Reversing privatisation to ensure public goods and services are supplied in sufficient quantities and to an acceptable standard – Part 1

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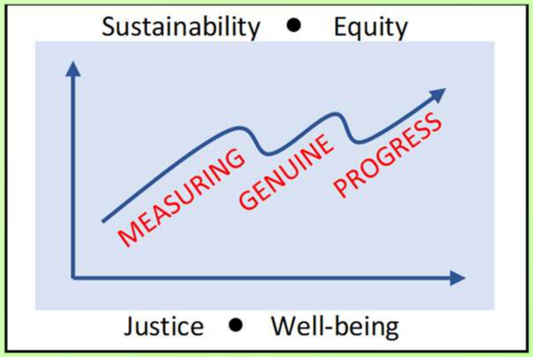
Measuring Genuine Progress



Part 1 – the argument against privatisation

- **There are two aspects pertaining to the failure of privatisation and the need to return the provision of public goods to the public sector**
  - **(1) The first is the argument against privatisation and the argument in favour of having a currency-issuing central govt (e.g., the Federal Govt in Australia) either directly supply public goods and services or at the very least fund their provision by either State/Territory or Local Govts (as defined by the Australian Constitution) or by an outsourced private sector organisation**
    - **Note: I believe most outsourcing to the private sector should be confined to the construction of public assets (e.g., a currency-issuing central govt (CICG), such as the Australian Fed Govt, might pay a private company to build a hospital on behalf of a relevant level of govt) – there are exceptions, such as household garbage collection and disposal, and many day-to-day goods**
    - **Except for obvious cases, outsourcing should not extend to the private sector ownership and subsequent use of public goods to provide ongoing services**
    - **Where a public good is built by the private sector, having been funded by the Fed Govt, the Federal Govt or a lower-level govt should own and manage the asset and use it to supply ongoing services, also funded by the Federal Govt**
    - **Why? It is easier for a govt to oversee the private sector construction of a public good and ensure it meets building standards than ensure a service is provided at an acceptable standard – poor construction can be remedied; often poor services cannot (e.g., sub-standard medical procedures)**
  - **(2) The second is how to return the ownership and provision of public goods to government hands once it has been privatised**

Part 1 – the argument against privatisation

- **My presentation today (Part 1) deals with the first aspect**
- **Why is it important to present an argument against privatisation? Isn't there already sufficient evidence (it is now thirty years since many public goods were privatised) showing that privatisation has failed?**
- **Yes, there is good evidence showing that privatisation has failed – but evidence isn't always enough**
- **A privatisation advocate could argue that the benefits of privatisation are yet to come; that privatisation is a work-in-progress and requires further fine-tuning to be successful; that the privatisation of some public goods has not succeeded because success relies on the privatisation of a broader range of govt-owned assets (i.e., we need to go further with privatisation to gain the full benefits of privatisation)**
- **To argue against privatisation, it is necessary to demonstrate that privatisation inherently fails – that is, no amount of tweaking can overcome the fact that a reliance on private sector provision of public goods will inevitably lead to the underprovision of public goods and the more than likely provision at below-acceptable standards**
- **Not only has privatisation failed – our Constitution and system of fiscal federalism inherently fails us (more later)**

Part 1 – the argument against privatisation

- **The failure of privatisation has little to do with private sector greed, although that too can be a problem**
- **The fundamental problem with privatisation is that it <u>asks the private sector to achieve the impossible</u> – it expects private sector organisations, as profit-making currency-users, to supply unprofitable public goods in the quantities and at the standard society expects**
- **In addition, the Australian Constitution asks State/Territory and Local Govts to achieve the impossible**
  - **The Australian Constitution expects currency-using State/Territory and Local Govts to meet their constitutionally-defined responsibility of supplying public goods in the quantities and at the standard society expects without possessing currency-issuing powers – this is impossible, despite having taxation/rate-setting powers, without adequate grants (funding) from a CICG (the Australian Fed Govt)**
  - **It should be no surprise that State/Territory and Local Govts have so many problems coping with the provision of public goods and services**
    - **Much of the 1990s privatisation drive was a means of State/Territory and Local Govts handing over the responsibility of public goods provision and shedding the associated difficulties to a (willing) private sector provider**
    - **The misunderstanding has also led to unnecessary democracy-diluting amalgamations of Local Govts**

