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Privatization and urban governance: The continuing challenges of efficiency, voice and integration

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ABSTRACT

Privatization has been promoted as an urban reform for more than 40 years. Although cities around the world have pursued privatization, it has not delivered the promised efficiency, voice and service integration gains. City managers recognize the challenges of market management for urban service delivery and the critical difference between a citizen and a consumer. This has led to new hybrid forms of service delivery which jointly engage public, private and citizen groups. However, concerns over efficiency, voice and equity remain.

Introduction

Privatization was heralded as a new reform in the late 1970s by Margaret Thatcher and followed by Ronald Reagan. The idea was that market competition would lead to increased efficiency (lower costs) and more consumer voice in urban service delivery (Savas, 1987). The popular book, *Reinventing Government*, by Osborne and Gaebler (1992) encouraged city leaders to "steer and not row," and explore new forms of service delivery which involved private contracting, more consumer choice and neighborhood engagement. Although privatization involves a host of reforms, contracting out is the most common. Three other reforms in the broad scope of privatization include: asset sales and new public–private partnership financing arrangements (P3s), club forms of service delivery (such as Common Interest Developments and Business Improvement Districts) and service shedding. Privatization is often equated with contracting out, and this is the most widely studied strategy. With contracting, government retains responsibility for delivery and finance but transfers production of the service to a private entity (paid by government). In this article I will focus on the promise of privatization (contracting out) in terms of increased efficiency, consumer voice and service integration and reflect on the empirical evidence regarding these claims.

In the 1990s we saw an expansion of local government contracting. While the UK made competitive tendering compulsory from 1988–1998, the US did not need to do so as contracting out is longstanding practice among local governments in the US and city officials generally have a positive view of New Public Management reforms. Compulsory approaches to privatization generally did not hold. The UK, Australia and New Zealand all stepped back from such a strong pro-privatization stance in the late 1990s and shifted to a more balanced approach looking at "best value" – a concept that embraces more than cost efficiency and looks at a broader array of service quality, market contestability and citizen scrutiny concerns (Martin, 2002). In New Zealand, the government of Helen Clark recognized that too much attention had been given to enterprise based contracting and there was a need to rebuild the capacity of local government to address the complex intersection of service delivery, economic development, environmental management and local democracy building. The new local government law of 2002 recognized this multi-functional role of local government. In Australia, increased recognition was given to the importance of service integration across the metropolitan region – leading to consolidation reforms and the promotion of inter-governmental cooperation in service delivery (Aulich et al., 2011). In the US, local governments followed an increase in experimentation with contracting in the 1992 to 1997 period, with a return to direct public delivery in 2002 – a process of reverse privatization (Hefetz & Warner, 2004, 2007; Lamonthe, Lamonthe, & Feiock, 2008). Levels of contracting back in (18%) exceeded new contracting out (12%) in this period (Hefetz & Warner, 2007). Today, inter-governmental contracting is as common as for profit contracting among US local governments – suggesting that the new urban governance reforms may come as much from cooperative approaches as from the competitive approaches emphasized in the 1980s and 1990s (Warner, 2011a).

In this article I will explore the promises of privatization – as regards cost efficiencies, enhanced citizen voice and the potential for market forms of integration to gain economies of scale. I will assess the empirical evidence and discuss implications for the future. I will conclude with a view toward the future and the new reforms

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– beyond contacting out – which are gaining interest among cities across the world.

Efficiency

Privatization was heralded as a means to promote more efficiency in urban service delivery. By turning public delivery into a contract market – a certain level of competition and scrutiny would be brought to the urban service delivery process. No longer would government be the sole monopoly provider. Instead, private purveyors would create competition for government service delivery contracts – bringing a market into public service delivery. This would have the dual advantage of promoting market development and reducing costs to government due to the discipline of a competitive market (Savas, 1987).

What cities have found is that contract markets are at best quasi-markets with one buyer (the city) and few sellers. A recent survey of the level of competition for 67 services typically provided by US cities, finds on average less than two providers in most urban markets for most services. Services like garbage collection, child care, vehicle towing and legal services enjoy competition levels over three providers (the minimum recommended for a competitive market), while services like water, sewer, and hospitals have under one alternative provider (Hefetz & Warner, 2012). Only a third of the 67 services measured had competition levels over two alternative providers. This lack of competition undermines the potential for cost savings under privatization and is associated with lower rates of privatization among US cities (Hefetz & Warner, 2012). For many city services, competition is typically *for* the market, not *in* the market. Once the contract is let, competition erodes. Lack of competition raises costs for city managers. Contact officers spend time chasing competition – often at the expense of contract oversight and monitoring (Johnston & Girth, 2012). City managers respond by splitting markets for service delivery – to keep competition in the market (Albalate, Bel, & Calzada, 2011; Bel & Warner, 2009). Mixed public/private delivery also enables city managers to maintain cost pressures on both public and private deliverers, allow benchmarking and assure attention to citizen satisfaction (Warner & Hefetz, 2008). In some countries, such as the Netherlands, national policy has tried to encourage competition by levying tax on local public units so as to make private providers more competitive – but this can lead to collusion (Dijkgraaf & Gradus, 2007). Smaller cities and rural areas especially face competition problems as markets are thinner in less populated areas and private providers typically prefer larger urban and suburban markets (Bel & Fageda, 2011; Hefetz, Warner, & Vigoda-Gadot, 2012).

