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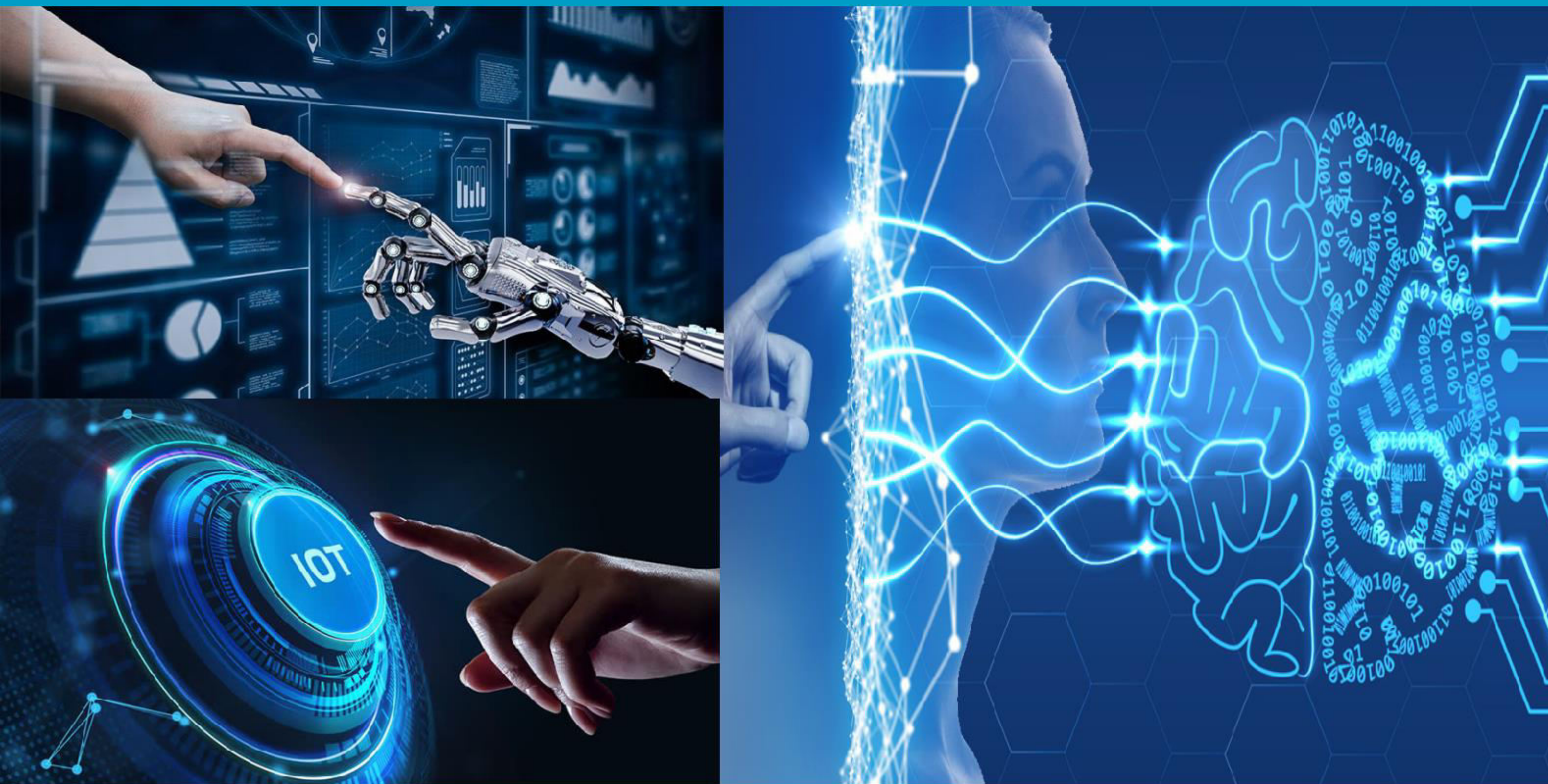

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Privatization of Public Enterprises and It's Implications on Economic Policy and Development

