DEBUNKING THE MYTH OF PRIVATISATION

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The main points that will be raised in this chapter are that:

1) The case for privatisation is built on unfounded assumptions;

2) The belief that the public and private sectors are separate is traditional in Western culture;

3) New Zealand diverged from this belief because when settlers came here the country was undeveloped and had no cities, industries, or services. The private sector was unable or unwilling to build the infrastructure and the government was the only organisation capable of doing the job;

4) The New Zealand government set up, nurtured, and shepherded the major proportion of our export earners and the country's international competitive position is largely due to government's activity plus our "natural factor conditions"

5) The future of our international competitive position will continue to rest on government's shoulders since it falls to government by default to build infrastructure and enskill the workforce;

6) The principle argument in favour of privatisation is the inefficiency of bureaucracy. All organisations that manage themselves in bureaucratic fashion are similarly inefficient;

7) When the management model changes, the inefficiencies change;

8) Typically what happens when assets are sold to monopolies is that costs go up and inefficiencies grow worse, as with the privatisation of water in England. The lion's share of New Zealand's state assets were sold to private monopolies and costs went up, not down;

9) No matter how cheaply a private operator can perform a service the potential is there for it to be cheaper when the profit motive is removed;

10) Ultimately the taxpayer pays both the cost of the service and the profit the owner has to make;

11) Public organisations are more responsive to customers and the further away from public influence the organisation becomes, the less responsive it is;

12) Privatising assets puts them into the hands of financiers who manage the big multi-national pension funds that are the future of world trade;

13) Share market disciplines are a myth as was proven by 1987 share market collapse;

14) Privatisation may be mainstream economic/political theory but this more to do with the policy of the World Bank and the International Monetary Fund than with intrinsic merit;

15) Being mainstream doesn't make it right, as we know from other mainstream beliefs now disproven, such as the belief that the world was flat;

16) Given sufficient autonomy, and by appointing well qualified managers, public services can in fact be run more efficiently than private ones and there are many good examples of this;

17) Private ownership has a poor record in relation to the major problems in the world, like pollution, destruction of the rain forests, the ozone layer, global warming, and others; 18) privatising services can create new and unexpected problems.

19) The one thing that privatisation does is confer ownership but there are ways of conferring ownership, and gaining the benefits, without actually conferring title and losing possession of the income stream.

20) All four of these current pillars of political management are mutually depend upon each other for support but each cannot support its own weight of argument let alone that of the others.

Fundamentally all four of the current pillars of current political management - competition, choice, personal responsibility, and privatisation - are mutually dependent upon each other for support but each one of these cannot support its own weight of argument let alone that of these others.

Specifically here, the arguments in favour of privatisation are based on a series of unfounded and false assumptions which, when bought to light, reveal the case for privatisation to be like a building lacking foundations - as you would expect, it falls over.

In one of the few comprehensive reports on privatisation, the authors, whilst still favouring privatisation in some instances, conclude that "Those who advocate it on ideological grounds - because they believe business is always superior to government - are selling the American people snake oil."

It's time to take that snake oil and analyse it to see just what medicinal effect it really has.

For centuries the belief that church and state are separate dominated the mainstream of Western culture. The belief that the public and private sectors are separate is also a traditional belief and every bit as powerful as its companion belief. Under this belief, politics and business don't mix; so government shouldn't interfere with business and conversely business shouldn't interfere with government.

From the beginning, New Zealand diverged from this belief out of necessity. When settlers first came here in large numbers and an organised fashion during the 1800's, they arrived to find an undeveloped country with no customary infrastructures. There were no houses or shops, no towns or cities, no sewage or water supply, no highways, no land transport, no manufacturing and no industry, no employment, and no economy to speak of,

All these essentials had to be built from scratch and the private sector, which then consisted largely of speculators and economic refugees, wasn't willing or able to undertake the necessary development. That left only one organisation with the ability, authority, and willingness needed to build the country from the ground floor up - the government.

