From: Raven, J. (1995). *The New Wealth of Nations: A New Enquiry into the Nature and Origins of the Wealth of Nations and the Societal Learning Arrangements Needed for a Sustainable Society (pp.90-106)*. Unionville, New York: Royal Fireworks Press; Sudbury, Suffolk: Bloomfield Books.
Raven, J. (1995). *The New Wealth of Nations: A New Enquiry into the Nature and Origins of the Wealth of Nations and the Societal Learning Arrangements Needed for a Sustainable Society*. Unionville, New York: Royal Fireworks Press; Sudbury, Suffolk: Bloomfield Books. (Chapters 1 [which summarises the whole book], 4 ["Some Observations on Money"], and 17 [Summary of Parts I to III and overview of Part IV: The Way Forward] are available at www.npsnet.com/cdd/nwn.htm).

Chapter 9

Privatisation

Having examined the mismatch between market theory and the needs of modern society, we may now look more specifically at the concept of privatisation. This discussion is particularly important because many people who have come to question the utility of market mechanisms as a means of running society still somehow feel that privatisation has a significant role to play.

The term "privatisation" is applied to a number of different processes and activities about each of which people hold many beliefs. As a result, discussions of one form of privatisation are infused by thoughts and feelings derived from consideration of quite other forms. This is not, however, the main source of confusion. This is that the privatisation process is driven by powerful social and economic forces which are rarely discussed. This chapter will focus on some of the arguments which are openly debated. The next will review the covert functions of privatisation.

The not-entirely-consistent thoughts and impressions provoked by the term "privatisation" include, on the one hand, recognition of the need for public provision and a desire to minimise the kinds of exploitation commonly observed in private enterprises ... and, on the other, awareness of the conspicuous laziness - and obvious incompetence - of some public sector employees. Another pair of contradictory beliefs involves an awareness that there are many outstanding people, undoubtedly devoted to the public interest, in the public service ... and a feeling based on personal experience that bureaucracy contains people who are exclusively concerned with their own advancement and unwilling to take personal responsibility. These feelings are reinforced by having to spend endless time filling in forms and experience of time-wasting inquisitions into easily detected trivial "offences" whilst the more difficult task of pursuing major fraud is neglected.

What is Privatisation?

The different *kinds* of privatisation include:

i. Sale of government property: this may include sale of public housing to its occupants, sale and leaseback of public buildings, and privatisation of the care of historic buildings with or without sale of the property.

ii. Transferring services such as hospital cleaning, road maintenance, park keeping, and defence research to the private sector.
iii. Sale of public monopolies (water boards, telephone utilities, insurance, pensions, and railway companies).
iv. Sale of more or less profitable manufacturing companies (e.g. steel, electronics).
v. Putting large contracts out to tender - even though an army of public servants is still needed to generate detailed specifications, check what each contractor plans to do, and later check that the contractor has carried out the work as agreed.

Privatisation can transfer assets and control to owner occupiers, private owners, shareholders, employees, or pension and insurance companies. Purchasers can be local, national, or international concerns.

Justifications Commonly Offered for Privatisation

While the most common justification for privatisation is the observation of mis-management on the part of the public service coupled with the (highly questionable) assumption that "a private firm would not tolerate these failings", the motives for privatisation are as varied as its forms. Some advocates are concerned to make cost savings, as is often the case with the privatisation of public housing and services. Others are concerned to lay their hands on capital available from liquidating assets like profitable public companies (especially monopolies) and public buildings. The sale of assets enables us, as a society, to live off our capital, thereby helping to conceal true current levels of public expenditure - and thus minimising taxation in the short-term. Others, aware that the world has become dominated by giant TNCs and impressed by the fact that Adam Smith was writing about a very different world of small, lean, and competitive enterprises which would constitute a self-guiding system, seem mainly to hope to re-create (create?) Smith's market-organised world. Still others seem to be primarily motivated by the "serendipitous" discovery that privatisation somehow creates jobs, not only in the highly lucrative privatisation process itself, but endlessly thereafter. These new employees carry out market research, devise packages, prepare brochures, collect and keep account of payments, advise customers and investors, and act as consultants. Clearly many of the jobs directly created are middle-class ones and their holders are likely to vote for conservative political parties. And the education and training deemed necessary as preparation for these tasks creates still further jobs in "education" and its ancillary publishing, conferencing, and consulting industries.

Demand for privatisation is reinforced by the way in which the problems of Eastern Europe have been presented. It is repeatedly suggested that the conspicuous problems of these societies were due to the absence of market mechanisms. Their true causes are rarely discussed. These include the way in which these societies were established by Stalin with the explicit aim of subjugating and exploiting them. They include the way in which their governmental, and emergent governmental, arrangements were repeatedly destroyed, with tens of millions of people being butchered in the process. They include their failure to create the monitoring and feedback mechanisms necessary to ensure that a socialised regime dedicated to serving the public interest functioned effectively - crucial arrangements which we also failed to establish in the socialised sectors of our own economy (like the health service). And they include the absence of a Third World to exploit for below-cost food, minerals, and labour.