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ABSTRACT: Privatization occurs when a government-owned business, operation, or property becomes owned by a private, non-government party.Privatization may also describe a transition that takes a company from being publicly traded to becoming privately held. This is referred to as corporate privatization. Privatization of specific government operations happens in a number of ways, though generally, the government transfers ownership of specific facilities or business processes to a private, for-profit company. Privatization generally helps governments save money and increase efficiency.In general, two main sectors compose an economy: the public sector and the private sector. Government agencies generally run operations and industries within the public sector. In the U.S., the public sector includes the U.S. Postal Service, public schools and universities, the police and firefighter departments, the national park service, and the national security and defense services.Enterprises not run by the government comprise the private sector. Private companies include the majority of firms in the consumer discretionary, consumer staples, finance, information technology, industrial, real estate, materials, and healthcare sectors.

KEYWORDS: privatization, public enterprises, economic development, policy, government, agencies, sectors

I. INTRODUCTION

Corporate privatization, on the other hand, allows a company to manage its business or restructure its operations without the strict regulatory or shareholders' oversight imposed on publicly listed companies.This often appeals to companies if the leadership wants to make structural changes that would negatively impact shareholders. Corporate privatization sometimes takes place after a merger or following a tender offer to purchase a company's shares. In order to be considered privately owned, a company cannot get financing through public trading via a stock exchange.[1,2]

Dell Inc. is an example of a company that transitioned from being publicly traded to privately held. In 2013, with approval from its shareholders, Dell offered shareholders a fixed amount per share, plus a specified dividend as a way to buy back its stock and delist. Once the company paid off its existing shareholders, it ceased any public trading and removed its shares from the NASDAQ Stock Exchange, completing the transition to being privately held. In 2018, Dell reverted back to being a public company. Proponents of privatization argue that privately-owned companies run businesses more economically and efficiently because they are profit incentivized to eliminate wasteful spending. Furthermore, private entities don't have to contend with the bureaucratic red tape that can plague government entities.On the other hand, privatization naysayers believe necessities like electricity, water, and schools shouldn't be vulnerable to market forces or driven by profit. In certain states and municipalities, liquor stores and other non-essential businesses are run by public sectors, as revenue-generating operations.

Before 2012, the state of Washington controlled all sales of liquor within the state, meaning that only the state could operate liquor stores. This policy allowed the state to regulate how and when liquor was sold, and to collect all revenue from liquor sales within the state. However, in 2012, the state moved to privatize liquor sales.

Once privatized, private businesses such as Costco and Walmart could sell liquor to the general public. All previously state-run stores were sold to private owners or closed, and the state ceased collecting all revenue from liquor sales. One of the most famous and historically important examples of privatization occurred after the fall of the Soviet Union. The Soviet Union's form of government was communism, where everything was owned and run by the state; there was no private property or business. Privatization began before the collapse of the Soviet Union under

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Mikhail Gorbachev, its then-leader, who implemented reforms to hand over certain government enterprises to the private sector. After the Soviet Union collapsed, there was mass privatization of previous government enterprises to a select portion of the populace in Russia, known as oligarchs, that dramatically increased inequality within the nation.

Many types of institutions and facilities typically run by public officials or governments can and have been privatized. These include, among others: prisons; public schools & universities; hospitals; highways; [3,4]airports and harbors; public utilities (e.g., water, electricity); waste disposal; mail delivery; and communications infrastructure. Prisons and jails are often owned and operated by local or state governments. But, there has been a trend to privatize these facilities as governments seek to lower costs, raise capital, and create jobs in their communities. Proponents argue that specialist companies are better-equipped and skilled at controlling prison populations, Critics, however, argue that for-profit prisons are rife with scandal, cutting corners, prisoner abuse, and other ethics violations. Shareholders first must agree to give up ownership in the company in exchange for some amount of money. If approved, all shareholders will receive a certain amount per share, often at a premium to the market price. Afterward, they are no longer shareholders and the company's shares would be de-listed from exchanges.

