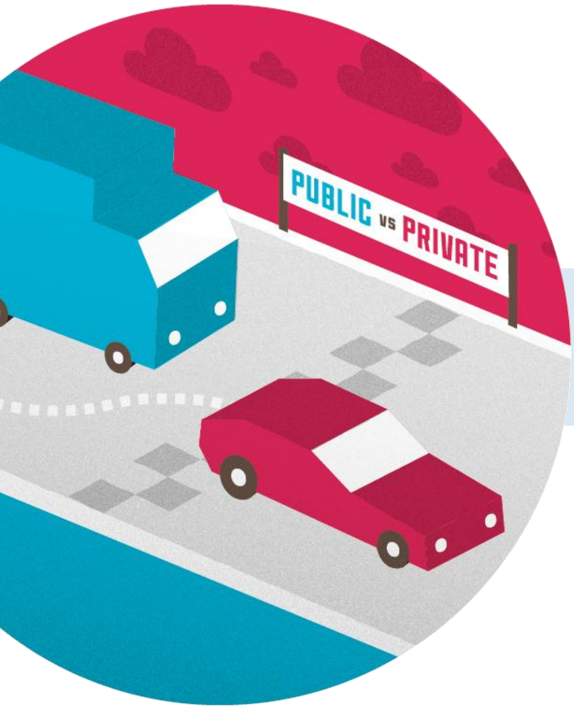

Mythbusters

from **nef** and the Tax Justice Network

"The private sector is more efficient than the public sector"

Andrew Simms

Private sector dynamism versus public sector inefficiency has been a dominant political narrative of the last few decades. It has supplied the excuse for upheaval in many of the public services that we rely on. Yet from healthcare costs to train company subsidies, evidence of private sector superiority is thin. The public sphere in its broadest sense – including voluntary, mutual, cooperative and social enterprise models – can be more efficient and more effective.

The myth

The Western world witnessed market failure on an epic scale during 2007–8. Weak regulation, perverse incentives, dysfunctional risk models and monumentally imperfect information all conspired to allow a financial crisis that was arguably the worst in living memory. Most governments are today dealing with its consequences still. Yet the notion that a minimally regulated, private sector-led, market system is generally superior to the public sphere endures.

The myth of private sector superiority has three components that feed-off and reinforce one another. Firstly, that the private sector is always dynamic and best, secondly that the public sector is costly and inefficient, and thirdly, the conclusion that everyone benefits from the continual, incremental privatisation of the public sphere. As we shall see, all three elements are false.

In 2010 David Cameron spelt out his priorities for government, which were to use "all available policy levers" in order to "create the right framework for enterprise and business investment". This in turn would make it easier for the private sector to "create a new economic dynamism".[1] He claimed that "to create the growth, jobs and opportunities Britain needs, we've got to back the big businesses of tomorrow".[2]

On its own, promoting enterprise is fairly uncontroversial. Certainly, commentators from across the political spectrum are happy to encourage the small business sector, given the broader power shift in favour of big corporations. But there was a second part to the project.

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In 2011 David Cameron announced that he was, "taking on the enemies of enterprise". These included, "The bureaucrats in government departments, […] The town hall officials [… and] the public sector procurement managers".[3] The Chancellor of the Exchequer, George Osborne, developed this theme further. It wasn't just that the one sphere was generally better than the other. He argued that the public sector was "crowding out" the private sector. In order to allow the latter to flourish, the former would need to be cut back. "It is my deeply held belief," said Osborne, "that a genuine and long-lasting economic recovery must have its foundations in the private sector". For that to happen, he argued, a state was needed that was not "crowding out private endeavour". [4]

In practice this meant reducing, "employment in the public sector […] at a pace that allows the private sector to fill the gap".[5] Here, in a nutshell, was the practical application of the Chancellor's cherished doctrine of "expansionary fiscal contraction". He believed that cutting back the public sector would ignite a private sector revival.

