenty to 99 years and cover construction, operation, maintenance, and capital costs. Typical PPP projects are roads, bridges, airports, water systems, pipelines, and power plants, but prisons, stadiums, schools, and municipal buildings have also been developed through this method, as have urban economic development projects.¹⁵

By Grants and Other Subsidies. Delegation is also carried out by awarding grants, below-interest loans, favored tax treatment, and other kinds of subsidies. Instead of government itself carrying out an activity, it arranges for a private entity to do the work, and it provides financial support. In the United States, grants are used for mass transit, low-income housing, maritime shipping, and innumerable other activities. Grants are distinguished from contracts in that grants usually involve only the most general requirements (run a bus service, build houses that rent at below-market prices, conduct research, promote the arts), whereas contracts are usually specified in great detail for a particular service (sweep the west side of certain north-south streets between 7 a.m. and 9 a.m. on Tuesdays and Fridays). Grants and loans can generally be thought of as one-time payments, often to initiate a new activity, while favorable tax treatment and other subsidies tend to be continuing and to cover pre-existing as well as new services.

By Voucher. Governments can also delegate by issuing vouchers to eligible recipients of formerly state-run services. Instead of subsidizing producers, as grants do, vouchers subsidize consumers. Vouchers are used in the United States for food, housing, education, job training, health care, drug treatment, treatment of developmental disabilities, child day care, cultural activities, and transportation. For some services, for example, food and housing, eligible recipients can supplement food stamps or housing vouchers with their own funds when purchasing these goods and services in the market place. Vouchers offer great promise but possibly great complexity, depending on the service being “voucherized.”

By Mandate. The fifth and final form of privatization by delegation is a government mandate requiring private agencies to provide a service at their expense. Unemployment

insurance is a long-standing example of such a mandate in the United States; private employers provide it for their employees. Privatization connotes a direction of change and therefore mandates, like grants, vouchers, franchises, and contracts, can be considered forms of privatization only when they lead to a lesser, not a greater, role for government. Thus if the government-run social security (retirement) system in the United States were replaced by mandatory, individual retirement accounts as in Chile, this would be privatization by mandate, a form of delegation—in this case, to private individuals. On the other hand, if market-based health care were replaced by mandatory, employer-provided health care, this would be the opposite of privatization, as it would involve a greater rather than a lesser role for government. A trend in the United States that many consider ominous is to create new social programs (for example, family leave, aid to the handicapped, job training) by imposing government mandates on private employers instead of doing it directly. The net economic effect, of course, is the same, but the public is forced to pay covertly, through higher prices, rather than openly, through taxes.

Divestment

Divestment means shedding an enterprise, function, or asset. Like delegation, this requires a direct, positive act by government but unlike delegation it is a one-time event. The enterprise or asset is either sold or given away as an ongoing business, or shut down. Where state-owned enterprises are abundant, “denationalization” is frequently used to mean divestment.

By Sale. Throughout the world, state-owned enterprises are being sold and thereby transferred to the tender mercies of the marketplace. Four common ways to divest by sale are the following: (1) by selling the enterprise (or asset) to a single buyer, as was done with the Vista Hotel in New York City, which had been owned by a government authority and was sold to a major hotel chain; (2) by issuing and selling shares to the public, as was done with Conrail, the government-owned freight railroad in the United States, in 1987; (3) by selling the enterprise to the managers or, more broadly, to employees, as was done with the National Freight Company, the state-owned British trucking company;¹⁶ and (4) by selling the enterprise or asset to its users or its customers. For example, state-owned land may be sold to ranchers or loggers, and a rural electricity or water system may be sold to a cooperative of local users.

Governments in the United States own more than \$4 trillion in real estate assets, it is estimated,¹⁷ a tempting target for privatization. It is commonplace for government to sell land, buildings, equipment, and other assets that are no longer needed, or to avoid future departmental expansions. Mayor Bret Schundler of Jersey City, New Jersey, pioneered a highly original divestment by securitizing and selling tax liens, an idea replicated in New York City by Mayor Giuliani.¹⁸ At the federal level the largest privatization in the United States since the Homestead Act took place when the Clinton Administration began to sell government-owned uranium enrichment plants, helium plants, power-marketing agencies, and oil fields.

By Free Transfer. Divestment does not require sale of an enterprise; the latter could be given away, for example, to employees, to users or customers, to the public at large, or to a qualified class of people.

