

# Privatization's Narrative of State-Owned Services: panacea or threat to businesses and to labour force democracy?

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## Abstract

This paper seeks to clarify some ambiguities in the privatization debate and offers a constructive framework suggesting ways forward. The business and social impact of privatization is examined via representative arguments and case studies. The International Labour Organization (ILO) estimates that by 1998, Europe accounted for over half of all privatized assets in the world. Governments<sup>1</sup> in the European Union, regardless of their political colour, claim the necessity of privatization in such fields as railways, postal services, hospitals, telecommunications, water and social security for sustainable competitiveness. Trade unions, various social groups and opinion polls indicate demands that governments guarantee public services of all kinds<sup>1</sup> emphasizing unemployment and income distribution effects. The debate has concerned: 1) Does privatization merely respond to free market stances or also to real market needs? 2) Is privatization a "quick fix" for the wider society? 3) Do private social services firms perform better than the state-owned ones?<sup>2</sup> Ways forward could include clarification of the objectives and assumptions of particular privatizations, boundaries concerning what is to count as privatization, evaluation of performance, compensation of losers, and when restoration might be appropriate.

## Key words

Privatization, Business, De-mutualisation, Labour force, Mutualisation, Re-mutualisation

## Introduction. Privatization in theory and practice

The International Labour Organization (ILO) estimates that by 1998, Europe accounted for over half of all privatized assets in the world. Governments in the European Union<sup>1</sup>, regardless of their political colour, claim the necessity of privatization in such fields as railways, postal services, hospitals, telecommunications, water and social security for sustainable competitiveness. Trade unions, various social groups and opinion polls indicate demands that governments guarantee public services of all kinds<sup>2</sup> emphasizing unemployment and income distribution effects. The

debate has concerned: a) Does privatization merely respond to free market stances or also to real market needs? b) Is privatization a "quick fix" for the wider society? c) Do private social services firms perform better than the state-owned ones?<sup>3</sup>

This paper seeks to clarify some ambiguities in the privatization debate and offers a constructive framework suggesting ways forward. The business and social impact of privatization is examined via representative arguments and case studies.

## The drive towards privatization

The ownership, regulation and control of the businesses that produce goods and services have historically taken many forms. Arguments from the need for state support of infrastructure and for major investment for modernization led to the nationalization of coal and steel production in the 1940s in Britain and elsewhere.<sup>4</sup> Banking, insurance and finance, though typically produced by private corporations, have traditionally been subject to regulation by governments. Even when wholly privately owned, industries have traditionally been supported in part by public contracts, for example, for defence procurement. The drive towards privatization is generally regarded as having its origin in the critiques of nationalization and its shortcomings by Milton Friedman, Friedrich von Hayek and others<sup>5</sup>. By the early 1990s, the transfer of state-owned or municipally-owned enterprises became commonplace in many countries.

The debate on privatization has tended to concentrate on the benefits and disbenefits that are held to have ensued, and it is suggested here that that privatization has the appearance of being a "practice without a theory". Evidence for this is to be found in the nature of the arguments used by proponents and opponents. The principles that seem to be relied on in favour of privatization seem to be those of the free market. The difficulties adduced by critics relate to the pragmatic observation of unwanted consequences. The response to criticisms tends to be that the privatization has, in some cases, not been carried out well enough or that there were unexpected difficulties, with what seems to be assumed to be an obviously required policy.

Fafaliou and Donaldson (2006) proposed that there is a need to develop evaluation criteria, specifically that ways forward could include clarification of the objectives and assumptions of particular privatizations, demarcation of the boundaries concerning what is to count as privatization, evaluation of performance, compensation of losers, and circumstances in which restoration might be appropriate. These arguments are not repeated here. Rather, some suggestions are offered on how the criteria could be applied. Some characteristic arguments are examined, relating firstly, to the effects on labour markets, and particularly in labour force democracy, and secondly, to the impact on small businesses.

### Labour force democracy

Labour force democracy is here regarded as having two main relevant elements, namely, the presence and viability of independent representative organizations for workers and employees, as envisaged by the International Labour Organization's Labour Standards, and the provision of facilities for enabling participation in the labour market on acceptable terms. These latter terms include the so-call "family-friendly" policies that encourage entry into the labour market, and encourage participation by individuals in creating an adequate quality of working life. It is accepted here that notions such as family friendliness and quality of working life involve judgements of value. Such judgements are continually being made or implied in, for example, the directives of the European Union and in the legislation of members countries. Such judgements, of course, inform and generate the published standards of the International Labour Organization.

There is an inevitable gap between the aspirations encapsulated in the standards already referred to, and the practical dynamic of labour markets. Industries grow and decline, competition arises, sometimes from unexpected sources, as, for example with the rise of new technologies, or of environmental shocks. What needs to be explored are the extent to which the privatization movement can or does help, in ameliorating these influences, and the extent to which it has become one of them. From the point of view of employees made redundant as a result of privatization, it appears to be an external, policy-driven shock. From the point of view of the economy as a whole, it is often seen, in principle at least, as a move towards market efficiency.