Behind this perspective, is a relentless chorus of special interests repeating the message: 'public good – private bad'. Hence, the Adam Smith Institute, a long-standing advocate of privatisation, which also profits from advising governments on how to privatise, rails against "the bloated UK public sector".[6] And the Centre for Economics and Business Research decries, "the increasing inefficiency of public-sector spending," and blames this for why "much higher taxes" do not result in "a commensurate improvement in public services".[7]

We are left with an impression, constantly reinforced by politicians, lobbyists and parts of the media, that services delivered by the public sector are, as David Hall of the Public Services International Research Unit (PSIRU) summarises, bureaucratic, slow, expensive, unaffordable luxuries that are a burden on the real economy. But, does the evidence support that view? Following decades of privatisation in Britain, and with many international comparisons, there's no shortage of examples to assess.

The reality

The railways

Rail privatisation was a bold experiment to roll back the post-war nationalisation of Britain's railways, which had entered public ownership in 1948. The railways remained state-owned and state-managed until 1996 when John Major's government divided British Rail into more than 100 different businesses and sold them off. One result, according to the *Financial Times* (FT), was that it "introduced hard-nosed commercial tensions into relationships that often needed to be co-operative," and "broke traditional bonds and practices of passing on skills and experience".

The complexity of contracts, targets and blurred lines of responsibility introduced numerous inefficiencies. For example, the FT noted that, post-privatisation, the industry employed hundreds of people just to fight over who is to blame for every minute of delay to trains.[8] Figure 1 illustrates how government support of the rail industry has increased dramatically since privatisation.

Gerald Corbett, the chief executive of Railtrack (the company with, in effect, the task of coordinating the privatised elements of the railway network), who resigned after safety and maintenance failures led to the lethal Hatfield railway crash, said with regard to another crash at Ladbroke Grove, "there is a tension between shareholder interests and public service obligations. The only way we can make profits is by not doing the things we should do to make the railways better".[9] Brendan Martin, of *Public World*, observed that, "A key idea behind fragmentation and privatisation was that market mechanisms guarantee more effective transmission of information than can be achieved by hierarchical bureaucracies. This neglected the integrity of the rail network as a knowledge system, which depended in turn on flows of information – via both formal and informal channels – between people sharing trust-based relationships". [10]

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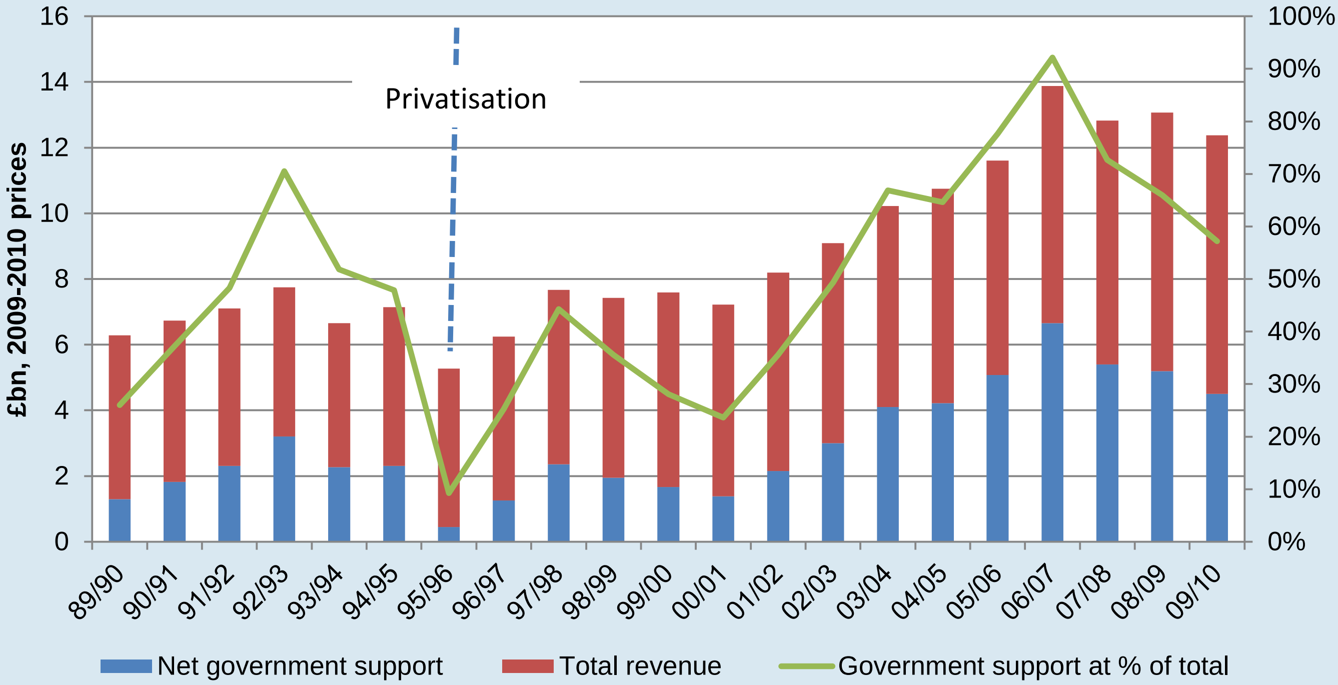
Figure 1: Rail industry revenues and subsidy, 1989/90 to 2009/10 (privatised 1996)



