

White Paper on Privatization

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Most of what we hear about privatizing public services these days carries the same simple message -- privatizing is good. More sophisticated stories explain that the reason privatizing is good is that only the private sector can deliver a quality product at the lowest possible price.

However, like most things in life, privatization is more complex than this. Whether to have certain public services and how to deliver them are decisions with profound impacts on all of us. As San Diego, California, and the country move towards privatizing, it's time for us members of the public to learn more about this issue or risk forfeiting our role in this democracy.

This paper takes a look at some of the most commonly held beliefs about privatizing public services. Some of what you read here may surprise you or raise issues you hadn't seen discussed before.

1. *Governments are broke because public services and tax dollars have been mismanaged.*

Here are some important reasons governments are finding themselves with budget problems these days.

- One important reason governments have been struggling with deficits during the past few years is that they have lost major sources of revenue. One important source of lost revenues has been ever lower tax rates on those who earn the most and on corporations. Lowering taxes by a percentage here or there doesn't mean much for most of us, but when tax breaks are given to corporations and the very rich the money lost is enormous. For each 1% a millionaire's tax rate is lowered, the government can lose \$10,000 in taxes.

Over the past 15 years, we have seen the tax rate on wealthiest lowered again and again. Each time, revenue is lost. If any of us kept having our incomes lowered each year, we'd have trouble paying the bills pretty soon. Governments are having the same problem.

It is estimated that the richest 1% of the population has received over \$80 billion in tax cuts since 1977. While this has happened the amount of wealth which has flowed to the richest has increased at enormous rates.

The share of corporate taxes as a percentage of federal revenues has declined from 23% in 1960 to 9% in 1990. Corporate property taxes show the same decline. The corporate share of local property tax revenues has dropped from 45% in 1957 to 16% in 1987.

Corporations are not paying lower taxes because of declining profits. Corporate profits have soared. An important part of those profits is money that once would have gone to support government services we all would benefit from. One important justification for those tax breaks was to give corporations more money to invest in creating good jobs. Instead of investing the money to create jobs, corporations have gone spending sprees to buy each other. Others have taken the money and used it to finance moving work out of

the country.

Corporate mergers and acquisitions and moving jobs abroad have not benefited the American public. All too often these days, we open to paper and read about the layoffs that result. People who are laid off from good jobs don't have the money to pay taxes. They are transformed from taxpayers into people who need government services. The tax breaks for corporations have ended up costing the rest of us a lot.

- Tax cuts aren't the only money governments have given corporations in recent years. Nowadays, corporations think they have the right to demand huge subsidies to remain in or come to a city, county, or state. Governments feel they have no choice but to pay when corporations threaten to move if they aren't given subsidies. The amounts of tax dollars being handed over to corporations is no trivial sum.

Kentucky announced a public-private partnership with a Canadian steel company that would bring 400 jobs to Gallatin County, near the Indiana border, in return for an incentive package with up to \$140 million in income-tax credits over 25 years. The tax break equaled \$350,000 per direct job created. In addition, the incentive package included a \$4 million state loan to a local water district for water and sewer improvements, a state grant of \$132,000 toward job-training and an accelerated construction schedule for widening a major highway in Gallatin County.

Kentucky is not alone. South Carolina lured a 2,000-employee BMW automobile plant in 1992 with \$130 million in incentives -- or about \$65,000 per job. In 1991, the United Airlines maintenance center in Indianapolis, received \$294.5 million in incentives, or about \$42,000 per promised job. General Motors has received all sorts of welfare assistance from the State of Michigan and City of Detroit. The list of companies who have pitted one area of the country against another goes on and on.

Studies have shown that these subsidies rarely result in the creation of jobs, and certainly not the number promised. Unfortunately, job starved cities and counties feel they have no choice, and the corporations know it's a seller's market for them.