We may now examine some of the arguments for privatisation in more detail.

The Claimed Benefits of Privatisation

1) *The belief that private ownership leads people to care for property*.

There are several variants on this theme. It is claimed that people are more likely to look after property if they own it, that they are more likely to care for others' property if they have property of their own, and that, regardless of whether or not they possess property of their own, they are more likely to treat property with respect if it is privately owned. To the best of my knowledge, none of these hypotheses has been carefully tested while holding other things constant. In emphasising that, in seeking to test these beliefs, it is necessary to hold other things constant I have in mind that one reason (which has nothing to do with the private ownership thesis) why vandalism may be more likely to be directed at public rather than private property may be that governments have been unwilling to spend money creating and maintaining attractive public buildings because those buildings are intended for the "undeserving poor" and not for the middle-class. If their owners (the government) do not care about, and for, them, why should others? Beyond that, the "tattiness" of such buildings conveys the message that those who have to depend on the State are worthy of, at best, second-rate provision. Demeaning and degrading treatment of this kind may well evoke a negative reaction especially when it is accompanied by inquisitorial means-testing, denial of good will and responsibility, and detailed dictation of social and personal behaviour.

There are other variants of the ownership thesis, particularly that people who "own" their houses are much more likely to care for them than those who do not. The notion that maintenance costs will go down and the general quality of the housing areas will improve if the property is sold gains currency. The question of inequity toward people who need to be mobile and those who cannot afford mortgages, somehow gets overlooked. So, too, does the fact that it is, given the current system of taxation, from the individual's point of view, much more cost-effective for private property owners to maintain their property themselves instead of hiring someone else to do it and, to cap it all, reap untaxed capital gains in the end. DIY maintenance deprives the community of the tax revenues which would have been obtained if the maintenance had been conducted through the formal economy and so raises the question of whether it is equitable for the less well off, who live in rented public housing, to have to pay tax on the costs of having their maintenance done for them while property owners avoid paying such taxes by doing the maintenance themselves and then profit from untaxed capital gains. It follows from these observations that the most common justifications put forward for the sale ("privatisation") of public housing do not stand up to examination.

Another problem with the generalisation that "you cannot expect people to care for property unless they own it" is that people *cannot* own most of the property on which the quality of their lives is most dependent: They cannot own their hospitals, workplaces, schools, cities, trains, buses, or leisure haunts. Of course it can still be argued that they may be more likely to treat it with respect if it is privately owned. But to establish the truth of this proposition one would have to examine the situation more carefully. Privatisation of hospitals may lead their owners to spend more of their clients' money on their maintenance or on private guards. This may force those who cannot pay such high fees to get what care they can in much poorer provision which they may be still more tempted to vandalise.

In summary, therefore, the attractive thesis that the privatisation of property leads to a greater tendency to care for it needs much more careful examination before it is accepted.

2) The belief that privatisation induces greater effort and responsibility.

One reason offered for promoting the privatisation of enterprises is to reduce the levels of laziness, irresponsibility, and indifference to customers' or clients' needs. It is said that people will be less likely to cheat private employers than the state. This will arise partly because they will recognise that there is no bottomless pit from which money can be drawn - that the company has to earn whatever is paid out - and partly because their superiors will be more likely to stamp out such behaviour.

Be that as it may, what frequently happens when firms are privatised is that a new set of problems is substituted for the old: The employees of privatised companies frequently get exploited. All too often, companies taking over services from the state agree to employ the existing staff. However, immediately they acquire them, they create conditions of employment which lead most of those staff to leave - and without the redundancy payments and pension rights which the state (as their previous employer) would have had to provide. The new owner's lawyers simply point out to those concerned that they have been employed by them for only a few days - not the 30 or 40 years they have served the state. They therefore have *no* such rights. Those who remain are forced to work longer hours, and may be deprived of paid holidays, insurance, and pensions. Not infrequently, they are forced to use dilapidated and unsafe equipment. Under these circumstances, the goods and services provided *are* cheaper and people *do* work harder - but the cost is considerable.

If the a state or authority lets a contract to a *small*, local business, the owners typically find themselves underbid and out-smarted next time round by more unscrupulous, larger firms which can survive without profits from that particular activity until they have cornered the market. In the meantime, the owners of small firms end up working long hours compiling VAT and other returns and, in the end, frequently lose the life savings they have invested in their businesses. In the longer term, as before, the process leads to an *increase* in the direct costs of the service, to exploitation and overwork of employees, to huge increases in the costs of monitoring the operations of service providers, and to enormous increases in the cost of maintaining those rendered unemployed in idleness (and thus to either increases in taxation or cuts in other services).

3) The belief that the market mechanism - and thus privatisation - provides a self-regulating system which precludes the need to take explicit steps to guard against patronage, nepotism, and bureaucratic corruption.

