

THE HERITAGE LECTURES

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Why Asset Sales Are
Good Public Policy

By Stuart M. Butler

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The Heritage Foundation

Of the many forms of privatization utilized around the world, the sale of state-owned assets has been the most popular among governments, but the most controversial among scholars and politicians. Supporters of asset sales argue not only that such sales bring some quick relief for overstretched national budgets, but also that changing the ownership of the assets leads to economic benefits to society. And in many instances, they claim, as in Britain's sale of more than one million public housing units to tenants, it leads to desirable social benefits as well.

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Critics reply that sales are little more than a one-shot bookkeeping ploy to hide part of a government deficit and yield no net economic benefit or long-term improvement in the public finance picture. In the United States, this has sometimes been characterized as the "smoke and mirrors" objection to privatization. Some opponents of asset sales also argue that they constitute an abrogation of government responsibility, and that the potential social benefits are either nonexistent or exaggerated.

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For instance, Congress has added riders to legislation to prevent agencies from just studying the potential benefits of selling such assets as Amtrak or federal power marketing administrations. By taking these actions, lawmakers are systematically preventing the American public from learning of a better policy than public ownership. This "know-nothing" strategy is scandalous. Congress is acting like a trial judge who systematically prevents the defense from offering evidence and then claims that the trial is fair.

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Restoring Balance. Fortunately the President's Privatization Commission is able to study privatization options, and thus its report will be critical in restoring some balance to the debate. The report will provide Americans with at least some of the findings that their representatives in Congress wish to withhold from them.

Confusion persists in the case of asset sales, in large part because of the efforts of some lawbreakers to ignore the basic characteristics of this form of privatization. *Note: Nothing in this book is to be construed as an attempt to aid or hinder the passage of any bill before Congress.*

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1) **Well-structured asset sales do lead to economic benefits** to the nation and to a real improvement in the condition of federal finances. Thus asset sales would be good policy even if the federal government were enjoying a healthy budget surplus.

2) **Certain creatively designed asset sales can help the public interest** by enabling government to reach public policy goals more effectively than is possible by retaining full control of the asset. Thus asset sales actually could be the best way to help those whom society wants to assist.

3) **Asset sales can be a highly successful vehicle** for widening the base of free enterprise in the United States and abroad, and privatization therefore should be a central feature of U.S. policy for encouraging economic development and political stability in less developed countries. Thus the strategy of asset sales could further U.S. economic development policy abroad and help the quest for democracy.

THE ECONOMIC BENEFITS OF ASSET SALES

The buying and selling of assets is a basic feature of American capitalism, from Wall Street to Main Street. These sales take place — in the vast majority of cases — not to accomplish a mere bookkeeping purpose, but because there are economic advantages to both the buyer and seller. For the seller, the cash raised and the flexibility it gives him are more advantageous than actually holding the asset. For the buyer, the value he places on the purchased asset is greater than the value he gives to the cash.

How Sales Improve Efficiency

In the case of strictly income-producing assets, such as businesses, transactions occur because the buyer estimates that under his management the business will yield greater income than under current management, while the seller is offered a price that is greater than the present value of future returns he expects under his own management. This potential for improvement in income under different management is why it often makes sense for the owner of a profitable business to sell, and it is why even a chronically money-losing business can sell for a good price.

Moreover, in the aggregate, such sales in the private sector lead to a net general economic gain. The reason for this is that the change in management leads to an improvement in the use of the assets; that is, an improvement in productivity. This is good for the general health of the economy. Only in those cases where the buyer misjudges the potential of the asset under his control might there be a net general economic loss, because the asset passes into the hands of a less competent manager. But buyers who make such mistakes do not last long in the market, while shrewd buyers prosper. Good managers drive out bad, to the benefit of the whole economy.

owns forests and wilderness areas because it wants to protect the environment; it operates public housing with the aim of providing shelter to the poor. These critics maintain, again correctly, that if such assets were simply handed over to the private sector, in all likelihood many aspects of these services would be discontinued as unprofitable. Thus, it is said, government ownership is needed, even if it is much less efficient, to guarantee continued provision of these services.

Alternatives to Direct Government Ownership

Leaving aside the issue of whether or not such services should be provided, the fact is that ownership of an asset is rarely the most efficient or effective way to secure any service. Careful use of privatization can serve the beneficiaries far more efficiently, and in certain instances the creative use of asset sales can lead to public policy benefits well beyond those already being provided under government ownership.

