Market Failures vs. Failures of the Market:
Holistic Economics, Political Decision-Making & the Privatization of Liquor Retail Operations

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Preface: Theoretical Structure

Taking efficiency to be the maximization of outputs upon a given set of inputs, this paper establishes how *inefficient* actors in an economy can actually contribute to its *efficiency*. Although the scenario appears a paradox, I will use a case study to demonstrate its occurrence. Particularly, I observe how the transfer of ownership through privatization may increase the *firm's* efficiency, but decrease the *economy's* efficiency. In other words, scenarios exist in which State-Owned Enterprises (SOEs) produce economically efficient outcomes despite having operational inefficiencies relative their privatized counterparts.

My explanation depends upon an understanding of market economies as institutions that are dependent upon political entities. Markets (i.e. networks of decentralized transactions) are institutions with prerequisite costs; moreover, they are unable to internalize these costs unto the specific transactions constituting them. Consequently, markets depend upon centralized authorities to collect revenues through taxation to fund their outlays. Inefficiencies, through the distortions and disincentives of taxation, result in the economy. One implication: instances exist where the firm-level inefficiencies of SOEs are offset by their ability to improve the structural efficiency of the economy, through their contributing profits to the government at a rate less inefficient than raising said revenues by alternative means of taxation.

Consequently, I find limitations to increasing an economy's efficiency through the piecemeal aggregation of firm-level efficiencies; moreover, this finding informs my concluding reflection upon the roles of decentralized and centralized economic decisions. Thus, while ensuring the efficient use of inputs is generally achieved through the market's decentralizing mechanisms, I contend that the economy's efficiency also requires targeted deviation from a strategy of maximizing unit-actor efficiency, so as to centrally plan for its structural inefficiencies.

The Logical Framework

As a placeholder definition, an efficient firm, industry or economy is one that maximizes outputs upon a given set of inputs. Intuitively, making a firm in the economy more efficient should make the economy itself more efficient, for one expects unit-level efficiency gains to transfer to the whole. I wish to contend, counter-intuitively, that the efficiency gains of individual transactions *need not* translate to efficiency gains in the economy at large. Making this argument requires the assembling of many individual pieces, each rather involved. As such, it is worth bearing in mind an overlay of the paper's logic:

1. Establish a paradoxical scenario: barring market failures, increasing the efficiency of a economy's actor need not improve, and might even weaken, an economy's efficiency.
2. Demonstrate an "out" to the paradox of (1), (i.e., prove the scenario's logical plausibility):

However, this requires:

I. Defining the metric of efficiency

And,

II. Selecting a subset of the paradox's occurrences, given the impossibility of proving the entire universe of cases whereby (1) occurs. As such, I only assess instances in which the transfer of ownership, through privatization, increases the *firm's* efficiency but decreases the *economy's* efficiency.

I demonstrate the occurrence of (2.II) by the following sequence of deduction:

i. Markets, i.e. decentralized networks of economic transactions, require certain, costly, institutions to preexist them.
ii. Markets lack the required mechanisms to collect the funds, as per (i), required to ensure their own reification.
iii. In consequence of (i) and (ii), markets are dependent upon centralized authority (i.e. the state apparatus) to extract (that is, tax) required revenues from the economy.
iv. By (iii) markets are reified, but also spawn their own inefficiencies since taxation creates distortions (on the price mechanism) and disincentives (on the profit motive).

Moreover, concerning the SOE,

v. A SOE may, at once, run a profit margin while also being a relatively inefficient firm, in contrast to its privately operated counterpart.
vi. If, by transferring profits to the state (v), the SOE generates revenues at a rate *less inefficient* than by alternative means of taxation (iv), then it may at once be inefficient as a firm, but nonetheless result in a more efficient economy.

Consequently,

3. Presuming one accepts steps (i) through (vi), statement (2.II) holds and, in turn, statement (2) holds in contradiction to (1).

Hence, to recapitulate, there exist some inefficient SOEs (relative their privatized counterparts) that can, nonetheless, be justified on grounds of efficiency. As outline above, the argument proceeds by considering how the market is not costless. Rather it is an institution with costs that come *prior* to its functioning. These costs create a requisite need for a centralized authority to collect revenues, which, in turn, creates inefficiency by distorting economic signals and incentives. This innate inefficiency of markets will be shown to make plausible the scenario by which the organization of the economy must deviate from a strategy of maximizing market actor (unit-level) efficiency if its (structure-level) efficiency, overall, is to be maximized. By circumscribing the extraction of government revenues to economic activities less sensitive (inelastic) to it, funding the market's prerequisite institutions will be of minimized efficiency burden. One must separate the efficiency of firms (i.e. the unit level) from the efficiency of the economy (i.e. the structural level). Thus, the curious paradox of the *efficiency of inefficient SOEs* arises: the need to raise government revenue creates space for SOEs to operate when they prove able to raise profits at a rate of *lesser* inefficiency *relative* to raising said revenues via alternative means of taxation.

I conclude by extrapolating upon my findings to note three matters of broader consequence:

A. It is tenuous to leverage microeconomic findings to influence policy of macroeconomic intention. For instance, if the policy-maker heeds (accurate) microeconomic findings concerning firm-level efficiency, s/he would overreach in privatizing SOEs to build a more efficient economy. More generally, not only do my findings suggest an overstatement of privatization's effectiveness, but also sheds concern unto any economic theory that acts on the premise that a more efficient economy will directly result from aggregating, piecemeal, efficiencies amongst its units.
B. I find the economy must deviate from a strict strategy of maximizing unit actor efficiency. Consequently, these limits of decentralized decision-making necessitate a role for policy vis-à-vis *planned inefficiency*, whereby centralized actors must intentionally ignore incentives to pursue potential efficiency rents so as to circumscribe inefficiencies that would otherwise arise elsewhere in the economy.
C. If the state is to effectively plan inefficiency, then it must be have competency as a 'centralized' decision-maker. However, while the state is expected to fulfill society's need for centralized decision-making, it is not truly a unitary actor. I discuss how the state does not innately have adequate mechanisms to make decisions consistent with collective rationality, when the decentralizing mechanisms of the market fail to do so. This is, rather, a matter of organizational design.

Hence, the paradox I present, i.e. the efficiency of inefficient SOEs, is not merely an academic curiosity, but gives rise to: first, a definition concerning the efficiency roles of centralized and decentralized decision-making in an economy; and, second, questions regarding how state institutions and policy processes can be designed to manage the responsibilities of centralized decision-making.

Section 1: Introduction

At the core of the privatization literature there is a hypothesis: *privatization causes efficiency*. It is at once simple and yet deeply polarizing. It does, however, set the broad agenda for the literature. Even for theorists contesting the clause, the hypothesis nonetheless remains the organizing tenet of their reply. Quantitative findings have provided a mixed bag of inconsistent verifications and refutations, with bold conclusions, nonetheless, drawn by proponents on both sides of the spectrum. Defining privatization as "the deliberate sale by a government of state-owned enterprises (SOEs) or assets to private economic agents" (2005, 3), William Megginson establishes that "the first true lesson of privatization is that [public] ownership of most productive assets must be considered a historical failure, and the policy of privatization has been adopted in order to improve their business performance" (ibid., 38). Letza, Smallman and Sum (henceforth LSS) argue to the contrary: the case for privatization has been built upon myth, whereby private vs. state ownership is but a negligible component of a much broader set of factors that are determinant of a firms efficiency. My evaluation nuances that there exists variables with which ownership interplays and these make the probability of privatization to be a success (or failure) more (or less) likely. Hence, the extent to which ownership matters is dependent upon other variables operating within the environment that the firm inhabits. The goal is to distill some of these environmental effects through a literature review operating at the theoretical level, and then to contrast the contesting theoretical propositions against empirical results from both (1) broad quantitative analyses of datasets compiled on privatized firms and (2) an analysis of the divergent paths taken by the Liquor Control Board of Ontario (LCBO) and the Alberta Liquor Control Board (ALCB). The purpose of reviewing liquor retailing is to illustrate how certain firm-specific aspects of internal organization and industry-specific environmental characteristics interplay with ownership in a formative process that shapes a firm's efficiency.

Sec. 1.1: Layout

With this introductory material representing the first section of this paper, in the second section I consider that, if I am to address the literature's contentions with regards to the 'privatization causes efficiency' hypothesis, then I must first speak to the *standard of success* by which these evaluations are made: *efficiency*. Efficiency to attain what? It is, after all, a vacuous term.

Efficiency requires we define a goal of what is to be efficiently attained. Section 3 will address the theoretical underpinnings of our privatization hypothesis. This will clarify what factors, specifically, differ between the State-Owned Enterprise (SOE) and Private Enterprise (PE). Further, how do these factors bring the SOE and PE to operate at different levels of efficiency? The questions considered are of two fields: (1) microeconomics, i.e. of the manners in which individuals and firms respond to incentives; and (2) institutionalism, i.e. of how political environment interacts differentially between the SOE and PE so as to alter their sets of incentives. The fourth section addresses what I have perceived to be a gap in the literature, which may lead to serious oversights in policy decisions/advice. The section concerns itself with constructing a bridge between the microeconomic to the macroeconomic. I will contend that the whole is substantively different from (indeed, somehow more than) the sum of its parts. Thus, aggregating microeconomic observations does not simply equate to an accurate macroeconomic reading (of how the economy, overall, will perform). Sometimes an individually inefficient SOE might be, given its properties as an individual firm, a good candidate for privatization, however its holistic role as a firm situated in a broader economy may merit its continued public operation. Hence, I will contend separate macroeconomic considerations need be made before embarking on a privatization project. Section 5 will utilize the framework established by the two aforementioned sections (3&4) to consider the efficiency of private vs. public operation of liquor retailing. Political decision making regarding privatization will too be considered. Presumably, one model of liquor retailing is more efficient than the other. However, if this is the case, then why has neither Ontario nor Alberta pursued the other's model, on basis of which is more efficient? Hence, the role of political rationale in privatization decisions will be considered, in conjunction with the economic analysis. Section 6 will conclude by connecting our findings regarding liquor retailing as they are relevant to our earlier theoretical stipulations from Sec. 2, 3 & 4: Was Alberta's privatization model or Ontario's public model the more efficient option?

Sec. 1.2: Thesis

My thesis seeks to make a dual claim, both economic and political: (I) it weaves considerations of the macro- and micro-economic into a coherent whole by which to evaluate privatization practices. I will contend that the intervening variable, which disrupts a simple bridging of the micro- to the macro-, is the necessary presence of taxation. This inefficiency acts against growth in the marketplace due to taxation's distortionary effects. Given this reality I will contend the profits of a representative SOE, pending the microeconomics of how inefficient it is, might reduce the burdens of taxation sufficiently (by subsidizing the tax base) so as to result in an efficient economic outcome overall. However, because the evidence is clear that there is no universal inefficiency common to all SOEs, but rather that efficiency ranges on a spectrum, the microeconomics will prove vital in establishing: (a) which industries are best suited to play a macroeconomic role of SOE revenue subsidization (and which should be subject to privatization); and (b) whether potential exists to improve the efficiency of currently existing SOEs, by amending their incentive structures. I will demonstrate the result of (a) & (b) in Section 3 to depend upon (i) industry potential for competition, (ii) costs of regulation and (iii) the possibility of introducing incentives aligned to the pursuit of social benefits within the firm. Further, (II) I will present empirical evidence that privatization decisions are often based upon political reasoning, which need not take basis in the economics of the outcome. Feasible policy sets will only exist insofar as they establish privatization recommendations that are consistent with political opportunity cost structures. *The general structure of an evaluatory frame for privatization is as follows:*

(i) However much one might be a proponent of 'free markets' there is no such thing as markets which are free. In the contemporary era the state apparatus is funded to provide a series of public outlays that constitute the prerequisites of the marketplace, ranging from defense, policing and the judicial system to enforce private property rights, to infrastructural provisions that are of a 'public good' nature (a collectively rational economic investment which is individually irrational).

(ii) The collection of needed funds is done by way of taxation. Taxation is, however, distortionary, meaning that it reduces economic growth by creating a disincentive to produce.

(iii) There may exist SOEs that, even if less efficient than their privatized counterparts, are able to raise profits. If these profits are used to subsidize the tax base, it is possible they might reduce the burdens of taxation to an extent greater than they burden the economy with their own inefficiency. In such an instance, the micro- and macro-economic readings will contradict each other: the inefficient SOE will produce an efficient outcome in the broader economy, despite its shortcomings as an individual firm.

(iv) Which SOEs operate with greater efficiency than the rate of taxation's inefficiency will be dependent upon its microeconomic performance. This is affected by a host of variables review in Sec. 3 including (i) industry potential for competition, (ii) costs of regulation and (iii) the possibility of introducing incentives aligned to the pursuit of social benefits within the firm. The LCBO will be considered as providing an excellent demonstration of these features, both at the micro and macro levels.

(v) However, jurisdiction over any privatization decision will be shown to lie in the balance of political decision-making. Feasible policy advice will be dependent upon providing its counsel

> from within the frame of political opportunity costs. As liquor retailing will demonstrate, privatization is an act of political, not economic, rationale.

