Privatize This?
Assessing the Opportunities and Costs of Privatization

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## Contents

Preface vii
Acknowledgments xi

**Part One  Introduction**

Chapter 1  A Brief History of the Nationalization versus Privatization Debate 3

Chapter 2  Evaluating the Privatization Process: Making Sure the “Game” Is Fair 15

**Part Two  International Examples**

Chapter 3  Privatizing Sin: The 21st-Century Cigarette Industry 31

Chapter 4  Privatize or Nationalize? Argentina’s Privatization of Its Oil Industry 41

Chapter 5  The Never-Ending Cycle of Privatization and Nationalization: Venezuela’s Oil Industry 55

Chapter 6  Public Good or Inefficiency? Port Facilities in the United States and Canada 71
<table>
<thead>
<tr>
<th>Part Three</th>
<th>State-Operated Industries That Were Once Private Enterprises</th>
<th>87</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chapter 7</td>
<td>State-Controlled Liquor Stores I: Pennsylvania</td>
<td>89</td>
</tr>
<tr>
<td>Chapter 8</td>
<td>State-Controlled Liquor Stores II: New Hampshire</td>
<td>109</td>
</tr>
<tr>
<td>Chapter 9</td>
<td>Public Transportation Regional Authorities: Should the Boston, Philadelphia, and New York City Systems Be Privatized?</td>
<td>127</td>
</tr>
<tr>
<td>Part Four</td>
<td>Proposed and Newly Privatized Industries</td>
<td>145</td>
</tr>
<tr>
<td>Chapter 10</td>
<td>The Evolution and Scope of the Privatized Prison Industry</td>
<td>147</td>
</tr>
<tr>
<td>Chapter 11</td>
<td>Privatizing a Lottery: The Case of Illinois</td>
<td>169</td>
</tr>
<tr>
<td>Part Five</td>
<td>Conclusion</td>
<td>189</td>
</tr>
<tr>
<td>Chapter 12</td>
<td>General Motors and the Government Bailout: The Hybrid Privatization</td>
<td>191</td>
</tr>
<tr>
<td>Index</td>
<td></td>
<td>203</td>
</tr>
</tbody>
</table>
Chapter 1

A Brief History of the Nationalization versus Privatization Debate

The landscape of the air travel industry in the United Kingdom (UK) has changed dramatically over the past three decades, and the major changes have nothing to do with recently imposed fees for checked bags, blankets, or bottles of water. Instead, the main shift relates to the transfer of ownership of aviation-related companies from the British government to the private sector. Two of the most prominent examples of this type of change are the divestitures of airline giant British Airways and BAA Limited, self-identified as the “world’s leading airport company”¹ and owner and operator of seven airports in the UK.

British Airways was formed on March 31, 1974, through the merger of the British Overseas Airways Corporation (henceforth identified as “BOAC”) and British European Airways (“BEA”). Both BOAC and BEA were state-owned at the time of the merger, and consequently, the newly formed enterprise was also owned by the British government. In 1979, as the political scene in Britain began to shift when the Conservative Party led by Margaret Thatcher came into power, the business setting experienced significant change as well.

British Airways, however, was not an immediate target for privatization, although it clearly required change. The airline was stuck in a rut of unprofitability, sustaining losses as great as $170 million in 1982.² Therefore, the government needed to prepare for the company’s privatization. As Ellen Pint points out in her 1990 article published in the Journal of Public Policy, “the [British] Government needed to improve [the airline’s] profitability to make it saleable.”³ Consequently, over 20,000 of the 58,000 BA personnel
Chapter 2

Evaluating the Privatization Process: Making Sure the "Game" Is Fair

During the past decade, one of the more interesting developments in the evolution of strategic management literature has been the introduction of game theory. The founders of game theory have won a series of Nobel Prizes in mathematics and economics (John von Neumann, a mathematician; Oskar Morgenstern, an economist; and John Nash of A Beautiful Mind fame). At first glance, however, the introduction of the rather esoteric concepts of game theory would seem to run contrary to strategic management's traditional stress on being useful to "practicing" managers or public policy makers as they decide how to provide a service or product to the general public. Yet the concept of a "game" provides some tools for guiding one's thinking in public policy situations and can provide a broad overview that is extremely useful.

In the strategic management context, game theory has been used to describe how managers need to think about how their competitors will respond to the actions they take. In other words, there is a strategic interdependence among the various participants or stakeholders. In traditional economic theory, each individual makes choices in isolation, unaware of what other competitors are doing. However, in game theory, two or more participants try to maximize their utility, knowing that competitors are aware of what they are doing.

But what makes game theory even more revolutionary in the development of economic theory (and in turn strategic management) is that it takes into account the risk preferences of the various participants. No longer is it assumed that every competitor wants to maximize profits or have perfect
Chapter 3

Privatizing Sin: The 21st-Century Cigarette Industry

Few industries have undergone the rapid change that the cigarette industry has during the past 30 years. The industry has been consolidated to such a degree that there are only four major worldwide players: Philip Morris, British American Tobacco (RJR), Japan Tobacco, and Imperial Tobacco. But this is clearly a very recent phenomenon. Up to the 1980s, the industry was a mixture of private firms such as Philip Morris, RJR, American Tobacco, and British American Tobacco, but the predominant purveyors of cigarettes were nationalized firms such as Tabacalera (Spain) and Seita (France).

Most governments (except the United States and Great Britain) preferred to operate their own cigarette firms and establish a monopoly on cigarette sales within their borders. The production, distribution, and sale of cigarettes were strictly controlled by a government monopoly. These firms produced their own brands and also “licensed” popular U.S cigarette brands such as Marlboro, but in no way were American cigarette makers permitted to control the distribution and pricing of their brands. In fact, American brands sold at a premium price along with a higher ad valorem sales tax. So the domestic brands were cheaper, and the excise tax rate on the domestic brands was lower than on the American brands.