New York City proposed to privatize its municipal hospitals by giving them away to newly created, local, nonprofit, community-based boards representing the residents (i.e., users) who rely heavily on that hospital. Proposals to privatize America's air-traffic-control system call for giving or selling the assets and responsibilities to a consortium of airport users.¹⁹

By Liquidation. Finally, divestment can be carried out by shutting down and liquidating a poorly performing government enterprise, that is, selling its assets if no buyer can be found for it as a going enterprise and if the prospects are bleak for ever making it profitable. This can be considered privatization because the assets are recycled into the marketplace and become available for better uses.

Displacement

Besides divestment and delegation, privatization can proceed by displacement, as shown in Table 1. In contrast to the first two methods, which require positive acts by government, displacement is a more passive or indirect process that leads to government being displaced more or less gradually by the private sector—a withering away of the state, so to speak, as markets develop to satisfy unmet public demands. It has also been called privatization by attrition,²⁰ or by stealth.²¹ Often unrecognized as a form of privatization, displacement is both commonplace and an extremely important process by which effective privatization often occurs with relatively little political battling.

Displacement occurs by default, by withdrawal, by voluntary action, and by deregulation, and it depends ultimately on local initiatives and entrepreneurship. It can be accelerated by imposing market-based user charges on hitherto “free” government goods and services—which makes the cost of government provision clear and invites private competitors—and by encouraging voluntary action. Generally speaking, it does not involve competition per se, but it does involve choice: on the part of the entrepreneur or volunteer who initiates the alternative and on the part of the customer who patronizes the nongovernmental option.

By Default. When the public considers government production of goods or services to be inadequate, and the private sector recognizes and satisfies this unmet demand, this is displacement by default. This, too, satisfies the definition of privatization, namely, relying more on the private sector and less on the state to satisfy people's needs. Gradually, the public begins to look to the private sector for this activity, and, if the service grows over time and the government-supplied goods or services continue to be neglected or the government role shrinks in relative terms, the private sector will play a larger and larger role. Simply put, customers desert or avoid the public service. A common example is the growth of private transportation where the public deems government-provided bus service unsatisfactory or inadequate. Gypsy cabs, commuter vans, minibus systems and other informal, quasilegal, or technically illegal transport services have emerged in numerous cities throughout the world. We are also seeing displacement by default in public education in large American cities: Even parents of limited means have been withdrawing their children from the public schools in droves, enrolling them in proliferating private schools and schooling them at home.

Private police offer another example. The public's unsatisfied demand for conventional police protection and dissatisfaction with the level of public safety in the United States led to the growth of private guard and patrol services. Although the latter have not displaced the former, in the United States the growth has been primarily in the private sector: by 1990, private police comprised three-fourths of all police.²²

Throughout the United States and elsewhere, private firms are satisfying infrastructure needs that government agencies alone cannot. Thus, the private sector is financing, building, owning, and operating roads, bridges, water systems, and wastewater-treatment plants. The pressing need for such facilities can be considered examples of "default," but these are, in effect, franchises, and often involve some public support through complex public-private partnerships.

By Withdrawal. Whereas default is unintended or inadvertent, government can engage in deliberate withdrawal, or "load shedding,"²³ by constricting the growth of a government agency or shrinking its size while the private sector expands into that field. This has also been termed "privatization by extinction."²⁴ In the United States, local governments often give funds to nonprofit organizations such as museums, zoos, opera houses, theaters libraries, and social service agencies. Such institutions are in the anomalous position of paying no taxes but receiving city services, while businesses pay taxes but do not receive certain city services (for example, refuse collection). City governments could withdraw some or all of their support, reduce their subsidies, or otherwise encourage—for example, with matching grant programs—the cultural institutions to raise more funds from patrons and philanthropists.

Withdrawal often goes hand-in-hand with default. In Britain, private health care is re-emerging as the system of socialized health care deteriorates in quality and availability and funds are cut; people are slowly migrating toward a private alternative.²⁵

Load shedding, or withdrawal, can occur by accommodation, that is, informal cooperation between government and private-sector providers. This happens when the latter relieve the former of a function the public agency would rather not perform. For example, private companies provide security inside shelters for the homeless, an unpleasant task, but it is agreed that regular police officers will respond expeditiously to calls for help from such private guards.²⁶ Some states grant campus police and other private security personnel the power of arrest and give them jurisdiction on public streets in the vicinity of their employer's property.