- Is it really true that government mismanages or squanders money. Compare the cost of government services with what has happened in key areas of the private sector. Health care is a good example. Those of us have health coverage -- provided by private sector insurance companies -- have seen costs increase; less coverage; and less choice as businesses move to PPOs and HMOs to cut costs. Far more of each private sector health insurance dollar goes to overhead, such as advertising, and administration than is the case for government run programs. A dollar spent on administration is a dollar not available to spend on health services.

Health insurers compete against one another, but this does not seem to have meant that they have been careful with their revenues or provided a service in a way that most of us would say is satisfactory.

2. Government spending is full of incompetence, waste and fraud. Privatizing would eliminate this problem.

- First, this argument assumes that the private sector is free from these problems. Ask whether this belief is based on a private sector which is uniquely competent, thrifty, and honest or one that has managed to escape scrutiny. If the same standards of judgment were used, it is obvious that the private sector does not escape problems of waste and fraud. The past decade has seen many corporate leaders sent off to prison for corruption and misusing their positions.

If you have trouble thinking of any, here is a list to get you started. Beech-Nut sold sugar water as infant apple juice. E.F. Hutton pled guilty to 2000 felony counts in 1985. The Exxon Valdez spilled 240,000 barrels of oil into Prince William Sound.

Remember the S&L fiasco -- the one we taxpayers are still paying for. The government has had to come in to bail out the private sector. General Motors' mismanagement led it to lose billions each year and to layoff tens of thousands of employees. Even in the face of the misery management's failures had cause, it kept paying huge salaries to the very officers whose decisions brought about this disaster.

There is no reason to think that these problems will not arise in the case of subcontracted public services.

- Robert Monks (Republican politician) and Nell Minow (a corporate lawyer) begin their book on problems with the American corporate structure, *Power and Accountability* with a story of driving through the woods in Maine and coming upon industrial discharge which was killing the plants along the river. They comment:

Who wants this to happen? Not the owners of the company, the shareholders, not the managers or employees, not the community, not the government. I could not think of anyone connected with the company emitting the effluent who wanted the result I saw. This was an unintended consequence of the corporate structure. The very aspects of the company's design that made it so robust, so able to survive changes in leadership, in the economy, in technology, were the aspects that led to this result -- pollution that no one wanted, and everyone would pay for.

They are friends of corporations and yet they think that American corporate structure is ill-equipped to stop practices which make profits but which harm society, even in some cases in which the law is violated.

- Unfortunately, private corporate mistakes don't stay private. Hundreds of thousands of workers found that out when they were laid off. The lucky workers -- the ones who escaped layoffs are overworked and under stress. Communities have been hit as local business had to close for lack of customers. The roads, sewage systems, and other public services which were built to serve corporations who decided to seek higher profits elsewhere are now useless. None of these common corporate actions should make us comfortable with leaving the delivery of public services to the private sector.
- Yes, there are a few well-known examples of government overspending, such as the military's purchase of toilet seats and wrenches. These examples are notorious but do not paint an accurate picture of government spending. In any case, the public sector has a

long way to go to catch up with the private sector in terms of misused funds.

3. Market forces and competition ensure that the private sector delivers a higher quality service at a lower cost than the public sector.

- First, all of us over the last 15 years have had a chance to see the impact relying on market forces have. These are the forces which have led to the devastation of our cities and the failure of the S&Ls. Given their performance, we can't assume their results are always benign.
- It's a popular myth that the private sector can feed multitudes with a few loaves and fish. Simple logic should tell us it's impossible for the private sector to deliver the same service for less and make a profit as well. In fact, there is less of miracles done with loaves and fish and more of magic acts done with smoke and mirrors.

Most of seem to forget that private companies owe a legal responsibility to make a profit for their investors. Even if they are providing a service to the public they only are doing it as a way to make money for their investors. This means that when a public service is privatized, there is you have to subtract the investors' profit from the money available to provide the service. $2 + 2$ will still be 4 whether or not it's the private or public sector that does the addition. Given this simple math, how can a private company pay a profit and still provide the same level of service and at less cost than the public sector?

