THE POLITICS OF PRIVATIZING WATER SERVICES: IN THEORY AND PRACTICE

A thesis submitted in fulfilment of the requirements for the Degree of Master of Arts in Political Science in the University of Canterbury by Victoria Treliving

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ABSTRACT

Since the early 1980s, the phenomenon of privatization has quickly spread worldwide, changing the balance between the state and the market in favour of the latter. Its adoption questions and replaces the traditional role of the state in providing and controlling certain public services. One formerly predominantly public service to be affected by privatization is piped water services, as it is commonly argued that private suppliers stimulate greater efficiencies and innovations than public suppliers.

Most of those writing on this subject tend to focus narrowly on comparisons of public and private water companies in an attempt to argue that one or the other is best. Alternatively, some concentrate on the policy process through which privatization found favour. However, the thesis takes a very different approach to the analysis of privatizing water supplies, contributing to an area that has attracted little attention: its theoretical context and its implications for democratic politics.

The aim of the thesis is to concentrate on, and extend, the types of assumptions – efficiency and innovation – inherent in arguments for privatization, thus providing a wide-ranging theoretical context in which to locate the privatization of water services. After discussing at some length exactly what comprises privatization, the thesis examines the theoretical foundations from which the policy originates. With reference to two case studies of privatization - Britain and Wales, which privatized water services in 1989, and New Zealand, which has not fully privatized its water, but is increasingly favouring more commercial practices – the thesis then illustrates how the theories have informed privatization in practice. The thesis concludes that privatizing water supplies is an inappropriate extension of these theories because, first, they do not recognize the inherently non-commercial nature of water services and, second, because their implications for citizenship, and therefore democratic politics, are potentially very damaging.
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Without the contributions of the following people, the last year and a half spent researching, formulating and writing my thesis would have been an arduous and lonely time.

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I am very grateful to the University of Canterbury for granting me a Masters’ Scholarship, which encouraged me to undertake this year and a half of study after completing my Honours’ year. Finally, I would like to thank my supervisors, Martin Holland and Joanna Goven, for their insightful comments and, in particular, Joanna’s patience while I was racking my brains for a topic, and her advice and suggestions when I occasionally lapsed into mild states of panic over the construction of my thesis.
INTRODUCTION

Although particularly topical over the last twenty years, the issue of whether water services most appropriately fit into the public or private sphere is not a new one. As seen in the fierce debates between J. S. Mill and Edwin Chadwick over the nationalization of London's water supply, this controversy, in fact, dates back to the 1850s (Schwartz, 1966). The rapid increase in the adoption of privatization in many Western industrialized countries has been accompanied by a diversification of those assets sold, and water supplies have not been left untouched by privatization's influence. With water services being traditionally overseen by the public sector, whether at a regional, local or municipal level, it does not seem an exaggeration to suggest that many would never have predicted their eventual complete privatization in Britain and Wales, or the increase of similar policies along more commercial lines in other countries.

The thesis will investigate this policy of privatizing water services, now being increasingly applied by more and more countries. Privatizations of this type signal a change from the view held traditionally that the state has a role to play in providing various services to the public. That is, "in the provision of basic services to its population...the state has disengaged from assumptions that planning and responsibility lies [sic] with the nation state, preferring to adopt a competitive, consumerist, model of service provision" (Foster and Braddon, 1996, p.290). In relinquishing its traditional role, the state effectively absolves itself from many responsibilities, although in some cases it may still have a role to play in a privatized industry, for example, in the regulation of privatized monopolies.

The theory beneath the transformation of the role of the state in controlling public services is especially significant because it can offer many insights into the rationale behind privatization, and the world-view that may arise with its implementation. When viewed in this way, it becomes clear that privatization is not solely an economic technique or policy, but is also a significant means of means of transforming the political landscape. It is important to realize that the theory beneath privatization has implications that reach far beyond simply removing an activity from the public sector, as will be seen in this thesis.
Examinations of the privatization of water services can take two forms, either concentrating on whether or not it has successfully met its objectives, or discussing the worth and implications of those objectives (Buttle, 1996, p.29). The majority of discussions tend to focus on examining the former types of arguments, with reference to efficiency, competition, consumer responsiveness and accountability. Although theoretically feasible, it can be difficult to determine the effect of ownership in the operation of an activity, primarily because advocates of privatization idealize the effects of private ownership, and exaggerate or concentrate on the disadvantages of public ownership (Ogden and Watson, 1996, p.723). While still a valid approach to take, and one that will be very briefly considered towards the end of the thesis, it seems that the latter area of privatization analysis – its worth and implications - has been neglected in favour of the former approach, and has not in fact attracted very much attention at all. For this reason, this thesis will analyze in some detail common arguments for privatizing. It will then extend those arguments to expose the underlying political theories beneath them, and the implications they have for a concept central to political analysis: democratic citizenship. It will take into account the practical experiences of two case studies in order to illustrate the theoretical conclusions.

Several terms are used throughout the thesis that require preliminary clarification. First, the term ‘water services’ can involve eight distinct functions: resource ownership (of the water); the policy/decision to build; a regulatory function; construction of a system; financing; ownership of the assets; management of the operation; and finally, maintenance (KPMG Peat Marwick, 1995, p.3). Consumer also provides a useful definition: water services “comprise both the supply of freshwater [through pipes] and the treatment and disposal of wastewater: all the used water from sinks, baths, showers and toilets that goes into council pipes” (1998, p.30). This is the definition that will be used in this thesis. As well as ‘water services’, the terms ‘water supply/supplies’ and ‘water utilities’ are also taken to encompass the same ideas, and therefore they are used interchangeably with the former term throughout the thesis.

Second, at this early stage, it is sufficient to state that privatization means a change to private involvement in a formerly public area, although this may be at varying degrees of involvement. Implicit in definitions of privatization are the notions of ‘public’
and 'private'. Although seemingly straightforward in meaning, as demonstrated in the first chapter, this is in fact not the case at all. A fourth term that often accompanies privatization is 'the market' or 'market mechanisms'. This is usually taken as meaning an ideal self-enforcing system in which price signals reflect the value of goods being voluntarily exchanged in a competitive environment, thus producing results which are "generally beneficial" to all parties to the transaction (Self, 1993, p.198).

The thesis has a fairly straightforward structure. Chapters one and two are essentially theoretical examinations of privatization. I suggest in the first chapter that the term privatization can have several meanings. Some key features of privatization are then identified, followed by several interpretations of the nature of goods, which have an influence on how they are placed in organizational arrangements. The different arrangements for water services are then briefly discussed. Chapter two examines the political theories behind the policy of privatization. Although not stated explicitly, it is clear that the policy draws much of its influence from a family of theories. I have grouped these theories together under the term 'the economic approach to politics' because they use the methodology of economics to reduce complex political issues to more simple ones, for example, being regarded as contractual problems.

The central part of the thesis takes a comparative approach, focusing on the experiences of two case studies: Britain and Wales, where privatization occurred in 1989, and New Zealand, where there is currently much debate on the merits of encouraging private involvement in the provision of water services. The experiences of some other countries are also mentioned, albeit, to a far less degree.

The two case studies have been chosen primarily because it is hoped that, by comparing a country which experienced privatization of its water eleven years ago, with what New Zealand is currently on the brink of undergoing, some perspective can be gained on the process. Illustrating how privatization has occurred in Britain and Wales may give some indication as to what the control and structure of water services in New Zealand could look like if it too adopted complete privatization. It also appears that New Zealand is currently in a similar position to Britain and Wales prior to the changes that occurred in the lead-up to privatization. Third, the case of Britain and Wales is one of only two known cases of divestment (the transfer of ownership from public to private
hands), and therefore the opportunity to study the most extreme form of privatization with a far more moderate one in New Zealand will be particularly useful in determining the effects, if any, on democratic citizenship. Fourth, the United Kingdom's privatization programme is frequently regarded as a blueprint for other countries to follow. This can be seen in current debates in New Zealand where the experience of Britain and Wales is cited by proponents of privatization as evidence of improvements New Zealand's water industry is bound to make if privatized. It will be useful to see whether their admiration is founded in fact.

The remainder of the thesis returns to the earlier theoretical approach. Chapter five argues that there are limits to the areas of the public sector to which privatization may be applied, and that its application to water services is extremely problematic. Chapter six examines the implications of privatizing water services for citizenship and democracy, suggesting that its introduction may transform traditional notions of social citizenship into a type of privatized citizenship. Following this chapter is the conclusion of the thesis, in which some points made in earlier chapters are revisited and the approach taken in this thesis is reflected upon.
CHAPTER 1

PRIVATIZATION: IN THEORY AND PRACTICE

Adam Smith once wrote of the state's duty of "erecting and maintaining certain public works and certain public institutions...because the profit could never repay the expense to any individual...though it may frequently do much more than repay it to a great society" (quoted in Donahue, 1989, p.18). For many years, physical infrastructure has been regarded as such a 'public work': "something to be provided and maintained by the state for the general use of the population at large" (A. Smith, 1999, p.2). Recently, however, this perception has been challenged by the extension of market principles and practices to more and more areas of life. Thus, the concept of the public utility (for example, piped water supplies) - public provision of an essential service, designed to prevent abuse of private market power - has also been subject to some heavy scrutiny. This chapter introduces the scope of the thesis as a whole and clarifies the central concepts that will arise throughout.

The thesis ultimately examines the theoretical underpinnings and the implications for citizenship, and therefore democracy, of transferring the responsibility for piped water supplies from the public to the private sector, that is, privatizing. Before reaching this stage, it is essential that some main concepts are defined and established. In order to examine the meaning of privatization, this chapter is limited to four main issues: the meaning of the public and the private sectors; the meaning of privatization; the classification of goods and services used to justify or argue against its implementation; and finally, the varieties of privatization policies that have been applied to water services. It is worth emphasizing at the start that privatization can actually be used to describe a wide variety of organizational arrangements. It does not have to be merely confined to the sale of state assets and enterprises, which is a commonly held misconception. However, at this early stage in the thesis, the intention is not to state that one arrangement is better than another, but rather to present a framework in which various perspectives

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1 See Miller (1995) for an excellent discussion of this in relation to the telecommunications industry.
and basic concepts can be established. The next chapter in particular will provide a more thorough theoretical analysis of these arguments.

1.1 The public/private distinction

Privatization is not the only term used in the thesis that is only superficially straightforward. Two other words particularly relevant to the whole of this study – public and private – are similarly ambiguous. There seems to be a perception that their boundaries are clearly defined, instantly recognizable, and that the two terms have little or nothing in common. However, this is not necessarily the case at all and, because the following chapters are dependent on these terms, their meanings will be discussed here first.

The generally accepted definition of the public sector includes the following aspects: government making a policy decision, and a public organization, at the same or a different level, performing the activity (Kolderie, 1991, p.251). Another version is suggested by Seader: “The public sector represents, identifies, defends, and expresses the public interest – the will and the needs of the people and the services that they demand” (1991, p.30).

Compared with the public sphere, there is little explicit discussion of what is contained within the private sphere. However, in most cases the accepted view is that the private sector is organized through market transactions (in contrast to the public sector being organized by government), with the market coordinating relationships through competitive buying and selling (Ostrom and Ostrom, 1977, p.8). Both Donahue (1989) and Lane (1985) believe that the market’s significance lies in its status as an organizing principle, rather than as an institution in itself. That is, the market is reliant on the state to a certain extent for its very existence, for example, the laws of property (such as those against theft and fraud) provide the basis on which market exchange can occur safely and effectively. For example:

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2 Samson suggests that the Thatcher and Reagan governments actively tried to create a binary distinction between the two concepts of public and private in order to emphasize the deficiencies of the former and the benefits of the latter (1994, p.9). For example, while the public sector was “too big, unwieldy and inefficient”, the private sector “incarnates efficiency, honesty, the work ethic, independence and freedom” (Reagan, quoted in Samson, 1994, p.9).
Even the seemingly most private of interactions directly or indirectly comprise a public component; for example a barter exchange among neighbors is ultimately constrained by legal definitions of property, strictures regarding who may undertake contracts, and available recourse to governmental sanction in the event of misrepresentation or fraud. By the same token, even the seemingly most authoritative exercise of governmental intent directly or indirectly relies on the cooperation or contribution of individuals or private firms (Feigenbaum et al., 1999, p.9).

It is increasingly difficult to classify organizational arrangements using a simple public/private distinction. For example, one advocate of privatization notes that “the distinction between public and private is elusive” (Savas, 1987, p.3). Another writer regards it as ‘messy’: “ill defined, shifting, and disputed” (Donahue, 1989, pp.6, 15). Lane writes “[t]here is not one single way to make the private-public distinction” (1985, p.46). The attempt to identify the essential elements comprising what is ‘public’ or ‘private’ is thus fraught with much difficulty, as shown below.

There are three main reasons for this difficulty in clearly distinguishing between public and private. First, with the public sector increasingly acquiring private sector characteristics at a rapid rate (Antonsen and Beck Jørgensen, 1997, p.338), it can be difficult to identify a ‘pure’ classification of each sector. Second, many authors do not explicitly clarify their terms, leaving it to their readers to determine for themselves what is meant. This can be a crucial omission, as ‘public’, like ‘private’ can have many different meanings depending most obviously on the author’s argument, but also on the context in which it is applied. Finally, it appears that the two realms define each other through opposition – what one is, the other is not. As will be seen later, this may not necessarily be the case at all, as the sectors can share similar characteristics.

In a detailed discussion on the demarcation of public from private, Lane (1985, pp.5-9) suggests that there are several elements that together comprise notions of the public sphere. One approach places much emphasis on the public sphere as public administration or public authority, reflected in the following possible definitions: “[g]overnment activity and its consequences” or “[g]overnment authority and its outcomes” (Lane, 1985, p.6). In contrast, another approach would emphasize budgetary or allocation aspects: governmental consumption, investment and/or transfers (Lane, 1985, p.6). Third, “government production” could confusingly be interpreted as either
government provision and/or government ownership of the means of production, both of which would require a further distinction to be made about the nature of employment (Lane, 1985, p.7).

Another attempt at distinguishing between public and private has been undertaken by Antonsen and Beck Jørgensen (1997). They also identify contrasting approaches to clarifying the distinction between the two sectors: the core and the dimensional approaches. The core approach, similar to Lane’s third approach, is relatively simple to apply, depending primarily on legal status, or ownership (government owned or privately owned), as being the key deciding factor (pp.338-339). However, this approach is becoming increasingly irrelevant as it is now often very difficult to determine the boundary between the two: ownership does not necessarily imply a certain organizational arrangement, as it may once have done (Antonsen and Beck Jørgensen, 1997, p.338). Perhaps more realistically, the dimensional approach regards the difference between public and private as a matter of degree: “publicness is both a behavioural category, not a legal one, and multi-dimensional” (Antonsen and Beck Jørgensen, 1997, p.338).

It is clear that both investigations come to a similar conclusion:

The public-private distinction is not one distinction but several. If the opposite to the public sector is sought, then we have to admit the possibility that there will be many different entities; actually their number will be a function of the various meaningful ways of specifying the concept of the public sector (Lane, 1985, p.8, emphasis added).

This leads Lane to conclude that there are several aspects to the ‘public’ side of the public/private distinction: bureaucracy; planned economy; authority; public resource allocation; public distribution of income; public ownership; public employment (1985, p.47). Savas also emphasizes this point: “Confusingly, we use the same word, public, to

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3 In a very interesting article, they investigate the ‘publicness’ of several Danish public organizations (defined according to the ‘core’ approach). They define ‘publicness’ as “the degree to which public organizations adhere to public sector values”, thereby suggesting that it is not necessarily the activities performed by the organization, but the values they uphold while performing the task (Antonsen and Beck Jørgensen, 1997, p.340).

4 ‘Publicness’ can be measured by the impact of external political authority on the organization (Bozeman, cited in Antonsen and Beck Jørgensen, 1997, p.338), or the degree of adherence to ‘public sector values’ (Antonsen and Beck Jørgensen, 1997, p.338).

5 This quote reinforces an earlier point: that public and private define each other through opposition.
describe three very different circumstances: government ownership, widespread ownership, and widespread access” (1987, p.4).

For the purposes of this thesis, it is sufficient to recognize that there are several dimensions to the public/private distinction. Public can be conceived as being “open and visible”, or that which applies to the general public, or the domain of the state6 (Starr, 1988, p.2). I take the term privatization to correspond to withdrawals from any of the “conceived public spheres” (Starr, 1988, p.2) outlined in the previous paragraph by Lane and Savas, as their interpretations are in accordance with most of the available literature on privatization. The complexity of the public/private distinction must be kept in mind in any analysis of privatization.

1.2 Privatization in theory

It is important to discuss exactly what comprises privatization, because without a good understanding of the importance of this term, much of the subsequent discussion in further chapters will be rendered meaningless. Privatization can also be a rather emotive term, used by those either for or against it to further their own arguments. This usage is illustrated in the following quote:

‘Privatisation’ is a word invented by politicians and disseminated by political journalists. It is designed not to clarify analysis but as a symbol, intended by advocates and opponents of the processes it describes to dramatise a conflict and mobilise support for their own side. Thus it is a word which should be heavily escorted by inverted commas as a reminder that its meaning is at best uncertain and often tendentious (Donnison, 1984, p.45, emphasis added).

I would argue that Donnison is too cynical in his estimation of the unimportance of the term privatization. Therefore, in this section I attempt to disentangle privatization from the political symbolism that surrounds it, and produce a more precise meaning that will be useful for analyzing the various arrangements used for piped water supplies.

Privatization as a term can be interpreted in many different ways, in many cases being used as an umbrella term to cover a wide range of strategies and policies (Henig et al., 1988, p.442). There does not seem to be a definitive version7; instead, different

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6 Determining the boundaries of the state is also an immensely difficult task, and is beyond the scope of this thesis.

7 According to both Pirie (1988a, p.3) and Hanke (1985, p.101) privatization is a relatively new word, making no significant appearance in political or economic literature before 1979. Savas notes that it was
authors manipulate the term to mean different things. A brief sampling of these definitions could lead to some confusion. First, privatization can have a rather general meaning: “any initiative that increases the role of the market in areas previously considered the province of the state (national or local)” (Feigenbaum and Henig, 1997, p.338), “the act of reducing the role of government, or increasing the role of the private sector, in an activity or in the ownership of assets” (Savas, 1987, p.3) or alternatively, “policies designed to curtail the size and influence of the public sector” (Dobek, 1993, p.24).

On the other hand, it can also have a very narrow and specific meaning: “the transfer of public assets, infrastructure, and service functions to the private sector” (Hanke, 1985, p.101), or emphasis on the “sale to the general public of shares in at least 50 percent of the assets and earning power of previously nationalized or state-owned public corporations” (Weyman-Jones, 1993, p.94; also emphasized by Beesley and Littlechild, 1994, p.15). This variation in definitions is summarized most succinctly by Feigenbaum et al.:

To some, privatization represents a move from government to private ownership. To others, it connotes a reduction in the regulatory role of government. Another group of scholars bounds the concept more narrowly, identifying it with some specific techniques for introducing competitive bidding among private firms to provide publicly defined services. And in some cases the term is so hospitable as to include any and all tendencies to increase individuals’ responsibilities for their own needs (1999, p.5).

1.2.1 Privatize ‘what’?

Even the previous quote, which highlights the imprecise nature of the term privatization, provides few answers to an inquiry into the essential identifying features of privatization. Few (Samson, 1994; Henig et al., 1988; Savas, 1989-90; and especially Lundqvist, 1988) have considered this issue thoroughly enough to adequately address the fundamental question - what is privatization?

Most of those writing on the subject of privatization recognize that specifying ‘what’ is at issue, that is, what is to be privatized, is not the easy task some simpler
definitions quoted earlier would suggest, and that several different “dimensions” (as Feigenbaum et al. [1999] put it) or elements are involved in the distinction between public and private provision. Most identify two: providing or arranging and producing or delivering (Savas, 1987), also phrased slightly differently by Donahue (1989) as financing and performing; or three: provision, subsidy and regulation (Le Grand and Robinson, 1984, pp.3-5). Lundqvist decides that his three dimensions are regulating, financing and producing (1988, pp.14-15).8 Feigenbaum et al. (1999, pp.9-11) even suggest that there are four. In addition to these core three (which they have defined as being financing, delivery and decision-making), they add another dimension that few others have considered, that of responsibility. This is a significant addition, as it implies a further issue to be investigated, especially in a later chapter. The following quote articulates well the subtle differences between some of these elements:

It [the state] can provide a particular commodity itself through owning and operating the relevant institutions and employing the relevant personnel. It can subsidise the commodity by using public funds to lower the commodity’s price below the one that would otherwise obtain; sometimes, the price is lowered to zero, the commodity being provided free. Or the state can regulate the provision of the commodity, regulating its quality, its quantity or its price (Le Grand and Robinson, 1984, pp.3-5, emphasis added).

Whether two, three or four, a distinction of this type will prove to be extremely useful for further analysis of privatization later in the thesis.

Following from the previous point, an important clarification to make at this stage is the subtle yet “profound” (Savas, 1987, p.61) difference between provision and production9. As Savas also points out: “It [the difference between provision and production] is at the heart of the entire concept of privatization and puts the role of

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8 It is clear though that there are some areas of overlap between the content of the elements identified by some authors:

Where Kielland...refers to regulation, subsidization, and production, Leat...distinguishes between regulation, funding, and provision, while Le Grand and Robinson...talk of regulation, subsidy and provision. As I [Lundqvist] read these authors, ‘subsidization’, ‘funding’, and subsidy’ all refer to the financing of goods. It is also clear that when using the term ‘provision’, Leat as well as Le Grand and Robinson actually refer to the production of goods and services (Lundqvist, 1988, p.14).

9 See Kolderie (1991) for an excellent discussion of this point.
government in perspective (1987, p.61). In privatizing provision, government simply withdraws from (or at least reduces) its role in the particular activity, leaving people to decide for themselves whether or not to pay for it if they want it (Kolderie, 1991, p.257). “Since the essence of government lies in...deciding what it will provide – what it will require and buy and make available; where and when and to whom and to what standard – this is the real...privatization” (Kolderie, 1991, p.253).

Production, on the other hand, is slightly different and it is clear that the distinction is not merely a semantic one as it has many implications. Privatizing production is not as extreme as privatizing provision: government still decides what to supply, but it does not have to supply the goods or services itself: “A government that decides that a service is to be provided at collective expense does not have to produce it using government equipment and government employees” (Savas, 1987, p.61). Kolderie also emphasizes this subtle difference, which can be represented in the following way:

**Figure 1.1 Alternative Meanings of ‘Provision’ and ‘Production’** (adapted from Kolderie, 1991, p.252)

<table>
<thead>
<tr>
<th>Provision</th>
<th>Policy making, deciding, buying, requiring, regulating, franchising, financing, subsidizing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production</td>
<td>Operating, delivering, running, doing, selling, administering</td>
</tr>
</tbody>
</table>

Taking the different dimensions or elements into account, the following table devised by Lundqvist illustrates eight possible combinations of activities and responsibility, although it does make a distinction between public and private for each activity that may not be as clear-cut in reality:

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10 As Savas also notes:

Opposition to privatization often comes from those who do not appreciate the difference between providing and producing, and mistakenly assume that if government divests itself of the producer function, it must automatically abandon its role of provider as well. Thus, false alarms are raised about privatizing services that are said to be ‘inherently governmental’, the responsibility for providing the service can be retained by government, but government does not have to continue producing it (1987, pp.61-62).

11 Some combinations may also be difficult to imagine, for example, private regulation accompanied by public financing and production.
1.2.2 Direction of privatization movement

It is widely agreed that privatization involves a change in the relationship between government and the private sector. Although conceding that this change implies a reduction in governmental responsibility, most suggest that it is the explicit direction of the transfer of responsibility that defines whether or not privatization can be said to be taking place (Lundqvist, 1988, p.4). Although quite narrow in comparison to some others mentioned in this chapter, Hanke’s definition of privatization makes the direction very clear: “the transfer of public assets, infrastructure, and service functions to the private sector” (1985, p.101, emphasis added). In contrast, Kay and Thompson’s definition is noticeably vague on the issue of where responsibility is moving: privatization “cover[s] several distinct, and possibly alternative, means of changing the relationship between the government and the private sector” (quoted in Lundqvist, 1988, p.4). Although certainly implied, it is up to the reader to determine through reason that a change of direction towards the private sector is what is meant.

For privatization to occur, there must be a noticeable change in direction towards the private sector. Savas argues that (in relation to the ten ‘degrees’ of privatization that he identifies in Figure 1.4) there must be two parallel movements. First, there must be a clear movement from an arrangement with a high level of governmental involvement to one with less, and second, this must be accompanied by an increased role in the private sector in the activity in question (Savas, 1987, p.88). For example, movement from a market to a grant arrangement, that is, introducing a government subsidy, is not privatization, although the private sector still delivers the service (Savas, 1987, p.88).

As will be seen in a later chapter, the privatization of some services, especially monopolies, is usually accompanied by state regulation. As such, the state still has a significant role, albeit a transformed and reduced one, to perform in some privatized services. As Feigenbaum et al. explain:
Privatization in this sense is relative and directional rather than absolute; a
formidable state that sheds some functions can be said to be privatizing even
though it continues to play a much more substantial role than does the more
limited state in another nation that has historically eschewed state ownership or
other obvious forms of intervention (Feigenbaum et al., 1999, p.9).

Therefore it is the direction of the transfer of activities towards the private sector that is
the significant factor in identifying privatization. As noted by Starr, privatization “does
not denote a specific origin or destination” (1988, p.4). “Its meaning depends on the
point of departure – the public-private balance previously struck in a particular domain”
(Starr, 1988, p.4).

1.2.3 Principles for privatizing

It seems obvious that there must be some rationale for privatizing in the first place,
otherwise it would not be adopted. This is covered relatively straightforwardly in the
following chapter, therefore a different approach, taking into account wider
considerations, is taken in this section.

It seems that market mechanisms may often feature in reasons for privatizing. Henig et al. provide a typical example in their definition that illustrates this well: “the
deliberate effort by governments to increase reliance on market mechanisms as a means
of pursuing public goals” (1988, p.442). Pirie also gives a good example of a definition
of this type:

It [privatization] denotes the point at which government discovered...that the
market itself is superior to the institutions of it, and began the process whereby
public sector activities were transferred to where they would be exposed to its
influences. Privatization manages to subject state operations to market influences
by actually placing them within its orbit (1988a, p.11).

However, it is important to realize that it is very difficult to make a link between market
principles and principles for privatizing, as competition between companies, profit and
other motives can all still be used as criteria for encouraging efficiency. A conscious
preference for market mechanisms, although often a factor, is not necessarily a
prerequisite for those adopting privatization (Lundqvist, 1988, p.8).

However, in practice the distinction between market principles and privatization
is rarely recognized, with the two often being conflated. This has already been seen in
the two previous quotes from Henig et al. and Pirie, and others are also more often than
not phrased in terms emphasizing the improvements that moves towards market provision would ensure, such as greater efficiency, self-determination, consumer choice and cost-effectiveness. However, market principles are only a small component of privatization strategies, with other considerations also being important.

An alternative set of principles behind the rationale for privatizing considers three different types of privatization. Privatization may consider several principles, being pursued for either pragmatic, tactical or systemic reasons (Feigenbaum et al., 1999, pp.42-43)\(^\text{12}\). As with the merging of market principles with privatization, the three can overlap (Self, 1993, p.60). Pragmatic privatization is perhaps the most popular, and is concerned only with maximizing the efficiency of a particular service. It is perceived as simply being one among several options. Tactical privatization, on the other hand, is implemented to pursue the short-term political goals of parties, politicians or interest groups. Systemic privatization is aimed at reshaping the whole of society away from reliance on the state towards greater independence. However, as Self notices, pragmatic reasons for privatization may be cited, but a systemic belief may be held in the “intrinsic superiority of private provision” (1993, p.61). This would support the earlier view that market principles, which are not necessarily an inherent feature, are often implicit in, or infused into, definitions of privatization.

1.2.4 Sovereignty

Another feature of privatization is that government (whether local, municipal or central) is the primary actor. Lundqvist therefore introduces the concept of sovereignty as an essential component legitimizing the decision to privatize. Privatization can only be said to occur when specific actions and specific actors are involved:

Only the sovereign can make decisions on the transfer of hitherto public attributes or functions to private ones legally binding on all concerned. In other words, the decisions and actions to shift from public to private, i.e., to have a policy of privatization, rests with the politicians in national and local government (1988, pp.4-5).

\(^{12}\) See their excellent book Shrinking the State: the Political Underpinnings of Privatization (1999) or a shorter article by Feigenbaum and Henig, “Privatization and Political Theory” (1997), in which they use three countries as case studies of each type of privatization: United Kingdom for systemic, France for tactical and the United States for pragmatic privatization. See also Self (1993, pp.60-62).
Including the element of sovereignty into the dissection of privatization, the following definition applies: “actions taken by actors legitimately representing the public sector, to move or transfer something that has hitherto been within that sector away from there and into the private sector” (Lundqvist, 1988, p.6).

1.2.5 American privatization

A final feature which influences the definition of privatization should also be mentioned – that of the different emphasis taken in the United States from the rest of the world. In the mid 1980s the Thatcher Government in Britain sold many publicly owned assets. France, Spain, Italy, Japan, Turkey, Malaysia, Singapore, Mexico, Brazil and New Zealand all followed a similar line of sales of government enterprises and assets. However, the United States was never able to implement this type of privatization programme for the simple reason that it never had the numbers of government enterprises and assets to dispose of that the other countries mentioned did (Kolderie, 1991, p.254; Goodman and Loveman, 1991, p.32; Donahue, 1989, p.6). American privatization is therefore regarded by some as “simply a new name for contracting” (Kolderie, 1991, p.254).

1.3 Nature of Goods and Services

Now that the elements of privatization have been discussed, the chapter will focus on classifying goods, services and activities which are often transferred to the private sector. This is useful because, before examining the variety of roles of government and the private sector in providing water services to society, the classifications determine the appropriateness of later organizational arrangements. How readily they can be defined and classified will have much influence on these organizational arrangements.

When considering piped water supplies, it seems that there are two opposing views. One view sees water as a social and public good to which everyone has an unquestionable right: For example: “[C]lean water and hygienic sewerage disposal are basic human needs which should be owned by the community and managed to meet our common social and economic requirements” (Harre, 1995). On the other hand, another perspective, heavily influenced by economics, asserts that piped water supplies do not

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13For example, public utilities, Jaguar, British Airways, British Aerospace, British Petroleum and British Steel.
meet strict public good criteria – inherently available to all, with one person’s use not impeding that of another. They should therefore be treated and allocated more as a private good in a market-type situation. In order to investigate the validity of these two claims in a later chapter, three classifications and observations of the characteristics of water supply will be considered here.

1.3.1 Ostrom and Ostrom’s classification of goods

Ostrom and Ostrom’s typology (1977, pp.7-18) is commonly cited both directly (Stein, 1990) and indirectly (Savas, 1987; Lane, 1985) as providing the neatest classification, albeit from an economist’s perspective, of goods and services. They freely admit to taking a public choice approach (see chapter two) with which to perform their analysis. “This mode of analysis...involves the application of economic reasoning to non-market decisionmaking” (1977, p.7).

Using two characteristics, Ostrom and Ostrom classify all goods and services, and then suggest (what they believe to be) the appropriate forms of organizational arrangement for their provision\(^\text{14}\). Classifications depend on two variables: exclusion and jointness (or rivalry) of consumption. “Exclusion occurs when buyers of a good or service can be denied consumption or use of the product by producers at a relatively low cost” (Stein, 1990, p.43). To be effective, the means of exclusion must be reinforced by a set of property rights that are economically and legally defensible (Ostrom et al., 1994, p.6). “It follows that the legal and economic feasibility of excluding or limiting use by potential beneficiaries is derived from the physical attributes of the goods and from the institutions used in a particular jurisdiction” (Ostrom et al., 1994, p.6).

The second variable, jointness of consumption, indicates the situation when goods or services can be consumed jointly and simultaneously by an unlimited amount of people without depleting the quantity or quality of that good or service. In other words, “[g]oods that diminish with their consumption lack jointness of use and possess the trait of subtractability" (Stein, 1990, p.44). However, Stein concedes that this may not be as clear as it seems:

Most goods and services possess some degree of subtractability: at some level of consumption, one additional person’s consumption of a good subtracts from

\(^{14}\text{See Ostrom and Ostrom (1977) for greater detail, and a lengthy discussion on public goods in particular.}\)
another person's consumption of that good. The level, or threshold, at which subtractability increases is defined as congestion and can drastically affect the provision of goods and services (1990, p.44).

Combined, these two variables lead to four types of goods: private goods, public goods, common property or common pool goods, and finally, toll goods.

**Figure 1.3 Four types of goods classified in terms of their characteristics** (adapted from Stein, 1990, p.43; Ostrom and Ostrom, 1977, p.12; and Savas, 1987, p.56).

<table>
<thead>
<tr>
<th>Easy to deny access (feasible exclusion)</th>
<th>Difficult to deny access (non-feasible exclusion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual consumption</td>
<td>Common-pool goods (also known as common property resources) - water pumped from ground-water basin, fish taken from ocean</td>
</tr>
<tr>
<td>Private goods - bread, shoes, cars, haircuts, books</td>
<td></td>
</tr>
<tr>
<td>Joint Consumption</td>
<td>Public goods (also known as collective goods) - national defense, air pollution control, street lighting, lighthouses</td>
</tr>
<tr>
<td>Toll goods - theatres, telephone services, library, water supply (through pipes)</td>
<td></td>
</tr>
</tbody>
</table>

Goods for which exclusion is feasible and there is a degree of subtractability are known as private goods. Typical examples are food, cars and housing (Stein, 1990, p.44). Private goods are well suited to market mechanisms: “Consumers demand the goods; entrepreneurs recognize the demand, produce the goods, and then sell them to willing buyers at a mutually satisfactory price” (Savas, 1987, p.44)\(^\text{15}\).

The second category, public goods, is probably the most discussed in literature because its application and definition creates the most controversy\(^\text{16}\). Being opposed to private goods in both attributes of exclusion and subtractability, public goods “are used simultaneously by many people and no one can be excluded from enjoying them” (Savas, 1987, p.47). The most frequently cited examples are national defense, lighthouses, street lighting and police forces.

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\(^{15}\) "Of course, no one will be able to secure all the private goods he [sic] may deserve, and some may be too poor to afford even the rudimentary necessities without assistance" (Savas, 1987, p.44).\n
\(^{16}\) As many have acknowledged, this situation – joint consumption and non-exclusivity – is likely to result in many people ‘free riding’, that is using the goods or services without paying or contributing their supply. It is unlikely that anyone will want to pay for the goods, and it is equally unlikely that anyone would wish to produce them, therefore collective contributions, usually in the form of taxes, are obtained to ensure an adequate supply.

In small groups, social pressures may be sufficient to assure that each person contributes his or her fair share to secure the collective goods, but in larger, more diverse groups, legally sanctioned coercion (such as tax collection and compulsory military training) is necessary (Savas, 1987, pp.47-48).
For the third category of goods, common-pool goods, exclusion is difficult to enforce and consumption by one user can deplete the consumption of another (Stein, 1990, p.44). As most authors (Stein, 1990, pp.44-45; Savas, 1987, p.45; Lane, 1985, pp.18-21) notice, this category presents some complex problems, mainly to do with the possibility that, because there are no means to prevent their consumption, their supply is likely to be severely depleted. “No rational supplier would produce such goods, and they would exist only through the benefice of nature” (Savas, 1987, p.45).

It is the final category, toll goods, which is of most relevance to this thesis. These goods are feasibly excludable, but also hold joint consumption properties, a significant issue that should be addressed when considering their allocation. Some, including piped water supplies, have a unique characteristic, in that they are natural monopolies, a situation usually interpreted as meaning that collective action is the most appropriate course of action to ensure their adequate supply.

Mitchell and Simmons (1994, pp.96-97) suggest that the typology’s extension of traditionally pure public goods’ theory to include two intermediate categories between public and private – toll and collective goods – creates a more inclusive and precise means of determining allocation and funding issues than previously considered. However, although Ostrom and Ostrom’s typology of goods may be useful in some instances, the focus on the four categories may be too narrow, inflexible and inapplicable in some situations.

The typology appears to be implicitly reducing the number and types of goods or services which can be said to meet the narrowed public good criteria. Therefore, indirectly, by applying the two attributes of exclusion and subtractability to goods or services, a subsequent value judgement can be made about the suitability of certain types of provision of those goods or services – public, private, or a combination of both. Nevertheless, while bearing this reservation in mind, their typology is still a valuable tool of analysis that is likely to prove to be a useful basis for discussion in this chapter.

1.3.2 Essentialness and non-substitution
Ernst implicitly proposes an alternative to Ostrom and Ostrom’s four classifications of goods and services, again dependent on two attributes: essentialness and the possibility of
substitution. Although not as complex as their typology, it offers a necessary complement to Ostrom and Ostrom’s analysis of goods.

Water utilities are usually regarded as being ‘basic necessities’ because “they are literally necessary for sustaining life” (Ernst, 1994, p.38). They are also absolutely central to individual and collective well-being. As well as the essential nature of these goods being an important characteristic, they are also non-substitutable, that is, there is no realistic and practicable alternative to their use. For example, there is no realistic or hygienic alternative to water’s essential use in washing, food preparation, cleaning and disposal of human waste (Ernst, 1994, p.38)\(^{17}\).

The relationship between demand and supply, traditionally used in the market to determine the appropriate levels at which goods or services are provided, can never apply in the case of public utilities. A reasonably constant level of water services is required to meet those needs outlined in the previous paragraph, as they are necessary for physical and social well-being. Secondly, the relationship between want or need and usage is not as clear as it is in market transactions:

although the level of demand may rise with an increase in income or a decrease in price, it is unlikely to do so in direct proportion to changes in income or price, nor is it likely to continue to rise indefinitely beyond the point where the need for these basic services is satisfied (Ernst, 1994, pp.40-41).

This last point is also emphasized by Miller, who states that “demand will be highly price inelastic; that is, there will exist a high element of necessity in demand” (1995, p.2). It seems self-evident that these two characteristics should carry as much weight (if not more) as the previous two variables when determining how allocation is to be undertaken.

1.3.3 ‘Market failures’

In addition to the characteristics mentioned previously – excludability and non-subtractability; essentialness and non-substitutionability – there is a final set of circumstances that have traditionally been cited as being a reason for government provision of some goods and services, including water supplies: that where the market is

\(^{17}\) Ernst concedes that in the case of domestic energy use, there are substitutionable possibilities, for example, gas for electricity. However, a qualification should be made about this example, as the cost of doing so – purchase and fitting of new appliances, multiple supply charges – may be too high to be realistically possible (1994, pp.37-38).
deemed to ‘fail’. One of these circumstances, public goods, has already been discussed, therefore only the remaining three – natural monopoly, externalities and merit goods - will be mentioned here.

**(a) Natural Monopoly**

The first aspect to be considered is the degree to which the water supply industry can be said to be a natural monopoly. As Ernst notes, defining utilities in terms of natural monopoly is again a predominantly economic argument (1994, p.45), but it does prove to be a central concept when considering the merits of arguments for public or private provision. Sharkey summarizes well what is meant by this term:

> [T]here is natural monopoly in a particular market if and only if a single firm can produce the desired output at lower cost than any other combination of two or more firms. Natural monopoly is defined in terms of a single firm’s efficiency relative to the efficiency of other combinations of firms in the industry (quoted in Ernst, 1994, p.46).