Another approach to market management is the use of public or mixed public/private firms to gain scale and to promote competition. Italy has seen the emergence of multi-utilities which combine across services to enjoy economies of scope and multi-government firms (in the same service) to gain scale (Bognetti & Robotti, 2007). In the Netherlands, multi-government public firms are common in refuse collection and help promote competition with private providers, whereas in Spain cities cooperate to gain scale so they have more market power in the private contracting process (Bel, Dijkgraaf, Fageda, & Gradus, 2010; Dijkgraaf & Gradus, 2008). In Portugal, municipal corporations (Tavares & Camoes, 2007) and mixed public–private companies (Cruz & Marques, 2012) are becoming more common. Mixed firms capture the benefits of economies of scale with monopoly provision, but they maintain public control and gain management and labor flexibility. This creates a more stable form of privatization in Europe. In the US, where city managers focus their efforts on creating mixed markets with competition between public and private delivery, privatization is both lower and more unstable (Warner & Bel, 2008).

The challenges of managing a market have led scholars to focus much more on the transactions costs of contracting. Attention is given to the characteristics of the service (how specific is the asset), the characteristics of the contract (how difficult is the contract to manage and monitor), the characteristics of the market (competition, costs), and the characteristics of the place (heterogeneity and citizen interests) (Brown, Potoski, & Van Slyke, 2008; Hefetz & Warner, 2012; Lamonthe et al., 2008; Levin & Tadelis, 2010). Attention to transactions costs is fundamental to the contracting decision and urban scholars are discovering that transactions costs for urban service delivery contracting are quite high (Whittington, 2010).

Regarding privatization and costs, the evidence is mixed. Lower costs are most likely to be found in competitive markets were some innovation in service delivery has led to improved process efficiency. A recent meta regression analysis of all published studies from 1965–2010 in water delivery and solid waste collection found no empirical support for lower costs under private delivery (Bel, Fageda, & Warner, 2010). Early studies were more likely to find cost savings, but as time passes, competition erodes and so do cost savings. Markets alone, through liberalization and privatization, have not delivered lower prices or higher consumer satisfaction in network infrastructure services in the European Union (gas, telecom, electricity, water, transit) (Ceriani and Florio, 2011; Ceriani, Doronzo, & Florio, 2009; Clifton & Díaz-Fuentes, 2010) and comparisons of public vs private infrastructure providers in Europe over the 20th century provide "no evidence that privatization has raised productivity" (Millward, 2011: p. 392). Cost data on other urban services is harder to find in part because budget data is not collected in a way that permits before and after comparisons.

City managers use a pragmatic approach to explore new reforms, test them in the field of practice, stick with what works, and change what doesn't. Studying the dynamic behavior of city managers over time is one way to assess their satisfaction with privatization reforms. Change, not stasis, is the status quo. The US is the only country that has longitudinal data across cities over time and several scholarly teams have tracked this to show how contracting rises and falls (Brown et al., 2008; Hefetz & Warner, 2004, 2007; Lamonthe et al., 2008). Urban structure (size, income, competitive markets) have been shown to be more important than managerial capacity or political ideology in explaining these shifts.

Most countries do not have longitudinal data and so studies typically compare cities that privatize with those that retain public delivery. Here again, the research finds city managers are primarily pragmatic actors (Bel & Fageda, 2007; Hebdon & Jalette, 2008; Joassart-Marcelli & Musso, 2005). Although political ideology has been a driver of national policy (in the UK, the EU, Australia and New Zealand) and the preferred urban governance model of international funders such as the World Bank, when city officials are given the option to choose the best service delivery model, pragmatic considerations trump political ones. A meta regression analysis of all studies of local government privatization around the world (most studies are from the US and Europe) found that political ideology was not a driver (Bel & Fageda, 2007). City officials are driven primarily by pragmatic concerns with cost savings and service quality. This is because residents can see the quality of reforms in the services delivered. When reforms do not work, city officials are pressured to reverse course or pursue other innovations. At the national and international levels, ideology holds stronger sway because there is not a natural citizen scrutiny and accountability as service delivery at the national level is less tangible and visible to the resident. This has enabled the World Bank to stick with a pro-privatization agenda long after evidence challenging the efficacy of this approach has been well documented. For cities in developing countries, this poses special problems as the World Bank typically links financial support to selection of a pri-