The answer is that most often it isn't happening. Either it will provide a different service or it will provide the service in a way that makes us uncomfortable or it is given subsidies of public money or services that are not counted in the total of amounts spent.

The easiest way to do all this is make more poor people: if wages are reduced and benefits are eliminated there is money to go towards profit. The company's profit comes at a huge cost to the public though.

A community is like a tube of toothpaste. If it's squeezed in one spot, it puts pressure somewhere else. If the contractor saves by not paying for health insurance and pockets that money as profit, these workers or their families are likely to wait to see a doctor or to use emergency rooms. This is not only more expensive but the public has been picking up the tab. In other words, the price of the subcontractor's profit can be very expensive for the community.

- We want the same level of services, but what quality of services are we getting when they are delivered by a workforce willing to work for low wages and no benefits. Each of us needs to ask if we feel comfortable with a police force hired at minimum wage and given guns and close contact with corrupt people offering large temptations. Lots of government jobs are positions of trust. Government workers have access to confidential information, assets, and other items of values. There is no question that money saved in salaries this way is pennywise and poundfoolish.
- Many privatizers get special subsidies or in-kind services from governments. Often these are not counted when comparing before and after costs. The only fair way to compare would be to add these items to the cost of privatizing. Among the added costs that should

be added in are services such as oversight and supervision, use of government-paid facilities or equipment, or outright subsidies. Also included in the cost must be lost revenues if the privatizer is allowed to keep the fees that would otherwise be returned to the government. A good example of the latter is the way Resolution Trust Corporation has been allowed to operate, by taking a percentage of money recouped.

- The biggest supporters of privatization are really saying that greed is the strongest and most reliable of human feelings. Is this a view you endorse? Should government be promoting greed as a building block of society?

What is the impact of greed? EAI lost its contract with the Baltimore School District because it would not agree to cut its profit when the school needed to address a budget shortfall. Recently, Warner-Lambert pled guilty for hiding faulty procedures in making drugs and agreed to a \$10 million fine. DuPont was fined \$115 million for concealing evidence in a trial involving its fungicides. Executives recently were convicted of concealing information on using faulty heart catheters during surgery. Where there is money to be made there is temptation, and that temptation is expensive for all of us. Each year we face the impact of \$200 billion of white collar fraud.

We're told that greed as a motivator is the engine that creates jobs and makes the economy work. In fact, what we see is greed leading to mergers, a focus on short term profits, and layoffs of thousands of workers each year. This year layoffs are up 45%.

Most of us are motivated by many things other than greed. Who among us would choose money over the life and happiness of a loved one? Most of us feel emotion such as love of community and nature and pride in our jobs. These are the very values that motivate many who go into public service. If the greed promoters are right in their dismal view of humans, why does anyone choose to become a teacher or a public health worker. Ask if we would want a society made up only of Wall Street traders.

Would we rather have public services provided by the greedy or by people committed to the value of public service.

- People motivated by greed need to be watched, especially when they have access to public money, information, and property. Overseeing private contractors to ensure there is no fraud or waste adds expense and is a very inefficient way to deliver public services. Yet this expense has to be borne to ensure that the contractor performs the job and to avoid being vulnerable to the unscrupulous. Overseeing subcontractors means having to retain skilled technicians or managers who can evaluate their actions. Had the services not been subcontracted, these skills would be used directly in performing the job.
- In San Diego, the school bus service provided by public employees has been so much more efficient and less expensive than private bus services that all subcontracted transportation is being taken in-house. This story is not unique. Public workers can provide better service and get better wages while costing the public less. Unions have played an important role in this San Diego success story.

4. *It's impossible to get rid of bad public employees, so they don't care about their jobs.*

- There seems to be an assumption that public employees are bad workers. It's time this was corrected. Think about the tragedy of the recent Oklahoma City bombing. That was a vivid example of public workers -- fire fighters, police, rescue squads, medical personnel, social workers, and many, many others -- putting in long hours searching for victims, caring for the injured, and assisting the bereaved. This behavior by public servants is far from unique. A recent outbreak of a plague of encephalitis in California was held in check by dedicated public health workers and the Center for Disease Control.