Covenants. For instance, adding covenants (requirements that the purchaser perform a service even if it is uneconomic) to an asset sale agreement can ensure that the purchaser continues serving specific groups, while also introducing private sector efficiency into the provision of the service. Thus the public objective can be realized while efficiency is improved and the cost to the taxpayer reduced. Covenants attached to the 1987 Conrail sale agreement, for instance, required the new owners to continue certain operations for an agreed period. Covenants attached to the sale of British Telecom by the Thatcher government in 1984 included such provisions as the requirement to serve even unprofitable customers and to maintain a series of emergency payphones across Britain.

It should be remembered that, by requiring such covenants, the attractiveness of the asset to a private buyer is reduced and the bid price thus will be lower. In addition, as in the case of the Conrail sale, powerful politicians often will use covenants to provide special-interest protections and benefits by forcing the buyer to maintain services that reward constituents rather than pursuing the public interest. But although these reduce the gains from the sale, all they do is make explicit the social costs currently carried under public ownership. Efficiency gains are still obtained, and public finances are still improved — just not as much as they would be without the special-interest covenants.

Regulation. An asset sold to the private sector also can be regulated, bearing in mind the long debate about the effectiveness of regulation versus competition as a form of consumer protection. The British are currently wrestling with this issue. Several large government commercial assets, including British Telecom, were sold as regulated monopolies rather than first being broken up to promote competition. The government is now reviewing this strategy with an eye to future privatizations and considering steps to encourage greater competition in existing cases.

Vouchers. Some mixture of asset sales and other forms of privatization also may be more effective than public ownership. Take the case of housing. By shifting from government ownership or subsidized construction of housing to a policy of housing vouchers, the government can gain the benefits of a more efficient market mechanism for supplying housing, while ensuring that the families that the government intends to assist have the

means to obtain housing in the market in spite of their low income, which otherwise would keep them out of the housing market. And incidentally, such a voucher system means that only those families are assisted, and not the developers, construction firms, and public housing managers who prosper so much under government ownership.

Wider Public Policy Goals

Asset sales combined with such other devices as covenants or vouchers can do far more than just reach existing goals more efficiently. In some cases the change of ownership, of itself, can fundamentally change the social and economic dynamics of a situation, such that unexpected positive effects occur.

Housing. Again, take the case of housing. In their program to sell public housing to tenants, the British have discovered not only that the approach improves the finances of government-assisted housing programs, but also that the ownership change itself has led to a transformation of the projects involved. Homeownership leads residents to assume a very different attitude toward their neighborhood and their housing. A walk through such a project shows the effects of this change very clearly. New homeowners have been improving their homes and gardens, and they have been taking action to protect the value of their investment by cleaning up common areas and tackling such social problems as vandalism.

The experience in the United States suggests that there will be similar results when the privatization provisions of the recent housing legislation take effect. The new law allows successful tenant-managed public housing projects to move to homeownership. Just with management control, tenants in such projects already have achieved quite dramatic social as well as economic improvements, as this Commission learned during its hearings on the subject. Tenants and other advocates of full privatization agree that the homeowner incentive will spur greater improvements. At last, privatization may enable these projects to become ladders out of welfare and decay, as they were intended to be, rather than sinkholes for the hopeless, as public housing has become under public sector control.

Public Lands. Similar arguments have been advanced in the case of public lands. Environmentalists of the New Resource Economics school point out that public ownership of forests, rangeland, and wilderness areas is actually ownership by nobody, and that the lands therefore are operated according to bureaucratic and political incentives, not primarily in the interests of the environment. They note that many environmental organizations, such as the Audubon Society and the Nature Conservancy, own some wilderness tracts privately and that these are managed far better than those operated by the government. As direct owners, these groups have the incentive to consider the long run and not just this year's federal budget allocation. They are interested in preservation, not creating Forest Service or National Parks Service jobs. And they are prepared to allow carefully screened energy and mineral exploration to raise revenues for the purchase and protection of additional land. As do good museum trustees, these private owners use carefully screened commercial activities to raise money for additional land purchases, and trade lands to improve their "collection" and thus pursue their overall goals. The New Resource Economists argue that control of wilderness lands should be transferred to a

Wilderness Board, consisting of respected environmental organizations, so that the objectives of public ownership can be pursued more effectively than is possible by keeping these lands under the bureaucratic control of the federal government.

