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**Working Paper — Digitized Version**

## Privatization and local government reform in Germany: A slow train

Kiel Working Paper, No. 891

**Provided in Cooperation with:**

Kiel Institute for the World Economy – Leibniz Center for Research on Global Economic Challenges

*Suggested Citation:* Schmidt, Klaus-Dieter (1998) : Privatization and local government reform in Germany: A slow train, Kiel Working Paper, No. 891, Kiel Institute of World Economics (IfW), Kiel

This Version is available at:

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# Kieler Arbeitspapiere

# Kiel Working Papers

Kiel Working Paper No. 891

**Privatization and Local Government Reform  
in Germany: A Slow Train**

by  
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The Kiel Institute of World Economics

ISSN 0342 - 0787

Kiel Institute of World Economics  
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Kiel Working Paper No. 891

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November 1998

870032

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## **Abstract**

The paper investigates the recent trends in privatization by local government organizations in Germany. It comes to the conclusion that the privatization policy has been two-directional: on the one hand, municipalities have reduced their economic activities, mainly by different forms of "contracting out"; on the other hand, they have expanded them into profitable fields. In many cases they have preferred a "phantom privatization": government bodies have only been transferred into a private-law establishment. The paper examines the barriers to privatization and provides a strategy to overcome them (H4).

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## I Introduction: Structural Reforms and Economic Performance<sup>1</sup>

Whilst the 1960s and 1970s manifested themselves as the decades of nationalization, the 1980s and 1990s became the decades of privatization. Frustrated with the poor efficiency in the public sector and with rising budget deficits, conservative governments in western democracies started to redefine the role of the state and to roll back its frontier in the economy. Meanwhile, the tide of privatization has reached even the remotest corner of the world.

The world-wide move towards privatization comes from the realization that the economic performance of organizations relates to the manner in which they are organized: i.e., whether they are a public sector organization or a private sector enterprise. Although the task of public and private sector organizations is similar — both provide goods and services to meet everyday needs — they are differently organized and are operating under different conditions. As a general rule, public sector organizations

- are hierarchically and rigidly structured and headed by democratically elected officials whereas private sector organizations prefer flexible and tractable organizational arrangements and are run by managers appointed by the owners of capital;
- work under fixed standards set by legislative bodies whereas private sector organizations work on the basis of flexible contracts;

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<sup>1</sup> An earlier version of this paper was presented on a workshop held from 23–25 September 1998 in Jungeup. The workshop was organized by Center for Local Autonomy, Hanyang University, and the Friedrich Naumann Foundation. I am grateful to the participants for their helpful comments and to Wolfgang Winkler for linguistic improvements.

- operate within narrow geographic boundaries whereas private sector organizations are free to adjust their scale of operations;
- are sheltered from competition whereas private organizations must meet the test of the marketplace;
- are funded from tax revenues and cannot go bankrupt whereas private organizations have to make profits — otherwise they cannot survive.

Accordingly, public and private sector organizations have a different incentive system: incentives in private sector organizations consist of the "carrot" in form of profits for good performance, and the "stick" in form of losses for bad performance. Public sector organizations have neither the "carrot" nor the "stick" [Bennett and Johnson 1981].

From this we have to draw an important conclusion. In the absence of an effective incentive system, efforts to link public sector organizations to efficiency-related goals must fail. Like a chameleon, they can change their colour (e.g., by altering the legal status), but they still remain the same — namely bureaucracies. This point is important: in search for better performance, government organizations in Germany have increasingly re-organized themselves by changing their legal form, in particular by adopting the status of private-law enterprises. However, this formal privatization cannot be the solution to the problem. The only cure is an effective privatization by ownership transfer.

It has often been argued that production in public and in private sector organizations should not be confused since both have to meet different needs: the former ones are supposed to supply so-called public goods which can be consumed only on a collective base by definition. However,

this argument is wrong in almost all cases. There are only a few public goods which must be publicly produced. As Musgrave [1959] stated, "the inapplicability of the exclusion principle refers to the demand, not to the supply of goods and services needed to supply public wants" [43]. There is no convincing argument why government organizations should run powerstations, railways, postal services, banks and housing companies which can usually be run at lower costs by private sector organizations.

