

Problems of privatization of essential services and the impact substantial democracy

Birgit Mahnkopf, Berlin School of Economics

Content

- The trias of globalization
- The history of public services and infrastructures
- Lessons to be remembered
- Size and scope of public services as a matter of political debate
- Driving forces of privatization
- Various approaches of privatization
- Problems related to privatization: competition, cost savings, efficiency, FDI, corruption
- Effects on labor and the quality of services
- The impact of privatizing public services on women
- Lessons learned concerning the debate on social services
- From the establishment of public services as institutional rights
-to "neo-liberal constitutionalism" (St. Gill)
- The development of two-tier services
- Roll-back from "status to contract"
- Conclusion

Trias of globalization

Deregulation:

withdrawing regulatory laws and regulations which protect labor, the environment or consumers

Liberalization: opening of markets

- to foreign goods and services
- foreign direct investment
- By kicking away the ladder of state intervention and opening of government functions to competition from private companies

Privatization:

- sale of state-owned enterprises or assets to the private sector
- contracting out public services to private entities for a long period
- public-private-partnership
- withdrawing government funds from a service – re-privatization of social security into private households

**Key
mechanism
for
leaving
as much as
possible
to
market
forces**

The history of public services and infrastructures

- They have been developed over a long period, **in virtually all countries** (ancient Chinese state, Inka state, Roman empire)
- In medieval Europe the state carried out many functions and much of these were done by **raising taxes and employing people to do the work**
- In the 18th century new infrastructure services in transport and utilities were started privately – **companies were given a protected monopoly** to raise charges and taxes to finance the business – until the system broke down because of corruption, costs and inefficiency
- In the late 19th century the main mechanism was „**municipalization**“ („municipal socialism“): democratically elected councils bought utilities and transport systems, and set up new ones of their own
- In the first part of the 20th century **public provision of education, healthcare extended** across Europe, North America, Latin America, and Japan and **new services continued to be added**
- After winning post-colonial independence **nation-building** in developing countries was done through **nationalization of industries** and by the **development of public services**

Lessons to be remembered:

In **developing countries** the greatest health and education advances were made through countries with:

- state-run systems,
- universally available
- financed out of government revenues

These services are affordable even in poor economies because they are labour-intensive, and labour costs are low in such countries