II. DISCUSSION

For decades prior to the 1980s, governments around the world increased the scope and magnitude of their activities, taking on a variety of tasks that the private sector previously had performed. In the United States, the federal government built highways and dams, conducted research, increased its regulatory authority across an expanding horizon of activities, and gave money to state and local governments to support functions ranging from education to road building. In Western Europe and Latin America, governments nationalized companies, whole industries, banks, and health care systems, and in Eastern Europe, communist regimes strove to eliminate the private sector altogether. Then in the 1980s, the tide of public sector expansion began to turn in many parts of the world. In the United States, the Reagan administration issued new marching orders: “Don’t just stand there, undo something.” A central tenet of the “undoing” has been the privatization of government assets and services.

According to privatization’s supporters, this shift from public to private management is so profound that it will produce a panoply of significant improvements: boosting the efficiency and quality of remaining government activities, reducing taxes, and shrinking the size of government. In the functions that are privatized, they argue, the profit-seeking behavior of new, private sector managers will undoubtedly lead to cost cutting and greater attention to customer satisfaction. This newfound faith in privatization has spread to become the global economic phenomenon of the 1990s. Throughout the world, governments are turning over to private managers control of everything from electrical utilities to prisons, from railroads to education. By the end of the 1980s, sales of state enterprises worldwide had reached a total of over $185 billion—with no signs of a slowdown. In 1990 alone, the world’s governments sold off $25 billion in state-owned enterprises—with continents vying to see who could claim the privatization title. The largest single sale occurred in Britain, where investors paid over $10 billion for 12 regional electricity companies.[5,6] New Zealand sold more than 7 state-owned companies, including the government’s telecommunications company and printing office, for a price that topped $3 billion.

Developing countries have been quick to jump on the privatization bandwagon, sometimes as a matter of political and economic ideology, other times simply to raise revenue. Argentina, for example, launched a major privatization program that included the sale of its telephone monopoly, national airline, and petrochemical company for more than $2.1 billion. Mexico’s aggressive efforts to reduce the size and operating cost of the public sector have resulted in proceeds of $2.4 billion.

Over the next decade, privatization is likely to be at the top of the economic agenda of the newly liberated countries in Eastern Europe, as well. Czechoslovakia, Hungary, and Poland are all committed to privatization and are in the process of working out the legal details. The most extensive change thus far has taken place in what was the German Democratic Republic. In 1990 alone, the Treuhandanstalt—the public trust agency charged by the German government with the task of privatization arranged the sale of more than 300 companies for approximately $1.3 billion. The agency still has more than 5,000 companies on its books, all looking for buyers. Having migrated around the world, privatization has also changed venue in the United States, from the federal government to state and local governments. Over 11 states are now making use of privately built and operated correctional facilities; others plan to privatize

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roadways. At the local level, communities are turning to private operators to run their vehicle fleets, manage sports and recreation facilities, and provide transit service. In the past several years, more and more state and local governments have adopted privatization as a way to balance their budgets, while maintaining at least tolerable levels of services.[7,8]

This growth of privatization has not, of course, gone uncontested. Critics of widespread privatization contend that private ownership does not necessarily translate into improved efficiency. More important, they argue, private sector managers may have no compunction about adopting profit-making strategies or corporate practices that make essential services unaffordable or unavailable to large segments of the population. A profit-seeking operation may not, for example, choose to provide health care to the indigent or extend education to poor or learning-disabled children. Efforts to make such activities profitable would quite likely mean the reintroduction of government intervention—after the fact. The result may be less appealing than if the government had simply continued to provide the services in the first place.

Overriding the privatization debate has been a disagreement over the proper role of government in a capitalist economy. Proponents view government as an unnecessary and costly drag on an otherwise efficient system; critics view government as a crucial player in a system in which efficiency can be only one of many goals.

There is a third perspective: the issue is not simply whether ownership is private or public. Rather, the key question is under what conditions will managers be more likely to act in the public's interest. The debate over privatization needs to be viewed in a larger context and recast more in terms of the recent argument that has raged in the private sector over mergers and acquisitions. Like the mergers and acquisitions issue, privatization involves the displacement of one set of managers entrusted by the shareholders—the citizens—with another set of managers who may answer to a very different set of shareholders.