As Crocombe, Enright, & Porter observe, "The government has played a major role in establishing the basic infrastructure of the country, including roads, rail, ports, telecommunications, airlines, shipping lines, hotels, hospitals, and electricity and gas suppliers." (Upgrading New Zealand’s Competitive Advantage p139)

Additionally, a seemingly inexhaustible list of major New Zealand institutions and industries were brought into being by the government, from banks, finance houses, and insurance companies, to producer, trade, and export boards.

As well as building infrastructure, and for similar reasons, the government found it necessary to set up, nurture, and shepherd the industries which have since become the major proportion of New Zealand's export earners - either directly through subsidies and just plain doing it, or indirectly through provision of infrastructure, protection from competition, and research.

In 1987, producer boards superintended almost two-thirds of our top 25 export earners. Producer Boards constitute only one government initiative and are by no means the full extent of government effort.

In the pursuit of privatisation the success of government's activities in the business sector has been down-played by some and totally ignored by others - it doesn't fit their preconceived belief in the separation of public from private. Nor does it fit their argument of the superiority of private sector over government business development.

As the evidence shows, government has been remarkably successful in circumstances where the private sector couldn't or wouldn't cope. The success of this country and its present competitive advantage, far from being the corollary of input by private concerns, rests on the back of efforts of public concerns in one form or another. Foreign capital, as you know, is vital to investment and ongoing development.

According to US Secretary of Labour, Robert Reich, there is a growing correlation between "the amount and kind of investments that the public sector undertakes and the capacity of the nation to attract worldwide capital." (Work of Nations p264) Specifically, the global market has keen interest in two areas of public expenditure: (1) on the skills of that nation's workforce; and (2) on the quality of its infrastructure.

The burden for this expenditure falls on public shoulders for one simple reason; the private sector is unwilling to fund it themselves. Therefore, the future well-being of New Zealand's competitive advantage will continue to rest on the back of the public sector, as it has in the past.

In respect of that historical situation and of the nation's probable future in the global economy, privatisation will be of no benefit - it isn't relevant, necessary, or effective - and the belief that the public sector should stay out of the private sector is neither justified nor justifiable.

The principle rationale for the pro-privatisation case arises out of the gross inefficiencies of bureaucratic organisations. Worldwide, government bureaucracies are reputed to have the lowest level of productivity of any industry.

Sir Doug Myers, (Rotary Club 7 March 1994) laments: "In one field after another, we have found that heavy state involvement means high costs, poor services and lower moral standards."

Indeed, all organisations, public or private, that adhere to antediluvian management practices are similarly plagued - the difference being that a public organisation is more heavily shielded from the consequences of their behaviour than a private one and therefore perpetuates itself longer.

That inefficiencies are prevalent in government bureaucracy is unsurprising for several reasons, Firstly, bureaucracies are unnecessarily over-regulated. The main purpose of such regulatory restraints is allegedly to improve efficiency and eliminate waste and fraud but the evidence is that an abundance of rules does the exact opposite - it compounds inefficiency.

When the US government freed their Department of Defence from bureaucratic restraint, they were able to slash their rule book by 796 pages, from 800 down to 4, and make considerable gains in efficiency.

Secondly, the very nature of political bureaucracy has required bureaucrats to listen to and heed their masters instead of their customers. Yet to improve service to those self-same customers, bureaucrats must find out what each customer wants and needs in order to tailor the service to fit.

For example, the New Zealand Income Support Service has latterly adopted a customer focus through its "Customer Care" programme. Though they still have some way to go, there nevertheless has been dramatic change in operation and remarkable improvement in customer service,

The development and application of management theory and practice - which, incidentally, was systematically trialled first in the public service - has given us the insight and understanding to realise that it's the bureaucratic system of management that creates inefficiencies, not the bureaucrats themselves. When the management model changes, the efficiencies change.

A complexity in the argument has been that in changing ownership from public to private, the system changes, and any benefits of a change in management practice have often been erroneously attributed to the change in ownership.