After balancing the trade-offs, I will demonstrate the virtue of operating alcohol retailing by SOE (i.e. Ontario), since (1) at the micro-level the SOE is able to operate with relative efficiency to its PE counterpart (i.e Alberta); and (2) the inefficiencies of public operation are compromised for by the profits they generate which offset the tax base, thus reducing distortionary effects upon the economy as a whole (even if to the cost of efficiency within the liquor industry). However, I will place doubt on the venture's political feasibility in the Albertan context. In sum, by (I) economic principles a nationalization of Alberta liquor retailing could theoretically be justified, however, on basis of (II) political feasibility there is little reason to believe this could be synchronized with the political opportunity cost structure on which the decision depends. With my thesis laid out and the broader project in mind, I will now set out to clarify what I speak of when I make reference to our standard of evaluation: efficiency.

Section 2: What is the efficiency I seek to measure?

The necessary starting point is to ask what efficiency, in the context of this review, refers to. In common parlance it is not uncommon to hear, as in the case of our hypothesis, that privatization causes efficiency. Efficiency however, is a vacuous term: *what* is more efficient as a result of privatization? Is efficiency gained in job creation, economic growth, optimizing resource allocation, etc.? Since the ends of efficiency are exogenously stipulated, one could efficiently attain universal equality via one policy over a host of others, or the same might be said about growth with no concerns of equity. A dog most efficiently comes to feed itself by begging for table scraps as to chasing squirrels; whatever merits the chase might have in its own right. A student finds great efficiency in drinking before supper. My case in point: efficiency is a property of method and of means (and not of ends). Our presuppositions exogenously stipulate what we seek to attain. Efficiency then acts from this point to take 'the path of least resistance,' so to speak; to attain our given ends with the least resources possible. In this sense, efficiency cannot be separated from the political processes which defines its own end goals: only after coming to a collective decision of what we pursue, can we know how we might come to 'efficiently' operate in order to attain the objective. The key takeaway from this overview is that efficiency *does not require* any one set of end goals to compose it, *a priori*. Rather, much like rational choice analysis, we exogenously stipulate a set of goals and then consider whether our methods and means to attain our goals come at a minimal disposal of resources.

Two of the difficulties facing the privatization literature revolve around definitional contentions of efficiency. (1) Often SOEs are presumed to seek the same goals as PE, and thus may be evaluated on a comparative basis. That this is generally the case, however, seems highly dubious. This will be discussed in the ensuing section. (2) The econometrics done on privatization are painfully difficult to find consistency in; each study has a different measure of 'efficiency'. Hence I best immediately establish the measure I will use so as to have a consistent basis on which to comment on the literature:

The standard of efficiency invoked here seeks to follow after Jones' conception whereby we seek to measure the 'public profit' of the firm. The public profit is the difference between its social benefits and social costs, i.e. "the difference in the value to society between what the enterprise takes out of the economy (costs) and what it puts back in (benefits) in any one period" (1991, 189). To neutralize differentials in firm size, I will speak to efficiency as the rate at which a firm converts its inputs into this net result (i.e. [Social Benefits – Social Costs]/[Social Costs], which can otherwise be stated as 'public profits as a percent of total inputs')[1]. I must caution, however, that the measure of social-costs and -benefits is tricky. Given the empirical work one has to work with in the literature, it is best to be cognizant of the various social benefits that may come of SOEs but not PEs, and vice versa, while acknowledging that the best indicators available only measure the difference in private output and private input. This is not ideal, particularly given that SOEs are often brought to the marketplace to address market failures (i.e. where private costs and social benefits, or private benefits and social costs, do not meet in an optimal equilibrium). Nonetheless, the econometrics will provide a basis on which a qualitative commentary might provide corrective approximations, especially through a 'thick' analysis of

[1] By focusing on the maximization of the rate at which a firm converts inputs to public profits, this paper endorses a Pareto style measure, whereby "outcome A is defined as Pareto superior to outcome B if those who are better off under A (the 'winners') can fully compensate those who are better off under B (the 'losers'), and still enjoy net benefits" (Demartino 2000, 46). At the political level one need ask if this suggested redistribution is in fact happening. However, even in the absence of redistributive information, the measure is helpful in being able to assess the consequences of public vs. private ownership to raise the productivity of inputs, which establishes the *potential* for society, ceteris paribus, to have increased wealth which all might share-in.

liquor retailing so as to account for the peculiarities of the industry and to demonstrate the importance of industry-characteristics to nuance our understanding of the 'privatization causes efficiency' hypothesis.

Section 3: The Microeconomics of the Privatization Debate

At the level of the firm, I want to focus on the ways in which two distinct, but interrelated, concepts are active in the privatization hypothesis: motives and the price mechanism. Motives will be assessed first (Sec. 3.1). How do the differences in environment, between SOEs and PEs, alter the motivations of individuals within the firm? We will see arguments to be rooted in the profit motive and how the SOE's closeness to political influence distorts this. Thus, we begin with considerations of incentives. Sec. 3.2 will consider how monitoring can temper incentives with negative consequences. Secondly, we consider the signaling properties of the price mechanism. How does the price mechanism affect the efficiency of SOEs as to PEs? I will take this in three steps, considering non-market pricing (Sec. 3.3), then Soft Budget Constraints (SBCs) (as an illustration of non-market pricing), and finish with a consideration of non-economic motives.

The following sections are organized such that the case for privatization is made first, with a section labeled 'counterpoint' following immediately afterwards, so as to consider the case made by skeptics of privatization on the given topic. This helps order the claims both for and against privatization by the type of argumentation made.

Sec. 3.1(a): Inefficiency Due to Weak/Adverse Incentives

Principle-agent theory (or simply, agency theory) observes that managers (the agents) of both SOEs and PEs are similarly motivated, whereby they seek the "maximization of their own utility rather than that of the organization or its owners (the principal)" (Villalonga 2000, 45). However, their environments are differently designed, leading the same self-interest to come to very different results. The individual in private enterprise, regardless of how self-centered his intentions might be, serves the public good through a personal mission of profit maximization. Competition in the marketplace creates the threat of bankruptcy, takeover and lost market share. Competition, thus, forces one to outperform others in cost reduction and quality improvement. As a result the private entrepreneur serves consumers by serving herself. Thus, the most central mechanism by which privatization offers an efficiency gain is in reducing management "to a single owner whose one overriding objective is to maximize profits" (Kikeri, Nellis & Shirley 1994, 245). Hence, privatization "brings with it private owners who place greater emphasis on profit goals and also carry out new investments that lead to increased output and employment. As a result, efficiency improves and profitability follows" (Boubakri & Cosset 1998, 1102). The profit-maximizing agent is the source of free enterprise's 'dynamic vitality,' whereby "the benefit of any steps taken to increase firms revenues or reduce costs accrue to the company's private owners," thus providing firms with "very strong incentives to maximize profits and to invest in efficiency improvements and new product innovations" (Megginson 2005, 38).

The bureaucrat is argued to lack the necessary incentives to invest him or herself personally into the innovation of methods by which to improve the quality of service offerings or to reduce costs. With the assets being publicly owned, the public manager has relatively weak incentives to make these investments "because this manager is not the owner and hence gets only a fraction of the return" (Shleifer 1998, 137). Rather, according to the public choice theorists, bureaucrats will "basically pursue their own utility rather than the public interest" and as a result will seek "security of careers, better jobs, higher salaries, and the entrenchment of power," (LSS 2004, 163). Thus, contrary to self-interest in PE, utility maximization in the public sector gives "rise to over-expansive budgets and over-supplied public output, which leads to waste, higher costs and thus, inefficiency" (ibid.). Reifying the inefficient results of bureaucratic 'empire building,' SOEs often have legally protected monopolies. As a result they will not lose market share due to issues of low innovation, since consumers are without an option for *exit*. This leaves the allowance that their incentive structures reward being behind the technology curve, unresponsive to clients and overstaffed with overpaid, uninspired, employees (Anthony 2007, 12). Yarrow speaks of privatization as being the tool by which a reduction may be achieved in the political influence acting upon "economic incentives, behavior and performance" (Yarrow 1999, 160). The removal of such influences opens the industry to the discipline of the marketplace and the competitive forces within it: the inefficient are weeded out and incentives are properly aligned with the managers now married to a share in the benefits that arise by improved efficiency (Jones 1991, 180).

Sec. 3.1(b): Counterpoint

Much of the literature that is skeptical of the pro-privatization position still endorses the contention that the profit motive is a dynamic force of innovation, and that rent seeking has the contrary effect to suffocate productive efforts and investment. However, they are suspicious that the profit motive of the PE cannot be *mimicked* in SOEs. That the individual will not be motivated in an SOE is a fair claim, only if an alternative, performance-oriented, incentive structure cannot be provided. LSS (2004) claims this is a question of organizational structure, not of ownership. The potential exists for SOEs to invoke "a signaling system to guide and motivate managers to act in the interests of society as a whole" (184). The SOE can, thus, implement "a signaling system that specifies and rewards socially desirable behavior" (ibid.), a system they refer to as 'performance evaluation'. If the problem, as property rights theorists contend, is merely one of incentives, i.e. that SOEs fail to align employee self-interest with the public's interest, then LSS is quite correct in contending that "Privatization is one way to improve efficiency by linking it to management interests. Performance evaluation is another" (ibid., 204). Given his position, LSS appropriately surmises that:

> Privatized firms are not necessarily efficient. Public sector organizations are not necessarily inefficient. Rather people and the organizations they comprise can be venal, corrupt, greedy or lazy. Dynamic management and robust organizational design are the means of preventing the 'creed of greed' overtaking any type of organization. Ownership has little if anything to do with it (ibid., 177).

Thus, a reasonable contention is made: so long as the SOE's organizational structure is constructed with appropriate incentives, efficiency can be emulated as it is witnessed in the private sector. Privatization proponents, thus, must go a level deeper – they must establish why this is unlikely to be the case, which they in fact do. This comes through contentions regarding monitoring, and why it is difficult to carry out in the public sector. This is the next topic of consideration.

Sec. 3.2(a): Inefficiency Due to Inadequate Monitoring

An inefficient SOE is not sufficiently explained by the bureaucrat's detrimental agenda. Necessary though this might be, one must be able to point to the absence of adequate checks and balances, i.e. a mechanism must exist allowing the bureaucrat to operate against public interests.

If the citizenry could adequately monitor the SOE, then presumably a call for accountability could be made. If monitoring were simple, rewards could be issued to those employees of SOEs who innovate and make productive use of public resources. Those shirking such efforts could be tossed.

Agency theory, however, observes that extensive effort is required to collect information. The costs result in highly distorted information within the public sector, since citizens via the state collectively own SOEs. The disperse ownership results in "no single observer having the appropriate incentives to monitor SOE managers" (Megginson 2005, 39). This allows the bureaucrat's detrimental incentive structure to roam unaccountable. Drawn from the rational choice theory of Mancur Olson, the logic of collective action inherently leaves large groups to face frustrations. (1) The larger the group, the smaller the fraction of total benefit any one individual derives in the instance that the group succeeds; (2) so small become this benefit that it becomes increasingly unlikely any individual will be willing to bear the burden of producing any part of its costs; and (3) increasing groups size creates increasing costs of organization – a hurdle that must be first be cleared such that the collective power of individuals might be realized (Olson 1965, 48). In addition to each of these factors, the individual knows the effects of their efforts will be minor in the total contribution to the success of the group. Further, not only is the action of the citizen paralyzed, but the politician's incentives to discipline SOE management are too. Monitoring, for the politician, requires extensive effort for only marginal improvement in SOE performance, with even more limited electoral recognition[2]. Exaggerating the monitoring disparities, managers have the upper hand of asymmetric information, particularly given the highly technocratic roots required to run many SOEs efficiently. Hence, managers have negotiating advantages, making effective monitoring all the more unlikely.

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[2] The public choice school contends: "that politicians pursue their own utility rather than the public interest. Accordingly, they impose on state-owned firms goals that can lead them to gain votes but can conflict with efficiency. For the general public, who are the ultimate owners of the firm, the costs of monitoring this public sector behavior (e.g. information gathering, lobbying) are likely not to offset the benefits (e.g. less taxes, or more efficient public spending). This is not the case, however, for interest groups such as trade unions, which makes state-owned enterprises an easy target for rent-seeking activity" (Villalonga 2000, 45-6).

In contrast, privatization solves the principal-agent problem, which occurs when "the principal [owners] and the agents [employees] have different interests," and the principals (politicians, executive bureaucrats, citizens, etc.) lack "either the *information* needed to correct excesses or the *incentive* to do so" (Elster 2007, 430-1). This occurs because "the incentive for seeking profits by private owners leads to more effective monitoring of management performance" (LSS 2004, 162). Particularly, monitoring becomes improved since competition offers performance comparisons. This increases *allocative* efficiency through the substantiation of price mechanisms, which reveals true marginal costs and, hence, the opportunity cost to society of producing a given product. Competitive pressures also increase *productive* efficiency (the cost at which production occurs) by providing incentives for innovation and effort. Such mechanisms replace the inherently lumpy political process of monitoring, signaling and enforcement, which must operate by "legislative hearings, lobbying, vote trading, floor amendments, and bargaining" (Wolf 1979, 79). Such political processes are expensive and liable to rent seeking; the act of voting with one's dollars provides is, thus, advantageous.