Despite this many believe that public employees don't work hard or are incompetent. The evidence does not support this. Every day the papers are full of stories of ordinary public servants doing their jobs effectively and under great stress.

- If public workers don't do their jobs they can be fired. Tenure or civil service don't keep bad people in good jobs. What they do is require an employer to prove that it isn't discharging based on whim, that it has good reason to discharge; that the employee is given notice of the reasons for discharge and an opportunity to defend himself or herself; and that the final decision is made by a fair process. If an employee remains on the job but can't perform it, this means that management has not done its job of assembling evidence that would support the decision to discharge.
- Recently both Los Angeles' Mayor and the Orange County trustee -- people from the private sector business communities not noted as fans of the government -- made public statements that they had found the public employees they had dealt with to be dedicated, competent and hard working. If anything, they said, they had been disappointed by the quality of management in the public sector -- not the workers.
- Attacks on public workers are one way to make assaults on public services. Privatizing may be the first step in eliminating a service completely. If the legislature wants this, it should face the issue squarely whether or not to provide a service.

5. Private corporations make more efficient use of funds and eliminate waste.

- This view has become almost gospel. However, if it is examined carefully, there is strong evidence that it is not accurate.

Think about IBM and General Motors. They are struggling to stay alive because they indulged in wasteful practices that went unnoticed and uncorrected for decades.

- The law requires that private contractors have, as their number one responsibility, making a profit for their shareholders. This has been interpreted by many to mean short term profits on share prices. Educational Alternatives, Inc. (EAI), is a good example. This company has been trying to get contracts to run public school systems. It released false information about student test scores as a way to bid up its share prices. Others who play the stockmarket and who had sold short on EAI stocks (that is, betting that on a certain date the stock prices would decline), released information that was damaging to EAI. The stock prices declined so precipitously that the company was in danger of failing.

None of this was in the public interest. Had EAI failed, the schools would have been left with no one to manage them in the short term. Public services are too important to be left

to this sort of danger. The EAI story, however, is not an aberration. This is the normal way American companies and the free enterprise system operate.

- Stock market manipulation is not the only private sector problem that could endanger providing public services. The rate of corporate bankruptcies has been high over the past few years. If a company that is supposed to be providing public services goes bankrupt, how will the service be maintained?
- Many public sector workers have lost their jobs as federal, state and local governments have tried to cope with the lost revenues. Cutting jobs has not meant cutting out the work those people once did. Those who have remained have seen their workloads increase. For some the increase has been so great they are unable to perform all their new duties and suffer from burnout and frustration.

For the public this may appear to be incompetence or a bad attitude. Unfortunately this feeds the impression that the public sector is incompetent. The root causes, however, are insufficient support, and this will remain whether or not the public or private is the provider.

- Privatized public services may also be shut down by strikes. Private sector employees have a right to strike.
- All too often the discussion about privatization comes down to dollars paid or saved. Price is not the only consideration where public services are concerned. Other public values may be more important, such as quality of service, reliable availability and wide access.

To put it more concretely, think of the CDC stepping in to stop a potential epidemic of Hantavirus or encephalitis. None of us would have wanted the CDC not to investigate or provide services designed to stop the diseases from spreading to those too poor to pay. We all benefitted by having a stable service available quickly and without regard to price. Who could put a price on stopping an epidemic quickly? Other public services are similarly difficult to put a price tag on.

When it comes to mailing a letter, if I live in a city and can get a private contractor to deliver all my in-city mail at less than first class postage, I might think that's a pretty good deal. I may think less of it if I have to pay the full cost of delivery to my mother who lives across the country up a mountain down a dirt road. By paying more for my letters in the city, it's true I subsidize other letters. On the other hand, the system works well when provided on this large national scale. With public service, the whole is greater than the sum of its parts.

