A Political Economy of Privatization Contracts: The Case of Water and Sanitation in Ghana and Argentina

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In general, the process and outcomes of privatization have been studied from the point of view of efficiency. In this article, we consider issues in the course of contract design, implementation, management and enforcement in privatized public services and utilities. The study is based on two case studies, involving several water concessions in Argentina and a management contract in the urban water sector in Ghana. Three key arguments are presented on the basis of these case studies. The first is that an individualistic analytical framework is often utilized by the mainstream economic perspectives, but these are inadequate for a comparative assessment of private versus public provision in public services where there are distinct collective or group interests and hence a wider socio-economic context and representation of different interests becomes highly important. Instead, the article proposes a political economy perspective, which pays due attention to distributional issues, group interests, ideology of states and power relations for the assessment of privatization contracts. Second, the administrative capacity of states and their resources play a key role for the outcomes of privatization. Finally, while some contractual issues could be resolved through resourcing and experience over time, others are inherent to the contractual relations with little prospect of remedy.

KEYWORDS privatization, public services, contracts, water and sanitation sector, Argentina, Ghana

Introduction

Since the early 1980s the privatization of economic activities across the world has taken place in three phases. The first started with the privatization of manufacturing, banking and agricultural activities (especially in the developing world) and was more or less completed by the end of the 1990s. This was followed by the privatization of infrastructural and public utility services, beginning in the early 1990s and continuing
to the end of the 2000s with some set back after the 1997 financial crisis in Asia. The third wave of privatization in different forms is now on-going for core public services such health and education.

This process has been accompanied by the emergence of a prolific literature on the outcomes of privatization. Most of these studies have assessed the process on the basis of various performance indicators such as profitability and efficiency, involving output and cost comparisons (Florio & Manzoni, 2004; Goldstein, 1999; Megginson & Netter, 2001; Megginson et al., 1994; Parker & Kirkpatrick, 2005; Villalonga, 2000).

In this article, we focus on the privatization of public services and infrastructure and assess the process, using service contracts as unit of analysis. The private sector is often brought into utility and public services — such as health and education, water and electricity — through long-term contracts. Private finance contracts to build and operate hospitals and schools, concession, lease and management contracts to supply water and electricity have been used across the world. However, contractual failures involving renegotiations, protracted disputes and cancellations have been widespread in many countries (Dagdeviren & Robertson, 2011; Guasch, 2004). Examining the process and outcomes of privatization of services through a focus on the design, implementation and outcomes of service contracts can often provide invaluable insights that cannot be acquired from the conventional studies of performance and efficiency assessment. Studies on service contracts, for example, can reveal crucial evidence on opportunistic behaviour, the nature of conflicts of interest and the institutional capacity in the design, implementation and enforcement of contracts, all of which have a crucial bearing on service performance and users’ welfare.

The discussion and analysis in this article is based on primary research in Argentina and Ghana. The first is a case study of four concession contracts in water and sanitation in Argentina; the second is a study of management contracts in the water sector in Ghana. Although there are substantial differences between these countries in terms of their socio-economic, political and institutional development, considerable commonalities exist with regard to the contractual problems they face with privatized public services. The study highlights the problems encountered in the design, application and enforcement of contracts and suggests that, while some of the issues could be managed and improved upon with experience, extra resources, better monitoring and enforcement, there are inherent problems in contractual process for which little or no remedy exists. However, beyond contractual problems the analysis is broadly informed by a political-economy perspective by rejecting the methodological individualism that underpins mainstream economic perspectives. In addition, the role of the state is emphasized as being subject to pressure from different interest groups and also swayed by an ideological agenda not substantiated by evidence on privatization, rather than as an impartial arbiter of interests.

Mainstream theoretical approaches to the privatization of public services

Broadly speaking, mainstream economic theory has been against government ownership and control of resources on the grounds of efficiency considerations. The exceptions, as are often cited in textbooks, are cases where there are market failures; for
example, if the sector is a natural monopoly or it generates externalities or produces public goods. As market failures characterize many of the public services and utilities, the position of mainstream theory has therefore been in favour of public ownership for these sectors. However, there have been some detractors from this position, one of which is public choice theory (PCT). Applying methodological individualism to the political and public sphere (that is, assuming rational, self-interested bureaucrats), PCT counterbalances the emphasis on market failures with a focus on ‘government failures’ (Buchanan, 1978) arising from lack of incentives for cost-cutting (Niskanen, 1968, 1975), problems associated with majority voting in public decision making (Tullock, 1959, 1962) and rent-seeking (Buchanan, 1983).