Sec. 3.2(b): Counterpoint

Two presumptions tend to underlie claims of SOE inefficiency. (1) As laid out in Sec. 3.1(a), management, in being removed from the profit motive, lacks the incentives needed for performance improvement. I will consider this dealt with: there is no reason to presume, *a priori*, that incentive mechanisms cannot be implemented by aligning pay and advancement structures with contribution to the public profit. However, monitoring issues exist, which distort price signals: informational asymmetries will allow the bureaucrat to inflate costs and exaggerate the difficulties of their situation. The privatization skeptics generally agree with the premise that the price mechanism provides both information and incentive. However, they contend that the pro-privatization argument sneaks in a second presumption that (2) SOEs and monopoly circumstance is intimately tied, and privatization will alter this. If this does not occur, then we have no reason to presume that privatization will alter the information asymmetry. The skeptics, thus, contend that the case for private ownership, on basis of monitoring, is more a case for competition. It is not a statement of ownership, but environment.

Hence, the main point presented by privatization skeptics is that the tendency of studying SOEs that are in scenarios of monopoly or regulated duopoly, "cannot address whether public firms will be as efficient as private firms in competitive environments" (Boardman & Vining 1989, 7). Meaningful comparisons become difficult: "It is clearly unreasonable to use profitability measures as evidence of allocative efficiency or inefficiency in contexts where there are natural monopoly characteristics or other serious market failures" (ibid., 9). Here we look to environment, not ownership, as responsible for inefficiency. Yarrow contends, too, that it is largely due to the presence of market failures that SOEs are established to redress the resultant consequences and, as a result, tend to internalize inefficiencies fitted to their circumstance (Yarrow 1999, 35-6). The bureaucrat is no differently selfish, but lacks the competitive model by which his selfishness is channeled towards serving the public good. The question arising in the notion of the inefficient SOE is: to what extent have assessments of *the SOE conflated uncompetitive environment with the nature of a firm's ownership*? If conflation has occurred and SOEs are generally the product of uncompetitive environment (as to being the producer of this environment), then claims of SOE inefficiency are operating upon spurious causation. The nature of the industry (i.e. the presence of natural monopoly), as to the type of ownership (i.e. that of the state), would have to be considered the causal factor.

Sec. 3.3(a): Inefficiency Due to The Distortion of a Substantive Price Mechanism

Proponents of privatization note the market's supremacy in resource allocation since it transmits information on consumer preferences and on production costs, by creating a price mechanism. Government is without such a natural mechanism by which to allocate scarce resources amongst competing users and is, thus, inefficient in collecting, assimilating and acting upon information (Funnell, et. all 2009, 41). Much of the centralized decision-making of the state acts without price mechanisms. For SOEs this serves not only to distort prices within its own industry, but transcends other markets for which it supplies inputs. Inefficiency results in (a) other businesses facing insufficient inputs of critical provisions due to the increased costs of business, when SOEs produce at unnecessarily inflated costs. Alternatively, (b) though the pricing of inputs may remain inexpensive, the inefficiency of SOEs means this can only be achieved by subsidizing the SOE with taxation that burdens all of society. If the government goes so far as to subsidize the price of

SOE goods/services below their optimal production costs, then not only will the needed taxation distort optimality, but the provision will be used to a socially wasteful extent (with its over-consumption being the natural reaction of consumers to the product's artificially low price).

An Illustration: Inefficiency Due to Soft Budget Constraints (SBCs)

Herein lies a caveat of the distorted price mechanism: SOEs are provided with incentives to act inefficiently by being "insulated from the market by subsidies, government protection and guarantees against losses, and assured sales" (Wolf 1979, 76). Whereas private firms would face bankruptcy or hostile takeover, the state is unlikely to allow the SOE to fail. As in the case of SOE utilities, management has power over state officials, whereby a shortage in provisions to the citizens can damage the government's image. Thus, the budget constraints of SOEs are 'soft', because in a pinch the government will provide the needed funding to an SOE. Subsidy extension is, by-and-large, of lesser political cost than that of SOE bankruptcy and/or failures in provision of service. Subsidies are far less visible than lost service provision and the layoffs inherent to restructuring following bankruptcy (Megginson 2005, 40). Thus, governments are largely held hostage to the price tag issued by the SOE, even if inflated. In this manner, SOEs are not only separated from competitive efforts, but are also removed from engaging in efforts of cost recovery.

An Illustration: Inefficiency Due to Government Use of SOEs in Non-Economic Pursuits

Megginson makes explicit that full divestment of government ownership in any industry should be an ultimate goal, for "as long as a government retains ownership, in any important company, there will be both political pressure to intervene in the firm's operations and a convenient mechanism for doing so" (ibid., 392). SOEs are often targeted with charges of inefficiency since they pursue redistributive and legal goals that are tangential to their primary mission as a business. The deviation from making profit, given political masters, means that "SOEs will be inefficient because politicians force them to pursue non-economic objectives, such as maintaining excess employment, building factories in politically (but not economically) desirable locations, and pricing outputs at below market clearing prices" (ibid., 41). In other instances the SOE becomes a tool of redistribution or of patronage, where patronage is "the transfer of wealth to constituents through the use of government-owned assets in exchange for political support" (ibid.). It is all too common and yet "the prevalence of patronage also explains why government provision [of services] is much more widespread than is socially desirable" (Shiefler 1998, 142). These objectives of redistribution, patronage, and political expediency conflict with aims of profit and distort pricing mechanisms. Both of these two factors serve to move the market away from Pareto equilibrium.

Even those with a more benevolent view of the state agree the SOE faces particular difficulties that PEs can avoid. While all firms address issues such as "uncertainty, high costs of information (or its unavailability at any price) and difficulties in allocating the limited time of executives" (Aharoni 1981: 1341), SOEs must also address the issue of their management and task-orientation being pulled from many directions by a wide array of officials, each with their own conceptualization of what is in the public interest. After all, "the state" is neither a person, nor a single coherent organization.

Sec. 3.3(b): Counterpoint:

The SOE clearly may be, and historically has been, abused for purposes of corruption and rent seeking, that much is not in doubt. However, the SOE has also been used as a corrective for market failures in terms of externalities (public works and infrastructure development), imperfect information and risk (state development banks), monopoly (utilities), missing markets (i.e. rural postal services) and as investors in underdeveloped markets (when tasked with investing "in backward regions where private firms are unwilling or unable to absorb the costs" (Vernon 1984, 41-2)). Often they protect social interests in the face of declining industries (i.e. by maintaining excessive employment), or bear excessive costs in high tracking industrialization. In other instances their objectives include matters of fairness, which invoke cross-subsidization and expectations of reasonable prices or redistribution. Hence, the skeptics are right to suggest SOEs pursue non-economic goals, however they are wrong to suggest they are inefficient for it. One may, doubtlessly, charge the legislature's policy (with which the SOE is tasked) as inefficient, wasteful, corrupt, etc., however this has little to do with the SOE. The question of SOE efficiency regards the social benefit they produce with a given level of inputs, in contrast to how well a PE would perform once tasked by a policy to carry out a given political objective. To blame the SOE for the fact that it bares the burden of market failures is not unlike judging the weatherman for the bad whether he predicts, rather then the accuracy with which he predicts it. The case in point: we cannot compare profit margins where lower profits for some firms derive from them providing costly social benefits; i.e. where the cost-structure of the SOE includes expenses in providing non-appropriable benefits to society. Does this give the SOE a free pass? Absolutely not. The preceding 'counter-argument' is placed to illustrate what one cannot blame the SOE for, but it does not suggest the SOE is necessarily, or even generally, efficient. Rather, I will use the following section to consider what arguments must be considered when theories, both for and against privatization, have been weighed out and distilled.

Sec. 3.4: When Will Privatization Work Best?

Now that point and counter-point have been made, what is left after sifting through them? The counter-arguments certainly put a damper on the magnitude and seemingly universal applicability of pro-privatization arguments. However, they damper, not dismiss. Where, then, might we expect to see privatization be effective?

(1) Prices First

Almost cliché, it still stands that it is best to not manage what the price mechanism can take care of on its own. Where competition exists privatization will have a proclivity, but not necessity, to be preferable. This is rooted in the benefits of decentralization. Rather than incur the costs of gathering information to establish a system of performance evaluation for SOEs, allow the price mechanism to play the role of indicator and incentive. So long as market power is absent, even market failures such as externalities may be dealt with by government provision without government being the producer. For example, in provisions such as road construction, municipal landscaping, or refuse collection privatization has had much success (LSS 2004, 168). However, an important nuance is that one should not liquidate their successful SOEs. Especially where competition is been limited (i.e. oliogopic conditions), many municipalities have successfully introduced competition while leaving their SOEs to compete. Many of these municipal SOEs have proved their worth and have served a vital secondary function: cartel formation is prevented by the state preventing information asymmetries from arising between themselves and private contractors. The municipal SOE establishes price ceilings, based on the costs of their own sale prices, in case private contractors are exploiting informational asymmetries.

(2) Regulation or SOEs: A Matter of Asymmetric Information

Often, however, privatization does not mean competition. Regulation of privatized industry may provide a middle ground to nationalization/privatization. If market failures mean the government need ensure the provision of a good through their own funding, this does not mean they need to produce the good, if PE could provide such operations more cheaply. However, one must caution that when an industry is not competitive the corollary concern is the efficiency with which it can be regulated. Since managers have better cost/production possibilities knowledge than owners, regardless of whether ownership is private or public, the incentives s/he faces become very much the same in uncompetitive scenarios. With the equalization of these rent-seeking incentives, the arbitrary extent to which SOEs are simply inefficient (lacking profit motive incentives), may very well still remain optimal over the monopoly pricing at which the PE will supply a good to fulfill profit maximizing goals. Thus the SOE's isolation from the profit motive may hold a public benefit, contra circumstances of competition.

Amidst the privatization literature, "the theory of the rent-seeking bureaucrat is so predominant that it often serves to mask that private interests, just like civil servants, seek rents from private use of public authority" (Miller & Simons 1998, 521). This is particularly the case where the state fosters a dependency upon a private monopoly, and does not have access to effective monitoring processes. Shank contends, there are instances in which "with time, as contractors make the crucial decisions and develop expertise and authority, the government starts working for the contractor instead of the other way around," (Shank 1995, 18). Since modern business rarely operates in fully competitive conditions, many businesses act "just like the worst bureaucrats, [with] many contractors [seeing] the government as a bottomless pit of money and resources" (Shank 1995, 20). As a result the "theoretical gains in efficiency are offset by theoretical profits that shareholders extract from taxpayers-cum-consumers" (Miller & Simons 1998, 523). Hence, inefficiency takes a new form, but is retained regardless of whether government services are contracted out or remain provided by SOEs. In sum, in industries where *the ability to monitor falls into decline* with privatization, the SOE alternative, albeit with tradeoffs of its own, may become the lesser of two inefficient options. Thus, the "welfare effects of privatizing monopolies depend significantly upon how well regulatory problems are overcome" (Vickers and Yarrow 1991, 114). Since privatization of industries with market power requires their being tempered with regulation, one must ask if the efficiency created will be destroyed as regulations give rise to their own distortionary effects. As Alfred Kahn spoke of his experiences as a state regulator, "a plausible case can be made that regulation itself was one of the imperfections we were trying to overcome – that all this furious activity to reform utility rate structures was itself necessitated by regulation" (Kahn 1979, 2). Kahn points out that "the theory of second best tells us that if we want to go from point A to point C, it is not necessarily socially efficient to go part way" (ibid., 5). Similarly we might recognize that, in the pursuit of efficiency, it need not be the more efficient option to move from SOEs (point A) to regulated private monopolies (point B). Although PEs may operate at lower overheads, new distortions (expansive regulatory costs, monopolist pricing, etc.) can come to outweigh the benefits. Privatization becomes a matter, not of absolutes, but of subtle trade-offs.

On the flip side, regulatory processes in some industries are far simpler than designing incentive structures for bureaucrats. An aggregation of industry studies have shown the rather opaque process of electricity provision to be of questionable benefits when privatized, whereby 8 studies have been against, 9 have found no differences systematic difference in SOE vs. PE operation, and 8 have been for privatization. Other industries, with simpler monitoring processes that require less technocratic expertise, such as refuse collection, are better received as candidates for privatization (1 against, 6 indifferent, and 11 for). Other industries, have seen the introduction of competition serve to simplify the regulatory processes. This has been the case in reviews of the airlines industry, which has been reviewed with 0 against, 8 indifferent, and 21 for privatization (LSS 2004, 168). The last two cases represent industries, one by its low costs of contracting and monitoring, the other by way of price mechanisms revealed in competition, which have proven to be of low cost to regulate.

(3) Redressing Market Failure Or SOE Rent Seeking?

Certain environmental and institutional features of an industry will factor into the likelihood of non-market pricing being the product of rent seeking vs. being a corrective for market failures. This will be premised upon the feasibility of effective performance evaluation, whereby the requisite of objectives being clearly stated, agreed upon, and quantified, must be met. Here it is vital to separate false claims of slack in commercial performance from the costs incurred to attain noncommercial objectives. Thus, it has been suggested (and put to practice in France, Israel and Britain), that SOEs operate as a profit-motivated enterprise, unless mandated by government to do otherwise, in which case "a bargain is struck as to the incremental costs incurred in meeting the stated objectives" (Jones 1991, 198). This ensures the SOE's economic goals are separated from its social goals, "by compensating the enterprise for the economic losses incurred in the pursuit of government mandated social objectives" (ibid.). This better records the cost of social policy, allows costs to be better scrutinized by the public, and ensures national interest is determined through accountable processes, rather than in behind-closed-door meetings of partisans and SOE managers. It also forces criteria to be clearly established to guide managers, making objectives less ambiguous.

