

Beyond privatization and cost savings: alternatives for local government reform

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Abstract

Unsatisfactory results from privatization have caused local governments to seek alternative reforms. Inter-municipal cooperation, mixed public/private delivery and contract reversals are three alternatives that have gained traction in the last decade. These alternatives help local governments manage markets for public service delivery as a dynamic process. They maximize government/market complementarities and address a wider array of public goals beyond cost efficiency concerns. The alternative reforms show how local governments balance citizen, labor and community interests to ensure efficiency, coordination and stability in public service delivery.

Keywords: Privatization, intermunicipal cooperation; mixed public/private delivery; contract reversals; unionization

Introduction

The special issue published in 2007 (volume 33, issue 4) of this journal contained a set of articles which showed the debate on local government reform needed to move from a simple debate on privatization to a broader discussion of alternative reforms. Reforms

beyond privatization were increasingly experienced worldwide, as shown by the expansion of municipal corporations in Portugal (Tavares and Camoes, 2007), dynamic market management in different countries (Bel and Fageda 2007, Dijkgraaf and Gardus, 2007), relational contracting (Brown, Potoski and van Slyke, 2007), and reverse privatization in the US (Hefetz and Warner, 2007). In the decade that has elapsed since 2007, alternative reforms to privatization have expanded, in practice as well as in scholarly analysis.

Intermunicipal cooperation, mixed public/private delivery and reverse privatization have become much more common production choices over the last decades. Together they illustrate the importance of market management to secure benefits from alternative forms of service delivery. In this updated overview we present the latest empirical analyses of these reforms, exploring factors driving them and their outcomes, especially the evidence on costs. We find cost is but one concern local governments face. We highlight the critical role local governments play in managing markets, public values and community interests, especially labor.

Intermunicipal Cooperation

While privatization was based on the benefits of competition, inter-municipal cooperation reflects the importance of strategic collaboration as local governments form networks to achieve economies of scale and reduce negative externalities (McGuire and Agranoff, 2011; Bel and Warner, 2016). Intermunicipal cooperation in service production encompasses a variety of forms. To delimit different types of cooperative arrangements, Feiock and Scholz (2010) emphasize autonomy, viewed as the ease of entry and exit from a collaborative agreement. In Europe these types of agreements can take the form of joint corporations, in which municipalities share ownership and production. The collaborative may jointly produce one or several services, contract to one of the members, or contract to an external party – either for profit or non-profit. While intermunicipal contracting is more limited in Europe, in the US it is more common than privatization (Kim and Warner, 2016; Hefetz et al., 2012).

Cooperation has expanded in the last decade. Bel and Warner (2016) conduct a metaregression analysis on the existing multivariate empirical studies on factors explaining cooperation. While only 15 studies had been published on that topic before

2007, in the last decade (between 2007 and 2016) 34 studies were conducted (almost all of them published). While all 15 studies prior to 2007 were conducted for the US (but one for Mexico), the literature in the last decade has included analysis for Argentina, Brazil France, Germany, Italy, Sweden, Portugal and Spain. While practically all pre-existing studies on factors explaining cooperation followed the methodology used to study factors explaining privatization (see Bel and Fageda, 2007, 2017), more recent research is developing unique methodological and empirical approaches to address cooperation in its own right. These include differences in factors driving cooperation (Kim, 2018; Bel and Warner, 2016), and use of alternative modeling approaches such as a hazard model in Germany (Bergholz, 2018) or multilevel modeling to study duration of agreements in the US (Aldag and Warner 2018).

European studies treat cooperation as a service delivery alternative to privatization, but driven by similar objectives, primarily cost reduction. US studies give attention to a much broader array of motivating factors, beyond cost reduction, related to spatial location and organizational factors. Countries with fragmented local government face the challenge of regional coordination to address spillovers and externalities of service delivery, and intermunicipal cooperation is one response.

Empirical studies of inter-municipal cooperation find it is an important alternative to for-profit contracting (Brown, Potoski and Van Slyke, 2008; Hefetz, Vigoda-Gadot and Warner 2012). While competition and efficiency are the primary factors driving privatization, inter-municipal contracting is based on cooperation and is focused on longer term community concerns (Kim, 2018). Intermunicipal cooperation also is used as a market management strategy to enhance competition in uncompetitive markets (Girth et al., 2012; Hefetz and Warner, 2012), to achieve economies of scale while maintaining public control (Hefetz, Vigoda- Gadot and Warner, 2014b), to enhance market power of local governments in private contracting (Bel, Fageda and Mur, 2013), and to preserve service delivery in the face of fiscal stress, especially after the Great Recession (Kim and Warner 2016).