Part 1 – the argument against privatisation

- If a State Govt, why not hand the responsibility over to the private sector? Many state governments lost elections due to the financial difficulties they encountered (SA, Victoria, and WA) – Jeff Kennett turned privatisation and abdication of the State Govt responsibility of providing particular public goods into an art form!
- The Fed Govt has similar problems to State/Territory and Local Govts only because it doesn't use its currency-issuing and taxation powers – especially the former – to the extent that it can and should
- To guarantee that public goods are supplied in sufficient quantities and at an acceptable standard, we need the provision of <u>all</u> public goods to be fully funded by the Fed Govt
- The ownership and management of public goods/assets should be the responsibility of the relevant level of govt, as they are defined by the Australian Constitution, but the funding responsibility should be entirely borne by the Fed Govt
- Had a decent argument against privatisation been presented in the 1990s, it would have exposed the myths regarding privatisation and assisted in the case against it
- Not as many people would have been conned into believing privatisation was a solution to public goods underprovision and the financing problems faced by State/Territory and Local Govts
- It also would have helped if more people knew about modern money/taxation and the unlimited spending powers of CICGs (i.e., the spending powers of the Fed Govt and its capacity to fund the provision of public goods regardless of what level of govt is charged with the logistical responsibility of supplying them)

The failure of privatisation

- **The standard argument for privatisation**
  - **The private sector is more efficient than the public sector due to greater incentives and competition – public sector inefficiency is explained by public choice theory; people working in the public sector (e.g., politicians, bureaucrats) make decisions in their own self-interest and not in society's best interest**
  - **Greater efficiency lowers costs and the prices charged for public goods and services**
  - **Private sector provision offers more variety and facilitates greater innovation**
- **Facts**
  - **There is no evidence supporting the notion that the private sector is technically more efficient than the public sector – the principal-agent problem that forms the basis of public choice theory applies equally to the private sector (e.g., the separation of ownership and management)**
  - **Private ownership does not increase efficiency and lower prices – *competition* can lower costs and prices, but most privatised organisations are natural monopolies or powerful oligopolies subject to little competition; ownership and competition are different things entirely and private ownership does not guarantee competition**
  - **If there is no efficiency difference, the cost of private-sector provision is no lower than public-sector provision**
  - **If the public goods provider is owned or funded by a CICG, it can provide services free of charge (although it may have to impose higher taxes to free up required real resources) – since privatisation began in the 1990s, prices for many essential goods and services have risen faster than inflation**

The failure of privatisation

- **The profit motive often incentivises private-sector organisations to focus on degenerative cost-cutting measures rather than on service quality, especially if not subject to competition – privatisation has led to a decline in the quality of many goods & services once supplied by the public sector (e.g., child-care & aged-care)**
- **Some of the greatest technological innovations have been developed by public institutions (e.g., NASA in the USA, the CSIRO in Australia, public research centres)**
- **Most goods and services previously provided by public organisations, but now provided by privately-owned organisations, have *public goods* characteristics (some degree of non-rivalry of consumption/use and non-excludability of consumption/use) and cannot be provided profitably in the quantities and quality desired by the public – hence, under-provision is now common as is poor quality**
    - **The adequate provision of public goods and services, and the funding thereof, should be the responsibility of governments – this is standard textbook stuff!**
    - **Such has the ideological (subjective) position of mainstream economists become (e.g., markets are always better than central planning) that the need for governments to provide public goods has been overlooked and ignored**
    - **Economists also overlook that the corporations that now provide many public goods and services are nothing more than privately-owned nodes of central planning – nodes of central planning, whether within the private sector or public sector, dominate modern, complex, and technologically-sophisticated economies (a functional requisite in post-Industrial Revolution economies)**

- **Conclusion – Privatisation has failed! Public goods-providing organisations should be owned by governments and funded by a CICG**