This practice, though, depends on two overarching criteria for it to be met: (1) the ability to distinguish the cost structures of attaining social benefits, since "If goals cannot be specified, then 'good' performance cannot be distinguished from 'bad,' [and] managers cannot be rewarded on the basis of performance" (LSS 2004, 181). This will be characteristic of certain pursuits and not others. The more convoluted the goals the more it may make sense to privatize and then redress the market failure after the fact by regulation or government revenues/programming. (2) The strength of a countries institutions, in their transparency and accountability, will determine the overarching framework by which privatization might deter rent seeking. Sweden, for example, has established a state holding company of SOEs, the Statsforetag, to serve as a political buffer zone, through which parliament both monitors and negotiates. Thus SOEs in Sweden are a step removed from appropriation by interest groups and have a body to bring coherence to the many interests of the different ministries (Aharoni 1981, 1344).

Sec. 3.5: Concluding Notes

Sec. 3.5.1: A Cautionary Note

When pursuing the privatization question, "in comparing SOEs to privately owned firms, it is difficult, if not impossible, to determine the appropriate set of comparison [criteria] or benchmarks, [since] there are generally fundamental reasons that certain firms are government owned and others are privately owned" (Megginson 2005, 42). Hence, privatization empirics are limited to the extent that "the factors that determine whether the firm is publicly or privately owned likely also have significant effects on performance" (ibid.). Thus, in these manners we must be cognizant of spurious reasoning whereby: economies have (a) natural monopolies which, without the burden of competition, are without incentive to pursue efficiency gains; and (b) issues of asymmetric information paired with market power or externalities, in which optimal efficiency is not always ensured by regulation. The utilization of SOEs becomes dependent upon the expected effectiveness of regulation. This provides government with industries it has a responsibility to operate, which are *endogenously inefficient*, as to the observed inefficiency being a feature endogenous to government ownership.

There are two further difficulties appealed to earlier, in Section 2, which apply when considering empirical evidence: (1) the consistent use of a given measure of efficiency is a rare treat in the literature and (2) to assess the social optimality of the SOE, which requires measuring the rate at which a firm converts inputs into public profits, there is tremendous difficulties in accounting for these figures. Often the numbers are difficult to measure. Even if one could measure such numbers, finding the necessary data will often prove difficult where the social benefits are derived from programming that is informal in its nature – rather than being of public policy. Consider the local utility (be it waste collection, waste water, etc.) that, in not being fully exposed to market competition, uses its profits to run social programs on reducing consumption behaviours. This would not be noticed in anything but the most nuanced case study. The private cost taken on by the SOE, for the purpose of a non-appropriable social benefit will go unrecorded (in fact, if consumption drops as a result, not only would the benefits be non-appropriable, they would in fact hurt the local utility insofar as they would reduce their revenues in provision).

The final difficulty in the empirics on privatization has been the mixed results produced. This has been the case in both firm-specific micro assessments, and also in relatively wide ranging econometric studies with 'larger' sample sizes (ranging from 60 to 300 firms). It seems to be the case that, although a composite number may be construed, it represents a large mix of cases with SOEs that range from being relatively efficient, to SOEs that are grossly inefficient. In an analogous case, we would consider it odd to suggest that Foreign Direct Investment (FDI) should be avoided outright because it adds nothing, on average, to the economy, when this average comes by an offsetting effect of FDI having negative effects in natural resource extraction, but a positive effect in manufacturing. SOEs on an individual basis vary wildly in their efficiency. Thus, one might contrast the 1/5th of SOEs that became less efficient in productivity per employee when privatized, in Megginson's study (1994), and contrast this with the Ferrocarilla Argentinas, a national freight and passenger rail which increased labour productivity by 370% post-privatization. This gives credence to LSS's (2004) observation that there exist many factors, including political, legal, social and cultural issues, which:

> Shape the nature of corporate governance and profoundly affect the survival and long-term growth of firms [and thus the flaw of] orthodox privatization theory is apparent: it is heavily dependent on a single factor – physical ownership (leading to efficiency) – and ignores other important implications in business that are beyond the public–private distinction (169-170).

Sec. 3.5.2: Main Findings

To summarize a framework, to later be used in assessing the LCBO, vital to assessing SOE vs. PE efficiency, we focus upon three firm-level influences on efficiency:

(i) The possibility of bringing a competitive environment to the industry through privatization.
(ii) The costs of regulating PE vs. operating an SOE where monopoly is unavoidable.
(iii) The ability to build a system of incentives into the SOE, based on being able to align rewards with the pursuit of public profits.

Sec. 4: A Macroeconomic Assessment

Sec. 4.1: Introduction

There exists an elusive bridge between micro- and macro-economics. On the surface, the assumptions of a microeconomic approach are satisfying: maximize the efficiency of all the component parts and you will maximize the efficiency of the economy as a whole. However, the holist's long-standing quip gets, ever, in the way: the whole is not simply an aggregation of the parts, but is qualitatively different from (somehow more than) the sum of all its parts. If the aggregation of the parts do not constitute the whole, and if we still, in spite of the complication, wish to attain efficiency, then we might ask: what are the intervening variables preventing this seemingly logical aggregation and how might they be addressed? This question will focus the considerations of this section. This does not mean, however, that macroeconomic concerns of this section are somehow isolated from the microeconomic assessments of Section 3. On the contrary, without an understanding of the microeconomics, the broad framework of macroeconomic considerations is without any substantive content of which firms, specifically, are good candidates for privatization (or nationalization). Any privatization policy must have an integrated perspective of both components.

How do I connect these theoretical concerns with my studies of the SOE? There exist circumstances in which an inefficient SOE (relative its PE counterpart) may contribute to a greater macroeconomic efficiency. This will be postulated as a 'theory of the second best' solution, and thus I will establish in Sec. 4.2 what a theory of the second best is. Since a second best scenario only exists where a precondition necessary for the market to function optimally is absent, I will carry on in the ensuing section to explain what that missing condition is. I will argue this precondition to be the presence of costs required to create and maintain the market, i.e. what the citizen better knows as taxation. I will argue that given the distortion this places on the economy, profits derived by SOEs might offset some of this burden. Although the SOE has inefficiencies of its own, as long as its cost of raising a dollar to put against government revenues is less than the cost of raising that same dollar by taxation, the SOE provides an optimal means by which to attain it. Following the theoretical layout, a presentation of the empirics on the Deadweight Loss (DWL) of taxation and SOEs will ensue. I will review what this means regarding the extent to which SOEs should be utilized in the economy. I will conclude by incorporating this macro-frame with the micro, so as to set up the theoretical analysis which will be used to assess liquor retailing.

Sec. 4.2: The General Theory of the Second Best

How do individually efficient acts of privatization not yield efficient results for the economy as a whole? It is a puzzling idea, but becomes recognizable through Lipset and Lanchaster's 'general theory of the second best'. The general theory of the second best states that when a single condition required for Pareto optimality is not met, pursuing the attainment of the other conditions (needed for an efficient outcome) will no longer necessitate bringing about a more efficient outcome. Lipsey and Lanchaster (1957) explain:

> The attainment of a Paretian optimum requires the simultaneous fulfillment of all the optimal conditions. The general theorem for the second best optimum states that if there is introduced into a general equilibrium system a constraint which prevents the attainment of

> one of the Paretian conditions, the other Paretian conditions, although still attainable, are, in general, no longer desirable (11).

In brief, the theory stipulates that, although an aggregation of efficient micro-economic outcomes might achieve Pareto optimality by one set of circumstances (i.e. given perfect info in transactions, actors with market rationality, absence of externalities, and zero transaction costs), it does not (necessarily) follow that this will be the case given the removal of *one* of these conditions. Thus it is false to state, "that the more of the conditions for optimality that are satisfied, the closer one will get to the optimum (Elster 2007, 439). From a theoretical perspective, the microeconomic interpretation of efficiency-attainment is not wrong, but, if I can show that the parameters it presumes are not fulfilled, then its predictions of market optimality at the level of the firm, need not hold true of the economy.

I will contend, in establishing the SOE to play a role in a second best solution, that markets have inefficiencies inherent to them in the form of the costs they produce, which need to be internalized. Given this, one must consider not only what can be done to achieve efficiency *within* the system of the market, but also must consider how the units within a system have an effect upon the efficiency *of* the system, as a whole. As a manner of shorthand, I will speak of *sectoral efficiency* as distinct from *holistic efficiency*, in the ensuing sections. While the former refers to the optimal output of a *given firm* and/or industry, the latter denotes the status of the country's *economy* as a whole, with respect to its achievement of optimal output. Given the general theory of the second-best, the privatization of profitable SOEs need not necessitate an increased holistic efficiency in spite of increasing sectoral efficiency. Rather one must acknowledge and weigh the trade-off when privatization leads to an increased sectoral efficiency at the cost of removing revenues that would otherwise be applied against the costs of the market (i.e. a greater holistic efficiency). I will now explore what these costs, exactly, are.

Sec. 4.3: Transaction Costs of the Marketplace

In assessing holistic efficiency, one must begin by recognizing that transaction costs exist not only *within* the market, but are also *of* the market. On the former instance of transaction costs existing within the market, Coase observed that:

> In order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection

> needed to make sure that the terms of the contract are being observed and so on (Coase 1966: 15).

The assessment that "these operations are often extremely costly," brought Coase to observe that expenses could be, "sufficiently costly, at any rate, to prevent many transactions that would be carried out in a world in which the pricing system worked without cost" (ibid.). Government intervention often proves necessary to correct for scenarios where the price mechanism cannot create equilibrium (i.e. efficient) outcomes, due to the overriding costs of transaction.

Presupposed by Coase is the existence of a market, which circumscribes his assessment to sectoral efficiency. An assessment of holistic efficiency begins by observing how "a well-functioning market economy presupposes an effective institutional framework to work its wonders" (Ankarloo 2002, 9). The market has costs inherent to its existence, in its requirement that this institutional framework be sustained. Even a minimalist government, with the excesses of government eliminated, must utilize government spending sufficiently such that the establishment of the market's institutional prerequisites (and their continued maintenance) occurs.

What exactly must be created and maintained? Orthodox liberalism takes the stance that "the state should perform three important but circumscribed functions: to provide for national defense, protect members of society from injustice or oppression and provide public works and institutions (i.e. public goods), which private individuals and groups would not provide on their own" (Cohn 2003, 93). Public goods provision, albeit debated over as a matter of extent, includes a range of goods and services which are responsible for "lowering the level of transaction costs [in the market place]" (Gillman 1999, 590). Without this systemic lowering of transaction costs, including the establishing of social mores and contract law, barriers to trade would prevent a functioning marketplace. Thus government takes responsibility for these institutions and, in doing so, acts to internalize their costs upon the state apparatus. In this manner, society as a whole foots the bill to ensure the reproduction of market relations.

Milton Friedman too espouses his perspective on what government should provide, noting the government's role in protecting the individual from foreign coercion; from coercion within society (thus providing military, police forces and courts as mediators of last resort); to provide public works where action is logical for the society as a whole, while not being logical by individual action; and in obliging compensation where there are externalities that cannot be claimed by third parties harmed or where the third party cannot be credited for positive externalities, viably, outside of a framework of law (Friedman 1980, 29-31)[3].

Courts, police, defense, infrastructure, etc. are by no means cheap, and in essence these are the social costs of the marketplace. They are not costs, as Coase focuses upon, specific to exchanges occurring within a given industry, but are *of* the market as a whole: such costs are necessarily presupposed for market exchanges to occur at all. Thus, there are transaction costs relative to individual transactions that occur and then there are 'pre-transaction costs' which must occur before transactions themselves can be said to occur. What is important to note is that the phenomena of the marketplace is itself not free. These costs go beyond the costs incurred by any one transaction. In assessing how to gather the required revenues and then provide the required public goods, Friedman is correct in suggesting that government can *in part* be conceived of as a form of voluntary cooperation, which allows the achieving of goals most effectively solved through cooperation. However, on a cautionary note, while "it is clear that government has powers which might enable it to get some things done at lower cost than could a private organization," one must caution that, and structure analysis, with an account that "the governmental administrative machine is not itself costless. It can, in fact, on occasion be extremely costly." (Coase 1966, 17-8).

Sec. 4.4: Taxation: A Distortion Inherent to the Market

These expenses are afforded through the spending of government revenues. Revenues may be made through many means, though mainstream methods and assessments draw on expenditure as "financed by collecting taxes or running a deficit" (Schipke 2001, 40). The dismay of the neoliberal account towards high government spending is the distortionary taxation that ensues as result of this spending, either immediately or in the long-term financing of the outstanding debts. It is not that spending is a vice in and of itself, but rather that the resulting taxation serves to burden the health of the overall economy with inefficiency, since "national tax systems tend to be

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[3] Some caveats within the public goods perspective include government provisions of market information where there exists incomplete information; in establishing and sustaining stable currencies and infrastructure needed to provide low costs to interregional transportation and communication; establishing guiding rules of banking, insurance systems and credit markets; in addition to setting codes of behaviour so as to establish predictability, legitimacy and confidence in both business transactions and in the operating rules of the marketplace (Tordaro & Smith 2009, 67).

highly distortionary, [whereby] a change in the rate of a particular tax will cause economic behaviour to change" (ibid., 41). Taxes cause the price mechanism to be distorted both as an allocative and motivational tool. It distorts prices, for example, raising marginal costs such that goods are produced at higher prices and lower outputs, which alters supply and demand away from optimal levels. Taxation also coercively removes the product of one's labour from their ownership, creating incentive upon the individual to not exert the maximum of their efforts, given that they will only be returned a part of their rewards, thus creating a disincentive effect by which the health of the economy as a whole is reduced (Gillman 1999, 592).

