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BRINGING EFFICIENCY TO THE THIRD WORLD THROUGH PRIVATE PROVISION OF PUBLIC SERVICES

INTRODUCTION

Less developed countries today face the challenge of trying to raise their living standards while contending with debt burdens and economic stagnation. The resultant need to hold the line on government spending threatens to hinder the delivery of many essential services. Yet this should not be viewed as a catastrophe. To the contrary. The situation offers less developed countries an opportunity to adopt policies that will deliver these services more efficiently and, at the same time, ease the pressure on government budgets. The way to do this is by creating the mechanisms and incentives for the private sector to provide these services that now are supplied exclusively by government bureaucracies.

That this can be done is now beyond dispute. The private provision of public services has proved successful in most of the developed world and is attracting the attention of many less developed countries.

Public Goods. In a free market economy, most goods and services can be provided by individuals and businesses. Yet those who wish to increase governments' role in the economy often maintain that certain sectors must be the responsibility of the state. Water and roads, for example, are said to constitute a "natural monopoly" where only one supplier is possible or where multiple suppliers would be inefficient. Street lighting and national defense, it is said, cannot be financed by charging a fee to individual users. Some services, such as education, are believed to be good for society as a whole, yet might not be adequately supplied at market prices. In such sectors, it is maintained, government must provide the good or service, often using taxpayer funds as the source of finance.

Yet public provision has serious problems. Because there is no market competition with the government supplier, and because taxpayer funds can be used to cover expenses, there is insufficient incentive for such suppliers to be efficient or to render the best service possible to the customer. In less developed countries, the problem has been especially serious. With fewer avenues for personal advancement, jobs in state industries are much sought-after and are then protected by those who have them and by the political leaders they support. Corruption and bribery commonly result.

Further, these inefficient state industries often are money losers, requiring billions of dollars in subsidies. A significant part of the Third World debt goes to cover such losses.

Bringing In Market Forces. In such areas as public transportation, wholesale and retail marketing, and the production of consumer goods, the private sector can be the best supplier. Governments would do well to keep out of these areas and privatize all such state-owned enterprises. In areas where the state feels it necessary to be involved, market forces can be brought to bear for the private provision of public services. Example: governments can contract with private firms to construct roads, public facilities, and similar capital assets. Private companies can maintain and clean public buildings and administer state facilities. In the case of a public utility like water, a long-term monopoly franchise can be granted to a private firm. Services such as education can be provided by private schools with the government issuing vouchers to citizens to pay the fees of the institution of their choice. And private citizen cooperatives can be established to oversee and pass along savings for public utilities such as electricity.

All countries' economies can benefit from the introduction or strengthening of market forces. The private provision of public services, however, is especially useful for less developed countries in which a weak service sector hinders economic development. Private provision of services can help countries suffering from economic inefficiency, poor infrastructure, costly government budgets, and huge debt burdens. The United States Agency for International Development (AID), which is charged with promoting economic growth in less developed countries, as well as such international development organizations as the World Bank, Inter-American Development Bank, and African Development Bank, should make privatization of state-owned enterprises a central element of their general development policies. As important, when some state involvement is still required, these organizations should encourage private sector involvement wherever possible. They can do this by providing information on the successful privatization of public services and by not funding public sector providers that compete with private providers in less developed countries.

MARKETS FOR GOODS AND SERVICES

Societies need numerous goods and services. These include food, shelter, clothing, electricity, running water, transportation, education, entertainment, police protection, and law courts to name but a few. In a market system, individuals or businesses produce goods and services which they trade for other goods and services. Thus the quantities and prices of goods and services on the market are the result of all the individual acts of buying and selling. Customers seek the best values from competing suppliers, while suppliers attempt to make the best possible deals with customers.

Some governments, however, feel it is necessary for certain goods and services to be produced or consumed by the state. In Western society these services traditionally have included police protection, law courts, and armies. The government uses taxpayers' money to produce these services. The government in a sense is also the consumer of these services, which it utilizes to maintain an orderly society. The quantity of these services is determined not by the market demand but rather by political decisions.

ARGUMENTS FOR GOVERNMENT INVOLVEMENT

There are a number of reasons why it is believed that the state rather than the private sector should produce or consume certain goods or services in addition to police and legal systems. These include:

1) Natural Monopolies

Some services, it is maintained, can be supplied only by means of source or a factor of production that cannot be duplicated. A city's water supply, for example, may come from just one source. In such circumstances, a private owner of the water source would not face direct competition; he would, therefore, be able to exploit those who want water by charging prices considerably higher than his costs of extraction and distribution. A public agency providing water in this situation, however, would be politically responsible to the beneficiaries and would do so at nonmonopolistic prices.