In modern society, there is a fundamental problem with the notion that privatisation will create Smith's marketplace - a marketplace in which people can base their purchasing decisions on their feelings in such a way that these non-verbalised insights cumulate to affect the overall direction of development. The problem is that most customers are not now purchasing on their own behalf but on behalf of government departments, corporate giants, and consortia of governments (like NATO). The purchaser thus has little personal interest in the quality or cost of the goods or services being acquired. He or she is not spending his or her own money. That is why a bribe may well lead to the spending of vast amounts of employers' money in ways which are not in the latter's - and often society's - financial interest: Witness the success of gas-station gifts and "frequent flyer" programmes. Thus, contrary to expectation, a privatised system is in some ways *more* open to corruption and mis-application of funds than a wholehearted state system. Procedures which exactly parallel those needed to guard against patronage, nepotism, and corruption in state (committee) administered scarcity need to be introduced to monitor the workings of the privatised system.

Beyond that, the firms which are created through the privatisation process are typically very different from the small entrepreneurial units which lie at the heart of Smith's image of capitalist, market-based, economies. Owners of hostels for the aged, suppliers of services to hospitals, and suppliers to Marks & Spencer or Mitsubishi are dependent for their profitability on the arrangements they are able to make with their patrons. As such, they are dependent on the non-economic criteria that patrons apply to their work. They are also extremely vulnerable. Many use their knowledge of this vulnerability to force their employees to accept demeaning - and often illegal - terms of employment which would not be tolerated in other sections of the economy.

If the costs of monitoring both small and large firms and enforcing compliance with regulations are included in the calculations of the economic benefits of privatisation, the apparent increase in efficiency disappears. To force large privatised utilities - such as water and electricity boards, hospitals, telephone companies, and bus companies - to act in the public interest it would be necessary to:

i. Create procedures to debate the standards to be achieved in such areas as the prevention of pollution and improvement of public health and amenity;
ii. Develop the tools and procedures required to monitor the organisations' performance in relation to multiple goals of this sort;
iii. Monitor the internal workings of the organisations to find out what is going on and alert the public to activities that are not in the public interest. Such activities may involve deliberate failure to meet social welfare goals that have been publicly espoused, the manipulation of social indicators, and the generation of disinformation. But they may also include previously unanticipated activities like dumping polluting waste, selling city centre sites, reducing the maintenance of buses, and cutting cross-connecting bus routes, thereby forcing people to use cars;
iv. Develop the procedures needed to find out whether the organisations are acting in innovative ways to achieve their wider and ill-defined environmental and social goals - such as conserving energy (as distinct from producing electricity as cheaply as possible) or promoting the use of the countryside they own;
v. Develop procedures to force the organisations to attend to environmental and social goals when these conflict with the organisation's interest in short-term profitability.

Note that, although the costs of these procedures and requisite monitoring arrangements will often be considerable, they will not be any higher than the same procedures in a publicly-owned organisation. Indeed, had these monitoring procedures been properly carried out when the organisations were publicly owned, many of the problems of public provision which have fuelled the demand for privatisation - waste, unresponsiveness to client needs, lack of innovation, concern with the provider rather than the patient - would never have arisen.

If privatised government services and procurement are not to be dependent on patronage, whim, and favourable legislation one needs both a huge bureaucracy of experts to evaluate paper proposals for future developments (paper proposals, which, almost by definition cannot be innovative *or focus on creating the climate needed for innovation) and an army of peripatetic Peeping Toms* with unprecedented powers of investigation - and then a system for holding *the inquisitors* accountable to the public. One of the remarkable features of privatisation is that, in at least one of its variants, it tends to make firms dependent for their contracts on the goodwill and patronage of civil servants ... who, while they call the tune, are not themselves subject to any effective form of public scrutiny.

4) The belief that privatised firms offer greater variety and are more responsive to customers' or clients' needs.

One of the most common reasons for pressing for privatisation is experience of the lack of variety in, and the inadequacy of, public provision and the unresponsiveness of bureaucrats.

We will explore some of the reasons for this - and the steps needed to counteract it - in a later chapter. Here it is more important to ask whether market provision does much better. Of course, in the market, the well-off have more choice of commodities, but the price is high. Even then, there is little market-provided choice in the domains which most importantly determine the quality of life - a satisfying job, security, a satisfying family life, and a livable environment. Under the market system, choice of living and working arrangements, the satisfactions available in work, the *kind* of health care programme (e.g. community support vs. holistic medicine) available, and the *kind* of educational programme available to one's children (including, for example, programmes which will identify and develop the children's idiosyncratic talents) are all very restricted. The opportunity to chose to live in a sustainable society virtually does not exist.

Even choice of consumer goods and television programmes is, on the whole, restricted to a few main variants, with minority tastes being poorly catered for. As is particularly notable in television programmes, the market tends to the proliferation of choice on a particular theme, while other options - like programmes presenting alternative scenarios for society - are virtually unavailable. The less well to do, those in poor health, those with poor family circumstances, and those who work long hours tend to be very poorly catered for.