Second, property rights theory (PRT) posits that privatizing economic resources in general would resolve the inefficiencies associated with market failures. It was suggested for example that the externalities arising from collective ownership, such as the over-utilization of resources, free-riding on investment and innovation, difficulties of measuring, attributing and rewarding effort correctly, could be internalized through privatization (Alchian & Demsetz, 1972, 1973; Demsetz, 1967; Furubotn & Pejovich, 1972). Competitive bidding and rivalry (Demsetz, 1967, 1971) and independent regulation (Goldberg, 1974; Shirley, 2002) or use of anti-trust laws (Posner, 1974, 1999) are recommended for addressing market failures such as those arising from monopolistic market structures in utilities.

Further extensions to the PRT have been made by incomplete contracts theory (Grossman & Hart, 1986; Hart & Moore, 1988, 1999) on the grounds that the former does not provide sufficient guidance on the forms of ownership when contracts are incomplete. This theory predicts a superior performance under private ownership for services such as water and sanitation, health, waste collection and prison services. It is proposed that some efficiency improvements in the form of cost reductions and/or quality enhancement are non-contractible *ex-ante* because costs and benefits are non-verifiable (though observable). It is assumed that any non-contracted improvement by public managers is subject to approval by bureaucrats and the results will not fully translate into direct benefits. This is called the ‘hold-up’ problem in the public sector, where incentives for innovation are considered to be lower. Privatization is expected to resolve the hold-up problem on the basis of the assumption that activities leading to efficiency gains would not be subject to approval in the private sector. On the basis of this analysis, the proponents of the theory of incomplete contracts (TIC) reach the general conclusion that private arrangements increase efficiency unless the social gains from cost-reduction are small and offset by the negative impact of cost-cutting efforts on quality (Hart *et al.*, 1997).

While TIC recommends privatization of public services to deal with the ‘hold-up’ problem in the public sector, the evidence in this article shows that privatization replaces one incomplete contract (between state and public manager) with another (between state and private provider) and the possibility of hold-up by any of the parties is not eliminated. The incessant disputes and renegotiations over contractual terms and conditions (e.g. tariffs and investment in Argentina and non-revenue water (NRW) in Ghana) can often be initiated by the private sector and seen as a form of hold-up.

Another relevant theoretical framework for privatization is the transaction cost theory (TCT), which is built on the Coasian (1937) critique of neoclassical theory.
There is wide recognition in this literature that property rights, contractual hazards, uncertainty and information imperfections (incompleteness and asymmetry) matter and give rise to transaction costs (North, 1990; Williamson, 1971, 1979, 1981). The basic premise of the theory is that trade via the market is best when transaction costs are low. Otherwise, integration within a firm helps in reducing the cost of transacting via markets. While the scholars within the TCT tradition have been generally in favour of the ‘private order’, the principal elements of TCT do not provide an unambiguous rationale for privatization, particularly for public services. This is particularly the case because the factors that give rise to higher transaction costs (for example, incomplete information, contractual hazards and uncertainty) are not unique to the public sector and do not disappear with privatization; in fact, in some cases transaction costs increase under the private model.

Finally, the fact that business activities are usually carried out in firms where ownership and management are separated leads to the recognition of agency costs associated with delegation (Fama & Jensen, 1983). These arise from asymmetric information between owners and managers with different objectives and give rise to what is known as the ‘principal–agent problem’. Principal–agent theory does not make a uniform suggestion in favour of public or private ownership in terms of minimizing delegation costs. Instead, it suggests that ownership decisions should be informed by an incentive structure that depends on information asymmetries and agency relations (Laffont & Tirole, 1991; Sappington & Stiglitz, 1987; Shapiro & Willig, 1990).