Some dispute the fact that water services are a natural monopoly. For example, both Savas (1987, p.148) and Roth (1987, p.236) argue that some aspects of water supply are not in fact an instance of natural monopoly and that they can be separated out into three elements – extraction, transmission and distribution to the final consumer. However, the practicality of implementing a structure like this would be difficult; as Roth (but not Savas) concedes, for example, “[t]here might... be scale economies that would make it more economical to purify water in large plants” (1987, p.236). Here, Roth makes a useful distinction between distribution via pipes (“a textbook example of the natural monopoly” [1987, p.236]) and, particularly in developing countries, distribution via water vendors or carried from the source by consumers (not an example of natural monopoly)\(^\text{18}\).

The main reason that water is said to be the “natural monopoly par excellence” (Littlechild, 1988, p.44) is that, like electricity supplies, it is a network industry, that is, the services are distributed and supplied through pipes (or power lines in the case of electricity). “Because the means for supplying customers requires a complex and capital-intensive infrastructure, it would be inefficient, uneconomic and disruptive to duplicate
these networks, in order to provide alternative avenues of supply" (Ernst, 1994, p.48). Walsh, although labeling natural monopoly slightly differently (as “increasing returns to scale”) notes that it is likely that there will be “reduced incentives for innovation and change, and therefore a lack of dynamic efficiency, because of the lack of competition” (1995, p.8). It is for this reason that many countries have maintained public ownership of natural monopoly industries, and have retained control of prices and outputs in order to maximize the public good.

Because of their status as natural monopolies, competition is impracticable. The character of the industry minimizes the likelihood of new competitors entering the industry, the need for major initial and on-going investment, and the large ‘sunk costs’ involved. “In addition, predatory and anti-competitive behaviour on the part of existing monopoly producers, with the aim of preserving their privileged position in the market, will further complicate the emergence of competition” (Ernst, 1994, p.47).

(b) Externalities

Another aspect of market failure is the existence of externalities, positive and negative. Helm et al. define externalities as the situation that arises “when the private costs of production and consumption are not equal to those of society, because costs or benefits spill over to those not directly involved” (quoted in Ernst, 1994, p.49). This constitutes market failure because “the distribution of costs or benefits associated with providing a particular service is not confined to the parties directly involved in its production and consumption” (Ernst, 1994, p.49).

The negative externalities usually associated with water supply are its end products – wastewater disposal, sewerage and effluent discharges into freshwater sources (Roth, 1987, p.239; Ernst, 1994, p.49). However, standing water can also spread disease, and relentless extraction can also lead to a depletion of the resource itself (Bennett, 1995, p.180). On the other hand, positive externalities can make a valuable contribution to economic and social welfare. As Roth points out, “since safe water is beneficial to health, an improved water supply can benefit people other than those directly involved in providing or receiving the water” (1987, p.238) by preventing epidemics and disease. It

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18 The thesis is concerned only with the former method of allocating water (via pipes to consumers), which is a natural monopoly
is essential for many industrial production purposes, both as a raw material and also as an additional substance\(^{19}\). "Because of their fundamental contribution to individual and collective social well-being, it could be argued that the paramount expression of positive externalities in the water and energy industries, could be found in the universal provision of adequate quantities of energy and water to all households in society" (Ernst, 1994, p.49).

(c) Merit goods

The basic importance of public utilities such as water supply to individuals and the infrastructure of society can also be expressed by another term – merit goods. Merit goods were first conceptualized by Musgrave and Musgrave as those goods “the provision of which, society (as distinct from the preferences of the individual consumer) wishes to encourage or, in the case of demerit goods, to deter” (quoted in Ernst, 1994, p.39). For example, education would be seen as a merit good because “it is believed to contribute to economic growth and civic responsibility” (Walsh, 1995, p.10; Self, 1993, p.37). On the other hand, drugs, tobacco, alcohol and even gambling are examples of demerit goods (‘merit bads’) (Walsh, 1995, p.10; Self, 1993, p.37). The application of such guidelines can be controversial, with the interference of perceptions of good or bad on individual choice, or the possibility of favouring certain social or economic effects (Self, 1993, p.37).

Beckerman adds another dimension to the definition: merit goods are those which “society believes should be supplied to – and where appropriate actually consumed by – everybody, perhaps only to certain minimum levels, whether they like it or not and whether they can pay for it or not” (quoted in Ernst, 1994, p.39). There is some recognition that there is a need for public policy to address the goods in question as a matter of priority, “in particular, the need for action to overcome information failure, imperfect knowledge and underconsumption” (Ernst, 1994, p.40).

The need for the government to provide merit goods may arise because people lack information that will enable them to make effective consumer decisions, because of consumer irrationality, or because consumers do not want to make decisions and consequently consumer sovereignty is not attainable. *Government needs to act to provide merit goods because individuals are not necessarily the*

\(^{19}\) See Bennett (1995, pp.22-23) for an elaboration on this point.
best judges of what is in their own or the public interest (Walsh, 1995, p.10, emphasis added).

Piped water supplies are an excellent example: “The government should guarantee water to all because low-income sectors of the population usually do not know all the health benefits of an adequate water supply and may not choose to purchase enough water “ (Bennett, 1995, p.180). Roth gives the example of rural Thailand, where many people prefer “the more tasty untreated water from traditional sources” to the safer, chlorinated, piped and treated version (1987, p.243). Government action is more likely to ensure that merit goods are delivered to all at an appropriate level of access than private action (Walsh, 1995, p.10).

Obviously, one consequence of implementing the merit goods’ philosophy would be that theoretically there would be no limit to how many goods of this type should be provided. Another aspect of this same argument is that there would be some moral and ethical standard set by the public which would determine which type of good should be provided collectively. “There is no limit to how many merit goods there should be apart from those that the normative standard implies” (Lane, 1985, p.25). Mitchell and Simmons disagree with any notion of the public deciding how many, and which, goods should be provided collectively, concluding that “most so-called ‘merit wants’ [they have deliberately changed the phrase which Musgrave and Musgrave coined] are the want of elite intellectuals” (1994, p.97).

Merit goods are regarded by some as the reason for unnecessary state expansion. Savas suggests that one of the reasons for government growth was the societal decision, through government, to provide some private and toll goods completely or partly at collective expense (1987, p.52). He also suggests that a “transformation” has taken place: that some “private and toll goods...migrated into the class of collective goods” (1987, p.53). This is for two main reasons. First, everyone benefits to some extent when merit goods are consumed, that is, there are positive externalities, and second, exclusion has been abandoned (by government) because the positive externalities are themselves deemed worthy. Some examples of this migration of goods are bridges, mass transport,
public utilities such as water supply, electricity, gas and telephone services and education\textsuperscript{20}.

1.4 Privatization in practice

It is evident from the three previous sections of the chapter that there are many factors to be considered before even arriving at the implementation stage of privatization. For example, how one conceptualizes and classifies various goods and services will determine how one regards the appropriateness of organizational arrangements. It is the variety of those arrangements applicable to piped water supplies that will be discussed in this final section.

It is clear from a previous diagrammatic representation (Figure 1.2) depicting the complex relationship between public and private financing, producing and regulating, that there are many possible arrangements that can be called privatization. Pirie’s rather extreme, but certainly thorough, list of twenty-one different privatization methods is an indication of the wide range of privatization possibilities (1988a)\textsuperscript{21}. As Asher explains, “Pirie’s point...is not the utility or popularity of a particular method, but the variety of ways in which privatisation might be carried out” (1987, p.6). Lundqvist’s taxonomy (Figure 1.2) would suggest that there are six. On the other hand, Savas has developed an unusual, but very effective way of categorizing privatization. He does not specify the types of privatization, but has developed a scale that can be used to determine whether or not an arrangement can be called privatization (1987, pp.58-90). This re-emphasizes an earlier point – that privatization only occurs when the organizational arrangement shows a clear directional movement towards the private sector.

\textsuperscript{20} “Education was considered to have major, positive side effects associated with it, and therefore it was not only made freely available to all, but its consumption was actually made compulsory” (Savas, 1987, p.53).

\textsuperscript{21} His categories are as follows: selling the whole by private share issue; selling complete and separate parts of the whole; selling a proportion of the whole; selling to workforce or management; ‘giving’ to the workforce; contracting out the service to private business; diluting the public sector; buying out existing interest groups; charging for the service; setting up counter groups; deregulation via private associations; encouraging alternative institutions; making small-scale trials, repealing monopolies to allow competition to grow; encouraging exit from state provision; vouchers; admitting demand pressures; curbing state powers; applying closure proceedings; withdrawal of the activity; and finally, the right to private substitution (1988a).
Figure 1.4 *Ranking of arrangements by degree of privatization* (Savas, 1987)

<table>
<thead>
<tr>
<th>Arrangement</th>
<th>Complete privatization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market; voluntary; self-service</td>
<td></td>
</tr>
<tr>
<td>Franchise</td>
<td></td>
</tr>
<tr>
<td>Voucher</td>
<td>Privatization is a shift from a lower- to a higher- ranked arrangement</td>
</tr>
<tr>
<td>Grant</td>
<td></td>
</tr>
<tr>
<td>Contract</td>
<td></td>
</tr>
<tr>
<td>Government vending</td>
<td></td>
</tr>
<tr>
<td>Intergovernmental agreement</td>
<td></td>
</tr>
<tr>
<td>Governmental</td>
<td>No privatization</td>
</tr>
</tbody>
</table>

However, the more traditional diagram representing privatization activities is illustrated below:

Figure 1.5 *Options for allocation and funding* (adapted from Boston, 1995, p.82; Donahue, 1989, p.7, and Lane, 1985, p.11).

<table>
<thead>
<tr>
<th>Collective payment/public funding e.g. taxes</th>
<th>Individual payment/private funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public sector delivery</td>
<td>'Core' public functions</td>
</tr>
<tr>
<td></td>
<td>Commercial functions undertaken by the public sector</td>
</tr>
<tr>
<td>Private sector delivery</td>
<td>State-funded activities undertaken by private organizations</td>
</tr>
<tr>
<td></td>
<td>Purely Commercial activities - government role limited to enforcement of contracts, regulating and monitoring</td>
</tr>
</tbody>
</table>

In practice, this leads to the following types of arrangement (although there can certainly still be variations within each option).

Figure 1.6 *Privatization options* (adapted from Seidenstat, 1996, p.465)

<table>
<thead>
<tr>
<th>Who produces</th>
<th>Private sector</th>
<th>Who makes provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private sector</td>
<td>Divestment - the complete transfer (of ownership, control and operations), usually by sale, of goods or services from a public agency to a private one</td>
<td>Contracting out - government retains ownership and control, but employs a private organization to deliver the service.</td>
</tr>
<tr>
<td>Private sector</td>
<td>Franchising - usually the award of monopoly privileges to a private organization to supply a service, often accompanied with price regulation by a government agency.</td>
<td>Vouchers (common in the States, but relatively uncommon elsewhere) - public sector provides a voucher to the user of the service, who then uses it to pay the supplier of the service.</td>
</tr>
<tr>
<td>Public sector</td>
<td>Contracting in - private sector hires a government producer, e.g. police for security purposes</td>
<td>Subsidization</td>
</tr>
<tr>
<td>Public sector</td>
<td>No privatization</td>
<td></td>
</tr>
</tbody>
</table>

1.4.1 Publicly provided water supplies

As many writing on the subject point out, providing water supplies is an area in which governments, whether municipal, local or central, have traditionally been centrally...
involved. “Historically, water supply has been one of the most public of all services, that is, one which the private sector has been least involved” (Savas, 1987, p.148)22. Roth also notes that the provision of piped water by the private sector has been “comparatively rare” (1987, p.251).

Roth suggests four possible explanations for this historical trend: “[t]he absence of property rights with respect to water, its critical importance in times of war, the difficulty of collecting payments, and the magnitude of resources required” (1987, p.251). Economists also suggest four scenarios (outlined above) in which the private sector may not necessarily be the most efficient, that is, when the market ‘fails’: natural monopoly, externalities (positive and negative), when the service cannot be charged for according to differing rates of consumption or perceived value (natural monopoly), and finally, when it is regarded by society as being essential, but may not be supplied adequately by the private sector (merit goods) (Bennett, 1995, p.179-180). Other reasons for public supply have been a concern to act in the ‘public interest’ and provide essential services to safeguard the public’s health. These reasons for public provision are highlighted in the following two examples.

In the United States, there is a mixture of private and public water suppliers, but municipal water companies predominate, serving about six times as many people as private companies do (Donahue, 1987, p.74; Savas, 1987, p.148). Public involvement has taken many forms: regulation23, public ownership, operation and investment in infrastructure and services (Spulber and Sabbaghi, 1994, p.199). This is a reflection of the view held since the nineteenth century that water is a public good, and that government ought to be responsible for meeting the needs of the public: “Government

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22 However, it will be seen later that Savas may be extending his argument too far when he writes that “it may be a consequence and not a coincidence that in many countries the water supply is both insufficient and unsanitary” (1987, p.148).
23 Recognizing the potential problems (reduced output, increased costs, misallocation of resources) that an unregulated natural monopoly may create, the method of regulation used is known as ‘rate of return’. Companies apply for rate increases to state commissions, which evaluate the proposed increases’ justifications using formal judicial proceedings (Begg et al., 1995, p.97).
agencies have reserved to themselves the power and prerogative to establish institutions for allocating and controlling all water uses" (Spulber and Sabbaghi, 1994, p.196).

The United Kingdom's water industry has also been predominantly controlled by government. Writing on the role of the state in Britain in the early nineteenth century in assuming responsibility for water, gas, transport, education, housing and health services, Dawson notes that it was a "piecemeal response to the inadequacy or inefficiency of private enterprise and voluntary organisations in supplying these services" (quoted in Whitfield, 1992, p.13). Both private companies and local authorities had been involved in providing supplies of water at this time. With Parliament encouraging private sector involvement, competition and market forces, from 1831 – 1851 the industry was semi-privatized, with several companies taking over town supplies (Whitfield, 1992, p.14). As the quality and quantity of private water supplies decreased, it was thought that only public ownership could restore the public's health and a more efficient supply of adequate water and by 1907 public ownership was again the predominant mode of provision (Whitfield, 1992, p.14). Water supply and sewerage were transferred to regional water authorities in 1974, and the changes subsequent to that (which culminated in privatization in 1989) are discussed in chapter three.

1.4.2 Complete privatization

The complete contrast of public provision is privatization. The first, and most complete, form of privatization is known alternatively as divestment, load shedding (a politically loaded term, as it defines public provision as a burden [Starr, 1987, p.125]) or, especially in Europe, denationalization. Rees phrases this meaning very clearly: "Divestment transfers the ownership of infrastructure assets into private hands as well as giving the private companies responsibility for all operations, maintenance, revenue raising and investment" (1998, pp.98-99). This complete type of privatization is "the most widely practiced [sic], most ambitious, and most visible form of privatization" (Zahariadis, 1995, p.5).

24 The main agencies include, at the federal level, the Departments of the Interior, Agriculture and Defense, the Environmental Protection Agency and, at the state level, there are counterparts of the federal agencies (Spulber and Sabbaghi, 1994, pp.196-198).

25 For this reason, the more neutral word 'divestment' will be used.
Divestment is the type of privatization implemented throughout most of the world, except for the United States. However, it has rarely been applied to the water industry, with the exception of long-established asset-owning private operators in the United States and United Kingdom (Rees, 1998, p.99). It is believed that divestment has occurred only twice: with the flotation of the water utilities in England and Wales in 1989, and the sale of 51% of the shares of Thailand's East Water bulk supply company (Rees, 1998, p.99). Divestment by asset sale can allow employees, customers and other interests an opportunity to gain a stake in their water company, and it also encourages the establishment of indigenous water companies rather than foreign ones through share sales and management buy-outs (Rees, 1998, p.101). It may also be a preferable option to a concession-based arrangement, which may become inflexible as time passes (Rees, 1998, p.101; see below).

Regulation inevitably accompanies divestment, as "unregulated water and sanitation companies are simply not an option" (Rees, 1998, p.104). It is needed to prevent water companies abusing their monopoly position and usually makes provisions for protecting consumers, ensuring that sufficient infrastructure investments are made, and dealing with externalities (usually to do with water pollution) (Neto, 1998, p.108). This can lead to government adopting a wide range of roles, which A. Smith has labeled "government as inspector" (regarding the design and construction of new facilities and the operation and maintenance of established ones), "government as defender of the realm" (maintaining key public services) and "government as strategic planner" (coordinating and mobilizing the resources of society to avoid chaos and accomplish tasks) (1999, pp.80-90).

Referring back to previous arguments on the nature and properties of goods and services, it seems that divestment is an extension of the belief that piped water supplies (a toll good) can be supplied in a similar way to private goods. In this view, water is a scarce resource with competing uses, and there is not enough water available for the

26 "A scenario where one dominant major service supplier might use commercial strength to force smaller suppliers out of business, thus creating a monopoly situation with a sole supplier able to charge whatever price he [sic] thinks fit to the detriment of the consumer, is usually considered most undesirable and governments have, in the past, frequently used this concern as a reason for direct public ownership" (A. Smith, 1999, p.79).
unlimited use of all, hence the market is believed to allocate water to those who 'value' it most, that is, those who are prepared to pay for it. Savas (1987, p.47) and Stein (1990, pp.44-45) see market provision as at least a possible, if not preferable, mode of arrangement for this reason.

1.4.3 Public/private combinations

Some water services' arrangements cannot be said to be either public or private, but contain features of both. They are able to take into account the traditionally public nature of water services, but can also incorporate elements of privatization strategies. For example, the profit-seeking motives of private companies are assumed to make them more responsive to customers' wishes (resulting in improved quality), and this makes private companies more efficient (Bennett, 1995, p.181). Public/private combinations accommodate both the public nature of goods or services and the requirement to encourage a more commercial approach to stimulate efficiency. The problems of responsiveness and inefficiency are argued by some to be an inherent feature of public ownership and control of piped water supplies. They are to be examined in the following chapter, as they are obviously closely linked to the rationale for privatizing (also to be discussed there).

There are several arrangements that enable the private sector to participate with government in the operation of public utilities. For example, in the United States, like many other countries, private involvement in water services is increasing in popularity. However, the “distinction between public and private service delivery is increasingly blurred...by State and Federal efforts to promote ‘public-private partnerships’” (KPMG Peat Marwick, 1995, p.37).

The only significant example of private companies being consistently involved in government-controlled water supply is in France. According to Roth, they have become “the most advanced, technically and commercially, both within and outside of the country” (1987, p.252), something also noticed by Hanke and Walters (1987, p.111) and Savas, who adds that they “are also dominant internationally in research and development, in equipment manufacture, and in the management and provision of water services” (1987, p.148). This has resulted in many French companies becoming involved (either through affermage, buying shares in existing companies, or engaging in
partnerships with local authorities) in areas as diverse as the French territories (such as French Guiana, Martinique and New Caledonia), United States, Spain, Canada, Japan, Thailand, Malaysia, and North and West Africa\(^{27}\) (Roth, 1987, p.256).

The second major type of privatization arrangement, known as a franchise, is still a form of privatization, but incorporates at least some measure of public sector involvement in the arrangement. For this reason, it is sometimes regarded as being more acceptable to opponents of privatization, as it recognizes that water supply (as a toll good) contains elements of public goods\(^{28}\). In a franchise agreement, the government grants a private organization the right (often the exclusive right) to sell a service or product to the public, with the private firm usually paying the government a fee in return (Savas, 1989-90, p.348).

There are four slightly different franchise arrangements, varying according to the level of involvement and responsibility granted to the private company. The first, known as a concession, is where a private company takes responsibility for the construction of the facility, as well as its complete operation. The concession period can last up to fifty years, but is usually between twenty-five and thirty (Rees, 1998, p.99). As Hanke and Walters point out, this arrangement is obviously convenient for governments lacking immediate funds for infrastructure construction or improvements: “The concessionaire advances all capital for construction and operation, assumes full responsibility (and risk) for monitoring, management, and maintenance of facilities and collects payments directly from users” (1987, pp.110-111).

In the second variation, affermage (or leasing), the public sector takes responsibility for the installation expenses of major works, with the private company then providing only working capital, managing and maintaining the completed facilities (Neto, 1998, p.114; Hanke and Walters, 1987, p.111). This would be an advantage to governments when “financing can be provided at preferential interest rates” (Hanke and Walters, 1987, p.111). “All electromechanical, hydraulic, and metering equipment is the operator’s responsibility, while civil works, water collection, and facility expansion are

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\(^{27}\) Local authorities took over the French systems when many countries in Africa gained independence (Roth, 1987, p.256).

\(^{28}\) However, this in itself seems illogical because the private company often retains ultimate control.
the responsibility of the municipality; pipe renewal may be the responsibility of either party" (Hanke and Walters, 1987, p.111). In both the concession and *aftermage* arrangements, the contract between the public sector and the private company will usually specify and set the prices charged (Hanke and Walters, 1987, p.111).

*Gérance* (management) is a variation of the *aftermage* in that the private company is hired to perform only specific services, and therefore has limited responsibility while the *commune* (France’s version of local government) retains responsibility for everything else, including remuneration of the contractor (Neto, 1998, p.114). The services (sub-contracting) arrangement is very similar to *gérance*, differing in the areas – operations or management - in which the contracting can take place (Neto, 1998, p.114). These franchise arrangements are also known by several other synonyms, which are represented in Figure 1.7:

**Figure 1.7 Concession-based methods** (adapted from A. Smith, 1999, pp.71-76).

| Build, Operate, Transfer (BOT) | The facility is designed, financed, constructed, operated and maintained by the concession company for an agreed period, at the end of which all operating rights and responsibilities return to the public authority (which retains ownership throughout the contract). |
| Build, Own, Operate, Transfer (BOOT) | Similar to the BOT arrangement, but ownership of the utility remains with the concessionaire for the duration of the contract. At the end of the concession period, ownership and operating rights again return to the public authority. |
| Build, Transfer, Operate (BTO); Build, Transfer, Service, Maintain (BTSM) | Ownership of the facility returns to government at the end of the construction phase, with the private company being responsible for the maintenance and operation of the facility for the period of the concession. |
| Build, Own, Operate (BOO) | Usually complete privatization, or often the facility is let on a concession basis for a fixed period with no provision for transfer of ownership to the public authority. |

France is typically cited as an example illustrating the application of the franchise arrangement in water supply. The provision of water supply and sewerage in France falls under the jurisdiction of 36 000 *communes* (local municipalities), which are legally entitled to determine whether water supply should be publicly or privately provided, and under what terms (Neto, 1998, p.114). The first example of the franchise of water supply in operation came in 1782 when, following the example of private provision of piped water in London, the Perrier brothers established a company that was granted a license to supply piped water to Paris for fifteen years (Roth, 1987, p.251; Hanke and Walters, 1987, p.110). Similarly, the use of concessions for water supply also spread to Spain, Italy, Belgium and Germany from about 1850, although their use declined in popularity.
as the infrastructure was completed (A. Smith, 1999, p.8). However, the success of their venture and its subsequent expansion led to much jealousy and opposition. Consequently, after the French Revolution, the city of Paris took over the Perriers’ firm and two other private organizations that had been established, and the Paris Municipal Water Department was created (Roth, 1987, p.252). Some areas were still supplied by private companies as early as the 1850s, but many local governments chose to build and manage their own systems (Hanke and Walters, 1987, p.110). However, it seems that since the 1950s there has been an increase in the private sector share in drinking water supplies as the volume has increased from 30% in the mid 1950s to 55% in the late 1970s to about 75% at the moment (Neto, 1998, p.114). “Moreover, an increasing process of horizontal integration has occurred in the French water industry, with the number of private water companies being reduced to five in the later 1980s, and only three today” (Neto, 1998, p.114).

One of the few critics of the franchise system points out that two commonly cited advantages (as indicated by Hanke and Walters previously) of the concession system of the franchise should be viewed with some skepticism. The two advantages - companies bidding against competitors to win the contract (thereby providing incentives for efficiency29), and reducing the regulatory ‘burden’ on government agencies by using the contract as the regulatory mechanism - may not be as realistically practicable as they may seem (Rees, 1998, p.100). Rees (1998, p.100) raises a number of doubts in this area. First, competition for the contract is likely to be constrained by the fact that there are very few companies in the concessions market, and those in existence are likely to be disadvantaged by the incumbent companies’ ‘insider’ knowledge of the contract, making them more likely to retain it 30. Second, major companies, of which there are relatively few, are unlikely to take part in competitive bidding for smaller contracts (1998, p.100). Third, even if there is competition for the contract, the gains from this would surely be short-term unless “regulatory mechanisms exist to curb the tendency towards economic

29 See Hanke and Walters (1987) and especially Demsetz (1968) for further elaboration on this point.
30 It seems that this has already happened in France where, although in theory people can choose between water suppliers, private water supply is dominated by two huge companies, Compagnie Générale des Eaux and Lyonnaise des Eaux Dumez, suggesting that there is a water duopoly in the country (Neto, 1998,
inefficiency inherent in monopolies” (Rees, 1998, p.100). Once the concession has been granted, a monopoly is still created, protecting the concessionaire from most forms of competition (1998, p.100). Finally, there are some doubts about the efficacy of the contract as a regulatory mechanism:

*it is a simplification to assume that the state’s role can be confined to monitoring company performance against the contract conditions. It is impossible to predict changing economic, social and technical conditions over a 20-30 year period and incorporate these within contract terms* (Rees, 1998, p.110, emphasis added).

1.5 Conclusion

No arrangement for supplying piped water is perfect or free of criticism. It is inevitable that there will be arguments both for and against any arrangement, whether completely public, completely private, or one of various combinations of the two. Therefore, trying to find the single mode of provision that is best (an imprecise term in itself) is likely to be a huge and complex task, and one that this introductory chapter has not attempted to cover. What this chapter has discussed provides a basis for further analysis in the rest of the thesis.

Each mode of provision discussed here has consequences far beyond simply issues of allocation and these are to be covered in a later chapter. One of the most fundamental aspects of the analysis of privatization has obviously been omitted in this chapter – the reasons for its adoption. It is such an immense area that the following chapter is dedicated to this subject alone. However, an attempt at answering the question, ‘why privatize’, must be accompanied by a comprehensive examination of the ideas and assumptions behind that strategy. This is the task of the following chapter.

p.114). They may even have colluded on prices as studies have shown that prices charged in privatized municipalities are up to 50% higher than in publicly supplied areas (Neto, 1998, p.114).
CHAPTER 2

ECONOMIC APPROACHES TO POLITICS AND THEIR INFLUENCE ON ARGUMENTS FOR PRIVATIZATION

It is through the systematic construction of a ‘theory of public incompetence’ or ‘government failure'\(^{31}\) from various strands of economic and political thought, that privatization has gained much of its appeal. This is illustrated in the following claim: “The policy of privatization...derives from a recognition that the weaknesses of the public supply are inherent” (Pirie, 1988a, p.52)\(^{32}\). By attacking all aspects of the public sector as comprehensively as they do, economic approaches to politics, now an established part of political science, seem to legitimize privatization almost by default. Because the private sector is seen as the complete opposite of the public sector, it is regarded as the answer to the inadequacies recognized (to use Pirie’s term) by these approaches.

While the previous chapter established exactly what comprises privatization and identified examples of it, this chapter aims to discuss the theoretical rationale behind its implementation, both from a general and a more academic perspective\(^{33}\). The influence on privatization of five economic approaches to politics, all of which contribute to the construction of the ‘theory of public incompetence’, will be examined. The proponents of these approaches “believe their quest for universal and logically consistent theories makes them the only true practitioners of political science” (Cohn, 1999, emphasis added), as they use the methodology of economics to analyze political affairs:

\(^{31}\) See Wolf’s theory of government failure (1993, which he calls ‘non-market failure’), constructed in opposition to the well-known theory of market failure. According to Mitchell and Simmons, “Government failure is at least as pervasive as market failure...Because people turn to government when it appears that markets fail, there has been little or no incentive to solve perceived problems through contracts or other private solutions” (1994, p.219-220). See also Le Grand’s critique (1991) of Wolf’s theory, and Haque’s general response to privatization’s attack on the public sector (1996b).

\(^{32}\) It is not surprising that Pirie subscribes to this view, as his book Micropolitics (which is used in this chapter), based on public choice theory, is described by Self as being the “Mein Kampf of Thatcherism” (1990, p.25). Self suggests that the Thatcher Government successfully employed the tactics described by Pirie to reduce the public sector as part of its extensive privatization programme (1993, pp.77-78).

\(^{33}\) Therefore, it (almost) goes without saying that, unless directly relevant, there will be no country-specific justifications made for privatization as there is an extensive amount of literature already available on this topic.
Economists previously had based their claim to expertise upon the distinctiveness of the economic sphere; the analogy between government and private-service providers suggested the possibility that government and political action might be considered subsets of economic action... [I]t fell upon a fairly tight community of scholars coalescing under the banner of public-choice theory to translate that recognition into a formal deductive theory and to expand it to encompass a broader range of governmental activities” (Henig, 1989, pp.653-655)

The link between theory and practice is certainly a very difficult one to prove. Hood is quite correct in expressing some reservation about the link between economic theories of politics and privatization:

It [the link] does not necessarily tell us anything about the real influence of academic theorists, since the same principles might emerge spontaneously in the world of practice, in complete ignorance of their academic provenance. But it can give us some indication of which principles have been on the crest of the wave in practice, serving as a (perhaps unconscious) blueprint for, or at least a reflection of, what is actually happening (1987, pp.168-169, emphasis added).

However, it seems to this writer and many others that there is a strong link. The contributors to the various economic approaches to politics admittedly do not usually explicitly discuss the policy implications of their theories, and privatization advocates do not usually refer to the theories on which privatization is based. However, it is clear that there is a sense in which the two are engaged in an interdependent relationship. The economic approaches to politics indirectly heavily influence the legitimacy of arguments for privatization while, in turn, the implementation of privatization would seem to those theorists to be an indication of the validity of their theories. Examining the theories behind privatization will lead to a greater understanding of the motivations and

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34 See Cohn (1999) for the rise of the rational choice approach in political science.
35 See Hughes (1998, p.10) for a brief discussion of the rise and popularity of economic ways of thinking in public policy formulation. Rhodes (1991, pp.545-547) also stresses this point in reference to Britain, suggesting that economic theories of politics are, in many cases, primary source material for policy innovation. They therefore force a reevaluation of the concept of the political theory of public bureaucracy, and consequently, generate administrative reform. Self (1993, ch.4) concentrates on the efforts of Britain and the United States to “slim the state” and suggests that public choice and other market-based theories were very influential. He argues that it is through a process of “dilution” from academic writing to governmental think-tank to the politicians themselves that the theories are transmitted (1993, p.71). Haque’s excellent article (1996a) is also very useful in this respect. He argues that the privatization movement, by denigrating the public sector’s practices, values and motivations and praising the virtues of the private sector, has significantly challenged the public sector’s legitimacy and even its existence (Haque, 1996a). By extension privatization is also challenging the academic field of public administration. See also Gray and Jenkins (1995).
assumptions that it is implicitly reliant upon. As will become clear as the chapter unfolds, I suggest that privatization is the ideal policy prescription for implementing many of the theoretical ideas. As Martin and Parker put it (in complete contrast to Hood): "Together they [the theories] have provided a formidable a priori argument in favour of reducing state budgets and, wherever possible, transferring state activities to the private sector" (1997, p.15).

This chapter will address only the first link - between economic theories and arguments for privatization. Generally speaking, this chapter does not subject the theoretical arguments to criticism, focussing instead on presenting the arguments as they apply to privatization. The fifth and sixth chapters of the thesis will discuss the implications and validity of these types of arguments with reference to the privatization of piped water supplies.

2.1 Theories underpinning privatization

At first glance the general arguments advocating privatization (discussed in the next section of this chapter) seem clear-cut and robust enough to stand on their own with no supporting cohesive theories behind them. However, they are in fact given their strength and conviction from a large and diverse body of literature (property rights, public choice, the new public management, agency theory and transaction cost economics) within political science. They have in common their methodology, the application of economic arguments and analytical thinking to politics, and their world-view of human nature being dominated by rational self-interested motivations. The contribution of this literature to the rationale behind privatization will be examined after each theory is briefly outlined.

In the main body of this chapter I will be concentrating on the contributions of various strands of economic thought, now increasingly being applied to political life, which provide a theoretical base for the implementation of privatization. I will not be discussing the theories in their entirety, but rather only those aspects of the economic theories of politics that are relevant to privatization. I have chosen to focus on five main theories which are relevant to this argument: property rights, public choice; the new public management; agency theory; and, transaction-cost economics. Before discussing

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36 As mentioned in the introduction, these five theories have been chosen because they are closely related and complement each other well. Property rights theory is perhaps the most fundamental, as this theory's
the theories, it is important to understand a key assumption that they have in common: individualism.

The essential assumption behind the five theories, and property rights and public choice in particular, is the strong emphasis placed upon the inherently selfish nature and behaviour of the individual. This belief, known as methodological individualism\textsuperscript{37}, is the foundation upon which a substantial amount of the theories are built. All outcomes can be explained with reference to individual behaviour, with collective entities being understood only in terms of the individuals who comprise them (D. King, 1987, p.94). For example, "it is by reference to the maximizing actions of individual persons that collective outcomes must be explained" (Green and Shapiro, 1994, p.15, emphasis added). By implication, from the pursuit of rational utility-maximizing behaviour by individuals emerges a "desirable social order" (D. King, 1987, p.95).

Human nature is argued to be the same in all environments, regardless of whether they are political, economic or social. "If both activities [politics and economics] are viewed as forms of mutual exchange, based upon similar motivations and objectives, it will follow that there are considerable similarities between the two processes" (Self, 1985, p.51). Public choice theorists in particular believe it is nonsensical to conceive of different conceptions of human nature, dependent on the environment in which they operate. "If economics is correct to assume that man [sic] is first of all a selfish creature then he/she must be so, not only in the market, but in politics too" (Udehn, 1996, p.60). Because all human behaviour is argued to be based on self-interest, it seems logical to public choice theorists (and other theorists from the economic approach to politics) to apply theories of economic behaviour to those of political behaviour, as politics is simply the activity of self-interested individuals making collective decisions.

Therefore, homo politicus, political man (or woman) has the same interests as homo economicus, economic man (or woman): In the political realm, an individual will assess policies and parties according to the likely benefit they will bring to him/herself insights into the implications (such as incentives and behaviour) that stem from different types of ownership are taken as given in public choice, agency theory, the new public management and transaction cost economics.
rather than society as a whole (Self, 1985, p.50). The market analogy can also be extended to other areas of political life:

voters can be likened to consumers; pressure groups can be seen as political consumer associations or sometimes as co-operatives; political parties become entrepreneurs who offer competing packages of services and taxes in exchange for votes; political propaganda equates with commercial advertising; and government agencies are public firms dependent upon receiving or drumming up adequate political support to cover their costs (Self, 1985, p. 51).

However, while self-interest operates efficiently in the economic marketplace, in the political sphere, it has adverse consequences. It is for this second reason, to be discussed in some detail in the last section, that most of the theories advocate that the scope of governmental activity be minimized, thereby maximizing the scope of the market. Having examined this essential assumption (individualism) underpinning the economic approaches to politics, the next section can focus on the theories themselves.

2.1.1 Property rights

Almost all justifications for privatization are based upon interpretations of property rights theory. The importance of this body of literature lies in its belief that “alternative forms of property ownership give rise to different economic incentives and, subsequently, different economic results” (Hanke, 1987, p.48). That is, it explains differences in organizational behaviour and performance on the basis of individual incentives created by the structure of property rights (Starr, 1988). Property rights theory argues that private and public managers and employees are likely to behave differently, according to the degree of incentives present in their work, and consequently, overall, private organizations are likely to be more efficient than their public sector counterparts. This provides a very strong argument in favour of privatization.

Defining property rights is not the simple task it may seem. One definition defines property rights as “the rights of individuals to the use of resources...established

37 This term was first used by an Austrian economist, Joseph Schumpeter, who took it to mean “the point of departure for descriptions of economic Phenomena [sic] is the actions of individuals” (Udehn, 1996, p.166).
38 For comprehensive reviews of public choice theory see Orchard and Stretton (1997), Stretton and Orchard (1994, pp.21-52) and Mitchell (1988).
and enforced not only by formal legal rules and the power of the state but also by the social conventions that characterize society" (de Alessi, 1987, p.26). Consequently, this definition leads to three types of property, depending on the properties of the good in question: exclusive and transferable (private), exclusive but nontransferable (usufruct), and nonexclusive and nontransferable (common ownership with open access) (de Alessi, 1987, p.26)\textsuperscript{40}. Another definition regards "[P]roperty rights [as] specify[ing] the social and economic relations that people must observe with each other in their use of scarce resources, including not only the benefits that owners are allowed to enjoy but also the harms to others they are allowed to cause" (Starr, 1988). This alternative interpretation takes into account not only possession or ownership as the main indicators of a 'property right', but also a wider range of relationships (Barzel, 1997, p.4)\textsuperscript{41}. In addition to "the rights to use, exchange and alienate goods or services" (Walsh, 1995, p.38), Starr suggests that the right to change the good or service in "form, substance, or location [where appropriate]" is also important (1988).

Property rights are potentially changeable in nature, possibly because for their very existence they depend on states to define them. This is noticed by Barzel (1997, p.4), and Ditwiler:

Government is the machinery through which change is achieved. \textit{Any question of a change, creation or abolition of a property right must therefore include people, their motivation for change, the government entity with jurisdiction, and the people's ability to exert pressure on that entity} (Ditwiler, 1975, p.666, emphasis added).

\textsuperscript{39} The following quote from Hanke further emphasizes this view: "Property-rights arrangements provide the key to understanding the behavior of private and public employees and the performance of private and public enterprises" (1985, p.102).

\textsuperscript{40} De Alessi also illustrates the situation that can arise when individuals concurrently have different property rights to the same resource:

The owner of a bundle of (private) rights to the use of a parcel of land may retain some of these rights while assigning the usufruct of others to a lessee. At the same time, a neighbour may own the (usufruct) right to walk across the land, everyone in the community may own the (common) right to dump smoke on it or fly over it, and the government may have the right to build a road through it (1987, p.26).

\textsuperscript{41} Barzel makes a distinction between 'economic property rights', that is, the ability to enjoy a piece of property, and 'legal property rights', what the state assigns to an individual (1997, p.3). "Economic rights are the end...whereas legal rights are the means to achieve the end" (Barzel, 1997, p.3). For this reason, I will be concentrating on 'economic property rights' because, as Barzel points out (1997, pp.3-4), 'legal property rights' essentially reinforce the existence of 'economic property rights'.

The italicized section of the quote will be discussed in some detail in a later chapter, which deals with the implications for citizenship when changing from a collective to a more individualistic form of provision of piped water supplies, that is, changing public property rights into private property rights.\footnote{Ditwiler’s explanation of property rights in relation to water is also worth quoting at this point: A system of property rights for water is really an intelligence system. Property rights confer upon individuals duties to and rights over resources and other individuals. Property rights convey rights}

Many property rights theorists believe that the cause of inefficient outcomes is the inadequate definition and distribution of property rights (Walsh, 1995, p.38). In order to use and/or distribute resources efficiently, these two things must be easily distinguished. Two other factors, motivation and incentives, are crucial to this line of thinking, which in turn have further implications for other pro-privatization arguments (namely those based on the assumption that private ownership or control always leads to increased efficiency).