As State Owned Enterprises now irrevocably prove, the change in ownership is actually irrelevant - the same level of improvement, and greater, can be achieved when leaving the ownership in place but changing the management charter.

There are also many good overseas examples to reinforce this proof. The answer to public service inefficiency has nothing to do with privatisation and everything to do with management change and improvement. As Deming says, the biggest problems in the Western World today, are problems self-inflicted by management that is off course. (The Deming Management Method by Mary Walton).

Allied to the efficiency claims are claims of lower cost brought about by improvements in efficiency. To the contrary, as the Americans and English discovered, often when governments privatise an activity, they wind up turning it over to a private monopoly, and both the cost and the efficiency grow worse.

Consumers Institute chief, David Russell, reports that "Everywhere else in the world where water has been privatised the domestic consumer has been disadvantaged." (1YA Monday 23 Jan 95) For example, take the case of England.

England, claims Megatrends (Megatrends p155), is the model for privatisation. It has privatised just about everything it can with only Rail left and most of that which was privatised became commercial monopolies.

When England privatised water, the shares were sold at a discount so that those people who bought them could make a profit right away. The cost of water went up immediately. Many people faced rapidly increasing bills, some because their newly privatised suppliers went to a system of paying for what you use and you don't have to use much to end up paying more than before.

Generally, there were no detectable increases in efficiency and the profit from the new water supply enterprises wasn't, in the main, reinvested into improving water quality and supply - it went into the fees payed to directors which skyrocketed so high that huge salaries in the region of $1 million dollars (NZD) became common.

Following hard on the heels of England, New Zealand also sold the lion's share of state assets to private monopolies. The New Zealand experience of privatised electricity companies has resulted in higher costs with some of the new private energy businesses contemplating heavy increases in the cost of supply.

Some, like Mercury Energy, split their charges into line rental and line maintenance. They then set the line rental at the same cost that the entire supply had been before privatisation and made the charge for line maintenance an extra cost to the consumer. Telecom, under restraint by the "Kiwi Share", increased its revenue through an identical manoeuvre.

Why does privatisation increase the cost? Crocombe, Enright, & Porter suggest a part explanation with the following: "Several of the state's key assets, such as telecommunications, were sold as effective monopolies on the basis that if legislative protection of these companies was removed a competitive environment would be created.

Privatisation and deregulation were not followed up with ensuring that a truly competitive situation emerged, either through the sale process or through anti-trust type actions." Upgrading New Zealand's p 144 Competitive Advantage

In other words, many of the assets privatised are monopolies - there's only one water pipeline coming into your house, only one power line bringing your electricity, and only one telephone cable connected to your phone - and these monopolies use their monopolistic position and legally protected status to increase the cost of life's necessities knowing full well they have captive customers.

A second part of the explanation is that private firms, whether monopolies or not, are always going to be potentially dearer than public concerns for one very good reason - they must make a profit on top of providing the service. Public organisations lack the profit-motive which is why it is found they tend to be cheaper. No matter how cheaply a private owner might be able to perform a service, the potential remains for a public owner to perform the same service more cheaply once the profit component is removed.

And thirdly, these are now commercial operations and so, they argue, they must pay commercial rates. Strangely, when looking for salary comparisons, many look towards the US where, on average, top executives get paid more than 100 times the pay of their organisation's lowest workers and not to Germany where the difference is 23 times or Japan where the difference is 17 times. Profit sharing and goal achievements often add 3% to 5% extra no top of their salary.

As the English found, directors fees usually rise rapidly to previously unthinkable levels - justified on the grounds that the new salaries simply reflect what is paid internationally - and operating costs rise to cover these new salaries. The Race Without A Finish Line p 263 for salary figures.

Similarly, it's fudging the issue to claim that the costs of running the business are borne by the owner, not the taxpayer. In the literal sense it's true, the money for the costs does come out of the pockets of the private owner but it only gets in those pockets after first being extracted from the wallets and purses of taxpayers.

Experience shows that the owners of any genuine business set their charges to make a minimum level of profit. If they exceed that level, rather than reduce charges they pocket the extra as due reward for their cleverness in operating the business so well.