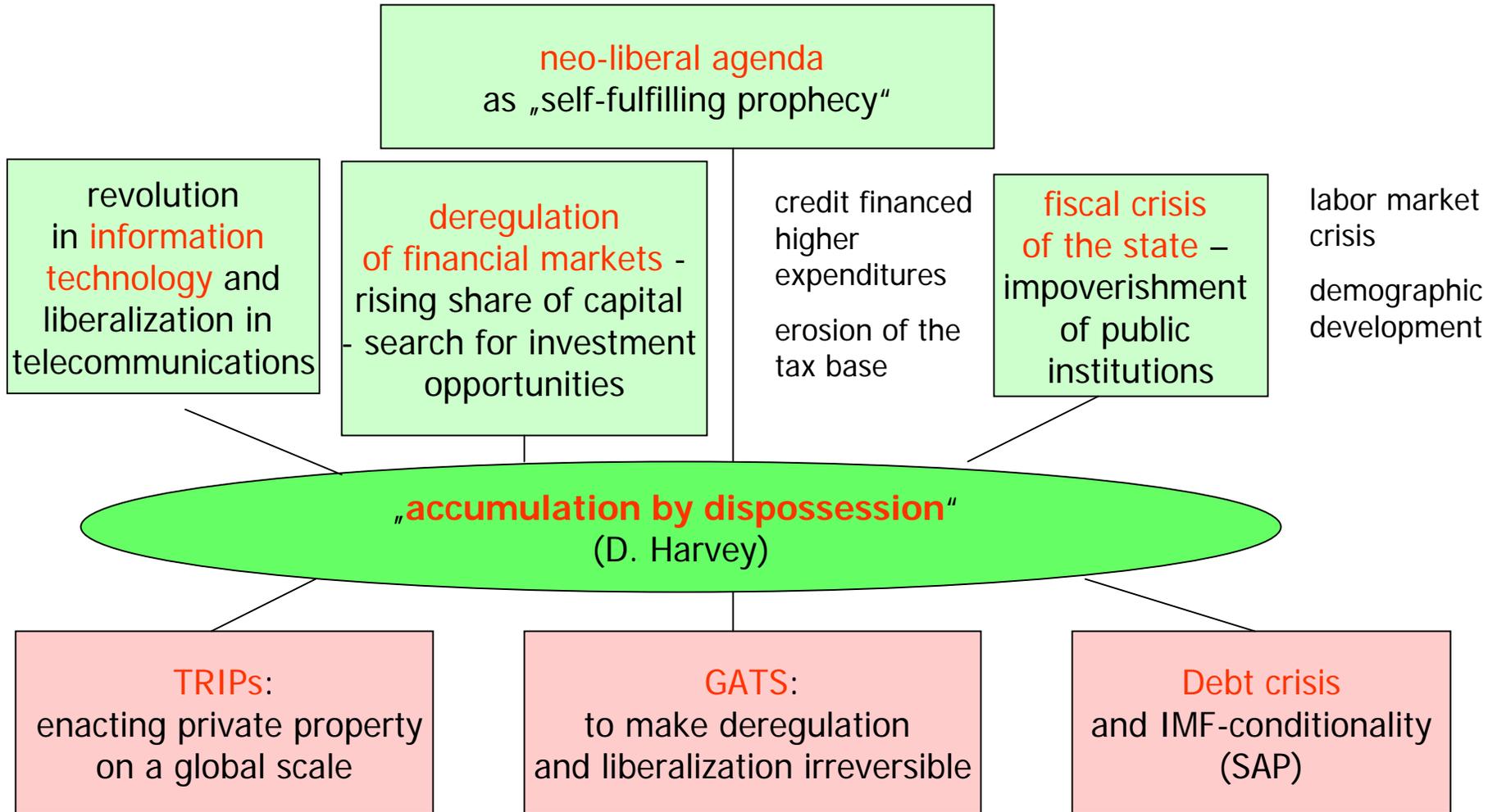
„a poor economy may have less money to spend on health and education, but it also needs less money to spend to provide the same services which would cost much more in richer countries

Country	Life expectancy (years)	Infant mortality (deaths per 1,000 live birth)	Physicians per 100,000 population
Cuba	76.3	7	346,1
Brazil	67.0	32	121.3
Mexico	72.1	29	160.0
France	78.5	5	251.6
Germany	77.0	5	241.9
UK	77.2	6	145.1
US	76.9	7	215.2
source: World Bank, World Development Indicators 2001			

Size and scope of public services as a matter of political debate

- Public services and state activity may **cover a wide variety of activities**
- **Political perspectives vary** across time and place
- **Some functions** of the state are traditionally **supported by the political right**
- Some service may be **viewed differently by different groups**
- Some services can be provided by the market, but **societies prefer to deliver them through public services** because of better results
- The **public provision of public services as a norm and all embracing** – not a case of market failure (as the economists´ concept of „public goods“ assumes)
- Actual public services are **subject to variations for technical and economic reasons**, as well as **political values**

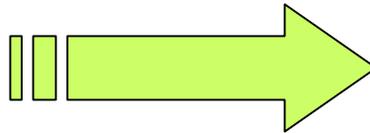
Driving forces of privatization



Various approaches of privatization

predominantly closed markets
and public services

which nevertheless include
elements of competition and
private management and
appropriation



predominantly open markets
and private supply of
services

for which nevertheless
elements of public regulation
and restriction of competition
are maintained

- to **sell** government industry and public services outright to private corporations, with very little regulation (UK under Thatcher)
- **corporatizing** state enterprises by financing them to operate according to commercial principles, then selling them to private corporations (New Zealand)
- **private management of pension funds** (Chile, Argentina, Brazil, Mexico, Peru)
- privatization through **voucher auctions** of state-owned assets (Russia)
- **contracting out** services to private entities for a long time
- government giving individuals **coupons to pay** for goods and services
- **withdrawing government funds** from a service