WIDENING THE BASE OF PRIVATE OWNERSHIP

The third key aspect of asset sales concerns the way they can be used to further the objective of wider capital ownership. While this is an important policy goal in the United States, it is even more important for U.S. policy abroad.

In Britain, France, and Japan, and in some less developed countries such as Jamaica, asset sales have been combined with a strategy of wider share ownership and more extensive employee ownership. By aiming large privatization public offerings at the small investor, for instance, Britain has increased the number of households owning shares of any kind by a factor of three and the number of blue-collar stockholders by a factor of five. Commentators generally agree that this wider ownership has helped to reduce the deep class divisions between "them" (owners) and "us" (workers) which for decades have held back British industry.

Britain has also experimented with outright employee ownership. The National Freight Corporation, Britain's largest trucking firm, a loss-making, government-owned operation, was sold to its employees in 1982. At its last annual stockholders' meeting, worker-directors announced that a unit of stock purchased in 1982 is now worth forty times its original value, thanks to the dramatic improvements in productivity and profitability achieved by the new owners. The worker-stockholders made it clear to the media that there was nothing magical about the transformation; when you own the company you work for, they said, you work harder and you eliminate restrictive work practices rather than expanding them.

The United States has had long experience with employee-owned enterprises, and worker takeovers have managed to save a number of firms seemingly destined for bankruptcy, such as the Weirton Steel Company of West Virginia. Employee-ownership models should be considered aggressively within the context of privatization in the United States and in the less developed countries.

Amtrak. Amtrak's northeast corridor and parts of the Postal Service would seem to be candidates for serious consideration. If Britain's National Freight Corporation experience is any guide to the potential, transferring the Washington-Boston corridor to Amtrak workers at an attractive price could have dramatic effects on productivity and the financial bottom line. Instead of privatization posing a threat to Amtrak workers, it would then become an opportunity for workers as owners to gain directly from improvements in productivity. And instead of Amtrak being a money-losing albatross that cannot be sold because of worker and rider opposition, it could become an efficient alternative service without draining the Treasury.

The Postal Service. Similarly, transferring, say, the Postal Service's bulk mail system to its employees at a suitable price would allow the worker-owners to compete head-to-head with private competitors without having one hand tied behind their backs with federal red tape. The result would be better service for customers and a better deal for workers.

Promoting Economic Democracy Abroad

Employee ownership also should be a central feature of U.S. development policy abroad. Treasury Secretary James Baker, together with the Agency for International Development, has already made the transfer of commercial assets to the private sector a condition for certain assistance. This is a welcome step — but only a first step. If such privatization took the form simply of transferring control from government bureaucrats to their cronies in the private sector, or even to large international private firms, it very likely still would be opposed by some moderate and most leftist governments, and it would maintain the popular image of capitalism as control by a powerful oligarchy. If, instead, privatization took the form of spreading ownership through wide stock ownership (where that were feasible) or through worker ownership, the resulting "democratization" of capitalism could be a powerful force for free enterprise. By associating capitalism with worker control, this form of privatization would be more palatable to unions and to socialist leaders. And by introducing incentives for productivity improvements, it would help spur the economy — an attractive benefit for employees and for political leaders of all persuasions.

Thus worker-ownership as a form of privatization should be an important dimension of U.S. development policy overseas. In Central America, in particular, there is a tradition of employee ownership through such organizations as the Solidarista labor movement. As Ambassador William Middendorf argued in his report on economic development in the region, the *High Road to Economic Justice*, presented to President Reagan last year, U.S. policy should build on this tradition by linking privatization to employee ownership. This, said the Ambassador, would mean a policy of fostering economic democracy alongside the current strategy of encouraging political democracy.

Good Public Policy. Asset sales are an important form of privatization. Unfortunately, though perhaps understandably, the discussion of such sales has focused almost exclusively on their impact on the deficit, and even that discussion has been marred by a misunderstanding of the true effect of sales on public finances. The fact is that asset sales are good public policy whether or not the government is in deficit, because they can achieve more important objectives than simply making the deficit books look better. Asset sales can lead to genuine improvements in the economy, because of the efficiency gained through ownership changes. They can be used to achieve public policy objectives more effectively. They can help ordinary Americans obtain better services. And they can give employees an opportunity to obtain rewards for enhanced productivity