Alternatively, if they fail to make the profit they expect, they seek ways to increase their charges in the hope to recover the loss in profit and at the same time meet their profit targets for the coming year.

Ultimately, the taxpayer pays both the costs of running the business plus the profit the owner makes over and above his expenses.

Proponents argue that customer satisfaction increases when services are privatised but customer responsiveness grows worse with privatisation, not better. In fact, public organisations can have much greater customer commitment than private companies whose commitment is more to making a profit than to delivering a service.

Banks provide us with an example in the difference between public and private ownership in attention to customers. Ask yourself, which banks in the marketplace have been the most innovative and the most responsive to customer needs?

The answer - community owned banks. Trust Bank and the ASB have, and always have had, better services, more services, and cheaper mortgage rates than their commercial counterparts.

While you're at it also ask yourself which banks have contributed most back to the communities they operate in? You get the same answer. When public enterprises are sold this valuable contribution is permanently lost to the community.

Where proceeds are used to repay public debt, there is a brief benefit then a long term loss of an irreplaceable stream of income. Private interests snap these enterprises up to get their hands on that income, sometimes at bargain basement prices.

The further away from public influence an organisation grows, the worse its responsiveness to people becomes. For example, media personality Gordon McLauchlan was so incensed by the insensitivity of privatisers that he wrote the following:

"The anti-democratic contempt for public opinion which has spread right through the business community is nowhere better exemplified than by the case of the Ports of Auckland. A waxing of public opinion against the sale made absolutely no difference to the determination of the board and senior management staff of the company to sell what is not theirs.

Public opinion was seen as an expression of ignorance and folly whipped up by the media. it was clear public opinion meant nothing to them, that the planning to sell would continue without pause. When they could get away with it, they would sell." The Big Con p6

With private ownership there is no opportunity, as of right and where necessary, for the community to influence the decision making process. With public ownership that process of influence, while not perfect, at least guarantees the community must be heard in a public forum of some sort or other. And at least community access to decision making can also be improved whereas the public are firmly and irrevocably locked out of decision making when it's in private hands.

The decision making process is not the only place the public are locked out of. Once assets have passed from public hands to private hands, they can be on-sold to whomsoever they please, local or foreign, friendly or unfriendly, just so long as they make the purchase payment - and there's not a damn thing the public can do about it, For instance, there is nothing to prevent Saddam Hussein buying our power companies if he can afford to,

The contention is that this side of privatisation puts the business into the share market and thus puts control of the business directly in the hands of individual shareholders and the buying public - a contention which is misleading at best. The mainstream direction of shareholding is towards control by huge pension funds, and these pension funds are under the control of banks, insurance companies, and global financiers.

Drucker predicts that Pension Fund Capitalism, as he calls it, will become the universal mode of ownership. He says that the age structure of developed countries makes this practically inevitable. Peter Drucker Post Capitalist Society p77 Individual shareholders and the buying public have no say in these circumstances.

Roger Kerr, Executive Director of the Business Roundtable, said in a 1993 speech titled The Case For Accelerating The Privatisation Programme that "In, addition, it is not possible to replicate in a rigorous way the disciplines which the share market, the market for corporate control and the ultimate threat of commercial failure, impose on private sector firms."

The share market disciplines alluded to are a myth. To paraphrase Megatrends, the 1987 crash was a great gift. It demonstrated once and for all that the stock market is a casino economy, not connected to the real economy, and wholly lacking in discipline.

Likewise, the global economy lacks discipline. It has no captain, and drifts and rolls, to and fro, out of control on the current of hunches, feelings, and world opinion. The unpredictable rise and fall of the US dollar, the English pound, and the Japanese yen; and the increase or decrease in interest rates, the overnight rate, and government bonds: these arbitrary and capricious mechanisms substitute in the market for disciplines.