Government provision and ownership

- **If governments are to be fully responsible for ensuring an adequate supply of public goods at an appropriate (minimum) standard, which level of govt should shoulder the responsibility for what public goods?**
  - **Australia has three levels of government – Federal, State/Territory, and Local Govts**
    - **All levels of govt have responsibilities laid out by the Constitution – if that needs changing, as I believe it does, it requires careful consideration, identification, and a successful referendum**
    - **The provision of public goods and services and associated regulations should match the universality, or lack of it, of the need for such goods and services**
      - **At the very least, health, education, transport, communications, energy supply, and basic financial services should be administered by the Federal Govt, since needs in these areas are common to all Australians**
      - **Some public goods and services need to be tailored to meet the needs of people in different parts of Australia (e.g., urban v rural) – these goods and services are best administered by State/Territory and Local Govts**
  - **The Federal Govt is a currency-issuing 'central' government (CICG)**
    - **CICGs have unlimited spending power, albeit they have limited purchasing power (there is a limit on the real resources available for purchase)**
    - **CICGs can operate budget 'deficits' forever – a budget deficit entails a CICG creating and spending more base money into the economy than it permanently destroys through taxation; hence a budget deficit is really a 'net fiscal injection' which increases the net financial assets of the non-govt sector; a CICG's net fiscal injection (deficit) equals the non-govt sector's**

Government provision and ownership

- The Federal Govt is a currency-issuing 'central' government (CICG)
  - CICGs have no need to sell the public assets they possess or privatise the services they provide to finance their spending
  - CICGs face no funding 'trade-offs' – they may face purchasing trade-offs if total spending equals the economy's productive capacity (full employment)
- State/Territory and Local Govts are *currency-using* 'regional' governments – they have limited spending power
  - Under current fiscal federalism arrangements, State/Territory and Local Govts rely on taxes, fees, council rates, borrowing, the sale of public assets, and grants from the Fed Govt to finance their spending
  - The lack of sufficient grant money from the Fed Govt has contributed to:
    - (1) privatisation of State/Territory Govt-owned assets – they feel there is a need to (are sometimes forced to) sell govt-owned assets to finance spending in other key areas
    - (2) amalgamation of many Local Govts (i.e., taking advantage of economies of scale to lower the cost of service provision), which comes at the cost of diluting the democratic voice of people at the local level
  - CICGs can use their unlimited spending power to finance (bankroll) the spending of State/Territory and Local Govts – indeed, they can bankroll any non-CICG spending; they already bankroll the spending of welfare recipients (e.g., old-age pensioners)

Government provision and ownership

- State/Territory and Local Govts are *currency-using* 'regional' governments – they have limited spending power
    - Provided there is adequate Fed Govt funding, there should be no need for a State/Territory or Local Govt to sell the public assets they possess or privatise the services they provide to finance their spending in other key areas – not unlike CICGs, currency-using govts need only face purchasing trade-offs should total spending already equal the economy's productive capacity (full employment)
- Currency-users, whether they be a level of government below the CICG or the non-govt sector, are financially incapable of providing the full range of desired public goods & services at the minimum required standard (the latter even more so than the former) – hence, the reason for the failure of privatisation
- Regardless of which level of govt is best suited to administer the provision of public goods & services, <u>*the funding should always be the sole responsibility* of a govt with the spending and taxation powers required to enable all levels of government to obtain, at will, the real resources required to supply the public goods *they have been elected to provide*</u>
- In Australia, this means that although the responsibility of public good provision should be shared by the various levels of government as defined by the Australian Constitution, the funding responsibility and the taxation required to free up the necessary real resources (i.e., to transfer real resources from the private sector to the public sector) should rest exclusively with the Federal Government

The characteristics of public goods

- **The non-rivalry and non-excludability of consumption/use of public goods and services renders their provision unprofitable**
  - ***Non-rivalry of consumption/use* – the consumption/use of a good by an individual does not preclude someone else from consuming/using the good (e.g., lighthouse services – if one enjoys the service provided by a lighthouse, it does not affect someone else's ability to enjoy the same service)**
  - ***Non-excludability of consumption/use* – an individual or organisation cannot be excluded from consuming/using a particular good if they don't pay to consume/use the good (e.g., lighthouse services – if one does not pay for the service provided by a lighthouse, it is impossible for a private sector supplier to preclude them from enjoying the service)**
- **A lighthouse is an example of a pure public good – many goods are impure public goods in that there is some degree of rivalry or excludability associated with them, or there is rivalry but not excludability, or a little bit of both**
- **To make a profit from supplying a good, you must be able to charge a price to consume/use the good – if there is non-excludability, you cannot force people to pay for a good or exclude them from consumption/use if they refuse to pay for the good**
  - **Supply comes at a cost; consumption/use (demand) of a public good comes with no sales revenue**
  - **Result? – public goods are unprofitable to supply**

