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Why do local governments privatise public services? A survey of empirical studies

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Abstract

Many empirical works have been devoted to analysing the factors explaining local privatisation. Overall, most of the empirical analyses have low explanatory power due to the methodological difficulties in capturing the dynamic nature of the privatisation decision. The variables most often considered are those related to fiscal stress and cost reduction and political processes and ideological attitudes. Our review indicates that fiscal stress and pressure from interest group are explanatory factors of local privatisation in those early studies devoted to the US that consider a broad range of services. Furthermore, cost considerations seem to be taken into account by local governments, particularly when scale economies and transaction costs are taken

together. Finally, ideological attitudes of policy makers do not seem to influence local service delivery choices in any systematic way.

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Notes

1 Indeed, empirical literature on privatisation and costs provide very interesting insights, and it has been reviewed elsewhere (Bel & Warner, 2006).

2 The seminal work by Vickers and Yarrow (1988) provided a comprehensive approach to studying privatisation. Megginson and Netters' (2002) survey published in Journal of Economic Literature offers extensive information on this literature.

3 Proposition 13 in California in 1978 is a good example of this. Proposition 13 introduced important provisions that changed the structure of the California local tax system. The property tax rate was limited to 1 per cent of assessed value, and those values were rolled back to 1975. The growth in assessed value was limited. Thus, local governments were restricted in raising local property tax rates or assessed property values to raise additional revenues. At the same time, control over the allocation of property tax revenues was transferred to the state. The combination of these provisions centralised authority over the property tax in state government, and undermined the role of property tax as a tool of local government revenue generation. Hoene (2004) contains an analysis on the effects of Proposition 13 on the fiscal regime of cities in California.

4 Political processes and ideological attitudes were introduced together in the previous section. Nonetheless, the very different nature of the variables used to check these hypotheses makes it advisable to analyse results on political processes and on ideological attitudes separately.

5 We are aware that some other works, such as extensive case studies or studies based on statistical correlations between two variables, can offer interesting insights. This is the case for example of the works of Christoffersen and Paldam (2003) or Young (2005). However, results from studies using econometric multivariate methods are more suitable to generalisation to other contexts.

6 It must be said that the study by Hebdon and Jalette (2007) includes observations for Canada.

7 However, some studies that analyse just one service also find a significant relationship between fiscal stress and privatisation. This is the case in the study of Feldman (1986) for urban buses and the study of Hirsch (1995) for solid waste collection.

8 Some studies of US cases analyse the alternative hypothesis; large cities will privatise more often since they can take advantage of competition from a larger number of service providers. In order to test this hypothesis, these studies use variables for core metropolitan areas, suburbs and rural areas. Interestingly, results from the works of Warner and Hefetz (2002) and Hebdon and Jalette (2007) imply that suburbs of metropolitan areas privatise more often than core metropolitan cities or rural areas. Levin and Tadelis (2005) conclude that large and urban areas tend to externalise production to private firms more often, while smaller towns tend to externalise to public agencies.

9 Evidence on the scale economies hypothesis is not clear in the works of Chandler and Feuille (1994) for sanitation services and Miralles (2006) for water services. The latter service could be influenced more by density rather than by scale economies, while the amount of fixed costs in the sanitation services is low.

10 Interestingly, Nelson (1997) tests the transaction cost theory to explain why there is less privatisation than that predicted by public choice theory. He finds that local governments take into account the transaction costs implied by their choices. Hence,

he suggests that governments are not as inefficient as predicted by public choice theory.

11 A small number of studies also looked at the influence of sensitive consumers, outside of low-income households, such as elderly people.

12 Regarding the influence of income per capita on service delivery choices, Boyne (1998b) distinguishes between an economic and political interpretation of the effects related to this variable. Indeed, high-income households may prefer privatisation, but at the same time more easily afford additional expenditures associated with the externalisation of local services production. In any case, the political interpretation seems to predominate in the empirical literature on local privatisation.

13 In fact, among the studies that consider a broad range of services, only Benton and Menzel (1992) and Hebdon and Jalette (2007) do not find a significant influence on service delivery choices from low-income households and unions, respectively.

14 Among those studies that test such hypotheses and include small towns in their samples, only Walls et al. (2005) do not find the expected relationship significant.

15 Martínez Rodriguez (2004) and Miralles (2006) obtain mixed results.

16 Many of the studies that consider just one service focus attention on solid waste collection. Several studies show the relevance of scale economies for this sector (Stevens, 1978; Callan & Thomas, 2001; Bel & Costas 2006).

17 In fact, among the studies that consider a broad range of services, only Benton and Menzel (1992) and Hebdon and Jalette (2007) do not find a significant influence on service delivery choices from low-income households and unions, respectively. In addition, some studies that focus on just one service, such as school buses (McGuire et al., 1987), solid waste collection (Dubin & Navarro, 1988; Hirsch, 1995), sanitation (Chandler & Feuille, 1994) or water (Miralles, 2006) also find a significant influence of group interests. The high economic relevance of all these services could explain this result.

18 Recent studies show that reverse privatisation may be an emerging issue in countries like the US (Hefetz & Warner, 2004, 2007) and Canada (Hebdon & Jalette, 2007). As of now, such a phenomenon does not seem to exist in the European Union.

19 Additionally, it is worth noting that the years since privatisation (n) may be different in each city.

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