} (USA)

Problems related to privatization: competition

advocates of privatization argue:

markets: increase competition
are more efficient
cost effective
produce higher quality



government is: monopolistic
inefficient
bureaucratic and
staffed with feather
bedding functionaries

1. The question of competition

bidding for a contract may be competitive – the larger corporation generally win by submitting an extremely low initial bid and driving out small competitors

- reaping many of the benefits stemming from the ore-privatization efficiency enhancing restructuring under public ownership
- new private owners are able to capture quasi-monopolistic rents
- gain easy access to a new market quickly
- eventually monopolize the service



**the process generally results
in an oligopoly**

Problems related to privatization: cost savings

cost cutting usually is realized at the expense of workers – it leads to

- lost jobs
- hiring less than full-time workers
- reducing or eliminating benefits
- decrease in wages

but **low wages** lead to

- a high rate of labor turnover
- that often result in higher training costs
- more inexperienced workers
- higher accident rates
- inferior service to the public
- even law suits

empirical evidence show:

the cost difference between contracting out and direct service provision is small

if wages of public sector employees were controlled for education, skill level, job tenure, studies showed that public-sector employees are paid 4 to 5 percent less than their private-sector counterparts

it is only among the lowest skilled and lowest paid occupations that public employees have a significant wage advantage – and this advantage have been eroded by welfare reform in many countries

Problems related to privatization: efficiency

It is true that public operations are sometimes inefficient and the use of the „spot market“ may lead to more efficiency

- but when **complex contracting** is involved there is no empirical evidence that private corporations manage more efficiently than government (see British rail service)
- increases in efficiencies are **different according to time flow**: the multiplication of administrative and management costs of privatized social security schemes can become a disadvantage for competition (see US health care costs in relation to UK´s national health system)
- the **legitimacy** provided by public ownership is a real strength (see UK water corporations during the drought of 1976)

The private sector is not necessarily more efficient



Problems related to privatization: FDI

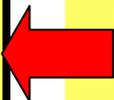
The question of FDI, debt burden and guarantees in developing countries

The debt burden of government has been identified as a serious problem – however, the pressure of privatization in public services create in parallel an increasing burden of debt obligations on government –

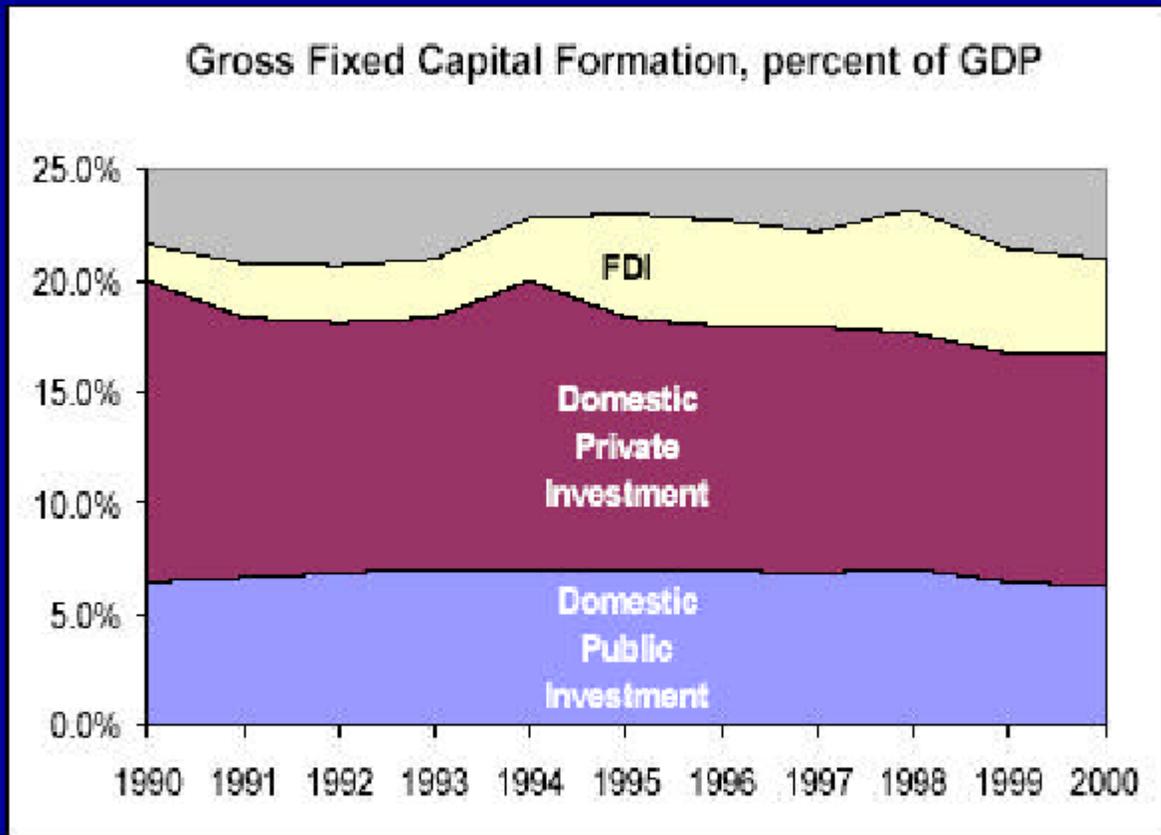
since governments are expected to give guarantees to underwrite any loans taken out by private companies for investment in privatized services

