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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.

Introduction

Several theoretical approaches have been developed in relation to the privatisation of local services. Among them, Public Choice was the first to comprehensively analyse delivery choices within the domain of public services. According to the theory, overproduction and inefficiency will be the outcome when politicians and bureaucrats monopolise public services delivery (Niskanen, 1971), and policy makers will extract rents and political power from managing local public services (Savas, 1987). The standard public choice remedy for inefficiency is competition in markets for public services. Two basic hypotheses that can be inferred from this approach are that contracting out by local governments will provide lower costs in the delivery of services and that technical efficiency in service delivery will improve (Boyne, 1998a).

Another group of theories also stresses the role of costs in the service delivery choices of local governments. In these approaches, transaction...
costs, which include administrative costs as well as costs from incomplete contracts, are important in the choice to make or buy a service (Williamson, 1979, 1999), and factors such as monitoring and control play a central role (Sappington & Stiglitz, 1987). From these theoretical works, the following core hypothesis emerges: privatisation can deliver cost savings whenever the transaction costs involved are not huge. Hence, the conditions that influence the level of transaction costs (such as asset specificity, or difficulty of performance monitoring) should be central in determining when a local service can be successfully privatised.

Another important approach has emerged from property rights theory beginning with seminal works such as Alchian (1967) and Alchian and Demsetz (1972). The theory of incomplete contracts provides a useful analytical framework for studying situations in which contracting is a complex operation (Grossman & Hart, 1986; Hart & Moore, 1990). Within this framework, Hart et al. (1997) show that — with private production — the manager has incentives to reduce costs without concern for quality erosion. Therefore, privatisation will most likely reduce costs, but can also deliver a lower quality of service.

Theoretical works in the 1970s and 1980s, particularly those within the Public Choice approach, strongly endorsed privatisation of local services. On the empirical side, multivariate studies published in the 1970s frequently found cost savings from privatisation of such important services as solid waste collection (Kemper & Quigley, 1976; Kitchen, 1976; Pommerehne & Frey, 1977) and water distribution (Morgan, 1977; Crain & Zardkoohi, 1978).

However, while all these studies suggested that local privatisation had the potential to reduce costs of service delivery, many local governments were reluctant to privatise and chose to continue delivery of most services through public production. Why were so many governments reluctant to reap the benefits of cost reductions through privatisation when the earliest evidence indicated that privatisation saved money? This paradox focused subsequent analysis on the objectives of local privatisation, and, in the last two decades, the question of why (or why not) governments privatise local services has been addressed in many empirical works.

In this paper, we extensively review and analyse the empirical evidence obtained from multivariate empirical studies of factors explaining local privatisation. We want to be clear that our objective here is not to examine the effects of privatisation on costs. In fact, almost none of the papers reviewed here analyse this relationship. Based on the analysis of the literature on motivations for local privatisation, we conclude that very few elements of the reviewed studies are suitable for generalisation. Most studies do support the hypothesis that considerations related to costs are important, particularly when scale economies and transaction costs are taken together. Beyond this point of agreement, however, results for other hypotheses show large variability between studies. Overall, the most general feature of the empirical research is the limited ability of existing studies to explain what
drives local privatisation. We address some issues related to this lack of explanatory power and the variability of results in a methodological note before our concluding remarks.

The rest of the paper is organised as follows. In section two, we briefly state the general context of privatisation. The third section presents and explains the large families of hypotheses that have usually been considered in the empirical studies: fiscal restrictions, economic efficiency, and political process and ideological attitudes. In section four, we review the empirical evidence and focus on the results as they relate to the mentioned families of hypotheses. In section five, we discuss some methodological problems common to most empirical works that could explain why results are so diverse and explanatory power is so low. Section six summarises the main conclusions.

