

11 November, 2019

Public Management

#7 privatization and productivity (merit and demerit)

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Today's goal

- understand several fruits of privatization
- understand several pitfalls of privatization and other ways for eliminating X-inefficiency in public sector

Think about some advantageous features of privatization

	Privatisation	Nationalisation
Ownership	Firm owned by private sector	Firm owned and managed by government
Incentives	Profit motive acts as incentive for owners and managers	Workers <i>may</i> feel motivated if they feel company belongs to them.
Externalities	Private firm may ignore external costs (pollution) and external benefits	Government can put social benefits above profit motive.
Efficiency	Incentive to introduce new technology and increase labour productivity	Nationalised firms may find it hard to sack surplus workers
Knowledge	Private firms employ managers with best skills.	Politicians may interfere based on political motives
Natural monopolies	Private monopolies, e.g. water / trains may charge high prices.	Government can set prices based on social factors.
Depends on industry	Worked well for BT, BA	Natural monopolies, like trains /water. Non-profit services like health care.

1. Financial Resources

The main advantage of privatization is to generate financial resources for the government in order to generate resources disinvestment of public sector enterprises.

2. Optimum Utilization of Resources

It has been observed that the public sector has failed in the optimal use of national resources. The private sector may success in the optimum use of resources by maintaining efficiency.

3. Fostering Competition

Most of the public Enterprises enjoy the status of monopoly. It results in inefficiency and losses. Privatization creates a situation of competition for public Enterprises and they are forced to improve their efficiency.

4. Reduce Fiscal Burden

Privatization reduces the fiscal burden of the state by relieving it of the losses of the public enterprise and reducing the size of the bureaucracy.

5. Economic Democracy

Privatization helps to control government Monopoly. It helps to attract more resources from the private sector. It emerges economic democracy by private participation in Economics sphere.

6. Better Industrial Relations

Privatization may increase the number of workers and the common man who are shareholders. This could make the Enterprises subject to more public vigilance.

7. Reduction in Political Interferences

The process of privatization reduces political interferences in the public sector enterprises by giving more representation to the private sector in the management of Public Enterprises.

8. Reduction in Bureaucracy

Public Enterprises become synonyms bureaucracy. They can be made from bureaucracy by the process of privatization.

9. More Productivity

The private sector can improve productivity by maintaining efficiency in its operations

10. Economical

The process of privatization maintains the economy in the operations, whereas the operations of public Enterprises are costly.

11. Individual Motivation

The success of private sector resides in the profit motive. Privatization motivates the managers to make efficiency in the operations of the enterprise so that I can earn more and more profits.

Disadvantages of privatization (in case of UK)

1. Natural monopoly

A natural monopoly occurs when the most efficient number of firms in an industry is one. For example, tap water has very significant fixed costs. Therefore there is no scope for having competition amongst several firms. Therefore, in this case, privatization would just create a private monopoly which might seek to set higher prices which exploit consumers. Therefore it is better to have a public monopoly rather than a private monopoly which can exploit the consumer.

2. Public interest

There are many industries which perform an important public service, e.g., health care, education and public transport. In these industries, the profit motive shouldn't be the primary objective of firms and the industry. For example, in the case of health care, it is feared privatizing health care would mean a greater priority is given to profit rather than patient care. Also, in an industry like health care, arguably we don't need a profit motive to improve standards. When doctors treat patients, they are unlikely to try harder if they get a bonus.

3. Government loses out on potential dividends.

Many of the privatized companies in the UK are quite profitable. This means the government misses out on their dividends, instead going to wealthy shareholders.

4. Problem of regulating private monopolies.

Privatization creates private monopolies, such as the water companies and rail companies. These need regulating to prevent abuse of monopoly power. Therefore, there is still need for government regulation, similar to under state ownership.

5. Fragmentation of industries

In the UK, rail privatization led to breaking up the rail network into infrastructure and train operating companies. This led to areas where it was unclear who had responsibility. For example, the Hatfield rail crash was blamed on no one taking responsibility for safety. Different rail companies has increased the complexity of rail tickets.

6. Short-termism of firms.

As well as the government being motivated by short term pressures, this is something private firms may do as well. To please shareholders they may seek to increase short term profits and avoid investing in long term projects. For example, the UK is suffering from a lack of investment in new energy sources; the privatized companies are trying to make use of existing plants rather than invest in new ones.

Discussion

In order to alleviate the disadvantages of privatization, what means or methods could be replaced ?

OR

Is it available to manage these disadvantages without replacement the method of privatization?