Overall, while theoretical positions in mainstream economics are in favour of the private system in general, where there are market failures this position is often modified to postulate the superiority of public ownership or reflect indeterminacy a priori between private and public. In other words, the choice depends on the empirical conditions with reference to the extent of market versus governance failures as well as imperfect information and transaction costs.

Despite the absence of a strong theoretical rationale for privatization of utilities and public services, an unfettered tendency in that direction on a global scale has gradually been taking place. In the next section, the discussion around contractual implementation in two case studies from a low- to middle-income country aims to show failures of privatization in public services. This enables a discussion of the shortcomings of mainstream economic theory in understanding contractual problems and points to the necessity of a wider political economy approach.

**Argentina: post-privatization contractual disputes in the water and sanitation sector**

Argentina was one of the first countries to begin privatizing its utilities extensively from the early 1990s onwards, largely through foreign direct investment with the involvement of multinational companies (MNCs), as part of a wider set of neoliberal reforms that started in the 1980s. The country had entered into bilateral investment treaties (BITs) with more than 50 other states and the guarantees given to MNCs by these agreements played an instrumental role in attracting foreign investors. A severe economic crisis in 2001 and the abandonment of the pegged exchange
rate affected the profitability of these companies and started a process of disputes and renegotiations in which over 60 MNCs sought protection within BITs.

In the water and sanitation sector, six concession contracts of 30 years’ duration were cancelled. In this case study, we discuss four of these:

1. Aguas Argentina, privatized in 1993, re-nationalized in 2006 — dispute with Suez and Agbar.
2. Compañía de Aguas del Aconquija, privatized in 1995, re-nationalized in 1997 — dispute with Vivendi.
3. Aguas Provinciales de Santa Fe, privatized in 1995, re-nationalized in 2005 — dispute with Suez and Agbar.
4. Azurix Buenos Aires, privatized in 1999, re-nationalized in 2002 — dispute with Azurix.

The analysis draws on the information contained in 16 claim and counter-claim files submitted by the private investors and the government of Argentina to an international arbitrator. Although the narrative in these files is subjective, reflecting the interests of individual parties, in some cases the claims of contracting parties overlap, which aids verification of the facts.

**Common features in the narrative of dispute files**

First, issues of tariffs, investment targets and strategy of financing investment were the main subjects of disputes in all cases, reflecting a contest in relation to the allocation of risks and profits. In some cases, the dispute was related to the differences in the interpretation of contracts. For example, in one case, in contrast to the public agencies’ interpretation, the operator insisted that the contract allowed for taxes to be passed on to users through prices. In other cases, contracts permitted various forms of increase in service charges, which in practice caused social unrest and became politically unsustainable. Hence, companies asked for a reduction in investment targets in return for a more socially applicable tariff structure. Such social (and distributional) conflicts have been widespread, especially in the developing world, but these issues are not tackled by the theories covered in the previous section because they focus on firm-level efficiency.

Second, in cases where disputes arose following the economic crisis, a major disagreement was related to the accumulated external debt, which the companies had used to fund their investment with very little equity in the 1990s when interest rates were low and the exchange rate was fixed. After the crisis, a substantial devaluation threatened the financial viability of these companies as they had to pay their debt in foreign currencies, while earning their revenues in domestic currency. Hence, companies requested adjustment to their tariffs in order to service their debt, which the government refused, pointing to the fact that investment funding strategies (i.e. whether funded by external or internal resources) were business decisions and, as such, the associated risks should be assumed by the companies that made such decisions.

Finally, one of the common features of the narratives in the dispute files was the prevalence of opportunistic behaviour by contractual parties from the beginning to the end, when the contracts were finally terminated. For example, public authorities disregarded user opinion in the process of privatization, in that plans for large scale
privatization of utilities were implemented as a result of political decision making with no consultation with users and civil society groups. However, after the emergence of disputes, they exploited public opinion when necessary; for example, during the arbitration proceedings. Similarly, the request by some companies to renegotiate the terms and conditions of their contracts after winning the concessions by submitting the most favourable bids (that is, those with the lowest tariffs or highest concession fees) could be seen in the same light.