Background: Privatisation as a Policy

Privatisation policies have been implemented worldwide in the last two decades. Many governments have transferred to the private sector state-owned enterprises (SOE) that were operating within both monopolistic environments and competitive frameworks. Telecommunications and energy provide outstanding examples of sectors where such operations have been usual. In addition, many local governments, particularly in the developed countries, have contracted out public services, such as solid waste collection and water distribution. Many studies, both theoretical and empirical, have been devoted to this issue.2 However, it is clear that European literature has been more prone to analyse privatisation of SOEs, whereas literature in the US has focused on public services privatisation. Indeed, selling SOEs was not a usual experience in the latter country given the much lower tradition of public ownership of firms.

Literature on privatisation of SOEs has been very extensive, and some consensus has been reached on the objectives followed by governments with SOE privatisation. First, governments have looked to financial, political and ideological, and efficiency-related objectives. According to the literature, the most important objective has been financial: decreasing expenditures and increasing (short term) revenues for the Treasury (Yarrow, 1999). This objective has been given priority in privatisation for stabilisation purposes in less developed economies (e.g. Latin America and Eastern Europe), as well as in developed countries, as in most European countries in the period previous to the Economic and Monetary Union.

Political and ideological objectives have also influenced privatisation, particularly in governments with a strong ideological bias, like those in the United Kingdom and Chile. Examples of desired outcomes have been the weakening of trade unions, and the building of support from groups that would benefit from this policy (Biais & Perotti, 2002). In addition to financial and political considerations, some industrial policy objectives have
been pursued as well. Increasing efficiency has been an important target of privatisation when firms were already operating in competitive environments. However, increasing the efficiency of large monopolies through privatisation has been a very controversial issue, and most works in the literature emphasise competition (rather than privatisation) as a tool for increasing efficiency (e.g. Kay & Thompson, 1986).

Concerning the contracting out of public services, the number of empirical works dealing with the objectives pursued with privatisation has increased in the recent years. However, in contrast to privatisation of SOEs, the literature is still missing meta-analyses that try to draw general conclusions from a review of the body of individual studies. This is precisely what we intend to do with the review and analysis in the following sections.

Local Privatisation Objectives: A General Discussion

While there is no absolute agreement on what factors might influence local privatisation, the hypotheses in the literature may be comfortably grouped into two economic and two political families. Economically, governments may be inspired by some combination of fiscal restraints and anticipated lower costs, while, politically, leaders may be moved by loyalty to an ideology or a desire to win the support of key interest groups.

Fiscal Stress

Over many decades in the twentieth century, governments have used tax increases to cover the growth of public expenditure needed to fund the expansion of welfare mechanisms and public services at all levels of government. At the local level in the US, this trend toward increasing tax burdens ended in the 1970s. Tax revolts and state legislation limiting increases in local taxation were important motives. This was consistent with suggestions in Tiebout (1956) concerning taxpayers’ reaction to increasing local exactions. Simultaneously, a widespread economic crisis decreased transfers from federal and regional governments to local governments. Hence, the two main restrictions on local finance were working simultaneously: a) local restrictions reduced the ability to raise revenues; and b) supra-local restrictions limited transfers from other governments. As time went by, similar fiscal restrictions came to bear on other countries. Most studies of privatisation include fiscal variables designed to measure the effects of such restrictions, and the usual hypothesis is a positive relation between fiscal constraints and privatisation.

Economic Efficiency

Within the academic literature, two explanations have been offered linking privatisation to cost reduction. One proposes that privatisation works by
introducing competition where there is a public monopoly (Savas, 1987), while the second points to the possibility of exploiting economies of scale when the public service has been delivered over a suboptimal jurisdiction (Donahue, 1989). According to public choice theory, contracting out was expected to produce cost reductions by breaking the monopoly of public services. Hence, the potential for reducing costs may be higher in larger and metropolitan urban areas where the availability of external providers is higher. On the other hand, the exploitation of scale economies when a local service is delivered in a suboptimal jurisdiction requires only the aggregation of jurisdictions for the delivery of the service. Privatisation can be a useful tool in such aggregation because one firm can deliver services in several towns, thus operating at a more efficient scale. Hence, smaller cities may obtain benefits from privatisation solely due to the lower cost of operating in optimal scale.