Government withdrawal from established services is not easy, for a new political consensus must be achieved to replace the one that brought about government entry in the first place. Nevertheless, discontent with government services suggests that such a consensus may emerge for specific services. This need not involve a bruising battle between opposing ideologies. All that is needed is appropriate encouragement of forces already at work. Evidence concerning the extent to which working adults care for their elderly relatives is instructive. A study of employees in a large American insurance company showed that 28 percent of the full-time employees over the age of thirty provided regular care for elderly relatives and friends; they devoted an average of 10.2 hours per week to such care, and 42 percent of the caregivers had daily contact with the elder.²⁷ The remarkable aspect of this finding is that this traditional pattern of family care persists and is adhered to even by people holding full-time jobs outside the

home. To the extent that this practice can be rewarded, made easier, and encouraged by government through changes in tax and zoning policies and in building codes (for example, allowing extensions to single-family houses to accommodate aging parents—“grandma flats”), the demand for more government provision of such care will be reduced.

By Voluntary Action. Besides private action instigated by government default or withdrawal, government-encouraged voluntary action may also lead to cost displacement in particular cases. Examples are programs to adopt highway segments and parks for cleaning and to adopt libraries, zoos, and schools. Such “adoption” generally means making voluntary contributions to subsidize those activities and institutions. These go beyond ordinary and conventional contributions to charitable and other nonprofit organizations.

Another form of voluntary action is the creation of geographic collective units. A new, very local level of government has emerged in the United States. Ranging in size from a single building to a condominium, a neighborhood organization, a civic association, or a large community, it can be called a voluntary microcollective, a micropolis,²⁸ or a common-interest community.²⁹ These provide an array of collective goods, including cleaning and maintaining local streets and parks, removing snow, collecting refuse, operating volunteer ambulance and fire services and block patrols, and providing plantings and attractive urban “street furniture” (signs, litter baskets, benches, bus shelters, street lights, and consolidated newspaper vending machines).³⁰ City services are often reduced in these areas, as unneeded local governments step aside. Almost one-fifth of the U.S. population lives in communities governed by such associations.³¹

Besides improving the local quality of life, such organizations can forge a desperately needed sense of community and can restore and hone citizenship skills atrophied from disuse, skills without which a democracy cannot long survive. Voluntary associations obtain the services they want, custom tailored to their specific local needs and preferences, thereby exercising direct influence over the quality of their surroundings, although complaints are growing about the intrusiveness and dictatorial behavior of such bodies.³²

These kinds of units can best be formed in established communities that have well-defined geographic boundaries, are relatively homogeneous in terms of income or ethnicity, and have shared values with respect to the services to be provided through this mechanism. Local leadership is necessary, as is an encouraging posture by the local government. The latter can mean giving tax rebates to residents in areas that forego city services. This poses a minor administrative problem for the local government, but many communities do it, including Houston, Texas and Kansas City, Missouri. In the latter, local Homeowner Associations can choose to opt out of municipal refuse-collection service and receive a proportional rebate on their property taxes, but they contract with private firms for a higher level of service than the city provides. Moreover, government can encourage the creation and assure the viability of such self-governing associations by granting them taxing authority as special assessment districts. New York State has such legislation.³³ Dozens of business improvement districts, “BIDs,” in New York City and elsewhere utilize this approach.

An important attribute of such microcollectives is that members may have an opportunity to contribute their labor instead of their money. In the days of a barter economy, people could pay their taxes in specie such as grain and livestock. In a market economy they must pay cash. Voluntary associations can restore to the taxpayer the choice of paying in kind—with labor. One might then think of “off the books” earnings in the underground economy as having their counterpart in “off the books” tax payments, that is, payments in kind for collective goods.

As the demand for certain collective goods exceeds the ability of government to supply them at a suitable price and quality, dissatisfied citizens subsidize, supplement, or supplant the municipal service. Displacement occurs through government default and withdrawal and as citizens desert municipal services and band together in voluntary action.

By Deregulation. Government-owned enterprises and government activities often exist because they have monopoly status and the private sector is prohibited from competing. Deregulation facilitates privatization if it enables the private sector to challenge a government monopoly and even displace it altogether. In the United States, message delivery by facsimile and express mail services and parcel delivery by competing companies have grown rapidly by *de facto* deregulation, at the expense of the U.S. Postal Service. The latter claims and vigorously defends its exclusive right to handle first-class mail and prohibits its competitors from depositing mail in recipients’ mail boxes, but the regulations are under attack and their repeal was advocated by the President’s Commission on Privatization.³⁴ In any event, e-mail is displacing conventional mail.