**Root causes of the disputes**

Several factors could be highlighted as the fundamental causes of the disputes involving concession contracts in water and sanitation services. First, the four cases of disputes provide compelling evidence that these essentially boil down to *social conflicts of interest* over the supply of a vital service (that is, water and sanitation). Social unrest and political campaigns to reverse privatization and penalize private companies as a result of high service charges and a number of incidents when water supply was affected by turbidity reflect the response of user groups when affordable and good quality water is damaged. Bakker (2010: 140), for example, reports that protests continued from the mid- to late 1980s in the City of Buenos Aires, from 1993 to 1999 in the province of Tucuman. After the crisis, similar campaigns took place in Cordoba in 2002 and the Province of Buenos Aires in 2006. On the other hand, after 2002, the intervention of powerful external institutions and governments (for example, the World Bank, the French government and the International Monetary Fund) in the process of renegotiations between the companies and Argentine public agencies reflects efforts to protect the interests of private investors in the water and sanitation sector (see Azpiazu & Castro, 2012: 63).

Second, the narrative in the claim and counter-claim files indicates that *problems of representation and negligence of social context* in the pre- and post-privatization periods has been very significant in relation to the rise of contractual disputes. A few examples substantiate this argument. One of these is related to the political commitment of the public authorities to privatization, which can be discerned from the testimony of a regulatory expert before the arbitration panel:

> [S]uch an important concession looked at by all the world . . . It was not possible for it to fail, it was imperative to find remedies to give it sustainability. . . . (PTN, 2006: 35)

It is usually presumed that public agencies represent the interests of users (as well as others), but this is highly contentious when governments are committed to privatization in such a way that they concede to the demands of operators in the process of renegotiation in order for privatization to not fail. The problematic nature of representation by the governments becomes clear when the predominant ideology and predetermined mandate with respect to privatization is considered together with the involvement of the powerful MNCs; the absence of user participation in the process of formulating contractual obligations and targets; and the fact that contracts are often seen as commercially sensitive documents, shrouded in secrecy and under no obligation to make their details transparent.

The social unrest caused by the increases in service charges (for example, those related to additional infrastructure charges) that later proved politically inapplicable
reveal either public authorities’ lack of understanding of (or indeed negligence in relation to) issues related to the affordability of services charges and expectations of users since some of these increases were permitted by the contracts. Later, in their counter-claims submitted to the arbitrator against the claims of the disputing companies, public authorities utilized a legal argument about the ‘defence of public necessity’, reflecting the afterthoughts on matters such as affordability and the social context of service provision.

Finally, defects in the design of contracts were widespread. In some cases, contracts failed to specify the consequences of non-compliance with investment targets, for example. In other cases, contracts permitted the indexation of tariffs to the US dollar when this was prohibited by the national laws of Argentina. More importantly, no matter how scrupulous the efforts expended on the design of contracts, it seems impossible to write flawless contracts that are not open to differences in interpretation or disposed to uncertainties. Indeed, the water and sanitation disputes in Argentina also contained myriad examples in these respects. The interpretation of contractual clauses by the relevant parties differed widely on matters such as which costs could be passed on by tariffs, what sort of factors could trigger tariff reviews or what procedures should be followed in tariff reviews.

**Ghana: management contract in the water sector**

Ghana contracted out its water supply services for five years from 2006 following a major restructuring in the sector that aimed to improve its attraction to private investors. For this purpose, the rural water supply and sanitation services (the unprofitable elements) were separated and retained within the public sector. The contract was awarded to a joint venture company of the Dutch Aqua Vitens and South African Rand Water. The privatization process had been supported by various donors, especially the World Bank, with grants and technical assistance. The management contract described the obligations of the private operator in some detail, the most important of which were the following:

- Reducing non-revenue water (NRW), i.e. leakages, non-payments, illegal use, etc. by 5 per cent per year.
- Increasing revenue collection and reducing chemical and power consumption.
- Maintaining the standard of water and improving customer response.
- Lowering water consumption by the public sector.