Political Processes and Ideological Attitudes

Non-economic factors, specifically political processes and ideological attitudes that might explain the decision to privatise local services have also been adopted as variables. Within a democratic environment, two main motivations guide politicians in their decisions. On the one hand, politicians seek to win elections and obtain governmental positions. On the other hand, they have preferences for some policies over others according to their ideological attitudes. This double dimension of the politician in a democratic system has been named the citizen-candidate approach (Osborne & Slivinski, 1996 and Besley & Coate, 1997 offer theoretical insights; Levitt, 1996 and Lee et al., 2004 offer empirical support). Within the domain of political interests, the decision to privatise is dependent on the existence of pressure groups having a particular interest in the rents derived from a given form of service delivery. Hence, a high level of unionisation has been negatively linked to privatisation. On the other hand, strong industrial interests should be positively linked to privatisation. Ideology may also influence privatisation. Right-wing parties have been linked to more pro-private business values, whereas left-wing organisations are conventionally associated with public values. If these assumptions are correct, right-wing governments should be positively associated with privatisation, and left-wing governments should be associated with public production.

In short, the hypothesis more commonly analysed and empirically tested in the literature examining factors explaining local privatisation can be summarised as follows: 1) there should be a positive relationship between fiscal constraints and privatisation; 2) the choice of private production may be designed to reduce costs, either through competition or by the exploitation of scale economies; 3) the relative strength of different interest groups, such as unions or industrial business, should influence local government privatisation decisions; 4) right-wing governments will be more
prone to privatising local services, while left-wing governments will be more reluctant to do so.

A Review of the Empirical Evidence on the Motivations for Local Privatisation

In this section, we review the results of studies of the decision to privatise local services as they relate to the significant relationships stated above. We organise our analysis around the families of variables used to test those relationships: fiscal restrictions, economic efficiency, political process and ideology.4

Methodology, Sources and Data

We will consider only those studies that use econometric and multivariate methods, where the decision to privatise is conceived as a function of several explanatory variables. Multivariate studies allow the causal relationship between the privatisation decision and any of the explanatory variables to be identified, since such a relationship is conditional upon the value of some other control variables. In this way, inferences from results of multivariate studies tend to be more robust than those obtained in studies using different and less complex techniques.5

The studies we have considered in our review have been published in academic journals in the fields of Economics, Political Science, and Public Policy and Public Administration. Additionally, some recent unpublished manuscripts presented in International Academic Meetings or edited in relevant Working Paper Series (such as Social Science Research Network – SSRN) have also been covered in our review since inclusion in these collections constitutes a signal of quality.

To date, about 30 works have used multivariate regression techniques to study the decision to privatise local services. Table 1 displays basic information on all these studies. It can be seen that all studies published in the period 1980–99 refer to the US. Since 2000, some studies are still devoted to the US, but we have also found several works that analyse different European countries.

Fiscal Restrictions

The variables more commonly used to test the hypothesis that fiscal stress influences (positively) privatisation are the following: tax burden, legal limitations on local tax levels and the size of transfers from the central to local governments.

Early studies of the US, those where data collection was completed in the 1980s, frequently find that financial restrictions on local governments influence the choice of production form. Among these studies, only McGuire et al. (1987), and Chandler and Feuille (1994) infer from their
### Table 1. Main characteristics of the studies analysed