- although, the **contribution to investment** in public services in developing countries **from FDI** has been less than expected by market enthusiasts
- although, **TNCs leave operations** which turn out to be insufficiently profitable (see UK-based bus company in Kenya and Malawi or the withdraw of Suez from water business in developing countries)
- although, **using private sector to finance capital investment** in exchange for long-term guaranteed contracts means that the private operator has a clear incentive to sustain its profits by maximizing the payments it demands and limiting the resources it provides to the service

risks in private finance are even higher



Domestic capital flows predominate

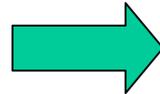


Percentages above are annual averages for 111 developing countries.
Source: World Bank and IMF data.



Problems related to privatization: corruption

Privatization of many services generate valuable long-term contracts – which in turn create incentives and opportunity for corruption



- private companies have a preference for non-competition
- non-competitive shopping has been on the rise (in particular in the US, but also in Germany)

When countries identify corruption processes in an international private transaction, the reaction of IFIs and OECD government is to defend the company and pressure the government to abandon legal proceedings for corruption

Effects of privatization on labor and the quality of services

Very often privatization leads to **casualization of jobs and lower wages** - especially in sectors which have been a big provider of employment - therefore reducing

- employment opportunities for women
- opportunities for apprenticeships and training
- affirmative action policies
- sources of sheltered employment for physically and mentally handicapped workers

Low pay or insecurity **affects the quality of services** (f.e. of services delivered by health workers) – can lead to

- informal charging of top-up fees for access
- taking on second jobs
- moving into the private sector

Privatization, contracting-out or the introduction of “private sector style” managed practices into the public services **affects autonomy and commitment** especially of professional workers

The impact of privatizing public services on women

Privatization has two parts:

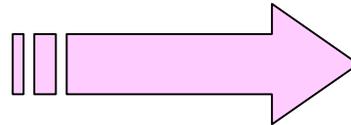
Privatization and commercialization of infrastructures and services