The following paper examines the recent trends in privatization in Germany. Its focus is directed on local government organizations which incorporate an enormous potential for privatization. Germany, in contrast to France or Italy, has a tradition of extreme decentralization.<sup>2</sup> This is reflected in its bottom-up profile of government organizations, which has made the States (*Länder*) and the municipalities rather than the central government the largest public employer. Local government organizations in Germany provide most public utilities (water-, gas- and electricity-supply, garbage and sewage collection, local public transport, cultural facilities) and are heavily engaged in health service, education and housing. Thus, they are favourite candidates for privatization.

## II Extent and Forms of Public Sector Production

Germany's much-admired "Soziale Marktwirtschaft" is less market-oriented than is usually thought. It reflects to a great extent the idea (*Leitbild*) of an active state, which was laid down in the philosophical work of German thinkers such as Johann Gottlieb Fichte, Friedrich Hegel and

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<sup>2</sup> Until the Wilhelmine Reich was founded in 1871, Germany had been a nation, but not a state.



Karl Marx. In Prussia, which was the architect in the process of unifying Germany in the 19th century, the government, not the private sector spurred industrialization. At the beginning of World War I, 95 percent of the total railway network was in public ownership whereas in Britain, nationalization of railways started just after World War II. All in all, in Germany governments have played a far more active role in the economy than governments in many other states with a liberal, market-oriented tradition [Stolper 1940; Schmidt and Rose 1985].

Although government organizations in Germany contribute a considerable share to overall production, it is difficult to trace its size and structure. Public sector production takes a variety of organizational forms, which can have the legal status of

- government agencies,
- public-law undertakings without own legal personality (*Regiebetriebe*),
- public-law enterprises legally and financially independent of a government agency (*öffentliche Unternehmen mit eigener Rechtspersönlichkeit*),
- private-law undertakings with the legal status of a joint stock company or of a limited liability company fully or partially in the hands of a government agency (*privatrechtliche Unternehmen mit eigener Rechtspersönlichkeit*).

The principal distinction among these legal categories concerns accountancy, financing, executive management and audit, and the legal status of employees. The crucial problem is that the official statistical

categorization excludes those establishments which take the form of a private-law company.

According to the definition used by the official statistics, public employment in Germany accounted for 6.5 mill. persons in 1997, roughly one fifth of overall employment in Germany (Table 1). Two thirds of them were in government agencies, one third in other public bodies and enterprises with their own commercial accounting. Whereas the function of government agencies is to provide mainly collective (or public) goods (administration, tax collection, defence etc.), the function of others is to provide goods which are either given away to the public or are sold in the market — and which could be produced without difficulties by private sector firms. In an earlier study, Schmidt and Rose [1985] estimated that in 1980 about one quarter of total public sector employment was in private sector organizations. Since then, the share has remarkably increased — not because government organizations have reduced employment but because they have increasingly reorganized the production of goods by turning dependent bodies into independent enterprises under private law.

Table 1 – Public Employees in Germany by Type of Organization 1997  
(1,000)

	Total	of which in ...		
		Government agencies	Legally dependent bodies <sup>a</sup>	Legally independent enterprises
Total	6,545	3,899	815	1,382
of which				
Federal government	1,281	526	102	653
State governments	2,476	2,155	247	74
Local governments	2,005	1,218	465	322
Mixed establishments	182	–	–	182
Others	601	450	–	150

<sup>a</sup>With own commercial accounting.

Source: Federal Statistical Office.

Table 2 – Provision of Goods by Independent Public Funds, Bodies, and Enterprises in Germany 1993 and 1994<sup>a</sup>