Private enterprises are defined to be those owned by individuals (or presumably groups of individuals forming larger organizations), working within the limits of the law, who have the right to use and exchange their private property rights at whim (Hanke, 1987, p.48). Hanke articulates well the link between property rights and the efficient, or inefficient, performance of private or public enterprises respectively:

When private enterprises produce goods and services that consumers demand, at costs that are lower than market prices, profits are generated. As a result, property owners’ wealth is increased. Alternatively, if losses are realized, the value of private assets declines and their owners’ wealth is diminished. Hence, the owners of private firms not only appropriate the gains but also bear the costs that result from the way in which private property is used. In short, private-property owners must ultimately face the ‘bottom line’ (1985, p.102).

"Under private property, people bear the value consequences of their decisions" (de Alessi, 1987, p.34, emphasis added) or, as Starr puts it, the “more individuals stand to gain from tending to their property, the better it will be tended” (1988).

The reverse is also claimed to be true: where an individual’s property rights are not clearly established, the less motivated he/she will be to efficiently use that property (Starr, 1988). Because public enterprises are not technically owned by those who manage them, but by “taxpayer-owners” (Hanke (1985; 1987) or “shareholders” (Starr,
1988), public managers and employees do not have the same incentives to strive for efficient practices: “They do not bear the costs of their decisions, nor do they appropriate the gains from efficient behaviour” (Hanke, 1985, p.103). Because the “nominal owners” (Hanke, 1985; 1987), that is taxpayers, do not directly control the property rights of public enterprises (since they are unable to buy or sell them), they have little incentive to actively monitor the performances of public managers or employees. In some cases (such as monopoly), they have no opportunity to signal their dissatisfaction with its performance by moving their business elsewhere, as can happen with private enterprise. Consequently, public employees are likely to engage in “shirking activity and the acquisition of various prerequisites that increase production costs” (Hanke, 1985, p.103).

In other words, public enterprises are less efficient than private ones because their ownership status shelters them from the discipline of the private market. Privatization is the logical means of focussing individuals’ incentives towards achieving greater efficiency.

2.1.2 Public choice theory

The second theory which contributes greatly towards the rationale for privatizing is public choice theory. Mueller’s definition is the most commonly cited, so I shall quote it here also:

to capture the benefits associated with resource use or disposition and the duty to bear the burden of certain obligations and costs (Ditwiler, 1975, p.666, emphasis added).

Hanke does concede that in some instances taxpayers would benefit from increased efficiency of public enterprises in the form of tax reductions. However, the cost of obtaining this benefit – gaining information, monitoring employees, and organizing a force to change the behaviour of public enterprises – is likely to far outweigh the minimal benefit that an individual would gain (especially since the benefits, such as tax reductions, would be spread over many taxpayers) (1987, p.49).

Public choice theory is also known as social choice theory, rational choice theory, the ‘economics of politics’, the mathematical approach to politics, the new political economy and even the economic theory of democracy (Kingdom, 1992, p.74; Boston, 1991, p.2). Dunleavy makes a useful distinction in public choice theory, which will be used here, between ‘first principles’ literature and ‘institutional public choice’ (1991, pp.1-10). The former is concerned with techniques such as game theory and algebraic economics, used to examine individual behaviour. These results can then be extrapolated to “make sweeping assumptions about how large groups of people behave in order to explore a whole society’s development” (1991, p.1). “Even when reasonably close-fitting empirical examples can sometimes be found, translating ‘real life’ into ‘first principles’ analysis is so difficult that we end up able to explain only small slices of the political process disconnected from each other” (1991, p.1). It has little in common with the traditional concerns of political science. On the other hand, institutional public choice has had much more influence on political science and policy making: “A substantial body of work now offers a coherent picture of almost all aspects of the political process and government institutions”, such as the behaviour of interest
Public choice can be defined as the economic study of non-market decision-making, or simply the application of economics to political science. The subject matter of public choice is the same as that of political science: the theory of the state, voting rules, voter behaviour, party politics, the bureaucracy, and so on. (1989, pp.1-2).

Dunleavy identifies four elements in public choice literature which together comprise the foundations of the theory (1991, p.3).15 First, “people have sets of well-formed preferences which they can perceive, rank and compare easily”. Second, these preference rankings are logically consistent, for example, if someone prefers A to B, and B to C, then they will prefer A to C. Third, the decisions people make are designed to produce the biggest benefits and the least costs for themselves. Fourth, people are “egoistic, self-regarding and instrumental” in their decision-making, choosing behaviour that maximizes their personal welfare. The culmination of these four factors is rationality: “[people] act rationally when they pursue their preferences in an efficient manner and maximise benefits net of costs...[S]omeone behaves ‘rationally’ if they optimize their preferences in a consistent fashion, however substantively ill-advised we may judge their preferences to be” (Dunleavy, 1991, p.3). Another assumption, which accompanies the five discussed, is that all individuals have enough information to determine a rational course of action (D. King, 1987, p.95).

Public choice theory greatly contributes to the theory of ‘public incompetence’, therefore advocating privatization almost by default, by extending the behavioural assumptions just mentioned to the public, or political, sphere. It focuses on two main concepts – that government spending is inevitably increased by factors outside the control of the governing party; and that government (which should exist only to provide certain public goods and services) is inherently inefficient (Zahariadis, 1995, p.17). These two views emerge, in turn, from three sources of government failure identified by public choice theorists (Starr, 1988). First, self-interested politicians pursuing their own objectives are unlikely to respond to demands for various public goods and services unless they will gain some personal benefit from meeting the demands. Second,
bureaucrats will not respond to the wishes of politicians, even if they do act in the public interest, because they also act in a personally expedient way. Third, it is unlikely that bureaucrats will produce what is desired because it is in their interest to be inefficient.

These problems are said to be the consequence of the self-serving behaviour of *homo economicus* acting in the political arena. The consequence of his/her behaviour in the public service is allocative inefficiency, the wrong mix of services, and X-inefficiency (Walsh, 1995, p.17). Public choice theory reaches similar conclusions to property rights theory, but takes a subtly different approach. As discussed previously, the distribution of property rights is said to create different types of incentives, depending on the type (usually public or private) of ‘property’ in question. Building on the assumption that individuals working in the public sector do not have the incentives to perform efficiently, it is suggested that they will try to increase their utility in other areas (Peters, 1996, p.21). Three groups of actors are covered in the following sections: politicians, bureaucrats and voters/citizens. Public choice theory argues that, because of their self-serving behaviour, outcomes in the political process are likely to serve the interests of the specific actor involved, rather than the citizenry.

(a) Politicians

Mitchell and Simmons’ gleefully gloomy view of the ‘successful’ politician is typical of public choice theorists: “shifting, smoothing, evading, concealing, lying, and diffusing hostility. Insincerity and flattery are common forms of political behavior; so, too, are paranoia, hatred, envy and cynicism” (1994, p.51). This type of behaviour is said to be the inevitable consequence of the actions of *homo economicus* - self-interested, rational, utility maximizing – in politics.

Politicians (in pluralist political arrangements), it is suggested, are not attracted to office by a commitment to serving the public interest. Their primary goal “*is to reap the rewards of holding office per se. They treat policies purely as means to the attainment of their private ends, which they can reach only by being elected*” (Downs, 1957, p.28, emphasis added). Since it is only by holding onto power that politicians can exploit their position, election and re-election are their prime concerns. This leads Downs to suggest

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46 See the discussion on the different types of efficiency in the next section.
that “parties formulate policies in order to win elections, rather than win elections in order to formulate policies” (1957, p.28).

Politicians and their parties are elected and re-elected by implementing policies with an immediate rather than long term impact, as voters will be more likely to ‘reward’ politicians at the next election with their support in the form of votes. According to Mitchell and Simmons, the “courting of voters forces practitioners to adopt tactics rivaling those of Machiavelli’s prince” (1994, p.51). They take credit for popular programs and pass to the responsibility for unsuccessful policies to their opponents.

Politicians then pursue those policies that will be the most politically expedient for themselves. They will favour spending rather than controlling costs and “policies that involve the production of highly visible outputs at the expense of the more beneficial but less obvious projects” (Walsh, 1995, p.19-20). Even significant political obstacles designed to be a check on overall budgetary growth, such as the prime minister or president, are unable to exert any influence on the politicians’ behaviour as it is also in their best interests to create “favourable economic conditions” in election years to ensure their own re-election (Dunleavy, 1986, p.16).

(b) Bureaucrats

The self-serving behaviour of bureaucrats has been a topic much discussed by public choice theorists. There are many, sometimes contradictory, critiques of the self-serving bureaucrat. One familiar interpretation is that of the “slothful, indolent bureaucrat” maximizing his/her enjoyment of “on-the-job leisure” (Peters, 1996, p.21). Second, and probably the most influential and well-known theory of bureaucracy, is Niskanen’s Representative Government and Bureaucracy, in which he “pits representative government against bureaucracy in the struggle over what is a fundamental resource of the state, namely the public purse” (Aucoin, 1990, p.116). His main argument is that all goals pursued by a bureau chief are connected to the desire to maximize the size of

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47 It is interesting to note that politicians’ and parties’ pursuit of votes is argued to reduce the actual choice available to voters, as the main parties will converge to the median voters’ views (Walsh, 1995, p.20).
48 Walsh gives the Concorde and the ‘space race’ as two examples of this (1995, p.19).
his/her budget, in order to increase his/her power and prestige (Self, 1985, p.67)\textsuperscript{49}. As Peters points out, in comparison with the first view, this assumption "raises the specter of the activist, megalomaniac bureaucrat – certainly the antithesis of sloth" (1996, p.21).

Self-interest is again the predominant feature in bureaucrats' decision-making, making "salary, perquisites of the office, public reputation, power, patronage, output of the bureau, ease of making changes, and ease of managing the bureau" (Niskanen, 1994, p.38) prime considerations. The larger the budget, the more likely the increase in the bureaucrat's status, salary and power.

In Niskanen's theory there are two types of actors: bureaucrats (the suppliers of public goods and services), and politicians (sponsors of government production of goods) (D. King, 1987, p.103). Each has a main objective: for bureaucrats it is to maximise their budget, while for politicians it is to maximise votes (D. King, 1987, p.103). In an argument obviously influenced by agency theory (see below), there is likely to be a disparity of information due to the principal/agent relationship between the actors. For example, a bureaucrat will more about the costs and production processes of the bureau's services than the politicians who sponsor their spending (Niskanen, 1994, p.29) Bureaucrats are able to take advantage of this disparity of information and maximize their interests in the budgetary process: "A bureaucrat needs relatively little information...to exploit his [sic] position as a monopoly supplier of a given service. The officers of the collective organization, in contrast, need a great deal of information...to exploit their position as a monopoly buyer of this service" (Niskanen, 1994, p.29).

These combined factors – bureaucrats' wish to maximize their budgets, and also the asymmetric information between bureaucrat and politician – have undesirable but inevitable implications. For example, "the added funds go to overstaffed agencies employing costly procedures, provide higher incomes and unnecessary perks to employees, and underwrite a more pleasant lifestyle than their counterparts in private enterprise enjoy" (Mitchell and Simmons, 1994, p.60). Consequently, bureaucracies over-supply outputs, creating a budget which delivers more than the necessary level of

\textsuperscript{49} For this reason Dunleavy (1986, 1991) calls it the 'budget maximization thesis'. For criticisms of this theory, see Udehn (1996, pp.75-78), Self (1985, pp.67-68) and Stretton and Orchard (1994, pp.36-38,134-135).
services which would be provided by private firms with perfect competition (Dunleavy, 
1986, p.16)

An alternative consequence of the budget-maximizing bureaucrat’s behaviour is 
the under-supply of goods and services. The superior information advantage possessed by 
the bureaucrat described earlier may not necessarily be to their advantage. If politicians 
do not understand or have full information available to them, they may find it easier to 
cut the bureau’s budget (Breton and Wintrobe, cited in Walsh, 1995, p.18). Then, given 
the choice between supplying public or private goods and services through the budget, it 
is argued that bureaucrats will choose to supply the latter. This is because (pure) public 
goods are not valued as highly by citizens as private goods, which can benefit particular 
individuals personally (which public goods cannot as no one can be excluded from their 
supply)Private goods will therefore have a higher “political payoff” (Peters, 1996, 
p.24). It then follows that bureaucracies will under-supply public goods and over-supply 
private goods.

(c) Voters/Citizens

Because economic and political man and woman are both self-interested, a voter and a 
customer also have the same interests at heart. “We assume that in both he [sic] will 
choose the product or candidate he [sic] thinks is the best bargain” (quoted in D. King, 
1987, p.100). A two dimensional interpretation of the citizen highlights some of the 
contradictions present: first, he/she is a taxpayer and therefore indirect funder of 
government spending, and second, he/she is also a beneficiary of that government 
spending (Mitchell and Simmons, 1994, p.47). The citizen-beneficiary role is likely to 
supercede that of the citizen-taxpayer for two reasons (Mitchell and Simmons, 1994, 
50 See Dunleavy (1985) for a reconstruction of this model of bureaucratic behaviour. Using a public choice 
framework, he argues that budget maximization will not necessarily be the predominant outcome because 
of four main reasons. First, there will be collective action problems within the bureaucracy, which will influence bureau behaviour. Second, bureaucrats’ personal utilities are only associated with a small part of the overall budget, and this will also vary depending on the types of budgets and agencies themselves. Third, bureaucrats can only budget maximize up to a certain level, “defined by the intersection of curves showing their discounted marginal utility pay-offs from budget increments and the marginal costs they incur in advocating further expenditure” (1985, p.300). Fourth, bureaucrats are more likely to pursue work-related benefits rather than monetary benefits. “Their strategies for improving work-related utilities hence focus not on budget maximization but on reshaping their bureaus to bring them into a closer conformity with an ideal form” (1985, p.300).

51 It seems that this argument could apply equally well to politicians.
First, politicians, bearing the brunt of citizens complaints and, acting in their own best interests, will want to appease them in order to maintain support, presumably to be re-elected. Second, as a beneficiary of government spending, a citizen would support measures that he/she will personally benefit from, regardless of the total size of the budget.

The previous point is very closely linked to the second: the disparity between voters' demands for government spending and the consequences (or lack of) directly on themselves. Because voters often do not bear the direct financial costs of government policies, the production of goods and services is thought to be inefficient. "[I]f voters related these costs more directly to the taxes they pay, support for government programmes will evaporate immediately" (D. King, 1987, p.101). This public choice insight is used as one of the main reasons for privatizing (discussed later) as citizens bear the complete cost of their decisions. Therefore an optimal level of services will result.

Thirdly, public choice theory argues that the act of voting is a flawed process and is an inadequate means of determining citizens' preferences. Voting involves either/or decisions, usually accompanied by 'tie-in purchases', for example: "To get a labor policy I like, I may also have to accept a foreign policy I abominate" (Mitchell and Simmons, 1994, p.48). As well as having to deal with this problem, voters must also consider the possibility that their vote may not count at all, as is the case if they are in the minority. "[I]f we vote for something but are in the minority we do not get it...if we vote against something and are in the minority, we get it and are compelled to pay for the unwanted goods or services" (Mitchell and Simmons, 1994, p.48).

Pirie argues that, in an effort to cater to the interests of all citizens, the public sector becomes "marked by uniformity rather than by variety" (Pirie, 1988b, p.220). Therefore it is perceived that decisions do not need to be, and cannot be, responsive to all individuals' wishes, but instead try to accommodate as many people as possible. A service received by many people gains more political support than one granted to a small number and therefore has "less value in the political market place" (Pirie, 1988b, p.221). This lack of attention paid to individual preferences by the public sector is regarded as a significant problem by public choice theorists, as the whole theory is founded on the belief in methodological individualism, that is, that all social behavior is the product of
the free choices of individuals (Self, 1990, p.23). "[T]he problem is one of transforming a standardized, producer-oriented public sector into the range of individual alternatives which people would choose to fit their own requirements" (Pirie, 1988b, p.223).

2.1.3 The new public management

In complete contrast to the other theories discussed, the new public management (NPM) has emerged primarily from the non-academic sphere, that is, from practitioners and private sector consultants (Boston et al., 1996, p.25). Essentially, it relies on an assumption of generic management, that is, "management is management, no matter where it takes place" (Peters, 1996, p.28). Hence, those management and organization practices used in the private sector should be applicable to the public sector.

Hood (1991) coined the phrase 'the new public management' to describe the overall approach. It is comprised of seven 'doctrinal components', but they all do not always have to be present, and there may be some inconsistencies between them (Hood, 1991, p.4). It is important to recognize these two qualifications, as they emphasize the diversity within NPM approaches. Hood's seven components are as follows (1991, pp.4-5):

- 'Hands on' professional management in the public sector: "Active visible, discretionary control of organizations from named persons at the top" (Hood, 1991, p.4);
- Explicit standards and measures of performance, such as goals and performance indicators (preferably expressed in quantitative terms);
- More emphasis on outputs, that is, a move from "process accountability to accountability for results" (Boston et al., 1996, p.26);
- A move to disaggregation of public sector units, that is, breaking up 'monolithic' units;

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52 As Hughes points out, this approach is known by many different names: managerialism, the new public management, market-based public administration, the post bureaucratic paradigm and entrepreneurial government (1998, p.52).

53 Hood regards the emergence of NPM as a "marriage of two different streams of ideas" (1991, p.5), between the 'new institutional economics', which comprises public choice, transaction cost economics and agency theory, and business-oriented managerialism in the public sector, which promoted ideas such as the generic (and therefore portable) nature of management (1991, pp.5-6). As Hood points out, there is a definite conflict between them: the former's emphasis on being 'free to choose' is not the same as the latter's being 'free to manage' (1991, p.6).
• A move towards greater competition in the public sector, reflecting a preference for private ownership, contestable provision and the contracting out of public service (Boston et al., 1996, p.26);
• Emphasis on private-sector management styles, a reflection of the belief that there is no difference between the public and private sectors, therefore they should be managed in the same way;
• Emphasis on discipline and reducing costs.

In summary, NPM literature argues that many of the justifications for public service and related concepts are a means of excusing inefficiency (Peters, 1996, p.28). This reinforces the construction of the ‘theory of public incompetence’ mentioned earlier. By using private sector management techniques, public sector managers should produce “better government for less money” (1996, p.28). The implications of NPM as an influence on the rationale for privatizing are quite significant. They will be discussed in some depth in the final section of this chapter.

2.1.4 Agency theory

The fourth economics approach to politics is agency theory. Its importance lies in its analysis of the contractual relationship between parties, and its identification of factors which influence power imbalances in this relationship, for example, asymmetrical information and conflict of interest. The main idea behind agency theory is that social and political life can be reduced to being a series of contracts between two actors: a ‘principal’ and an ‘agent’ (hence the term ‘agency theory’). The agent acts or performs a task on behalf of the principal, and in turn the principal rewards the agent. Initially used to analyze problems in ownership and control of firms (for example, the different interests of managers and shareholders), agency theory has been extended to analyze most areas of social, economic and political life (Boston et al., 1996, p.19). As such, it is readily applicable to public and private sector exchange relationships, and has much influence on arguments for privatizing.

There are three core assumptions which form the basis of the theory (Perrow, 1990, p.122). Like the other theories, in agency theory relationships, individuals act in their own self-interest, and are rational utility maximizers. A consequence of this is that social and political life is regarded as a series of contracts, or exchanges, “governed by
competitive self-interest" (Perrow, 1990, p.122). Third, agency theory highlights potential problems of information and control in transactions.

It seems self-evident that the interests of principals and agents rarely coincide, and may conflict, as both participate in an exchange in order to maximize their own interests at the expense of the other. "There is no occasion when behavior will intendedly [sic] be other-regarding, rather than self-regarding, on any predictable basis or to any significant degree" (Perrow, 1990, p.123). Consequently, there can be no guarantees that an agent hired by a principal will pursue the principal's interests or do so efficiently (Moe, 1984, p.756). "The agent has his [sic] own interests at heart, and is induced to pursue the principal's objectives only to the extent that the incentive structure imposed on the contract renders such behaviour advantageous" (Moe, 1984, p.756, emphasis added).

A further factor compounding the nature of the principal-agent relationship is the degree of information available to both parties. When there is perfect (and free) information available there is no difficulty in monitoring the agent's performance against the agreed contract (Walsh, 1995, p.36). "Failures in performance, and the reasons for the failure, will be instantly and accurately recognizable" (Walsh, 1995, p.36). However, this is impossible more often than not, with many principal-agent relationships being complicated by incomplete or asymmetrical information (Boston et al., 1996, p.19). As seen in the public choice discussion on the disparity of information between bureaucrat and politician, agents usually have access to information that principals do not (and vice versa). Because they are dominated by self-interested concerns, agents are likely to exploit this situation to their own advantage (Boston et al., 1996, p.19).

Two further concepts are used in agency theory analysis: adverse selection and moral hazard. Adverse selection usually refers to the lack of information known prior to the agreement of the contract by the principal, that is, some information the principal may want to know about the agent is difficult to observe. The agent therefore has an

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54 The classic example of adverse selection is an employer looking to fill a vacant position (Boston et al., 1996, p.20; Moe, 1984, p.754). While the employer (principal) has rough indicators of an applicant's (agent) suitability — qualifications, education, work experience — he/she cannot know for certain other relevant aspects such as ability, intelligence, attitude and work habits. The employer cannot be sure that he/she has chosen the best person for the job. On the other hand, the best applicant, who does know this
information advantage over the principal, which he/she may conceal, meaning the principal might make an adverse selection. On the other hand, moral hazard is the situation that arises from the principal’s inability after the negotiation of the contract to assess whether or not the desired results have been achieved. The greater the difficulty in assessing the outcome of the contract, the greater the potential for the agent to shirk, or even not carry out the work at all (Walsh, 1995, p.47).

All political relationships can be viewed in principal-agent terms. For example:

Citizens are principals, politicians are their agents. Politicians are principals, bureaucrats are their agents. Bureaucratic superiors are principals, bureaucratic subordinates are their agents. The whole of politics is therefore structured by a chain of principal-agent relationships. (1984, pp.765-766, emphasis added).

Agency theory is a useful means of analyzing basic questions of democratic control, performance and accountability (Moe, 1984, p.766). It is therefore particularly useful for analyzing arguments for privatization.

Building on the insights of public choice theory, of most interest for agency theorists is the situation that occurs when politicians are principals and bureaucrats their agents. This highlights the problem of politicians’ control: “the problem of political control is analogous in many respects to the economic problem of the separation of ownership and control, with politicians attempting to control bureaucrats rather than stockholders trying to control managers" (Moe, 1984, p.766). However, “translation and elaboration” are required when agency theory is applied to this political subject matter (Moe, 1984, p.766).

2.1.5 Transaction cost economics

There are two possible ways to coordinate economic activities: markets or planning (Walsh, 1995, pp.32-33). The former relies on the familiar price mechanism to provide information, for example, supply and demand, of goods or services. On the other hand, planning involves “the authoritative allocation of resources to defined purposes, and the

unquantifiable information about him/herself, cannot show him/herself to be the best person for the job, because all applicants present themselves in the best light in order to maximize their chances of gaining the job.

55 “For example, it may be difficult [for the principal], without excessive levels of inspection, to determine whether the fact that the streets are littered is a result of the fact that the person [the agent] paid to clean them did not do so, or that they have been littered after having been cleaned” (Walsh, 1995, p.47).
use of explicit processes of coordination” (Walsh, 1995, p.33), that is an implied role for government.

Bearing this in mind, the aim of transaction cost economics (TCE) is to determine the best way of organizing the production and exchange of various goods and services. Williamson, the main contributor to TCE, states that this theory is “an examination of the comparative costs of planning, adapting, and monitoring task completion under alternative governance structures (e.g. hierarchies versus markets)” (quoted in Boston et al., 1996, p.21). The best organizational form will depend on the level of transaction costs, that is, the costs involved in making exchanges (Walsh, 1995, p.33). “Transaction costs may well be high when the process of exchange is difficult or complicated, for example, if detailed contracts must be prepared and managed or if it is difficult to evaluate the quality of the products” (Walsh, 1995, p.33). It can be seen that agency theory and TCE are very closely related, with the latter merely focussing on agency costs, that is, the costs that become part of the contractual arrangement (Althaus, 1994, p.4).

There are five main ideas in TCE: uncertainty, small-numbers bargaining, bounded rationality, asset specificity and opportunism. Uncertainty is “the dynamic element that makes equilibrium of the market unstable” (Perrow, 1991, p.129). There are two types: general uncertainty, which is the absence of perfect information, and changes that the owner cannot foresee or control; and behavioural uncertainty, which refers to a lack of confidence in one of the parties to a contract (Boston et al., 1996, p.22, Perrow, 1991, p.129).

Small-numbers bargaining is the situation that occurs when there are initially few potential buyers or sellers. If a long-term contract is signed, the party that won the contract will be at an advantage, as it is likely to have more experience, resources, task-specific labour skills and ‘insider knowledge’ at the renegotiations stage than those who did not win the contract (Boston et al., 1996, p.22, Perrow, 1991, p.129). This may mean that subsequent competition is either limited to a smaller number of bidders or eliminated altogether if the advantages gained by the first contractor are significant enough (Boston et al., 1996, p.23). Asset specificity is closely related to small-numbers bargaining. This is the situation that arises when "it makes a necessary contribution to the production of a good and has much lower value in alternative uses" (Vinning and Weiner, quoted in
Boston et al., 1996, p.23). If a company invests in a piece of equipment for which there is no alternative use, or which cannot realistically be transferred, this would be an example of a 'sunk cost' or a 'sunk investment' (Boston et al., 1996, p.23)\(^{56}\).

When a supplier has assets of this nature it enjoys an advantage over potential competitors, who face barriers to entering the relevant market. At the same time, a supplier with specific assets also faces a potential loss if there is a collapse in demand for the goods it produces. Where asset specificity is absent, and firms can enter or exit costlessly, the market is said to be perfectly contestable. On the other hand, where a high degree of asset specificity occurs, the market will be relatively uncontestable (Boston et al., 1996, p.23).

Bounded rationality refers to the inability of individuals to gather all necessary information and knowledge and then compute and analyze their options to make fully informed decisions. Very closely related to this idea is that of opportunism, which is heavily influenced by the self-interested individual used in public choice and agency theories. Opportunism is the assumption that rational individuals will pursue their own interests at the expense of others. If one party to a contract has an advantage of information or has more power, it is possible for that party to exploit the other by breaking the terms of the contract without facing the consequences of this action (Walsh, 1995, p.34). Without perfect information it is impossible for one actor to determine whether the other is behaving opportunistically.

### 2.2 Why privatize?

The relationship between the theories just described and arguments for privatization is reasonably transparent, and is likely to already be clear to some readers. In this section I will briefly discuss the arguments commonly cited as reasons for privatizing, which the previous economic approaches inform greatly. The final section of the chapter then clarifies the link between theory and practice and its implications for policy, focussing on privatization.

\(^{56}\) This example is a clearer one than that provided by Perrow (1991, pp.129-130), who uses a worker acquiring certain skills in an organization that outside workers do not have. The employer has to think seriously about firing this worker, or about his/her demands for a pay rise, because the worker is said to have an increased sense of bargaining power. On the other hand, the worker is of no use to any other organization, because of his/her specific skills, therefore negating the supposed bargaining advantage.
2.2.1 General arguments for privatization

(a) Efficiency

The primary reason for privatizing is that its introduction will increase the efficiency of the enterprise concerned. In most discussions condoning privatization, efficiency is taken as meaning ‘the least possible cost’ for “this is the commonest and for many practical purposes the best test of efficiency” (Stretton and Orchard, 1994, p.84). The following quote is typical of this assumption: “[p]ublic enterprises perform relatively poorly in terms of their competitive position, use labour and capital inefficiently and are less profitable” (Moore, quoted in Ernst, 1994, p.71). The primary reason for this argument is the belief that market mechanisms are the most effective means of allocating resources to society, and that other forms of allocation, for example, through public bureaucratic means, distort the outcomes otherwise produced by the market (Peters, 1996, p.23).

More technically, a move towards private enterprise is thought to improve what economists call X-efficiency, allocative efficiency, and technical efficiency. X-efficiency is ‘getting things done at minimum cost’. Le Grand adds a qualification to this definition: “production of a commodity at the minimum possible cost in terms of the resources used. If resources are wasted or employed in a profligate fashion in the production of a commodity, then there is X-inefficiency” (1991, p.425, emphasis added). Allocative efficiency is a wider concept, taking into account X-efficiency, but also considering aspects such as whether or not the commodity effectively meets the wants and expectations of its consumers. “More formally, an allocation of resources is defined as allocatively efficient if it is impossible to re-allocate resources in such a way as to make one or more persons better off without making someone else worse off: a definition that is also known...as Pareto-efficiency” (Le Grand, 1991, p.425). Technical efficiency is the ability of an enterprise to innovate and therefore lower production costs or meet consumers’ wishes more effectively (Le Grand, 1991, p.426).

Three areas of criticism of the public sector’s inefficiency indirectly advocate the efficiency of the private sector. Their basis in property rights theory is quite obvious, with the incentives of private or public enterprises being the main reason for efficiency and inefficiency respectively. First, in many cases, a public enterprise holds a monopoly position. It is therefore permanently sheltered from the discipline of market forces
present in the private sector (Ernst, 1994, p.72). Closely related to the previous point is the fact that government guarantees their existence: “there is no threat of bankruptcy; the management does not have to answer to shareholders and are not under the threat of takeover if they are inefficient” (Le Grand, 1991, p.432). Third, non-commercial objectives, implicitly or explicitly imposed on public enterprises by government, interfere with their running as economically viable enterprises. For example, objectives such as considerations of the ‘public good’, ‘public interest’ or public service, are regarded as irrelevant for an enterprise to run efficiently.

These wider social considerations may be used by those running public enterprises to excuse behaviour that is incompetent and benefits themselves at the expense of the organization or its tax-payer ‘owners’. Because bureaucrats and politicians are not constrained by the market conditions present in private firms they may find it easy “to obtain subsidies and mask their utility-maximizing behavior under the guise of fulfilling other social goals” (de Alessi, 1987, p.31). Here, a direct reference to public choice theory can be clearly seen. Moore would also agree with their point: “Are the industries businesses or social services? Social and commercial objectives intertwine to the detriment of both (1996, p.483).

(b) Competition
A necessary accompaniment to achieving efficient outcomes is competition, as it is generally accepted that transferring ownership from the public to the private sectors alone will not stimulate efficiency. That is, ownership is not necessarily the essential variable to change. This was seen in chapter one with the variety of privatization methods that do not necessarily involve the complete transfer of assets to the private sector. The introduction of competition is more important, as it is argued to lead to further positive results: “increased productivity and efficiency, greater public accountability and enhanced consumer power” (Ernst, 1994, p.73).

However, some disagree with the importance placed on competition and suggest that it is the move from public to private ownership is the significant factor in

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57 Another good example of this is a statement by Pryke: "It [public ownership] could have a harmful effect by inducing the belief that the activities should act as social services and take the national interest into account" (quoted in Ernst, 1994, p.72).
privatization. Pirie suggests that the transfer of “political entities” (public) into “economic entities” (private) means that decisions made about them are then concerned only with economic performance in the market, rather than political influence (1988a, p.53). However, there is an interesting alternative to the factors of competition and ownership. For example, Starr suggests that markets do not necessarily need to be perfectly competitive in order to perform efficiently; they only need to be contestable (1988). An influence here from agency theory and TCE is obvious, as it is from these theories that the concept of contestability originates. Contestability requires the absence of asset specificity and the ability of firms to enter a market without cost.

(c) Consumer responsiveness – price, quality, service

Another frequently mentioned consequence of privatizing are the benefits its introduction will bring to consumers, through consumer sovereignty (or choice), usually a reduction in costs, and increased quality of goods and services. I have gathered together these benefits under the heading ‘consumer responsiveness’. It is in the financial interest of companies to be more responsive to the preferences of consumers, in order to maintain and increase consumption of their goods or services. Many of these types of arguments have already been indirectly mentioned in the previous sections, so they will only briefly be restated here.

The freedom and opportunity to choose between suppliers of goods and services, or even to choose to have those goods and services at all, is said to liberate citizens from being forced by the legislature or bureaucracy to receive them (Peters, 1996, p.44). Choice is achieved by either subjecting state-owned monopolies to more competitive markets, or by providing a wider range of service options to citizens, for example, vouchers for housing or education, or simply providing them with more information about the options available (Peters, 1996, p.44).

In private companies, the consumer has a degree of control over the goods and services produced, as they are more likely to be oriented towards satisfying the consumer. In order to survive, private companies must produce the goods or services in the variety, quality and quantity that the consumer demands. “Where the public has no choice but to pay and taken what is provided, as is usually the case in the public sector, this degree of control is absent” (Pirie, 1988a, pp.25-26).
(d) Accountability

Another main reason for privatizing is that accountability structures will improve. The implementation of privatization changes the traditional hierarchical structure of accountability. Usually, one is accountable to those in superior positions of authority in the "hierarchical chain of bureaucratic command" (Gregory, 1995, p.59), for example, public servants to public officials, to politicians to voters (Walsh, 1995, p.213). However, the type of accountability introduced with privatization does not conform to this type of clear organizational arrangement, challenging it in two ways: first, the separation of political (setting policy and standards) from managerial (management) levels within organizations, and second, as discussed in the section on efficiency, the merging of social objectives with commercial ones (Walsh, 1995, pp.213-214).

In addition, many of those in favour of privatizing argue that the market is in fact more accountable than traditional elected forms of government. Because private goods' and services' providers are in a closer relationship with consumers than government can be (because contact is more direct and not filtered through different agencies and levels of government), it is in their interests to produce what the consumer wants. "In this sense the market sector is more genuinely democratic than the public sector, involving the decisions of far more individuals at far more frequent intervals" (Levitas, quoted in Walsh, 1995, p.214).

2.3 Economic approaches to politics and their influence on arguments for privatization

Each of the five theories discussed earlier takes a slightly different approach to economic and therefore political matters, however, despite this, the policy implications are very similar, and from the previous two sections it may be clear already what some of these are58. Although the theories are certainly distinctive in their own right, their contributions to privatization policy will be considered collectively as there is not the time or space to examine each in depth. Analyzing the theories in this way is also appropriate because they do not exist in a vacuum, but instead indirectly rely on each

58 While every effort has been made to eliminate unnecessary repetition of central concepts, in some instances this is unavoidable.
other for their own reinforcement, for example, it is clear already that most are based on a
notion of property rights.

Rational self-interested individuals are the dominant actors in all five theories: property rights, public choice, agency theory, TCE and, to a certain (implied) extent, NPM. A critical step in the formation of the "privatization thesis" is the realization, heavily influenced by public choice theory, that economic behavior and government behavior can both be regarded as manifestations of individual behaviour. (Henig, 1989, p.653) In this view, political activity is a subset of economic processes (Henig, 1989, p.653). For example, public choice identifies self-interested politicians and Niskanen's budget-maximizing bureaucrat, as groups striving to maximize their status, power and wealth (Henig, 1989, p.655) rather than attend to the needs and wishes of the public. Agency theory suggests that because both principals and agents are guided by rational self-interest, and because of factors mentioned earlier (asymmetrical information, moral hazard and adverse selection), their interests are unlikely to coincide, being more likely to conflict. TCE assumes also that principals and agents are opportunistic and "self-interest seeking with guile" (Williamson, quoted in Boston et al., 1996, p.22), thereby directly influencing the level of agency costs present in a transaction, which in turn determines the most appropriate organizational arrangement.

This behavioural assumption creates a difficult situation for those responsible for formulating public policy: how to channel such behaviour into outcomes that are beneficial and fair for those participating in society. This difficulty is compounded by the inadequacies identified by public choice theory of the vote as a communicator of

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59 Kelly states categorically that NPM is based on rational and public choice assumptions, and pro-market and private sector assumptions, which in turn are based upon methodological individualism and "an instrumental conception of individual rationality" (1998, p.2). This is illustrated in the following quote:

Assuming that citizens are the same as customers/consumers, the New Public Management most typically argues that individuals receiving some governmental good or service are attempting to maximize their utility (often defined as satisfaction) with regard to the good or service, and that contractors acting in a competitive market and seeking to maximize their profits, will perform better, i.e., more efficiently, than if a government bureaucracy provides the good or service directly (1998, p.2).

However, the link between rational self-interest and the practice of NPM, which can certainly be inferred, does not appear to be as clear as the quote would seem to indicate.

60 I have chosen to use the term 'those participating in society', rather than 'all citizens' because, as will become clear in a later chapter, the market (privatization's close companion) does not necessarily cater to those (the unemployed, ill, handicapped) who cannot participate in it (D. King, 1987, p.106).
complicated policy preferences. The vote is an effective means for a majority to preserve or reject a program but those not in the majority cannot have their policy preferences recognized.

Two issues have thus been identified in considering the self-interested nature of the individual: how to enable individual preferences to be expressed and/or channeled towards positive political outcomes; and how to curb the consequential tendency of bureaucrats, politicians and voters towards unnecessary state expansion. The first issue is directly concerned with the implications of rational self-interested behaviour on the political system, while the second questions the scope of the state's activities, and therefore the role of the state itself. Privatization is regarded by many as the ideal solution to both of these problems. The various privatization prescriptions for public services of the economic approaches to politics are discussed below with reference to the four general arguments for privatizing mentioned above.

2.3.1 User charges

User charges, where the consumer pays a charge per unit for goods or services, are an integral part of a privatization program as they enable consumers to exercise (or choose not to exercise) freedom of choice in the goods and services they purchase. User charges for public services, in the form of a per-unit charge, rather than indirect payment from general taxation funds, are favoured by public choice theorists (Hood, 1987, p.149) and, I would also suggest, the theorists of the other economic approaches to politics. Using allocative and X-efficiency as the ends to be achieved, it is argued that per-unit charges do not distort the information about consumer preferences which occurs in services provided from large budgets, which are allocated periodically from general tax funds (Hood, 1987, p.149).

As mentioned in relation to public choice theory and agency theory, tax-payer funded services can have adverse effects on people's preferences. They introduce moral hazard, and increased demand or consumption because individuals pay for the service indirectly through taxes, rather than per unit as they use them (Hood, 1987, p.150). Niskanen likens taxpayer funded goods and services to a group averaging their bill at a

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61 I concede that user charges, and some of the other policy prescriptions, can be adopted without complete privatization.
restaurant: "each person has an incentive to order a high-price meal than if the bills were separate" (1994, p.143). Encouraging people to make decisions on the basis of their willingness or ability to pay forces them to consider whether or not they really want the goods or services in question.

Agency theory also seems to support user charges because, as mentioned previously, it can be very difficult to determine precisely who the principals and agents are in taxpayer-funded goods and services. User charges, in simplifying the contractual relationship between consumer (principal) and the goods’ or services’ provider (agent) would help overcome this, as identification of the relationship between the two becomes more transparent than it would be if the same services were funded through taxation, where there are many principal/agent relationships to complicate the process and increase the level of agency costs.