Day care is a good candidate for deregulation. Since time immemorial, parents have arranged for relatives, friends, and neighbors to care for their children, and parents have taken into consideration the character and qualities of individuals to whom they entrust their children and the surroundings in which their children are placed. In recent years, however, day care became the object of increasing government involvement and financing. The result has been an increasingly complex web of legal restrictions as to who can provide the service, the number and kind of personnel who must be in attendance, the nature and design of the facilities, and so forth. The statement of an incredulous and indignant day-care operator to a zoning board in Washington, DC, is worth quoting: “You’re telling us we cannot operate a day-care facility in a residentially zoned middle-class neighborhood with a large number of working mothers, but we can operate a center in a commercial zone between two topless bars?”³⁵ The bizarre result of all the restrictions, however well intended, was that most families and homes would not be certified by government as suitable for childcare. In fact, the situation has been changing: vouchers for childcare have been introduced, and they can be given to any provider of care chosen by the parent.

In many countries, years of state regulatory intervention have produced bureaucratic obstacles and economic stagnation. Hernando de Soto illustrates how much time is wasted in Peru following the labyrinthine official procedures to start a business or build a house: It takes 289 days to register an industrial enterprise and 26 months to license informal taxi operators, for example. The informal economy (i.e., “black market”) encourages far greater productivity than the official sector.³⁶ (It is dismaying to realize that getting a license for an informal taxi is even more difficult in New York City.³⁷) He advocates deregulation, debureaucratization, and

decentralization. One prominent journal succinctly summarizes the situation in developing countries: “[B]ad government is the biggest single reason for poverty in the third world, and less government is the most effective single remedy.”³⁸

Post-socialist countries revived their devastated economies by repealing laws that prohibited private ownership, thereby encouraging entrepreneurs and allowing market mechanisms to prevail. “Marketization” is another term for this process, which aims to achieve economic efficiency through exposure to market discipline. The end result of deregulation is the emergence of demand-driven, market-based arrangements to satisfy unmet needs.

Overall, the People’s Republic of China offers the best example of privatization by displacement. The first step was the deregulation of agriculture in 1978. In effect farmers were able to exercise virtually all property rights customarily associated with ownership of specific parcels of land, provided they paid rent to the state in the form of contracted deliveries of grain. Agricultural production mushroomed, in sharp contrast to the famines that occurred under collective farming, when millions died. The resulting rural wealth, coupled with further *de facto* deregulation, led in turn to the creation of (politically correct) village and township enterprises which engaged in manufacturing that contributed immensely to China’s economic boom. Although some may question whether this can be called privatization, such enterprises are analogous to employee stock-ownership plans. In the 1990s this nominally communist country withheld support for SOEs, often by failing to pay the workers, thereby hastening their departure from the inactive, moribund enterprises. This is withdrawal of sorts, but it aroused social unrest. At the same time the rulers are encouraging the formation and growth of private enterprises instead of forbidding them as in the past. Many displaced workers are getting jobs and starting businesses in the new, booming private sector. Finally, in 2004, private property rights were legalized, essentially ending the 55-year Communist nightmare and driving the final nail in the socialist coffin. The end point of such deregulation in this former socialist state is capitalism.

CAVEATS ABOUT PRIVATIZATION

Critical concerns about privatization are both pragmatic and theoretical (or ideological, or philosophical). The pragmatic concerns cluster about the kinds of failures that sometimes occur under privatization:

1. Public officials fail to specify properly the full dimensions of a service to be purchased from contractors; this inevitably leads to misunderstandings and disputes.
2. They undervalue an asset to be divested, thereby short-changing their citizens.
3. They fail to conduct a proper competitive procurement or sale. Conflicts of interest in procurement are a constant danger in the purchasing process of both public agencies and private companies; vigilance and oversight are necessary. Sole-source procurement is not necessarily bad, but one resorts to it with caution and only after full justification.
4. They fail to monitor the performance of a private provider, thereby abdicating their responsibility and leaving an opening for an unscrupulous provider to cut corners and lower service quality.
5. They fail to penalize poor performance, perhaps because of failure to monitor properly or because of a cozy relationship between the monitor and the provider.

6. They fail to set and maintain performance standards in a voucher system; agents authorized to accept vouchers and provide services (e.g., schools, private housing) must satisfy certain conditions germane to the service.
7. They fail to maintain a competitive environment after privatizing by delegation (e.g., contracting and franchising), and therefore the incumbent provider gradually acquires and exploits monopoly status. Trading a public monopoly for a private one is not a prescription for better government.
8. They fail to protect current employees adequately.

