# SUMMARY

After three decades of privatization and anti-state rhetoric, government ownership and public management appear to be back in vogue in water supply sector.[1] The movement away from full private ownership or sufficient private ownership (e.g. concession) and towards corporatization and other hybrid ownership structures under public ownership is said to be motivated by the "inadequate" quality and scant cost savings of privatization.[2] Notwithstanding, the shift in ownership patterns does not provide a credible policy guide on what is a suitable ownership arrangement for a particular country, city, or municipality. Both theories and empirics do not provide conclusive findings on the optimal choice of ownership in water service provision. This can be attributed to the fact that water supply sector is traditionally controlled by the state, creating a well-entrenched political and institutional bias against privatization. Approximately 90 per cent of (urban) water services in the world are delivered by public water utilities, a vast majority of which are corporatized utilities. In France, most water undertakings had been privately operated, but both ownership and responsibility of water remained within the public sector. Aggressive privatization efforts by international financing institutions in developing countries in the 1990s, had to contend with various institutional, economic and political hurdles which may have affected the design of PPP schemes and, consequently, impaired the efficient functioning of the arrangement.

In view of this, I bring sharply into focus the differences in the bargaining dynamics between public management and a concession arrangement to establish the relative advantages of a concession-based privatization to corporatization. I argue that a concession may be preferred in a transactional setting where a high level of efficiency and investment is required but cannot be

[1] D. Cardwell. 2013."Cities weigh taking over from private utilities", New York Times, 13 March.
[2] D. McDonald, 2014, ed., Rethinking Corporatization and Public Services in the Global South. New York: Zed Books Ltd.

met under public management due to inefficient political interference, such as the case with a large, complex water supply system in urban areas in developing countries. The reasons are as follows: *(i) The high level of investment and efficiency requirement of large, complex water supply systems would demand substantial rents that cannot be accorded adequate protection and incentive under public ownership as benefits under administrative hierarchies are extensively shared; (ii) The allocation of virtually all control rights to the private operator makes accountability less costly to enforce as the cost of any decision or choice is largely thrust on the private operator whose sizeable investment makes him internalize the cost of his inefficient actions; (iii) The delineation of service provision and regulation makes the bargaining process transparent and open to exploration of potential remedies to contractual hazards; and (iv) The high demand for investment and efficiency of the system reduces the political benefit of low-cost pricing and increases the political cost of poor service quality and other bureaucratic inefficiencies making the decision of politicians to shift from public management to concession a credible commitment device (not to interfere in the operation of the utility).*

To maximize the gains from a concession-based privatization and privately-run utilities and, in effect, forestall ownership irrelevance, I explore two strategies: *(i) adopting a partnership approach to contracting; and (ii) establishing a two-tiered unified regulatory framework where all ownership types and their regulators are subject to a common regulatory oversight.* The partnership approach derives its rationale from the legal doctrine of impracticability which allows contract adjustment and burden-sharing in the emergence of an event of which impact on the financial value of the transaction is beyond the reasonable expectations of the parties. Taking into account specific bargaining conditions *(e.g. size of investment, and the level of regulatory and market risks)* a partnership contracting explores a proper mix of relational and formal elements in the choice of incentive devices (e.g., *risk allocation*) and ex-post governance mechanisms (*e.g., regulatory agency and arbitration*) to facilitate a value-preserving bargaining process. Specifically, the approach seeks to overcome double-sided opportunism in administrative contracts (i*.e. government imposes highly redistributive regulatory policies and the private operator maximizes rents*) via double-sided threat of punishment and reward. The government is contractually obligated to accommodate risk-sharing and grant a generous rent that is proportional to the information and bargaining advantage of the private operator in order to reduce the value of outside option of the private operator relative to the concession agreement and to lower the threat of public opportunism, which is high in a traditionally publicly-managed water supply sector provided it does not frustrate the efficiency and investment motive of shifting from public management to a concession arrangement. By disallowing the termination of the contract unless objectives of both parties have been frustrated, the parties are made to internalize the cost of deviating from their contractual obligations and are induced to mutually cooperate.

Another way of maximizing the gains from a concession arrangement is to establish a unified regulatory framework. A sound regulatory framework may help facilitate efficient functioning of all ownership types. A favorable performance of public utilities could increase the outside option of the government, perching the state in a better position to bargain for highly favorable contract terms and outcomes under a concession arrangement. At the same time, enhanced performance of publicly-owned utilities may attract private capital paving the way for increased private sector participation in the water supply sector.

To motivate the analysis of the relevance of ownership structure and explore the empirical validity of the propositions made or alluded to in the study, I conducted regression analysis and case studies on the performance of publicly-owned and private utilities in the Philippines. The empirical results generally lend support to the superiority of a concession arrangement and private utilities to public management or corporatized utilities. In fact, the demerits of corporatization have shown to be magnified in the case of the Philippines where there are serious flaws in the corporatization strategy. The key findings of the study are as follows: *(i) Privately-owned and run water utilities register a highly favorable trade-off between affordability and level of service (e.g. service coverage) on account of efficient staffing and spending patterns, where salaries are strongly tied to staff productivity improvement, and performance-based profit orientation; and (ii) Corporatization has shown to be most effective in modifying the pricing behavior and profit orientation of water utilities – it makes water utilities adversely commercially-oriented. Water tariffs of water districts are vastly driven by operational inefficiencies and profit motive almost without regard for the ability of consumers to pay. Water districts register high water rates even in low-income areas. Large spending in non-personnel expenses has not been accompanied by an improvement in service quality. The most profitable water districts can be the worst-performing water districts.*

With accumulated experience with contracting, adoption of a partnership contracting and establishment of a unified regulatory framework, the study predicts a gradual increase in private sector participation in developing economies. Through the prism of a partnership contracting and as illustrated by privatization experience of the Philippines, the gains from a concession arrangement may be maximized if the investment and efficiency requirements are high enough to fully exploit the financial and technical resources of the private operator and make profit a significant welfare component. In such case, an increase in the rent of the private operator would offer similar benefits to the consumers, enhancing the incentive for mutual cooperation. Also, political commitment to a concession-based privatization as a reform strategy is critical for the success of a concession-based privatization. With limited political commitment, the government may refuse to respect bargaining and informational constraints, which is crucial for establishing a stable pattern of mutual cooperation in a sector where there is substantial regulatory risks.