As well as enabling consumers to pay the true (and therefore fair) cost of their consumption of goods and services, user-charges are also encouraged as they are said to control producers’ opportunism and the transaction costs involved in the ‘contract’ between them. Referring to agency theory again, it is in the principals’, that is, the producers’, best interests to either distort or conceal information about services’ production and costs in order to gain a larger budget allocation (Hood, 1987, p.150) from their agents, politicians. “This line of argument goes that the budgetary process will turn into a political poker game, marked by concealment of information, histrionics, melodrama, contrived crises, and frequent deadlocks” (Hood, 1987, p.150). Therefore the level of goods and services available will only be a reflection of the “political bargaining skills” (Hood, 1987, p.150) of the providers, rather than what consumers want.

There is a further reason that public choice theorists favour user charges: As discussed in chapter one, many public goods confer private benefits onto the recipients, for example, education. It therefore seems reasonable to expect them to pay at least some of the cost: “Where such benefits exist, user fees should be instituted as a means of requiring recipients of the private benefit to pay that portion of the cost which represents the private benefit” (Jennings, 1991, pp.119-120).
2.3.2 Small-scale provision
Small-scale rather than large-scale organization is preferred as consumer preferences are better signaled. Producer (agent) power is weakened by a subsequent increase in consumer (principal) power, since dissatisfied consumers can exit an unsatisfactory enterprise and taken their business elsewhere (Hood, 1987, p.148). The principal’s costs in monitoring the contract, agency costs, which are usually slanted in favour of the agent, will decline in a small organization, thus subverting the usual power imbalance that favours the agent.

2.3.3 Eliminate public monopolies
If monopoly status is inevitable, a private monopoly is preferable to a public monopoly. Using an argument similar to that used for the responsiveness of user-charges (though it could fit equally well in later discussion on curbing public sector power), it is argued that monopolies are under little pressure to be efficient or responsive for consumers. “Where government is the dominant provider...the situation is even worse” (Feigenbaum et al., 1999, p.23). At least with a private monopoly, the consumer may choose not to pay for the goods or services if they do not meet his/her expectations.

However, with a public monopoly, he/she must continue paying through taxes, even for goods or services he/she does not want or use (Feigenbaum et al., 1999, p.23). For this reason, a private monopoly is preferable to a public one. In spite of the obvious fact that a private monopoly has no more incentive to be efficient, responsive or keep costs down, consumers are at least charged for what they use, and can leave the at any time. “Because citizens cannot readily trace the links between the taxes they pay and the particular services the government provides, public monopolies can mask their wastefulness more easily” (Feigenbaum et al., 1999, p.23). If monopoly provision of public services is unavoidable, small-scale rather than large-scale monopolies are preferred because X-efficiency and information loss about consumers’ needs and wants become more serious as the monopoly’s size increases (Hood, 1987, p.148).

2.3.4 Emulate private enterprise
While citizens’ self interested behaviour may be harnessed by the introduction of user-charges, the solution to harnessing bureaucratic self-interest is quite different, and privatization again provides the means to achieve this. Despite some potentially
contradictory interpretations of bureaucrats' behaviour, the different economic perspectives mentioned earlier have in common an underlying belief in at least some form of self-interest, merely manifested in different ways. However, the result is the same: the principal/agent relationship inevitably leads to public sector waste and inefficiency. Here it can be seen that efficiency and property rights are very closely linked, with the former being dependent on the status, private or public, of the latter. When principals negotiate with agents over the use of their property or property rights, it is argued that it is the divergent goals of the two parties that causes inefficiency to occur, through the agent's "slacking and...dysfunctional behaviour", thereby reducing the underlying value of the property rights in question (Martin and Parker, 1997, p.6)\(^6\). There are two possible solutions to this situation.

First, the bureaucracy, the focus of public demands for goods and services in the political process, could be radically modified. As mentioned above, public monopolies should be eliminated or at least reduced. In addition; the process in which bureaucrats request funding could become more rigorous and competition could be increased within public bureaucracies to increase efficiency and productivity (D. King, 1987, p.102).

The second solution to curbing public sector power, is the introduction of a type of privatization - contracting out. It is influenced by TCE, although its "specific influence...is hard...to discern" (Boston et al.,1996, p.27). As mentioned previously, TCE attempts to determine the optimum mode of organization for an activity, which is highly relevant for any discussion on the most appropriate arrangement for public goods and services. Efficiency can be determined from the combination of uncertainty and small numbers (environmental factors) with opportunism and bounded rationality (human factors) (Moe, 1984, p.753). Using these factors, TCE can determine the circumstances when a firm may prefer contracting out to in-house provision, and when the public sector may find it less costly to contract out to encourage competition and reduce costs (Hughes, 1998, p.14). Contracting out will be preferable when the supply of a good is contestable (which implies low asset specificity), and when the transaction costs are low (which implies restraints on opportunism and a high degree of certainty) (Boston et al., 1996,\(^6\)

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\(^6\) See Martin and Parker (1997, pp.6-7) for further discussion.
p.23). That is, contracting works when the quality and quantity of the goods or services can be measured easily, and where there are a large amount of potential supplier at the negotiation of the first and later contracts (Boston et al., 1996, p.23).

However, the reverse is also true: "there are some public sector transactions... that in-house provision would actually be better" (Hughes, 1998, p.14). A hierarchical governance structure is likely to be more efficient under the opposite conditions to those of the previous paragraph: where there is uncertainty and high asset specificity there are agency problems, high transaction costs and limited contestability (Boston et al., 1996, p.24). A hierarchical governance structure reduces the need to specify the terms of the contract in advance, and allows a more flexible and ad hoc approach to be taken to individual situations (Boston et al., 1996, p.24).

2.3.5 Increase the role and scope of the market

By introducing user-charges and modifying or reducing the scope of the public sector, another feature of the economic approaches has already been obviously implied: a substantially increased role for the market, and therefore a subsequent reduction in the role of the state. "[P]ublic choice practitioners...suggest that as many social functions as possible be entrusted to the private sector. In practical terms, this prescription translates into wholesale privatization of government operations" (Dryzek, 1996, p.102). According to Henig, public choice theory’s "added sheen of legitimacy...lent to the familiar argument that big government was bad government (1989, p.655). Privatization is the obvious solution to these problems.

Eliminating public enterprises altogether, and relying on market mechanisms is the most complete privatization strategy. NPM would support this, as the main thrust of this approach is that there is no significant difference between the public and private sectors. Therefore the former should try and emulate the practices of the latter as much as possible, and there is no better way of doing this than actually becoming part of the private sector. Based on the principal/agency relationship, the government manager [principal] is then responsible only for formulating policy and setting observable
performance standards, and then choosing an agent to deliver the goods or services (Kelly, 1998, p.6)\textsuperscript{63}.

However, there are some disadvantages to wholeheartedly embracing this approach. For example, the feasibility of privatizing depends on the nature of what is to privatized, “the lines of responsibility, and the performance standards” (Kelly, 1998, p.6)\textsuperscript{64}. This is also noticed by Martin and Parker, who suggest that if privatization means implementing NPM techniques with the purpose of increasing managerial efficiency, it must be accompanied by “policing of agent behaviour” and constraints on managerial discretion (1997, p.7), as agency problems will still exist. That is, a change in ownership involves a new set of principal/agent relationships with transaction costs (Martin and Parker, 1997, p.7). This will be seen in the following chapter, where the privatization of water services in Britain and Wales was followed by a new regulatory structure.

In such attempts to extol the virtues of private sector management practices, the economic perspective argues the superiority of the private sector, and therefore the market, by also attacking public sector incentives, values and practices and creating a subsequent theory of public incompetence. For example, while the principal/agent relationship in the private sector is a relatively simple one (shareholders/directors), in the public sector it is much more complex. Because the owners of the state assets are the public and between them and those who manage the assets, there are many “layers” of agencies (Martin and Parker, 1997, p.13). “The existence of layers and of agents seems to provide more scope for ‘noise’ to distort the information flow between principals and resource managers” (Martin and Parker, 1997, pp.13-14).

A major concern is the difficulty in determining who the principals are, and what they want. “The principals, the owners, of the public service are the electorate, but their

\textsuperscript{63} This reflects the NPM view of the term ‘management’ used in the private sector, “denoting as it does a concern for the use of resources to achieve results” (Aucoin, 1990, p.118). In comparison, the more traditional ‘administration’ used in the public sector, emphasizes formal process and procedure: “Public sector bureaucrats...are perceived essentially as administrators, and thus are considered inferior to the private sector equivalents who ‘manage’ their organizations” (Aucoin, 1990, p.118).

\textsuperscript{64} Donahue (1989, pp.79-98) also considers this issue in some detail, concluding:

The more precisely a task can be specified in advance, and its performance evaluated after the fact, the more certainly contractors can be made to compete; the more readily disappointing can be replaced (or otherwise penalized); and the more narrowly government cares about ends to the exclusion of means, the stronger the case for employing profit seekers rather than civil servants (1989, p.97).
interests are so diffuse that effective control of the agents – public managers – is unlikely to be effective” (Hughes, 1998, p.13). Compared with the private sector, there are no profit incentives or markets in shares to strive for, and no bankruptcy to fear. Privatization reduces the amount of ‘noise’ in the principal/agent relationship, and introduces means to align the agents (for example, a service provider) to the principal’s (consumer’s) goals (Martin and Parker, 1997, pp.13-14).

The power of ‘noise’ to produce public sector inefficiency can be reduced by simply replacing public with private enterprises. This would introduce transferable ownership (that is private property rights) and the outcome it is supposed to produce – efficiency – “providing...that it operates within the context of a well-informed, sophisticated and competitive capital market” (Hood, 1987, p.151). Private enterprises’ success depends on officials aligning their own interests with the performance of the enterprise. The private enterprise will gain as long as individuals recognize that “there is no escape from private motivations” (Green, 1987, p.107). If they perform well, officials may gain benefits, while conversely, if they do not, they can be held accountable:

Where ownership is not transferable, and high officials are paid only from fixed salaries, the incentive for the self-regarding opportunist is to favour investments which bring maximum present benefits to producers – which may mean favouring investments which are far from profitable or appropriate in the long term (Hood, 1987, p.151).

As mentioned above, there is a substantial agency problem in the public sector due to principals being unable to trade their property rights. Obviously influenced by property rights theories, public choice theorists also point to the fact that publicly owned bureaucracies are not transferable through sale of assets or stock exchanges, and are not subject to bankruptcy. This means that any surpluses or losses made through their operations are dispersed throughout the population (Hood, 1987, pp.150-151). The agency costs involved in monitoring their performance will be high: “In order to limit X-inefficiency, a heavy apparatus of audit and evaluation will be needed. To be effective, this itself will be very costly and the elaborate record-keeping and statistical returns that it requires from bureaucracies will further increase their operating costs” (Hood, 1987, p.151). Because of this, it would be much simpler to replace them with private enterprises.
2.3.6 Reduce conflicting performance objectives

As indicated above, in many instances public enterprises have more than one performance objective to uphold. “This means that any service provided through public bureaucracy is likely to become overlaid with purposes extraneous to that service, rather than carrying out a specific service at least cost” (Hood, 1987, p.151). Efficiency in the strictest sense of the word, ‘the least possible cost’, would be easier to achieve if public enterprises could adhere to this objective only, instead of the myriad of others that their status as a public enterprise includes.

2.3.7 Increase accountability

Privatization is also argued to be more democratic, in that accountability structures are more transparent. Accountability can be viewed in terms of a principal/agent relationship, where an agent carries out tasks and reports back to the principal on how they have been performed (Hughes, 1998, p.226). It is determined on the basis of the ability of the principal to judge the quality of the product and his/her ability to leave transactional relationships where the agent is ineffective (Donahue, 1989, p.40). However, in the public sector, accountability is dispersed because of the dispersion of ownership among citizens. This is an inevitable consequence of the collective nature of government: “The potential for chronic inefficiency, then, is a special peril for collective endeavors” (Donahue, 1989, pp.50-51).

The private sector is argued to have clearer lines of accountability than the public sector because of its layered structure. For example:

Ownership is wholly or partly distinct from operations. Production workers are accountable to managers...Managers, in turn are accountable to owners...Finally, the owners are accountable to customers, and collect a profit – the excess of revenues over costs – in exchange for organizing and monitoring the whole process (Donahue, 1989, p.43).

Efficiency and accountability are inextricably linked in this argument. The former is produced through private transactions designed to harness the self-interested nature of the principal and agent so that they both benefit from the relationship. This relationship must be accountable in turn in order to work effectively (Hughes, 1998, p.227). The private enterprise is therefore regarded as a “model – the best available practice” for the public sector (Hughes, 1998, p.227). “It follows that giving provision of that good or service to
the private sector will improve service delivery and efficiency by adopting the accountability mechanisms which exist in the private sector” (Hughes, 1998, p.228).

It is clear that the implementation of privatization leads to an alternative conception of accountability. The traditional mode of political accountability (through those elected in the political process to act on the public’s behalf) is superceded by the market model of accountability, as illustrated by Peters:

Rather than being defined as progressing upward through ministers to parliament and then to the people, accountability is defined increasingly in market terms. In this emerging definition, instruments such as parliamentary oversight and judicial reviews become less important than the financial bottom line (1996, p.43).

The important distinction to be made is that after privatization accountability is measured by the observable outputs rather than the processes by which an end is achieved (Peters, 1996, p.43).

2.4 Conclusion

The economic approaches to politics greatly inform, and add much impetus to, the theory of privatization. Their insights are valuable for identifying the incentives that arise from different organizational arrangements and the problems in developing an effective system of contracts between government and its citizens (Walsh, 1995, p.39). By discussing the five theories’ relationship to privatization, a more comprehensive understanding of the rationale for privatizing is gained. However, contained within the economic approaches is an expression of the changing role and purpose of the state. Therefore, to consider privatization as solely an economic issue would be to ignore significant political implications that arise from its implementation. The relationship between government and citizens is thus inevitably transformed with its introduction.

Bearing this in mind, the following two chapters focus on privatization of water supplies in two countries: the United Kingdom, where water was privatized in 1989; and New Zealand, where there is currently much debate on this issue because partial privatization measures have been introduced in some areas of the country. The implications of privatizing water supplies, the culmination of these economic approaches to politics, on democratic politics will then be considered with reference to these case studies.
In 1975-76 and 1995 there were serious water shortages in Britain. At the first drought, the population cooperated with water authorities’ pleas to reduce water consumption, and “in the worst drought for 250 years, engineers managed to keep the water flowing” (Pearce, quoted in Ward, 1997, p.94). However, twenty years later the public response was quite different, with many blaming the water companies for their lack of foresight in predicting and dealing with the drought. Typical of this view is the following: “Are we not entitled to expect that, as long as we pay our bills, we should be able to use just as much of the stuff as we like...Isn’t the buyer entitled to use it just as he [sic] likes – just like any other commercial product?” (Ward, 1997, p.95). The change in attitudes to water is obvious: from regarding water as a publicly owned resource that everyone has an interest in conserving, it was now seen as an individual consumer product that everyone has the right to obtain as long as they are able to pay. This perception is likely to have been at least influenced, if not solely caused, by the most significant and controversial structural change to occur in Britain’s water industry – privatization, accompanied by regulation - in 1989.

The privatization of water was not an isolated incident, but was instead part of an immense privatization programme, widely recognized as being one of the most extensive in the world, with few publicly owned industries remaining untouched by its influence by the early 1990s. It is for this reason that the British experience of privatization regarded as a ‘blueprint’ for other countries to follow (Veljanovski, cited in Marsh, 1991, p.459). However, there is not the same consensus on whether or not it has been a success, probably because for some industries, including water, it may be too soon to make a definite judgement. Nevertheless, as Marsh eloquently puts it, “[p]erhaps the jury is still out, but the interim verdict must be sceptical” (1991, p.477, emphasis added).

65 A Yorkshire Television phone-in poll produced some startling results in response to its question, “are you prepared to help Yorkshire Water?” 437 callers said ‘yes’, but about ten times as many said the company did not deserve their help (Simpson and Bingham, 1998).
Although an analysis of Britain’s privatization programme would be interesting, it is beyond the scope of this chapter which is concerned with privatization and its impact on the water industry. However, it is important to understand the political, economic and ideological context from which privatization came to be applied to the water industry, therefore some background information will briefly be covered before specifically discussing the water industry.

3.1 Britain’s privatization programme

For the purposes of this chapter on the issues surrounding the privatization of the water industry in Britain and Wales, quite a narrow definition will be used, concerning state-owned asset sales to the private sector. As well as the obvious fact that water was itself an asset sold by the Conservative government, this narrow definition also reflects the content of most of the literature on the subject of British privatization.

Four different phases of privatization have been identified (Feigenbaum et al., 1999, pp.66-70), almost corresponding to the Conservative party’s terms of office. I shall label these experimental, acceleration, extension and controversial. The first experimental phase corresponded with the Conservative government’s first term of office (1979-1983). Privatization policy in this period was concerned mainly with selling profitable firms already on the outskirts of the public sector, introducing liberalization into the transport and telecommunications sectors, and most significantly, the selling of council houses to the tenants inhabiting them.

The second phase (1981 or 1983 - 1987) saw the rapid acceleration of privatization, resulting in many sales of public corporations. In 1984 and 1985, Enterprise Oil, Sealink Ferries, Jaguar cars, British Telecom, Cable and Wireless, British Aerospace and Britoil were sold. In 1986 British Gas was privatized, and the following year British Airways followed suit. British Telecom and British Gas were the first public

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66 Many English writers use another term, ‘denationalization’, the sale of state-owned industries, to also describe this process.

67 This was known as the 'Right to Buy' policy, and allowed tenants with over three years' residence the right to buy their property at a discount of 30% of the market value, rising to 50% for tenants of more than fifty years. 'This policy reflected a long-standing Conservative dislike of the extensive public housing sector in Britain, which accounted for almost a third of all units, and a desire to foster wider property ownership' (Feigenbaum et al., 1999, p.67).
utilities to be sold, and it is from this point that Feigenbaum et al. (1999, p.68) believe that 'systemic' privatization began.

The third phase (1987-1990s) marks the extension of the programme. Major privatizations included the British Airports Authority (1987), Rolls Royce (1987), British Steel (1988), but the major development in this phase was the decision to privatize the water industry (1989), regional electricity distribution companies (1990) and the electricity generating companies (1991) (Feigenbaum et al., 1999, p.68). Other areas affected by commercialization include most public sector services (including local government), education and the National Health Service. Most significantly, this was the phase that began to generate fierce opposition to privatization. This was mainly directed at the privatizations of the major utilities and the deregulation of bus services, as it was feared that privatization would mean a deterioration in service and an increase in prices (Feigenbaum et al., 1999, p.69).

The final controversial stage continued the unpopularity generated by the sale of the water companies, with the privatization of British Coal and British Rail, and the abandonment of the plan to privatize the Post Office. As Feigenbaum et al. suggest, the nature of the privatization programme had now changed substantially, from being a pragmatic strategy to being a "systematic overhaul" of the public sector (1999, pp.69-70).

Any attempt to examine the Conservative government's attraction to privatization can only be determined by speculation because, for much of the time while it was being introduced and implemented, there was no official declaration of such a policy commitment. According to Thompson, privatization policy "crept up on an unsuspecting economy and electorate" (1990, p.142). For this reason it is very difficult to determine whether widespread privatization was a consistent and systematic plan, or alternatively, a gradual and tentative discovery process. It is such a debated issue that a

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68 "In fact, market-oriented reforms had been introduced into the public service as early as the Financial Management Initiative (1982), 'Next Steps' (1988), and the 'Citizen's Charter' (1991), all of which aimed at making the public service more like a private corporation, and transforming citizens into customers" (Feigenbaum et al., 1999, pp.68-69).

69 Thompson (1990, p.143) suggests that it was to the Conservative government's advantage (whether it was planned or not) not to specify the objectives it hoped to achieve through privatization, because then there can be no comparison between the intention behind the policy and the results it has brought about.
significant amount of literature (Marsh, 1995; Saunders and Harris, 1994; Clarke, 1993; Dobek, 1993, pp.102-119; Foster, 1992) is devoted to this point alone.

Most agree to a certain extent that “privatization was not so much conceived as accidentally discovered in Britain” (Feigenbaum et al., 1999, pp.59-60). This argument is also well summarized by Gamble: “The Government seems to have stumbled into the policy” (quoted in Feigenbaum et al., 1999, p.70). Only Young (cited in Feigenbaum et al., 1999, p.70; also cited in Marsh, 1995, p.598), Wolfe (cited in Marsh, 1995, p.597) and Dobek (1993) significantly challenge this view.

Vickers’ and Yarrow’s (1988, p.157) list of what they believe to be the seven principal aims (in hindsight) of the British privatization programme is cited (Morgan, 1995, p.10; Marsh, 1991, p.463) as being the most comprehensive list compiled so far. The objectives are as follows: to improve efficiency; to reduce government involvement in enterprise decision making; “easing problems of public sector pay determination”; to reduce the public sector borrowing requirement (PSBR); to widen share ownership; to encourage employee share ownership; and finally, to gain political advantage.

It should be noted that their list does not place any priority or emphasis on any objective(s) in particular. As Thompson points out with his own list, a “shifting set of arguments and justifications has emerged... which can be supplemented, denied or abandoned as counter-evidence emerges” (1990, p.143). This can be seen in the discussion which follows, because in addition to debate over the origins of the privatization policy, there is also much debate on the relative importance of each factor - economic, political and ideological - in determining the overriding imperative behind it.

The last four objectives on Vickers’ and Yarrow’s list have been considered by many to be the most significant. Although conceding that asset sales may have initially

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70 However, many other commentators (Saunders and Harris, 1994; Thompson, 1990, Foster, 1992) have compiled lists of their own which include most of Vickers’ and Yarrows’ points.

71 Vickers and Yarrow (1988, p.157) note that this objective has only ever been implicit, although many (Dobek, 1993; Marsh, 1995) regard it to be one of the most important. See Foster (1992, pp.102-119) for a very useful summary of the arguments.

72 Vickers and Yarrow themselves point out that, in practice, “objectives are likely to differ between Government ministers and to change over time as opportunities, constraints, and perceptions develop” (1988, p.157).
been motivated for economic reasons\textsuperscript{73}, Saunders and Harris (1994, pp.18-19) suggest that political and ideological factors became more important as time went on\textsuperscript{74}. Clarke also supports this perspective: "[p]rivatization was pursued for political reasons related to the government’s troubled attempt to manage the economy and stay in power, rather than to the economic pursuit of efficiency in the industries concerned" (1993, p.207). It may seem contradictory that the pursuit of privatization, eventually a very unpopular policy, was politically advantageous to the Conservative government. Yet the argument that privatization became a politically inspired policy, rather than an economic one, is convincing and worth briefly mentioning.

Public choice theory has had much influence on arguments about the political nature of the privatization programme. For example, using a public choice-type argument, Dobek suggests that politicians' only goal is to maximize power: "politicians will always try to maximise their political benefits, no matter what public policy they are pursuing" (1993, p.25). Second, Brittan argues that selling public assets was "politically much easier, and more popular" than cutting public spending (cited in Marsh, 1995, p.601). Third, privatization was also an alternative means of controlling the PSBR (proceeds from asset sales are treated as negative public expenditure) (Marsh, 1995, pp.601-602). Fourth, privatization disturbed existing political power relationships, and created new ones. This is highlighted by Samson: "Companies that bid successfully for government contracts or purchase state-owned industries are empowered, while former 'private' beneficiaries of state provision that has been cut or discontinued are weakened economically and politically (Samson, 1994, p.8). Those empowered by privatization, for example, private companies will be more likely to be supportive of the government in the future.

Fifth, in its promotion of ‘popular capitalism’ (also known as the ‘property-owning democracy’), made possible through privatization, the government sought to

\textsuperscript{73} Marsh (1995, p.601) refers to an "economic crisis" as providing the background context to Thatcherite economic policy, and suggests that this is what drove the Conservative Government to restructure through privatization. The crisis included increased unemployment, inflation and interest rates, declining manufacturing outputs and a deepening of the recession (Marsh, 1995, p.601).

\textsuperscript{74} This does not necessarily mean that privatization can be classified as a premeditated political or ideological strategy, but rather that, in hindsight, these two factors became more important to the Conservative government as time went by.
increase the freedom and independence of citizen-shareholders. According to Saunders and Harris, "a heroic vision was adopted in which the mass of the population would own shares and the culture of Britain would be transformed as a result" (1994, p.26). Many studies had found shareholders and homeowners to be more likely to vote Conservative, and Dobek suggests that the Thatcher Government seized this trend and devised a policy to increase their numbers, that is, privatize (1993, p.27). Privatization led to a threefold increase in the number of shareholders, increased the number of the self-employed, expanded homeownership, decreased the number of union members by three million, reduced the number of those employed in the public sector (Dobek, 1993, p.28). Marsh also suggests that the privatization programme was an "electoral success" (1995, p.602). Dobek is a little more circumspect in his appraisal of the influence of privatization on the electorate, but does suggest that creating millions of new homeowners and shareholders "could have played a significant role by reinforcing the loyalty of traditional Conservative supporters and by influencing some non-Conservatives to vote Conservative" (1993, p.28).

The water industry is a good example of the view that privatization was an unplanned and incremental process. As Maloney and Richardson put it, "the process of water privatisation is best characterised as more a case of muddling through, leaving many issues and problems to be resolved at the implementation stage, than a purposive well thought-out steering from the centre" (1995, pp.52-53). Indeed, it appears that the eventual privatization of water, which took place in late 1989, was not predicted at all, even by those with a pivotal role in the policy process. This can be seen in the following quotes (all from Richardson et al., 1992, p.157), which highlight the progress of the policy of privatizing the water industry:

We have absolutely no intention of privatising the water industry. The government have [sic] no plans to urge that upon the water authorities. There has been some speculation about it in the past, but there is no intention to do so (Neil MacFarlane, Parliamentary Under-Secretary of State for the Department of the Environment, 20 December 1984);

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75 See their book, Privatization and Popular Capitalism (1994), devoted to this subject alone, for a thorough examination of this phenomenon.
76 See Dobek (1993) for further analysis of these five consequences of privatizing.
The Government would welcome new ideas on privatisation. However, the water authorities are natural monopolies for many of their functions and we need to be particularly careful when considering replacing a public monopoly by a private one (Margaret Thatcher, Prime Minister, 31 January 1985); and,

In the last six years we have made the water authorities fit and ready to join the private sector...Privatisation is the next logical step. It will bring benefits to the customers, to the industry itself and to the nation as a whole (Kenneth Baker, Secretary of State for the Environment, 5 February 1986).

If even those people in such influential positions as those quoted above did not foresee plans to privatize the water industry, then one would have to wonder how and why water came to eventually be on the agenda for privatization. Although it does not seem to have been consciously planned from the outset, it can be seen (with hindsight) that it was the inevitable conclusion to the “fascinating” (Spulber and Sabbaghi, 1994, p.202) changes the industry had been undergoing for many years. After the reviewing these changes, the privatization of the water industry will be more closely examined, considering the regulatory regime which now monitors the industry, its effects on consumers, and the employment relationship.

3.2 The water industry prior to privatization
Prior to 1973, the water industry was dominated by three categories of organization: water undertakings, responsible for the supply and distribution of water; sewerage and sewerage disposal authorities, responsible for the treatment and disposal of water-borne wastes; and thirdly, river authorities, responsible for the control of environmental aspects – conservation, pollution, land drainage (Vickers and Yarrow, 1988, pp.389-390). The institutional structure of the water industry was highly fragmented, with water supply, sewerage, and regulatory functions being divided among many local organizations (Spulber and Sabbaghi, 1994, p.202). This structure was similar to that of the pre-nationalized gas and electricity industries: “public ownership was predominant but Government involvement in the industry occurred via local authorities” (Vickers and Yarrow, 1988, p.390).
The 1973 Water Act made each regional water authority (RWA) responsible for all three aspects of the water industry. It created ten separate multi-purpose RWAs from 198 water supply and over 1000 sewerage disposal units (both single-purpose) throughout England and Wales, (Maloney and Richardson, 1994, p.115; O'Connell Davidson, 1993, p.23; Richardson et al., 1992, p.159). The Act was based on the principle of 'integrated river-basin management' (IRBM), that is, each RWA was responsible for the entire water cycle in its catchment area and should plan and control all water-related functions (Spulber and Sabbaghi, 1994, p.202). However, it also created a conflict of interest for the RWAs: “the combination of the regulatory and utility functions in the same organizations meant that the authorities were both poachers (polluters of rivers via effluent discharges) and gamekeepers (regulators of river quality)” (Cowan, 1994, p.115).

The Act was also significant in the fact that it increased the role of central government in the water industry. It increased central government’s financial control of the industry as the RWAs had to conform to government directives on charging, long-term planning and borrowing (O'Connell Davidson, 1993, p.23). Richardson et al. (1992, p.159) also note the dominance of engineers in the emphasis on technological, rather than political, criteria, contributing to a more corporate identity. The year 1973 thus marks a significant change in the way in which water services were to be managed.

77 See Carter et al. (1992, pp.149-158) for a very interesting and helpful examination of the use of 'performance indicators' in the water industry during the pre-privatization period. See also Ogden (1995, pp.199-203). Richardson et al. (1992) and Maloney and Richardson (1995 and 1994) provide the most comprehensive account of the lead-up to privatization, as they examine the role of all the groups involved and the influence they had on the policy formation process. Maloney and Richardson's conclusion is indicative of the state of the water industry: “Conflict rather than consensus has often been a feature of the policy process - and continues to be so” (1994, p.134).
78 As Vickers and Yarrow point out, in reality there is usually more than one river basin in the area covered by each RWA, but the element to notice is “that the legislation created organizations based on river catchment areas, rather than on artificial administrative boundaries that required separate bodies to be responsible for different parts of the same river system” (1988, p.391).
79 There were specifications for two budgets – a revenue budget for operating services, and a capital budget for investment (O'Connell Davidson, 1993, p.23). The RWAs had to raise the funds for the revenue budget through charging both domestic and industrial consumers, charges for water abstraction and other miscellaneous charges, such as licenses. It was hoped that this revenue budget would eventually become self-financing, so that the system could remain intact. “Repayments on loans inherited from local authorities and on new loans were likewise to be funded through the revenue budget. The capital budget was raised through borrowing and through government grants” (O'Connell Davidson, 1993, p.24).
and conceptualized, for example, "Water was now to be regarded as an economic good' (Sewell and Barr, quoted in Richardson et al., 1992, pp.159-160).

The 1983 Water Act introduced further radical change into the water industry, with the primary aim being to grant more independence to the RWAs by shifting control of the authorities from local to central government. This can be seen in the abolition of the statutory requirement that local authority nominees make up the majority of RWA membership (Richardson and Maloney, 1994, p.115; Richardson et al., 1992, p.160 Vickers and Yarrow, 1988, p.391). A small group of Ministerial appointees replaced a large number local authority members, typically representing businesses (ironically many polluters\(^8\)), the intention being to create a more commercial style of management (Spulber and Sabbaghi, 1994, p.203; O'Connell Davidson, 1993, pp.29-30). This move towards the private sector was hastened by the reduction of public accountability and banning the right of the press and the public to attend water authority meetings (O'Connell Davidson, 1993, p.29). As with the changes in 1973, the changes of 1983 also signaled a change in direction for the water companies: "The industry had become more 'managerial' and 'technocratic' and conventional public accountability had declined" (Richardson et al., 1992, p.160).

A second significant change was the replacement of the National Water Council, responsible for planning and coordinating national water policy, with the voluntary RWA membership of Water Authorities Association (WAA) (O'Connell Davidson, 1993, p.29). This encouraged the RWAs' adoption of a commercially based structure, as did the final exclusion of local authority representation on RWAs (Richardson et al., 1992, p.160).

A third change was the government’s declaration that it would reduce financial contributions to the water industry by reducing costs and restraining investment, as well as increasing profit targets (Spulber and Sabbaghi, 1994, p.203). Privatization was soon to be on the policy agenda, as the introduction of a more commercial and independent approach was making some impatient with government interference in the running of the industry (Spulber and Sabbaghi, 1994, p.203). These initial changes certainly paved the way for privatization to occur. It had become an appealing solution to many in the

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\(^8\) Colling identifies examples of these 'polluters' as being ICI, Rio Tinto Zinc, English China Clays and Associated Lead (cited in O'Connell Davidson, 1993, p.29).
industry, with many frustrated RWA chairpeople and senior executives now regarding privatization as freedom from “unpredictable, short-term and politically motivated” financial control of the industry (O’Connell Davidson, 1993, p.32).

Throughout 1985, privatization of the water industry became a much debated and discussed issue, culminating early in 1986 with a White Paper, written by Stephen Littlechild, on the economic regulation of privatized water authorities. It proposed that the RWAs be privatized in the state they were in presently (including both utility and regulatory functions). In spite of indications beforehand that this was the direction which the water industry may follow, the White Paper was a shock to many, arriving on the policy agenda quite suddenly, as the government had been maintaining for some time that there were no plans to privatize this industry (Richardson and Maloney, 1994, p.121; Richardson et al., 1992, p.161; O’Connell Davidson, 1993, p.32). Both those in the water industry and the government had not fully considered it, “and even the main proponents appeared to have no clear ideas of how it might be achieved, or of what the political obstacles might be encountered” (Richardson and Maloney, 1994, p.121).

However, because of significant problems with several of the White Paper’s proposals, it was another three years before the legislation was passed and the industry floated. This may have been caused by an inappropriately narrow policy consultation process – consisting of only the relevant government organizations and the RWAs themselves, while not considering the impact of opposition from various other influential bodies (Richardson et al., 1992, pp.122-124; and Richardson and Maloney, 1994, pp.162-164). The increasing importance of the trans-national politics in the form of the European Union (EU) could not be overlooked either: “In comparative European terms the expectation would be local authorities to be significant policy actors” (Richardson et al., 1992, p.164). However, they had been eliminated long ago from consideration.

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81 Richardson et al. cite a specific example which illustrates this point well. With many customers annoyed by increasing water charges, several RWA chairpeople became hostile towards the government’s control over the industry, blaming the government for the price rises. The Thames Chairman, Roy Watts, claimed that a more efficient service could be ensured if Thames were in the private sector, and that Thames had become a revenue-raiser for the Treasury (1992, p.160).

82 There was a diverse range of opposing bodies – the Council for the Protection of Rural England (CPRE), the Institute for European Environmental Policy (IEEP), the Country Landowners Association (CLA), the Institute of Water and Environmental Management (IWEM) and the Ministry of Agriculture, Fisheries and Food (MAFF).
There were several concerns (Vickers and Yarrow, 1988, pp.400-401; O'Connell Davidson, 1993, pp.32-33), which will (briefly) be mentioned here, raised by the White Paper that significantly affected support for privatization.

- The existing legislation governing water was spread over many different acts and statutes, and to accumulate these into a coherent strategy for privatization was a very complex process.

- The legal right of the government to sell assets which it had acquired from local authorities without compensation in the 1973 restructuring was questioned.

- The 'natural monopoly' issue meant that customers were unlikely to be provided with a choice between competing suppliers bringing water of a different quality and/or price to their homes. "Privatization, far from exposing the 'winds of competition', would therefore make consumers captives of private, rather than public, monopolies" (O'Connell Davidson, 1993, p.32).

- All RWA functions except land drainage and flood protection were to be privatized, leaving private water companies responsible for the regulation of environmental functions such as protection of river systems, pollution control and fisheries. This would have meant that private bodies would have the power to license other private bodies, and "restrict or deny them use of a resource vital to their activities" (O'Connell Davidson, 1993, p.32).

- Following on from the previous point, it appeared that commercial water companies would have no interest or incentive to balance profits with environmental and social concerns. This argument proved to be the most damaging to the water privatization cause.

It was clear that both economic and environmental regulation would need to be addressed further before the privatization cause could be advanced.

### 3.3 Privatization of the water industry

Six months after the White Paper’s publication, the privatization of the water industry was postponed. It was not until the Conservative Party published its manifesto for the

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83 The local government trade union NALGO took Thames Water to court for spending money on furthering the case for privatization before Parliamentary authority had been given (Vickers and Yarrow, 1988, p.401).
May 1987 general election that the issue reappeared, albeit with some changes. Of most significance was the abandonment of IRBM, with the proposed creation of a new public body, the National Rivers Authority (NRA). It was to be responsible for RWAs' environmental and quality functions, and as such, answered much of the criticism which had been aimed at the issues of separation of utility and regulatory functions.\(^{84}\)

However, the NRA proposal met with much hostile opposition from many of the RWAs, represented through the WAA. "In none of the government's previous privatizations has it been faced with such reluctant managements" (The Independent, quoted in Saunders and Harris, 1994, p.48). The opposition was not only directed at the abolition of IRBM, but also the fact that the NRA was the section of the water industry with greatest potential for successful and profitable expansion after privatization (Saunders and Harris, 1994, p.48). 6000 of the industry's 50 000 workforce was to be transferred to the NRA, including many of skilled staff who would be needed if the companies were to be privatized (Saunders and Harris, 1994, p.48). Yet threats to withdraw the support of RWAs came to nothing\(^{85}\) and the NRA was eventually established.

The privatization bill had its second reading in December 1988, and only on July 6\(^{th}\) 1989, after various amendments were made to it, did it become law as the 1989 Water Act\(^{86}\). The original act was later succeeded by the 1991 Water Industry Act (dealing with the Office of Water Services [OFWAT] and its powers) and the 1991 Water Resources Act (dealing with the NRA). The 1989 act provided for the establishment of OFWAT headed by a Director General of Water Services (DGWS). This followed the regulatory

\(^{84}\) "Given that privatization was to occur it was clearly safer to make this separation, although the functions could have been separated without privatization of the authorities" (Cowan, 1994, p.117).

\(^{85}\) Diminishing opposition to the NRA was cunningly achieved by granting generous government concessions to the RWAs – debt write-offs and provisions for the costs to be incurred in meeting tighter EC pollution controls to be passed onto customers. Although grossing £5.2 billion from the share flotation, the government eventually made a £1.2 billion loss on the sale because of the debt write-off agreement - £5 billion – and the £1.5 billion donation to help companies meet their new investment requirements (Saunders and Harris, 1994, pp.48 and 50)

\(^{86}\) However unpopular water privatization may have been with the general population, there was certainly no lack of interest in investing in it. The flotation in December 1989 was undoubtedly a success: 2.7 million people applied for water shares and the offer was over-subscribed 5.7 times (Saunders and Harris, 1994, p.51).
regime\textsuperscript{87} imposed on three other privatizations beforehand: Telecommunications in 1984, Gas in 1986 and electricity in 1989, which all also have Directors General in charge of an office known by its acronym\textsuperscript{88}. The regulatory regime (described below) is based on the following privatization legislation: the Telecommunications Act 1984, the Gas Act 1986, the Electricity Act 1989, the Water Act 1989, the Water Resources Act 1991, the Competition and Service (Utilities) Act 1992, the Environment Act 1995, and the Gas Act 1995 (Thatcher, 1998a, p.124).

\textbf{3.4 The regulatory regime}

In privatizing water, the government was privatizing a number of natural monopolies, and therefore "normal market mechanisms could not be relied upon to discipline them" (O'Connell Davidson, 1993, p.36). As mentioned in chapter one, natural monopoly is the term is used to mean the situation that arises when there is little realistic prospect of competition between companies because economies of scale mean that production is most effectively organized by a single agency (Saunders and Harris, 1994, p.39). That is, if companies wanted to install their own networks of water mains and sewerage systems (and therefore duplicate those already in existence), they would almost certainly be put off by the prohibitive costs involved in doing so (S. Bailey, 1995, p.334; Cowan, 1993, p.15)\textsuperscript{89}.