<table>
<thead>
<tr>
<th>Study</th>
<th>Country</th>
<th>Year data</th>
<th>Service</th>
<th>Small towns</th>
<th>Fiscal Stress</th>
<th>Scale economies</th>
<th>Interest groups</th>
<th>Ideology</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ferris (1986)</td>
<td>USA</td>
<td>1982</td>
<td>43 services</td>
<td>NO</td>
<td>+</td>
<td>–</td>
<td>(+)</td>
<td></td>
</tr>
<tr>
<td>Feldman (1986)</td>
<td>USA</td>
<td>1980</td>
<td>Urban buses</td>
<td>NO</td>
<td>+</td>
<td>+</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Mcguire et al.(1987)</td>
<td>USA</td>
<td>1979–80</td>
<td>School bus</td>
<td>NO</td>
<td>0</td>
<td>+</td>
<td>+</td>
<td>0</td>
</tr>
<tr>
<td>Morgan et al. (1988)</td>
<td>USA</td>
<td>1982</td>
<td>56 services</td>
<td>NO</td>
<td>+</td>
<td>–</td>
<td>(+)</td>
<td></td>
</tr>
<tr>
<td>Ferris &amp; Graddy (1988)</td>
<td>USA</td>
<td>1982</td>
<td>Several services</td>
<td>NO</td>
<td>+ (some services)</td>
<td>+ (some services)</td>
<td>(+)</td>
<td></td>
</tr>
<tr>
<td>Dubin &amp; Navarro (1988)</td>
<td>USA</td>
<td>1974–75</td>
<td>Solid waste</td>
<td>NO</td>
<td>+</td>
<td>+</td>
<td>(+)</td>
<td></td>
</tr>
<tr>
<td>Stein (1990)</td>
<td>USA</td>
<td>1982</td>
<td>64 services</td>
<td>NO</td>
<td>+ (some services)</td>
<td>+ (some services)</td>
<td>(+)</td>
<td></td>
</tr>
<tr>
<td>Benton &amp; Menzel (1992)</td>
<td>USA-Florida</td>
<td>1988–89</td>
<td>76 services</td>
<td>NO</td>
<td>Mixed</td>
<td>–</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Miranda (1994)</td>
<td>USA</td>
<td>1982</td>
<td>64 services</td>
<td>NO</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td></td>
</tr>
<tr>
<td>Chandler &amp; Feuille (1994)</td>
<td>USA</td>
<td>1973–88</td>
<td>Sanitation</td>
<td>NO</td>
<td>0</td>
<td>0</td>
<td>+</td>
<td></td>
</tr>
<tr>
<td>Greene (1996)</td>
<td>USA</td>
<td>1988</td>
<td>70 services</td>
<td>NO</td>
<td>–</td>
<td>–</td>
<td>+</td>
<td></td>
</tr>
<tr>
<td>Nelson (1997)</td>
<td>USA</td>
<td>1992</td>
<td>63 services</td>
<td>YES</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>0</td>
</tr>
<tr>
<td>López-de-Silanes et al. (1997)</td>
<td>USA</td>
<td>1987</td>
<td>12 services</td>
<td>YES</td>
<td>+ (some services)</td>
<td>+ (some services)</td>
<td>+</td>
<td>0</td>
</tr>
<tr>
<td>Kodrzycki (1998)</td>
<td>USA</td>
<td>1992</td>
<td>Several services</td>
<td>NO</td>
<td>+</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Warner &amp; Hebdon (2001)</td>
<td>USA-New York</td>
<td>1997</td>
<td>8 service areas</td>
<td>YES</td>
<td>Mixed</td>
<td>0</td>
<td>+</td>
<td>0</td>
</tr>
<tr>
<td>Bel &amp; Miralles (2003)</td>
<td>Spain</td>
<td>1979–98</td>
<td>Solid waste</td>
<td>YES</td>
<td>0</td>
<td>+</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Warner &amp; Hefetz (2002)</td>
<td>USA</td>
<td>1992–97</td>
<td>64 services</td>
<td>NO</td>
<td>Mixed</td>
<td>+</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ohlsson (2003)</td>
<td>Sweden</td>
<td>1989</td>
<td>Several services</td>
<td>YES</td>
<td>0</td>
<td>0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(continued)
Table 1. (Continued)