The wave of mergers and acquisitions that shook the U.S. business community in the late 1980s was a stark demonstration that private ownership alone is not enough to ensure that managers will invariably act in the shareholders' best interests. The sharp increase in shareholder value generated by most of the takeovers was the result of the market's anticipation of improvements in efficiency, customer service, and general managerial effectiveness—gains which might, for example, come from the elimination of unnecessary staff, the cessation of unprofitable activities, and improvements in incentives for managers to maximize shareholder value. In other words, the gains from takeovers were the result of the anticipated removal of managerial practices commonly thought to characterize public sector management. The lessons from this experience are directly applicable to the debate over privatization: managerial accountability to the public's interest is what counts most, not the form of ownership.[9,10]

Refocusing the discussion to analyze the impact of privatization on managerial control moves the debate away from the ideological ground of private versus public to the more pragmatic ground of managerial behavior and accountability. Viewed in that context, the pros and cons of privatization can be measured against the standards of good management—regardless of ownership.

1. Neither public nor private managers will always act in the best interests of their shareholders. Privatization will be effective only if private managers have incentives to act in the public interest, which includes, but is not limited to, efficiency.

2. Profits and the public interest overlap best when the privatized service or asset is in a competitive market. It takes competition from other companies to discipline managerial behavior.

3. When these conditions are not met, continued governmental involvement will likely be necessary. The simple transfer of ownership from public to private hands will not necessarily reduce the cost or enhance the quality of services.

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III. RESULTS

Privatization, as it has emerged in public discussion, is not one clear and absolute economic proposition. Rather it covers a wide range of different activities, all of which imply a transfer of the provision of goods and services from the public to the private sector. For example, privatization covers the sale of public assets to private owners, the simple cessation of government programs, the contracting out of services formerly provided by state organizations to private producers, and the entry by private producers into markets that were formerly public monopolies. Privatization also means different things in different parts of the world—where both the fundamentals of the economy and the purpose served by privatization may differ.

One accounting of privatization appears in Raymond Vernon's The Promise of Privatization, a comparative analysis of international privatization activities of all sorts. According to Vernon's figures, by the late 1980s, the growth in state-owned enterprises in Africa, Asia, Latin America, and Western Europe had generated a nonfinancial state-owned sector accounting for an average of 10% of gross domestic product, with much higher shares in France, Italy, New Zealand, and elsewhere. In many developing countries, state-owned enterprises operated at substantial deficits and were responsible for as much as one-half of all outstanding domestic indebtedness. In many instances, Vernon says, privatization in these countries was driven purely by the public sector's sorry financial condition. As conditions worsened in the early 1980s and credit markets tightened significantly, these governments sold off public assets to raise cash.Contrary to the skeptics' assertion that governments won't sell the winners and can't sell the losers, governments sold off many prized assets in the 1980s. The most notable example is in the United Kingdom, where by 1987, the Thatcher government had shed more than $20 billion in state assets, including British Airways, British Telecom, and British Gas. Sales also ran into the billions of dollars in France and Italy, and many less developed countries sold off a large portion of their interests in public enterprises.[11,12]

The story in the United States has been somewhat different, largely because the U.S. government has never had as many assets to privatize. Compare, for example, the concentration of public sector employment in other nations to that in the United States. In the late 1970s, nearly 7% of employees in other developed market economies worked in state-owned enterprises; the comparable figure for the United States was less than 2%. Unlike other industrialized countries where many of the utilities and basic industries are state-owned—and thus ripe targets for privatization—in the United States, the telecommunications, railroad, electrical power generation and transmission, gas distribution, oil, coal, and steel industries are entirely or almost entirely privately owned.If there is a similar privatization phenomenon in the United States to the one Vernon describes in developing countries, it is in state and local governments where financial conditions in recent years have reached crisis proportions. Budgetary shortfalls have induced administrators to consider privatization as a means to avoid higher taxes or large cuts in services. Touche Ross surveys of state comptrollers in 1989 and city managers and county executives in 1987 show that the vast majority of state and local governments contract out some services to private providers. The most often cited motivation for contracting out was to achieve operating cost savings; survey results from city and county administrators suggest that, in nearly every case, some cost savings were achieved. The second most often cited reason for contracting out was to solve labor problems with unionized government employees. Asset sales, on the other hand, were uncommon: only 5 state governments of the 31 that responded to the survey had used that approach.