It the context of the current enthusiasm for privatisation, it is instructive to examine the case for privatising education in more detail. Despite what is argued, the conspicuous problems of the educational system cannot be solved by "returning" the activity to the marketplace. This is because:

a) If our society is to develop, many attitudes and skills (which it is the responsibility of the educational system to identify and nurture) need to be widely shared by many members of society and not just possessed by an elite.
b) We need a wide variety of people who possess different combinations of specialist information the need for which cannot become clear until after the event and which people are unlikely to see the need to purchase as individuals for their personal advancement.
c) Many people are in no position to pay for their children's education.
d) The main benefits are not going to be derived by people *as individuals* but by them as members of a society which develops *as a whole*. If *everyone* is going to benefit (even those who have no children), everyone should pay for education. As individuals, people would be most willing to pay for those "educational" programmes which lead to credentials which would in turn buy entry to protected occupations. But those credentials neither testify to the development of important competencies nor lead those who provide the courses to nurture such competencies. What is more, those who could pay and expect to recover the costs from increased personal income would be those who were most concerned about their own advancement and most willing to use the educational system to achieve it. Hope[9.1], Jencks[9.2], Chomsky[9.3], and Nuttgens[9.4] have

all discussed this problem in more detail and Hogan[9.5] has provided a useful demonstration of the destruction which these self-interested people cause in the organisations which employ them.

e) If different schools are to offer programmes which foster very different qualities, it will be necessary to change the criteria which are used to assess pupils at the point of interface between schools and society. To influence the assessment procedure, privatised schools would need to band together to fund the necessary - fairly fundamental - research and development. Similar collaboration would be required to evolve the new curriculum specifications that are required and the tools needed to translate them into practice. In other words, in order to offer the very variety and choice the market claims to offer, *communal* action would be necessary.
f) Choice of school provides no mechanism to enable parents and pupils to influence what happens *in* schools. Because of constraints on geographical mobility and income, most people will always have little effective choice between different types of school if provision of that variety is left to the marketplace. Some areas will have good schools and others poor ones. Even when there is a choice, schools tend to offer educational *packages*, most of the elements of which fail to meet a particular child's or parent's needs. To get what they need, parents and pupils must be able to influence what goes on *within* schools.
g) Some minority groups (most notably the handicapped and the poor) need special provision. Unfortunately, in society as it is currently organised, those in greatest need are also those least able to meet the greater financial costs of special provision.
h) Market mechanisms provide no way of tackling sociological causes of demand. The "demand" for "education" is primarily a demand for certificates which allocate position and status or, more strongly, in Jencks' terms "legitimise the rationing of privilege". This demand is accordingly met on the same terms: what people are offered does not merit the name education but it does offer the opportunity to scramble for credentials. Tackling the problems of the educational system has centrally to do with finding a way of handling this conflict between its educational and vocational goals on the one hand and the sociological functions it performs for society on the other. The market mechanism provides no way of doing this.

5) The belief that privatisation leads to efficiency and cost reduction.

The apparent efficiency of private firms is often misleading. Not only is their seeming profitability often illusory (the appearance arising, for example, from cycling property around at higher and higher values, creative accounting, and similar practices), it is also often dependent on hidden subsidies and on political intervention to drive competitors out of business. Thus Mercedes, which is known for its high quality cars, makes virtually all of its profits from government defence contracts. Indeed, much of the money required to fund the development of the advanced equipment which eventually finds its way into its cars comes from military contracts. In the longer term, such companies use their size to lower their prices in order to put competitors out of business and then greatly increase prices. The point may be illustrated by the American airlines' reactions to de-regulation. At first, this created a swathe of small companies. But, within 3 years, it led, not only to the conspiracy which destroyed Laker and People's Airlines, but also to the collapse of Continental and then Eastern Airlines. 80% of the business moved into the hands of just 4 companies. Immediately after the collapse of People's, fares were increased by 20%, Western and Continental sacked most their staff, and the employees of other airlines were required to both take wage cuts of 25% and work longer hours. Similarly, US telephone charges went up by 300% as a result of disbanding

AT&T and the introduction of "competition". Large businesses did end up spending less on their phone bills, but this was achieved at the expense of their *customers* - who had to spend more on their phone calls to them.

It is often argued that the goods and services required to meet public requirements can be provided more efficiently by private firms. However, the cost savings which sometimes follow privatisation are usually achieved by paying lower wages, sacking longer-serving employees, foreclosing on pension agreements, and evading social security and safety legislation. Even then, many of the apparent cost reductions are illusory. They arise from such things as failing to count the greatly increased costs of managing the tendering and quality control arrangements that are required in a privatised service as well as the cost to the taxpayer of having to care for the unemployed and the injured.

There is no doubt that the privatisation of previously state owned firms often increases their profitability. But the inference that this derives from their increased efficiency is rarely justified. As we have seen, the increase in profitability often arises from lowered costs arising from evasion of employment conventions and laws and moving production abroad. But there are other ways in which it is achieved. Privatised companies can play the stock market, they can invest (both directly and via their pension funds) in Third World companies in order to make greater profits abroad than they can at home; they can force those companies to trade on disadvantageous terms; they can transfer work from home to less developed countries with lower standards for pollution control, safety, and pensions; and they can arrange things in ways which evade taxes at least at home and often abroad as well. Doing any of these things as a publicly owned enterprise would almost certainly lead to a public outcry. As a private firm what they do is regarded as their own business, and, indeed, one of the objectives of the laws of incorporation which corporations did so much to promote was to *make* it their private business for which they could not be held responsible and for which they were not required to give an account.