Merit goods

- **There are also ‘merit’ goods**
  - **Merit goods are goods and services that do not necessarily have public goods characteristics, but which society (a democratically-elected government) deems as essential and should be provided either free of charge or at a price below supply cost to every person in society**
  - **Supply at a price below the cost of provision ensures everyone has affordable access to ‘necessities’**

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Funding v ownership/provision of public goods

- **Because of the unprofitable nature of supplying public goods and providing merit goods at prices below supply cost, currency-users cannot provide them in sufficient quantities and at a guaranteed acceptable standard (the latter often when there is a lack of adequate regulations/oversight and competition)**
  - **The private sector's ability to finance the provision of public/merit goods is confined to earning sufficient revenue from the sale of the goods to at least cover the cost of their supply**
    - **Because of the characteristics of public goods, the revenue will invariably be insufficient to cover costs, let alone make a profit**
    - **Consequence? – there is private-sector underprovision of desired public goods and an inability of low-income people to afford merit goods**
  - **Currency-using governments (State/Territory and Local Govts in Australia) have an advantage over the private sector – they have taxation and licence fee-imposing powers to raise additional revenue to cover costs; however, imposing the taxes and fees to 'balance the books' can be destructive in other ways, especially at the macroeconomic level (e.g., it can reduce total spending below productive capacity and lead to unemployment)**
  - **CICGs have an advantage over all currency-users in both the private sector and public sector – they don't have to recover funding 'costs', which are zero in any case when you can issue the currency for your own spending purposes; CICG-imposed taxation is only needed to free up real resources to provide public/merit goods in a non-inflationary manner**

Funding v ownership/provision of public goods

- **Don't govts have to cover costs? – isn't a public sector financial loss (negative profit) automatically equivalent to a societal loss?**
  - **Brief answer: no! The narrowly measured profit/loss of an entity supplying goods and services is no measure of the holistic net benefits to society of supplying them**
  - **In terms of costs, the *only* cost to society from the use of a particular resource by the public or private sector is the 'opportunity cost' (OC)**
    - **OC is what you forego when you use a particular unit of a particular resource to provide something (i.e., to generate a consumption/use benefit)**
    - **OCs are unavoidable for two reasons:**
      - **We live in a finite world – there are only so many real resources that can be put to use at any one time and over a particular period (scarcity)**
      - **The Entropy Law – no real resource can be used the same way twice (energy cannot be recycled; matter can be recycled, if the technology exists, but it requires the use and degradation of energy and of matter (depreciating machines) and thus it is impossible to reconcentrate all degraded matter at any point in time without further losses of usable matter (i.e., 100% reconcentration of degraded matter at any point in time is impossible!))**
  - **What matters is how we 'incur' or bear OCs**
    - **How we bear OCs is widely misunderstood, and I'm including mainstream economists, many with PhDs and professorships at major universities**
  - **Understanding how OCs are borne is critical!**

Funding v ownership/provision of public goods

- **How do we bear the OC of obtaining a private good presumably purchased from a private-sector supplier in a market?**
  - **(1) Let's assume that I have the choice of purchasing private goods α, β, and γ and they have a price of $100 – I decide to pay $100 for private good α**
  - **I have good α, but have $100 less to purchase private good β or γ**
  - **Presumably, due to my preferences, I have chosen private good α because I receive more benefits from α than from β or γ (i.e., I have a greater willingness to pay $100 for α than pay $100 for β or γ) – in strict financial terms, purchasing α for $100 means I've foregone $100 of β or γ. What I have foregone is my OC**
- **How do we bear the OC of receiving a public good provided by a CICG?**
  - **Let's assume that the majority of society has voted for a political party to provide public good A for everyone to enjoy, of which everyone's share of it (non-rivalry of consumption/use) is worth $100 (i.e., a CICG has created base money on society's behalf and then purchased the required real resources so that public good A can be provided in quantities sufficient for everyone to enjoy $100 of the public good)**
  - **How do I pay for public good A? There are two ways – one is imposed at my behest (i.e., society grants a CICG with taxation and money-creating powers to free up required resources and then supply them in the form of public goods); the other is by way of a voluntary decision**