Throughout the contractual period, these targets were not achieved and obligations were not fulfilled by the private operator, except for some reduction regarding the consumption of electricity and providing faster responses to customer calls. Although there was some recovery in revenue levels this was due to a considerable increase in water charges rather than as the result of better operational performance. Further, there was extensive non-compliance with water quality requirements. As a result, when the contractual period ended, the government resumed public ownership of the water supply service despite the initial intention of longer-term privatization.

While the experience with and outcome of privatization can be assessed from different perspectives, the *contractual underpinnings of poor performance* lay in several areas. The foremost defect of the contract was that it had not determined the
baselines against which the performance of the operator could be assessed. Instead, it had left these baselines to be determined in consultation with the operator after the contract was awarded. For example, although the contract required the management company to reduce NRW by a minimum of 5 per cent every year, from what level this reduction was to be achieved had not been specified. No agreement could be reached on most baselines in the five years when the management contract was in force. Renegotiations between the public counterparty and the private company proved futile since the private operator was in a more advantageous position with a defective contract (which made the assessment of its performance impossible) and guaranteed management fee. Moreover, the contract left the determination of penalties for the breach of contractual targets and requirements to the private operator. As would be expected, these penalties were not specified and hence could not be enforced despite widespread non-compliance.

Second, as in the case of contractual issues in Argentina, the water management contract in Ghana also contained many clauses open to interpretation. For example, the contract obliged the operator to make certain decisions ‘in consultation’ with the public counterpart. However, it was not clear how the ultimate decision would be made when consultation did not result in some form of negotiated agreement. Similarly, the public counterpart was defined as the ‘supervisor’ of the operator in one part of the contract, while the operator had been defined as ‘independent’ in another part. These inconsistencies created considerable conflict and affected the operations in a negative way. Moreover, in determining the payment priority (for salaries, inputs, repairs and maintenance, transfer of surplus to the public counterpart), the contract required the operator to be ‘prudent’ in spending and to cover ‘reasonable and necessary costs’. However, the vagueness of these terms resulted in spending patterns that caused significant hostility on the part of the public authority resulting from lack of surplus transfer for prolonged periods of time.

Finally, the companies bidding for the operation of water services had submitted detailed plans about finance and personnel, including the list of senior managers and their résumés. However, the public counterparty argued that the management company had not brought in the skilled personnel promised during the bidding process. The company could not be held accountable for this failure as the contract indicated that the only binding document was the contract itself and that all prior documents (bidding documents) were null and void.

Overall, the privatization experience in the Ghanaian urban water sector was characterized by capacity weaknesses in the design, application and enforcement of the management contract.

**Discussion**

At a more abstract level, various elements of the case studies discussed in this article reveal the relevance and importance of a political economy perspective in understanding the consequences of privatization of public services such as water and sanitation. Of the numerous political economy dimensions that could be highlighted, two are most imperative for the assessment of privatization programmes: (1) treatment of social and distributional conflicts and (2) the ideology and capacity of the state. Let us consider these in turn.
Treatment of social and distributional conflicts

Most of the theoretical arguments discussed above are based on what is known as ‘methodological individualism’ in that they focus on transactions between self-interested individuals. Wider socio-economic and political contexts and the distributional consequences of economic policies are ignored. Social or group interests which prevail for public services are not considered in these theoretical formulations. The case studies in this article show the crucial significance of such interests and the limitations of frameworks that utilize individual-based analysis. For example, in services where user charges apply, as in the case of the water sector in Argentina and Ghana, increases in tariffs to ensure cost recovery and profitability affected the welfare of users negatively, especially low income groups and the poor. An important implication of the approach taken by mainstream theories is that they are capable of dealing with conflicts between individual parties to a transaction but are not able to deal with social conflicts arising from such transactions. Social conflicts over service supply or charges inevitably lead to politicization of service delivery in countries with a relatively democratic tradition, and reversal of the private model is likely if the social and distributional context is not carefully considered, as in Ghana and Argentina where social discontent with the outcomes of privatization led to termination or non-renewal of the private contracts.