A second impetus for privatization emerged in the United States in the 1980s. Privatization was a central piece of the Reagan administration's efforts to reduce the size of government and balance the budget. A book by former Reagan staffer Stuart Butler, Privatizing Federal Spending: A Strategy to Eliminate the Deficit, provides an intellectual rallying point for conservative efforts to reduce the federal government payroll and put a brake on the growth in government spending. Butler argues that private enterprises will cut costs and improve quality in an effort to gain profits and compete for more government contracts. Government providers, on the other hand, will pursue other objectives, such as increased employment or improved working conditions for government employees—initiatives that only result in higher costs, poorer quality, or both.But most important, Butler contends, is that privatization can simply reduce the size of government. Fewer government workers and fewer people supporting a larger role for government means less of a drain on the nation's budget and overall economic efficiency.Butler's arguments for privatization find sympathetic ears at the California-based Reason Foundation, which has been advocating privatization of both public assets and public services since the late 1970s. Using language designed to push the hot button of the average taxpayer, the

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foundation claims: “If your city is not taking full advantage of privatization, your cost of local government may be 30% to 50% higher than it need be. The costs of state and federal government are also greater without privatization.”

To the Reason Foundation, the benefits of privatization are clear and nearly universal; there seem to be no limits to the type of government activities that would benefit from privatization. Its annual report, Privatization 1991, considers privatization activities of all sorts around the world, always with a uniformly optimistic perspective. The message is clear: the shift in ownership or control from public to private hands will necessarily lead to cheaper, better services for the citizenry. As its press release states: “No service is immune from privatization.”This may sound extreme, but there is a practical experience to support its ideologically driven claim. Within the United States, an impressive array of cities and local governments has made effective use of privatization to improve efficiency, increase competition, and reduce expenditures. Consider the case of Chicago. City towing crews could not keep up with abandoned vehicles that littered the streets, so in 1989, the city government turned to a number of neighborhood companies. The private sector operators paid the city $25 per vehicle, which they then sold for scrap. What had been a drain on Chicago’s resources turned into a $1.2 million bonanza. In addition, city crews were freed up to focus their efforts on illegal downtown parking.[13,14]

Chicago also found that competition from the private sector could create incentives for public managers to be more effective. In 1990, city street-paving crews in Chicago were inspired to improve their performance when the city government decided to hire private contractors to pave adjacent wards. According to Mayor Richard M. Daley, both sets of crews began to compete “to see who could do the job faster and better.”Of course, all of the evidence is not on one side of the privatization debate. The expansion of the private sector into prisons, for example, has generated considerable controversy. As John Donahue reports in The Privatization Decision: Public Ends, Private Means, corrections departments in all but a few states have contracted with private firms to build prisons. And over two-thirds of all facilities for juvenile offenders are privately run, albeit most on a not-for-profit basis.But in recent years, several large corporations have sought to extend the role of the private sector to the incarceration of adult criminals. This prospect of private corporations owning and operating prisons for adult offenders raises questions of costs and competition. As Donahue writes in a separate report on prisons: “Even if corrections entrepreneurs somehow succeed in cutting incarceration costs through improved management, there is unlikely to be enough competition, in any given community, to ensure that cost savings are passed on to the taxpayers, particularly after private contractors have become entrenched. Indeed, private prison operators insist on long-term contracts which buffer them from competition.”

Often privatization’s promises vastly exceed its results. In the Job Training Partnership Act (JTPA), for example, the federal government decided to relinquish most direct responsibility for job training. On the surface, the JTPA appears a resounding success: two-thirds of the adult trainees found jobs, and over 60% of youth trainees had positive experiences. But, JTPA local officials and training contractors can affect their measured performance by screening applicants.The problem in the JTPA system is not private ownership, but the controls and performance measurements of the private owners. With only short-term performance measurements and no enforced imperative to create long-term value, JTPA’s statistics give the impression that privatization has made much more difference for the employment, earnings, and productive capacity of American workers than it actually has.As Donahue notes: “It is as if Medicaid physicians were presented with a population of patients suffering from complaints ranging from tendinitis to brain tumors, were asked to choose two or three percent for treatment, and then were paid on the basis of how many were still breathing when they left the hospital.”