	Number of establishments		Gross production (mill. DM)		Profits or losses (mill. DM)		Number of employees (1,000) <sup>b</sup>
	1993	1994	1993	1994	1993	1994	1993
Total	6,596	7,337	360,988	365,911	-24,010	-1,629	2,000
of which:							
Culture	122	131	744	716	-337	-300	115
Sports and recreation	171	195	362	500	-160	-151	45
Housing	670	790	15,696	18,994	-976	1,798	30
Electricity	264	184	55,840	39,553	1,662	271	110
Gas	107	109	10,912	12,991	61	-30	10
Water	1,356	1,410	7,217	7,128	-215	-387	20
Sewage	551	644	4,198	5,529	-33	129	10
Waste	246	266	6,565	7,234	255	218	40
Transport	443	489	42,676	15,290	-1,210	-940	290
Combined transport and energy	94	719	12,978	71,327	-369	141	60
Baths and pools	204	218	1,250	1,433	-190	-147	10
Others	2,368	2,182	202,549	185,296	-22,498	-2,231	1,260
Note:							
Organized by							
Civil law	3,688	4,253	252,849	256,076	-13,679	-982	.
of which:							
100 p.c. public	2,655	3,328	164,316	205,103	-14,679	-2,438	.
Public law	2,908	3,084	108,139	109,835	-10,331	-647	.

<sup>a</sup>Without Hamburg and Bremen. – <sup>b</sup>Own estimation.

Source: Federal Statistical Office.

As a response to the increasing efforts undertaken by government organizations to separate economic from administrative functions, the Federal Statistical Office has started to collect information about economic activities of public funds, establishments and enterprises operating outside government agencies. Figures published recently cover the years 1993 and 1994. Accordingly, gross production accounted for 366 bill. DM and employment for 1.8 mill. persons — roughly 6 p.c. of overall gross production and employment in 1994 (Table 2). High shares in economic activity were registered in electricity, gas and water supply, public transport and others which include banks, hospitals and post and

telephone services.<sup>3</sup> These figures indicate that privatization in government organizations has frequently been implemented in a formal way by altering the legal and organizational form and not necessarily by ownership transfer: from 1993 to 1994 the number of public establishments increased by 11 percent, and the value of gross production by 1 percent.

Although published figures do not allow to separate economic activities by types of administrative bodies, it is well known that local bodies, in particular municipalities, are heavily involved in the following fields of activity: local public transport, electricity, gas and water supply, savings banks, sports and recreation centres, theatres and orchestras, parks and cemeteries, covered car parks and tourist information offices.

According to a representative investigation by Steinheuer [1991] dated from the early 1990s, three out of four municipalities ran e.g. swimming pools, data processing or sewage collection under their own responsibility. Only a negligible minority completely relied on private firms (Table 3). In other fields, such as garbage collection, slaughterhouses or land survey, where private sector firms were commissioned, they frequently established joint ventures. Usually, municipalities want to combine private capital and management skills with public control. All in all, activities with a dominating share of private sector firms are still rare.

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<sup>3</sup> After the split of the Deutsche Post (German Postal Services) into three public-law enterprises, the Telekom was partially privatized in 1997.

Table 3 – Public and Private Production in German Local Government Organizations 1990 (p.c.)

	Completely public	Partially public/private	Completely private
Swimming pools	79.2	14.8	6.0
Data processing	77.8	20.6	1.6
Sewage collection	75.3	22.0	2.7
Music schools	61.3	16.1	22.6
Markets	60.9	25.5	13.6
Parking	59.3	32.8	7.9
Winter weather service	55.8	41.9	2.3
Libraries	54.3	22.4	23.3
Green spaces and parks	51.7	47.1	1.2
Cemeteries	51.6	37.9	10.5
Zoos	37.1	20.0	42.9
Guarding of buildings	36.4	18.2	45.4
Sport grounds	36.0	64.0	–
Cemetery gardening	32.3	18.8	48.9
Road maintenance	23.5	49.8	26.7
Street cleaning	22.1	30.0	47.9
Maintenance of sewage installations	21.2	36.3	42.5
Urban planning	19.5	64.0	16.5
Room cleaning	18.0	74.3	7.7
Slaughterhouses	17.1	–	82.9
Accommodation registry	16.7	55.6	27.7
Exhibitions	15.6	67.9	16.5
Youth clubs	14.3	62.7	23.0
Garbage collection	11.4	9.1	79.5
Kindergartens	10.0	61.5	28.5
Printing	7.7	73.0	19.3
Laundries	5.3	24.3	70.4
Land survey	4.3	27.2	68.5
Window cleaning	2.7	46.6	50.7

Source: Steinheuer [1991].

