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Water supply: Public or private? An approach based on cost of funds, transaction costs, efficiency and political costs

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Author(s)

Pérard, Edouard

Description / Abstract

Most theories on private sector participation in water infrastructure are based on the sole supposed difference of efficiency between the public and the private sector. The review of 22 empirical tests and 51 case studies shows that private sector participation per se in water supply does not systematically have a significant positive effect on efficiency. Thus, the choice between public and private water delivery is probably not only a question of efficiency.

We developed a complete theory of the choice between public and private water supply based on four components: difference of cost of funds, transaction costs of outsourcing, difference of efficiency and potential political cost of privatizing. Since determinants of the theory fluctuate over the time and depend on the local context, this theory can explain both privatization and municipalization movements as well as why some local governments outsource water supply, while others opt for direct provision.

The tests on 459 US counties in charge of water supply in 45 states provide substantial support for the theory. Significant determinants of the choice of public versus private water delivery include the cost of funds, especially the social cost of taxes, transaction costs, the difference of efficiency and the potential political cost of privatizing.

Moreover, we tested other literature's theories, which suggest employment as a motive of public provision and cost of public wages as a cause of privatization. These two arguments seem to be irrelevant.

We additionally tested the influence of ownership on the number of drinking water environmental violations and found no significance.

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