Thus, since "taxation gives rise to distortions in economic efficiency" (Yarrow 1999, 164), one must contextualize SOE inefficiency to alternative means by which such funds are to be raised. Both the burdens of taxation and the inefficiencies of the SOE must be understood as a part of society's burden in raising government revenue. A tradeoff occurs: the SOEs' inefficiency distorts society from optimal consumption by producing at higher costs, thus making the input more expensive and reducing society's use of it overall. But the SOE's revenue stream subsidizes government revenues, thus serving to reduce the deadweight loss (DWL) of taxation. One must decide, "whether the gain from preventing the harm is greater than the loss which would be suffered elsewhere as a result of stopping the action which produces the harm" (Coase 1966, 27), where we can imagine the harm to be the SOE. While many espouse privatization as good policy, the problem becomes "to devise practical arrangements which will correct defects in one part of the system without causing more serious harm in other parts" (ibid., 34). If the SOE is a defect, is it a preferable one in this imperfectable world?

Sec. 4.5: The Burden of Taxation

Postulated as a conditional, the proposal that a sufficiently efficient SOE will contribute profits at a rate of lesser inefficiency than the burden of taxation is entirely reasonable (even if it does not conforming to our norms of how governments raise revenues). The extent to which we wish to employ the SOE for such purposes is, however, going to be an empirical question. It will depend on (1) how efficient SOEs generally are and (2) on how inefficient the burden of taxation is. Lets start by considering the burden of taxation, whereby the "social cost of financing a marginal dollar of public expenditures is the sum of that dollar, which is diverted from private use, plus the change in the total welfare cost of taxation caused by increasing tax revenue by the dollar" (Stuart 1984, 352). The latter component, the welfare cost, is the DWL of taxation, i.e. what is taken out of the economy as a whole to transfer a dollar from the private to public sector. The DWL is equivalent to "the amount the individual needs to be given to be as well off after the tax as he was before the tax minus the tax revenue raised" (Hausman 1985, 245). Thus, in asking what it costs to raise a dollar of government revenue, we will receive a figure to compare with the cost of raising a dollar of government revenue via the SOE, which is the difference between SOE and PE in the rate at which they convert 'x' units of inputs into a unit of net profit (i.e. see public profit discussion in Sec. 2). The forgone efficiency, in either case, represents the cost to society of raising the dollar of revenue.

While the literature on the relative burden of taxation is rife with its own methodological frustrations and disagreements (which would merit its own paper), approximations have been made with a *degree* of consensus (in terms of a cluster of reasonably close measures). Hausman reviews 4 measures, with a range, of the real cost of raising a dollar in the US via taxation (with the dollar transferred subtracted), from $.260 to $.405, with an average of $.341 between the measures (1998, 42). On a methodological disagreement, Feldstein argues the true cost to be about three times as high, at a $1.06 (Feldstein 1999, 678), once one factors in that:

> The true deadweight losses are substantially greater than these conventional estimates because the traditional framework ignores the effect of higher income tax rates on tax avoidance through changes in the form of compensation (e.g., employer-paid health insurance) and through changes in the patterns of consumption (e.g., owner-occupied housing) (ibid., 674).

Feldstein continues on to explain DWL arises as individuals opt to work less hard (amount of effort, responsibility accepted, etc) and receive non-cash compensation (receiving the corner office, fitness facilities, subsidized corporate day-care, first-class travel, etc). For the purpose of challenging the propositions I put forth (that SOEs offer a viable alternative source of government revenues), we will work with the more conservative figures, which, if anything, reduce the potential role of the SOE in attaining a holistic efficiency.

Sec. 4.6: The (In)efficiency of SOEs

The most important point with regards to the inefficiency of SOEs has already been made: it is difficult to speak of a 'representative SOE', insofar as their efficiency sprawls wildly; from being of similar (and, in ~1/5th of Megginson's [1994] cases, of superior) efficiency, to being terribly inefficient, i.e. consider the earlier example of Argentina's national freight carrier which saw a 370% improvement in sales per employee post-privatization. Thus, clearly there will be many SOEs not worth liquidating given the $.341 cost of a dollar raised through tax revenues. However, divulging on some figures will give an idea of the extent to which this is the case.

Megginson provides intriguing figures. While his indicators suggest a *mean* increase of converting inputs into net profits of 45.2%, post-privatization (Megginson, Nash & Van Randenborgh [MNR] 1994)[4], the *median* is curiously far below the mean, at 31.7%[5], meaning that (given an average indicator of $1 raised by taxation costing $.341) the median $.317 cost of a dollar raised by SOEs justifies the presence of slightly over 50% the firms Megginson tested. MNR's (1994) microeconomic measure would see only 30.8% of firms remaining SOEs. Thus, taking the difference, my macroeconomic measure justifies (in excess of) an additional 20% of the tested SOEs to merit *NOT* being privatized (in spite of the firm itself being less efficient than if it were a PE). This 20% figure represents a major policy limitation of not looking beyond the microeconomics.

Sec. 4.7: Caveat: Funds From Post-Privatization Taxation

Presumably the state, in operating the SOE at an annual rate of profitability 'x', might opt to sell to a firm at a level greater than 'x' (in the form of sales revenue and expected future taxation). If the increased efficiency of the firm as a PE leads to profitability of 'x+y', then it seems the private investor will pay the state an annual rate greater than 'x'. However, we must also assume an opportunity cost on any investment. Where Megginson and D'Souza (1999) find a potential

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[4] Where the net income divided by sales (ROS) indicates the efficiency with which the firm converts inputs into profits and, thus, the cost of producing a dollars profit in a given firm. The change from pre- to post-privatization ROS may be found by dividing the net change in ROS (post-privatization) by the original ROS figure. This indicates the relative efficiency of an SOE in converting inputs into a dollar value added (approximating public profits). In the study a measure of (.0551-.07991)/.0551 resulted in the 45.2% increase in ROS. A latter study by D'Souza and Megginson (1999) found a similar result of 46.5% on the data of (.086-.12)/.086. (1999, 1431).

[5] Found by same method of footnote 2 above, however with median figures such that (.0442-.0611)/.0442 brought a 31.7% increase in ROS. Note that the substantial inefficiency difference between mean and median indicates the wide deviation in SOE efficiency I earlier spoke of.

arbitrage of 4% in efficiency between the SOE and the PE (figures based on f.n.3), the difficulty is that the opportunity cost of investment will generally be above this, given other profitable ventures to invest in. Thus, the PE's profit is 'x+y' = 'x+4', however what they are willing to pay is 'x+4-z' where z is the potential profits to be made elsewhere through an investment. On the relatively efficient end of the spectrum, where there is a *MAXIMUM* difference of 4% in PE ownership over the SOE, the profitability of skimming the efficiency gains is negligible, given other worthy investments.

Thus, since the state is capable of averaging 8.6% profit margins on their own efforts of running the SOE, privatization will require their post-privatization revenues to be higher than this. Say the PE does buy out the SOE, and attains the average efficiency of 12.6%. They, thus, have a 4% margin to split with the state, such that both actors gain by the deal. However, even if the split is set up to benefit the PE as much as possible (i.e. say the final split is 3.9% PE, 8.7% state), the PE is unlikely to capture profits sufficient to cover opportunity cost of investment, given the empirical evidence on SOEs in 'above-average' standing (i.e. profit margins of 8.6% or less). This proves increasingly relevant once one accounts for risk and the political reality of many developing countries in which privatization movements have been followed by social turmoil intervening in firm operations. However, on the inefficient half of the spectrum, especially as we consider horribly run SOEs at the tail end of the spectrum, the probability for both state and PE to make greater funds post-privatization through efficiency rents is likely large.

Sec. 4.8: Concluding: The Interrelation of the Micro- and Macro-Assessments

The case presented is not an attack on the firm-level privatization perspective, but rather an outlining of where it comes to its limits in determining the extent to which privatization should take place. However, the frame I set is entangled in the microeconomic realities of the firm. The macro- is entirely intertwined with the empirical realities existing at the firm level. (1) If the SOE, as LSS suggests, may see future efficiency gains via the incorporation of incentive mechanisms by performance evaluation, then this dynamic gain will lead to an encroachment by the SOE on the share of revenue efficiently raised via taxation. Further, it must be considered that some countries may have comparative advantages in relatively SOE friendly environments, whereas others will not. Ultimately, it is factors that play out in determining the firm's efficiency that determine the extent to which the SOE can efficiently contribute to government revenues. (2) While I established the DWL of taxation in the US as a standard, the relative efficiency of various forms of taxation in a given country will differ on basis of a country's endowments. A national character of work ethic would, hypothetically, mean a country could tax higher without the same disincentive effects upon its peoples, contrary to a country where people are only willing to work as hard as the dollar they are paid. Many other factors may have such effects, including resource endowments and the country's level of prosperity, which alters the revenues that may be most efficiently generated by taxation.

I wish to contend, in concluding, is that the SOEs involvement will depend on very specific factors, there is no single level at which the SOE is to be involved. Rather, this will depend very specifically on the relative costs of raising revenues via the SOE, relative costs of taxation, which will vary on basis of a country's endowments (i.e. some countries may have many industries conducive to SOE participation, others not) and the optimal level of government spending. Such factors will determine the extent to which the SOE has a role in raising revenues. The following section will merge this macro-analysis with a micro-analysis in order to understand the dynamics of public vs. private liquor retailing in Alberta and Ontario.

Sec. 5: Liquor Retailing in Ontario and Alberta

When generalizations such as 'governments should pursue privatization' are derived from sweeping quantitative studies, we ignore the importance of nuance. The difficulty exists even when we presume laboratory style control of variables in our quantitative studies; i.e. including the isolation of the proclivity of SOEs to operate in uncompetitive industries (environmental effects), profit margins drained on pursuit of positive social externalities (miss-measurement), the endogeniety of privatizing the best SOE candidates first (spuriousness), etc. Why would difficulties still remain? Because the focus of the generalization misses the more pertinent question: why do some public enterprises, even if merely a select minority, nonetheless remain more efficient than their private counterparts? Even according to the results of those studies most supportive of privatization, such as Megginson (1994), we receive results suggesting a fifth of SOEs remained more efficient than their private counterparts, post-privatization. Why the disparity across SOEs? Should unsuccessful SOEs pursue privatization or simply seek to emulate successful SOEs?

This section builds a 'thick' analysis of provincial liquor retail operations so as to avoid the aforementioned difficulties of relying on 'thin' conceptions of the firm. The choice to study liquor retailing in Alberta and Ontario provides two particular benefits for an experimental design seeking to test the 'privatization causes efficiency' hypothesis:

First, both the Albertan and Ontarian governments hit a critical juncture in the 1990s when they redefined the goals of their publically operated liquor retailing. The new goals they established were the same, which provides us with a meaningful baseline for comparison. Had the two provinces sought to meet different objectives, it would be very difficult to meaningfully say who more efficiently attained their objectives. Complementing this, the two provinces pursued different methods to attain these goals. Thus, we are enabled in asking: did the privatization model of Alberta or the public monopoly model of Ontario more efficiently attain their government's goals? Their shared goals are as follows: (i) shift retail operations from controlling consumption to encouraging responsible consumption (i.e. avoid sales which would lead to drunk driving, alcoholism, fetal alcohol syndrome, selling to minors, etc.); and (ii) maximize crown revenues by maintaining output (alcohol sales) while reducing the required inputs (through streamlining the administrative and operating costs of retail operations). Hence, savings were sought in the expenses of transferring alcohol from supplier to warehouse, warehouse to storefront, and storefront to consumer; this would raise profits without offloading the burden onto consumers through higher prices.

Secondly, our Ontario-Alberta contrast serves to control for a wide range of variables given many commonalities across the two provinces. The fewer the independent variables that need be considered the more feasible our study will be. By maintaining a study which looks to the liquor retailing operations of provincial crown corporations, we isolate certain effects that would vary in other industries and in cross-country studies: (i) cultural effects of corruption, leisure, etc.; (ii) product differentiation within an industry; (iii) interaction of the firm with the state; and (iv) levels of human capital and infrastructure available to the firm. Consider the example of comparing the PE and SOE in the petroleum industry, whereby the costs of inefficiency could not be separated from the costs incurred due to being differentially implicated by the variables listed:

(i) Political culture: the costs incurred by Venezuela's, state owned, PDVSA to payout the costs of cronyism in contrast to the minimal burden faced by Albertan and Norwegian firms.

(ii) Product differentiation: Whereas the PDVASA drills offshore for heavy oil, the private operators in Iraq draw on light crude from land wells. Costs of processing differ exponentially.

(iii) Interaction of state and firm: In Iran the state petroleum company is under political ultimatum to operate on whatever margins it can from selling 10-cent a liter gasoline to the Iranian population. This is a political inefficiency, not a corporate one. However, it burdens their corporate efficiency by under-capitalizing them. In contrast Norway does not subsidize civilian use of gasoline and corporations do not need to build this into their cost structure.