Holding other things constant, privately produced goods and services are actually *more* expensive than publicly produced ones. Privatisation creates more highly paid jobs within the firms themselves, in their marketing agencies, in their consulting companies, and in public monitoring agencies. It creates jobs in education to provide personnel required to carry out these tasks. And it creates greater externalised costs: Costs externalised to the Third World, to the community as a whole, and to the future.

We have seen that, empirically, the cost of market processes is enormous. Miller[9.6] has shown that this is not due to any particular fault of our market system. It arises *inevitably* from reliance on the market mechanism. Transaction costs pose a particular problem. The time and costs involved in assigning values to, and prioritising, personal preferences, negotiating with others to set one's own time-and-value costings against theirs, drawing up contracts, and enforcing those contracts are inevitably enormous. The costs to a purchaser - even a firm - of maintaining quality control across market suppliers, ensuring constant supplies, and preventing suppliers colluding with each other to push up prices or divert their supply to other users are enormous. Miller argues that it is these costs which lead firms to abandon market-based internal and external sub-contracting arrangements and resort to ownership and direct hierarchical management. It is these costs which deny so many people the opportunity to use the market to optimise their purchasing.

Notwithstanding everything that has been said, it is still widely believed that, once the goals of an organisation have been defined, the quest for profits will lead privatised organisations to achieve those goals more effectively than would the public sector. Unfortunately, a focus on profits (like a focus on any other single and simple index - like hospital waiting lists or reading attainment in schools) frequently does not lead to the desired outcomes. Instead it creates opportunities for the unscrupulous to find ways of maximising that outcome without delivering the desired benefits - for example by playing the stock market, evading taxation, cutting the staff required to produce innovations for the future, or using the media to create a misleading image. Transport companies become asset-strippers and property companies, selling off, or developing and then selling, bus stations and railway sidings. Privatisation of water companies leads to the sale of assets to increase short-term profitability.

If, in an attempt to restrain such practices, privatised firms are required to satisfy other criteria assessed by simple indices the overwhelming desire for profits simply provides an added incentive to manipulate the statistics without delivering the benefits. School systems become still more inclined to manipulate test scores and hospital managers to push people off waiting lists.

What these observations mean is that privatisation leads to a change in the *nature* of the service provided. If one looks simply at "economic" indices, one is not comparing like with like. One does not get the same service for the same price from publicly and privately operated refuse-collection systems, parks, hospitals, and research. Since the nature of the service is frequently at issue, it is important to note that there tends to be more debate of performance criteria in the public sector. Hogan, Sutherland, and the Counter Information Service[9.7] are among the few who have evaluated the effectiveness of private organisations against broader criteria than profitability.

There are other reasons why the typical privatisation process does not lead to the kind of efficient self-governing system envisaged by Smith. For example, it is typically impossible to privatise a whole field of activity. Yet, if one omits only one bit, it prevents the *whole* field working according to market principles. For example, one cannot run a private theatre very effectively when others are heavily, but indirectly, subsidised. So long as even part of the area is under government control (and we have seen that this is inevitably the case in modern society) it is necessary for anyone who wishes to start up new things to get government support - or at least approval - the very things privatisation was intended to avoid. What this means is that the cost of running mixed - semi-privatised - systems (which most economies are) is typically very much greater than running a wholehearted public system.

6) The belief that private enterprise is less given to making serious blunders than the public service.

This belief is in part based on experience of public sector developments which have been poorly researched and badly planned. However, many of these stem, not so much from errors on the part of public servants as from the imposition of ideologically based "solutions" to conspicuous problems by politicians. Examples in transport, housing, education, agriculture, and health spring readily to mind. Publications like Chapman's[9.8] support this impression of public sector incompetence. But the impression is misleading. It is felt to be more legitimate for the public to enquire into the blunders of the public service than equally serious blunders - and destruction of the environment - by the private sector. Beyond that, the public sector deals with vastly more problems of this sort, the problems they deal with are more complex, and they bear more directly on the public interest. Serious contributions to the destruction of the environment and errors of judgment by the private sector are excused by arguments like "it was necessary to do this if a profit was to be made" or "it was the investors' own money which was wasted".

Such statements are misleading, not only in the sense that money and human and other resources were in these ways diverted by the private sector from potentially more useful activities, but because grants and public sector infrastructural support were usually involved as well ... and the lost profits affected, not so much private investors, as the public who rely on publicly mandated pension companies. They did not come out of the pockets of the pension scheme managers who made the mistake.

Finally, many of the public service "blunders" - like butter mountains and wine lakes - actually represent overshoot on important and successful policies. The fact is that *without* the Common Agricultural Policy - the public investment in the reform of landownership, agricultural research, the agricultural advisory service, and "intervention" - we simply would not have enough food, never mind a surplus.