Therefore, in the absence of competition, a regulatory framework was needed to ensure that the privately owned companies did not exploit their monopoly power. Regulation had two overall aims. First, it was to provide a reasonable balance between the interests of owners, employees, customers, and competitors, for example, preventing water companies from increasing prices to consumers, ignoring the quality of their 'product' (in this case, water), restricting output, or (in the case of water especially) adversely affect the environment. Second, regulation was to "arrange the pursuit of business objectives which are economically efficient" (Glynn, 1988, pp.76-77).

\textsuperscript{87} Thatcher (1998b, p.212) sees regulation as being a 'regime', because although it is applied to four different industries, they have many regulatory features in common.

\textsuperscript{88} The DGTT (Director General of Telecommunications) heads OFTEL (the Office of Telecommunications), the DGGS (Director General of Gas Supply) heads OFGAS (the Office of Gas Supply) and the DGES (Director General of Electricity Supply) heads OFFER (the Office of Electricity Regulation).
As mentioned above, the water industry adopted the regulatory regime imposed on the other privatized utilities. The British model of utility regulation is based upon two reports written by Stephen Littlechild for the government in the early 1980s. There are two key elements to this model of regulation which will be discussed below: price cap regulation through the RPI - X formula (modified for the water industry), and the role of the competitive order in becoming the ultimate 'regulator' after the initial transition period has ended. This is the first aspect to be considered in assessing the success (or otherwise) of privatization - the performance of the regulatory regime itself. Helm states that a paradox of "private ownership but greater public intervention [through regulation] - is more apparent than real". However, much of the evidence suggests this is not true.

3.4.1 Office of Water Services and the Director General of Water Services

The formal institutional framework of regulation is composed of regulatory organizations, OFWAT and the DGWS in the case of water, which are independent of central government. This has been achieved by distancing politicians and civil servants from the regulatory process in two ways. First, through the granting of licenses which imposed formal obligations on utilities, and second, through the establishment of the Director Generals (DGs) with statutory duties and powers. "They are custodians of the licences, in the sense that they play the critical role in enforcing and revising the conditions" (Helm, 1994, p.26). It is also significant that the legislation confers the duties and powers on the DGs as individuals, rather than their

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89 However, Hanke and Walters point to the example of Edwin Chadwick who, writing in 1859, observed there were two or three sets of pipelines running through urban districts in England, leading to "bad and deficient supplies at high charges to the public" (1887, p.104).

90 These two reports were Regulation of British Telecommunications' profitability (1983) and Economic regulation of privatized water authorities (1986). "These two reports were seminal in providing the basic framework and philosophy upon which the development of, and legislation enacting, the UK model of privatized utility was to be based. Professor Littlechild has subsequently, and appropriately, been described as the 'architect' of the system of regulatory control of utility industries that has developed in Britain since 1984" (Burton, 1997, p.159).

91 In a very interesting and informative article, "The Competitive Order or Ordered Competition?: The 'UK' Model of Utility Regulation in Theory and Practice" (1997), Burton examines the theory on which the UK regulatory regime was based. He concludes that the regulatory system has not become a 'competitive order' as envisioned by Littlechild, but has metamorphosed instead into a system termed by Hayek to be 'ordered competition'.
offices, that is, it is a very "personalized regime" (Melville, 1994, p.393). It is obvious then that the choice of who to appoint as regulator to the various utilities is a crucial one (Thatcher, 1998b, pp.212-213). This aspect of the regulatory regime has attracted much criticism, and the following quote is representative of this: "Regulatory institutions should not be built on the assumptions that a 'good chap' [sic] will be found" (Helm, 1994, p.19, emphasis added).

The DGWS has two main responsibilities. First, the DGWS has the primary responsibility of ensuring that water and sewerage functions are "properly carried out" and that the water companies are able to finance the provision of these services (Thatcher, 1998b, p.213; Ogden and Anderson, 1995, p.540). Secondary duties are: protecting the interests of all actual and potential customers, especially with regard to charging; the conditions of supply and quality; promoting research and development; ensuring safety; protecting the environment; protecting certain categories of service (for example, emergency services); and finally, protecting specific types of user (for example the elderly, rural dwellers, disabled and chronically sick) (Thatcher, 1998a, p.126; Ogden and Anderson, 1995, p.540). In addition, legislation also states that the DG is to exercise his/her powers "in the manner that he [sic] considers best calculated" to fulfil the various duties (Thatcher, 1998a, pp.125-126). The possibility of these responsibilities contradicting each other seems highly likely and the fact that they are defined so broadly means that the DGWS has a considerable amount of discretion available to him: "virtually any action by the regulator can be deemed to fall within them" (Helm, 1994, p.27).

The regulatory regime can be regarded as a practical example of principal/agent theory, examined in chapter two. The regulator represents the principal, and the water
companies represent the agent (Wolfe, 1999; McMaster and Sawkins, 1996; Melville, 1994; and Vickers and Yarrow, 1988). However, information, rather than goods, services or activities, is the basis of exchange in the relationship (McMaster and Sawkins, 1996, p.8). Therefore, trust is an essential component of this relationship: “Custom and convention reinforce this trust as companies supply reliable information to the regulator, and the regulator in turn maintains a stable and predictable regulatory environment within which the companies can work” (McMaster and Sawkins, 1996, p.8). Although superficially not affecting the relationship between one set of principals and agents (consumers and the water companies respectively), privatization in fact disrupted the trust-based relationship between the water companies.

This process began with the 1983 Water Act, when the more commercial approach was first encouraged by central government. “The free exchange of information between water authorities that had existed before, was replaced by a growing secrecy and contractual approach to activities in general and regulatory reporting in particular” (McMaster and Sawkins, 1996, p.9). With privatization, the closing of channels of information increased, as companies were now put in a position where their performance was compared with that of other companies, and company takeovers were possible (McMaster and Sawkins, 1996, p.9).

The emergence of carefully written licenses, an increased statutory burden, the use of independent professionals to validate data going to Ofwat, and elaborate reporting requirements all indicate with ways in which regulator-regulatee relationships changed, and trust was compromised, around the time of privatization (McMaster and Sawkins, 1996, p.10).

Post-privatization, there appears to be a high degree of negotiation between the DG and the water companies in the regulatory process. Consultation takes place on general principles, key financial assumptions, and company-specific issues, such as the setting of the price limits (Melville, 1994, pp.392-393)95. However, there is scope for an unbalanced relationship between the DGWS and the water companies: “[t]he regulator’s most important resources are legal authority and the power to gain information, but it is

95 However, according to Melville (1994, p.401), OFWAT’s dependence on industry experts for more technical and specialized information means that they are more likely to be able to influence the regulator, who may not understand the complexities of their arguments.
small in comparison to the companies it must control and is therefore vulnerable to being challenged or out-manoeuvred” (Melville, 1994, p.392).

Although seemingly independent, OFWAT in fact relies a great deal on the cooperation of the water companies to maintain the validity of its role. The regulators base many of their decisions on information made available to them, with the main source being the regulatee, the water company (Helm, 1994, p.20). OFWAT is aware of the dependence this situation creates: “to do anything we require reliable data…So in a sense we’re dependent on industry goodwill” (quoted in Melville, 1994, p.389). In extreme cases, this may lead to the situation known as ‘regulatory capture’, where the control of information is complete, and the regulator acts de facto in the interests of the regulatee (Helm, 1994, p.20). As Helm put it, the “information game…remains heavily biased towards the utilities” (1994, p.20). The water companies have the power to present information selectively, and work the regulatory relationship to their advantage, for example, “providing business plans which may over-state costs and understate demand, and in selectively fitting the information to suit their interests” (Helm, 1994, p.20).

The importance that the regulatory regime places on information may also have a drawback for the water companies themselves, as there is now a need for very specific information that they simply do not have (Melville, 1994, p.389). However, the regulator is able to compare the information made available to him with that provided by other companies, and has also required that ‘independent certifiers’ be appointed, to increase the quality and accuracy of the information (Melville, 1994, pp.393-394).

3.4.2 Competition

As discussed above, the prospects for competition are limited in the water industry because of the monopoly characteristics in the whole of its business. This is also recognized in the regulatory regime, as the DGWS, unlike the other DGs, is responsible only for facilitating, not promoting, effective competition (Cowan, 1997, p.84).

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96 Helm indicates that because the regulator has much discretion over when he chooses to intervene, the prospect for regulatory capture - the scope for acting in the interests of the utilities – is increased (1994, p.29). For a very good discussion on the independence of regulators see Foster (1992, chapters 8 and 11).

97 For example, Yorkshire Water employs two teams of people to only collect information about surface assets, such as treatment plants (Melville, 1995, p.389).
However, competitive forces of five different types could operate in the water industry (not all of which have been applied in Britain and Wales): yardstick competition; competition for the market (franchising); contracting out of services; capital-market competition; product-market competition (Cowan, 1997, p.85).

First, yardstick competition occurs to a certain extent in the exchange of information between regulator and water company, as it relies on a comparison between two geographically close companies. By relating firm A’s allowed price to firm B’s unit cost level, A has the incentive to be efficient and cut costs, which in turn lowers the allowed price of B (Cowan, 1997, p.85). This situation could be complicated if the two companies decided to merge, in which case the Monopolies and Mergers Commission (MMC) would assess their application (Cowan, 1997, p.85). Such a merger would reduce the number of water companies and therefore reduce the DGWS’ ability to conduct yardstick competition (Cowan, 1997, p.85). Yardstick competition has proved to be more difficult to apply than first thought. There are a variety of factors which vary from one company to another, for example, geography, geology, the nature of the sources of supply, population, density of connections, and the nature and condition of infrastructure (Ogden and Watson, 1996, p.733), thus making a meaningful comparison problematic.

Second, franchising is another privatization option used in many developing parts of the world to increase private sector involvement in the water industry, but has not been used yet in Britain and Wales. It would be unlikely to work there because usually the franchisee does not have large investment obligations, because of the impossibility of recovering so-called “sunk” investments when the contract ends (Cowan, 1997, p.85). The need for investment was cited as one of the main reasons for privatization, and it seems unlikely that the franchise company would wish to spend a significant amount of money on an asset that, at the end of the franchise contract (usually thirty to fifty years), would either return to the original owner or be put out to contract again.

98 There have been a number of proposed mergers referred to the MMC, which has had to balance the benefits of merger against the loss of comparators for yardstick competition (Armstrong et al., 1994, p.340). In one case, the MMC ruled that since the merger was based on efficiency savings of 10%, this benefit should be passed onto consumers in the form of lower prices (Armstrong et al., 1994, p.343).
Third, many services - information technology, billing and revenue collection - are already contracted out in the water industry. The main advantage to the company is that if there is enough competition for them then it will achieve cost efficiencies (Cowan, 1997, pp.85-86). This is quite common in the public sector, but as Cowan points out, there must be some reservations about requiring private sector companies, which the privatized water companies are, to contract services out to tender. "The private incentives of firms are generally in line with the regulator's objectives, and the style of UK regulation has been not to try to second-guess management about the appropriate way to run the business" (Cowan, 1997, p.86).

Fourth, competition in the capital market is almost like a private sector version of yardstick competition, with investors being the ones making the comparisons between companies, and companies responding to changes in their share prices (Cowan, 1997, p.86). Fifth, direct product-market competition is possible through additions to the existing network of mains and sewers through cross-border competition (Cowan, 1997, p.86). There are provisions for this in the 1989 Water Act, where a company applies for an "inset appointment" to provide water or sewerage services to a customer located anywhere within the area of an existing company. Domestic customers can ask any company to supply them with water, as long as they pay for the pipelines. "This provides a source of potential competition without the requirement to go through the complex process required for an inset appointment" (Cowan, 1997, p.86). However, there has not yet been cross-border competition in practice.

3.5 Results of water privatization
The government's main justification for privatizing the water industry in particular was the belief that the industry would be more efficient at providing water services if it were in the private sector, subject to the disciplines of market. As noted in chapter two, in theory, consumers should notice improvements as a result of greater efficiencies in three ways. First, prices should fall as a result of efficiency and productivity gains. Second, there should be an improvement in service, as private firms have an incentive to be concerned about their public image to maintain their customers. Third, there should be an improvement in quality, as private companies can attract more money for investment and will be concerned to innovate to attract customers (Sanders and Harris, 1994, p.55).
Consumer organizations had responded with a concern that the privatization of essential utilities – water, gas, electricity and telephone - would threaten the most vulnerable sections of society. With directors demanding higher profits, and shareholders higher dividends, it was feared that these concerns would take precedence over service, “with falling standards, higher prices, and greater numbers of disconnections” (Clarke, 1993, p.221). The privatized water industry will now be examined in light of these, and the previous efficiency, assumptions.

3.5.1 Price

For water companies, the price limitation formula RPI + K is the main form of economic regulation. Essentially, it determines how much the privatized companies are allowed to raise their prices to meet the government’s pre-fixed efficiency goals (O’Connell Davidson, 1993, p.37). The formula works in the following way. ‘RPI’ stands for the Retail Price Index, a measure of inflation, with the ‘K’ value being determined by what a company needs to finance the provision of services to customers. The formula also takes into account the amount needed for capital expenditure and operating costs, which are in turn offset by improvements in productivity and proceeds from the sale of land (G. Taylor, 1996, pp.189-190). The ‘K’ values were originally to be reassessed after ten years, but the water company or the DGWS can request a review after five years (Armstrong et al., 1994, p.337). This happened in 1994 when ‘K’ was reassessed and reduced, meaning that that companies would have to meet the costs involved in improving standards from increases in their operating efficiency (G. Taylor, 1996, p.190).

The ‘K’-setting process seems to be a subjective one, relying primarily on the DGWS’ judgement. This is likely to be a further effect of the “personalized” regulatory regime. Because each individual water company is assessed, the regulator takes into

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99 RPI + K is in effect RPI – X (which refers only to economic regulation), the formula which regulates the other utilities, + Q (which refers to environmental regulation and the costs of meeting improved quality standards required by UK and EU legislation) (S. Bailey, 1995, p.337).

100 The price limitation formula applies only to the core activities of water supply and recovery, while diversification into so-called 'enterprise' activities such as consultancy, engineering, construction or computing are not subject to regulation (Saunders and Harris, 1995, p.63; O’Connell Davidson, 1993, p.37). Water companies are not allowed to use revenue from the core activities to finance diversification, and also have an obligation to ensure that they do not suffer because of diversification (Saunders and Harris, 1994, p.63).
account demographic, geographic and climatic differences between companies when determining ‘K’ values (O'Connell Davidson, 1993, p.38). The ‘K’-setting process relies on the input of those actually involved in the running of the water companies themselves, rather than remaining distant from them: “despite its superficial appearance as a precise and scientific instrument…ultimately the K setting is the outcome of a social bargaining process between the company and the government” (O’Connell Davidson, 1993, p.39). The effect on water charges from this pricing formula has been significant.

Contrary to what proponents of privatization may believe, it appears that a common initial consequence of privatization is increased prices to customers. Marsh (1991, p.466) supports this view, and another survey also confirms it: “The privatized utility monopolies were apparently far more concerned to increase profits, dividends, and share prices than they were to reduce prices to the consumer” (Feigenbaum et al., 1999, p.76).

This has certainly been the case with the water industry. Consumers have been paying much more for the same service (Feigenbaum et al., 1999, p.76). The rate of increase in water prices has been much faster than that of other commodities and price rises “have been steep and have far outstripped the general rate of inflation”, increasing by an average of 20% in real terms in the first three years after privatization (Saunders and Harris, 1994, p.67). OFWAT itself even predicted that water bills would be likely to rise by 22 – 122% in the ten years following privatization (cited in Huby and Anthony, 1997, p.208). It was quite correct: between 1989-90 and 1997-98 the average unmeasured bill for water increased by 91% and for sewerage by 97% in England and Wales (Huby and Anthony, 1997, p.208). However, recently the DGWS has claimed that for the first time since the industry was privatized in 1989, consumers can look forward to lower water bills from the year 2000 (OFWAT Press Releases, 2 March and 8 May 2000). This will, of course, vary from company to company and from year to year (OFWAT Press Releases, 2 March and 8 May 2000).

The concern over price increases for water, controversial enough on its own, was compounded by the fact that many people were unable to pay their water bills, resulting
in their water supply being disconnected\textsuperscript{101}. The number of disconnections increased drastically (177\%) in 1991-92 (Clarke, 1993, p.221), though it is now falling. From 1992 on, the number of disconnections has consistently been falling, to a low of 1129 in 1998-99, down 41\% from the previous year (OFWAT Press Release, 17 June 1999). It is interesting to note that the Water Industry Bill currently before Parliament includes provisions which would prohibit water disconnections or the use of restrictive flow devices for non-payment of bills (OFWAT Press Release, 17 June 1999). Perhaps this is an indication that Government has realized that water companies have a social as well as an economic responsibility to fulfil.

Nevertheless, the DGWS has maintained that customers must pay their water bills. For example, he has stated that “water bills must be paid: it is not right that other customers should pay higher bills to cover bad debt”, although he concedes that “taking legal action to recover unpaid bills, and more significantly cutting off someone’s supply are drastic steps” (Byatt, quoted in Ogden and Anderson, 1995, p.548)\textsuperscript{102}. In 1992, with the DGWS issuing new disconnection guidelines to companies, there was some regulatory intervention: “[i]t was necessary to push the companies into much better procedures and better payment methods for customers who have difficulty in budgeting...there are some customers who cannot afford to pay their bills – and they need a sympathetic approach” (Byatt, 1997, pp.77-78). This issue in particular raises a very difficult question (which will be discussed in chapter five): how can the private sector business concept of water as a consumer product be reconciled with the public sector social service notion of water as an essential service which should be available to all, regardless of ability to pay?

\textsuperscript{101} See Huby and Anthony (1997) for a very interesting discussion on the geographical impact of water charges on low-income households, and the different options available for budgeting and other assistance. They argue that regional differences in water charges, when social assistance benefits are assessed nationally, mean that in some areas water charges as a percentage of income are twice as high as others. They conclude that there needs to be a more integrated approach between the private water companies and the public sector to address these inequalities to ensure that people on low incomes are not penalized because of where they live (p.216).

\textsuperscript{102} With evidence of dysentery breaking out among those who had had their water disconnected, it was claimed that OFWAT and another organization were “doing too little too late. The water companies, monopoly suppliers of the most essential commodity, seem set to extend the drought to more of Britain’s poor” (The Guardian, quoted in Clarke, 1993, pp.221-222).
The price increases cannot be directly attributed to privatization itself, as there are other factors also involved in the price increases. However, it seems that the general population is not aware of the demands the regulatory regime imposes on water companies, for example the intricacies of the RPI +/- K formula and the investment programme requirements (Saunders and Harris, 1994, p.67). In addition, continued under-investment in infrastructure and the increasing need for water conservation, while keeping up with health and environmental standards, mean that the costs of water service provision were rising even before the introduction of privatization (Huby and Anthony, 1997, p.208).

It is through the ‘K’ factor in the price formula that increases have mainly occurred. It is through the amount above inflation that water companies are able to "offset the substantial injections of capital required to upgrade the infrastructure and meet existing environmental obligations" (Ernst, quoted in Huby and Anthony, 1997, p.208). That is, RPI + K reflects increases in costs incurred in meeting environmental and quality obligations as well as operating cost-efficiently (Cowan, 1998, p.161). Huge investment programmes were needed to bring the quality of drinking water and wastewater into line with the European Commission (EC) standards (Anderson Consulting, 1998). Estimates suggest that £24 billion of investment was needed over a ten year period to make up for years of neglect (Huby and Anthony, 1997, p.208). Companies must also now meet the stringent quality standard required by the EU’s Drinking Water Directive, Bathing Waters Directive and Urban Waste Water Directive (S. Bailey, 1995, p.336).

Environmental considerations were also a factor in the price increases. The expenditure programmes required emphasize the relationship between economic and environmental regulation, which differentiates water from the other public utilities: gas, electricity and telecommunications (S. Bailey, 1995, p.347). “Environmental considerations were central to decisions on future investment programmes and the nature and implementation of charging systems" (G. Taylor, 1996, p.191). With environmental standards rising, it was likely that water charges would rise (G. Taylor, 1996, p.192). “Consumers face a dilemma: either they pay for higher standards or they will be
subjected to increasing levels of pollution and, in some areas, increasingly severe water shortages” (S. Bailey, 1995, p.347). 103

The new investment required in water industry infrastructure is largely being financed on a ‘pay-as-you-go’ basis, from revenue gained through charges rather than borrowing (S. Bailey, 1995, p.345). OFWAT has recognized this and, in the 1994 periodic review, required companies to increase the proportion of profits used to finance the programme, reduce dividends to shareholders, and encourage borrowing (S. Bailey, 1995, pp.345-346). Nevertheless, it could be argued that current consumers are bearing much of the financial cost of the investment programmes.

Besides being required to finance investment programmes of benefit to future consumers, it could also be argued that current consumers are being asked to make up for the lack of investment in water and sewerage during the 1970s and 1980s, the cost of which would have otherwise fallen on the tax-payer (S. Bailey, 1995, p.346).

S. Bailey points out that there are actually three adverse funding redistribution effects occurring:

• From current to future consumers;
• From holders of equity to consumers; and
• From general taxpayers to consumers.

A further major reason that water and sewerage were privatized was to pass the costs of necessary improvements onto the private sector. This would avoid the effects it would have on public expenditure, taxation and the PSBR “at a time when the Conservative government was trying to constrain or reduce all three” (S. Bailey, 1995, p.346) 104. If this, and the previous point about the cost of improvements for past, current and future consumers being met by current consumers only, are correct, then it appears that the privatization of the water industry by the government was a cunning and also

103 It is interesting to note that a British newspaper’s survey of ten privatized water companies found that, since privatization, they had collected 237 criminal convictions for pollution between them, “making them the worst polluters in Britain” (B. Martin, 1996, p.4).

104 “Between 1989 and 1994 some £15 billion was invested by the companies. At an average of £3 billion a year there would have been particularly dramatic increases in the PSBR...Similarly, it could be argued that the ‘pay as you go’ financing of capital investments relieves shareholders of the costs and risks associated with relatively high levels of interest and amortisation charges, payment of which takes precedence over dividends on equity” (S. Bailey, 1995, p.346).
disturbing strategy. It would mean that “privatisation and regulation have actively exploited rather than protected customers”. (S. Bailey, 1995, p.346).

3.5.2 Standards of quality and service
Since privatization was introduced in 1989, quality standards are now assessed mainly by three government agencies. The Drinking Water Inspectorate (DWI) monitors the water coming through the taps to make sure it meets public health standards; OFWAT regulates prices in the industry and checks the quality of service provided by water companies; and finally, the NRA is responsible for the water environment (Saunders and Harris, 1994, p.57). There are also some other agencies involved: Her Majesty's Inspectorate of Pollution (HMIP), the Office of Fair Trading and the Monopolies and Mergers Commission, and government departments such as the Department of the Environment, Ministry of Agriculture, Fisheries and Food, and the EC. These environmental regulators must also abide by EU legislation: the Drinking Water Directive, Bathing Waters Directive and Urban Waste Water Directive (S. Bailey, 1995, p.336). As one writer has observed, “[t]he most obvious point about...the regulators is that there are an awful lot of them” (Carney, quoted in Saunders and Harris, 1994, p.58). However, the large amount of regulatory bodies involved in the water industry means that there is also more information available on the various quality standards (Saunders and Harris, 1994, p.58).

While there may be more regulatory bodies and information available on quality standards, it seems that consumers are not convinced about the standards of their water. For example, Saunders and Harris cite the increasing sales of bottled water and water purifiers as an indication that consumers are not satisfied with the quality of their tap water (1994, p.58). However, the DWI's tests indicate that 99% of samples of British water do meet the quality criteria established at privatization (Saunders and Harris, 1994, p.58). One reason that the public may not think that their water quality is adequate is because of the failure of the British water supply to comply with EC standards seeking to reduce the amount of nitrates and other contaminants in the water supply (Saunders and Harris, 1994, p.59).105 “There is no evidence that water quality is any worse than it has

105 However, none of the other twelve EC states achieved the low levels of contamination which the EC requires either (Saunders and Harris, 1994, p.59).
ever been, and there are certainly no grounds for believing that privatization is reducing water quality” (Saunders and Harris, 1994, p.60). Privatization may have inadvertently increased consumer expectations of water quality because now they are more focussed on getting value for their money.

From the companies’ point of view, there is little incentive to improve water prices, quality or service if the household to which it provides does not have a meter and the bill is assessed on the rateable value of the property, as is current practice. Increasing quality might encourage extra consumption, but the water companies cannot gain extra revenue as a result of the increased demand (Cowan, 1993, p.19). Similarly with sewerage, if there is no meter, then households have little incentive to limit the amount of sewerage they discharge (Cowan, 1993, p.19). It seems that the use of meters is anything but widespread. Armstrong et al. estimate that only a “tiny minority” of domestic customers have a meter (1994, p.351). Since the majority are charged according to the rateable value of their home there is little relationship between their consumption and charges: “When there are no meters there is no feasible way to use charges to give price signals to consumers” (Cowan, 1993, p.19).

Service quality is a much more difficult area to monitor than quality of the ‘product’, water. OFWAT has introduced a range of criteria – imposition of hosepipe bans, incidence of interrupted supply, reductions in mains water pressure, incidence of flooding due to inadequate sewer provision – as indicators to determine the quality of service provided by each water company (Saunders and Harris, 1994, p.60). However, as yet, it is difficult to determine the effectiveness of the increased monitoring: “all that can really be said with any confidence at this stage is that quality of service is now being rigorously monitored for the first time” (Saunders and Harris, 1994, p.60).

106 Although the number of households with meters is increasing, by March 2000 it was estimated that only 18% are expected to be metered (OFWAT, 1999, section 4.4). Legislation states that an alternative charging system to rateable values must be implemented after 31 March 2000. Metering trials were conducted in 1993 found that the annual running cost of a metering system were around £19 and installation costs were around £165-£200. “Demand fell by between 2% and 21%, with an average of about 11%” (Armstrong et al., 1994, p.351). OFWAT believes that universal metering would be uneconomic, but selective metering might be justified in regions where water is in short supply, for those who can economize on their water use, and those for whom installation is simple (Armstrong et al., 1994, p.352). At the moment, customers can have a meter as long as they pay for its installation, and not surprisingly OFWAT is keen to encourage this (Armstrong et al., 1994, p.352).
3.5.3 Employment relationship

Privatization has also had an effect on groups other than consumers, which although interesting, will be only be briefly mentioned here. Harris (1995, and with Saunders in 1994) and O’Connell Davidson (1993) both examine the impact of the privatization of water on employees and the employment relationship in general. The government argued that privatization would be an advantage to managers, who would be able to escape from political control and be free to manage: “high rewards in terms of both salary and job satisfaction could flow from this new-found autonomy” (Saunders and Harris, 1994, pp.77-78).

Employees also were said to benefit, being offered the opportunity to own shares in the company for which they worked, and “if managers and workers ‘pulled together’ to make these companies successful, then ordinary workers would benefit from both increased pay and from dividends based upon rising profits” (Saunders and Harris, 1994, p.78). In an argument influenced by property rights theory and public choice theory, it was thought that as workers realized that their increased personal prosperity was linked to the company’s profitability, there would be an alignment between ‘labour’ and ‘capital’. This would result in a situation where workers’ interests as shareholders would compliment their interests as wage earners (Harris, 1995, p.229). However, the reality of these claims was quite different.

A study found that the majority of employees did buy shares in their company – 96% accepted the offer of free shares (Harris, 1995, p.228). Interestingly, the “higher the grade of employee, the greater the enthusiasm displayed for share purchase” (Harris, 1995, p.228). However, the purchase of shares did not have the predicted effects of increased employee loyalty. Trade unions argued that employees would own too few shares to significantly influence their behaviour (Harris, 1995, p.237). Although significant numbers of employees did buy shares in all privatizations, the value of total worker shareholdings remained “derisory” (Clarke, 1993, p.222) at between 0.1% and 4.3% (Abromeit, cited in Marsh, 1991, p.472). The ‘us versus them’ mentality of employees does not seem to have been eroded, as share ownership has had no significant effect on employees’ willingness to strike, or their views on management (Harris, 1995, pp.230-236). It seems to be those in top management positions, who were in a better
position to take advantage of the various share offers, who have benefited most from the schemes. Harris therefore predicts “a situation in the future where the ‘them and us’ attitude is further entrenched through divisions between those seriously involved in share ownership and the rest” (1995, pp.237-238).

One aspect of privatization which has attracted an immense amount of attention and criticism is the huge salary increases of company executives (see Table 3.1)\textsuperscript{107}. “Whilst paying ordinary workers annual increases of 6 per cent or 7 per cent, senior executives have happily awarded themselves up to ten times this figure, free of the constraints of any real form of public accountability” (Clarke, 1993, p.222).

**Table 3.1 Salaries, bonuses and benefits of highest-paid directors 1993-1998 (£)** (Simpson and Bingham, 1998, pp.xii-xiii).

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<tr>
<td>Severn Trent</td>
<td>210 600</td>
<td>224 200</td>
<td>230 700</td>
<td>239 800</td>
<td>292 700</td>
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<tr>
<td>Thames Water</td>
<td>240 000</td>
<td>332 000</td>
<td>335 000</td>
<td>247 000</td>
<td>255 000</td>
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<tr>
<td>United Utilities*</td>
<td>325 000</td>
<td>337 800</td>
<td>380 700</td>
<td>326 300</td>
<td>443 600</td>
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<tr>
<td>Northumbrian</td>
<td>123 000</td>
<td>170 000</td>
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<tr>
<td>Southern Water</td>
<td>157 000</td>
<td>279 000</td>
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<tr>
<td>Anglian Water</td>
<td>169 000</td>
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<td>216 000</td>
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<tr>
<td>South-West Water</td>
<td>116 000</td>
<td>125 000</td>
<td>134 000</td>
<td>172 000</td>
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<tr>
<td>Wessex Water</td>
<td>166 000</td>
<td>183 000</td>
<td>184 000</td>
<td>202 000</td>
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<tr>
<td>Yorkshire Water</td>
<td>156 000</td>
<td>163 000</td>
<td>170 000</td>
<td>176 000</td>
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* United Utilities is the UK’s first multi-utility, formed in 1996. It provides water, sewerage and electricity services to greater Manchester and the North-west.
- Company merged or was taken over.

In many cases, the directors are effectively doing the same job as they did prior to privatization, so their salary increases seem unjustified (Feigenbaum et al., 1999, p.78; Clarke, 1993, p.224). The salary increases were likely to have been strongly influenced by the pay levels of executives in businesses elsewhere as, in order to attract suitably qualified people, water companies would have to at least match or better salary rates already in the private sector (Ogden and Watson, 1996, p.741).

However, if the salary issue is disregarded, it seems that managers have benefited in other ways from privatization. “They feel that their jobs have been enriched, that they are more autonomous and, that they are freer to use their initiative in decision making” (Harris, 1995, p.227). With attractive financial incentives to produce results, through
personal contracts and performance-related pay, it is not surprising that many managers and directors are now feeling more motivated in their jobs (Saunders and Harris, 1994, pp.82-84).

3.6 Conclusion
Although there is certainly much more that could be written on different aspects of privatization on the water industry, it would be safe to conclude that at least in the short term, it has not produced the desired results. Water was one of the most controversial privatizations, and also one of the most complex, raising many issues not seen previously in other privatizations. The monopolistic nature of the water industry means that effective competition is unlikely to ever emerge, and that regulation will always be required to ensure that companies maintain standards and do not take advantage of their monopoly position: “The overall level of price increases is controlled, the regulator has statutory powers to prevent undue price discrimination, and investment plans and levels of quality and pollution are closely monitored” (Cowan, 1994, p.133).

In addition to this, the “competing logics” (Ogden and Anderson, 1995, p.557) of public and private sector provision of water – public service versus consumer product - are unlikely to be resolved satisfactorily under the existing regulatory regime. As Armstrong et al. have observed, “it is overoptimistic to view regulation as a stopgap until sufficient competition arrives” (1994, p.361), because competition is unlikely to emerge. Although it may be too soon to conclude that the government has simply swapped a public monopoly for a private one, early indications are that this would be a fair assessment.

\[107\] See Ogden (1997) and Ogden and Watson (1996) for examinations of corporate governance structures in the privatized water industry.
CHAPTER 4

WATER SERVICES IN NEW ZEALAND

Most commentators on the water industry will at some stage mention the frequently used statistic: “water is a $6 billion business” (Consumer, 1998, p.30) in New Zealand\(^{108}\). “That makes it bigger than the Telecom network and roughly comparable to the national investment in electricity transmission and distribution” (Consumer, 1998, p.30). Yet, for an industry with such a huge operating expenditure - $600 million (Kerr, 1998a, p.2) – until relatively recently, it has remained largely untouched by any conscious effort at restructuring by central or local government compared with others, being considered “trapped in a time-warp” (Wilson, quoted in Kerr, 1998a, p.2) by many. This chapter therefore assesses the extent to which privatization has been introduced in the structure of New Zealand’s water services.

Like Britain, New Zealand has undergone a radical and comprehensive restructuring programme since 1984 affecting most areas of the public sector. Easton (1997) uses the term commercialization to describe the policy approach used in this reform programme. In general, it is "the application of business (or commercial) principles to the public sector (or a particular public sector activity)" (1997, pp.25-26). This approach has been extended to influence the ways in which many of New Zealand's utilities are now provided.

It is not surprising that the supply of water and wastewater services, currently largely owned and controlled by local government, may be next on the agenda for reform. According to Kerr, "[m]arket-oriented reforms have substantially improved the performance of overseas water industries and there is the same potential for improvement in New Zealand" (1999, p.1). The debate on the water industry follows the corporatization of electrical generation and transmission in 1987, the privatization of telecommunications in 1990 and the privatization of electrical distribution in 1993 (Davin, 1994, p.15). If water and services are to follow the market-oriented reforms implemented in other areas of the public sector, political involvement in the form of local
government and its control of the services should cease or at least be substantially minimized.

Many assume that the industry is in fact archaic (without examining whether it is), therefore much of the contemporary debate in New Zealand concentrates on the validity of various options for reform, rather than discussion of the state the water industry is in now. While certainly of value, discussion on the direction that the water industry should be heading in the future can sometimes blur the structures that exist at the moment.

A second point related to the previous one that has a lot of bearing on the content of this chapter, is the nature of the available sources. While every effort has been made to present a balanced account of the current state of New Zealand’s water services, a substantial difficulty is present in the types of sources available on the subject. It seems that, as implied above, this issue has recently become highly politicized. Much of the published material, therefore, comes from a particular point of view, usually advocating reform of the water industry and expressing hostility towards local government provision of the service (for example, Kerr, from the New Zealand Business Roundtable; Prebble). Most, if not all, of the sources also tend not to be academic in nature, that is, they may be from those actually involved in the industry itself (Wilson), from local government organizations (Marshall, Stigley), or groups either supportive of or ideologically opposed to public provision (for example, Auckland’s Water Pressure Group and The New Zealand Business Roundtable respectively). Because of the nature of the sources, the information they provide also tends to be rather brief and fragmentary and (apart from a review undertaken by the New Zealand Business Roundtable in 1995), unlike the situation in Britain and Wales outlined previously, there is little in-depth analysis available. Although these difficulties presented in writing on the water industry are not necessarily a disadvantage, it is wise to keep the sources’ origins in mind when considering their points of view.

It is important to first have a basic understanding of the structure, activities and constraints imposed on local government, as water services have traditionally been regarded as part of its jurisdiction, rather than a central government concern. This

108 In actual fact, this is the estimated value of the investment in water and wastewater infrastructure (Begg et al., 1995, p.1).
discussion will then be related to water services more directly, including traditional assumptions about the general services to be provided by local government, the legislative provisions surrounding water services, and what is actually happening in practice.

4.1 Local government in New Zealand

Until the late 1980s New Zealand's local government structure was "excessively complex and fragmented" (Bush, 1997, p.117), a result of many years of unfocussed structural evolution. Before 1987 there had only been one significant reform, and that was in 1876 when provinces were abolished, creating "a two-tier governmental system of central government and local government and without provinces, states or prefectures" (Anderson and Norgrove, 1997, p.117). The new local government framework of counties, cities and boroughs that then replaced the provinces did not create a more streamlined, clear-cut system, but in fact led to greater problems (Easton, 1997, p.189).

The "patchwork" (Anderson and Norgrove, 1997, p.125) continued to grow as county councils, city councils, and borough councils became the main territorial units of local government. They also became complemented by an ever-increasing number of special-purpose and ad hoc bodies, such as harbour, rabbit, water, river, roads, education and health boards (Palmer and Palmer, 1997, p.208; Anderson and Norgrove, 1997, p.125). With the evolution of these special-purpose bodies, introduced to deal with specific local needs that the general purpose territorial bodies did not have the capacity to deal with, an increasingly inconsistent system developed. For example, "particular functions, such as drainage or electricity power supply, could be met by special purpose bodies in some parts of the country and general purpose territorial bodies in other parts" (Mulgan, 1997, p.193).

Early attempts at reform failed. This was because of a combination of an extremely strong sense of local parochialism and the fact that local government's

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109 The lack of attention paid to issues relating to local government in New Zealand by political analysts is striking. Graham Bush, and more recently the group of Philip McDermott, Vicky Forgie and Robert Howell, appear to be the only significant contributors to substantial work on the subject.

110 A national system of 21 regional catchment authorities was established with the Soil Conservation and Rivers Control Act 1941 (R. Taylor et al., 1997, p.776). With the Water and Soil Conservation Act 1967, this management role was extended to include the quantity and quality of water – "for this role they were referred to as regional water boards" (R. Taylor et al., 1997, p.778).
functions were limited by central government. By 1989 the total number of local authorities (encompassing all of the groups mentioned) had reached 822 (Anderson and Norgrove, 1997, p.125).

The fourth Labour government, accompanied by the Local Government Commission, initiated major change at the local government level, making its structure significantly simpler. This became most apparent in 1989, with the amalgamation and disestablishment of many local authorities (see Table 4.1). Reforms were also implemented, including the abolition of many of the special purpose bodies, the creation of quasi-governmental community boards, and the introduction of central government management practices (Bush, 1997, p.117). One major area which government noticeably left alone was water and sewerage activities (Law, 1998, p.2).

Table 4.1 Number of local authorities before and after amalgamation (B. Anderson, 1997, p.18; Local Government New Zealand website)

<table>
<thead>
<tr>
<th>Type of Authority</th>
<th>Before Nov. 1989</th>
<th>After Nov. 1989</th>
<th>1996</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Territorial Authority</td>
<td>219</td>
<td>73</td>
<td>70</td>
<td>69</td>
</tr>
<tr>
<td>Regional Councils</td>
<td>22</td>
<td>12</td>
<td>12</td>
<td>12</td>
</tr>
<tr>
<td>Unitary Councils</td>
<td>0</td>
<td>1</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Special Purpose Authorities</td>
<td>500</td>
<td>6</td>
<td>6</td>
<td>No data</td>
</tr>
<tr>
<td>Total</td>
<td>741</td>
<td>92</td>
<td>92</td>
<td>-</td>
</tr>
</tbody>
</table>

It appears that the themes of the central government reforms implemented at around the same time were particularly influential in the local government restructuring (Palmer and Palmer, 1997; Howell et al., 1996, p.36; and J. Martin, 1991). Although expressed in slightly different terms, their arguments are centred on the same issues: “There is the same emphasis on clear objectives, separation of commercial, regulatory, and other functions, [and] the emphasis on accountability – both managerial (within the organization) and political (to the public)” (J. Martin, 1991, p.274). These themes can be seen in the current structure of local government.