<table>
<thead>
<tr>
<th>Study</th>
<th>Country</th>
<th>Year data</th>
<th>Service</th>
<th>Small towns</th>
<th>Fiscal Stress</th>
<th>Scale economies</th>
<th>Interest groups</th>
<th>Ideology</th>
</tr>
</thead>
<tbody>
<tr>
<td>Martínez Rodríguez (2004)</td>
<td>Spain</td>
<td>2000</td>
<td>Several services (estimated separately)</td>
<td>YES</td>
<td>0</td>
<td>Mixed</td>
<td>Mixed</td>
<td></td>
</tr>
<tr>
<td>Walls et al. (2005)</td>
<td>USA</td>
<td>2001</td>
<td>Solid waste (recycling, disposal)</td>
<td>YES</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>+</td>
</tr>
<tr>
<td>Levin &amp; Tadelis (2005)</td>
<td>USA</td>
<td>1997</td>
<td>30 services</td>
<td>YES</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>+</td>
</tr>
<tr>
<td>Zullo (2005)</td>
<td>USA</td>
<td>2002</td>
<td>Several services, solid waste</td>
<td>YES</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Brown et al. (2007)</td>
<td>USA</td>
<td>1997</td>
<td>Several services</td>
<td>YES</td>
<td>+</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Hebdon &amp; Jalette (2007)</td>
<td>USA &amp; Canada</td>
<td>2004</td>
<td>Several services</td>
<td>NO</td>
<td>+</td>
<td>Mixed</td>
<td>0</td>
<td></td>
</tr>
</tbody>
</table>

Note: Symbol ‘+’ implies that the hypothesis tested is not rejected; symbol ‘−’ implies that the hypothesis tested is rejected; symbol ‘0’ implies that the variables used for hypothesis testing are not significant; symbol (+) for the interest group hypothesis implies that the level of public employment is used as a testing variable.
data that fiscal stress is not a significant influence on the privatisation choices of local governments. In more recent studies on the US, those where data collection occurred from 1992 to 2004, fiscal stress appears as a significant explanatory factor only in the works of Kodrzycki (1998), Brown et al. (2007) and Hebdon and Jalette (2007). It is worth noting that a common characteristic of most of the studies of the US that find a positive relationship between privatisation and fiscal restrictions is that they analyse several services. Among the studies for European countries, only Dijkgraaf et al.’s (2003) study of the Netherlands finds fiscal restrictions to be a relevant influence on local service delivery choices.

**Economic Efficiency**

The population of cities, as well as the demand for the service (when available), are the variables usually used for testing whether a desire to exploit scale economies has contributed to privatisation of local services. The hypothesis associated with these variables is that governments in small towns should use contracting out more frequently to take advantage of the scale economies provided by private firms or public agencies producing in several jurisdictions. Additionally, several works take into account the role of transaction costs. Such costs from privatisation might be relatively high in small towns, which could offset cost savings from exploiting economies of scale.

Evidence from studies that analyse just one service (rather than several) is more favourable to the hypothesis that scale economies are a major determinant of privatisation. Indeed, results from McGuire et al. (1987) for school buses and Feldman (1986) for urban buses support the hypothesis, as do the studies of Hirsch (1995), Stein (1990), Bel and Miralles (2003) and Dijkgraaf et al. (2003) for solid waste collection. In contrast, most of the studies that consider a broad range of services do not find significant influence from scale variables.

Finally, it is worth noting that some recent studies focus on the role of transaction costs in the delivery choices of local governments. In this sense, Menard and Saussier (2000), Levin and Tadelis (2005), Walls et al. (2005) and Brown et al. (2007) argue that the likelihood that production will be externalised is higher for services associated with low transaction costs, that is, services with low specific assets and whose performance is easily measurable. Additionally, some studies (Nelson, 1997; Martínez Rodríguez, 2004) argue that the positive relationship that they find between privatisation and population homogeneity is due to the lower transaction costs associated with such homogeneity.

**Political Processes**

Political considerations are analysed through the relationship between privatisation and the relative strength of interest groups affected by such
policy. The variables more usually considered in the literature for capturing this effect are the percentage of public employees over population, the degree of unionisation of public employees and the income level of households.\textsuperscript{11} In this field, it is commonly assumed that public employees and unions are in favour of internal production, while high-income households have a greater preference for privatisation.\textsuperscript{12}

Here we must recall that the variable for the weight of public employees is statistically biased since the determination of service delivery choices and the percentage of public employees is simultaneous. Indeed, a more intense use of external suppliers implies \textit{per se} a reduction in the number of public employees. Hence, we will not consider results from studies that use this variable for testing the group interest hypothesis. We will come back to this issue in our methodological note, below.