But perhaps the most fundamental reason why the myth that the public sector is more given to making blunders persists is that few attempts are made to assess the effectiveness of private provision: The only question asked is whether the activity is profitable.

In summary, then, the belief that the private sector is less likely to make the kind of blunder associated in many people's minds with public provision arises from the fact that one is not comparing like with like. In this context it is vital to note that, under current forms of privatisation, politicians and public servants will continue to make the most important decisions. Thus the *only* way of avoiding the kind of blunder of which we are all too familiar is to find ways of improving the quality of public sector decisions.

7) The belief that a quest for private profit will lead to high quality provision.

Profitability and quality are often in conflict. While examples abound, an interesting example of quality being sacrificed for supposed profitability will be found in the privatisation of the media. Contrary to what might be expected, this actually leads to both a decline in quality and an *increase* in government control. Funds for investigative journalism and programmes which provoke thought about social issues can be withdrawn on grounds of inefficiency, to be replaced by soap operas and game shows. Privatisation creates more advertising, leaving less time for programmes. The programmes become less serious because the producers have to worry more about the size of the audience and its make up. This has two sets of consequences. First, and most importantly, producers cannot risk producing serious programmes about the workings of society because these might offend the well-off people who are the most likely to purchase advertised products. If they switched off, advertisers would lose their custom and producers would lose their jobs. Second, producers have to target more programmes at the less serious-minded and more gullible members of the population who will be more likely to purchase the junk foods and junk products that are advertised.

It is of interest to note that in a system funded from advertising, much the same revenue is collected from much the same population as in a state funded system, but the costs of collecting the money and the accounting processes through which it has to pass are vastly increased. The result is that the funds available for programme production are greatly reduced.

8) The belief that private enterprise stimulates innovation.

The provision of pensions and insurance through the marketplace has led to the creation of giant financial corporations. These corporations now own most other companies (whether manufacturing or service) and, in Britain at least, most land[9.9]. Because their main concern is maximising profit, they specialise in moving assets from company to company. They have little interest in the long-term development of the individual firms they own. From their point of view, the development of new products and provision for the long-term welfare of their workforce are unnecessary drains on resources ... they can always sell declining firms with major pensions commitments and buy rising stars who have survived the risks of bankruptcy so common among those who undertake development work. These enterprise-owning corporations have little feel for new ideas which will pay off in the future if they are provided with the necessary time, effort, and encouragement. “Market” provision of the most important commodities in modern society (pensions, insurance) therefore stifles the development of the very climate of innovation that market processes are currently believed to encourage and they do this every bit as much as does direct government ownership.

Even in a more limited sense, market management does not in fact stimulate the levels of innovation with which it is often associated. The explicit management of the market through taxes, grants, and levies, together with investment in non-market driven R&D (including military R&D), has contributed to virtually all the major improvements in efficiency (e.g. in agriculture, communications technology, and transportation) that have been introduced in the past half century[9.10]. Indeed, despite the widespread belief that privatisation will promote innovation, it is widely recognised (for example in the Alvey Report[9.11] on developments in computer technology and the subsequent ESPRIT programme[9.12]) that the long lead times and the risk involved demand public funding of innovatory activity. Perhaps ironically, perhaps self-interestedly, while recognising the need for public funding, these committees believe that the required public funds should flow into private research! Priorities for research are determined by large companies which lack a track record of effective research and development. It emerges that their main concern is to divert public funding into private pockets. They are able to ensure that no independent innovator gets access to the funds because they are able to devote much more substantial resources to the preparation of proposals and ensure that they satisfy what lies behind the opaque criteria which their own board members have generated. They have the right contacts and know the “hot” topics, keywords, and the deadlines for the submission of “proposals” ahead of time.

It is important to note that economic development in the US has been innovation-led rather than investment-driven. The crucial developments were in science and technology, but these were later picked up and backed by public- and private-sector finance. Only rarely did innovation come from commercial firms knowing what they could sell and commissioning R&D to find ways of meeting the need. Rather, well-positioned researchers would become aware of a need which could be met by the further development of something on which they were already working. They then had to sell the idea that there was a market for the product. Well known examples include 3M “Post-Its” and micro-computers.