Consequently, there is still an enormous potential for privatization in local government organizations. German municipalities produce to a large extent goods and services which are principally "marketable". The potential presently contains some profitable activities like energy supply and banking, but also many unprofitable ones like public transport, theatres or swimming-pools. Given the permanent financial constraints, it is

hard to understand why the municipalities have not yet paid more attention to low-cost alternatives.

### **III Strategies of Shifting Production from Public to Private Sector Suppliers**

Initially, Germany was a leader in privatization. However, after a promising start in the 1960s, privatization efforts fizzled out. Now, Germany has become even a lagger in this field. In a retrospective, we can distinguish three periods:

- In the 1960s, the Federal Government started to sell parts of large industrial enterprises in state-ownership like the Volkswagen AG and the Preussag AG. The sale of shares to the public (at favourable prices) aimed at propagating the idea of "people's capitalism" (*Volkskapitalismus*). Note: around the same time, the UK and France started a wave of nationalization in strategic sectors like coal-mining, iron and steel, and railways.
- In the 1970s, under the pressure of rising budget deficits, new privatization initiatives were taken up. However, results were meagre. The Federal and the State governments completely failed to push actions ahead. Only some cities started with contracting out such activities as cleaning, guarding or garbage collecting. At this time, Germany failed to follow the broad privatization movement undertaken in the UK and in other industrialized countries.
- In the 1980s, when the ideas of a "lean government" became popular for political leaders, the debate flourished again. However, privatization efforts were not successful until the early 1990s. With the economy burdened by the enormous costs of German unifica-

tion and state budgets moving deeper into the red, the Federal Government sold almost all of its shares in industrial enterprises. It splitted off the postal services and privatized the Telekom. In addition, it started to privatize the state-owned flight airline carrier Lufthansa. Ready for privatization are now the Postbank and some large specialized banks. Still on the agenda remains the privatization of other postal services (*Deutsche Post*) and of the railways (*Deutsche Bahn*) which were transformed into a joint stock company in 1994, but with the shares still being held by the government.

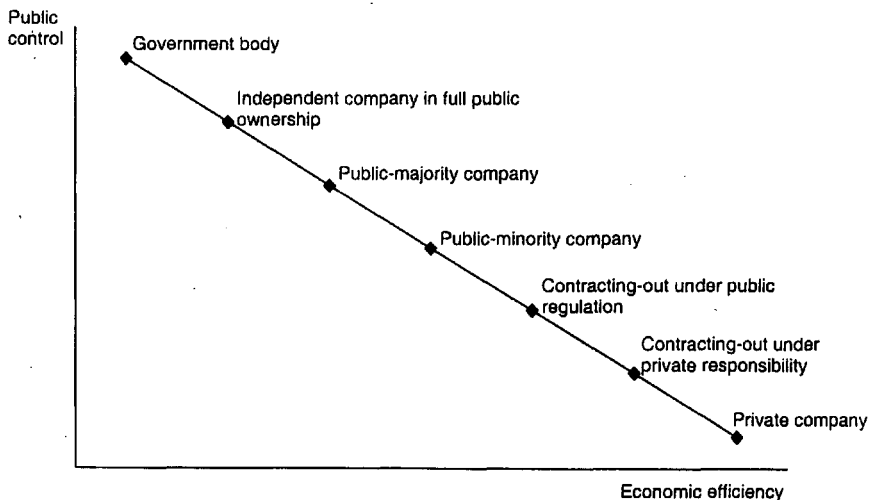
In contrast to the Federal Government's privatization efforts, state governments have remained very passive. They are owners, e.g., of large and influential state banks (*Landesbanken*) and of some insurance companies. They hold, in addition, an important stake in electricity supply companies. The hesitation of state governments to go ahead with privatization can easily be explained: they consider these establishments their long arm in the pursuit of industrial policy goals.

Privatization policies of local government organizations have been two-directional. On the one hand, municipalities have reduced their economic activities, mainly by forms which can be labelled by the umbrella term of "contracting out". On the other hand, they have expanded them into profitable fields such as energy supply or telephone services. Interestingly, deregulation in monopolistic markets has also opened new business opportunities for local government organizations — which they grasped with both hands.