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111 Law gives two possible reasons for this. First, the water industry may not have been seen as particularly important to “the national economic performance” (Law, 1998, p.2). Second, “Perhaps also the tide of adverse public opinion on corporatisations which turned to privatisations and the emotional element the water industry seems to involve, left the government thinking the political pain to economic gain ration was wrong” (Law, 1998, p.2).

112 These objectives summarize several reforms implemented at local government level, which are as follows: annual planning and consultation processes; strategic planning and forecasting; asset management plans; the separation of service delivery from regulatory functions; and the creation of Local Authority...
4.1.1 Structure of local government

New Zealand's local government is now “rational, lean, generally uniform, and its essentials are easy to grasp” (Bush, 1997, p.117). The structure of local government is based on a “trichotomy” of region, district and community (Bush, 1995, p.111). Local government is now comprised of regional councils and territorial authorities separate but complementary functions (Anderson and Norgrove, 1997, p.139).

The directly elected territorial local authorities are made up of cities and districts. They have a mix of service delivery and regulatory functions (Bridgeport Group, 1994, p.9). The directly elected regional councils have mainly a resource management function (Anderson and Norgrove, 1997, p.137). In 1992 the law governing regional councils was amended to make their role as primarily regulatory bodies clearer: “A distinct line was drawn between territorial and regional government by preventing regional councils from carrying out what could be considered to be service delivery functions specifically those also provided by territorial authorities” (Bridgeport Group, 1994, p.5).

4.1.2 Role of local government

The closest thing to a statement about the role of local government is contained in section 37K of the Local Government Act 1974 (LGA), which was introduced at the time of the 1989 amendments:

Purposes of local government – The purposes of local government in New Zealand are to provide, at the appropriate levels of local government, -

(a) Recognition of the existence of different communities in New Zealand:
(b) Recognition of the identities and values of those communities:
(c) Definition and enforcement of appropriate rights within those communities:

Trading Enterprises (Blakely, 1999, p.3; Reid, 1999, p.14). As Reid also emphasizes, “alternative service delivery arrangements being used by councils in carrying out their functions are driven by similar imperatives as those driving change at national level; of particular concern are efficiency, accountability, responsiveness and the reduction of fiscal and policy risk” (1999, p.14). Palmer and Palmer also sum this up succinctly: the aims were to make local government “more effective, more democratic, more accountable, and more economical” (1997, p.209).

113 As the Bridgeport Group points out, regional councils do have limited service provision functions, but they are closely related to resource management-type (that is, regulatory) functions. “In addition to these service delivery functions a number of regional councils own shares in port companies and investment land acquired from the former harbour boards. These potentially may create interests in conflict with a regional councils [sic] resource management responsibilities” (1994, p.8).
(d) Scope for communities to make choices between different kinds of local public facilities and services:
(e) For the operation of trading undertakings of local authorities on a competitively neutral basis:
(f) For the delivery of appropriate facilities and services on behalf of central government:
(g) Recognition of communities of interest:
(h) For the efficient and effective exercise of the functions, duties, and powers of the components of central government:
(i) For the effective participation of local persons in local government.

Yet there is no mention of the priority of one objective over another: “In practice each objective may require consideration depending upon the activity or function concerned” (K. Palmer, 1993, p.28).

There are six main functions which have traditionally been taken as the responsibility of local government (Bush, 1995, pp.127-166; 1997, pp.118-119):

- **Protection** against ‘nuisances’ – litter, animals and plant pests, pollution, refuse and sewerage, human corpses;
- **Control** of various activities – building, monitoring dangerous goods, dogs, selling of liquor, swimming pools and car parking;
- **Planning** for the sustainable management of the natural and physical environment – including land, air and water, energy, transport, inland waterways and coastal waters;
- ‘Improvement’ of communities (also termed ‘amelioration’) – recreation and entertainment – libraries, parks, roads and footpaths, economic development (land subdivision, malls, tourism, sister cities);
- **Social welfare** – housing for the elderly, citizens’ advice bureaus, crèches and youth programs;
- **Trading/operating utilities** – supplying water, owning forests, airports and electricity supply enterprises, liquor vending by licensing trusts. “With the corporatisation of the ports and formation of energy companies, this interest has become more tenuous, shifting from hands-on direction to shareholder status” (Bush, 1997, p.119).

Local government does not exist in a vacuum: it is subject to scrutiny and control from other elements – central government and its residents. Bush sees its relationship with central government as a constrained one: “Local government has sporadically
chaffed at the fact that it is a dependent variable in the totality of government, and that its autonomy and objectives are circumscribed” (1995, p.171). As Bush (1995, pp.171-173), K. Palmer (1993, pp.45-53) and Palmer and Palmer (1997, pp.210-213) all note, any legal powers that local government has are granted by the grace of central government. Councils can pass their own laws – called by-laws – but they must be agreed to by members of the council, and can only relate to topics which Parliament has agreed that local authorities can make laws on. “A local authority has no inherent law-making power and by-laws cannot contradict the general law of the land (Palmer and Palmer, 1997, p.211)\textsuperscript{114}.

4.2 New Zealand and water services

It is from within the above framework of local government that general services are provided. All of the aspects mentioned previously in the section on local government shape the ways in which the various local bodies deal with the provision of water services.

“[C]ontroversy has never dried up in the water supply industry” (Bush, 1995, p.159). As Bush points out, the main issue for local government used to be whether or not water should contain fluoride. Now the most debated issue is private sector involvement:

From the start of 1995 there has been assiduous but scarcely disinterested promotion of the notion that the real barrier to efficiency and productivity gains in the ‘industry’ is public ownership...The government promptly denied that it had any plans to privatise water – which it did not own anyway – but ideas like contracting out or franchising water supply operations were still being sprinkled about (Bush, 1995, p.159).

Puns aside, it was simply a matter of time before the delivery of water services was examined in close detail, following the tendency of local authorities to opt for various business-oriented forms of providing services.

\textsuperscript{114} "Unpalatable it may well be, but local government proceeds from two premises which are virtually immutable: first, that it possess no sovereign power; second, that its wide world is suffused with conflicting goals and standards of behaviour. Invested with a measure of legal authority and issues with a survival kit, it is adequately equipped for its mission. If in serious trouble it can send an SOS to its ultimate mentor, Parliament, and confronted by rebellious ‘subjects’, it can seek recourse in law" (Bush, 1995, p.171).
Most water supplies in New Zealand originate from rivers and streams, sometimes from storage made by damming waterways or from groundwater. It is then processed and piped to consumers (Begg et al., 1995, p.10). The largest cost involved in supplying water comes from the installation and maintenance of the distributing pipelines, while pumping and water treatment costs make up a relatively small part of the total cost of providing water services (Begg et al., 1995, p.10).

4.2.1 Uses of water

Water is used in many varying activities: in electricity generation, recreation, “sustenance of flora and fauna”, land use including irrigation and livestock, and in household, industry and commercial consumption (Begg et al., 1995, p.7; see table 4.2). “The value of fresh water for waste disposal, water supply, recreation and commercial fisheries has been estimated at around $1.5 billion per annum. This estimate does not include the ecological and cultural value of water” (Begg et al., 1995, p.8). Households use water in many different ways, but most New Zealanders use around 200 litres of water per day each (R. Taylor et al., 1997, p.7/43).

Table 4.2 New Zealand Water Supply and Use (Begg et al., 1995, p.113)

<table>
<thead>
<tr>
<th>Estimated total supply and use</th>
<th>Cubic kms p. a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Freshwater yearly reserves</td>
<td>300 000</td>
</tr>
<tr>
<td>Annual use, excluding hydro</td>
<td>2 000</td>
</tr>
<tr>
<td>Annual hydro throughput</td>
<td>100 000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Distribution of use excluding hydro</th>
<th>Cubic kms p. a.</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Irrigation</td>
<td>1 110</td>
<td>57</td>
</tr>
<tr>
<td>Livestock</td>
<td>350</td>
<td>18</td>
</tr>
<tr>
<td>Industry</td>
<td>260</td>
<td>14</td>
</tr>
<tr>
<td>Household</td>
<td>210</td>
<td>11</td>
</tr>
<tr>
<td>Total</td>
<td>1 920</td>
<td>100</td>
</tr>
</tbody>
</table>

It is significant that most New Zealanders expect to receive water of a standard high enough to drink from the tap. Only about 1% of water is used as drinking water, although some industrial processes may require high standards of purity (McKinlay Douglas Ltd, 1996, p.39).

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115 Most New Zealanders' reticulated water supplies originate from running rivers, or reservoirs, but in the Canterbury Plains, the Heretaunga Plains and the Waimea Plains, underground sources are also very important (D. Smith, 1992, p.21; Christchurch City Council, 1996, p.1; Begg et al., 1995, p.7). Therefore Christchurch, Lower Hutt, Napier and Hastings all draw on underground water for at least some of their requirements (Begg et al., 1995, p.7).
In many countries, tap water is not considered drinkable and it is interesting to speculate whether the costs of providing water good enough to drink for flushing toilets, watering gardens and washing (these uses together making up 90% of household use) outweigh the costs involved in providing water separately (bottled water, rainwater collection) (McKinlay Douglas Ltd, 1996, p.39).

As different qualities of water cannot be delivered down one set of pipes, a common standard must be adopted. Yet Prebble observed a conservation approach taken during a water crisis in Auckland: “People used brown water for washing cars, used roof water for gardens and swimming pools, sunk bores to untapped natural springs” (1998, p.2).

The water supply powers (discussed later in this chapter) relate to pure water. Other provisions use different terms for a similar concept: the Water Supplies Regulations 1961 make it illegal to put non-“wholesome” water into water mains (McKinlay Douglas Ltd, 1996, p.35). “NZS 9201 CH 7: 1994 Model General Bylaw: Water Supply refers to the health criteria of 1984 Board of Health Drinking Standards and to ‘fit for human consumption’” (McKinlay Douglas Ltd, 1996, p.35). Local authorities have no statutory powers to provide ‘grey water’ for uses other than human consumption, for example, industry (McKinlay Douglas Ltd, 1996, p.35).

4.2.2 Maori and water

A second aspect of the significance of water to New Zealand is its unique importance to Maori. Although not strictly relevant to the discussion in this chapter regarding the present state and future direction the water industry is likely to take, this point must still be mentioned because it may have an influence on the way in which water can be appropriated and allocated. As mentioned above, water has a cultural value that cannot be quantified, and this is especially clear with regard to Maori.

As K Palmer has suggested, under the Treaty of Waitangi (1840), it may be possible to argue that water is part of the property that the Crown agreed to hold for Maori. “Under this agreement, Maori would have the [sic] greater claim to allodial ownership than the Crown, pending any settlement of purchase by the Crown of the

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117 K. Palmer gives the example of a 1982 case in which a woman objected to a water-right discharge from the Glenbrook steel mill into the Manukau Harbour, as it was pollution that caused offence because of the importance of the harbour as a traditional Maori shell-fish reserve (1988, p.337).
water” (K. Palmer). The Resource Management Act (1991) imposes obligations to consider the “relationship of Maori and their culture and traditions with their ancestral lands, water sites, waahi tapu and other taonga” (s. 6[e])\textsuperscript{118}. As K. Palmer also notes, additional considerations relevant to Maori include “particular regard” to Kaitiakitanga, that is, the exercise of guardianship based on the nature of the resource. “Hence, it is necessary to consult with iwi regarding regional policies, plans, district plans and resource consent applications, where there could be a Maori input on Kaitiakitanga and stewardship” (K. Palmer).

4.3 Local government and water supplies

The responsibility for providing water services has largely been left to local government which, perhaps for historical reasons more than anything else, has been left to make do with the current legislative and institutional framework provided for it by central government.

Most water services are controlled by local government. Ninety percent (by volume) of water supplies are provided by local authorities (Prebble [1998, p.2] estimated in 1998 that there were 80 council owned water supplies), but a substantial number are provided by other organizations (McKinlay Douglas Ltd, 1996, p.31). However, according to Wilson, there are at least 1,400 private entities somehow involved in operating public water supplies in New Zealand (1998b, pp.22-24). The Register of Community Drinking Water Supplies in New Zealand (at the Ministry of Health) has 428 drinking water supplies provided by local authorities, compared with 427 that are not (McKinlay Douglas Ltd, 1996, p.31)\textsuperscript{119}. There are also many community- (as opposed to council-) owned water suppliers, either operated cooperatively or as trusts, or supplied as a by-product from other activities (McKinlay Douglas Ltd, 1996, p.32)\textsuperscript{120}.

\textsuperscript{118} On the relationship between Maori and the Resource Management Act, see Karaitiana, “Core Values and Water Resources” (1999).

\textsuperscript{119} R. Taylor et al. (1997, p.7/77) use another figure: 1638 community drinking water supplies which serve 85% of the population. Of these, only 7% (serving 54% of the population) are considered safe, and another 2% (serving 5% of the population) are bordering on safe (R. Taylor et al., 1997, p.7/77). 19% - serving 18% of the population – have an "unsatisfactorily" high risk of contamination (R. Taylor et al., 1997, p.7/77). The remaining 71% of water supplies have not been tested because they are in communities of less than 500 people (R. Taylor et al., 1997, p.7/77).

\textsuperscript{120} For example, New Zealand Steel supplies water to the 400 residents of Tarharoa Village; ECNZ supplies a few communities with small amounts of water (McKinlay Douglas Ltd, 1996, p.32). “Similar
4.3.1 Reasons for local government provision of water services

Local government has the obligation to provide for public health under various “scattered bits” of legislation (Marshall, 1998, p.3), and this is the primary reason that water has traditionally been provided at this level. First, water was originally managed collectively out of concerns for public health: to prevent cholera, dysentery and other diseases (Stigley, 1998a, p.8; Marshall, 1998, p.3). “That very basic value has worked down through the ages of human settlement and is a backdrop to where we are at today with the issue of water management” (Stigley, 1998a, p.8). However, there is nothing in any piece of legislation that compels local government to provide water, but as an activity that is vital to public health, many citizens expect local government to provide it (Marshall, 1998, p.3).

Second, there has also been an assumption that only public authorities can be concerned with the long-term planning and investment required for anticipated demand of services such as water supply, and that private suppliers may not be as interested in planning for the future. The size of investment required and the length of time before returns are realized may be perceived as risky for private companies (Stigley, 1998a, p.8). “There is no doubt that for a community to be economically viable it needs robust and reliable infrastructure. It is often argued that Council must control water and sewerage as it is only by so doing that development can be both ensured and controlled” (Wilson, 1998a, p.6).

Third, collective infrastructure assets, such as water, “have traditionally been provided for in New Zealand from a public and collective good culture” (Marshall, 1998, p.3). To many, water supplies are a public amenity, and any mention of change, whether or not it even involves a transfer of ownership from public to private hands, is met with suspicion. For example, as Stigley points out, to many citizens, amenities such as a water supply are viewed as community assets (1998a, p.6). “These electors may not always be able to come up with rigorous arguments to back up their desire to see water assets continue to [be] run by their local authority, but nonetheless many communities strongly identify with these amenities” (Stigley, 1998a, p.6).

but generally smaller examples could be found for a range of food processing industries including meat works and dairy factories” (McKinlay Douglas Ltd, 1996, p.32).
4.3.2 Legislative provisions for water services

The main pieces of legislation governing local authorities' powers and responsibilities to directly (and indirectly) provide water and wastewater services are as follows:

- Local Government Act 1974;
- Resource Management Act 1991;
- Health Act 1956;
- Rating Powers Act 1988; and

Yet, reinforcing an earlier point, Simpson Grierson Law points out: “There is no express obligation in the legislation for local authorities to provide water or wastewater services, although there is perhaps an implied obligation for them to do so...It seems the essential nature of these services has given rise to the implied obligation to provide them” (1996, p.3, emphasis added).

As Wilson also points out, the fact that there are around thirty eight Acts and Regulations of national application and around one hundred and thirty with local application relating to drinking water and sewerage networks, means that the current legislative framework is in a state of chaos: “Most [Acts] are outdated, conflicting, and have different application [sic] depending on whether the service is provided by a local authority or other entity” (1997, p.5).

The Local Government Act imposes a number of powers on territorial authorities with regard to the supply of water, but there is no express obligation to actually exercise these powers (Simpson Grierson Law, 1996, p.3)\(^{121}\). As mentioned below, an obligation to exercise these powers is implied as a result of the duties required in the Health Act and the Building Act (Simpson Grierson Law, 1996, p.3). In addition, “the initial utilization and taking of bulk water may require a water permit or resource consent, and this right may be subject to conditions related to sustainable management objectives [that is, those of the Resource Management Act 1991]” (K. Palmer, 1993, p.468). When a territorial

\(^{121}\) The Courts have decided that if a local authority supplies water and has a practical monopoly, there is an obligation upon the local authority to supply water to all those who require water, are able to be connected, and are prepared to pay a proper charge. This is sometimes referred to as the doctrine of prime necessity” (Simpson Grierson Law, 1996, pp.3-4).
authority does decide (or is instructed to do so through the provisions in the Health Act) to supply water, it must follow the few legislative guidelines in existence.

Territorial authorities' powers to supply pure water\textsuperscript{122} are found in Part XXIII of the Local Government Act\textsuperscript{123}. Section 378 states that "a council shall...have control of all watercourses, streams, lakes, and other sources of water supply within its district". This would appear to mean that there is a territorial monopoly on sources of water supply which would enable it to refuse any taking of water within the district by any other person or body than itself (Simpson Grierson Law, 1996, p.4). Yet this section is not interpreted in this way:

Subject to any requirement to obtain resource consent from a regional council, private supplies can be lawful. Part XXIII is regarded as merely empowering and regulating the supply of water by or for a territorial authority. It is not regarded as preventing the transfer of a territorial authority water supply to a LATE [Local Authority Trading Enterprise] (Simpson Grierson Law, 1996, p.4).

Section 379 grants powers of construction or purchase of waterworks\textsuperscript{124}, including the taking and acquiring of land, the taking of water, breaking or digging into the surface of any road (public or private), whether they are within or outside the district, alter drains, sewers, gas pipes and cables, and prospect for water. It may also keep those waterworks in good repair.

The relevance of the Local Government Act to current local governments' use of a wide range of contracting, franchising and management practices already implemented or being proposed (discussed below), has long been questioned. For example, "[I]legal authority to enter these can only be derived by interpreting a range of provisions which predate many modern arrangements and which were clearly not drafted with innovation in mind" (Marshall, 1998, p.4). "Even the Act's provisions relating to LATEs now

\textsuperscript{122} "The power to supply 'pure water' has been interpreted to permit a council to add chemical substances to the water to eliminate bacteria and to achieve recognised mineral standards. In particular fluoride may be added to enhance health objectives" (K. Palmer, 1993, p.468).

\textsuperscript{123} After the repeal of Part XXIV in 1992, regional councils (except for Wellington Regional Council) no longer have water supply powers (Simpson Grierson Law, 1996, p.4).

\textsuperscript{124} The term 'waterworks' is defined in the Local Government Act to mean "all rivers, streams, lakes, waters, and underground waters, and all rights appertaining thereto, and all land, watersheds, catchment areas, water collection areas, reservoirs, dams, bores, tanks and pipes, and all buildings, machinery, and all appliances of every kind, vested in the council or acquired or constructed or operated by or under the
appear primitive and inflexible in the light of experience and the emergence of other options for corporate structures” (Stigley, 1998b, p.28).

Only the Health Act gives an express statutory obligation to supply ‘sanitary works’, which includes water and sewerage systems. The Building and Health Acts require that buildings connect to a water supply and are therefore ‘sanitary’ and habitable (Wilson, 1998a, p.7). The Minister of Health can request the territorial authority to provide the works, and if this is not done the Department of Health can step in and provide the services, and charge the territorial authority (D. Smith, 1992, p.22). “The latter provision has never been held over the heads of territorial authorities in the past, but it has never been applied” (D. Smith, 1992, p.22).

In 1991 many of the existing water management laws – Soil Conservation and Rivers Control Act 1941 and the Water and Soil Conservation Act 1967 - were replaced by the Resource Management Act (RMA). This act revolves around the basic principle of promoting sustainable management of natural and physical resources, that is, managing the use, development, and protection of natural and physical resources in a way, or at a rate, which enables people and communities to provide for their social, economic, and cultural wellbeing and for their health and safety while –

(a) Sustaining the potential of natural and physical resources (excluding minerals) to meet the reasonably foreseeable needs of future generations; and
(b) Safeguarding the life-supporting capacity of air, water, soil, and ecosystems; and
(c) Avoiding, remediying, or mitigating any adverse effects of activities on the environment (RMA, s.5).

The Act makes regional councils responsible for maintaining water quality and supply for human purposes, “and to sustain fish habitat, ecosystems and other intrinsically or culturally valuable features” (R. Taylor et al., 1997, p.7/78).

Section fourteen of the RMA makes most water-based activities – on lake and river beds, the drawing-off of water and discharges of wastes into water – illegal unless a resource consent from the relevant regional council or unitary authority has been granted. There are some exceptions: “An individual’s reasonable domestic needs”, the “reasonable control of the council under this Part of the Act, or for relating to the purpose of water supply, whether within or outside the district”.

needs of an individual’s animals for drinking water”, the customary Maori use of geothermal water and for fire-fighting purposes (RMA, s.14)\(^{125}\).

Pawson et al. (1996b, pp. 307-309) investigated the issue of the Auckland water crisis further and conclude that “[a] full explanation...involves the interactions between climatic variability, restricted storage, lack of both short-term and long-term planning, and regional and local politics”. “There was also considerable argument between regional and local councils because of the lack of clear definition of responsibilities, leading to problems in managing the situation which developed” Pawson et al., 1996b, p.309, emphasis added). This should be kept in mind when considering the role of territorial authorities in water management.

Much criticism of the present approach to New Zealand’s water management is directed at the multiple, and conflicting roles, the local authorities have. This reflects discussion in an earlier chapter on agency theory, in which the roles and expectations held about the roles of principal and agent are often blurred in the public sector. For example, in the case of the water industry in New Zealand, it is argued that the council is usually the owner, customer representative, price regulator, service provider and regulator (Wilson, 1998a, pp.1-5). These conflicting roles “result in confusion between the roles and responsibilities of ratepayers and customers, provide weak feedback on performance, blur accountability issues and confuse ‘business’ issues with regulatory issues” (Wilson, 1998a, p.5). However, it is important to note that, as was seen in chapter two, these ‘problems’ are not necessarily self-evident, but become clearer and perhaps more legitimate with reference to the types of theories mentioned in chapter two.

The problems with the legislative provisions may be compounded by the lack of unity in central government taken in the approach to the water services provided by local government. The Ministry for the Environment is responsible for matters related to water resource management, while the Department of Internal Affairs, Ministry of Agriculture, Ministry of Commerce all have input in their areas of interest (Begg et al., 1995, p.10).

\(^{125}\) Yet “there is some evidence that the RMA’s ability to protect ecological values in resource development may well be compromised by political and economic expediencies” (Pawson et al., 1996a, p.254). Pawson et al. point to the Auckland water crisis of 1994 when central government tried to override the Resource Management Act through special legislation designed to hasten a pipeline to bring water from the Waikato...
The Office of the Controller and Auditor-General monitors the “compliance of councils with annual statutory documents” as well as “broader audits of the effectiveness of other functions undertaken by councils” (Begg et al., 1995, p.10). However, it is argued that the fact that there is no single agency monitoring advising local government on its management of water operations must be a significant contributing factor to the state the industry is now in: “It is hard to escape the conclusion that local government is so confused about its roles, weak on analysis and bogged down by petty politics that in most cases councils are incapable of sorting themselves out on their own” (Kerr, 1998a, p.1).

4.4 Variations on local government provision

A common misconception held about water and wastewater services is that they are untouched by the types of reform mentioned in the introduction of this chapter (Local Government New Zealand website). As will be seen below, this could not be further from the truth. In many of the examples that follow, local authorities have privatized production, because they have relinquished the responsibility for supplying water services themselves to an outside source, but have decided still to provide them to their constituencies. Only Papakura’s District Council has relinquished total control over the water services in its territory. In addition, when placed on Savas’ privatization scale (Figure 1.4) there is a definite movement towards privatization. Although moves towards privatization are occurring, I do not feel that complete privatization as a term can be used to describe these initiatives because local authorities retain control the water utilities. For this reason I prefer to use the term ‘commercialized’ to describe the changes that have occurred.

It appears that the atmosphere of reform implemented at local government level in 1989 has recently become influential in stimulating local authorities to adopt non-traditional means of delivering water to their citizens. A survey, initiated by the Department of Internal Affairs, on the state of local authorities’ water and wastewater services (in 1997/1998) produced some very interesting results (analyzed by the

River to Auckland, despite the fact that many scientists and environmentalists believed that it was polluted because of farm run-offs and industrial wastes, and not suitable for human use (1996a, p.254).
Bridgeport Group, 1998)\textsuperscript{126}. Delivery methods ranged from "in-house" (that is, direct provision from local government), to business units or Local Authority Trading Enterprises, to contracting out construction and maintenance.

According to some, New Zealand’s water industry is in desperate need of reform. "There are problems with a backlog of renewals and capital expenditure, caused by conflicting priorities for other Council services, short-term decision making, political interference, and no proper depreciation regime" (Wilson, 1997, p.5). Under-investment, particularly in on-going maintenance, is a frequently mentioned result of local government control of water services (Blakely, 1999, p.2). The following examples are just a small selection of the wide variety of specific ways through which local government has tried to address these problems, and pursue other goals such as efficiency.

4.4.1 Local Authority Trading Enterprises

One of the most significant areas recently to change in the structure of the provision of council services has been the establishment of Local Authority Trading Enterprises (LATEs)\textsuperscript{127}. A LATE is "a company wholly or principally owned by a local body and under the control of directors appointed by it to undertake a commercial activity" (Bush, 1995, p.219)\textsuperscript{128}. The extent of local authority ownership or control may vary: a local authority, or any combination of local authorities, may hold equity securities that carry 50 percent or more of the voting rights at any general meeting of the company (LGA s.594B). The principal objective of every LATE is to operate as a successful business (LGA s.594Q)\textsuperscript{129}. Approximately 160 LATEs have been established, with many being sold, especially those that incorporated traditional ‘works’ operations such as reading maintenance (Reid, 1999, p.15). It seems that recently many councils have been

\textsuperscript{126}The method of delivery for water supplies is assessed by surveying the period 1991/92, 1996/97, and forecasting the likely method for 2001/02 (Bridgeport Group, 1998, p.15).

\textsuperscript{127}These are likened by Bush to the local government version of state-owned enterprises (SOEs) (1995, p.219).

\textsuperscript{128}However, there are also some exclusions from the definition of LATEs, including energy companies, airport companies and port companies (LGA s.594B).

\textsuperscript{129}As pointed out by Simpson Grierson Law, there is no clear definition of what constitutes operating as a successful business (1996, p.14). "It would seem there is no impediment to a business pursuing a balanced set of objectives. Achievement of other goals eg. environment, social etc may contribute to achieving a balanced set of goals for a ‘successful business’ and this may also drive financial performance" (Simpson Grierson Law, 1996, p.14).
examining and choosing the LATE option to undertake their water and wastewater function, with most of the country's water supply being provided by ten large LATEs or territorial authority business units (McKinlay Douglas Ltd, 1996, p.46). Watercare Services and Metrowater, discussed below, which were established by the Auckland City Council, are just two examples.

There are some "perverse incentives" in the legislation regarding LATEs, especially with regards to water and wastewater services (Reid, 1999, p.15). They were not originally designed for operating utilities and monopolies (Simpson Grierson Law, 1996, p.15). LATEs must pay taxes, but other councils' internal business units do not. In contrast, councils are unable to charge for the cost of recovering wastewater, whereas a LATE can (Reid, 1999, p.15).

There are two good examples of LATEs in Auckland. First, Watercare Services Limited provides bulk wholesale water and wastewater treatment to the Auckland region. It was owned by the Auckland Regional Services Trust until it was dissolved by the Government in October 1998, and is now owned by Auckland's six territorial local authorities. The shares each holds is allocated on the number of water connections each council has with Watercare, as follows:

<table>
<thead>
<tr>
<th>Council</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auckland City Council</td>
<td>41.6%</td>
</tr>
<tr>
<td>Manukau City Council</td>
<td>25.1%</td>
</tr>
<tr>
<td>Waitakere City Council</td>
<td>16.7%</td>
</tr>
<tr>
<td>North Shore City Council</td>
<td>11.5%</td>
</tr>
<tr>
<td>Papakura District Council</td>
<td>3.7%</td>
</tr>
<tr>
<td>Rodney District Council</td>
<td>1.4%</td>
</tr>
</tbody>
</table>

These territorial local authorities are also Watercare's main customers – Auckland City Council (through its own LATE, Metrowater), Manukau City Council, Waitakere City Council, North Shore City Council, Papakura District Council (through its franchise company, United Water) and the Rodney District Council. These territorial authorities then supply water and wastewater services to their customers, the ratepayers of the Auckland region.

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130 See Simpson Grierson Law for further legal details on the water and wastewater issues that the introduction of LATEs provokes (1996, pp.15-17).
Watercare was the subject of much controversy in mid 1999 when it proposed increasing its wholesale water prices in order to increase its annual return on capital assets of approximately $1 billion from 2% to 8.75% in six years (Dearnley, 1999b). This would have meant that wholesale prices would have increased by 126% by 2006 for Watercare’s council owners (Dearnley, 1999b), increases which would undoubtedly have been passed on to the councils’ consumers in the form of higher water charges\(^\text{131}\). Four of the Auckland region’s councils refused to pay the increases, but after Watercare took the Waitakere City Council to the High Court to resolve the issue, a settlement was reached (Dearnley and MacLeod, 1999)\(^\text{132}\). Watercare agreed to raise wholesale prices only to cover its business needs and “not specifically to gain a return on its $1 billion of assets” (Dearnley and MacLeod, 1999)\(^\text{133}\).

The second relatively recently (July 1997) established LATE is Metrowater, owned by the Auckland City Council\(^\text{134}\). Already statistics imply that it is more efficient than the previous council operation in several areas\(^\text{135}\):

- It is gathering slightly less revenue ($52 million) than Auckland City would have gathered to run the wastewater business ($54 million) (\(\text{Consumer, 1998, p.31}\)).
- Operating costs have reduced, for example, laying a new water main now costs $64 000 per kilometre as opposed to $118 000 (\(\text{Consumer, 1998, p.31}\)).
- Computerized assets management software has led maintenance work to be more effectively prioritized (\(\text{Consumer, 1998, p.31}\)).

\(^{131}\) When Auckland’s water prices go up, the “local body middlemen” (the territorial councils and/or their LATEs) are quick to blame their wholesale supplier, Watercare (Rudman, 2000). As Rudman notes, “Watercare is the perfect scapegoat. It can’t answer back. After all, it is jointly owned by the very local bodies attacking it” (2000).

\(^{132}\) The terms of the settlement included the four water retailers agreeing to pay a combined total of $3.5 million and $200 000 interest (Dearnley and MacLeod, 1999). Waitakere City Council had the largest debt, of $2.5 million, followed by Metrowater (owned by the Auckland City Council) with $987 000, North Shore City Council and United Water (which provides Papakura’s water) with $87 000 and 75 000 respectively (Dearnley and MacLeod, 1999).

\(^{133}\) The expected price increases for the six territorial councils will now be in the region of 4.5-5% (Rudman, 2000).

\(^{134}\) It appears that there was much opposition to the establishment of a LATE for providing water. Over 80% of people were opposed (Gladwin and Bright, 1999, p.17), and Auckland City Council decided by just two votes to go ahead with Metrowater (Keane, 1997, p.6).

\(^{135}\) One wonders about the credibility of the huge statistical and financial improvements that have been made since Metrowater’s introduction.
In its first year of operation water losses reduced from 17% to 13%, and it achieved an A grading for water supply across Auckland City for the first time (Kerr, 1999, p.2).

However, there are two significant disadvantages with the introduction of LATEs. As mentioned previously LATEs must pay tax, and secondly, “there is less opportunity for the community to influence the management and operation of its water utility” (Consumer, 1998, p.31). Consumer also warns: “LATEs are a kind of ‘corporatisation’, and are seen as setting the organisation up for privatisation” (1998, p.31).

Like Watercare Services, Metrowater has consistently been the subject of much controversy over its user-pays system for water and wastewater services. Much of this is centred on its disconnecting of those who cannot, or refuse to, pay their bills136. Its wastewater charges in particular have been unpopular, with a growing boycott and hundreds of submissions being received by the Auckland City Council on its annual plan on Metrowater (Perry, 1999). On two occasions, Auckland City Councilors narrowly voted in favour (by 11-9 and 14-11) of retaining Metrowater rather than responding to public pressure and putting the company back under direct council control and taking payment for water from rates again (Orsman, 1999).

Controversy culminated in Metrowater taking two defendants to the High Court in December 1999 over its right to disconnect those who do not pay their water bills137. The judge dismissed the defendants’ claim based on a common-law principle that Metrowater, as a monopoly supplier, had a statutory obligation to provide them with water in return for a reasonable price (Dearnley, 1999e). The judge’s ruling was particularly significant in light of the content of this thesis in general, as he stated that he was “doubtful as to whether any such obligation exists, but even if it does, there is no doubt in my mind that the supply of water is a commercial activity. Indeed, a LATE is required as is an SOE to operate as a successful business (s.594Q Local Government Act)” (Salmon J. judgement, emphasis added). The common-law doctrine of “prime necessity” to which the defendants referred had been supplanted by the Commerce Act (Dearnley, 1999e).

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136 The Water Pressure Group’s ‘turn-on squads’ even reconnected and concreted over several water pipes of homes disconnected for not paying the charges (Orsman, 1999).
4.4.2 Contracting out to the private sector

In 1989 70% of council services were provided exclusively by "in-house" staff (B. Anderson, 1997, p.19). Six years later this had dropped to 25% (B. Anderson, 1997, p.19). With the development and increasing use of stand alone business units (SABUs), LATEs, various forms of contracting out have become more widespread at the local government level, "with reported savings between 15% and 60% of particular operating expenses" (B. Anderson, 1997, p.19). With water supply involving a high level of expenditure compared with other areas such as providing parks and recreation (B. Anderson, 1997, p.19), it is inevitable that this industry would come under review as one that may be more efficiently provided by other means.

The theoretical literature discussed in chapter two suggests that in order to contract out effectively, contracts must be designed carefully "to identify contingencies and to minimise opportunism that may arise from small numbers of tenderers and asymmetric information between the principal and their agent" (Davin, 1994, p.16). When applied to the water industry, contracts ought to be able to specify standards for the provision of fire fighting services, adequate water quality, and be able to guard against under-investment in the infrastructural assets (Davin, 1994, p.16). "Contracting out also ensures that there is a direct focus on the activity as the contract imposes responsibilities, and non-commercial objectives cannot be externally imposed" (Davin, 1994, p.16).

Councils have recently embarked on a significant amount of contracting with the private sector, with all now contracting out at least some parts of their operations (Reid, 1999, p.15). This will certainly have implications for the delivery of water services. This ranges from contracts delivering not only the traditional works services, but also internal administration, planning and regulation in the cases of councils such as Papakura, Queenstown and Rodney (Reid, 1999, p.15). Christchurch City Council recently conducted research into competitive tendering processes and found that 70% of water maintenance and design services are now being provided as a result of a contestable tendering process, and that this figure increases to 90% for water asset construction services (Marshall, 1999, p.1; Reid, 1999, p.15).

\[137\] It should be mentioned that Metrowater paid part of the defendants' legal costs in order to use them to confirm its right to charge them for wastewater (Dearnley, 1999d).
Manukau City Council has chosen a SABU\textsuperscript{138}, and a variation of this has also been proposed by the Wellington Regional Council. In the case of Manukau, the SABU model in practice means it is "a separately accountable unit within the council, focused on its purpose but subject to greater political control than either a LATE or a franchise would be" (\textit{Consumer}, 1998, p.32). The proposal in Wellington, as (briefly) outlined in \textit{Executive Summary: Review of Water Supply in the Wellington Metropolitan Area} (Ernst and Young, 1997) is for a single organization responsible for water supply, treatment, transmission, distribution and retail. This would replace the current situation where the Wellington Regional Council collects, treats and transmits water to four city councils, which are in turn responsible for the distribution and retail of water to their consumers (Ernst and Young, 1997, p.iii). Similar moves are also being discussed in New Plymouth, with a single delivery agency being responsible for water and wastewater services for the whole of the Taranaki region. Marshall (1999, p.3) predicts that cooperative partnerships such as this will become more widespread.

\textbf{4.4.3 Public/private partnerships}

There are also many examples of public/private partnerships - water and wastewater are now provided under a franchise agreement in Papakura, and the Wellington City Council has entered into a BOOT (build, own, operate and transfer) deal for the operation of its new wastewater plant (Reid, 1999, p.15). The BOOT deal means that assets are owned and operated by a private company before being transferred to the public authority after an agreed period, generally ten to fifteen years (KPMG Peat Marwick, 1995, Glossary).

One such system being used by the Papakura District Council is a franchise agreement, entered into in July 1997 with United Water (owned by the British company Thames Water and the French "water services giant" [Keane, 1999, p.6] \textit{Compagnie Générale des Eaux}) to run its water services for the next thirty years\textsuperscript{139}. For a one-off fee of $13 million, United Water has bought the right to control every aspect of water services' delivery (\textit{Consumer}, 1998, p.31). Papakura District Council was the first local

\textsuperscript{138} See Manukau City Council's '\textit{Water and Wastewater Discussion Document}' for a very informative and detailed discussion of the various options available to councils in general.

\textsuperscript{139} The initial term is 30 years, but there is provision for renewal of another 20 years (\textit{Report of the Controller and Auditor-General}, 1998, p.12).
authority in New Zealand to adopt such an approach (*Report of the Controller and Auditor-General*, 1998, p.12)\(^{140}\).

The Papakura agreement is essentially a facilities maintenance and operations contract under which United Water is responsible for all aspects of delivering water and wastewater services (including administration and billing) within the Papakura district. An important aspect of the Franchise approach is that the water and wastewater networks ("the assets") remain in public ownership (*Report of the Controller and Auditor-General*, 1998, p.12).

The ‘Papakura agreement’ (as it is known) effectively froze prices for two years, until July 1999. Ironically, when United Water announced its price increase of 11.3\% in June 1999\(^{141}\), it cited increases in its payments to the LATE, Watercare (see above), as the primary reason (K. King, 1999, p.27). At this time, United Water is allowed to increase its prices up to the Auckland Average Price. Both the *Report of the Controller and Auditor-General* (1998, pp.22-23) and *Consumer* (1998, pp.31-32) express some concern that this is a risk for ratepayers\(^{142}\).

The company doesn’t have to gear price rises to the needs of its customers or the demands of its own commercial activities...If United Water picks up another contract in the region, it will have the ability to manipulate the Auckland Average at a steadily increasing rate, thus rendering it meaningless (*Consumer*, 1998, p.32).