Early studies for the US, those where data was collected in the 1980s, usually find a negative relationship between privatisation and the degree of unionisation in the public sector or, alternatively, a positive relationship between privatisation and the weight of high-income households. Modern studies for the US tend to analyse such hypotheses less often, but some studies still find significant influence from unions (Warner & Hebdon, 2001; Levin & Tadelis, 2005) or high-income households (Warner & Hefetz, 2002). Miralles (2006) is the sole work that analyses the influence of interest groups on service delivery choices in a European country. He finds that the relative strength of industrial users influences privatisation.

The hypothesis of interest group influence is usually validated when a broad range of services is analysed.\textsuperscript{13} In addition, some studies that focus on just one service also find a significant influence of group interests (McGuire \textit{et al}., 1987 for school buses; Dubin & Navarro, 1988 and Hirsch, 1995 for solid waste collection; Chandler & Feuille, 1994 for sanitation; and Miralles, 2006 for water). Additionally, the influence of interest groups seems to be particularly high when small cities are included in the sample.\textsuperscript{14}

Lopez-de-Silanes \textit{et al}., (1997) test the hypothesis that political patronage affects service delivery choices, that is, the hypothesis that politicians obtain the support of public employees when production of services is done internally. In this sense, they find that state laws that impose accountability requirements in contracting for personnel encourage privatisation. However, later studies (Kodryrzycki, 1998; Walls \textit{et al}., 2005; Zullo, 2005) that test this hypothesis do not confirm these results.

\textit{Ideological Attitudes}

The influence of the ideology is usually captured through the percentage of left-wing (or right-wing) votes in municipal elections. It is generally expected that there will be a negative relationship between privatisation and the percentage of left-wing votes. The ideological attitude of the local population is found to be moderately significant in a very few studies. Among the
studies for the US, ideology is found to be a relevant explanatory factor for privatisation in the works by Dubin and Navarro (1988), Walls et al. (2005) and Zullo (2005) for solid waste collection. Among the studies of European countries, Dijkgraaf et al. (2003) for solid waste collection obtain a similar result.¹⁵

Discussion: Summary of Results and a Methodological Note

Summary of Results

The hypothesis that fiscal stress is a major explanatory factor of privatisation is more usually validated in studies that analyse several services, whereas studies that focus on just one service do not usually see influence from this factor. In fact, the effect on overall financial stress of the internal or external production of just one service should be marginal. Thus, decisions about how to produce local services should be more influenced by fiscal considerations when a broader range of services is being considered. Additionally, fiscal restrictions seem to be more influential in earlier studies than in more recent ones. It is likely that fiscal stress in the US could have been more intense in the 1980s, the period analysed in many of the studies that do not reject such hypotheses. Indeed, after Proposition 13 was passed in California in 1978 (see note 3) many states passed legislation that set restrictions on local governments’ freedom to manage their budgets.

The influence of scale economies on delivery choice is validated in many studies dealing with just one service. On the other hand, most of the studies that consider a broad range of services do not find significant influence from scale variables. The influence of scale economies should vary across services according to the size of fixed costs involved in the production of those services. Thus, it is reasonable to conclude that an analysis of just one service would more appropriately capture the economic efficiency effect.¹⁶

The size of transaction costs seems to be an important factor in determining the delivery choice. Low transaction costs are positively associated with privatisation, whereas high transaction costs are negatively related to privatisation.

Studies that analyse a broad range of services usually validate the hypothesis of interest group influence. This makes sense since these groups should focus on the whole activity of the local government.¹⁷ Additionally, the influence of interest groups seems to be particularly high when small cities are included in the sample. Indeed, local governments in small towns are particularly vulnerable to pressure from interest groups.