2) Economies of Scale

The efficiency of an enterprise can often be increased by enlarging its scale of production. Using costly specialized equipment, for instance, might be profitable only for large production runs; or inputs for a business might be purchased more cheaply in large quantities. If economies of scale are so great that only a few firms, or perhaps only one, can operate profitably in a given market, there is a danger of monopoly power. Some economists cite early electrically powered public transportation systems that required a single, expensive electrical generating system as an example of such an industry.

3) Externalities

Cases frequently occur when buyers and sellers who exchange goods and services create costs and/or benefits, usually called externalities, for people not directly involved in the exchange. A widely recognized negative externality, for instance, is the pollution caused by factories or automobiles, while a positive externality would be the beautiful gardens enjoyed by nonpaying passers-by. Some economists argue that, in the absence of government ownership or control, there is overproduction of goods or services involving negative externalities and underproduction of those involving positive externalities. Some suggested remedies include taxes to discourage negative externalities and subsidies to encourage positive ones.

4) Inability to Charge, or the Free Rider Problem

Some goods and services have to be provided to a group as a whole and cannot be subdivided for the benefit of particular individuals. Typical are national defense, street lighting, lighthouses, and conventional radio or TV broadcasting, often called "pure public goods." The same level of service is available to everybody, regardless of the extent to which each individual chooses to avail himself of it. There is no way, it is claimed, by which individuals can be charged for the service, or excluded for nonpayment. Because of the impossibility of charging, or of excluding nonpayers, the private market would not find it profitable to supply these pure public goods. Hence, it is said, the government must act to ensure their provision.

5) Merit Goods

Economists use the term "merit goods" to describe goods and services thought to enhance society as a whole that, if left to private markets, would be produced or consumed in insufficient quantity. The assumption is that many people would spend money on immediate needs and neglect long-term betterment for themselves or their children. Health and education are often thought of as merit goods, at least up to a certain level. As people might not voluntarily buy sufficient merit goods, it is suggested that they should be provided free by public agencies.

THE PROBLEM OF "GOVERNMENT FAILURE"

When private markets cannot by themselves provide the range, quality, or quantity of services considered desirable, governments often consider alternative methods. One alternative might be direct production of a good or service by government employees such as policemen, mail carriers, and public health experts. Yet, the possibility of government failure as well as market failure, must be considered. The private market may be faulty, but the government "remedy" is often worse.

First, governments tend to make decisions concerning public enterprises based on political considerations, granting favors to one interest group at the expense, and to the detriment, of another interest group or of society as a whole.

Second, because such enterprises are in fact government monopolies, they suffer many of the same problems attributed to private sector monopolies. Due to lack of competition, government enterprises are prone to inefficiency. Employees have insufficient incentive to provide the best service possible to customers.

Third, lack of competition often leads to huge financial losses, which taxpayers are forced to cover. The need of governments in poorer countries to cover billions of dollars in such losses from their budgets has diverted enormous resources from other crucial social needs and contributed to huge debts. In Argentina, for example, the state railroad requires a subsidy of $3 million per day.

Fourth, because taxpayers ultimately cover such losses, and because of the considerable political power of workers employed in government enterprises, such enterprises rarely shut down even when they fail to meet public demands.

And fifth, government economic forecasts are usually based on relatively few "scenarios" or projections of demand and are divorced from market processes. Thus government management of any given industry tends to be based on incomplete or outdated information. For example, the Indian Railroad Board failed for 25 years to come anywhere near the correct projections for how much coal to carry. Railroad officials explained to a commission of inquiry that their projections were based on official government economic forecasts.

In contrast to government enterprises, the private sector, taken as a whole, has an excellent information base. Market prices, the result of all economic exchanges in an economy, communicate information concerning the real demand for goods and services and the costs of producing them. Private provision, subject to market forces, thus helps to determine the real costs of goods and services. Further, the private provision of public goods and services introduces competition and thus avoids many of the problems of government monopolies. Services must meet customer demands and therefore tend to be of appropriate quality. And production tends to be in the most cost-effective manner.

Thus, production of goods and services by state enterprise, especially in less developed countries with extensive government regulation of the economy, usually would be better left to the private sector. Returning such enterprises to private citizens is often wise. Governments therefore would do well to become involved only in sectors where there is virtually no possibility of private provision. Yet even when the government still desires a role in a particular sector, it is possible to keep the private sector and market forces involved in the provision of public services.

METHODS FOR PRIVATE PROVISION

The private provision of services can be carried out in different ways, including:

1) Contracts from Public Agencies

In some situations, government is responsible for a certain sector and wishes to own and operate the material assets necessary to provide the required service to the public. The government also may wish to finance the service out of general tax revenues. Typical of such a sector are transportation infrastructure, government buildings, and military hardware. Yet even here, voluntarily that enabled a national interconnected network to be formed. Even today, there are over 1,500 separate private telephone companies in the U.S. providing local service, and some 40 companies providing long distance service. Europe has dozens of different telephone networks, all interconnected though almost all publicly owned. Private sector providers are to be found in the U.S., on some of the Caribbean islands, and in a few countries in which telecommunications have recently been privatized, like Malaysia and Britain. Competition, in the sense of consumers being given a choice in telephone service, exists only in the U.S. for long distance calls. Telephones owned by local cooperatives are to be found in Bolivia, Chile and Finland.