Funding v ownership/provision of public goods

- **How do we bear the OC of receiving a public good provided by a CICG?**
  - **(2) if all real resources are earmarked for use (i.e., full-employment), then to obtain additional resources, the CICG must impose a $100 tax on everyone to free up the appropriate real resources – I now have $100 less to purchase private goods – in strict financial terms, the $100 tax impost means I will forego $100 of private goods. That is my OC**
  - **(3) if some real resources are available for the CICG to purchase because everyone in society has chosen not to spend $100 (i.e., they have saved what they could have spent), the CICG has no need to impose a $100 tax on everyone to free up the required real resources; society has already freed up the real resources by electing not to spend (i.e., by saving) – in strict financial terms, my $100 of self-deprived spending means I have voluntarily foregone $100 of private goods. That is my OC**
  - **Note: <u>My OC is the same in all three cases</u> ($100) – in each case, my financial cost is also $100 – <u>the only thing that differs is the way I bear the OC</u>:**
    - **In the case of the private good (1), I directly bear the cost by spending $100, thus reducing my purchasing power by $100 (i.e., I reduce my ability to purchase something else worth $100)**
    - **In the case of the public good, and where all real resources are earmarked for use (full-employment of all real resources) (2), I bear the cost by being taxed $100, thus reducing my purchasing power by $100 (i.e., the tax reduces my ability to purchase something else worth $100)**

Funding v ownership/provision of public goods

- **How do we bear the OC of receiving a public good provided by a CICG?**
  - **In the case of the public good, and where the required real resources are available because each member of the private sector has refrained from spending $100 (i.e., each citizen has saved $100) (3), I bear the cost by foregoing $100 of private goods that I could have purchased**
- **Let's assume that the benefits of consuming the private good and the public good are the same – we now have the same benefits enjoyed for the same OC! Only the way each citizen bears the OC differs**
- **<u>Holistically – i.e., taking account of all benefits and all costs – the net benefits to society are the same in all three cases regardless of the narrowly-measured financial bottom line of the goods-supplying organisation</u>**
  - **In case (1), the private-sector providers of private goods can cover their financial costs – this explains why private goods can be adequately supplied by the private sector, albeit at excessive prices if private-sector suppliers have sufficient market power (this also applies to the private sector provision of goods with public goods characteristics – a typical consequence of privatisation)**
  - **In case (2), the tax impost (financial leakage) immediately destroys all the base money injected into the economy by the CICG provider of the public good (financial injection) – destruction of all the base money injected is not necessary for financial reasons, but simply a case of circumstances in this example**

Funding v ownership/provision of public goods

- **How do we bear the OC of receiving a public good provided by a CICG?**
  - **In case (3), all the base money injected into the economy by the CICG provider of the public good initially remains in the economy – however, since financial injections must eventually equal financial leakages, all the base money eventually leaks out of the economy in the form of subsequent savings, taxes, and import spending as per the expenditure multiplier process.**
  - **The subsequent increase in the tax impost will not equal the increase in CICG spending required to supply the public good and doesn't need to (i.e., ↑G = ↑S + ↑T + ↑M; therefore, ↑T = [↑G – (↑S + ↑M)]; therefore; ↑T < ↑G)**
- **The financial cost and the OC of obtaining real resources in the form of private goods are the same for a currency-using member of the private sector – the exception is where individuals and organisations within the private sector enjoy economic rents (unearned financial claims of goods and services), in which case the remainder of society bears a cost greater than the OC; included in this group of organisations in such a privileged but unjustified position are financial institutions, which have a licence to create credit money and advance it at interest**
- **For a currency-using govt (e.g., State/Territory and Local Govts), the financial cost of obtaining real resources to provide public goods is the difference between the OC and the 'revenue' used to fund the supply of public goods, which is obtained by imposing taxes, fees, and rates, and charging a price to allow citizens to consume/use public goods (the user pay principle)**
- **For a currency-issuing govt (e.g., Federal Govt), the financial cost of obtaining real resources to provide public goods is zero by being able to create base money at will for spending purposes**