Privatization advocates counter these concerns by pointing out that while privatization can indeed be mismanaged in these ways, management of ordinary public services suffers from many of these same shortcomings; that is, poor management can sometimes be found whether government is managing public employees or the privatization process. It is not inevitable, however, and it is easier to manage a privatized service than an in-house one, asserts Mayor Stephen Goldsmith of Indianapolis.³⁹ (When mismanagement occurs in the private sector, market forces tend to weed it out ruthlessly. This rarely happens in the public sector; public agencies that perform poorly are often given a larger budget in order to improve their performance.)

As for the last-listed concern, about inadequate protection of current public employees, proponents reply that (1) many effective policies are commonly used both to protect workers and to balance the public interest with the workers' interest;⁴⁰ (2) this is a value judgment, and public employees are not entitled to greater job security than the vast majority of taxpayers who work without the dual protection of public-employee unions and tenure under a civil service system.

Paul Starr voices the fundamental ideological and political opposition to privatization:⁴¹

...[P]rivatization undermines the foundation of claims for public purpose and public service....

...It shifts power to those who can more readily exercise power in the market. It may also shift income and wealth, depending on the specific form of that policy

...[P]rivate service providers often maximize profits, not by producing services more efficiently but by seeking out the least costly clients [for social services] or by employing lower-wage workers, often on a part-time basis. Since wages tend to be more equal in the public sector, privatization is likely to skew income in the direction of greater inequality. Furthermore, while unions have lost ground in the private sector, they have generally made advances in organizing public employees. Privatization tends to undermine these gains...

In the extreme case, privatization is an instrument of class politics. Where privatization is used to break up public employee unions and reduce the provision of services, it effectively represents a means of reordering class relations.

Privatization is...a signal about the competence and desirability of public provision. It reinforces the view that government cannot be expected to perform well.

If, to many Americans, private means better, it is partly because of long-existing restrictions on the scope and quality of public provision. We commonly limit public services to a functional minimum and thereby guarantee that people will consider the private alternative a step up. The restricted quality of public provision is a self-reinforcing feature. Because the poor are the principal beneficiaries of many programs, the middle-class public opposes expenditures to produce as high a quality of service as they must pay for privately; and because the quality is held down, the poor as well as the middle class develop a contempt of the public sector and an eagerness to escape it. The movement toward privatization reflects and promotes this contempt, and therein lies part of its political danger.

Privatization ... represents an effort to alter the conditions of political competition by breaking up the coalitions supporting public provision and by promoting more market-oriented values. ... it is an attempt to fix in place the conservative orientation that has emerged forcefully in the 1980s. ... public institutions, like private ones, are bases of wealth and power. They are environments that encourage those who work within them to develop different political orientations. To alter the balance is to change the distribution of material and symbolic resources influencing the shape of political life... Since I do not share the values for which [the power of conservatives] is deployed, I distrust privatization.

One can apply his own values and judge for himself the validity and strength of these arguments and whether they outweigh the practical successes and democratic virtues of privatization and public-private partnerships.

SUMMARY

Privatization and public-private partnerships reflect market principles and together constitute a strategy for improving public management. Among the particular tools employed are contracts, public-private competition, franchises, vouchers, divestment, withdrawal, and voluntary action. Opposition to privatization is based on numerous examples of poor management of the process as well as fundamental opposition to the concept on ideological grounds.

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- ⁴ Lester M. Salamon, ed., *The Tools of Government: A Guide to the New Governance* (New York: Oxford University Press, 2002).
- ⁵ Executive Office of the President, *The President's Management Agenda, FY 2002* (Washington, DC: Government Printing Office, 2001).
- ⁶ Oliver E. Williamson, *Markets and Hierarchies* (New York: Free Press, 1975), p. 8–9.
- ⁷ Charles Wolf, Jr., *Markets or Governments: Choosing between Imperfect Alternatives*, 2nd ed. (Cambridge, MA: MIT Press, 1993).
- ⁸ Steven Kelman, *Procurement and Public Management: The Fear of Discretion and the Quality of Government Performance* (Washington, DC: AEI Press, 1990).
- ⁹ R. Miranda and K. Andersen, "Alternative Service Delivery in Local Government, 1982-1992," in *Municipal Year Book 1994* (Washington, DC: International City-County Management Association), Table 3/5.
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- ¹² Donald F. Kettl, *Sharing Power: Public Governance and Private Markets* (Washington, DC: Brookings Institution, 1993), chapter 8.
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