(iv) Human capital and infrastructure availability: The PDVSA has internalized the costs of making these goods available. Canadian companies draw from both state-funded universities and infrastructure networks.

How does the study of the liquor retailing in Alberta and Ontario control for these variables?

(i) Political culture: Drinking culture is constant across the two provinces, as measured by equal per capita expenditure at $721 (AB) and $722 (ONT), in addition to both provinces following the same trends in individual-level expenditure. Thus, they face the same market potential. Further, in terms of corruption, there is no reason to expect a difference in policing corruption or political corruption across provinces. At least, nothing of the sort has been reported indicating the differences to be substantial.

(ii) Product differentiation: The same products are available to both provinces, creating the same basis of product differentiation for the private Albertan and public Ontarian models.

(iii) Interaction of state and firm: Both industries share the same business-state relations with the Canadian government. Provincial laws differ minimally, particularly in contrast to the differentiation seen in cross-country studies.

(iv) Human capital and infrastructure availability: Standards across Canada are approximately the same, with no expectations placed on either Albertan or Ontarian operations to provide funding for public goods.

Having established why provincial liquor retailing lends itself nicely to assessing the privatization hypothesis, I will briefly layout the framework of the coming section. First we will consider the history of the state as an alcohol retailer: why was the state implicated in the first place? Then we will consider the history of Alberta and Ontario's control boards, in respective order. Next, the divergent paths taken in the 1990s will be assessed. After this, the economics of the industry will be considered to determine which of the divergent paths came to be the more efficient outcome. I will conclude upon the three major findings of this section: (1) interestingly, there is an absence of economic motive in the decisions made by both provinces. Given the broad similarities across both provinces, the efficiency with which an alcohol-retailing model operates in one province should be very similar for the other. Hence, if the models turn out to be of differing efficiency, then the divergent paths taken must not be the product of economic reasoning (since the more efficient model would have been adopted by the province currently not using it). Rather, the historical peculiarities between both provinces lead to a political rational of divergent retailing outcomes. (2) While some analysts have drawn the conclusion that Ontario would benefit to follow Alberta's model (Hrab 2003, 68), others have drawn the opposite conclusion (Flanagan 2003). However, both parties fail to appraise the existing tradeoffs of the two models. Efficiency is not defined strictly by greater consumer accessibility and lower consumer transaction costs (claimed by the pro-privatization model), nor is it determined by the lower cost structures of public monopolies (the pro-LCBO model). Efficiency, as a concept of *utility,* requires a cost-benefit analysis of these two components: are the additional cost structures of privatizing the industry compensated for by the increase in accessibility? What one can determine is a dollar amount of what Albertans pay for their improved access. The welfare implications of this are near impossible to establish. (3) Lastly I will comment on efficiency as growth: forget about the industry, what are the total economic effects of liquor retailing privatization? I will make an assessment using a holistic framework, which considers the, generally ignored, macroeconomic effects of privatization.

Sec. 5.1: History of State Liquor Control

Both Alberta and Ontario have a similar history and rationale regarding the inception of their liquor control boards. Initial prohibition by both provinces in 1916 represented a political decision to sanction drinking, whereby the potential economic effects were deemed worthy in order to address the temperance movement's perceptions of a morality issue. Both provinces saw effects that were near universal to prohibition: those feeling too distanced from inebriation and willing to pay a slightly higher black market price, found their alcohol through illicit means. This resulted in large revenue flows towards organized crime. The use of liquor control boards became a compromise between pragmatic politics and the temperance movement. The ALCB was established in 1924 and the LCBO in 1927 to replace legislation prohibiting the sale of alcohol. Their objective was to control consumption, with a side-goal of raising revenues. Their importance as state organizations quickly solidified. State monopoly over alcohol distribution could be used to temper consumption, while undercutting the criminal tendencies of prohibition. Though perhaps not borne of intentional design, alcohol soon presented itself as a cash cow to the state. In contrast to prohibition times, government benefitted threefold: (1) the funding of organized crime through alcohol sales was undercut; (2) enforcement expenditures could be relaxed; and (3) with ownership of a state monopoly on distribution, the government claimed exclusive rights to the profits of a multi-billion dollar industry (in current dollars). The dividends of ownership are substantial, providing revenues through an 'invisible taxation': "What could be more valuable to a government than a revenue stream that most people don't know they are contributing to?" (Bird 2012: 10). However, the revenues, while solidifying the place of liquor control boards in the state apparatus, were considered a convenient byproduct to the broader goal of controlling consumption (Bird 2010: 5). The goals of liquor control provide an important historical consideration: efficiency comparisons are essentially impossible where goals shift dramatically, say, from alcohol 'control' to profit maximization. One cannot compare these measures. This point is particularity important since the privatization literature employs a form of shorthand where efficiency refers specifically to profit margins on operating costs. This is begging the definition, however. We measure efficiency by looking to the resources used to come to a given goal, if the goal is to control sales, then we do not define efficiency by the maximization of profit margins, whereby profit motives run contrary to the needed ethic for the 'efficient' attainment of control. Conveniently for this study, however, a historical juncture took place in the 1990s as both provinces sought to overhaul their mission statements with regard to liquor retailing. Profit maximization, in the context of promoting responsible drinking, became both provinces' stated goals, in contrast to the use of retail outlets as a point of 'control'. Had only one province made this redefinition, comparison of the different methods employed by these provinces would not provide telling results. With the governments of both provinces reorienting the mandates of their liquor retailing operations, they also took divergent paths to attain their new (shared) goals, allowing us to compare their choice methods.

It should be noted their parallel timing in coming to critical juncture was not merely coincidental. New Policy Management (NPM) represented a historical trend in governance through the 1980s and 1990s. It represented a movement towards adopting alternative methods of governmental operation for the sake of efficiency. Corporatization (adopted by the LCBO) and privatization (adopted by the ALCB) are two amongst these methods. Alberta's model followed on precedents from the federal government, where "privatizations reduced the number of federally owned or controlled Crown corporations from 56 to 47 between 1985 and 1997. Over the same period, the number of employees in federal Crown corporations was reduced from 186,442 to 75,074" (Hrab 2003, 4). The path taken by Ontario was similarly a practice of the times; commercialization was popularized in the 1990s particularly with the objective "to apply business-like approaches and to allow market forces, incentives and mechanisms to affect the delivery of government services" (Padova 2005, 1).

We will now consider these divergent paths, considering Ontario and then Alberta respectively. What is important to consider is that the separate histories of both provinces established a network of payoffs that political actors where enmeshed in. The environment of the provinces, in differing, altered outcomes. As Bird (2012) expresses: "Governments do not face "blank" policy fields where they can impose their will according to some sort of ideological ideals, but rather face ones that are full of entrenched powerful interests and institutions that are used to certain consistencies; altering such conditions is difficult, often impossible" (11). Thus, our considerations are two-fold: what were the ideological proclivities of the political actors with the power to pose policy influence and did they find institutional harmony or constraint when placed in a position to push their policy?

Sec. 5.2: Ontario's Continued Public Ownership

Ontario, while retaining a public model of liquor retailing, underwent a rejuvenation effort in 1995 under the Harris government. In the previous election the Conservative government had issued promises to privatize liquor retailing. However, even as holders of a majority government, the political opportunity costs of privatization proved to offer little potential gains, whereas the potential costs represented a minefield. Nonetheless, a shared consensus existed amongst the governing Conservatives of Harris and the Opposition of Rae that a massive modernization was in need. They were collectively "embarrassed at the condition of the LCBO as a retailer," which stood as a symbol of the archetypical "ailing public asset" (Bird 2010, 4). The negative review should not have been unexpected: the LCBO's 600 stores had access to capitalization funds of $7.7 million in 1986, which proved 'anemic' in contrast to Alberta's $13 million for one-third the number of stores. Low resources meant poor employee training, a dull customer experience and a minimalist store network. What were the specific political costs that prevented a move to privatization? Further, after opting for a modernization effort, what were the results? These questions will be considered in turn.

Twenty-five years ago, privatization was proposed and yet "successive Ontario governments, but especially the Conservative government of Mike Harris [despite their initial position], which governed from 1995 to 2003, did not alter the liquor distribution market because such a decision would require significant political effort, while resulting in relatively marginal gains" (ibid., 4). Consider the influence of factors including (i) party politics, (ii) political culture and (iii) interest groups.

(i) At the party level, opposition from Rae would have placed negative outcomes of privatization on the incumbent government. Politically, this made it a difficult gamble to justify.

(ii) In Ontario's political culture, popular consensus took the LCBO to be a 'non-issue'. The opportunity to lose votes was large, while the possible gain from privatization in future elections was forecasted to be negligible. Hence, the most obvious surface explanation is such that "No government would waste energy resolving a problem most Ontario residents 'didn't know they had' with their liquor distribution system" (Bird 2012, 11).

(iii) Interest groups also fostered support for the government-owned regime. Liquor suppliers were persistent supporters: dealing through the LCBO "reduced administrative, marketing, labour, and transaction costs" since stores were directed through a centralized system (Lacobucci & Trebilcock [Henceforth LT] 2012, 25). Operating in a decentralized private system would increase supplier costs since the negotiation and administering of one very large contract would become the negotiation and administering of thousands of very small contracts with thousands of independent liquor storeowners. The public monopoly of the LCBO benefited suppliers, since "marketing, administration and distribution expenses are reduced considerably when interacting with one large operator that has consistent province-wide policies and operational systems" (Bird 2010, 8). Sales reps did not have to be hired to visit hundreds of stores to encourage individual owners to

> provide shelf-space and neither did hundreds of separate contracts need be managed. Worse yet, while small businesses come and go, government cheques never bounce (granted, Greece may put that to the test). Further, regional development initiatives of the government, fostered through LCBO programming, made the state distributor a hit with provincial producers and wineries, who enjoyed privileged rates and the provision of in-store promotions, which included “a high level of product selection, a relatively large amount of shelf-space given their small market share, and annual promotions” (LT 2012, 25). Lastly, the state liquor board produces ‘monopoly rents’ allowing it to pay high wages. Union strength was strong within the LCBO. Retail staff stood to lose a lot with privatization, since the competitive salary for cashiers on the market was a fraction what they were earning: today wages of liquor store staff in Alberta are approximately half that of Ontario. In sum, the structure of state monopoly meant rents had produced widespread vested interests where, “none wanted to see any changes to their lucrative (and closed) rights” (ibid., 27).

With privatization prevented, what have the outcomes of modernization been? Although some reviewers still claim privatization would be the Ontario government’s most efficient option (LT 2012, 27), the government’s corporatization move to modernize the LCBO has been taken by some reviewers as an unqualified success: “once a decrepit and inefficient retailer, it is now regarded as a leader in its field” (Bird 2010: 1). The redirection was enabled by an initial push from the Premier’s Office, which replaced the board of directors after headhunting for individuals who had retail expertise from private enterprise. New rules were legislated: “there was to be no more political interference in the day-to-day operations of the LCBO” (Bird 2010, 6). This is not to say the province was removed from the aspect of social objectives in the liquor industry, but that they would only be “free to set overall direction for the liquor retailer, but could not use it to meet short-term political or partisan goals” (ibid.). Hence, obstacles were set to prevent political intervention in LCBO human resources (contra a tradition of patronage appointments, resulting in non-meritocracy and overstaffing), nor in directing the lease and purchase of property. Managing from an arms length, in setting a broad agenda, the government sought the LCBO to increase its remittances to the government, without increasing the prices or volume in alcohol sales (setting a broad direction to reduce the social ills of drinking). The LCBO responded through marketing tactics, including appealing to wealthier clients, females and health conscious clients, with the result of convincing “individuals to purchase higher-value alcoholic products” (ibid., 7). As Bird explains:

> People quite like shopping at its stores and very few of them realize how much of the price of alcohol is actually a sin tax, collected in a variety of ways, on their indulgence. Even fewer appreciate how their preferences for higher-value products have been partly shaped by the LCBO's slick marketing efforts, nice stores, helpful staff and the like, which are there to convince them to purchase products that they otherwise might not buy (ibid., 8).

To accomplish this marketing feat of 'up selling', the Harris Tories increased allowance on capital spending to $52.5 million annually since 1999, lifting the 'anemic' capitalization of the business, so as to revamp the LCBO retailing experience. The dividends of this investment are said to have paid off, with the LCBO representing a war chest of $1.41b in profits on sales of $4.34b in the 2009/10 fiscal year, having expanded profit margins every year since 1995. In sum, corporatization succeeded by refocusing LCBO objectives upon a:

> Narrower task domain (it no longer was responsible for liquor regulation); increased use of performance measures; increased power of the CEO, as well as greater discretion of the senior management to control budgets and employees). . . a formal ending of political interference into day-to-day business decisions; increased allotments of capital, which are needed to improve the physical and human infrastructure (Ibid.,13).

Sec. 5.3: Alberta and the Path to Privatization

Amongst all Canadian provinces, only Alberta has pursued privatization of liquor retailing. In 1993 the Klein government rapidly moved to privatize retail operations of the ALCB. Within a mere six months the transfer of retailing ownership had been completed. The privatization of the liquor-retailing arm of the government, responsible for $718 million of sales in 1993, "was announced on September 2, 1993, and was completed on March 5, 1994" (West 2005, 4). The government paid out $17 million to 1800 laid off ALCB-union employees and all ALCB retail properties were sold in a two-year time frame for an approximate $51.2 million. The outcome, divergent from that witnessed in Ontario, is considered the product of many influencing factors on political reasoning, considered in following order: (i) party politics, (ii) political culture and (iii) interest groups.