If mail service gets divided up by competing subcontractors, the advantages of a national service -- a service that helps knit us together as a people -- will be lost. Here, cost is not the most important value; equity and access to service on a national basis is.

- Information is a public service we don't often think about. The government collects and maintains a great deal of information. Some of it is confidential. Should a subcontractor or a series of subcontractors have access to this information? Under these circumstances,

isn't it likely that some of it might leak or be used in ways we are not comfortable with?

We all know that knowledge is power. Should we subsidize a private company to amass information which it then can sell back to us.

- There have been notable instances in which private companies have been subcontracted to collect, provide or maintain information created at public expense. In some cases, they have refused to return the underlying data or documents to the government at the termination of their contract, thus depriving the government and the taxpayers of materials they paid to create. Lawsuits and other efforts to recover the government's property only add to the costs. These problems can make a cheap service very expensive.

6. *Money paid in taxes would make us all richer if spent in the private sector.*

- This has been a popular belief since the 1980's. However, to see its effects all we have to do is look around us. More than 180,000 fulltime state jobs have been eliminated in this time. Most of us do not feel richer or more secure as a result. Why is this the case?

When good jobs are lost the people who had those jobs don't have money to spend in their communities. Most jobs created in recent years have been lower paid. Slowly the grocery stores, gas stations, clothing stores, restaurants, and other businesses are pinched for customers and close.

A 1992 study by the Corporation for Enterprise Development found that creating new jobs has only a very loose connection with a state's overall economic performance. Creating large numbers of low wage jobs with low job security often results in poor economic performance. The study found that states cannot thrive by creating new jobs that don't pay well enough to support a family, that offer few benefits, and that are so loosely tied to the community that the jobs are likely to be moved. Privatized jobs are often a tradeoff of good jobs for bad jobs.

It's easy to lose sight of the fact that public employees pay taxes too. Each time we see that a public sector jobs is eliminated we should see tax revenues lost.

The bottom line on all of this is that practices that were supposed to enhance industry have been destructive to all of us. After years of pursuing them it's easy to see that none of this has made us any richer. Experience living under a system based on the theory that private sector dollars are better spent should tell us it's time to discard it.

- The truth is that all of us would rather keep money than have to pay it. None of us especially likes to pay taxes.

But the truth also is that we get a lot of services for those tax dollars. We accept them as natural and almost don't realize how much we receive each day.

Look around and count them up. It's easy to think of street cleaning, sanitation, police and fire protection. Even if we have no children, public schools benefit all of us by educating the citizens of tomorrow -- the people who will care for us as we age. Add to this animal control and public parks and zoos.

Every time we take an elevator, buy food, or eat a meal in a restaurant we can feel safer because we know that government experts have inspected what goes on behind the scenes that we can't see. The state makes certain that people who provide important services, such as our car mechanics, are licensed and competent to do their jobs.

We receive weather reports and know that disaster relief is available if needed. We have roads to drive on thanks to public services. Airplanes are guided in by air traffic controllers.

It's hard to imagine how each of us as an individual could afford to buy these things. It's also easy to see that we each benefit just by having these available, even if we never use them. Only by pooling our tax dollars are we able to provide for our collective good.

- There are well-known cases in which the government has contracted out certain services only to find that when the contract ends, the contractor refuses to return the government resources they were allowed to use in the first place.

7. All the studies show that privatization is better.

- First, the facts of life. Where do studies come from? Who are the experts who made these findings?

If you look behind the surface you'll see that a lot of what we "know" about privatization is mere puffery. Groups such as the Reason Foundation and the National Council for Public Private Partnerships (formerly the Privatization Council) have spent a lot of time and money convincing the public that privatization is better. When they issue their reports or sit on panels or are quoted by the news media they are basically just making commercials for their product: private takeover of community services.