Financial injections and financial leakages

- **Three financial *injections* pertaining to each major sector of the economy**
  - **Domestic private sector (I) – spending on new goods and services by the domestic non-govt sector financed by (a) the borrowing of newly-created credit money; and (b) spending of past savings (a re-injection of past financial leakages)**
  - **Government sector (G) – spending on new goods and services by the govt sector financed by the creation of new base money**
  - **External/foreign sector (X) – spending by the ROW on new domestically-produced goods and services (i.e., exports)**
- **Three financial *leakages* pertaining to each major sector of the economy**
  - **Domestic private sector (S) – the non-spending by the domestic non-govt sector of its after-tax income (savings)**
  - **Government sector (T) – existing base money destroyed by taxation imposed by govts**
  - **External/foreign sector (M) – domestic spending on new foreign-produced goods and services (i.e., imports)**

Financial injections and financial leakages

- **Financial injections = financial leakages**
  - **(I + G + X) = (S + T + M)**
  - **Rearranged we get: (G – T) = (S – I) – (X – M)**
  - **And: (G – T) + (S – I) + (X – M) = 0**
    - **The balances of the three sectors sum to zero**
  - **If X = M, then (G – T) = (S – I)**
  - **Hence: G > T, and S > I (by the same amount)**
    - **The govt's 'deficit' = the non-govt's surplus, which is financially sustainable because a CICG has no spending constraint**
    - **This is the norm and characterised the stable post-WW2 period (1945-1975)**
  - **And: G < T, and S < I (by the same amount)**
    - **The govt's 'surplus' = the non-govt's deficit, which is financially unsustainable because the currency-using private sector has a spending constraint and cannot continue to accumulate debt and/or draw on past savings to finance its spending (i.e., it can't continue to run deficits)**
    - **This situation is typically the precursor of a private sector spending collapse (e.g., late-1980s prior to early-1990s recession; mid-1990s to mid-2000s prior to the 2008-09 GFC)**

Overall result – conclusion

- **Profitability is irrelevant in terms of the net benefits enjoyed by society from using real resources**
- **Profitability is relevant to a currency-using entity if we are relying upon it to provide the good or service – if provision is unprofitable, the good is not supplied by the currency-using entity in sufficient quantities or at all**
- **Since the provision of public goods and services is inherently unprofitable, we must rely on a currency-issuing entity (Fed Govt in Australia) to directly provide public goods or fund their provision to ensure they are supplied in sufficient quantities and to an adequate standard**

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Scenarios

- **Scenario 1: In the above example, let's assume that the benefits of consuming a private good are greater than consuming the public good**
  - **We'd be better off having the private good supplied; there are greater consumption benefits for the same OC as supplying the public good**
  - **So long as the private organisation providing (selling) the good is not using any market power to earn excessive profits (preventable through regulation), it is more than reasonable to have it supply the good**
- **Scenario 2: Now assume that the benefits of consuming the public good are greater than consuming the private good**
  - **We'd be better off having the public good supplied; greater consumption benefits for the same OC as supplying the private good**
  - **Since a private organisation cannot profitably supply the good in sufficient quantities and to a sufficient standard, it is necessary to have a CICG supply the good or fund its provision – privatisation would thus fail to adequately deliver desired public goods**

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What a CICG/society must consider

- If we focus on public goods for a moment, what is the cost to society of using real resources to provide them? – as pointed out, it is the things that society subsequently foregoes; when resource X is used to provide public good A, it cannot be used to provide private good α or public good B
- Hence, even if a CICG spends base money to obtain resource X for public goods-providing purposes, the CICG still needs to determine if resource X should be used to provide public good A, B, C, etc. – ensuring resources are used in the best possible manner is something that govts need to carefully consider
- Whether the CICG should spend base money to obtain resource X at all requires society to determine if it would be better off with private goods α, β, γ, etc. or public goods A, B, C, etc. – these decisions are usually made democratically via public elections and carried out by a CICG on society's behalf through the use of its spending (base money-creating) and taxation (base money-destroying) powers
- These resource-allocation decisions (private sector or public sector?) should be widely debated by society – they are not because the debate degenerates to whether govts can afford public goods and beliefs that the private sector is more efficient than the public sector; and people get conned into believing privatisation is desirable (end of debate!)