(i) The conservative party was committed to being implicated with the results of privatization, which stood as a tangible symbol of small government. Further, opposition parties expressed less discontent than witnessed in Ontario; their agenda challenged the government on matters of process and implementation, but accepted the overarching goal to privatize the industry. The political affluence of the Conservative party in Alberta likely brought the Opposition of the Liberals to pursue concessions, rather than futilely challenging the project outright.

(ii) The general political culture likely pushed party-platforms to the right. Populist electoral rhetoric was seen to have taken a turn to the right as the Klein platform operated upon a “popularized (and some might argue a mythologized) view of Alberta, its history and its political culture as a place of conservative ideals, including reverence for the importance of independent businesses and correspondingly smaller role for the state” (Bird 2012, 8). The liquidation of ALCB retail operations was, indeed, a manner in which the Conservative government could tap into ‘political capital’. Albertans viewed the recent recessionary times less as a cyclical feature of the economy, and more as the effect of an “overly interventionist Keynesian welfare state that was stifling the private sector’s productivity and creativity” (ibid., 4). Hence, it was not difficult for the conservatives to maintain their stance, contrary to the Harris government. Klein could push privatization without invoking a powerful social resistance.

(iii) Political interest groups did not have the same advantages present in Ontario. First, suppliers in Alberta lacked the organized power of those in Ontario, partially due to the centralization of suppliers in Ontario and, perhaps more importantly, given the speed and resoluteness with which the government privatized (a mere six months from first proposal to full implementation). With little hope of stymieing the government and given the vast resources one would have to be mobilize to lobby, little organized opposition formed. Whether the industry would have organized, however, is difficult to tell since the “the ALCB privatization plan was developed in secrecy, without any public consultation or input, and was executed very quickly” (ibid., 7). Suppliers moved to change their business models rather than form an opposition, they would have to play the government’s game rather than seek to change it. Even the union failed to garner much clout, in part because the Klein government took union busting as part of a small government mandate. In sum, from the outset, a strong provincial government backed by overarching ideological support from Albertan constituents convinced interest groups that the policy position was resolute; for suppliers, money proved better invested into gaining a first-mover advantage: find yourselves on the private retailer’s shelves before your competitors beat you to it.

Reviews of the final outcome are decidedly mixed. On the one hand, despite a decline in government revenues, prices for alcohol have outpaced (slightly) the indexes of other provinces, in addition to exceeding inflation by approximately 4% in the decade following the 1994 fiscal year of privatization (Flanagan 2003, ii). Others argue, however, that the threefold increase in liquor stores, while adding costs onto the structure of the industry (passed on to consumers (in alcohol prices) and government (in revenues)), is more efficient through the reduction of consumer transaction costs; i.e. added costs to the industry pay for the convenience of having readily accessible liquor stores with longer hours. Other factors such as social ills have received mixed reviews; some suggest they have increased while others suggest that industry regulation has tempered any dangers of the profit-motive in the alcohol retailing industry. Regardless, the costs of regulation must be considered part of the industry's cost structure. These considerations will be drawn out in later sections, which contrasts the economics of the public vs. private models.

Sec. 5.4: The Economics of Public Vs. Private Liquor Retailing

While many justify privatization by virtue that government operation is inherently inefficient (i.e. Commonwealth Foundation 2009) the liquor industry merits review since it holds many particularities and mixed evidence not maintained by broad generalizations. The beckoning of the state to intervene in liquor retailing, both to control sales and reap revenues, derives from particular features of the industry:

- The ills of liquor consumption have social costs. These negative externalities can be corrected for by increasing prices and through blocking sales to vulnerable target groups.
- Liquor is consumed in correlation with leisure; hence its taxation is not directly upon one's productive contribution to the economy, which minimizes economic growth implications.
- Liquor has inelastic demand, making it easy to tax without creating large deadweight loss within the industry.

In light of the social effects of the industry and the revenue role it plays, we will consider the following effects in turn: (i) social externalities, (ii) costs of regulation, (iii) market structure, and (iv) the role of political objectives, so as to come to a nuanced understanding of the performance of operating the industry by public vs. private methods.

(i) *Social Externalities*

The fascinating effect of social externalities is how quickly they can turn a reasonable formula for greater efficiency into an adverse effect. Consider this stipulation regarding the Alberta privatization model: "The Klein Tories believed that the competitive market would increase overall consumer value, all the while allowing government to earn the same amount of revenue from this newly configured alcohol distribution sector as it had before privatization" (Bird 2012, 7). Though it might seem odd, the Klein government could be correct in this account without actually raising efficiency for the economy as a whole, via the negative externalities wrought by alcohol on society. Studies have found that alcohol associated health care provisions cost Ontario \$440 million annually; counting indirect costs of "lost productivity, research, prevention, treatment, administrative costs, law enforcement, damage, as well as indirect costs resulting from morbidity and premature mortality and other costs" the sum comes to $2.85 billion annually in Ontario alone (Mann et al. 2009, 6). The resultant suggestion is that alcohol provision need not be made efficient if we want efficient economic outcomes for the economy as a whole. The Alberta Alcohol and Drug Abuse Commission (AADAC) estimates social costs for the province of $749 million in 1992. Whereas Albertan illicit drug abuse accounts for 3,439 potential years of life lost, alcohol is annually accountable for 3,429 potential years of life lost and drains hospitals of resources for 80,976 patient days (ibid.).

How might public monopolies be advantageous on this front? Evidence suggests that public monopolies will restrict availability and decrease consumption in three manners: (1) monopolies profit-maximize differently than competitive industries; by decreasing supply they can increase prices, which cannot occur in competitive markets if one wishes not to cede market share. (2) With consumers trapped, they minimize store outlay/networks in order to minimize costs, making alcohol less available. As of 2000, Alberta had approximately 3x the liquor outlets of Ontario (and the Canadian average) per capita (LT 2012, 37). (3) Since public employees do not need to make sales, as a store owner does, to ensure their financial wellbeing, the public enterprise will not have incentive to sell to certain target demographics who are at risk including minors, alcoholics, the inebriated, and those pregnant (the lifetime costs of one individual with fetal alcohol syndrome is $1.4 million in health and education costs (Mann, et al. 2009, 12)). The assumption is that all these mechanisms will serve to increase the costs of consumption (or provide an outright block) resulting in decreased rates of consumption. Of particular importance, while approximately 75% of Canadians consume alcoholic beverages, estimates suggest 10% of consumers purchase 50% of the product sold; the heavy drinkers are hit hardest in their purchasing by industry specific increased costs. Hence, the argument is made that public monopolies will increase costs "particularly among heavy consumers, and thus decrease alcohol-related problem rates" (ibid., 10).

Studies of private liquor retailing in the United States has increase consumption by a range of 13% to 150% depending on the state, in post-privatization phases. One estimate stipulates that "under conservative assumptions, a change in Ontario to a fully privately controlled alcohol distribution system would be expected to result in a minimum increase in consumption, burden of mortality and social costs of 10%" (ibid., 11). The general point on alcohol is that a low price is not (or should not be) an objective in the responsible control of alcohol consumption. Public welfare is higher when prices are high and consumption is low. Plus, the revenues obtained by setting higher prices compensates for the social costs of consumption. However, though public monopoly is well aligned to do this, why not just privatize and regulate? Can regulation amend these effects in a cost-effective manner?

(ii) Regulation Costs

However ill-aligned incentives might be for PE to consider the public well-being in their operations, regulation of the industry could bring the same effect as operating a public monopoly. Regulation is likely one reason why the Commonwealth Foundation found privatization to not correlate, in the United States, with indicators of alcohol consumption including volume sold and traffic fatalities due to impairment (2009, 1). However, in this case the costs of regulation need be considered as a total cost on the public for the cost of moving alcohol from its base ingredients through to consumer homes. It becomes, in short, a part of the cost structure for the industry as a whole.

In the wake of privatization in Alberta, incidents of 'supply to a minor' increased by 83%. Audits by the ALGC in 2002 showed that "liquor stores had the highest rates of failure to request ID [of those appearing under 25 years old at]," however, stepped-up regulations resulted in rates falling after a period of education, training and enforcement efforts, with only 17% of establishments failed in 2004 to request ID (Mann, et al. 2009, 11). Regulation can clearly have a corrective effect, however, with 34,000 audits in 2004 it also has a cost. This will be built into our latter considerations of the efficiency of the privatization model

(iii) Market Structure

The market structure of an industry has implications on the consumer price point. Ontario's retail market, for example, is an oligopoly dominated by the LCBO (611 stores), The Beer Store (440 stores) and 438 retail wine stores. Alberta, on the other hand, has decentralized retailing through private operators, with rules designed to support independent stores (as to large chains or grocery stores). Alberta, while privatizing retail, has maintained government revenues from the sale of alcohol by acting as the wholesaler to private industry, thus all retailers must pay the province its mark-up rate. To prevent grocery stores and large chains from capturing the entire industry, the government created three further features of the post-privatization industry:

a) *Uniform wholesale prices*: large retailers cannot negotiate discounts for bulk orders
b) *Uniform warehousing prices*: a 'postage stamp' delivery system has been implemented, whereby a store pays the same prices for shipping and handling, regardless of how far they are from the central warehouse (St. Albert, AB) and how large their order is (must pass bottom threshold for minimum shipment size). These close differences in transportation costs that would otherwise arise in rural areas and amongst small buyers (since shipment sizes cannot be economized on).
c) *Stand-Alone Policy*: Store operations must occur in a stand-alone building or in an enclosed section of a strip mall. The policy prevents grocery stores from economizing on their preexistent space and staff, by simply adding alcohol isles (West 2005, 6).

The effects of an independent retailer market structure have been interesting, if not ideal. Retailers have increased dramatically in number. A representative store is smaller in size now than pre-privatization, since the industry still has approximately the same consumption levels, while the increased number of operators dilute market share per store. Average store sales were $8.5 million in Calgary, $7.2m in Edmonton, and $2.2m for rest of Alberta in 1992; sales volume in 1995 fell to $2.9, $2.7 and $1.5 million, respectively. Meanwhile, the 155 Albertan municipalities with liquor stores, pre-privatization, increased to 218 by December 2001 (LT 2012, 8-9 & 36).

To put the stark difference of Albertan vs. Ontarian market structure into perspective, consider that "for all of Ontario's 13 million citizens there are a total of 1,745 retail outlets selling alcohol. To provide some contrast, in 2009 Alberta's 3.5 million residents had a total of 1,707 venues from which to purchase alcohol" (Bird 2010: 9). What are the efficiency implications of this difference in market structure? The effects are a balance of tradeoffs: at once we want to consider that there are added costs to running a three-fold increase in retail outlets (even when post-privatization wages have fallen by half), yet we also need consider that "when discussing retail price changes, one should focus on the delivered price of the product to consumers [and hence] with the larger number of liquor stores in Alberta, there is improved accessibility, which implies lower transportation and shopping costs, on average" (West 2005, 12). The costs of convenience are documented: a decade after privatization, price competition did not give way to lower prices, but a 4% real increase in alcohol prices. As one might expect of duplicated efforts, in addition to the costs of operating more store fronts, “more competitive markets, such as Alberta’s, often require suppliers to incur higher distribution and marketing related costs (one needs a large sales force to convince small retailers to carry your products, for instance)” (Bird 2010, 9) hence, while retailers might have to bid against each other, there are in-built costs of the market structure that are passed down to customers.

A second implication of the Albertan market structure is that, despite of the thousands of independent retailers, perfect competition was never attained. Economists predict that increased competition brings a bidding down of prices, however, for reasons (beyond in-built costs of Alberta’s market structure) this did not fully work out. Rather than a system of perfect competition arising, Alberta is known to have a system of ‘competitive monopolists’. What has happened is that every store establishes a small monopoly on its corner, with the surrounding locality becoming its captive audience. One, thus, gains limited price setting advantage via differentiation, namely of location (convenience). Though some consumers would take on added inconvenience to find discount prices, no storefront is pressured to price minimize, insofar as collecting ‘monopolist’ rents are better for the profit margin. Hence, firms, albeit selling *essentially* the same product, are differentiated from their competitors by their location. This prevents perfect elasticity of demand: consumers will not simply buy elsewhere because of high prices, in spite of product equivalence existing elsewhere. Hence, sellers lack the incentive to bid each other down. This is exacerbated by costs of acquiring information: “A liquor store market populated by independent retailers does little to economize on consumer search costs” (West 2005, 38). Further, it leads to excess capacity, insofar as wherever margins exist to be made, multiple stores will arise with their associated costs, even if one store would suffice to service the population. Naturally, this excess of monopolistic competition has it positives too; we can speak to the negatives of costs via duplicity of effort, of abusing location for profits, etc., however, perhaps the saved time, fuel, effort, etc. of conveniently located stores makes the higher costs worthwhile. A question, then, arises of whether the costs outweigh the benefits. Though it is difficult to make welfare readings, a dollar value will later be provided, in order to establish the cost of operating liquor stores by a PE model.

d) Role of Political Objectives

Political objectives can interfere with the day-to-day operations of a crown corporation, although empirically the LCBO demonstrates this is less a matter of inevitability than of political will. Seeking to rejuvenate the LCBO, an 'arms length' management approach was legislated. Nonetheless, long-term political objectives are still sought through the LCBO. Political objectives can be toxic or benign. They include both discordant rent seeking and productive public investments in positive externalities. Of positive externalities, the LCBO has been implicated in regional development projects. The distributive system of the LCBO is "specifically designed to assist Ontario based alcohol producers . . . In fact, some have argued that the Ontario wine industry would not exist were it not for the interventionist measures of the Ontario government" (Bird 2010, 10). The Niagara region, specifically, has taken on a cluster effect with resultant winery tourism providing rural community spin-off benefits. The LCBO uses marketing efforts and fiscal measures to promote Ontarian product, including "special efforts to promote many Ontario liquor producers by giving them prominent shelf space and actively promoting their products through tailored marketing initiatives," with added cash-benefits by way of "slightly lower mark-ups than their international competitors (58% rather than 64%)" (ibid.). Of course, such positive externalities do not need to be harnessed through public enterprise; one may simply legislate policies of local content. Hence, were Alberta to have an active industry in wineries, the government could still favour local product through PE. The regulation costs of ensuring firms follow through is another matter, which we cannot have empirical information on due to its counterfactual nature. Once again, a question of trade-offs would arise: would regulation and enforcement costs exceed the expense of ensuring local content promotion through a crown corporation?