Source: National Rail Trends, DfT Statutory Accounts, TOC Statutory Accounts

These unrecognised, uncosted benefits of the public model were lost to the narrower assumptions driving privatisation. The process dissolved the social glue that held the railways together. When the market value of Railtrack plummeted, as costs rose in a flurry of activity to address safety failures, government bowed to the inevitable. In 2001 Railtrack was disbanded and replaced with the publicly owned entity Network Rail. Writing in 2010 Martin points out that while "reducing public subsidy was central to privatisation's rationale, by 2002 the amount of public subsidy received by the privatised companies had reached double the amount received by British Rail at the time of privatisation – and since 2002 it […] doubled again".

A similar point about cost disparities was made by the TUC in comparing the subsidy to Virgin Trains and the UK's east coast line operated by the publicly owned Directly Operated Railways (DOR)[11]. According to the TUC, Virgin received the equivalent of a 3.6p public subsidy per passenger mile, although reporting a pre-tax profit of £41 million, while DOR in comparison was given 0.5p. [12]

We can learn more about public-private transport issues from the case of Metronet Rail's contract to work on the infrastructure of London Underground. Metronet was a public private partnership (PPP) that included the maintenance of trains, tracks, stations, signals and more. In the last year of a 5-year deal running up to 2008 Metronet went into administration. Its failure was estimated to have cost the public purse over £400 million. Reviewing the fate of the Metronet PPP, in 2008 the UK House of Commons Transport Committee came to some damning conclusions:

> *"In terms of borrowing, the Metronet contract did nothing more than secure loans, 95% of which were in any case underwritten by the public purse, at an inflated cost … Metronet's inability to operate efficiently or economically proves that the private sector can fail to deliver on a spectacular scale".*

The lessons to be taken from such a debacle, they concluded, were much broader, and went to the heart of the myths that loom over the choice between public or private sector pathways:

> *"We are inclined to the view that the model itself was flawed and probably inferior to traditional public-sector management. We can be more confident in this conclusion now that the potential for inefficiency and*

failure in the private sector has been so clearly demonstrated. In comparison, whatever the potential inefficiencies of the public sector, proper public scrutiny and the opportunity of meaningful control is likely to provide superior value for money. Crucially, it also offers protection from catastrophic failure. It is worth remembering that when private companies fail to deliver on large public projects they can walk away—the taxpayer is inevitably forced to pick up the pieces".[13]