Re-privatization of social services to private households

women buffer the externalization of social risks and costs

Women as users of public services

Women as employees within the public sectors

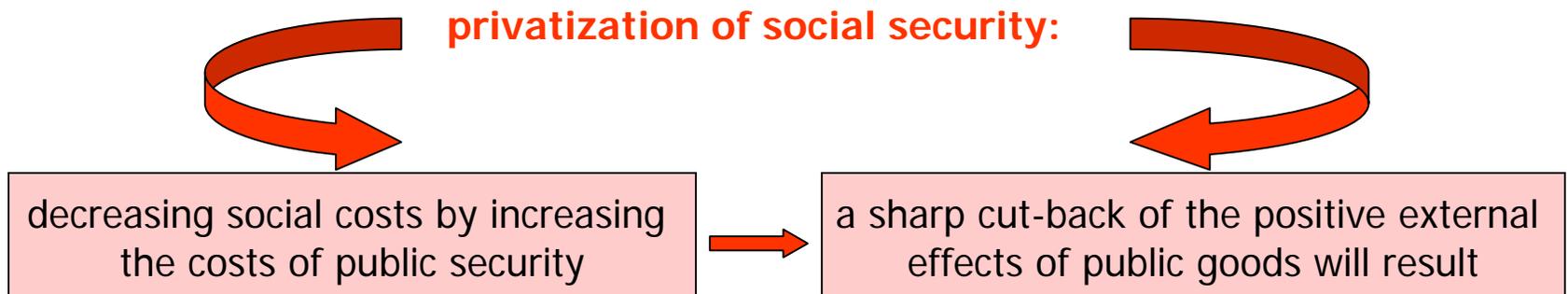


Women as unpaid care workers in households

Lessons learned concerning the debate on social services

there is a **trade-off between social expenditures and costs for public security**

- a high degree of socio-economic security for all citizens is correlated with low costs for maintenance, control, punishment, and re-socialization of those people, how came into conflict with legal forces
- comprehensive human security for all citizens heightens the motivation and the educational demands of all - thus
 - contributes to cultural and technical innovation
 - increases the productivity of work



From the establishment of public goods and services as a constitutional right

The implicit "social contract" of modern welfare states suggests:

freedom

requires a special degree of

equality

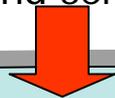
thus the "de-commodification" of labor and therefore

solidarity



requires to exclude essential goods and services from marked-based distribution

to enable all citizens to have equal opportunities to realize individually chosen life plans access to indispensable goods and services has to be assured



access to consumption of public goods and services are established as a constitutional and legal right

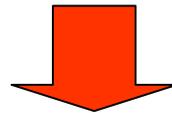
- Public goods are an outcome of compromises
- The law provides rules for the establishment of power
- The quantity and quality of public goods and services are open to democratic control

...to “neo-liberal constitutionalism” (St.Gill)

Historical retrogression from an implicit “social contract” to contractual agreements between private actors :

Provision, access and distribution of public goods and services regulated through the competition mechanism of market economy

- goods and services are thus exchanged by supply and demand
- power and rule are no longer regulated and bound, but are the outcome of negotiations between (unequal) partners – and therefore
- power and rule have to be consistently secured, maintained and legitimized



The loss of enforceable laws transforms citizens to customers, producers, investors (economic citizens with divergent interests)

The development of two-tier services

The state withdraw from regulation, control and administration of public goods and services has severe consequences for the quality of these goods and services:

“cherry picking”

where the affluent are able to purchase better quality services for themselves alone

- avoid contributing to the public services
- undermine the financial solidarity on which public services are based
- undermine the political consensus needed to sustain public services
- draw resources away from those services into a consumer-oriented market

which may be supplemented by cutting back of resources dedicated to public services

- which reduces the quality of the public sector
- encourages those who pay to buy themselves more resources from the private sector



The development of two-tier services - whereby the poor are left to pay for their own treatment through an increasingly poor public sector, which thus falls into a downward spiral

Roll-back from status to contract

Serious effects on social integration and cohesion have to be taken into account:

withdraw from political processes and active citizenship

- by those people excluded and marginalized through an undersupply of socially and culturally high valued (and indispensable) goods and services –
reacting with **defensiveness and resignation**, possibly with **anti-democratic rebellion**
- by the new economic elites which regard former public goods and services as “positional goods” that promise a privileged status –
defending their privileges by also **employing aggressive action**



of the three options available for articulation of interests in democratic societies the most important one – using ones “voice” (A. Hirschman) to change the government – become meaningless



to satisfy basic needs only the “exit”-option remains –the “buy-not buy”-option, available only for those who have effective monetary purchasing power