In addition to the problems of insufficient competition and monitoring, there are broader objections to the no-holds-barred advocacy of privatization. While acknowledging that privatization may make sense on economic grounds, Paul Starr argues in his paper, “The Limits of Privatization,” that privatization will not always work best. “‘Best’ cannot mean only the cheapest or most efficient,” he writes, “for a reasonable appraisal of alternatives needs to weigh concerns of justice, security, and citizenship.”Starr also attacks the claim that privatization leads to less government. He contends that profit-seeking private enterprises servicing public customers will find it in their interests to lobby for the expansion of public spending with no less vigor than did their public sector predecessors. In other words, privatization introduces a feedback effect in which influence on government now comes from the “enlarged class of private contractors and other providers dependent on public money.” This influence is especially dangerous if private companies skim off only

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the most lucrative services, leaving public institutions as service providers of last resort for the highest cost population or operations.[15,16]

It is not hard to find examples of undue influence. Michael Willrich's Washington Monthly article, "Department of Self-Services," describes corrupt contracting practices in Mayor Marion Barry's Washington D.C. administration that led to several investigations, trials, and convictions. Willrich claims that Rasheeda Moore, Barry's former girlfriend, received $180,000 worth of contracts to run summer youth programs. In 1987, Alphonse Hill, a deputy mayor, was convicted of steering $300,000 in city contracts to a friend's auditing firm.More generally, a lack of competition for government contracts actually leads to higher costs and creates perceptions of corruption. A New York Times special report, "The Contract Game: How New York Loses," provides several examples. New York City's Parking Violations Bureau hired American Management to help it design a system to bill for parking tickets and to record payment. As part of its consultancy, American Management wrote technical documents that became the basis for bid specification to build and implement the system. In 1987, the city awarded the $11 million contract to build and run the system to American Management, despite claims of impropriety from competing bidders. An audit by the New York State Comptroller showed that American Management had missed contract deadlines and that its system had billed millions of dollars in fines to New Yorkers who did not even own cars. The city had hoped to take over management of the system in 1990, but it has been unable to develop the necessary organization. Current plans anticipate city management in 1994. American Management has received a $10 million contract to run the system until 1992.The New York Times report shows that noncompetitive bidding is commonplace in New York City. In fiscal years 1989 and 1990, 1,349 of 22,418 contracts recorded by the City Comptroller's Office attracted only single bids; several of the single-bid contracts were for multimillion dollar projects. Thousands of other contracts had two or three bidders, a circumstance conducive to "high cost, collusion, and corruption."

Even in the absence of corruption, however, Starr argues that privatization should not be considered in terms of economic efficiency alone. Less government, he states, is not necessarily better; therefore, just because privatization may reduce the role of government in the economy, it is not necessarily beneficial. The voter and consumer, Starr argues, are also interested in access, community participation, and distributive justice: "Democratic politics, unlike the market, is an arena for explicitly articulating, criticizing, and adapting preferences; it pushes participants to make a case for interests larger than their own. Privatization diminishes this public sphere—the sphere of public information, deliberation, and accountability. These are elements of democracy whose value is not reducible to efficiency."While it is clearly impossible to decouple privatization from the broader social and political issues raised by Butler and Starr, it seems logical that privatization decisions can and should be based primarily on pragmatic analyses of whether agreed-on ends can best be met by public or private providers. The ends need not be limited to efficiency; they need only be clearly specified in advance.John Vickers and George Yarrow's recent article, "Economic Perspectives on Privatization," uses economic theory to show that there are flaws endemic in both private and public ownership: private ownership is not free of its own set of problems. In short, public provision suffers when public managers pursue actions that are not in the interests of the citizenry—for example, the employment of unnecessary workers or the payment of exorbitant wages. Private provision suffers when private managers take action inconsistent with the public interest—for example, performing shoddy work in an effort to boost profits or denying service when costs are unexpectedly high.[17,18]

These issues, which only now are beginning to emerge in the privatization debate, have been showcased for managers in another context. They were central to the wave of leveraged buyouts in the late 1980s, which showed that private businesses also often suffer from managerial behavior inconsistent with shareholder interests. Takeover artists like Carl Icahn saw the same excesses in corporations that many people see in governmental entities: high wages, excess staffing, poor quality, and an agenda at odds with the goals of shareholders. Monitoring of managerial performance needs to occur in both public and private enterprises, and the failure to do so can cause problems whether the employer is public or private.