In principle, local government organizations in Germany have the following possibilities of producing services. They can

- operate their own facilities, either in form of a government body (*Regiebetriebe*) or in form of an independent company in public ownership (*Eigenbetriebe*),
- participate in a joint venture with private partners, either as majority or minority shareholders,
- employ private companies by contracting out production either under strict regulation or in the companies' own responsibility.

Figure 1 –Organizational Forms of Production of Services with Respect to Public Control and Economic Efficiency



Finally, they can entrust the production and provision of services completely to the market (Figure 1).



These forms have some advantages and disadvantages with respect to public control and economic efficiency. Therefore, government organizations face a trade-off: in-house production guarantees a maximum of influence. However, it is often economically inefficient. Out-house production, in contrast, is cheaper but is difficult to control. This is why local government organizations increasingly opt for intermediate forms which are called Public-Private-Partnership (PPP).

An example for the popularity of PPP is sewage collection. In Germany, there exist now about 200 projects where public and private organizations form a joint venture. Three organizational forms can be found (Table 4):

- The investor model (*Betreibermodell*): planning, constructing, financing and operating of facilities are completely in the hands of a private sector firm. This firm concludes a long-term contract (usually for 25 years) with a local government agency which includes arrangements such as area of responsibility, user fees, supervision and legal liabilities. Usually, the private firm does not get the control over the sewer-system which remains in public responsibility.
- The co-operation model (*Kooperationsmodell*): the facilities are planned and installed by a local government organization, but operated by a private sector firm which usually holds a minority share in the joint venture.
- The operator model (*Betriebsführungsmodell*): a private sector firm operates the facilities completely or partially. The government organization remains the installations' owner. It is responsible, among others, for planning, construction, maintenance and charges.

Table 4 – Forms of Contracting-out in Sewage Collection in Germany  
(1995)

	Projects	
	Number	Percent
Investor model	37	33
Co-operation model	47	42
Operator model	24	21
Others	3	4

Source: Rudolph [1997].

PPP, however, do not necessarily imply a shift from public to private sector production. Frequently, the "private" partner of a municipality is an enterprise completely or partially in public ownership. One of the largest German PPP-contractors, the Vereinigte Elektrizitätswerke Dortmund, e.g., which is engaged in 60 PPP-projects in public utilities such as electricity and water supply, refuse and sewage collection or telecommunications, is a public sector company: 55 percent of the shares are held by several large municipalities. As a result, there is a tight network of completely publicly controlled relationships in the guise of PPP.

From all that, there are some important lessons to be learnt:

- First, local government reform in Germany has proved to be an extremely difficult task. Effective privatization has proceeded slowly rather than speedily. Some progress has been achieved in public utilities such as refuse and sewage collection, office cleaning and hospital laundry, catering, estate management and urban planning. No progress has been made in other fields such as public transport, energy supply, health care and banking where local government organizations still hold majority stakes. The privatization of prisons, which has been nearly completed in the US, is still unthinkable in Germany.

- Second, local government reform has often only led to a phantom privatization: government bodies have been transformed into private-law establishments whereas the economic environment in which they operate has remained unchanged. In particular, reform has not weakened the monopolistic position of public sector organizations, sometimes it has even strengthened it. An example is public local and regional transport where competition is still restricted by a licence system. Recently, many public transport companies have merged — as it is argued, to optimize supply and to gain from synergies, but in fact to keep down potential outsider competition.
- Third, local government reform has also led to an extension of public economic activities in profitable niches. Some municipalities have founded new enterprises which provide services exclusively for the market — usually in competition with private sector enterprises. Presently, telecommunication appears to be the most promising field for large cities since many of them operate their own net. About 80 municipalities intend to go into this business, a handful (like Net Cologne) are already active.

The question arises: what makes privatization in governmental organizations so difficult? The numerous objective obstacles fall in two categories: ideological and economic ones.