It is clear that the privatization movement has been a factor in the reduction of union membership<sup>6</sup> at the factory level, if only because many of the large, union-

organised factories (and mines) have closed as manufacturing production moves to emerging economies. Many studies show that privatization reduces the overall level of employment in many industries<sup>7</sup>. Whether these cases illustrate the effects of prior "over-manning" must depend on individual cases, and on the existence of criteria for judging efficiency levels before and after privatization.

According to Bosworth, Dawkins and Strombach (1996)

*Privatization, therefore, has oriented the companies towards profit maximization. There is some evidence that there have been resulting improvements in labour productivity. After the initial shock of privatization, however, what happens to the demand for labour over time depends crucially on the form of regulation. (Page 111)*

On the question of influence at work, it is reduced to zero for those employees who have been made redundant, but does it increase labour force influence in the internal labour market for those who remain? There are few studies that show a positive result in this respect.

There is some evidence on the effects of privatization on the movement of labour between industries. Bosworth, Dawkins and Strombach (1996) see it as part of the "flexibilization" of labour:

*"It seems that "flexibilization" of the labour market is a policy response which allows the adopting economy to adjust to major structural changes, enabling a higher proportion of individuals to find some form of employment. The evidence from the UK is that this occurs through their transfer into relatively low-skilled/low technology jobs, historically at least, located in the service sector. There is probably some element of truth in arguing that flexibilization of the labour market in the UK has led it more<sup>3</sup> in the direction of being a low-skilled/low-technology economy, while other countries have attempted to move in exactly the opposite direction – towards the high-skilled/high-technology end of the spectrum." (Page 446).*

This result implies that in the aggregate, influence of employees at work has shifted, in the UK at least in the direction of declining influence in the above cases in the UK.

### The role of small businesses

Many small businesses are being created as people who had been employees of public or state-owned

enterprises and services become contractors, or employees of contractors who are heavily dependent on former employers for work. Small businesses less likely than large ones to have, or be required to have collective bargaining arrangements in place. Small businesses, however, are exempt from only some of the regulatory constraints that apply to large corporations. In Britain, spokespersons for small businesses point to an increasing regulatory burden, especially in the employment of labour. One of the constraints that many small businesses, especially micro-businesses are not subject to is the need to have in place recognition of, and procedures for bargaining with, trade unions.

### A possible theoretical framework

If it is accepted that the above, somewhat sketchy, description of the impact of privatization on labour markets and on small business creation and regulation is broadly correct, some questions arise on the relationship between the labour market and small business operations on the one hand, and the efficiency gains of privatization on the other hand.

An implication of the above account is that privatization has produced losses in the control of or influence on working conditions by employees, directly, or through their representative organizations. Part of the case for privatization was indeed that in the 1970s, "corporatism", i.e. the duality of control of work of employers and unions through collective bargaining had produced rigidities in the developed economies of Europe that were preventing the market from responding efficiently to the pressure of competition from the emerging economies.

Turning specifically to the criteria for evaluating the privatization experience, an examination of the literature suggests that there are few direct attempts to identify such criteria. Rather, the literature appears to cover a wide range of effects. For example, there have been studies of employee participation in buy-outs and share-ownership, suggesting that such participation is very limited<sup>8</sup> (Some studies have concluded that competition is a more important predictor of financial performance than is the ownership of the business. (Shirley & Walsh (2004). Other studies conclude that governments often remain the largest shareholders (Bortolotti & Faccio (2004) and that efficiency, employment and an adequate regulatory framework appear to be important determinants of the privatization experience. (United Nations Economic and Social Commission for Asia and the Pacific (2002)

Development Paper 22, Bangkok, and Kikeri & Nellis (2004) Nellis (2003) Working Paper 25, Center for Global Development, Washington DC, February, concludes, in relation to privatization in Africa, that

"The long-run and difficult solution is the creation and enforcement of institutions that underpin and guide proper market operations".

Further, a study of popular discontent with privatization in Latin America concluded that the pace and size of privatization and the economic impact in areas of high income inequality, is associated with public unpopularity of privatization. (Florio, Chechi & Carrera (2004). In short, the studies appear to show 1) that financial and commercial performance, in terms of profit favours privatization, that competition, rather than ownership is a key determinant of performance. Cautionary notes draw attention to the pace of change, presence of major inequalities in income, and need for adequate regulatory and guiding institutions.