The ideological attitude of the local population is usually found to be insignificant. In fact, one might say that the only systematic result in the empirical literature is the lack of a systematic relationship between local privatisation and ideology. This result is consistent with the argument that
local governments are guided by pragmatic rather than ideological motivations.

A Methodological Note

In the review of the literature considering factors explaining local privatisation, the clearest pattern that we have found is the low explanatory power of these empirical analyses. One possible explanation of this general result is that most of the studies do not analyse, in reality, the factors that influence privatisation choices. Overall, the dependent variables do not capture the move from public to private; rather, they indicate only whether production is public or private in the year of data collection. Thus, these are static models where the production form in year $x$ is associated with the value $y$ of some explanatory variables in that same year.

A cross-sectional estimation for the production form can show correlations between the production form in the period analysed and the corresponding explanatory variables. However, this type of estimation does not allow results to be inferred with regard to motivations for privatisation since such a choice was made before the period in which data for explanatory variables were collected. An example can help to clarify this point. Several studies include the weight of public employees as a possible explanatory factor for local service delivery choices. In fact, it is clear that privatisation and the size of the public payroll must have a negative correlation. However, while privatisation certainly explains reduced employment in the public sector, the converse, which has been frequently assumed, is not true. This misunderstanding takes place in several studies that fail to take into account the dynamics of the considered empirical relationships; data on public employees refer to the year when the study is undertaken, while the decision to privatise was made in a previous year. Hence, since there was privatisation, the size of public employment was higher at the time of the decision.

Furthermore, it is generally accepted that local governments have limited capability to make discretional decisions about production form in the years after privatisation has been implemented. Several reasons explain the inertia in local government choices, such as the legal duration of a contract, difficulties in breaking up the status quo, difficulties of re-internalising production or finding alternative external providers, and so on.\textsuperscript{18}

All this goes to show that analysing the correlation between the production form and explanatory factors in period $x$ is very different from understanding why the local government made the decision to privatise in period $x - n$.\textsuperscript{19} Indeed, it should not be expected that fiscal restrictions in period $x$ or labour factors in period $x$ (and so on) explain decisions made in the period $x - n$. This shortcoming of the empirical analyses affects all the studies considered, except the works of Chandler and Feuille (1994), Bel and Miralles (2003) and Miralles (2006). Hence, this flaw is among the likely
reasons why empirical evidence for factors explaining local privatisation is still rather disappointing.

Concluding Remarks

In this paper, we have undertaken a review of the empirical literature examining motivations for local privatisation. Most of the studies considered have some shortcomings when analysing the dynamics of local privatisation. Hence, it is difficult to obtain systematic results from this literature. However, the following patterns can be inferred from our review.

First, fiscal stress and interest group pressures are especially likely to be considered as explanatory factors of local services privatisation in early studies devoted to the US that consider a broad range of services. Fiscal stress refers primarily to legal limitations on local tax levels, which are largely a US phenomenon. Political factors are also influential, particularly for governments in small towns, but it is difficult to interpret how this influence is transmitted to policy makers.

Second, the type and range of services considered seems to be the most relevant feature when one seeks to explain differences in results across studies testing the scale economies hypothesis. The impact of cost considerations is found to be particularly relevant when the exploitation of scale economies is taken together with the transaction costs associated with privatisation choices.

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

Local privatisation seems to be guided by pragmatic rather than ideological motivations. It is not clear what role fiscal restrictions play in this pragmatic approach. However, it is sensible to argue that motivations linked to political interest play a more or less important role depending on the particular institutional framework of government and the type of service under consideration.

In short, we find a high variability in the results of the empirical studies reviewed regarding the main relationships tested. Most of the empirical analyses have low explanatory power, which can be explained by the methodological difficulties of capturing the dynamic nature of the privatisation decision. Hence, generalisations about the factors that explain the decision to privatise local services should be drawn very carefully.

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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).
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.
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.

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. 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.

Martinez Rodriguez (2004) and Miralles (2006) obtain mixed results. 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). 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.

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.

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

References