Healthcare

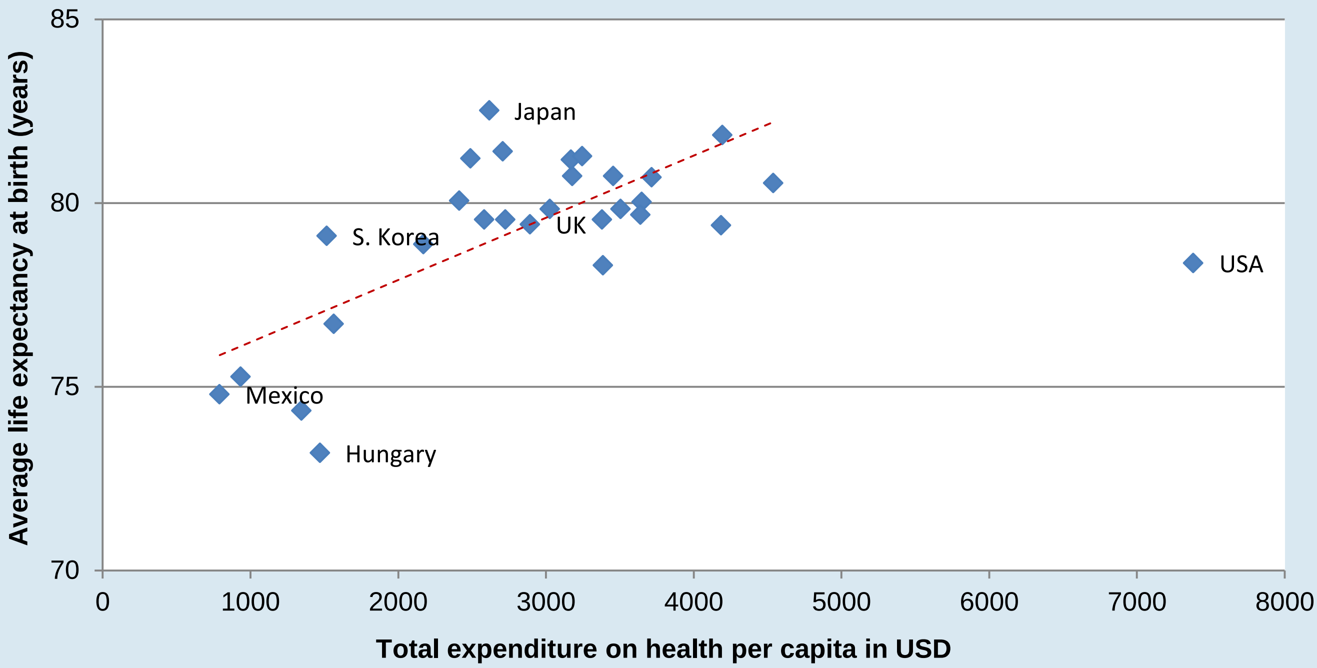
Healthcare is another area in which the line between public and private provision is shifting and blurred, and where politicians, senior civil servants and influential commentators make assumptions about the inherently greater efficiency of private sector operations. The pressure from government to further marketise the NHS through outsourcing, for example, is fairly constant.

Yet international comparisons between heavily privatised health care and countries with more public provision explodes these assumptions. As Figure 2 shows, in 2008, the United States, with predominantly private health care, spent around $7,000 per person on health. The NHS spent around half that sum per person. Yet, judging by outcomes such as life expectancy at birth, the NHS did just as well.[14] The same study that revealed these figures indicated that one reason was the higher cost of private specialist doctors in the US, who were able to charge much more for procedures. Life expectancy in the US is also among the lowest for wealthier OECD countries and lower even than Cuba. Infant mortality in the US is above that found in the Czech Republic, Portugal and Japan. [15]

A classic study compared blood transfusion services in the UK and the US. In the UK blood is donated, and in the US donors are paid. Introducing payment in the US was found to suppress the altruistic motive for donation, and encourage donors to be less honest about their health status. Overall the result was poorer quality blood being donated, raising the costs and health risks of the system – risks that were not even limited to the US, as blood products were exported.[16] In this case the market mechanism literally led to 'bad blood.'`

The impact on the delivery of NHS services of outsourcing to private providers has now been analysed quite broadly. A review of over 30 studies looked at whether the consequences had been positive, inconclusive or negative for the provision of everything ranging from cleaning to facility management, GP's out of hours services,

Figure 2: Healthcare spending per capita vs average life expectancy among OECD countries



Source: OECD Health Statistics

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independent sector treatment centres, clinical services, shared services and IT, and the voluntary and third sectors. Of the studies scrutinized 18 found negative impacts, eleven were inconclusive and four positive. The study concluded that "much of the evidence demonstrates either the negative aspects of introducing competition into the provision of health care services or inconclusive results," and, with some understatment, that, "Overall, there is a lack of evidence to show that outsourcing leads to improved quality of patient care". [17]

The influence of the private sector's need to address the single bottom line, and how this can undermine public interest and purpose comes starkly to light in the delivery of emergency services. The private contractor Serco is employed to provide call centre operations for out-of-hours GP services. In Cornwall, they introduced a cost-saving system that substituted skilled clinicians with call-handlers without medical training who followed on-screen cues to make decisions about ambulance call-outs. This resulted in a reported "fourfold increase in ambulance call-outs".[18] Measures taken by managers to control the number of call-outs resulted in staff turning whistleblower, motivated by concerns that lives were being put at risk, and leaking information that revealed concerns over data falsification and the introduction of potential delays to response times.[19]

Care homes

Problems relate to not just emergency services, the demands of the bottom line also effect long-term care.