- As a rule, trade unions put up a strong resistance to all forms of privatization. Usually, the target of privatization, better performance at lower costs, can only be achieved by reducing staff, lowering wages and increasing flexibility in working times. All that undermines the

comfortable working conditions of public sector employees.<sup>4</sup> Consequently, it is relatively easy for unions to mobilize employees and organize protest campaigns. Frequently, such campaigns find general support because they are concerned with ordinary people as the ultimate consumer of public services. The standard argument of unions is that privatization would deteriorate the quality of service, raise the costs of provision, and give profit-interested businessmen the control over services. By that, they can often convince the public opinion of the dangers of privatization.

- A further obstacle to privatization is the high degree of nepotism in local government organizations. Executive boards are often filled with "well-deserved" politicians who were elected or appointed with support of trade unions. As a result, bureaucracies can be characterized by paternalistic relationships between leaders and staff.
- Moreover, there are some built-in economic disincentives to privatization.
  - Activities of public-law organizations (including public-law enterprises) are principally tax-free. In particular, these organizations do not pay corporate taxes or value-added taxes. In this respect, they gain a fiscal advantage over private-law enterprises. As a consequence, government organizations have an incen-

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<sup>4</sup> In Germany, the conditions of work in the public sector differ from those in the private sector. In a sense, nearly all public sector employees can be considered to obtain a secure post which is unknown in the private sector. This guarantee was initially meant to prevent political patronage. Now, it has become a bulwark against more efficiency and flexibility. In addition, the gains from public employment rest on relatively high wages — although in recent years, the increase in wages in the private sector has outrun the public sector.

tive to run in-house production rather than out-house production which is, in terms of total costs, much cheaper. If they opt for a private-legal form, they tend to combine profitable and unprofitable production as the best way to avoid taxation. In large municipalities, e.g., public transport and energy supply are often combined in a private-law company in order to compensate losses in some activities with profits in other ones.

- The process of privatization can lead to a taxation when assets are undervalued in the balance sheets. In this case, a government organization has to pay income or corporate tax for profits attained. This can make privatization unattractive for government organizations.

In summary, privatization is far from being appealing to German local government organizations. It is often only considered as a means to cope with financial constraints, not as a lever for fundamental organizational reform. Accordingly, it has not been a success story. To be fair, in recent years, many municipalities have tried much harder than before to bring themselves up to date. They have, in particular, introduced economic accounting, private sector management and competitive tendering methods. But free-marketers who had hoped the 1990s would bring a fundamental shift of emphasis to the private sector cannot be satisfied.

#### **IV Economic Gains from Privatization**

The most important question is: how does privatization affect the costs of providing public services? There are good reasons to suspect that private sector firms operate more efficiently than public sector ones. Two decades ago, Borchering [1977] felt himself encouraged to formulate

the "Bureaucratic Rule Two": he argued that a removal of activities from the private to the public sector would double the costs. Borchherding has found plenty of allies, but also plenty of opponents. Meanwhile, there are numerous books and articles dealing with the costs of public and private sector production.<sup>5</sup> Unfortunately, a large part of "empirical evidence" comes from interest groups and must be classified as highly partisan. Fans of privatization tend to reflect achieved cost reductions whereas critics emphasize factual or apparent quality reductions.

The discussion among serious researchers has been highly controversial, too. The crucial point is: it is difficult to disentangle the effects of privatization from other factors which may influence the results. Pommerrehne [1976], e.g., who compared the costs of public and private garbage collection in Switzerland, isolated topography as a factor which might affect the costs: in the mountains, where public sector provision dominates, costs are much higher than in the lowland plains because of frequent snowfall. On the other hand, it can be argued that most studies are biased in favour of public sector provisions because they seldom include all costs that should be properly charged to the various services [Bennett and Johnson 1981].

A fair evaluation of available empirical studies about the impact of privatization in German local government organizations might result in the following conclusions:

- There seems to be clear evidence that private sector production has been found consistently more efficient than public sector production

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<sup>5</sup> For references to earlier literature see: Borchherding [1977], Bennett [1980], Fraser [1988], Bishop and Kay [1989].

[Gebhard 1989]. This applies not only to costs and prices but also to quality. Some studies come to the conclusion that there do not appear to be any differences between public and private production [Finsinger 1981]. But — and this is important — none of the studies reports that public production is far less costly than private one.