The ambiguous definition of services within the GATS

In Article 1.3 (b) of the GATS the definition of services

“include any services in any sector except services supplied in the existence of governmental authority”

The following article 1.3 (c) states that the exception applies to

“any service which is supplied neither on a commercial bases, nor in competition within one or more service suppliers”

- Any services could be included by the GATS unless these are exclusively provided by the public sector
- In order to remain outside the GATS negotiations, the education and health care system of the country must be completely financed and administrated by the state, moreover must have no commercial purposes
- Thus only a few public services would fulfill these conditions: most countries have a mix of public and private with the private sector competing with the public sector

mahnkopf@fhw-berlin.de

mahnkopf@fhw-berlin.de

Conclusion (1)

Privatization contributes to a new and deeper social divergence often forces a cut-back in the quality of public goods and services that remain in public responsibility

1. Public goods and services are of central importance for social and economic development

- they are based on political choices – which in turn depend on active citizen participation
- treating these sectors as actual or potential markets weakens the social cohesion

2. Only if public goods and services are **organized as social rights** and are available for all people through their citizenship status (i.e. are also available for well-to-do middle class people) might there be a pressure in favour of high standards and optimal supply

Conclusion (2)

3. Countries and their elected government must be able to make decisions on the form and shape of public services - therefore

- governments need the authority and resources to tax and employ in order to deliver services

4. Problems need to be addressed locally and publicly –

- a simple devolution of responsibilities to local government without devolving the necessary financial and human resources limits the ability to deliver public services

5. Democratic mechanism have to be key instruments for curbing incompetent policies – rather than policies imposed by bankers' conditionalities or regional and global trade rules

6. The principles of transparency, accountability, participation deserve widespread adoption and implementation – through participatory modes of political control

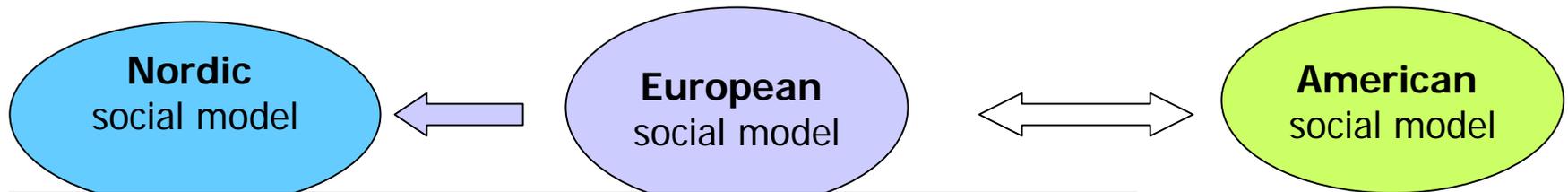
- **ELIMINATED SLIDES**

Taking into account: the concept of „public goods“

- Public goods are provided as
 - man made institutional infrastructures
 - material infrastructures
 - services - on different levels from local to global
- result from the protection of global, regional, natural or local commons
- many of which can be provided by private actors only poorly because
 - their production is not profitable
 - their provision prerequisites a competent and accountable public administration
- are hierarchically ordered: some are a prerequisite before others can be beneficial (healthcare before education, education before knowledge)

The principles underlying the development of social welfare

The central feature of modern public services is based on the principle of mutual support across communities, based on shared social objectives



Social welfare and security as a basis for a dignified life:

- unconditional right for all residents to a level of material resources
- access to all basic social and cultural institutions
- broad range of other public goods
- strong and publicly maintained network of social security systems (pension and health care)
- provision of public services (education, child care)
- eradication of homelessness and poverty as a social responsibility