Care homes under private management in the UK have faced a deluge of revelations concerning maltreatment and abuse of residents and patients, both of the old and young. Southern Cross Healthcare, a private provider, was the UK's largest care home operator, responsible for the care of over 30,000 people at over 750 care homes. In 2011 its financial model led it to collapse and be purchased by a consortium in which RBS, a bank substantially owned by the state, is a major shareholder.[20] An emergency operation to save residents from becoming destitute had to be mounted by the Department of Health and local authorities. Only the much-maligned public sector had both the motive and the means to prevent catastrophic failure.

And Southern Cross wasn't an isolated example. The sector as a whole was investigated by the FT, which found that many homes were close to bankruptcy and had poor standards of care. Private care homes performed significantly worse on average than publicly run institutions. In most cases the root of failure was in the very economics of the private sector and its approach to debt and equity. [21]

Prisons

The prison and security industry gives yet another example. In the United States, the prison population tripled between 1987 and 2007 to 1.6 million according to the American Civil Liberties Union (ACLU). Laws that reduce the courts' powers of discrimination over sentencing, such as the 'three strikes and you're out' law, led to huge increases in those incarcerated. During that period private companies came to provide for one in every eleven prisoners. "Prisons for profit have a different mission than public prisons: they must earn revenue," commented the ACLU, "this means they have an inherent interest in ensuring prisons stay filled".

A study in Ohio showed that states with higher proportions of private prisons had higher rates of re-offending and that private prisons offered fewer rehabilitation and training courses than publicly owned equivalents. An internal review by the State of Arizona, a leader in adopting private prisons, found that while minimum security prisons were no cheaper when run by the private sector, privately run medium-security prisons were more expensive.[22] According to the monitoring group NH Prison Watch, Arizona's response to discovering this, was not to reduce the proportion of prison services provided by private companies, but to end the requirement for the cost analysis which revealed the higher private costs.[23]

In light of the conflict between market dynamics and the public purpose of detention and rehabilitation of prisoners, the US Presbyterian Church passed a resolution calling for the abolition of prisons run for-profit:

> *"Since the goal of for-profit private prisons is earning a profit for their shareholders, there is a basic and fundamental conflict with the concept of rehabilitation as the ultimate goal of the prison system. We believe that this is a glaring and significant flaw in our justice system and that for-profit private prisons should be abolished".*[24]

In the UK, the private security firm G4S, hit by scandal over its failure to fulfill its contract to provide security staff for the London 2012 Olympics, had its work rescued, in effect, by state security personnel. G4S faced losses of £70 million on the contract but continues to be awarded publicly funded security work. In February 2013 an extension was announced for its contract to run one of seven homes for children on remand or under detention.[25]

Finance

The internal dynamics of several of the examples above unavoidably are driven by the role of private finance. Nowhere was the consequence of this more explicit than in the performance of the Private Finance Initiative (PFI) itself and the public private partnerships (PPP) that they create. The UK pioneered PFI in the early 1990s during John Major's term as Prime Minister as a way to finance public infrastructure without increasing the public sector borrowing requirement (PSBR). It became known as method for financing things 'off balance sheet.' Although criticized at the time by the opposition Labour Party, New Labour under Tony Blair continued and further developed PFIs.

Typically initiatives involve long contracts in which a newly created private sector entity known as a 'special purpose vehicle' finances, builds and operates a facility, while the public sector still essentially underwrites the risk. The public rationale for the PFI (whatever the actual accounting convenience for whichever Chancellor is in office) is that the private sector is more efficient and will provide greater value for money. The PFI has been used extensively in the NHS. Yet experience suggests it frequently proves more expensive than thought, and costs more to the public purse than would direct public investment to deliver projects. The European Services Strategy Unit (ESSU) estimates that for initiatives funded by a PFI "the average increase in estimated cost from the 'outline business case' is 72%".[26] The bail out of PFI schemes that go over budget takes money away from other community services. And, according to ESSU, "the costs of PFI contract negotiation have been estimated to be seven times higher than for traditional tendering". One hospital trust in Bromley Hospitals reportedly spent £3m just on negotiating its PFI.[27]