The ultimate threat of failure experienced by firms during the crash, saw a host of shonky, shady, and plainly fraudulent corporate manoeuvres that swallowed investors funds up into an economic black hole and led to several leading corporate chiefs being arrested and put in prison, where they will undoubtedly learn the rigours of discipline that are lacking in the marketplace. - Megatrends p 8

Roger Kerr also mentioned that "The range of privatisations taking place globally is a manifestation of a vast change which New Zealand cannot ignore - or dismiss as ideological." True, privatisation is the mainstream economic/political theory. John Pilger, the journalist who exposed the shameful massacre of East Timorese by Indonesia, identifies the American's position in the World Bank and the International Monetary Fund as being the cause for this theory dominating the world scene.

He [John Pilger] asserts, if you want international finance, you must first have your economy "structurally adjusted" by the World Bank and the IMF to prove to the satisfaction of America that you have adopted "market principles." He cites Vietnam as a case in point:

"In Bangkok [at a World Bank/International Monetary Fund Conference in 1991 that John covered for the press], the Vietnamese have been promising to do almost anything to get the Americans to lift its embargo so that the IMF can "structurally adjust" them and impose more austerity, if that's possible.

They say they have no choice but to sell off much of the forests not destroyed by American defoliants; and they took the opportunity to announce that they had abolished the minimum wage. Their labour force will now be the cheapest in Asia, which means that people must work in "free enterprise zones" for a pittance. Yet Washington still says no; the embargo stands; the punishment goes on." Distant voices p212

The conclusion is inescapable; the reason privatisation is the mainstream has little connection with intrinsic merit and much more to do with ideology.

Says Anita Roddick of Body Shop fame, "First, you have to have fun. Second, you have to put love where your labour is. Third, you have to go in the opposite direction to everyone else." Tom Peters Liberation Management p596 In other words, don't follow the mainstream.

Remember that mainstream beliefs from the past have included the belief the king is infallible, the world is flat, the sun revolves around the earth, machines heavier than air cannot fly, and it's impossible to run faster than four minutes for the mile. Being mainstream doesn't make it right nor does it make it any less ideological.

You can't argue with the assertion that politicians don't have the training, knowledge or incentives to make commercial planning and strategic decisions nor can they readily monitor the effectiveness with which public sector managers make decisions. It's a fact and for the good of the country, and to improve the quality of political management, the situation urgently needs to be remedied.

It's understandable that politicians who adhere to the philosophy of rulership and are aware they lack the skills to rule and to run enterprises effectively, should want to use privatisation as a means to shed difficulties and abandon responsibilities. It's also understandable that those outside the political sphere, who see the same deficiencies and adhere to the same philosophies, should encourage politicians to pursue privatisation.

However, politicians don't physically run the bureaucracy - bureaucrats do. And provided the politicians employ high calibre public service managers, and ensure they are given sufficient autonomy, services can be run by these managers at an efficiency level that rivals and outperforms that of private companies run under management.

Phoenix, Arizona runs its Public Works Department as a business in head-to-head competition with private companies for contracts to handle garbage collection, street repair, and other services. Orlando, Florida, set up public businesses under management and created so many profit centres that its earnings outstripped its tax revenues.

Reinventing Government p17 And, Visalia, California, benefited from adopting a new budget system which allows managers to use entrepreneurial management and respond to circumstances as they demand. Reinventing Government p2 to 4

Once again, changing owners is not required, but a change in management is. Politicians don't need to know how to run services in business-like fashion providing the managers they employ do. And public enterprises can perform just as well as private ones when given the opportunity - that opportunity consists of the freedom, finance, systems and leadership to optimise performance

Privatisers have argued that private ownership is more conducive to conservation and good stewardship than public ownership. How can that be when virtually all the really life threatening and serious problems in the world today have all been caused by private sector business as we eat, drink, fish, farm, and fuel our way into ecological difficulties? KK in Tie Your Profits to a Cause.

Most pollutants are industrial or commercial in origin and this particularly true of extra dangerous pollutants such as toxic wastes and nuclear power plant waste; most defoliation has been carried out for logging; most species now extinct or nearly extinct were endangered for profit such as with whaling and drift-net fishing; most starvation and hunger could be alleviated if it weren't for the repayment of debt by third world countries to first world countries.