Of course, not all political objectives are benign in their influence upon efficiency. First, a major distortion occurs by way of subsidizing rural consumers via urbanites, "the LCBO charges identical amounts throughout the province regardless of ease of access to distribution centers, thus resulting in the effective subsidization of rural areas" (LT 2012, 16). However, as witnessed in Alberta, via the flat rate, 'postage stamp' model, this is not unique to public enterprise when governments use alternative policies to attain objectives. Hence, the government in Alberta achieves the same effects by different model: we cannot call cross-subsidization a matter of crown corporation inefficiency, but rather of an inefficiency grafted upon an industry by exogenous political forces.

Secondly, of negative political influences, there is one long-term trajectory linked to the public holding of the LCBO, which the Albertan model dispelled post-privatization. The high rates of union salaries were common to both the LCBO and the ALCB. However, by 1996 the average wage of liquor store clerks in Alberta was halved from its former rate at $7.19/hr, whereas it was $14.39 (plus benefits and pension) under the operation of the ALCB. In Ontario, by comparison, starting wages are (as of 2010) at $17.39/hour and rise to $20.35 after five years service, plus pension and full benefits. These premiums on wages follow from a common practice of monopolist rent sharing, whereby the government is pressured to share its immense profits with politically powerful unions. With the province directly responsible for pay and working conditions, provincial unions can put political parties on the spot in a way that does not bear the same burden upon private enterprise, where reelection of the management is not an issue. Enabled by the hostile attitude towards public service unions, privatization could proceed in Alberta to cut wages in half, while tripling employment in the industry.

Sec. 5.4.1: Industry-Level Efficiency of Public Ownership

Given the redefinition of provincial goals, how has the Albertan privatization stacked up against the modernization efforts of the LCBO? The answer is indeterminate; although we have most of the pieces of the puzzle, one crucial component is essentially unattainable. Consider the following components:

I. Individually, under a decentralized model of liquor retailing, each store costs less to operate, in being smaller and having lower costs for employees. In making liquor stores more numerous, the consumer's transaction cost of purchase is reduced.
II. However, under privatization alcohol prices have outpaced inflation by 4-5% in Alberta, despite government revenues having fallen by $511 million over the decade following privatization (Flanagan 2003, iv). The cost structure of operating a 'monopolistically competitive' industry is passed on to consumers via the price of their product and reduction in government revenues. Consider the finding below:

> If the total operating expense in 1992 is corrected for inflation and population increases, and with an appropriate expansion in stores, it would have cost $125 million to operate the Alberta liquor distribution system in 2002, including the retailing. If we assume an average return of 15% (this includes GST on the retail markup) in the private retail market in Alberta, it cost more than $200 million in 2002 (ibid., 43).

III. Costs of regulation, too, must be considered. For example, in 2009 there were 34,000 inspections of liquor retailing premises. Their expense has been taken out, by definition, of the Liquor Control Board's remittances to the government above. Though I do not have the exact figure, they represent a part of the $511 million lost lump sum.

What is the cost of convenience in Alberta? To put a dollar figure on the costs of the industry I have compiled an estimate: 'lost government revenues/year + added cost structure = total incurred expense of private system over public monopoly'. The equation pans out as: ($511 million/10 years) + ($200 million cost structure of industry - $125 million estimated public monopoly cost structure of industry)= an approximate $126.1 million/yr.

While we have a dollar figure amount, the final welfare effect is difficult to determine; the key piece of information we do not have is whether the approximate $100.88 per Albertan household (14% of annual household expenditure on alcohol)[6] forgone in the higher cost structure is what consumers would in fact pay for the new, more convenient, retail network. Market structure is beyond the authority of our individual decision-making, especially when it is tied to the effects of legislation, and hence we cannot look to Alberta's market structure as the product of individuals 'voting with their dollar'. Consumption decisions are not entirely free, in being shaped by the institutions pre-existing our purchases. Hence, the welfare effect would have to be derived by way of polling Albertans ('is your $100 well spent in operating the current alcohol retail store network, in contrast to reverting back to the government's running of liquor stores in 1993?'), since market indicators do not reveal this information.

Sec. 5.4.II: The Role of Alcohol Revenues in the Context of the Broader Economy

How does the difference between the Albertan and Ontarian models, in raising revenues through liquor retailing, implicate growth? As per Sec. 4, *since retail revenues offset (subsidize) the tax base, their role in reducing taxation's distortionary effects can have growth implications.* Hence, revenue effects can load or offset the deadweight burden of taxation. Some have argued that in Alberta "government tax levels have been reduced several times since demonopolization of retail outlets, due to pressure from the alcohol retailers (Mann, et al. 2009, 10). Though the actual strength of lobbying efforts should be questioned, it is true that the privatization effort has, in

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[6] Estimates are based on an average 1.25 million households; taking $100.88 divided by the $721 annual alcohol expenditure per Albertan household derives the 14% figure.

effect, been subsidized by a reduction in government tax shares as a percent of final retail prices. In 1990 the government derived 3.02% of tax revenue from liquor sales, which fell to 2.18% in 2002, well below the national average of 2.50% (Flanagan 2003, 22). With the figure of $511 million displaced in government revenues, a conservative estimate (based on a $1.36 cost-per-dollar raised by taxation, as per Sec. 4) of the economic burden imposed is $695 million over a decade, or an annual household burden of $55.60 in taxation annually. This figure is based on a conservative methodology. Sourcing a figure through other means, by comparing the Albertan model to the British Columbian public monopoly, in 2002, we can derive a burden of $184.31 per household[7]. However, in this case, BC's higher liquor prices offer partial contribution to the widened difference.

Sec. 5.5: Past the Point of Return: The Triumph of Political over Economic Rationale

I wish to conclude this section upon a reflection of (1) how the public LCBO model and private ALCB model fit into the general framework I established, in Sec. 3&4, for assessing the efficiency implications of privatization. (2) Given the conclusions I have drawn on the efficiencies of both models, I wish to reflect upon the political rationale over the 'so called' economic decision of privatization. Hence, below are observations made of the divergent paths taken by the LCBO and ALCB:

- At the level of the industry, whether a public or private model brings greater utility per dollar spent will be dependent upon balancing tradeoffs. Alberta has a 3:1 ratio over Ontario in stores per capita. The higher shelf price of alcohol in Alberta must be balanced against unmeasured expenses including the lower transportation costs and freeing of leisure time which occurs by way of being closer, on average, to one's nearest liquor store.
- Nonetheless, we can estimate the expense of convenience at an annual $100.88 per household; further, though not a direct cost on liquor consumption, we can expect the Albertan economy to have taken a hit to the tune of $55.60-$184.31 per household, by way of increased tax burden on lost government revenues. This burden could be partially offset by increasing taxes on liquor retailers, however this would drive up liquor prices.
- Whether the divergent paths that Alberta and Ontario decided upon were made with misinformation or informed priorities, the decisions were political ones. The industry of

[7] Calculated by BC's return on sales of 48% times Alberta's 1.38 billion in sales for a potential earnings of $662.4 million; $662.4m minus an actual Albertan earnings on sales of $493 million for a difference of $169.4 million; or $135.52 per household; which according to our multiplier (1.36) is an increased tax burden of $184.31/household annually.

alcohol retail is not formed through passive interaction with market forces, insomuch as it has taken on a structure based upon political decisions. The separate paths taken expose the influence of political parties, culture and interest groups constituting the provinces' political landscape. Consumers 'vote with their dollar' within frameworks pre-provided. Markets were, thus, forged out of political decisions. Hence, while I have made clear that the Alberta model carries costs, it is unlikely that either retail nationalization or a radical increase in rates of alcohol taxation could occur. Short of a rupture in the political culture of its citizens, the inertia of political forces solidifies a certain path dependency in political decisions.

Sec. 6: Concluding Notes

The objective of this paper has been to appraise the efficiency of private (Alberta) vs. public (Ontario) liquor retailing operations, through the theoretical framework of Sec. 2, 3 & 4. As presented in Sec. 2, the first task of such an appraisal is to determine the *objectives* one seeks to *efficiently* attain. Despite presumptions equating efficiency to profitability, this paper demonstrates how the measure of efficiency is always premised upon a political definition of one's objectives in making a privatization decision. Hence, in the context of liquor retailing in Alberta and Ontario, a 1990s redefinition of provincial goals sought profit maximization to occur in the context of encouraging responsible drinking behaviour. Thus, in appraising outcomes for their efficiency, this paper would incorporate social objectives with considerations of profit margins.

With a definition of efficiency set, this paper sought to utilize the framework of Sec. 3 to appraise efficiency at the firm level:

(i) *The possibility of bringing a competitive environment to the industry through privatization*: while bringing large numbers of independent players to the market, 'monopolistic competition' came to set the market structure in the privatized Albertan liquor industry. Thus, a bidding down of prices never fully happened, while the cost structure of the industry rose in supporting the three-fold increase of retail operations. Greater efficiency attainment did occur through increased choice in retailer location, as owners made their businesses more conveniently located in order to gain a captive local audience.

(ii) *The costs of regulating PE vs. operating an SOE*: the asymmetric information between liquor store owners in Alberta and the government requires extensive audits, to the tune of 34,000 a year, which keep in check the selling of liquor to minors in addition to other 'at risk' demographics. Thus, regulation is possible, although at a cost. Free of the profit motive and thus incentive to sell to troublesome clients, the regulatory regime of the

LCBO and the ALCB (prior to 1994) only ever had to provide minimal framework to ensure good practice was maintained, mostly through employee training programs.

(iii) *The ability to build a system of incentives into the SOE, based on being able to align rewards with the pursuit of public profits*: The LCBO succeeded in pursuing efficiency gains through a corporatization model, which served to: (1) narrow the goals of the retailer, so as to make their performance indicators more representative of firm performance; (2) increase corporate autonomy from political expediency; (3) introduce retail expertise from PE, these individuals could apply models of performance evaluation so as to monitor managerial performance; (4) make transparent the expenses of political motives including the running of campaigns to promote local product and expenses of training employees on responsible alcohol retailing practices; (5) recapitalization so as to improve the customer experience and enable 'up selling' in order to capture higher profit margins for high price point products.

Further, Sec. 4 stressed the importance of evaluating privatization decisions from a holistic perspective that considers broad economic effects since "what may be true for each part is not necessarily true for the whole" (Lutz 1999, 6). Privatization decisions are prone to 'narrow' evaluations, which are made without appraisal of the firm's interplay with 'larger' effects; however, holistic appraisals, not sectoral ones, must be the method with which privatization decisions are framed. Sometimes this will mean accepting an inefficiency within a circumscribed sphere, i.e. of a specific industry, since strategic losses may prove to provide holistic gains: the player in chess thinks not of her lost knight piece, but rather of the opportunities such a loss, wisely played, opens up in regards the broader game at stake. The loss of government revenues through declining ALCB remittances provides such an example. Even if Albertans approve of paying more for their liquor if it means greater accessibility in its attainment, they may not approve of the added economic burden it places upon taxation, to the tune of between $55.60 and $184.31 per household, per annum. How we often seek to make marginal gains in one subsection of our daily life, while failing to look at the economy as a whole is reminiscent of Arthur Shoepenhauer's lamentation: "we think not of the totality of our successful activities but of some insignificant trifle or other which continues to vex us".

Lastly, as a point of reflection upon the case study of liquor retailing, beyond the theoretical scope of economic approaches, privatization decisions represent calculated political rationales. Often the inception and continued operation of a given SOE is said by economists to represent irrational decisions on the part of political leaders. However, when one's decision making is based upon pre-existent environmental influences of political culture and vested interests, it is not clear why a rational decision would be one which prioritizes an economic reading of the situation. The upshot of this observation is that feasible policy advice looks to find economic optimality within the allotted flexibility of political structures. It seeks to exercise agency within the confines of institutional limitations, just as market decisions are made by individuals within the set of choices made available by preexistent market structures.

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