Smith and Hayek have nurtured the belief that the desire for money leads to innovation. A series of studies[9.13] have shown this to be false: Innovations mainly come from people who possess a particular kind of temperament, who are sufficiently insulated from the pressures of earning a living to have time to pursue ideas and conduct experiments which "fail", and who have a network of contacts with others working on similar topics. Most of those who contribute the ideas on which innovation depends, and most of those who do things "first", make nothing from their inventions. The people who make money are those who know how to work legal, patents, and marketing systems. As the potential of innovations to yield profits becomes appreciated, they get taken up by large firms. This then forces producers with fewer resources to either follow suit or go out of business. In modern societies (other than Japan), in which most people work for large bureaucratic organisations, people advance themselves by ingratiating themselves with their superiors and not by inventing better ways of meeting clients' or society's needs. They are able to do this because there is no effective staff appraisal system to give them credit for engaging in one or other of the different types of activity that are required for innovation or condemn them for destroying the innovatory potential of their organisations. This is how it comes about that the base rate for incompetence among American managers is 60%. Many managers who come across as intelligent, socially skilled, and extraverted are able to give the impression of having created efficient workplaces by getting rid of anyone who expresses views conflicting with their own, by cutting out the time required to engage in the "parallel organisation" activity required for innovation, and by getting rid of research and development staff[9.14]. In fact, the desire to make money has all sorts of perverse effects: It leads to sharp business practices which breed distrust, to asset-stripping, to the destruction of organisations, and to tax evasion.

McClelland demonstrated more than 30 years ago that the question of whether an organisation is publicly or privately owned is, as far as innovation is concerned, a red herring. Some publicly owned organisations are both innovative and profitable. Cable and Wireless Ltd. was an innovative and profitable state-owned company. Indeed it was the most innovative and profitable company in the UK. AT&T was a private monopoly which, prior to deregulation, had one of the few really worthwhile research and development laboratories in the US private sector. These laboratories were destroyed by deregulation. What is important is the organisation's commitment to research, innovation, and customer feedback. It is extremely difficult to create this in a highly competitive setting - witness what has now happened to AT&T laboratories, the way the Japanese fund R&D through MITI, and the way the US and other countries fund R&D though defence contracts. With the growth of internationalism it has become even more difficult to recover the costs of extensive R&D from sales: It takes only 3 weeks for a new product introduced onto the American market to be shipped to Asia, copied, and shipped in bulk back to the US.

But the argument does not stop here. Even when it is recognised that the research must be publicly funded, it is often argued that privatisation of the research activity and competitive bidding for research contracts will lead to more innovative research! In fact as Roberts[9.15] has shown, it leads to the creation of a *facade* of competition - the winners are largely known beforehand and are chosen either through personal contact or for their personal qualities (like the ability to pull off an adventure). The central problem with the review process was that "the proposed technical approaches to the solution of advanced problems are only the subject of speculation ... only opinions". In other words, in deciding which proposals to fund, one is in fact relying on the judgments and innovativeness of *people*. "The best person to decide what shall be done is the man doing the research". Unfortunately, the pressures for privatisation have resulted in more paper proposals and more depersonalisation of the process since Roberts did his work. The result is the trivialisation of research. Public servants know less and less about whether those submitting the proposals have the personal capacities required to carry out innovative research. The demand to demonstrate “results” in a privatised system means that researchers have to publish well before any substantial programme of research could have been completed. The whole process is extremely expensive and results in the manufacture of useless work. Thus the cost of simply photocopying the proposals - never mind the cost of the time taken to write them, the cost of the time of the thousands of reviewers who read them, and the cost of photocopying and reviewing their comments - often exceeds the amount of money available for distribution as research grants.

Although Roberts’ research might not be replicable today, it still has something to tell us about how research *ought* to be organised. In the small number of cases in which a decision had actually to be taken as to who would get the money, the criteria which were used included “the contractor’s trustworthiness ... his flexibility, his willingness to work out unexpected problems amicably, the sharpness of his technical staff”. The winners were much more likely than the losers to have worked previously with the government agency concerned and to be known to them. Not only did the emphasis on formal procedures waste vast resources, they undermined morale (and, eventually, the whole enterprise) by teaching people that efficiency does not matter: That it is more important to play games in order to satisfy “the machine” than to do worthwhile work.

Finally, the study shows that making the contractors’ profits depend on the accuracy of their estimates or performance did *not* yield improved performance over cost-plus-fixed-fee contracts. The “profit motive” did *not* work in this situation - even in America. Instead it induced harmful short-cutting and work-stoppage threats. Formal review procedures and competitive bidding do not, therefore, improve performance. Indeed they have the opposite effect. The costs of implementing the system are vast, demoralising, counterproductive, and de-stabilising.

In connection with the justification for, and supposed effects of, differential reward for innovation, it is important to note that the success of an innovation is always dependent on the presence of a number of other innovations, many of them an outcome of a chain of largely unrecognised developments in the past, and on the assistance of many other people with skills in a wide range of different areas - both technical and social. Most of those who have contributed are dead, and many of those who are still alive - particularly those who are responsible for social innovations - never make a penny from their activities. Disproportionate reward for those who happen to be in the right place at the right time to bring relevant material together is, therefore, often hard to justify. The evidence against the view that that they would not do it without the prospect of reward is embedded in what has just been said - for *most of the innovators responsible for a conspicuous innovation did what they did without superior reward and without the prospect of superior reward*.

It is worth concluding this section by noting that the widely held belief that small firms are more innovative than large ones is almost completely untrue. Cannon[9.16] found that everything we know about bureaucratic resistance to change applied to small firms too: Their directors did not listen to ideas from subordinates or customers, ideas were not utilised, and feedback was neither sought nor used. But the most ironical finding disconfirming belief in the superior innovativeness of small firms was that, if they did innovate, they became large!