These nationalized cigarette firms were extremely profitable. While the U.S cigarette firms utilized their very substantial cash flows to diversify into other consumer products (for example, Philip Morris bought Miller Beer and General Foods as well as Kraft), part of these cash flows, as well as substantial tax revenues, also went directly into the Treasury. The cigarette
Chapter 4

Privatize or Nationalize?
Argentina’s Privatization of Its Oil Industry

Throughout the past two decades, governments in the developing world (as well as those in developed economies) have used the privatization of state assets as a key tool of economic policy. One of the more unique privatizations took place in 1993, when the president of Argentina, Carlos Saúl Menem, offered a landmark initial public offering (IPO) for the state-owned oil company, Yacimientos Petrolíferos Fiscales (YPF). Since its creation, YPF has always operated on the forefront of the public-private ownership debate in Latin America.

While many countries in Latin America had privatized state-owned industries, such as the telecommunications and airline industries, Argentina was the first to privatize a state oil company. State-owned oil companies in Latin America are different from any other state-owned industry because they provide a nationally controlled link to oil, the key resource for industrialization and competition in the global market. The goal of this chapter is to assess the wider economic and political benefits and the limitations of oil privatization, using YPF as a case study.

BACKGROUND

As discussed in the first chapter, privatization can be defined as any movement toward a market-driven economy or any increase in private ownership and control. Today, elements of privatization and free-market orientation can be seen in almost every economy in the world, from the mixed markets of Europe and the United States to the former communist economies of
Chapter 5

The Never-Ending Cycle of Privatization and Nationalization: Venezuela’s Oil Industry

Even before the Spanish Conquest, the indigenous people of Venezuela knew about the country’s abundant oil supply. They used crude oil that seeped to the surface for medicinal and other practical purposes. It was not until 1913, however, that the Caribbean Petroleum Company drilled the first commercial oil field in Venezuela. Soon after, Royal Dutch Shell and Rockefeller’s Standard Oil became the country’s major producers of oil. By 1929, Venezuela was the world’s second-largest oil producer after the United States, as well as the world’s largest oil exporter. From 1926 to 1947, Venezuela produced more oil than the entire Middle East combined.¹

Venezuela is now a world-class oil producer and holds what could be the largest oil province in the world, the Orinoco Oil Belt. (According to the U.S. Energy Information Administration, estimates of recoverable reserves from the Orinoco Belt range from 100 to 270 billion barrels.) In 2006, Venezuela was the world’s sixth-largest net oil exporter, and oil accounted for more than 75 percent of the country’s export revenues, half of its total government revenues, and about one-third of its total gross domestic product.² The oil industry is of central importance to the Venezuelan economy and has often been used as a foreign policy tool.

Since commercial oil activity began in Venezuela, the industry has experienced “on and off” nationalization. Foreign oil companies controlled almost all of Venezuela’s oil industry until the 1960s, when the government gradually moved toward nationalization. Formal nationalization of the oil industry occurred in 1976 with the creation of the state-owned oil company Petroleos de Venezuela S.A. (PDVSA). Beginning in 1989, however, the
Chapter 6

Public Good or Inefficiency? Port Facilities in the United States and Canada

Throughout history, ports have played a significant role in the exchange of cultures, ideas, and economic factors. In this current era of accelerated globalization, they have become even more important centers of financial activity. The vast majority of international trade, which is essential to the economies of numerous countries, is carried out through maritime transport. Only a small amount of international trade is transported by air. Clearly, trade plays an important role in the growth and prosperity of the economy (see Table 6.1).

In addition to facilitating trade, ports stimulate local businesses and provide jobs for local residents. In the past, ports employed a large amount of labor because they needed people to load and unload cargo from the shipping vessels. The jobs created by ports fostered economic development were a boost for the local town. The development of large cargo containers, however, significantly reduced the need for human labor. In the past couple of decades, ports around the world have become more capital-intensive, resulting in an excess of labor.¹

The prevalent use of containers has also led to an increase in the size of ships, which has created financial and environmental problems for the ports. Since vessel sizes are increasing at a rapid pace, the ports must accommodate by investing in new infrastructure. Furthermore, ports with relatively shallow harbors must dredge the harbor to make it deeper, which is expensive and damages the immediate ecosystem.

Despite the large costs, the port industry is still a profitable business. In fact, Dubai Ports World, a state-owned firm, offered $6.8 billion in 2006
Pennsylvania is one of 18 alcoholic beverage control states, commonly known as "ABC states." In an ABC state, the state government controls the sale and distribution of various alcoholic beverages, depending on state law. In Pennsylvania, wine and liquor are sold through state-owned stores; however, the stores do not sell beer. All wine and liquor in Pennsylvania are sold at a fixed price and quantity. This market power gives Pennsylvania a mandated monopoly over the wine and liquor industry.

Some states have privatized their ABC systems. Pennsylvania has attempted to privatize its system in the past but failed, and another privatization attempt is currently being discussed. Privatizing the system would consist of selling the state-owned entities to private entities and consequently replacing a "control system" with a "licensure system."

In theory, the privatization of a government-run business would disband the monopoly and its inefficiencies. This would drive price down to marginal cost with the establishment of a perfectly competitive market, and it would also maximize economic efficiency through sequential transactions. In addition, states can quickly increase funds through the liquidation of assets with privatization. State treasuries would be compensated from the sale with money to efficiently allocate for state needs.

Major beneficiaries of the privatization would include citizens in favor of decreased alcohol prices and citizens who are compensated from the allocation of increased Treasury funds. Employees of the state liquor system will lose from the privatization, since many will need to find other