A particularly challenging matter, it seems, is related to how the conflict of interests between users and private investors (or between service quality, access, affordability and cost recovery and profitability) are addressed in the contracts that outsource public services to the private sector. The complete lack of transparency about contract design, development and accessibility does not reflect well on the process in terms of user participation and accountability to the public. It is almost a universal international practice that the public service contracts are designed and applied often without user involvement and they are not available for public scrutiny despite varying levels of broader oversight by consumer groups and regulators after privatization. The fact that the so-called ‘commercial sensitivity of contracts’ takes precedence over public interest in essential services reflects a bias in favour of private investors. Although it is presumed that the state and its agencies can sufficiently and comprehensively represent the interests of a wide range of stakeholders in the process, this is rather dubious, as reflected by the case of Argentina, where tariff structures and levels agreed by the public authorities and permitted by the contracts proved to be socially unsustainable, or Ghana, where allegations of corruption derailed the earlier privatization plans.

Moreover, contractual disputes significantly increase the transaction costs associated with privatization. While knowledge about these costs is important for the assessment of the wider social benefits of privatization programmes, this information is not often in the public domain unless the disputes are channelled through formal institutions (i.e. courts or arbitrators). Four of the dispute cases in Argentina, for example, involved years of legal proceedings and all of these disputes are still pending. The claims of the companies are for over $1.5 billion and, if successful, these sums will have to be added over and above the initial transaction costs of privatization. In cases where disputes are resolved through renegotiations, compromising initial targets is common. Contractual disputes and renegotiations are very likely in
a number of circumstances. External shocks increase the potential for conflicts if they affect contracting parties’ costs and benefits. Lack of due diligence in the assessment of the contractual rewards and liabilities can lead to disagreements in the aftermath of privatization. Ineffective representation of users in determining the contractual parameters that affect their welfare can also fuel social opposition.

The ideology and the capacity of the state

From a theoretical perspective, the pro-privatization arguments have been based on the assumed superiority of the private sector in terms of efficiency. At a practical level, investment in public services has also played an important role for privatization of public services and utilities in an environment in which the arguments for a reduced role for the state have gained a stronghold position, leading governments to privatize cash-strapped services and relinquish their responsibility for looming investment requirements.

However, both the broader evidence and the evidence in this article indicate that investment by the private sector in utilities and public services has not always been at the levels expected and or smoothly forthcoming. The states have continued to invest a larger proportion of total capital in infrastructure and public services. In the developing world, for example, it was shown by Estache (2006) that 70 per cent of investment in infrastructure and utilities involving the private sector was committed by governments, 8 per cent by donors and only 22 per cent by private investors. This argument is also supported by Guasch and Straub (2006). The evidence from the case studies above reveals the problematic nature of privatization for investment in public services. The case study on Argentina shows that the private water companies have reneged on their investment targets, relied excessively on debt for funding investments and threatened the financial viability of operations; this situation has resulted in the state either taking over the services or injecting public resources to ensure their viability. The increasing tendency in African economies to use management contracts that retain the risk of investment in the public sector, unlike concessions and PFIs, reflects the deviation between the rhetoric and reality in dealing with investment needs in public services.

The case studies on Argentina and Ghana provide useful insights into the nature of states’ agency. Most significantly, they indicate that the state, its government and institutions are often subject to deeply entrenched ideological influences that displace coherent policy choices. The ideological commitment of the governments to privatization in general has meant that service users have not been consulted and opposition to these programmes has been disregarded in Argentina and Ghana. Lessons from the widespread failure of privatization of public services in other countries have been ignored.

Neither are the states and institutions neutral mediators of divergent interests held in the provision of public services. The political domain in which they operate is subject to contestation and pressure from different interest groups, including powerful political lobbies and civil society organizations. However, they are not passive respondents to such interactions. The transformation towards more neo-liberal and capital-orientated political regimes in the last several decades has led governments to show an ideological bias in upholding the interests of private capital. This is partly why the commercial sensitivity of public service contracts supersedes the public
interest in their disclosure. This is also why the regulators in Argentina felt that they had to ‘give in’ to the demands of private investors in order to not tarnish the image of privatization.

The case studies also highlight the importance of the administrative capacity of the state in terms of the outcomes of privatization of public services; however, this is ignored by some of the theories covered above. The evidence on the complex and troublesome nature of contract design, application, management and enforcement before and after the privatization of public services and utilities is compelling. These include difficulties in ensuring consistent and unambiguous contractual clauses on rewards and liabilities (e.g. investment versus tariffs in Argentina) and the roles and responsibilities of contractual parties (e.g. in Ghana) that are suitable for both current and future periods, should the operational environment change.