Scholarly analysis of the economic effects has expanded, particularly for European countries. In Bel and Warner's (2015) review, a total of eight empirical studies on cooperation and costs were found in the literature. Only one of them (Bel and Costas,

2006) for Catalonia-Spain had been published before we wrote Bel, Hebdon and Warner (2007). The other seven were conducted for Norway, Netherlands, Italy and other regions of Spain.

Most work in the US is based on case studies and finds cooperation results in cost savings less than half the time (Holzer and Fry 2011). A quantitative analysis of the economic effect of cooperation conducted for New York State by Bel, Qian and Warner (2017) found similar results. Six additional studies on cooperation and costs have been identified for Germany, Czech Republic and, again, for the Netherlands, Norway and Spain. In short, in only one decade, fourteen more multivariate empirical studies on the effects of cooperation on costs have been conducted.

Empirical studies typically find that cooperation reduces costs, particularly when services with scale economies and small municipalities are involved. However, transaction costs can be higher than potential savings for services where scale economies are small, and municipalities were already operating close to their optimal production dimension. When cooperation is not primarily driven by cost savings, as in the US, then cost savings are less likely to be found.

Mixed delivery

Mixed delivery occurs when a government provides a service through both public and contracted delivery. This may involve dividing the jurisdiction into several districts or dividing the service into several parts and using public delivery in some and contracted delivery in others (Warner and Bel, 2008; Warner and Hefetz 2008). According to Miranda and Lerner (1995), this ‘redundancy’ in delivery methods can be efficient because it makes benchmarking possible with the private sector, and also promotes bureaucratic competition in house. Thus, mixed delivery can promote competition by introducing pressures on public firms and by preventing monopolization by private firms (Miranda and Lerner, 1995; Girth et al., 2012; Bel, Brown and Warner, 2014).

Mixed delivery is very common in the US and grew along with private contracting as a means to manage contracts (Warner and Hefetz, 2008). In contrast, mixed delivery is less frequent in Europe (Warner and Bel, 2008) where mixed public/private firms are more common. In this type of organizational form, the government and its private partners share

ownership of the firm (Warner and Bel, 2008; Cruz et al., 2014). The model is also referred to as 'partial privatization' (Bel and Fageda, 2010).

The rise in mixed delivery seeks to achieve the benefits of both market and public delivery (Warner and Hefetz, 2008): private firms are interested in efficiency and profits; while also being interested in efficiency, the public sector is expected to provide failsafe delivery and public accountability and involvement. There are few empirical studies on the effects of mixed delivery on service costs. Miranda and Lerner (1995) was the first study to address this issue. They found US cities with a higher percentage of services provided by mixed delivery incurred lower expenditures than those with a higher percentage of direct production. Recently, Bel and Rosell (2016) studied the effects of mixed delivery and costs in a single service (metropolitan bus) within one jurisdiction (Barcelona). They found private delivery is more costly than public delivery within this mixed delivery system, and that competition for contracts helps reduce costs.

Recent studies of mixed delivery have moved beyond a singular focus on costs and instead focus more broadly on the challenges of market management. Reform is no longer considered to be a simple choice to 'make or buy,' but also the strategic management choice to both 'make *and* buy'. Hefetz, Warner and Vigoda-Gadot (2014a) draw from the private sector management literature on "concurrent sourcing," to build a theory for public sector mixed contracting. They argue that public managers face a broader range of contracting agents (both private for-profit and public inter-municipal) than private sector managers. In a study of 1474 US municipalities they found mixed delivery is more common with for-profit agents (38% of contracts) than among inter-municipal agents (13% of contracts). They argue that mixed delivery is a strategy to mitigate potential contracting risks, especially with for profit agents where goal congruence and principal agent problems are more pronounced. Mixed delivery is used to promote market complementarities, and ensure attention to citizen interests, while seeking to reduce costs.