Another way of looking at this same issue of pricing is that Papakura residents may end up paying for their water on the basis of how well other Auckland Councils run their operations (Campbell, 1997, p.7).

Like Watercare Services and Metrowater, United Water has also been plagued by controversy. According to the Papakura District Council Mayor, it has breached clauses

\(^{140}\) The franchising of the Papakura District Council’s water and sewerage system appears to be one of many services which have been contracted out, following maintenance and drainage, Animal Control Services, parks and reserves maintenance, resource management, building control, environmental health and engineering services (A. Turner, 1999, p.1-2). The Council now employs only 22 staff (excluding library services, which are currently under review) to provide for the needs of 13 361 ratepayers and approximately 41 600 residents (A. Turner, 1999, p.2). It has been reported that these moves to contract out may have “backfired” on the Papakura District Council, as residents may soon be facing 30\% rate increases as a result of the preference for contracting out (Kara, 2000).

\(^{141}\) This means a price increase of $48 per year, to $474, for an average household using 190 000 litres of water (Dearnley, 1999a).

concerned with water quality, infrastructural assessments, tariffs and supply of information, contained in its thirty year franchise arrangement (Dearnley, 1999c). This highlights some of the concerns raised about franchise arrangements in chapter one, for example, the obvious advantage the incumbent, United Water International, will have at the time of contract renewal, because of its ‘insider knowledge’, gained through its term in charge of Papakura’s water services. Although United Water is admittedly still at the early stages of its contract, it seems that another theoretical insight has already occurred in practice: “The franchisee’s incentives are to reduce quality in whatever ways are possible” (Davin, 1994, p.16). “With long-term contracts competitively driven, efficiency incentives are only at their sharpest at contract renewal time, and are blunted in the intervening periods” (Davin, 1994, p.16).

4.4.4 User charges

It has been very difficult to ascertain how widespread the sensitive issue of user-charges is in relation to water services, but most analysts suggest that, apart from those examples used above, it is not yet widespread. The Bridgeport Group study found that that presently a there was a combination of charges – uniform annual charges and meters – being used by rural, rural/urban, urban and mixed councils for residential and commercial services, with metering common for industrial services (1998, p.26). However, meters are being considered by all forms of council for use in the future for all three services (Bridgeport Group, 1998, p.26).

However, Marshall raises two interesting points about the efficacy of user-charges as a means of reducing water consumption (1999, p.4). In some areas of New Zealand “restricting demand is not an issue” as water is plentiful, while in others, where water is in high demand, “some local authorities have found metering a useful tool to manage demand and promote conservation” (Marshall, 1999, p.4).

143 Papakura’s Council originally became concerned when the district’s water quality rating fell from B to D (Dearnley, 1999c). However, as yet the council has not cancelled the contract.

144 These categories represent demographic and geographic characteristics. A rural council is a territorial authority with an urban population of under 15 000; a rural/urban council is a large metropolitan territorial authority (with a population over 20 000) with large rural areas; an urban council is a large metropolitan territorial authority, including its suburbs and outskirts; and finally, a mixed council is a territorial authority with no single towns with a population over 20 000, but “whose total urban population is estimated at over 15 000” (Bridgeport Group, 1998, p.6).
4.5 The Water, Wastewater (Sewerage and Tradewaste) and Stormwater Review

It is clear that the fragmentary nature of the water services’ legislative framework is in need of review and clarification. At least five years ago this was realized by central government, as in the 1996 post-election briefing to the incoming government it was stated that a review of water and wastewater provisions in the Local Government Act had already been underway for approximately two years. Its purpose was to “establish whether a holistic review of the legislation is needed, or whether minor amendments to the legislation are all that is required to remove impediments to greater efficiencies” (New Zealand Treasury, 1996, p.15).

Another two years later, in November 1998, the then Enterprise and Commerce Minister, Max Bradford, announced yet another review of water services. “The review is about finding the best way of managing and maintaining water and wastewater infrastructure to get the services we all need” (Bradford, 1998). The review team had an interdepartmental scope, including members from the Ministry of Commerce, Ministry for the Environment, Department of Internal Affairs, Ministry of Health and the Department of the Prime Minister and Cabinet. It was expected that the review would include consultation with local authorities and other interested parties involved in the provision of water services.

However, in July 1999, the structure of the review changed significantly, with local government taking it over, and asking for fifteen to eighteen months to “tackle reform without being directed by central government” (K. King, 1999, p.28). It is now up to local government to propose solutions to the existing fragmentary framework. One reason for this may have been that, because of the three main examples cited earlier (Watercare, Metrowater and United Water), water was becoming a highly political issue (Barnes, 2000). “Some might say that the Government has passed Local Government a somewhat poisoned chalice. Others worry that the task is too big and that Local Government is not adequately resourced for it” (Cayford). However, local government has been provided with several issues to consider: customers having access to safe water

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145 Those involved in the consultation process include Local Government New Zealand, many Councils, the Watercare Shareholder Representative Group and an Auckland Water Forum, designed to consider issues particularly relevant to the Auckland region (Cayford).
services at a reasonable cost; efficient and environmentally sustainable delivery; investment in assets and water quality; clear lines of accountability; and, the inclusion of incentives for innovation (K. King, 1999, p.28). At present, however, the government does not consider the water review a matter of priority (Barnes, 2000), and so it will be interesting to see how the review is conducted, and the suggestions that arise from it, in the immediate future.

4.6 Conclusion
It is clear today also that local government still regards water services as an area in which it still has authority. However, a significant transformation has occurred in the way in which they are now provided, with an increased reliance on more commercial approaches being taken through LATEs, franchising and contracting out various elements of water services. In other words, although local government may believe that it has a responsibility to oversee the provision of water services, it no longer feels the need to directly control them itself. For this reason, complete privatization seems unlikely to occur in the near future:

Local authorities regard water and wastewater services as core activities, and privatisation would be seen as an interference by central government in local autonomy and accountability. Therefore, although privatisation has much to commend it, its implementation would not be easy, if it could be achieved at all (Davin, 1994, p.17).

These recently introduced concepts – contestability, contracting out, franchising, privatization and user-pays – which have been examined in this chapter, and also in the rest of the thesis in relation to piped water supplies, do not accord with the traditional "governance function" (Reid, 1994, p.2)146 performed by government. The introduction of commercial practices into areas that have traditionally been public, questions not only the role of the state in providing those goods or services, but also the relationship between the state and its citizens. Whether the governance function, in which collective means (through governmental processes) are used to determine the values a particular community holds, can still be achieved after the commercialization of services such as

146 "Governance function" is a relationship between local government and citizens in which the former "offers a means of protection and an opportunity for the exercise of basic democratic rights" (Reid, 1994, p.2).
piped water supplies is a very difficult issue to resolve. This point, and the implications that arise from it, are the subjects of the following chapters of the thesis.
CHAPTER 5
THE POLITICAL ECONOMY OF WATER

As mentioned in the introduction, it was not the sole intention in this thesis to focus on whether or not the privatization of water supplies has been successful in meeting its objectives, or whether public or private control is more efficient. However, in this final brief chapter, I will consider the extent to which privatization has met the objectives outlined earlier. In the case of the privatization of water services, as seen in chapters three and four, many potential advantages of private control are discussed in terms of the personal benefits individuals may gain, through greater efficiency, competition, responsiveness and accountability, yet it seems that these benefits may not necessarily be achieved through the introduction of privatization. In addition, it seems that the privatization of water services is an extension of the assumption that they can be treated and allocated in a similar way to that of private goods. However, both assumptions are, in fact, incorrect.

5.1 Has privatization achieved its objectives? 147
5.1.1 Efficiency

As mentioned throughout the thesis, the main justification or benefit given for privatizing piped water supplies is increased technical or X- efficiency ('getting things done at minimum cost'), due to the transferable nature of the property rights involved. Leaving aside for the moment the obvious issue of whether or not this is in fact an appropriate measure to which a formerly public utility should primarily aspire, in the case of water services at least, the practical evidence does not support the theoretical view.

It appears that the tendency of private water companies to achieve superior levels of efficiency to publicly provided water is simply not correct. For example, after reviewing several studies which attempt to isolate the significance of public versus private funding and provision (Figure 5.1), Donahue, although certainly not claiming that public water utilities are more efficient, concludes that "there is no tendency for private water utilities to be any more productive" than their public counterparts (1989, p.75):

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147 The issue of accountability is covered in the next chapter, so it will not be discussed here.
"Despite the presumptively superior incentives of the profit-seeking form of organization, private water utilities, on average, are no cheaper than public ones" (Donahue, 1989, p.76, emphasis added). A more recent review on the same subject also supports Donahue's research (Bhattacharyya et al., 1994, p.9). Referring back to the economic approaches to politics presented in chapter two, the conclusion of Bhattacharyya et al. is especially significant: “it should be emphasized that the argument of public choice, or property rights, theorists that privatization of public enterprises will result in higher efficiency has not been unanimously supported by the existing empirical studies in the literature” (1994, p.9).

At this point, some criticisms must be mentioned about the importance placed on efficiency by advocates of privatization. The belief that ownership alone determines the performance of enterprises appears to be an idealized assumption. Property rights theory does not recognize the influence that other factors may have on performance. These factors include considerations of size, centralization, hierarchy, leadership, the incentives offered in different types of contracts (whether public or private), and taking the market (in which profit plays a crucial role) as the standard against which to compare public enterprises (Starr, 1988, p.8). This last point is critical in evaluating private and public organizations, because in many cases public organizations have other obligations to meet than simply making a profit or performing the most cost-effectively.

In addition, the emphasis placed on property rights or ownership as the major factor in determining the efficiency of enterprises is also questionable. In order to test this proposition, theorists should compare enterprises which are owned by their managers
with those that are not. "It would then expect small owner-managed firms to be efficient, *but big private as well as public enterprises – all those with salaried directors – to be equally inefficient*" (Stretton and Orchard, 1994, p.92, emphasis added). If incentives, such as promotion or pay bonuses, are argued to align the private managers’ interests with that of the enterprise’s owner, then this must also be the case with public managers.\(^{149}\)

Having established that there is actually no significant difference in technical or X-efficiency between public and private suppliers of water utilities, it is worth re-quoting Stretton and Orchard’s qualification of the meaning of efficiency in relation to public enterprises: “public enterprises often have multiple purposes and ought to be judged by the efficiency with which they serve all their purposes, not just one of them” (1994, p.84).

While efficiency may be easily determined through analyzing the level of costs involved in producing something (which, in the case of water, was seen to be no different between public and private suppliers anyway), other non-quantifiable considerations may be just as important. For example, Stretton and Orchard use the example of three suburban trams from different countries to illustrate this point (1994, pp.86-87). Considering various factors\(^{150}\) they suggest that other considerations are also important. These are not quantifiable in narrow terms of efficiency: but consider effectiveness, social purpose, meeting the needs of all individuals, and trying to achieve a balance between competing interests (for example, in the case of water, between consumers and those in control) (1994, pp.86-87).

### 5.1.2 Consumer responsiveness

Another of the main objectives of privatizing is to allow consumers freedom of choice in the market for the goods they wish to purchase. It is argued that this will inevitably lead to increased quality, decreased cost and a greater overall sense of responsiveness to consumers.

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\(^{149}\) See Stretton and Orchard (1994, pp.92-113) for further excellent discussion on related issues.

\(^{150}\) These factors, summarized, are: the number of drivers on each tram; the cost of collecting fares; the level of wages in each country; differing urban settings; costs of running the trams; and whether aged and handicapped people could use them (Stretton and Orchard, 1994, p.86).
As Dowding explains, in the context of 'increasing consumer choice', choice is usually taken to mean having more than one option: “choice requires at least two positive options, a and b, rather than the negative choice between alternatives a and not-a” (1992, p.303). Thus, consumers make choices in the market between alternatives that they do or do not want, that is, the market’s value is as “a preference-revealing device” (Dowding, 1992, p.312). Having alternatives is valuable because it ensures that a wide range of preferences can be catered to. Markets are valuable in this sense because consumer choices (in a perfect world) retain control of the quality and quantity of goods and services available: in theory, successful goods sell, while unsuccessful goods are withdrawn from the market (Dowding, 1992, p.313).

‘Consumer choice’ is usually promoted as a desirable consequence of privatizing utilities. However, in the water utilities’ ‘market’ the value of such alternatives is really quite irrelevant. There are no realistic alternatives or choices between suppliers. In addition, consumers are more likely to want a utility service that is simply “reliable, safe, and value for money” (Ernst, 1994, p.191), rather than one in which there are degrees of choice, dependent on quality and cost, as with other consumer products. This issue is raised by Dowding, who argues that: “Advocating markets on the basis that they increase consumers’ choice is doubly wrong: firstly, because choice is not necessarily something to be valued and secondly, because choice itself is not what is valuable about markets” (1992, p.312, emphasis added).

First, markets give consumers a wide range of choices. However, it is not the choices themselves which consumers value, but rather the goods, services or activities that the choices deliver. Because competition between water utilities is extremely unlikely to emerge in the foreseeable future, and they are likely to remain monopolies, in effect, consumers do not have a positive choice, only a negative one between a (water) and not-a (no water).

In the Britain and Wales, it could be argued that consumers do have a choice, albeit an expensive and perhaps not very practicable one. Although consumers of water services are essentially ‘captive’, in that they receive services from a monopoly supplier,

151 See also Dowding (1992, pp.303-307) for further interesting discussion on the meaning of ‘choice’ and ‘increasing choice’.
they do have two options (Foster and Braddon, 1996, p.294). First, they could move to another location. Second, if a customer wishes to receive water from a company in another area, the company has an obligation to supply water to them, as long as the customer pays for the required pipelines and installation costs (Cowan, 1997, p.86). However, this cannot be considered a real choice because the personal costs and difficulty involved would be greater than the worth of the end savings. Dowding therefore suggests that in “any particular area of public policy the usefulness of the market must be examined in relation to the ease of shifting from one alternative to another, the costs of making decisions and the ability of individuals to have clearly defined preference schedules” (1992, p.314, emphasis added).

Second, markets are valued because increased consumer control is argued to be a consequence of increased consumer choice. Because they are usually monopolies, whether public or private, they can become just as “unresponsive [in the private sector] to the wishes of consumers as the public enterprises were thought to be” (Buttle, 1996, p.29). Because there is no increased consumer choice (because there is no choice in a real sense at all), greater control cannot be achieved. Control must be sought through other means. As mentioned in chapters three and six, it is unlikely in Britain that those who bought shares in the companies when they were sold will ever be able to exert any influence over them, as the majority of the shares are held by large shareholders such as insurance and investment companies. “Thus privatization...has resulted in a society where important decisions are made by those who own and control the former public enterprises” (Buttle, 1996, p.30). This ought to be of obvious concern to all member of the public. As noted by Dowding, “This is precisely the justification for democratically elected bodies’ having oversight of institutions which make public provision” (1992, pp.313-314).

Consumer choice is also argued by proponents of privatization to increase individuals’ freedom. In spite of what those in favour of privatization believe, it appears that privatization has actually led to a loss of freedom for members of society (Buttle, 1996, p.29). Individuals are certainly freed of external interference (in the form of government), forcing them to receive goods and services they do not want. However, in the sense of having the freedom to participate fully in the normal life of the community,
freedom is lessened when services are transferred to the market and some do not receive them. “Such freedoms do not come from the minimalist state, they must be positively conferred by the state” (Kingdom, 1992, p.67). It also seems extremely unlikely that any individuals would choose to exercise the former type of negative ‘freedom’ and not receive water services, which are a basic necessity. In this way, freedom is in direct conflict with market principles. Democratic freedom is exercised in order to encourage participation in the construction of the type of community desired by its citizens, not to encourage them to leave or refuse to receive benefits if they are dissatisfied with the status quo.

5.2 Water services are not a marketable commodity

The rationale for privatizing water services is based on the assumption that they can be exchanged in the market on a similar basis to other goods. This view in turn relies on an assumption that water services are a private good, that is, including “rivalry in consumption and the ability to exclude non-payers” (Kerr, 1998b, p.2).

There are norms structuring market relations, that is, the mode of exchange implemented by privatization, that govern “the production, circulation, and valuation” of such private goods, defined as being “goods that are properly valued as commodities and [are] properly produced and exchanged in accordance with market norms” (E. Anderson, 1993, p.143). There are five main features that readily determine whether or not a good fits into the market: it is more fitted to ‘exit’ than ‘voice’, it is impersonal, egoistic, exclusive and want-regarding (E. Anderson, 1993, p.145). In addition, there is another (mentioned above) that is also vitally important for market-based transactions to occur effectively: choice. By applying E. Anderson’s concept of the economic good or commodity to water services, a conclusion can be reached about the efficacy of placing them in a market context, therefore ultimately determining whether privatization is appropriate.

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152 This seems to be a reference to social rights, which are discussed in the following chapter.
153 Although E. Anderson considers the first five features only generally with reference to civil society and political goods, concentrating on their application to personal relationships (1993, pp.150-158), they seem particularly relevant and useful for determining whether or not water services are a marketable economic good.
5.2.1 ‘Exit’ versus ‘voice’

Very closely related to the issue of choice, or lack thereof, are Hirschman’s well-known concepts of ‘exit’ and ‘voice’. In his discussion on the differences between markets and politics, “conceived of as different systems of resource allocation” (Pierre, 1995, p.72), Hirschman suggests that “exit belongs to the former realm, voice to the latter” (quoted in Pierre, 1995, p.72). Exit means simply leaving one supply source in favour of another, and voice means protest or participation to encourage better performance. These concepts can be applied to the analysis of water utilities, leading to some significant revelations.

The use of exit and voice depends on the personal costs involved and the expected value of taking action. Water utilities are public services characterized by low exit and strong voice because “exit for those dissatisfied with a service is impossible or expensive, but the scope for voice is considerable” (Paul, 1992, p.1052). Voice as a means of indicating dissatisfaction with the service has to be used because water companies are usually monopolies, there are no substitutes for water services, and product differentiation (providing different qualities of water through one set of pipes) is impossible. Therefore the public gets a uniform level of service. There is an element of the free-rider syndrome operating in exercising voice: “Even if only a segment of the concerned public is capable of exerting voice, everyone stands to benefit from such action due to the externality effect” (Paul, 1992, p.1053).

The use of only voice with regard to water utilities reinforces their status as a non-commoditable good, therefore not effectively exchangeable in the market and not readily integrated into the privatized model of citizenship, discussed in the next chapter. With voice being the only means of indicating citizens’ views, it is imperative that the public has an influence on the decisions made by those managing public utilities in order to be able to exercise voice. Options include encouraging the public to become shareholders in the public utilities and facilitating public participation in the regulatory process, thereby ensuring some control over management and performance (Paul, 1992, p.1056). Where

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154 Paul states that water utilities are characterized by large economies of scale and high barriers to entry (thus preventing competition and therefore the use of exit) and low differentiability of services and low or moderate information barriers (thus encouraging the use of voice) (1992, p.1052).
direct participation in decision making is difficult, the public ought to be consulted or invited to participate in matters affecting them (Paul, 1992, p.1056). “Public hearings or advisory panels for the revision of rates in utilities are a good example of this approach” (Paul, 1992, p.1056). However, as will be seen in the next chapter, the likelihood of these moves happening is fairly minimal under current structures.

While voice is the only option available to consumers of water services in theory, in practice it is not as simple to implement many of the measures just mentioned. Pierre also recognizes this, suggesting that encouraging the use of ‘voice’ in a market is somewhat incongruous and illogical, since the latter is supposed to rely on ‘exit’ as a means of signaling preferences (1995, p.72). Thus, the use of ‘voice’ in a market cannot be in accordance with either market or democratic processes:

In fact, introducing the concept of the (public) market in the context of public services may mean that an established channel of communication between the public and the private sectors — the democratic process — is largely abolished and replaced by the silent communication typical of markets (1995, pp.72-73).

Voice is usually regarded as belonging to the political sphere, with exit belonging to the market. Since voice is the only option for citizens with regards to water services, it seems logical to suggest that they be located in the sphere recognizing this, that is, the public, rather than the private, sphere. E. Anderson suggests that this is crucial for citizens to achieve freedom through democratic principles: “Their freedom is the power to take the initiative in shaping the background conditions of their interactions and the content of the goods they provide in common” (1993, p.159).

5.2.2 Impersonality of market relations

The “silent communication” referred to by Pierre is an extension of one of E. Anderson’s criteria for economic goods, that of the impersonality of market relations. “Each party to a market transaction views his [sic] relation to the other as merely a means to the satisfaction of ends defined independent of [sic] the relationship and of the other party’s needs” (E. Anderson, 1993, p.145). In the market, satisfying the consumer’s wish to consume is the only goal, and no further considerations about the consumer are necessary.
or relevant to the exchange: "Money income, not one’s social status, characteristics, or relationships, determines one’s access to commodities" (E. Anderson, 1993, p.145). Applying this type of mercenary logic to water utilities, which are a basic necessity of social and economic life, must undermine ideals of citizenship, because citizenship suggests a concern with the welfare of all members of the community, not just one’s own well-being.

5.2.3 Market relations as egoistic and exclusive
Related to the impersonal nature of economic goods, is their egoistic nature. Their egoism resides in the fact that “each party defines and satisfies her interests independent of the other [in a market transaction]” (E. Anderson, 1993, p.145). This can occur only with economic goods that are both exclusive and rivals in consumption, that is private goods (1993, p.145). As seen in Ostrom and Ostrom’s classification in chapter one, water utilities can be regarded as a toll good, characterized as being potentially excludable, but also jointly consumable. Because water utilities are not only important on an individual basis, but also on a societal level (see discussion below), it is problematic to strictly classify water services in this way.

5.2.4 Commodities are ‘want-regarding’
Economic goods are also characterized by being ‘want-regarding’, that is, the market responds to demands. No distinction can be made between ‘wants’ and ‘needs’ in the market (Self, 1993, p.255). As with the impersonal nature of the market, considerations about the consumer are unnecessary and irrelevant for a successful exchange to occur: "Since it offers no means for discriminating among the reasons people have for wanting or providing things, it cannot function as a forum for the justification of principles about the things traded on it” (E. Anderson, 1993, p.146, emphasis added). Water utilities can be regarded as both ‘needs’ and ‘wants’. Access to adequate water services is usually regarded as a basic need ensuring a quality life for all individuals, but other uses, for example, watering a garden, are essentially ‘wants’. The market equipped only to

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155 Pierre uses the term ‘public market’ to mean three closely related concepts: the commodification of public services, new forms of production and distribution of public goods and services, and the redefinition of citizens as beneficiaries of these services into customers or consumers (1995, p.71).
recognize wants, not needs, therefore the introduction of privatization means that "human needs are translated into individual wants" (Ernst, 1994, p.190), and subject to the laws of the market.

5.3 The public utility concept

5.3.1 The threat to the public utility concept

Utilities have traditionally been provided to and for the public because they are not marketable goods. Accompanying the earlier view that water services can be regarded as a marketable commodity, privatization is an obvious threat to the public utility concept. With privatization encroaching into more and more traditionally public services and into public utilities themselves, the public utility concept itself is being questioned. For example, commenting on the unpopularity of privatizing water in the United Kingdom, Thatcher directly attacked the public utility concept. She argued that, while water was certainly something provided by nature, it required human-made structures to transmit it to consumers:

Much emotive nonsense was talked along the lines of 'look, she's even privatising the rain which falls from the heavens'...[T]he rain came may come [sic] from the Almighty but he did not send the pipes, plumbing and engineering to go with it {quoted in Huby and Anthony, 1997, p.208).

It has been argued that the public utility concept is now quite outdated. If utilities are goods in the same sense as other marketable goods and services, then there is little justification for them to remain in the public sector. For example, "public utility services are, first and foremost, commodities that can and should be traded like any other product in the market economy" (Ernst, 1994, p.36). Thus, any need to consider their former status as a public utility is quite irrelevant. There should also be no more reason to consider the well-being of consumers than there is with other marketable goods (Ernst, 1994, p.37). The only obligation that utility services' providers should have is a customer-oriented approach. Wider considerations contained implicitly in the public utility concept, such as access, equity and distributional impacts, are deemed unnecessary.

156 This qualification echoes economist's discussions on the definition of public and private goods. A good is exclusive if its benefits are limited to the purchaser and, if given away, demonstrates rivalry in that the
5.3.2 The continued relevance of the public utility concept

The market, which distributes private goods, is unlikely to be the most appropriate mode of provision for water services. In chapter one, it was established that technically, water services are a toll good, and include both private and public properties. Thus, the provision of toll goods, such as utilities, roads, parks, and libraries, involves a paradox: compared with pure public goods, exclusion is possible, “but on the other hand it is not socially advantageous to exclude citizens since the marginal cost of consuming the goods is nil, or very little” (Lane, 1985, p.20). This highlights the distinctive feature of many toll goods which are said to be natural monopolies, the situation that occurs when, as the number of users increases, the cost per user decreases, making a single supplier most economical (Savas, 1987, p.47; Lane, 1985, pp.22-23).

Competition is unlikely to emerge in divestment of a public water utility, primarily because it is a natural monopoly (Lane, 1985, p.21). Yet this is not the only difficulty caused by market allocation of toll goods. Lane argues convincingly that it is virtually impossible to employ a differential pricing schedule to accurately represent different preferences, and an attempt to do so may in fact create “considerable social costs” (1985, p.22). “If the price is varied over groups of citizens in a manner that does not correspond to the differences in citizens’ preferences, then private cost may be larger or smaller than social cost” (Lane, 1985, p.22).

Taking both the previous paragraphs and the discussion of water services as included in the group of non-marketable goods into account, water services should more appropriately be included into the class of public utilities or “political goods” (E. Anderson, 1993, p.159), recognizing their importance to citizens. Public utilities, for example, water, electricity, telecommunications and gas, are usually regarded as providing an essential service to the public, for the public good. They also originated to prevent the monopoly abuse of market power in firms providing essential services.

Yet, contrary to what some may think, several social and economic characteristics of water utility services, which initially contributed to their public status, are still present. Although mentioned in chapter one, I believe the arguments are worth briefly

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first owner can no longer use it (E. Anderson, 1993, p.145).
re-emphasizing here also. First, perhaps the most important overall reason for the existence of the public utility concept “is that it has not only business goals but also public-interest responsibilities” (Miller, 1995, p.1, emphasis added). Public utilities provide essential services to the community and operate according to accountable and democratic processes. Providing goods such as water collectively expresses the idea that they are provided from the community for all its members, not just those who are able to pay for them. “To attempt to provide these goods through market mechanisms is to undermine our capacity to value and realize ourselves as fraternal democratic citizens” (E. Anderson, 1993, p.159).

Second, they are essential for a reasonable quality of life, contributing to the “physical and social infrastructure of all contemporary societies” (Ernst, 1994, pp.37-38). Third, there is a high inelasticity of demand for utility services, that is, a constant and unchanging level of demand will exist, irrespective of income level, as they are “necessary for physical and social well-being” (Ernst, 1994, p.40). Fourth, public utilities are usually considered to be natural monopolies, that is, there are significant barriers to entry into their ‘markets’: high thresholds of investment, substantial ‘sunk costs’, and the uniqueness of the assets involved (Miller, 1995, p.2). Fifth, positive and negative externalities exist, that is, the costs of production and consumption are not equal to society because even those not directly involved bear their costs or benefits.

5.4 Conclusion

It appears that no area of the public sector can escape from the influence of the market. In spite of the prevailing view, held by those in a position to implement policy, that water services are no longer a public service, but can be a source of profit, the arguments in favour of the public utility concept are just as strong and convincing today as they were when the concept was first conceived. It is also important to realize that simply transferring water services to the private sector does not necessarily change people’s views on the legitimacy of such a move. Holtham suggests that privatization lacks legitimacy as the public still largely remains “obstinately unpersuaded of its benefits” (1998, p.386). Therefore it seems that water services are still likely to be regarded for

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Ernst concedes that two other necessities of life, food and shelter, also share the essentialness characteristic with public utilities (1994, p.53) yet are traded as commodities on the market.
some time yet as a 'public service', even when privatized, for the reasons described in this chapter.
CHAPTER 6

THE DEMOCRATIC POLITICS OF WATER

Underpinning the decision over whether to place water services in the public or private realm must be a concern with what that placement means in a wider context. The “random stewardship of the free market” (Ernst, 1994, p.53), which complete and, to a certain extent, partial privatization invariably unleashes, does not account for the fact that public utilities have an immense effect on the quality of people’s lives, both at a household and at a societal level. As well as incorrectly applying the logic of the market to water utilities and equating them as being like any other economic good (as seen in the previous chapter), privatization also contains an implicit redefinition of the users, that is, citizens, of privatized goods and services. For this reason, attention in this final chapter will now turn to examining the impact privatization of water services has on ideals of citizenship and democratic politics.

Privatization redefines the concept of citizenship, commodifying it in a similar fashion as it does with equating water services as being an economic good. This is achieved primarily by supplementing and even replacing the notion of citizenship with an alternative based primarily on individuals’ consumption, which can be called privatized citizenship (Walsh, 1995, p.xvi). “In its extreme form this view reduces welfare to a commodity, and the delivery of services to shopping at a supermarket” (Deakin and Walsh, 1996, p.33). Privatized citizenship can also be regarded as an extension of the economic approaches to politics’ belief in the primacy of the individual, rather than society. Therefore, in addition to examining citizenship and democratic politics with reference to privatization, this chapter will also counter the arguments presented in chapter two that contributed to the construction of the policy of privatization in the first place.

6.1 Citizenship and essential services

Before discussing the political implications of this transformation with reference to water utilities, it is important to have an understanding of what citizenship generally and more particularly, social citizenship entail. There is an extensive amount of literature available
on both citizenship and social citizenship, however, for present purposes an in-depth
analysis is unnecessary and discussion will therefore be relatively brief.

6.1.1 Citizenship
Common definitions of citizenship generally highlight individuals’ participation in some
form of political community, and the entitlements and obligations associated with such
membership. Implicit in definitions of citizenship is the notion that citizens have equal
political rights and freedoms, and thus have an equal right to participate or be represented
in governmental decision making. For example: “A citizen is, most simply, a member of
a political community, entitled to whatever prerogatives and encumbered with whatever
responsibilities are attached to membership” (Walzer, quoted in Pierre, 1995, p.62).
Dagger’s definition adds an appreciation of the types of activities undertaken by the
citizen in order to promote the common good: “If citizenship is a public vocation, then it
carries with it a responsibility to act with the interests of the community in mind...This
means...that the citizen is expected to use his [sic] office not to accomplish his own ends,
but to further those of the public” (1981, p.718).

The following discussion in this chapter concentrates on substantive citizenship,
rather than formal citizenship. The former is “an array of civil, political, and especially
social rights, involving also some kind of participation in the business of government”,
while the latter incorporates (as the name suggests) formal membership of a nation-state
only (Marshall and Bottomore, 1992, p.66). Substantive citizenship is the most relevant
to considerations of privatization, as it will be suggested that water services are most
appropriately considered as part of the framework of social rights included in social
citizenship, rather than as a commoditable good utilized by the privatized model.

6.1.2 Social citizenship
An extension of the concept of citizenship is the modern idea of social citizenship. While
civil and political rights are the focus of the former, the latter also contains social and
economic considerations. The following definition of social citizenship illustrates well
what is meant by this term: “being a citizen means not only being able to participate in
the political life of one’s society, but also being able to participate in the standard
lifestyle and activities of one’s society” (Fabre, 1998, p.119). This is a significant
challenge to the idea of citizenship incorporating civil and political rights only, as the
introduction of wider considerations implies that there may be a right to either welfare or the resources which enable it to occur (Plant, 1992a, p.16). That is, in order to become a full member of a society, one must enjoy the same quality of life as others in the society. If outcomes produce inequality, they ought to be supplemented and/or modified by rights conferred by social citizenship. For example, “Social citizenship requires a certain level of bureaucracy and state intervention to uphold rights of equality against the tendency of the market to create economic inequality” (B. Turner, 1986, p.109).

6.1.3 Social rights

Much of this social citizenship conception originates from T. H. Marshall’s well known essay, *Citizenship and Social Class*, in which it is argued that citizenship rights are the product of an historical process of social development. Thus, the scope of legitimate citizenship extends in a gradual process (D. King, 1987, p.165) 158. Marshall’s interpretation of citizenship has three dimensions, with the third, social rights, being the essential component of social citizenship. The three sets of rights reinforce each other, with social rights in particular enabling individuals to exercise their political and civil rights on a par with others (Bellamy and Greenaway, 1995, p.470). These dimensions are as follows (Marshall and Bottomore, 1992, p.8) 159:

- **Political rights**: “the right to participate in the exercise of political power, as a member of a body invested with political authority or as an elector of the members of such a body”;

- **Civil rights**: “the rights necessary for individual freedom – liberty of the person, freedom of speech, thought and faith, the right to own property and to conclude valid contracts, and the right to justice”; and thirdly,

- **Social rights**: “the whole range from the right to a modicum of economic welfare and security to the right to share to the full in the social heritage and to live the life of a civilized being according to the standards prevailing in the society”.

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158 This often occurs as a result of conflict, for example between social classes and war, initiated by those without existing rights (D. King, 1987, p.165).

159 As D. King and Waldron suggest, the three sets of rights are not “rigid or mutually exclusive”, for example, free speech could be regarded as both a civil and a political right (1988, p.419). See their article (1988, pp.419-420) for further discussion.
Significantly, as seen in the previous list, citizenship 'rights' can be regarded as citizenship 'entitlements' (Held, 1991, p.20). “Such entitlements are public and social... They are ‘of right’ and can only be abrogated by the state under clearly delimited circumstances” (Held, 1991, p.21).

The three sets of rights, and citizenship theories generally\textsuperscript{160}, primarily aim to ensure an overall sense of equality between citizens:

The idea is that by providing civil rights, society mitigates the impact of force and violence in relations between people. By providing political rights, it ensures that power is not confined to an elite. And by providing minimum standards in these areas [that is, social rights] the state offsets the vagaries of market processes and corrects the gross inequalities of income distribution arising from the market (D. King and Waldron, 1988, p.419).

By extending the range of social services available to citizens, the state is not necessarily aiming to equalize incomes, but is rather trying to achieve equality of status to ensure that all citizens are considered valued members of a community. Social citizenship’s expansion of “people’s life chances”, that is, through social rights, is achieved by countering existing social inequalities and/or preventing them from becoming extreme (D. King and Waldron, 1988, p.423).

It is therefore important to note that the rationale behind social rights is not aimed at equalizing the wealth or income of citizens, but rather is aimed at equality of opportunity. This ensures that all citizens can participate in political life on the same level as others. “What matters is that there is a general enrichment of the concrete substance of civilised life, and general reduction of risk and insecurity, and equalisation between the more and the less fortunate at all levels” (Marshall and Bottomore, 1992, p.33).

Equality between citizens is therefore very important, as it is basis of participation in political life. If some members of society possess an unequal share in political authority, then there is likely to be great instability, as members struggle to assert their views at the expense of others. Social rights enable inequalities to be rectified and thus

\textsuperscript{160} See D. King and Waldron (1988, pp.426-429) for a brief historical account of the link between citizenship and equality.
enhance social integration and encourage a sense of fraternity between citizens (D. King and Waldron, 1988, p.427).

Social rights also encourage the emergence of economic equality. The idea behind this is that a citizen who is economically dependent can assert their own point of view in the political domain, rather than taking into account the views of others which that citizen relies on for economic survival. “As independent individuals, citizens can have some hope of reaching agreement on the common good; and no citizen would ever be interested in purchasing the vote or opinion of another unless he or she wanted to promote some sectional or peculiar interest of his or her own” (D. King and Waldron, 1988, p.427).

6.2 Challenges to social citizenship

6.2.1 Criticisms of social rights

The inclusion of social rights into the concept of citizenship has been met with much criticism. Criticisms of social rights are typically directed at general welfare provision, and are therefore largely beyond the scope of the thesis. However, they are still relevant here and, because I will argue later in the chapter that water services can be regarded as a specific, albeit very narrow, type of welfare, it is important that they are mentioned.

Some writers question the validity of regarding social rights as a component of citizenship, equal with civil and political rights. First, there is a suggestion that their emergence creates confusion between genuine citizenship rights and the means through which such rights are achieved (Barbalet, 1988, p.68). In this view, social rights are only essential because they enhance the exercise of civil and political rights, rather than being valuable in their own right. For example, “[c]itizenship rights are rights to equal participation in a national community, which is an end in itself. The real income achieved through social rights, on the other hand, cannot be an end but is a means” (Barbalet, 1988, p.68).

Second, social rights, like civil and political rights, are supposed to be universal. Yet individuals’ needs vary greatly depending on their circumstances, and therefore the need and access of individuals to social rights also varies accordingly (Barbalet, 1988, p.69). Therefore universal social rights can never actually exist. The state’s commitment to providing various social services as of right is also “only meaningful in terms of the
particular services themselves” (Barbalet, 1988, p.70). That is, social rights are only conceived in terms of those services currently provided by government.

Third, and closely related to the previous point, many social rights, unlike civil and political rights, are “fiscally conditional” (1988, p.70). They are dependent on the state to guarantee and provide them, something also recognized by Marshall (Marshall and Bottomore, 1992, p.35)\(^{161}\).

Fourth, critics say that the definition of social rights is vague and open to different interpretations. There could be a potentially limitless amount of social rights, “turning more and more of civil society away from private provision for which the individual is responsible towards politically conferred rights” (Plant, 1992a, p.22).

### 6.2.2 Privatized citizenship

Social citizenship is under intellectual attack from an alternative model of social interaction, privatized citizenship. The criticisms of social rights contribute greatly to this alternative concept of citizenship. This is the mode of membership\(^{162}\) implicitly promoted by the economic theories of politics and explicitly pursued with the implementation of privatization. It is essentially based on the ideas outlined in chapter two, for example, individualism, and the idea that through the spontaneous workings of individuals in the market, a desirable social order will emerge.

Privatization significantly alters the way in which public services in general are conceptualized and therefore allocated. Rather than being supplied with such services as a right of being a member of a community (as is the case with social rights and social citizenship), the state’s introduction of privatization reformulates public utilities as merely another commodity to be exchanged on the market like any other economic good. Determining how they are allocated then simply depends on what people are prepared to pay for goods and services. This freedom to choose is the basis of privatized citizenship. “In this sense moral merit or desert does not matter. What matters is the result of a person’s endeavors and whether others are prepared to pay for it. This is the only

\(^{161}\) Marshall said: “The rate of progress depends on the magnitude of the national resources and their distribution between competing claims. Nor can the state easily foresee what it will cost to fulfill its obligations, for, as the standard expected of service rises...the obligations inevitably get heavier” (Marshall and Bottomore, 1992, p.35).
criterion of value in a free society” (quoted in Pollitt, 1993, pp.138-139). This reinforces the importance of individual over the citizen, the consumer over the citizen, and thus the status of privatized citizenship over social citizenship.

While the concept of social citizenship stressed the importance of equality as the primary societal end to be achieved, it has been implied already that privatized citizenship emphasizes freedom. As Burtle notes, “At the heart of the moral vision to which the pursuit of privatization belongs is the vision of a free society” (1996, p.19). First, freedom is valued for its recognition of “the status of persons as rational and responsible agents” (Burtle, 1996, p.21), responsible for the direction of their own lives. Here, a direct reference can be seen to the assumption of individualism central to the economic approaches to politics. Being reliant upon the state (and, in particular, the welfare state) is seen as weakness, as it is viewed as a ‘paternalistic’ institution, treating individuals as if it knows what is best for them. Second, freedom is valued as it is believed to encourage more positive outcomes. Again, a reference to public choice theory and property rights theory can be seen, in the emphasis placed on the efforts of the individual. For example: “A free society is a society in which individuals have an incentive to work hard, to be creative, innovatory, to be productive, efficient and effective” (Burtle, 1996, p.21).