The system of financing public services

Cross-subsidy is crucial – otherwise the poor will never be connected to services they cannot afford for themselves

taxation

- core method
- most effective for redistribution (widest pool of potential contributors)
- depend on the political legitimacy of the state
- and on a system for collecting which is seen to be fair, honest and inescapable

insurance

- relies (very efficiently) on risk pooling across the population
- multiplicity of societies led to inequity, financial instability and reliance on government subsidies

charges

- the least redistributive form of financing
- especially if charges to users of services are designed to recover all the costs of provision (resemble the market price)

Public authorities can raise funds to finance investment and borrow more cheaply than private companies

The role of labor

labor is central to services

- The quality of some services (esp. in education and health care) is strongly and positively linked to both: volume and quality of labor
- Globalization of these labor markets presents particular problems: public health and education services in developed countries have used skilled labor from developing countries
 - it allows developed countries to acquire skilled staff cheaply
 - is denies developing countries a return on the investment they have made in training staff

The GATS provisions of the WTO may make this problem worse

The role of the WTO and the GATS negotiations

WTO - goals: to increase global trade
to expand the areas which should be liberalized
to enforce the rights and obligations in all the areas included in the agreements

WTO- basic features:

Most Favoured Nation-Treatment (MFN) (GATT 1994, Article I): countries may not discriminate between their trading partners: if a WTO member grants another WTO member a special favor, it will have to do the same for all other countries that are WTO members

National Treatment (NT): countries may not treat foreign trading partners and national ones differently; non-discrimination between an imported product and a „like domestic product“

Transparency provision enjoins a country to publish its laws, rules, regulations and practices widely, to that it is widely known to interested to persons/firms

Arguments of the GATS advocates

In early 2000 WTO launched new negotiations on services – covering everything

EU-
Commission

„...to achieve real and meaningful market access for European service providers for their exports of environmental services (which includes water delivery)“.

- in DCs **direct investment of foreign service suppliers** could be a **source of badly needed infrastructures** (e.g. in the sectors telecommunications, financial services, logistics/transportation, and energy and water supply)
- the agreement **is not an instrument to privatize or deregulate** service sectors, indeed **its stated aim is to liberalize currently protected and often inefficient service markets**
- by boosting FDI, the GATS could **open up new consumption and job perspectives**
- GATS signatories would retain a great number of possibilities to **include in their specific schedules exceptions and limitations on market access** and arrangement covering **national treatment**

Central concerns on the GATS

- (1) The service sector is dominated by Northern TNCs
- (2) The GATS is more an agreement to promote the right of foreign direct investors than an agreement on "trade"
- (3) It has an deeper impact on government decision-making, sovereignty, and democracy than other "trade" agreements

- services liberalization impacts access to water, health care, electricity, which are essential for household maintenance and human security
- if a country has agreed to sign its ...services up to GATS, it is complicated turning back – GATS is „effectively irrevocable“

- civil society resistance to the GATS agenda has grown since talks were launched
- few DCs have engaged in the request and offer negotiations
- the GATS round is not limited by the Doha agenda, has no definite end



This has enormous implications for democracy and the right of future governments to change the direction of economic and social policy

Demands on GATS (Global Unions Groups 2003)

- public services and socially valuable services should be exempted from all future GATS negotiations
- prior to the conclusion of the current round, there is a need for a comprehensive assessment of the trade in services
- social and ecological concerns should have precedence over the principles of „free trade“ and they should not be subject to any „necessity test“ by the WTO’s Dispute Settlement Body
- the latitudes of governments in formulating qualification rules, technical standards, and qualification requirements on FDI should not be restricted any further by the GATS
- formally submitted GATS commitments must be easier to revise
- art. I.3 (b) of the GATS, which is concerned with services provided in the „exercise of government authority“, should be more clearly formulated
- GATS „mode 3“ on „commercial presence“ should focus on corporate obligations as well
- there should be safeguards that GATS „modes 4“ on migration is consistent with ILO „core labor standards“ and social insurance requirements
- cultural diversity and identity of WTO members should not be put at risk by GATS negotiations (e.g. on audiovisual media)
- provisions of general services at uniform and affordable prices should not be endangered
- policy of secrecy should be abrogated (by publishing all requests and offers)