Table 1. Evaluation of PPP

Factor	Comparison	Evidence indicates
Cost of capital	Debt interest plus dividends	PPP more expensive
Cost of construction	Comparitive costs and completion	PPP more expensive/neutral
Cost of operation	Comparative efficiency	Neutral
Transaction costs	Procurement plus monitoring and management	PPP more expensive
Uncertainty	Incomplete contracts, contingent liabilities, impact on service	PPP riskier

Source: David Hall, PSIRU

David Hall of PSIRU also says that the cost of capital under a PFI scheme is higher for simple reasons such as that "shareholder dividends and company debt cost more than government debt", and much more so in times of crisis when finance providers become more risk averse. He estimates that PFI involves charges of 2 percent extra interest, amounting to an additional £20 billion bill for the public purse up to 2011. As long ago as 2004 the International Monetary Fund observed that, "while there is an extensive literature on this subject, the theory is ambiguous and the empirical evidence is mixed". Water bills, writes Hall, "would be £900 million lower per year if public". In the literature comparing PPPs with more straightforward public provision he finds at best no evidence base for greater efficiency and value from the private sector, and some evidence of the opposite.

Public or private: are they the only way?

This paper does not suggest that the only choice a society has to meet its needs is between the state or private sector. First of all, the public realm embraces far more than central government. It includes a rich mixture of both new and customary, communal ways to care for people and places, celebrate, create, deliver services and get things done. Under the Sustainable Communities Act, for example, a community may get together to chart a desirable new course for local economic development. Places that are openly accessibly and in the public realm might be owned and managed in a great variety of ways. There are circumstances where absolute divisions are not clear.

Then there are other realms that are distinct but related, and which contribute to both the public and private realm, but which can go officially unrecognised, or insufficiently acknowledged considering what they give. The core economy is a term used to describe a large part of the non-monetary economy, this includes much work done in the home, neighbourhood, community and civil society which goes unpaid, but upon which well-being and the resilience and conviviality of society largely depend. This core economy makes society function and civilisation possible but is often undervalued or ignored altogether. Making a thorough appraisal of its contribution is not easy, but the non-profit organization *Redefining Progress*, estimated that value of unpaid housework in the US to equal around one quarter of US GDP. Similar studies for France put the figure much higher, from 48 to 65 percent.

This is much more than an academic exercise. The cost of care has risen to the top of the political agenda, at the same time as there is intense pressure for everyone of working age to be in paid work. Yet, says Edgar Cahn, the originator of Time Banks, "it has long been assumed that 80 percent of the labor that keeps seniors out of nursing homes […] is unpaid labor provided by family and kinfolk". Costed at even a basic rate, the value of that work would vastly outstrip spending on formal care.[28] Voluntary, mutual, cooperative and social enterprise models – that respect, work with, and can strengthen the core economy – all represent important alternatives to either traditional private sector or state provided goods and services.

In conclusion

Private sector dynamism versus public sector inefficiency has been a dominant political narrative of the last few decades. It has supplied the excuse for repeated, one-directional upheaval in many of the services that we rely on, and which are essential to our quality of life. Although more recently lip service has been paid to the idea that the provision of services should be opened up to a greater diversity of providers, including charities, social enterprises and mutuals, in reality it is the large private suppliers – the likes of Serco, Atos and Capita – who are set to replace direct provision by the state.

At best, the evidence from a range of sectors does not support the notion that the for-profit sector delivers greater efficiency or value. Flawed accounting systems fail to measure the human relationships and different motivations of people in public service. As a result, payment and incentive structures built on the logic of the market can actually destroy value, rather than increase efficiency. At worst, some of the examples here demonstrate how that happens in practice, sometimes at the cost of lives as well as money.

The truth can be the opposite of the myth. Public, in its broadest sense, can be cheaper, more effective, productive, better for the economy, human dignity and in tackling a range of social problems. That is not to argue against innovation. On the contrary, innovation is desperately needed to reintroduce the human element to how things are run, and to break the power of the myth of automatic market efficiency.

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