There are only a few studies that have analyzed the determinants of mixed delivery and typically these look at mixed delivery along with for-profit and intermunicipal contracting: Brown, Potoski and Van Slyke (2008); Warner and Hefetz (2008), Hefetz, Vigoda-Gadot and Warner (2014a). Mixed delivery is generally found to be a strategy in service markets that face low competition (Girth et al 2012). Mixed delivery also has been

shown to reduce contract reversals (Warner and Hefetz 2012) – a point that will be explored in more detail in the next section.

Contract reversals

Contracting may involve movement toward market or back toward public delivery in a dynamic process over time. In the 2007 special issue, Hefetz and Warner (2007) noted that contracting reversals were part of a broader strategy of market management to ensure social choice - a balance between market, public and citizen interests. Since that time, additional work in the US has found contract reversals to be part of a pragmatic managerial process (Hefetz and Warner, 2016; Warner and Hefetz, 2012). By contrast, in Europe and the global south, case study research has given new attention to this contract reversal process and a new name, “re-municipalization,” arguing that it is primarily political in motivation (McDonald 2016; Hall *et al.* 2013). By contrast, the European papers using quantitative analysis (Chong *et al.* 2015; Gradus *et al.*, 2014; Perez-Lopez *et al.* 2015), find reversals to be a strategic element of pragmatic market management, often driven by problems with higher costs and lower quality of service under privatization. The most recent US data finds reversals more common in for-profit contracts than in intermunicipal contracts (Warner, 2016). While case study research suggests remunicipalization is an increasing trend, the US data show that contract reversals are not increasing – they are about the same level as new contracting out – suggesting a continuing market testing strategy as managers negotiate cross boundary interactions seeking complementarities as outlined by Hefetz (2016).

Managing union and community interests

While unionization is often considered to be an obstacle to local government reform, most studies use private sector or national level proxies and do not have local measures of public sector unionization. Those few studies that have direct measures of unionization find a more nuanced story. In a 2001 study of New York State, Warner and Hebdon (2001) found unions were only a negative factor when local governments implemented a single form of restructuring -- either privatization or inter-municipal cooperation. When more complex restructuring took place, for example, involving reverse privatization and entrepreneurship, the union factor was not significant. One possible explanation for this finding was that job losses in single restructuring cases might be offset by job gains when a more complex mix of delivery alternatives is used.

Jalette and Hebdon (2012) opened the union ‘black box’ and examined the actual strategies that unions took in the face of threatened job losses among local governments in Canada. They found that unions employed a range of strategies from strikes, legal actions, negotiations and suggesting alternatives, to acquiescence. Surprisingly, negotiations and suggesting alternatives were both more common and more effective than strikes. Also, the existence of the acquiescence strategy (support or no reaction), not often documented in the literature, also supported the idea of union practicality.

The most recent US studies have found unionization has no effect on for-profit contracting but has a suppression effect on intermunicipal cooperation (Kim and Warner 2016) – possibly because of the difficulty of crafting cooperative agreements across different public sector unions. Most studies use labor opposition to alternative service delivery, rather than actual measures of unionization. These studies typically find no effect on for-profit contracting (Kim and Warner, 2016; Hefetz et al, 2014b), a positive effect on for profit contracting (Lobao and Adua 2012) and a negative effect on contract reversals (Hefetz and Warner 2016), as professional managers understand how to manage labor interests alongside the other interests local governments must balance – citizen, budget and community concerns (Kim and Warner, 2016). These results suggest the power of unionization may be inside the organization in forcing more professional management practices. Hefetz and Warner (2016) find unionized governments are more likely to monitor contracts, less likely to contract out in non-competitive markets, and more likely to pursue cooperative labor management relations. Kim and Warner (2016) call this “pragmatic municipalism.”

Conclusion

Market-based reforms rely on competition to achieve cost savings. But cost savings are hard to secure as most local government markets are noncompetitive and transactions costs are high. Local governments have been leading in exploring new alternatives that address these problems. Mixed delivery and contract reversals recognize the important market management role of local government in creating competition between the public and private sector and over time. Intermunicipal cooperation moves beyond competition to explore benefits of economies of scale and scope.

While 20th century local government reforms focused primarily on the benefits of competition, 21st century reforms look more to the need for market management and the benefits of cooperation – across local governments, across public and private sectors and across labor, community and government interests. As fiscal pressures on local government mount, this pragmatic ability to engage in cross sector collaboration is the key reform for the future.

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