Performance of services under private contracting depends on the presence of effective monitoring and enforcement systems. Appropriate reporting forms should be completed at regular intervals to provide information for performance assessment; institutions should be set up to provide effective oversight of contractual obligations, enforcement mechanisms and procedures for contractual non-compliance. The study on Ghana demonstrated how acute information problems resulting from an absence of effective reporting systems made it impossible to apply any penalties to the water company. In both countries there is evidence of ineffective enforcement in relation to contractual non-compliance. For example, in Argentina investment targets were not fulfilled by the water companies; in Ghana the NRW target was not met. Lack of availability of service contracts for public scrutiny also weakens the potential for monitoring such contracts.

It is clear that contracts that outsource public services to the private sector can be better designed and implemented by those with more experience and resources (skills, financial) in combination with effective monitoring and enforcement systems. Nevertheless, there are a number of inherent problems in the design and management of contracts with little or no remedy. First, it is impossible to write fully consistent, unambiguous contractual clauses that provide optimal incentives to all parties. Second, and as is widely acknowledged, long-term contracts are inflexible and uncertain. What transpires in the future can change the projected costs and benefits of contracted services for different stakeholders, lead to sub-optimal outcomes and create winners and losers. This becomes particularly obvious in times of crisis and following downturns in investment cycles. Third, in privately provided public services the clash between private and public interests is ubiquitous. Fourth, opportunistic behaviour by contractual parties can be reduced but not eliminated. For example, if disputes and renegotiations generate higher rents by reneging on responsibilities, they are likely to prevail. Finally, there is no permanent ‘risk transfer’ in outsourced public services given that governments have to pick up the pieces following the failure of public service projects, as occurred in Argentina and Ghana.

Conclusions

In this article, privatization of public services has been discussed on the basis of contractual issues encountered in the process of implementation. The conclusions are
derived from two case studies from the water sectors in Argentina and Ghana. Four major points from the foregoing discussion deserve emphasis. First, social and distributional outcomes of provision in no other sector play as decisive a role as they do in public services. Any adverse change in service delivery, affecting the access of households, following privatization has to be set against firm-level efficiency gains. In certain socio-economic contexts such distributional conflicts can deal a serious blow to the viability of privatization programmes.

Second, representation of different interests in the design and administration of public service contracts seems to be rather problematic. While private investors do have direct involvement and influence in the process, the interests of users, especially the low income and the poor, are presumed to be represented indirectly by the agencies of the state. However, effectiveness of this representation is rather unconvincing in a world in which the selection of economic policies is significantly influenced by a political ideology aiming to enhance the penetration of private capital into areas that have traditionally been dominated by the public sector. The case studies above provide explicit or implicit examples that raise questions about the impartiality of public agencies’ representation.

Third, the capacity of states seems to be a crucial factor in the design, implementation, monitoring and enforcement of public service contracts. Both in Argentina and Ghana, capacity weaknesses arising from institutional problems or resource shortages resulted in flawed contracts and weak enforcement.

Finally, while some of the issues raised in this article could be dealt with by targeted interventions (greater resources, experience gained over time), others are innate to privatization and cannot be eliminated fully and permanently. For example, it is impossible to write fully consistent, unambiguous contractual clauses that provide optimal incentives to all parties into the foreseeable future.

Notes

1 Each of these contracts differs from one another in terms of length, assignment of investment responsibility and associated risks. For example, while under concession contracts, private agents take over the responsibility of both operations and investment on a long-term basis; management contracts transfer only the operations to the private companies for a management fee for a shorter period (up to five years), leaving the investment risk to be assumed by the public counterparty.

2 An extensive discussion of this case can be found in Dagdeviren (2011).

3 Most disputes were submitted to the ICSID, the International Centre for the Settlement of Investment Disputes. A few went to the UNCITRAL, the United Nations Commission on International Trade Law.

4 See Dagdeviren and Robertson (2013) for greater detail on and analysis of this case study.

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