The Inability of Private Provision to Meet Social Needs

If further evidence is required to show that privately owned and operated systems do not necessarily lead to efficiency, innovation, responsiveness to client needs, and meeting society's needs, one has only to ask oneself whether the legal system offers these claimed benefits.

But perhaps the most glaring example of the foolishness of relying on private provision for services which impact the whole population can be found in the United States of America, where, despite leading the world in the proportion of GNP devoted to health care (18%), about one fifth of the population have virtually no access to health care and 37 million people are not covered by any form of health insurance[9.17]. Medical practitioners typically call for numerous specialist reports on their patients. This is not only to make business for their friends, but also to protect themselves against the hazards of litigation - which has reached epidemic proportions. The process results in the provision of cosmetic dental care and surgery for some while others are deprived of basic health care. Providers have a direct interest in increasing demand: They compete to invent diseases and produce treatments. (In public provision increased demand only makes more work for the providers without earning them more money.) The care of the chronically mentally ill, who are typically least able to pay, is a particular scandal. Many are simply decanted into the community and their hospitals closed. Others are dragooned into mental hospitals which, not atypically, have something like 16,000 patients, 4 psychiatrists, and no psychologists. Such treatment as is performed is carried out by nurses who are ashamed to refer patients to the psychiatrist and who resort to the crudest (not always drugs-based) activities to maintain a semblance of order. These hospitals frequently maintain beautiful research facilities, but these are isolated from, and have virtually no contact with, the hospitals to which they are nominally attached. Contrary to what is typically argued, high pay does not attract people into the profession or lead to high quality provision.

Even MEDICARE and MEDICAID are in imminent danger of collapse. In an attempt to contain the escalating costs of treatment based on free choice of physician funded out of insurance, there has been a rapid and dramatic shift to various forms of *managed* care - that is, care managed by employers with the decisions about which treatments will be provided and by whom being taken by the organisations concerned and not by patients or physicians. In 1984 96% of employers' schemes offered the patient free choice of provider. By 1987 - only 3 years later - the figure had dropped to 40%. By determining the payments to be made for each type of treatment regardless of the needs of individual patients, managing organisations have induced hospitals to discharge their patients, regardless of need and regardless of such things as availability of home support.

State care can be much better than private care. Prior to the change of the regime, Poland had small mental hospitals with perhaps 1,500 patients each staffed by 70 psychiatrists and 40 psychologists offering therapy. Community care was provided by doctors, psychologists, nurses, priests, and voluntary organisations. Although doctors and psychologists were paid less than factory workers and miners, there was no shortage of them.

In a fascinating cross-cultural study of expenditures on health and education Klein[9.18] has shown that something similar applies when control of government expenditures is decentralised. Especially when, as in Britain, the money comes from central taxation but is released by local government, it is possible for local governments to decide "independently" to do things which have few financial implications for themselves because 80% of the funds required will automatically come from central government. To all intents and purposes, such local authorities "spend someone else's money". Diffusion of responsibility for financial control combined with competition between local authorities to offer the best service results in escalating costs. As the Thatcher government in Britain was forced to recognise despite their espoused philosophy of decentralisation, the way to control this - as had happened for much longer in relation to the Health Service - is to centralise control of budgets so that the total funds available to one service have to be secured in a closed and secret competition with the demands of other services. The debate has to be conducted in secret because public debate would exacerbate demand. One of the main reasons why the funds available for the actual treatment of patients in Britain are falling so dramatically is that the costs of administering the internal market are exorbitant.

In the United Kingdom services for the elderly have largely been privatised, with many N.H.S. nursing homes being sold. This has lead to a lowering in standards of care as experienced staff have been replaced by cheaper, less qualified workers who are themselves exploited. The private companies concerned have little interest in improving the quality of *health* by carrying out research or promoting healthier lifestyles.

Notes

9.1 Hope, 1984
9.2 Jencks et al., 1973
9.3 Chomsky, 1987
9.4 Nuttgens, 1988
9.5 Hogan, 1990, 1991; Hogan, Raskin and Fazzini, 1990
9.6 Miller, 1992
9.7 Hogan, 1990; Sutherland, 1949; Counter Information Services, 1976-1984
9.8 Chapman, 1979
9.9 Bellini, 1980
9.10 Something which has been noticable in the UK, but which may not be so characteristic of the USA, is that when large firms get into financial difficulties the State buys them at a low price, sets about modernising them, and when they are viable sells them back into private ownership.
9.11 Alvey Committee, 1982
9.12 European Strategic Programme for Research and Development in Information Technology (ESPRIT)
9.13 McClelland, 1961; Rogers, 1962/83; Taylor and Baron, 1963; MacKinnon, 1962; Torrance, 1965; Crockett, 1966
9.14 Hogan, 1990; Raven and Dolphin, 1978
9.15 Roberts, E. B., 1967
9.16 Cannon, 1991
9.17 Zimet, 1989
9.18 Klein, 1980