In the late 1980s, a wave of public company buy-outs swept across the previously insulated world of publicly traded corporations, prompted in large part by the failure of internal monitoring and control processes in these companies. These buyouts provide an important and useful analogy to privatization. In particular, Michael C. Jensen's analysis of these buyouts makes it clear why privatization alone is insufficient to guarantee that providers of important services will act in the public's interest.

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In his HBR article, "Eclipse of the Public Corporation," Jensen argues that a variety of innovative organizational forms that reduce the conflict between the interests of owners and managers are replacing the publicly held corporation. The problem has been that managers in many industries, especially those with little long-term growth potential, have wasted company assets on investments with meager, if any, return. Managers have been consistently unwilling to return surplus cash to their shareholders, preferring to hold on to it for a number of reasons: excess cash provides managers with autonomy vis-à-vis the capital markets, reducing their need to undergo the scrutiny of potential creditors or shareholders. And excess cash provides managers with an opportunity to increase the size of the companies they run, through capacity expansion or diversification.This unwillingness to surrender cash to shareholders is not limited to a few companies. Jensen reports that, in 1988, the 1,000 largest public companies (ranked in terms of sales) generated a total cash flow of $1.6 trillion. Less than 10% of these funds were distributed to shareholders as dividends or share repurchases. Private managers, it seems, are vulnerable to the same claims levied against government agencies.[19,20]

To monitor these tendencies on the part of public corporation managers, Jensen identifies three forces: product markets, the board of directors, and capital markets. The first two, says Jensen, have been falling short. Even the onslaught of international competition has been insufficient to prevent managers from squandering valuable assets. Moreover, boards of directors, consisting largely of outsiders selected by management who lack a large financial stake in the company's performance, are often unwilling or unable to prevent managerial initiatives that do not enhance shareholder value.In short, managers have been able to make investments that do not maximize shareholder value because the processes assumed to be disciplining their behavior no longer function effectively. In recent years, it has fallen to the capital markets to assume the role of monitor. Jensen writes, "The absence of effective monitoring led to such large inefficiencies that the new generation of active investors arose to capture the lost value… Indeed, the fact that takeover and LBO premiums average 50% above market price illustrates how much value public company managers can destroy before they face a serious threat of disturbance."The privatization of government assets and services has similar potential. But it should be clear from Jensen's finding that private ownership alone is not enough to make the difference. The key issue is how the private managers behave and what mechanisms will exist to monitor their actions.It is significant that the firms that specialize in LBOs have organizational features that differ dramatically from the corporations they acquire. These key criteria—rather than the simple category of ownership—account for the difference in performance and prevent the waste of resources perpetuated by the preceding management.

1. Managerial incentives tie pay closely to performance. There are higher upper bounds, bonuses are linked to clearly identified performance measures such as cash flow and debt retirement, and managers have significant equity stakes.

2. The organization is more decentralized, as incentives and ownership substitute for direct supervision from headquarters.

3. Managers have well-defined obligations to debt and equity holders. The debt repayments force the distribution of cash flow, and cash cannot be transferred to cross-subsidize divisions.

The LBO firms, in sum, differ radically from most public corporations; it is the installation of these changes that created the value associated with the "reprivatization." Had no such organizational changes been clear to the capital markets, the share prices of target corporations would not have risen as a consequence of takeover activity.[21,22]

Like the takeovers of public corporations, the privatization of government assets or services is a radical organizational change. The public seeks both monetary and nonmonetary value, including equal access to services, adherence to performance standards, and a lack of corruption. The public's goals for private garbage collection, for example, might include serving all members of the community (no matter how inconveniently located) at equal cost, disposing of waste in environmentally sound ways, and conducting honest bidding with city officials. But for these goals to be met, privatization will have to learn the same lesson taught by successful LBOs: managers must have effective incentives to act on behalf of the owners. The application of their lessons to privatization will help resolve the conflict between the public and the private providers, and identify cases where continued public provision makes sense.The major criterion is easy to specify: privatization will work best when private managers find it in their interests to serve the public interest. For this to occur, the government must define the public interest in such a way that private providers can understand it and contract for it. The best way to encourage this alignment between the private sector and the public interest is through competition among potential providers, which may include governmental entities. Competitors will