- The advantages of private production vary considerably from area to area. In some areas large-scale cost cuts, in others only incremental savings are reported. Savings up to 50 percent, however, are no exception [Oelert 1976; Hamer 1981].
- Large-scale cost cuts can be achieved in areas open for competition, not in those sheltered from competition. This suggests that not ownership transfer per se but contestable markets are the best solution.<sup>6</sup> There is some evidence that deregulation and liberalization have considerable positive effects not only upon public sector out-house but also in-house production. Needless to say that resistance to competition is high in governmental organizations. Therefore, ownership transfer can be considered as a vehicle to promote deregulation and liberalization.

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<sup>6</sup> This is what most international researchers believe: "Our principal conclusion is that public ownership is not inherently less efficient than private ownership — that the often noted inefficiency of government enterprises stems from the isolation from effective competition rather than from their public ownership per se." [Caves and Christensen 1980].

## **V Concluding Remarks: How to Achieve Progress through Local Government Reforms**

The conclusions appear to be irresistible: seeing that all the evidence proves that people can have provision of services at lower costs and prices as well as at higher quality, local government organizations must be encouraged to go ahead with privatization.

But what can be done to reach this goal? The theory of bureaucracy suggests that a government organization is a budget maximizer [Niskanen 1971]. It hopes to gain by extending not by reducing activities. Only a change of the incentive system can alter its utility function.

The paper, therefore, advocates a double strategy that is based on the concept of "stick" and "carrot". The "stick" is a framework which makes it difficult for government organizations to operate in fields of business. The "carrot" is a reward available to the winners and a compensation available to the losers of privatization which allow the passage of necessary measures.

- The best "stick" would be to prohibit all government organizations to do business as it has been suggested by many economists. This could principally be done by altering the Constitution. Presently, economic activities by government organizations in Germany are allowed if they are justified "by public interest".<sup>7</sup> However, given the fact that bureaucrats are not only opinion leaders but also hold the

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<sup>7</sup> The German legal system contains a variety of special regulations which apparently impede economic activities. In reality, these regulations, which mainly intend to protect government organizations from bankruptcy, are of minor importance. They cannot be considered a vehicle for privatization [Völmicke 1995].



majority of seats in legislative bodies, a change of the Constitution is wishful thinking. It would need an approval by a qualified majority of two thirds of the votes in both chambers of the Parliament. A more promising alternative could be to put national governments under pressure to go ahead with liberalizing regulated markets. In particular in the field of competition policy, the EU commission and the EU Supreme Court have considerable power to make markets more open and, hence, more competitive. The Commission can compel government organizations, e.g., to make public invitations to tender or to refrain from cross-subsidization. It can also prevent governments from discriminating private sector producers against public sector ones with respect to taxation.

- The complement to the "stick" of competition could be the "carrot" of financial reward for employees in government organizations and their heads. A first step could be the introduction of a new performance-oriented wage and salary system. It should also include compensation payable to those employees who lose their jobs through privatization. This appears to be necessary to overcome the resistance of unions. Privatization can be distinguished from other classes of economic reform by the fact that its costs will be borne extensively by a small number of people and its benefits will be spread out over a large number. Public choice theory suggests that in such situations, collective action will be easier to organize against the reform than in favour of it [Bates 1988].<sup>8</sup>

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<sup>8</sup> The main obstacle to the privatization of the German telecommunications sector was overstaffing. It was, therefore, blocked by trade unions for many years. The unions changed their minds when the government offered attractive settlements for redundant workers.

There are, of course, many small steps to privatization as suggested in the literature [Frankfurter Institut 1991, 1993]. For instance, government organizations could generally establish commercial accounting methods. In particular, they could clearly divide administrative from economic activities by a separate budgeting.<sup>9</sup> The control function of the audit offices could be strengthened and extended. Presently, these institutions look like a "knight without a sword". Finally, government organizations could introduce modern organizational and management methods as applied in the private sector economy.

The conclusions that flow from the paper might not appear to be terribly exciting. However, there is an important lesson that can be learnt from experiences gathered in Germany: local government reform is a slow rather than an express train. Radical reform proposals might be liable to decrease its speed rather than increase it.

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<sup>9</sup> This is obligatory for German non-profit organizations with commercial activities.

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