Ways forward could include clarification of the objectives and assumptions of particular privatizations. Fafaliou and Donaldson (2006) concluded that privatization has the appearance of being a practice without a theory, and that its apparent "negative benefits" seem to be generally regarded either as problems of perception, or to flawed operation of a business idea that is necessary for contemporary economies of all kinds. Thus, the critiques of and defences of privatization appear to apply to the practice, rather than the principle, whereas the principle involved remains obscure. This suggests that privatization has assumed the status of an ideology, rather than a practice that has been logically thought through and tested. Ways forward might thus appear to be possible if at least the main principles of privatization can identify the range of cases to which it can or should be properly applied, rather than seeing privatization as either an economic panacea or as anathema to civilised society.

### Evaluation criteria

A possible approach to the matter is to explore whether there exist or could exist any clear principles through which privatization can be evaluated. Several evaluative categories may be considered.

#### 1. Demarcation of the boundaries

Demarcation of the boundaries concerning what is to count as privatization, (as opposed, say, to elaborate contracting procedures through "agencies.") There appears to be a spectrum, extending from the "ideal

type" of pure competition to the "ideal type" of monopoly. It appears that there are no pure examples at either end of the spectrum, as all cases seem to involve a mix of oligopoly, subsidy, regulation and privileges, all of which are well described in the literature. Another spectrum includes a mix of private and public funding and initiatives, as in the "private funding initiatives known as PFI in Britain.

### 2. Evaluation of performance.

This appears to need longitudinal studies, involving the history of ownership and control so that comparisons can be made of performance in a variety of macroeconomic settings: e.g. the history of ownership, control and subsidisation of rail transport in Britain has been one of private ownership, nationalization, privatization, changing demand conditions, subsidies and major safety problems.

### 3. Compensation of losers.

The studies to which we have referred tend to recognise that there are winners and losers in the process. The assumption seems to be that the winners are lucky, and deserve their luck, but that the losers are unlucky, and are expected to move on in search of new opportunities. There seems to be little or no discussion of how such policy-driven redistributions could be justified or amended.

### 4. Restoration

Circumstances in which restoration might be appropriate. The idea that some privatizations could have been unsuccessful in practice, does not seem to have generated the idea that the process could be reversed.

## Some practical implications

If, as is suggested in this paper, privatization has been essentially a pragmatic movement, with no compelling principles that can be applied, and driven by (real or fancied) political imperatives, some ways forward can be suggested. Remaining with a pragmatic theme, it is suggested that the performance could be evaluated according to several criteria. The financial costs and benefits will inevitably take pride of place. Legitimate expectations of service may fail to be met, as in the case of some water privatizations, privatization of pensions and rail transport. Who are to count as legitimate stakeholders, and what their legitimate claims are would need to be a matter for debate, (rather than assumed worthiness or otherwise, as appears to be the current practice). These claims could then inform the eventual evaluative criteria.

Finally, on the basis that varying regulatory regimes, varying subsidies, retention in some cases of majority shares by governments all imply that not all forms of privatization are successful, a contingency plan in each case would be prudent. Such a plan may, in principle, include reversal of privatization, or substitution of other forms of ownership and control, such as by municipalitie, local consortia or Co-operatives. In principle, they could even be more productive than some current forms of privatization, but in the present climate of opinion, this last possible option seems unlikely.

## Notes

1. The International Labour Organization (ILO)-Action Programme on Privatization, Restructuring and Economic Democracy: Synthesis report by Professor J. Marcovitch, Geneva, May 1999. (available on line).
2. See for example, William Finnegan, "Leasing the Rain", *New Yorker*, April 8, 2002, p. 44; Or Massimo Florio, Daniele Checchi, Jorge Eduardo Carrera Privatization Discontent and its Determinants: Evidence from Latin America. Working Paper 104.04. Fondazione Eni Enrico Mattei (FEEM), Milan, June 2004.
3. See for example, Juliet D'Souza, William L. Megginson, Robert C. Nash, Effect of Institutional and Firm-Specific Characteristics on Post-Privatization Performance: Evidence from Developed Countries. University of Oklahoma, Norman, November 2004; Or Sunita Kikeri and John Nellis. An Assessment of Privatization The World Bank Research Observer, vol. 19 (1): pp. 87-118. Oxford University Press, Oxford, April 2004.
4. Fafaliou. I. and John Donaldson (2006) "The contribution of privatization to welfare." Paper presented at the 61st Atlantic Economic Conference, Berlin, 15-19 March 2006.
5. See, for example, Friedman, M. (2002) *Capitalism and Freedom: Fortieth Anniversary Edition*, University of Chicago Press and Friedman, T. (1999) *The Lexus and the Olive Tree: Understanding Globalization*, Farrar Strauss Giroux, New York.
6. This decline and its contributory factors are discussed in Burchill (1997), pages 50ff.
7. Burchill, F (1997) loc.cit.
8. Wright M. (2002) Conference: Privatization, Employment and Employees. October, Istanbul.

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