For example, during the 1980's third world countries sent $220 billion (U.S.) more to the West than was sent to them in any form; most wars and civil wars result from the private manufacture and sale of arms, for example deliberate the arming of Saddam Hussein; most of the cause of global warming is the burning of fossil fuels in pursuit of the mighty dollar; and most of the depletion of the ozone layer stems from the manufacture of CFC's.

Some might want to argue about any or all of these things but it's indisputable that the record of private ownership is extremely poor and that without public intervention in such issues the problems would be much worse.

One of the most interesting arguments bought up to justify privatisation is that public ownership is a form of churning where money comes from the pocket of taxpayers, into the hands of bureaucrats, and is then spent on services for those same taxpayers who parted with their money in the first place - much of that money gets lost during the cycle and ought to be spent directly.

Churning, of course, is a nasty private sector invention designed to fleece share market clients, in the main. The implication is that spending on taxpayer funded services is equally nasty since it produces this "churning."

There are inefficiencies in public spending but it is wrong to compare it to churning. What inefficiencies there are in public spending could be cured if the dead weight of accumulated rules, regulations, and obsolete activities was lifted from its back. Reinventing Government p 114

One suggested mechanism for returning the spending power to the consumer is the voucher system. It will create different and new problems. Tertiary education expense has already shot beyond the reach of many ordinary New Zealanders.

A fully privatised system of education would be worse in its effect. Public vouchers would give a larger percentage of the wealthy the chance to add their wealth to the vouchers and buy a "better" education for their children, leading to greater income segregation.

I have deliberately avoided any mention of the possibility that those calling loudest for privatisation are far more likely than ordinary citizens to benefit from privatisation - either through lower costs to their manufacturing businesses or through the acquisition of an income stream - while residential consumers of services will have their costs increased.

The probability of benefits to proponents is not a relevant issue. The case against privatisation stands on the virtues of evidence, not accusation. That evidence proves conclusively that privatisation, along with the other guiding management principles - competition, choice, personal responsibility - won't perform as claimed and must be abandoned in favour of better and more effective management guides.

Should some benefit from privatisation at the expense of others, in the short term, that situation will heal itself in time, especially when we improve political management. Today's millionaires, be they saint or sinner, are tomorrows history as are today's paupers - a fresh start and a clean slate awaits those being born to take their place.

A key issue in privatisation is; "What do the owners of the business want"? Do they want their business sold by the managers they employ, or would they prefer to keep on owning them? There has always been clear evidence that a significant proportion of the owners of the assets, the people, object to their assets being sold. NBR/Consultus poll in February 1995, asked the question: Do you prefer your power board to be owned by local government authority or by private sector companies?

- 61% Local Government
- 22% Private Sector
- 2% Neither
- 2% Both

We teach history for a reason, and that reason is to learn from it. If we are to learn from our own history the lesson we should learn is this: that community, cooperatives, and public institutions built the success of this country into what it is and a small, independent nation like our own needs to continue to pull together not apart.

Rather than dividing up, separating out, and selling off our assets and services, we should once again cooperate and combine our many weak economic threads into a strong, unified, financial cord.

The only thing that privatisation does that can be considered good is confer ownership upon people. With ownership there is freedom to change and grow, freedom to act, pride in one's work, and incentive to strive and improve.

Many businesses have experienced the difference in profitability between the business operated by the owner and the business operated under management. However, the ownership conferred by privatisation is quite different in nature to the ownership conferred by ownership of a small to medium size business.

The assets being privatised still need to be run under management so the benefits of ownership are diluted through the management system. Furthermore, there are ways of conferring ownership, and gaining the benefits, without actually conferring title and losing possession of the income stream.

"Everywhere else in the world where water has been privatised the domestic consumer has definitely been disadvantaged." David Russell from the Consumers Institute speaking on 1YA on 23 January 1995