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take it upon themselves to respond to the expressed wishes of the citizens.The city of Phoenix's experience with garbage collection, described by David Osborne and Ted Gaebler in their forthcoming book, Reinventing Government, illustrates the crucial role played by competition. In 1978, the mayor announced that the city would turn over garbage collection to private firms. The Public Works director insisted that his department be allowed to bid against the private firms, even though the city had promised not to lay off any displaced Public Works employees as a result of contracting out. After losing in four successive bidding opportunities, in 1984, Public Works employees introduced a series of innovations that resulted in costs well below those of private firms; and the Public Works department won a seven-year contract for the city's largest district. By 1988, Public Works had won back all five district contracts. The central lesson from this experience, says Phoenix city auditor Jim Flanagan, is that the important distinction is not public versus private—it is monopoly versus competition.[23,24]

IV. CONCLUSIONS

Competition is the first factor to help privatization; a second, also learned from LBOs, is linking the compensation of private managers directly to their achievement of mutually recognized goals that represent the public interest, goals which may include a variety of criteria like those Starr associates with the traditional role of government.

Osborne and Gaebler describe the extensive set of performance measurements used in Sunnyvale, California. City managers there are evaluated on the basis of service measures which include the quality of road surfaces, the crime rate and police expenditures per capita, the number of days when the air quality violates ozone standards, and the number of citizens below the poverty line. Departmental managers who exceed their "service objectives" receive annual bonuses that can be as much as 10 percent of their salary.[25,26]

There is another reason why goals and performance measures are critical elements in making privatization work: the failure to hold private managers to agreed-on results can be very costly. In 1963, President Kennedy established Community Mental Health Centers to serve the mentally ill outside of large institutional settings. Osborne and Gaebler report that the National Institute of Mental Health gave millions of dollars to private firms to build and staff the centers—but established no monitoring process to track the results. A Government Accounting Office investigation in the late 1980s revealed that many centers had converted to for-profit status and served only those who could pay. Others provided psychotherapy to patients without serious mental illnesses. Meanwhile, write Osborne and Gaebler, "Perhaps a million mentally ill Americans wandered the streets sleeping in cardboard boxes or homeless shelters."

As these and countless other examples make clear, there is a pragmatic way to view privatization. It is one arrow in government's quiver, but it is simply the wrong starting point for a wider discussion of the role of government. Ownership of a good or service, whether it is public or private, is far less important than the dynamics of the market or institution that produces it.Strikingly, these issues of managerial control have first emerged in Eastern Europe. The question there is less what to privatize than how to privatize. And the new governments realize that a privatization scheme is only as efficient as it is politically palatable. In Poland, the recently adopted method for privatizing the massive state industrial sector involves issuing shares in newly privatized companies and putting all the shares of many companies into a mutual fund. A number of mutual funds would then control the shares of all the companies. Citizens would receive shares in the mutual funds that would not be tradable for, say, one year.[27,28]

This plan is appealing because it provides equal access to the ownership of state assets and it offers citizens diversification against the tremendous risk of holding shares in any one or two companies. The shortcoming of the plan lies in its lack of control mechanisms. The fund managers must monitor the performance of many companies whose transitional problems are enormous. At the same time, there are no explicit incentives (other than reputation and patriotism) to ensure that fund managers act in the interests of shareholders. The short-term prohibition on trading shares between mutual funds further shields the managers from the immediate discipline of the financial markets. While these problems appear to be easy to anticipate, they have only recently come to light in Poland as politicians and economists begin to work through the details of the privatization program.

If the LBO experience teaches anything, it is that the focus of the privatization debate should be on the nature of organizational changes, not on a broad ideological debate over the role and efficacy of government. The replacement of

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public with private management does not of and by itself serve the public good, just as private ownership alone was not sufficient to maximize value to the shareholders of many large corporations.[29,30]

Accountability and consonance with the public's interests should be the guiding lights. They will be found where competition and organizational mechanisms ensure that managers do what we, the owners, want them to do.[31,32]

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