In less developed countries, even if the government must provide the capital for construction of a system, management contracts can be put out for bids to the private sector. In Botswana, for example, the government has employed Cable and Wireless PLC, a British firm, to modernize its system and to train its staff. In Argentina and Brazil, the compilation of telephone directories is contracted out to private firms.

Education

Education is not a service with the characteristics of a natural monopoly, nor are economies of scale a major problem for teaching. There is no free-rider problem since the service can be charged for. Nor are there negative externalities associated with education. Most governments justify their involvement in education on the grounds that it is a "merit good." Yet if the cost of education is too high, parents, especially those in poor financial condition, will be tempted not to spend money on their children's education, but rather to use available funds to meet immediate family needs. Furthermore, in many poor countries, parents keep their children out of school so that they can be employed in agriculture, vending, or other economic activities to supplement family income.

Throughout much of history, education has been a matter of private provision. In China in the 19th century, for example, people of a neighborhood would pool resources to hire a teacher for local children. It is estimated that during that time, in the rural districts of Kwantung province, 50 percent of the men could read.

Private tutors have been a means of educating children as far back as ancient times. Private schools, supported by fees and gifts, are widespread in the U.S. and are found in many European countries as well.

Parental Choice Through Vouchers. Governments concerned that all people, even the poor, have the opportunity for education can still retain the element of market competition in making the service available. Parents can be issued government vouchers for a certain sum of money, which they then can spend at the school of their choice to pay for their children's education. The school cashes in the vouchers with the government. Even where most or all schools are public, this technique allows parents to reward the best schools by enrolling their children in them and to "punish" the less effective schools by avoiding them. If a school is run so poorly that not enough parents send their children, the school will shut down. This gives parents control over the quality of their children's education and gives teachers and school administrators an incentive to do the best job possible. A variant of this system is used currently in Chile, where children go to the primary schools their parents chose, and the government pays the bill.

Other Public Services

There are many services, often identified as government functions, which can be delivered completely by the private sector. Other services that do require some form of government involvement still can utilize the private sector or market forces. These include:

♦ ♦ Governments contracting with the private sector to construct and maintain roads rather than maintaining a government highway department.

♦ ♦ Governments allowing private toll roads, as is done in Thailand.

♦ ♦ Private buses providing public transportation. In many less developed countries, and even in the U.S., extensive informal or illegal private carriers compete with inefficient, subsidized government systems.

♦ ♦ Private health maintenance organizations and competition between health care practitioners to keep down medical care costs.

♦ ♦ Local private cooperative banks to provide personal and small business loans.

♦ ♦ Choice for workers of enrolling in private pension plans rather than mandating the government system, as in Chile.

♦ ♦ Delivery of intercity mail, as is done illegally in India.

CONCLUSION

Governments, especially in poor, less developed countries, understandably desire to see their people's living standards raised quickly. In the past, these governments have felt that direct state responsibility for the provision of various goods and services was the best means to this end. Yet decades of experience, in both developed and developing countries, show that this typically leads to poor quality goods and services, huge financial losses and government debts, corruption of government officials, and declining living standards.

Keeping Suppliers Accountable. In many cases, such as production of most consumer, industrial, and agricultural goods, as well as such services as education, banking, public transportation, and medical care, the private sector is the most efficient and cost-effective means of satisfying popular needs. Competition between suppliers keeps costs low and makes the suppliers more responsive and accountable to public demands. Whenever governments can allow the private sector to provide these services, they should do so. But even where the government must have a role in the provision of certain goods and services, the private sector and market mechanisms should be used whenever possible.

The authority to involve the private sector in the provision of public services rests with the governments of the less developed countries themselves. But the U.S. Agency for International Development and such international organizations as the World Bank and Inter-American Development Bank can play a role in such reforms.

Searching for Innovative Solutions. First, AID and other organizations can provide information to less developed countries about successful cases of private provision in other countries and how to go about changing from complete state sector provision to partial or complete private provision. In many cases, the governments of less developed countries are not aware that such options are available, much less of how to make use of them. Second, AID and other development organizations should not provide funds to government-owned and operated public service providers that compete with private providers. The very existence of private providers indicates that the government service is not meeting market demands and that greater private provision would be possible.

Government officials in less developed countries should be imaginative, creative, and innovative in searching for ways to carry out such policies. Contracting out to the private sector for goods and services, offering monopoly franchises for a limited period of time to private suppliers based on competitive bids, issuing vouchers to individuals for purchase of services such as education from the private sector, or forming consumer cooperatives in certain situations are some very effective ways of ensuring that the demands of the public are met.

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