What do these statements and studies say. If you read the paper -- what they release to the public -- you hear stories about the future impact of privatization. They talk about how much money they think government will save if it privatizes particular projects and how much better the services will be. You see very few follow-up stories on what has really happened.

There's at least some reason to wonder how certain they feel about their own data. Recently many of these privatizers fought vigorously against legislation in the District of Columbia, which required that, before any public service was subcontracted, there had to be proof that there would be at least 10% savings. Why did they fight so hard? Surely if they believe what they say they would not object. Ten percent is such a small amount that it should be easy to prove. Despite this, the pro-privatizers have fought vigorously against the law and for a system requiring no proof to back up whatever they want to claim.

This is not the only gap between what they say and what they do. If you read what these groups send out to their constituents -- companies thinking of going into the privatization business -- you don't see talk about the public interest. The focus is on Profit. When the word "Profit" appears in their publications, you see it in boldface and large type.

They try to create a sense that privatizing is something good. The National Council for

Public-Private Partnerships even gives out its own awards for people who help the cause of privatization.

When we realize that these are just commercials, it's easier to see that we should take them with the same grain of salt we use when we're told that some shampoo will make us eternally happy. If the American public were given a more complete picture of the story of privatization, we'd see that these folks think they can sell us a bill of goods. When we buy the shampoo thinking it would make our lives perfect, all we end up with is a bottle of shampoo and less money and, hopefully, clean hair. When we buy privatization, all we end up with is privatization, more money in the privatizer's pocket, and hopefully, the same level of services.

But even that may not be the case.

- Privatization failures are never publicized. Yet they exist.

An example is the subcontracting of garbage collection services. In some cases, garbage and toxic waste has been improperly disposed of. The public had to pay to clean up, while the original contractor pocketed the money for services not received. Waste Management, Inc. is an example of a disposal company convicted for financial improprieties. It is well known that organized crime has infiltrated the waste industry.

The Challenger shuttle blew up because private subcontractor Morton Thiokol did not want to delay the launch. It also ignored internal warnings that its product was defective.

New York City subcontracted its Parking Violation Bureau to Datacom Systems Corp., a subsidiary of Lockheed. In 1987, evidence of bribes, extortion, and stealing were uncovered. When the work was returned to the public sector, stealing stopped and the cost of the service was 20% lower.

- In New York state it was found that \$12.5 million was paid to 22 crime related companies engaged in providing mental health services, police protection, construction, and services to the mentally disabled. Principals of many of these companies have been convicted of various crimes in performing their jobs.
- If privatization is efficient because of competition, then it follows there is no reason to subcontract services that cannot be subdivided among many competing providers. Merely being in the private sector is not what is supposed to create efficiency and improvements; it's competition. Where there's no competition, then the services might as well stay in-house.
- Here are some impacts the Cornell University Hebdon Report found that result from privatization:
 - diminished quality and access to services
 - lower employee morale, productivity and training
 - worker exploitation through lower wages and benefits

- increased discrimination against minorities and women
- loss of government control and sovereignty
- lost constitutional and other legal rights
- decreased efficiency as a result of difficulty monitoring and administering contracts
- loss of accountability and control
- lost infrastructure
- increased corruption, bribery, kickbacks, bid-rigging, campaign donations, low-ball bids, and contractor bankruptcy
- higher direct costs or hidden costs to pay for the loss of pensions and benefits of public employees
- increased conflict, strikes, grievances, and arbitrations

The Hebdon report found:

In conclusion, we found privatization to be, at best, a disruptive, socially destabilizing, and ultimately harmful method of cost saving. At its worst, privatization can actually increase costs, lower the quality of services, reduce public accountability, and marginalize citizen involvement in the democratic process. ... The rational solution is to seek creative alternatives to the way services are currently provided by improving the utilization of the existing workforce. The practical answer, we believe, can be found in fundamental reform of public sector work process through dialogue, discussion, and negotiations. This is the challenge for politicians, management officials in the public sector, public employee unions, and employees.

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