This vision of individuals’ freedom justifies the limitation, through privatization, of the interference of public authorities in their lives. It also strongly informs arguments for privatization. It reflects the well-known concept of negative freedom, that is, the freedom to do whatever is desired without impediment from the interference of other people (or institutions). For example:

A reduction in the extent of the jurisdiction of public authorities is regarded...as an essential requirement of ‘setting the people free’. The main concern, here, is to free people from the power of administrators, officials, interest groups and politicians to interfere with their wants and preferences (Burtle, 1996, p.19).

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162 For lack of a better term, ‘membership’, has been used here loosely, but I am not necessarily suggesting that this model of citizenship is an inclusive one.
People ought to be empowered to make their own decisions, based on their own preferences "rather than having decision made for them by the administrators of nationalized industries" (Buttle, 1996, p.20).

Because freedom is regarded as the most important end to achieve in the privatized citizenship model, there is a different understanding of the place of equality in society. Social justice, which Marshall's social citizenship rights aim to encourage through ensuring equality, is regarded as actually interfering with the individual's freedom to contract and exchange. Even if the result of such exchanges is inequality, no one is responsible for this outcome. In addition, any effort to adjust this outcome, for example through taxation, would be regarded as unjust because it would inevitably involve "an infringement of the liberty or rights" of individuals (Bellamy and Greenaway, 1995, p.471). Defining what social citizenship means by a 'just' allocation is also regarded as problematic, as it could be interpreted in different ways: "either effort, contribution or merit" (Bellamy and Greenaway, 1995, p.471).

In relation to Marshall's three sets of rights outlined previously, in this consumer-based model of citizenship, it is the exercise of civil rights rather than political or social rights which is emphasized. Privatization's proponents have an increase in civil rights in mind when they advocate its application, as transferable property rights (part of the larger class of civil rights) are essential in guaranteeing individual freedom and choice. The conception of privatized citizenship thus equates exercising one's freedom in the market as being akin to exercising one's civil rights:

Insofar as market failure still makes it necessary for the state to take responsibility for providing certain services...then citizens should be guaranteed the sorts of rights they would enjoy as consumers. In other words, the choice and guaranteed service delivery which we get when we contract in a free market ought to be made available to us when we pay for and use public services (Bellamy and Greenaway, 1995, p.472-73, emphasis added).

While civil rights increase in importance, social rights are actively reduced, since they conflict with the more important market-based rights. First, there is a tension between social rights and property rights. As just mentioned, redistributive policies, which realign property rights in favour of more equitable outcomes, are a clear interference in one's unrestricted right to property (Bellamy and Greenaway, 1995,
Second, and obviously influenced by public choice theory, there is thought to be a conflict between civil and social rights. Self-interested political action "can provide the means by which groups can organize and use the coercive power of the state to constrain those civil rights for the purpose of funding various social rights" (Bellamy and Greenaway, 1995, p.472). The exercise of one's civil rights thus comes at the expense of the other rights embodied in the idea of citizenship.

6.3 The limits of privatized citizenship

With regard to the status of citizens in political society, privatization re-conceptualizes the relationship between state and citizens as one between the market and the individual as a consumer. This is the logical extension of the economic approaches to politics, in which it is only with reference to the incentives and self-interested behaviour of individuals that outcomes may be explained. Wider considerations are irrelevant. Therefore the citizen becomes redefined as a consumer, reducing much of the content of citizenship. It is argued that, with reference to privatized piped water services, these implications are an inappropriate extension of the privatized model of citizenship. The privatization of essential services, implementing a kind of privatized citizenship, significantly misinterprets and undermines traditional ideas of citizenship. I argue more specifically later in this section that it seems most theoretically appropriate to consider water services as constituting a social right underpinning social citizenship.

6.3.1 The limits of privatized citizenship and the assumptions of the economic approaches to politics

As discussed in chapter two, implicitly contained in assumptions of the economic approaches to politics, which culminate in the application of privatization, is a philosophical preference for relationships based on simple contractual exchange between individuals. Therefore, individuals are addressed "predominantly through their identity as consumers" (Murdock and Golding, 1989, p.180)\(^\text{163}\). Ideas of collectivity and the

\(^{163}\) An excellent example of this is seen in Britain with the Citizen's Charter (1991), which emphasizes market exchange as being the basis of the public sector: "All public services are paid for by individual citizens, either directly or through their taxes. They are entitled to expect high quality services, responsive to their needs, provided efficiently at reasonable cost" (Prime Minister [John Major], quoted in Walsh, 1994, p.193). The Charter was designed to apply to all public services, whether in public control or not. As many writers have noticed, the Charter refers only to the protection of people's rights as consumers, and there is no concept citizenship, community membership or collective rights or duties (Bellamy and
common good, where “rights and duties [are] owed to or derived from the body politic as a whole” (Pollitt, 1993, p.139) are marginalized and displaced by the alternative identity of the consumer. As mentioned above, this is an obvious and logical extension of the economic approaches to politics’ view of individuals, as it recognizes their capacity to make decisions based on rational self-interest alone. However, the idea that privatization harnesses an individual’s selfish behaviour towards better outcomes by emphasizing his/her identity as a consumer alone is certainly quite doubtful, and may be refuted in several ways. This in turn refutes the legitimacy behind those arguments for privatization’s rationale, which relies on such assumptions.

First, and most importantly, the behavioural assumption that provides the basis of the market’s operation and extension into activities such as water services, formerly managed through political means, is questionable, to say the least. As mentioned in chapter two, this assumption depends on taking individuals’ behaviour, whether as voter/citizen, bureaucrat or politician, as always rational, self-interested and utility maximizing, with virtually no other commitments, for example, to the community or fellow citizens. This view of human nature is illustrated in the following quote: “Eschewing bonds of duty, comradeship, affection, honour or love, he \textit{[homo economicus]} does not have friends or fellows, only rivals and competitors. He \textit{[sic]} is not a member of society and is unmoved by art, sympathy, creativity, altruism or love for anyone but himself” (Kingdom, 1992, p.76). However, numerous studies (cited in Mansbridge, 1990, pp.16-19)\footnote{As just one example, experiments with prisoners’ dilemma and other games which reward self-interest at the expense of the group show that a significant number of participants refuse to take self-interested action “even under conditions of complete anonymity with no possibility of group punishment”} have found this to be a gross overestimation of reality. Other more theoretical examinations (Stretton and Orchard, 1994, pp.92-113; Self, 1993 and 1990; Orchard, 1989; and Kelman, 1987) have also reached the same conclusion.

In spite of what the theorists of the economic approaches to politics would wish society to believe, \textit{homo politicus} (political man or woman) \textbf{does} exist, and does not hold the same selfish concerns as \textit{homo economicus} (economic man or woman), the basis of Greenaway, 1995, p.478; Walsh, 1994, p.193). As such, it is an excellent example of privatized citizenship outlined in this chapter. See in particular, Bellamy and Greenaway (1995), Connolly \textit{et al.} (1994), Walsh (1994) and Lewis (1993).
the privatized citizenship model. The latter is based upon one extremely general motive, self-interest, when real motivations are complex and variable (Stretton and Orchard, 1994, p.127). *Homo economicus*’ self-interest would be likely to impede public-interested political action taken by pressure groups, parties or politicians, however, this does not usually happen. This can be seen in several examples in which individuals compromise their own concerns with those of a common interest. First, with the voter/citizen, voting (irrational because the likelihood of one person’s vote ever determining the outcome of an election is minimal), and the support of policies that may not necessarily directly benefit oneself, for example, public education, conservation, and reducing crime in areas other than one’s own (Self, 1993, pp.234-236). It is important to note that behaviour such as this, seemingly group-oriented, can also be of individual benefit. For example: “Voting is often driven by economic calculations, but voters seem to be concerned more with the overall state of the economy (a social state) than with personal calculations, although no doubt the voter assumes that a more prosperous economy will benefit her” (Self, 1993, p.236, emphasis added).

Second, politicians and bureaucrats are motivated to enter political life for many reasons other than the personal benefits they will supposedly gain. While certainly gaining attention may be a factor in politicians’ and bureaucrats’ decisions, considerations such as the desire to make and implement good public policy are also important (Kelman, 1987, pp.91-93). As Kelman points out, if the political system was really dominated by self-interest, then public policy would reflect only particularized interests (1987, p.86). However, the diversity of policies pursued by government, which usually take into account considerations of what it believes the public interest or common good to be, is contradictory of most of the economic approaches to politics’ assumptions.

Related to the previous point, if the assumptions were correct, then they ought to oppose, not encourage, privatization. Although the normative implications of the theory would seem to support the privatization measures discussed in chapter two, government officials should actually oppose them (Dryzek, 1996; Kelman, 1987; Dunleavy, 1986; Mansbridge, 1990, p.17). By encouraging group discussions, experimenters can raise group cooperation by creating a sense of group identity.
and Self, 1985). It is not very likely that, in the interests of achieving increased power, prestige and personal benefits, politicians and bureaucrats would introduce policies to reduce their own power. For example:

If privatization reduces agency costs then it lowers the funding totals controlled by top officials, and may adversely affect their status ranking vis-à-vis other departments. The shift of staff away from the agency to contractors reduces the manpower [sic] and organizational resources controlled by managers, potentially undermining their existing salary and seniority ratings, and cutting back on their ability to divert public resources towards satisfying private goals (Dunleavy, 1986, p.17).

In addition, someone must direct all the rational self interested utility maximizers towards the common good. He/she cannot be a self-interested rational utility maximizer him/herself because such a “public-spirited policy engineer” would violate most self-interest assumptions (Dryzek, 1996, p.106).

Because there are different concerns in the political and economic arenas, individuals manifest different types of behaviour depending on the ‘role’ they are playing. The citizen, ‘performing’ in a political setting, expresses preferences revealing “their opinions, values, and beliefs regarding the good of society as a whole”, while the consumer, ‘performing’ in a market setting, behaves in a want-regarding and self interested fashion (Lewinsohn-Zamir, 1998, p.1):

In its most extreme manifestation, the consumer/citizen distinction brings to mind the famous story of Dr. Jeckyll and Mr. Hyde. Citizen Jeckyll is a relatively altruistic person who attributes great value to – and is willing to make sacrifices for – the common good, whereas Consumer Hyde is an egoistic maximizer of personal wants and desires (Lewinsohn-Zamir, 1998, p.1).

The privatized citizenship and social citizenship models of individuals’ relations with the state do have one aspect in common: both are based on a notion of exchange of goods and resources between the individual and the state. It is the nature of the exchange that accounts for the differences in entitlements enjoyed by citizens and consumers (Pierre, 1995, p.64). Citizenship is an exchange in which the citizen receives entitlements from the state simply on the basis of membership of that state. In return,

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165 For example, Kelman cites a study which found that the reason many people enter politics is simply to realize the public interest by producing good legislation (1987, p.92).
through a variety of means, citizens participate in the democratic process, therefore supporting and legitimizing the state. On the other hand, customers receive entitlements simply on the basis of their purchasing power (Pierre, 1995, p.64, emphasis added).

It is argued that the market is more "democratic, harmonious and virtuous" (Bellamy and Greenaway, 1995, p.475) because the freedom to choose and pay for goods, services and activities resides with individuals. Citizens in the privatized model are argued to be more influential than their political counterparts because, unlike the political vote which occurs every few years, "everyone who goes into a shop and chooses one article instead of another is casting a vote in the economic ballot box" (Powell, quoted in Bellamy and Greenaway, 1995, p.475).

An obvious consequence of this 'freedom' is that it means the wealthy get more 'votes' than the poor. Because the market relies on the pre-existence of a structure of property rights, only those with such rights can effectively facilitate exchange. Although producing inequality, this outcome is regarded as fair because, as mentioned above, all individuals have equal civil and political rights, and can choose to exercise them how they wish. "If each individual transaction is uncoerced, then the outcome is procedurally just, being the aggregate result of individual acts of free exchange" (Plant, 1992b, p.95). While this consumption-based model based on economic empowerment, through purchasing power, may be easily applied to some goods and services, with other essential services, this is unlikely to be the case. Consumers of privatized public services cannot be solely thought of in terms of being consumers, because they are still citizens with rights as well (Pollitt, 1993, p.125). This creates a problem that becomes especially clear when such services become incorporated into a paradigm of consumerism through privatization.

Because there is no concept of social justice, or what is a 'just' outcome, in both the privatized citizenship and the economic approaches to politics, these considerations are irrelevant when considering market outcomes. Social rights, proposed to rectify inequalities, are regarded as unnecessary and undesirable (see discussion above). This consequence of privatized citizenship and the economic approaches to politics relies on the assumption of self-interest, criticized above. As self-interest does not actually prevail in individuals' estimations of the public good, it seems that there is a case for arguing for
the existence of social rights provided through political means. Only social citizenship, with its emphasis on equality and social justice and its communitarian ethic, can ensure that all citizens have an adequate standard of living with which to they can participate with others in the governing of their community. As Self puts it: "Responsible citizenship protests liberty by checking sources of tyranny and the abuse of power, and it protects justice with a developed sense of social equity" (1993, p.256).

Therefore, matters of political importance ought to be separate from economic concerns, and not regarded as simply a subset of them. Citizenship finds its realization in political life, not economic life, because it carries with it concerns for the well-being of others, and is the arena in which "intersubjective communicative action" (Orchard, 1989, p.274) takes place. Thus, there is a sense in which politics is a communal activity, in which citizens place the achievement of the common good, whatever that may be, above meeting their own selfish wants. On the other hand, privatized citizenship, in its emphasis on the exercise of civil and political rights at the expense of social rights, is very much an individualistically-oriented model, which does not take into account these factors. It is therefore a rather vacuous interpretation of citizenship.

Finally, economic theories of politics put into practice, cannot account for notions of citizenship because they do not have a concept of 'the state' in general (Pollitt, 1993, p.129). It is very difficult to see how the behaviour of individuals acting with solely their own interests in mind, could ever directly produce desirable consequences at a societal level, as is proposed by advocates of privatization. "Crucial to any ability to maintain public spirit is the continuing existence of a social norm that declares it appropriate for people to try to do the right thing in public behavior and inappropriate for them simply to seek to advance their personal interests" (Kelman, 1987, p.93).

6.3.2 A defence of social rights

The arguments criticizing the inclusion of social rights into ideas of citizenship, and the subsequent reconstruction of privatized citizenship based on civil and political rights only provide a very narrow view of relationships between the state and citizens, and also between citizens. This section of the chapter again argues against these views, by defending the concept of social rights.
First, the argument over whether social rights merely enable citizen participation through civil and political rights, or constitute a part of citizenship in itself, actually seems quite irrelevant. Both arguments recognize the existence and importance of social rights, but differ over whether their status merely supports or directly informs notions of citizenship. However, there are two ways of establishing the link between social rights and citizenship (D. King and Waldron, 1988, p.423). This is achieved by either considering whether citizenship has traditionally required “social provision and enriched equality” for its realization, and second (even if the first is not the case), a concept of citizenship that does contain these elements is likely to be more attractive than one that does not.

In answer to the first justification for social rights, in many cases the state has taken the responsibility for controlling various goods and services itself. It has therefore recognized the importance they have for social well-being. The justification for doing this has been that it is ‘in the public interest’ to promote equal access to those goods and services. This desire to increase equal access through the implementation of social rights in particular is a relatively modern concept as, according to D. King and Waldron, social citizenship is “largely a twentieth-century phenomenon” (1988, p.421)\(^{166}\). This is therefore a reflection of the evolutionary nature of the emergence of the different types of rights. For example, the emergence of social services such as education, health and guaranteed income, and I also suggest, water services, as social rights is relatively recent, the result of the state’s increased expansion and responsibility for them being taken for granted (D. King and Waldron, 1988, p.421). “For Marshall this expanded responsibility constitutes social or welfare rights and thus transforms them into legitimate attributes of citizenship” (D. King and Waldron, 1988, p.421)\(^{167}\).

A second rejection of the argument that social rights are a means, not an end, to realizing social citizenship, is that because the state has guaranteed the provision of various goods and services for so long, they have become incorporated into the way

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\(^{166}\) Marshall also reinforces this view, stating that “it was not until the twentieth century that they [social rights] attained to equal partnership with the other two elements in citizenship” (1992, p.17).

\(^{167}\) This statement emphasizes Marshall’s belief that the development of citizenship rights has been an evolutionary process, with civil rights developing in the eighteenth century, political rights in the nineteenth and social rights in the twentieth (Marshall and Bottomore, 1992, p.13).
citizens view themselves and their relationship with the state. This argument is therefore a convincing compromise between the state assuming responsibility for those goods and services, and the arguments that social rights are a means, not an end, to citizenship. This again reflects Marshall’s view that citizenship rights develop and expand “as new ways develop in which the state can offer various benefits that accrue from collective organization, and in which members can participate in those arrangements to make benefits available to each other” (D. King and Waldron, 1988, p.432).

Here a link can be seen between the privatization of water services and social citizenship. In chapter one, the traditionally public nature of water services was described in some depth, with their transfer to the private sector being relatively recent. Such a change in the mode of provision to which individuals have become accustomed is likely to be accompanied by a change in how they define themselves and the course of their lives: “[I]t is to attack their basic sense of what it is to live here, to make a life here, to belong here. It is, in that way, to attack their sense of citizenship” (D. King and Waldron, 1988, p.432).

The second argument against social rights – that they cannot be universal – also seems to be somewhat irrelevant with regards to water services. As established in chapters one and six, there can be no doubt that all individuals require a certain level of water services, irrespective of their socio-economic status. As well as the essential nature of these goods being an important characteristic, they are also non-substitutable, that is, there is no realistic and practicable alternative for meeting their needs elsewhere, for example, water is central in household washing, cleaning, food preparation and disposal of human waste (Ernst, 1994, p.38).

To be a full member of a community one’s needs must be met (Fabre, 1998, p.123). Fabre suggests that many needs are socially determined, for example, most people in Western society would regard a television set as a necessity to participate in the standard lifestyle (Fabre, 1998, p.124). However, she also makes an exception, stating that “basic subsistence needs” are not determined by the standard lifestyle (1998, p.124). As was established earlier, most (developed) societies would consider water services to be a necessity enabling them to fully participate in social and economic life, thus
ironically reinforcing Barbalet's first view (that social rights underpin civil and political rights).

The third criticism of social rights - that they are fiscally conditional – can also be countered. Civil and political rights also carry with them a governmental obligation to provide resources to ensure their protection. “Obviously if we were a community of saints and people did not coerce, interfere with, or assault one another, then these rights could be respected in a wholly costless way” (Plant, 1991, p.56). Threats to security are significantly reduced by police services, courts, prisons and even street lighting, and the political process also requires funding, for example, to run elections. These are “all key ways of protecting civil and political rights and…all involve costs” (Plant, 1991, p.56). Therefore it is not logical to make a distinction on the basis of cost between social rights and civil and political rights, as they all require resources.

A similar type of argument to that just used can be used to justify the existence of social rights based on criteria of need and social justice. First, critics cannot attack the existence of social rights selectively, because their arguments apply equally well to civil and political rights. Their argument assumes that civil and political rights do not have the same tendencies to be subject to the discretion of the state, or expand. However, civil and political rights are also based on a notion of what the needs and interests of citizens are (Plant, 1992a, p.23). As with social rights, they have also developed gradually in response to events and conditions prevalent in society. An attack on civil and political rights formulated in the same fashion as the attack on social rights would undoubtedly be received with much hostility.

Second, while the concept of social rights may potentially be “open to abuse and special pleading”, it is essential for social equity and justice (Self, 1993, p.255). Social rights are the means through which citizens become equal with one another, and “there can be no real citizenship without the notion of equal participation by all” (Kingdom, 1992, p.110). To argue against social rights’ legitimacy is to argue that inequality in society is not a matter for concern. As mentioned above, the privatized citizenship model also recognizes that inequity may be the result of market transactions, but regards any interference, through the introduction of social rights in these outcomes, as an infringement on other individuals’ rights. This expresses a view that rights may be held
against but never through the state (Self, 1993, p.255). Such a view is in direct conflict with ideas of citizenship, in which citizens participate equally with one another in democratic processes. As citizenship is a status which carries with it obligations to the community (see definitions earlier in the chapter), if some members are in need of services, citizenship provides the means through which they can be provided with them. Social rights thus rectify inequity to enable citizens to realize full citizenship.

### 6.3.3 Water services as a social right

While Marshall never referred to water services in his famous essay (perhaps because it would never have occurred to him, writing in 1950, that they would ever be removed from public control), they are a social right too. Water services are not simply physical services with neither “mandate, nor responsibility for social welfare” (Ernst, 1994, p.195), but are necessary for individuals’ well-being. For example, “[e]njoyment of the services of water, fuel and telecommunications utilities is the foundation of well-being – of welfare – in modern societies” (Fitch, quoted in Ernst, 1994, p.195). In regarding water services as a social right constituting citizenship, their contribution to social and economic life is also recognized.

In addition, the essential nature of water services to individuals living in modern society can be accommodated into the last part of Marshall’s definition of a social right: “to live the life of a civilised being according to the standards prevailing in the society” (Marshall and Bottomore, 1992, p.8). Marshall’s view that citizenship rights develop over some time would mean that, although earlier societies certainly may not have considered water services to be essential, modern (developed) societies are likely to have this belief.

### 6.4 Democracy and essential services

So far discussion has concentrated on the citizen as an individual. It has focussed on the citizenship rights they ought to be able to enjoy which enable them to participate fully in the community, which is threatened by the introduction of privatization. However, it is also important to emphasize that there is a wider context in which privatization has an influence over citizens: through its disruption of democratic processes. Citizenship rights also ensure that all citizens contribute to matters that affect them through those democratic processes.
"The property rights approach says that society would be better off, if instead of meeting approval in the political process, public organizations or their assets were privately owned and had to meet the test of profitability" (Starr, 1988, pp.8-9). Therefore, the privatization of water services has undemocratic consequences, being in conflict with the principles of citizenship just mentioned. The theory behind privatization is directly opposed to democratic values, because it removes important issues from "public determination", and therefore undermines "the notion of democracy as self-government" (Buttle, 1996, p.30).

The transfer of water services from the public to the private sector is unlikely to result in greater control by the general public in the form of individual shareholders, but by directors, managers and larger shareholders (Buttle, 1996, pp.30-31). Although exchanges in the market are phrased in terms which suggest there is equality between the parties to it, in reality, there is likely to be a significant imbalance in favour of the party with the greatest power. In the case of water services, this is likely to be either the water companies themselves, or the shareholders that retain control of them. The individual is therefore at a disadvantage when dealing with such powerful bodies, and is unlikely to be ever in a position of control. For example, it was seen in chapter three that, although many employees bought shares in the water companies that were sold in Britain and Wales, there was not an accompanying increase in control over those companies. In addition, although the initial flotation of shares in the water companies was popular, the overall number of shareholders fell from 2.7 to 1.1 million in the two years following privatization (Saunders and Harris, 1994, p.147). Because the majority of these shareholders, whether employees or the general public, bought shares as individuals (and therefore bought fairly insignificant amounts of them compared with the larger bodies), they could never be in a position of control or power.

With privatization, an essential service effectively becomes the property of a business-oriented minority, who can manage it however they wish without the need for consultation: "[t]hat which belonged to all [public assets] was sold to the few" (Kingdom, 1992, p.47). An interesting consequence of this type of privatization is that in privatizing

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168 For example, eighty-five per cent of Yorkshire Water’s shares were held by corporate bodies such as banks, insurance companies, and pension funds in 1994 (Melville, 1994, p.396).
public enterprises both government and society are disadvantaged (Buttle, 1996, p.31). The government itself loses revenue, because instead of profits being used by the state for the public interest, the profits go to private individuals or companies, who have need or interest to consider society as a whole.

The loss of control of essential services also means that the participation of its previous ‘owners’ - citizens – in its management are substantially reduced, if not removed altogether. Public goods and services in the public sector are subject to democratic control through the political process, however, when sold to the private sector, this possibility for influence is gone. This is an issue also raised by Buttle: “Privatization...results in an impoverishment of democracy and leaves large areas of society’s affairs beyond democratic influence” (1996, p.31).

The removal of important decisions from the public sphere decreases citizens’ incentives for participation in political life generally (Starr, 1987, pp.132-3). Reliance on privatization and similar measures designed to channel rational self-interest into the common good, may instead stimulate more economically rational behaviour (Dryzek, 1996, pp.103-5), to the detriment of society. At worst, “the more people experience markets, the more likely they are to become creatures of exit rather than voice...and the less conducive their behavior will be to the operations of democracy” (Dryzek, 1996, p.104). With an ever-increasing range of goods and services being subject to private markets, this must be an issue of great concern.

As seen in the experiences of Britain and Wales and New Zealand below, the movement from the private to the public sphere is not accompanied by a parallel movement from “constraint to choice” (Starr, 1987, p.132), as asserted by privatization’s

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169 Dryzek highlights as evidence a study by Claus Offe which found that public perceptions became more hostile to welfare as governments began to increasingly introduce market reforms (1996, p.104). As people realized that the state was no longer a “solid rock of common community”, but was oriented towards satisfying individual preferences at the expense of the community, their behaviour changed, emulating public choice-type arguments of the rational, self-interested, utility maximizer, free-riding on the efforts of others.

170 The type of behaviour just described has been seen in Britain, in response to its privatization of water services. As outlined at the start of chapter three, in 1975-76 and 1995 there were serious water shortages in Britain. At the first drought the public cooperated with public authorities and reduced their water consumption, but twenty years later people were not as willing to cooperate, blaming the water shortage on the water companies’ mismanagement. Considerations of others’ need for water services, and the need for
proponents. Instead, privatization transfers vital decisions from the public to the private realm. There are two significant differences between the two that determine the degree and success democratic participation will have. First, in comparison to the public sector, private companies have fewer obligations to conduct their business openly or publicly justify reasons for their decisions (Starr, 1987, p.132). Democratic values therefore cannot be observed with the implementation of privatization because of this. For example, “[d]emocratic politics is a process for articulating, criticizing, and adapting preferences in a context where individuals need to make a case for interests larger than their own” (Starr, 1987, p.132). Privatization, on the other hand, actively reduces the ability of citizens to consider matters of general concern.

Second, as mentioned above, the public and private sectors also differ in the types of empowerment they encourage: the public realm, through political means, uses equal voting rights, while the market responds only to purchasing power. When the private sector takes over an activity previously controlled by government, there seems to be an assumption that economic empowerment can easily replace the political empowerment used previously to control that activity. However, this assumption underestimates the fundamental differences between the two sectors: “Markets give us private rather than public modes of discourse, allowing us as consumers to speak via our currencies of consumption to producers of material goods, but preventing us from speaking as citizens to one another about the social consequences of our private market choices” (Barber, 1996, p.154).

However, in Britain and Wales, three regulatory initiatives have been implemented, which do take into account the need for public consultation between the public and the water companies. They also accord with the suggestions in the previous chapter for encouraging the use of ‘voice’ in the decision making processes of privatized utilities. The first are service indicators, designed to help OFWAT monitor the quality of service the water companies provide to their customers (Ogden and Anderson, 1995, p.541). Secondly, independent statutory bodies, customer service committees (CSCs),

conservation measures, had been replaced with the atomistic tendency to satisfy one’s own needs at the expense of others”.
were established to represent customers' interests (Ogden and Anderson, 1995, p.541)\textsuperscript{171}. Regular meetings are held between the CSCs, OFWAT and the DGWS. The CSCs' meetings are open to the public. Third, the OFWAT National Consumer Council (ONCC) was established in 1993 to provide customer representation with "a higher public profile on a national scale and more influence in the policy making process" (Ogden, 1995 and Anderson, p.551)\textsuperscript{172}. Despite these positive moves towards greater accommodation of the public interest, there are some aspects that are of concern.

First, OFWAT now has a customer-oriented focus, as opposed to a citizen-oriented one. Customers operate in a market environment controlled by the laws of supply and demand and the use of 'exit'. Because of OFWAT's focus on the customer, in theory there would be no need for political involvement through democratic processes because the market will ensure that customers' preferences are met. This assumption is reflected in the exclusion of customers from regulatory decision making. However, for the various reasons outlined in the previous chapter, water services cannot be commodified in a market exchange in the same way as other consumer goods. This is the very reason that they are usually controlled by public means.

Second, control over the direction the water companies takes is dominated by a relatively select few. The water company shareholders would be unlikely to support the use of political processes as a means of influencing the direction of the water company (Ogden and Anderson, 1995, p.555), because they would probably interfere with the profit-orientation of the privatized company. As mentioned in chapter three, the regulator must "protect the financial health of the industry ahead of other considerations" (Smith New Court, quoted in Melville, 1994, p.396). He must also ensure that the investors receive a reasonable return on capital (OFWAT, cited in Melville, 1994, p.396). In addition, rule making is dominated by "a closed profession community" which is strongly

\textsuperscript{171} Although 'independent', the chair and members of the CSCs are appointed by the DGWS, who also funds them from licence fees levied on the water companies, provides them with a full time secretariat and office accommodation (Ogden and Anderson, 1995, p.541). "Advice and support on legal, technical and policy matters is [sic] provided by Ofwat" (Ogden and Anderson, 1995, p.541).

\textsuperscript{172} See Ogden and Anderson (1995, pp.552-554) for the ways in which OFWAT and the CSCs have consulted customers about major decisions - charging on the basis of the property's rateable value and the planning and preparation process for the 1994 Periodic Review of price limits.
influenced by the arguments presented in chapter two, and a belief that their primary activity is to operate as a successful business (Melville, 1994, p.404).

Third, as discussed in the previous point, considerations of the right of citizens to contribute to the running of an essential service are secondary to the requirement of water companies to make a profit for their shareholders. The goal of achieving greater efficiencies in the water 'business' has thus been achieved with the subordination of citizens' interests. This has occurred primarily through the private sector customer-orientation that has been growing in the water industry since the 1983 Water Act, and it remains to be seen whether or not citizen's interests can once again be considered. Political processes, traditionally the means through which citizens' needs and concerns are met, no longer apply to this essential service:

Unlike Britain and Wales, where water utilities are owned and controlled by private companies, New Zealand's water still remains nominally in public hands. However, there seems to be a perception that public ownership is enough to ensure that the community's considerations are taken into account. This perception may prove to be "dangerous to its [local government's] continued survival and vitality" (Hambleton, quoted in Reid, 1999, p.5). Local government is a means through which wider values - environmental, consumer protection and security of supply - held by the community can be reflected in their assets (McKinlay, 1999, p.12). While communities may just want local government to provide them with certain services, they ought to still be actively involved in the decision making processes that determine the range of those services.

There is also much cause for concern in the structure of commercialized water services' in New Zealand. As with Britain and Wales, of most concern is the issue of democratic control. Related to the previous point, although the shareholders of Metrowater are the Auckland City Council, and therefore ratepayers, "daily operations run independent of political involvement" (K. King, 1999, pp.26-27). Similarly, because Papakura District Council has opted for a franchise arrangement with United Water, there is also no council involvement in its operations. The only practicable form

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173 It is interesting to note that Auckland's councillors were elected on a promise to abolish Metrowater, and that 15,000 submissions were received for its draft plan (Gladwin and Bright, 1999, p.17). However, Metrowater is still in business.
that concern can now take is “public scrutiny” (K. King, 1999, p.27). In spite of this, it should be mentioned again that the council has taken United Water to court for breaches of its contract.

The final issue to be covered in this section is accountability, which is very closely related to the concept of democracy. Accountability is essential when there are hierarchical relationships, such as those in the political process, and also when there are relationships between principals and agents, such as those in the market, as they “ensure that those with authority act in ways that their ultimate owners [whether taxpayers or shareholders] wish” (Hughes, 1998, p.226). Privatization was argued, by its advocates in chapter two, to be more accountable, and therefore more democratic, because it enables a closer and more transparent relationship between providers and consumers than that which is possible through political means. Therefore, it is the interests of the providers to be accountable and responsive to consumers’ wishes in order to attract their business. However, in reality, this situation appears to be not as clear-cut.

At governmental level, accountability means “that government action accords with the will of the people the government represents” (Donahue, 1989, p.23). When applied to essential services, especially when privatized, there are three especially important reasons that accountability must be upheld (Donahue, 1989, p.11). First, many important services and functions have to be carried out collectively (that is at a governmental level) and therefore the public has an interest in making sure that those making decisions on their behalf are accountable for them. This reason is still relevant to cases of privatization, as essential services’ providers should still be accountable for their actions. Second, because the public is an immense and varied collection of people, those in control can fail to take all of their interests into account. Third, accountability can be a problem, because the individual is in a vulnerable position before the powers of government.

However, despite what advocates of privatization may think, accountability to consumers is not the same as accountability to citizens. The former is measured through
tangible outputs, while the latter finds its realization in the democratic process. More importantly, political accountability also incorporates a sense of responsibility towards its citizens. This change in emphasis from market to political forms of accountability, as introduced by privatization, provokes many complex questions, for example, whether is it actually possible to measure the performance of some organizations without reference to the procedural aspects of accountability present in political accountability (Peters, 1996, p.43).

Second, the relationship between the principal and the agent, which forms the basis of the privatized transaction, is not simple in the case of privatized water services. For example, while the principals are relatively clear (citizens), there is some uncertainty about who should be held to account for the performance of such privatized services -- the water company, or the regulator, or government (which made the decision to privatize in the first place, and also oversees the regulatory regime).

With political accountability, the citizen can call a politician to account for unsatisfactory performance through the act of voting, because he/she initially elected the politician into public office (Hughes, 1998, p.230). However, accountability is quite different in the private sector. Privatized monopoly services, such as water, are generally not subject to realistic competition, therefore, in theory they would not need to be as responsive to consumers as they may be if competition was present, and consumers had the ability to take their business elsewhere. Therefore, there is no effective means of gaining recourse for unsatisfactory performance. In addition to being accountable to their customers, private companies are also accountable to their shareholders. There is a significant difference in the types of expectations each group holds about their relationship with the company. Shareholders expect a return on their investment (which is generated through the company’s financial success), while customers expect an adequate level of services at reasonable cost. Therefore, as was discussed above, there

174 There are two ways in which political accountability can occur. First, elected officials, such as politicians, can be held accountable by the voting public, while appointed officials, such as bureaucrats, can be held accountable by the elected officials (Gilmour and Jensen, 1998, pp.1-2).

175 This has resulted in the emergence of the “evaluative state”, in which it is taken as given that services’ specifications and standards of delivery are able to be measured (Walsh, 1995, pp.219-220). Walsh questions whether such an assumption is practicable in complex circumstances and if it is, then who should determine the standards (1995, p.254). See also Kettl (1993, pp.179-197), who has also considered the issue of government contracting services out to private enterprises in some detail, labeling it as the ‘smart-buyer’ problem.
may be some confusion over whose interests companies ought to **primarily** consider: their shareholders’, or their customers’.

Finally, public services have traditionally tried to encourage ideals of citizenship, rather than individual gain (which the consumerist model, introduced with privatization, is based upon). Accountability through market means is not what is desired by citizens: “The rights which have been fought for have on the whole not been those of efficiency and effectiveness, but rather, justice, representation, participation and (most recently) equal opportunities. *And these are...the rights which many citizens seek to inscribe in the organization of their public services*” (Pollitt, 1993, p.129, emphasis added).

6.5 Conclusion

The placement of water services in the market undermines ideals central to citizenship and democracy – accountability, public deliberation and citizen control. Issues of the allocation of essential goods, services and activities are a public concern, and should therefore be resolved through public means – democratic processes. Determining the boundaries of the state’s responsibilities should be a matter for full democratic debate, not a closed decision made by a few powerful individuals. Privatized citizenship is predicated upon individuals interacting in an atomistic fashion pursuing only their interests, thus contradicting common values held about citizenship. When these values are extended to changing the way in which water utilities are managed, as a commercial rather than a community asset, commercial considerations usurp political ones at the expense, both literally and metaphorically, of citizens.
CONCLUSION

The thesis has covered a wide-range of literature and subject matter. However, there are several significant points that have arisen as a result of the issues examined.

In chapter one, several of the main concepts and ideas to be used throughout the thesis were presented. It was argued that there are actually many forms of privatization, and the term does not necessarily have to denote the narrow meaning – the sale of a public asset to the private sector – that some assume.

The contributions of the five theories outlined in chapter two to constructing a theory of public incompetence, and subsequently, the policy of privatization as its antidote, create a new and potentially socially damaging model of interaction premised on the inherently selfish nature of the individual as the basic unit of analysis. Privatization was argued to harness this “ubiquitous trait” (Samson, 1994, p.10) and theoretically produce more efficient outcomes. As was seen in chapters five and six, this assumption is not actually founded in fact. However, its consequences affect not only the individual as consumer, which is the identity essentially focussed on in the economic approaches to politics, but also more importantly, the individual as citizen.

With reference to the comparative approach taken in the middle of the thesis, it seems that there were some factors present in Britain and Wales and New Zealand which were potentially troublesome for performing a comparison. First, although privatization in Britain and Wales occurred eleven years ago, and there is a lot of literature concerned with events and the policy process which occurred around 1989 and immediately afterwards, there is relatively little analysis available on more recent trends, for example, price increases or decreases and consumer responsiveness. It seems that it may still be too soon to make a definitive judgement on the long-term success or failure of this application of privatization to water services.

Second, significant changes are still occurring. This can be seen in the recent announcement that, for the first time since privatization, prices are likely to decrease significantly from 2000 – 2001, on average by 13% (Office of Water Services, 1999). This may be because, after suffering from years of under-investment, the water companies have undertaken, and are near completion of, comprehensive rebuilding in the years following privatization to meet certain requirements, for example, those concerned
with standards of water quality, sewerage treatment and the environment (Office of Water Services, 1999). They can now finally pass the savings they will make onto consumers.

In comparison with Britain and Wales, as mentioned in chapter four, there is a dearth of substantial and critical analysis available on the state of the water industry in New Zealand. For the purposes of the thesis, much has had to be gleaned from newspaper reports, conference papers, and very brief articles from popular literature sources, and it was always essential to consider the position of the author when examining his/her arguments.

There was a similarity between the two case studies in the way in which water services were provided. For example, prior to the 1973 Water Act, the structure of the Britain and Wales’ water supplies looked remarkably like that of New Zealand today, being highly fragmented in nature and evolving in an ad hoc manner. However, once the ten regional water authorities (RWAs) were created in 1973, the similarity ended. Local body representation was eventually phased out over the coming years and central government involvement and control strengthened. In contrast, apart from a few independent providers, New Zealand’s water industry still remains nominally in the control of local authorities.

The structure of the RWAs meant that privatization was relatively simple to implement in Britain and Wales because statutory water companies already existed, and they were supportive of privatization (Davin, 1993, p.12). In New Zealand, water services are currently a core activity undertaken by local authorities, whether they are commercialized or not, and it seems that complete privatization would be fiercely resisted. Local authorities may feel it would be an encroachment by central government on their jurisdiction, and I would also expect communities to be strongly opposed. I therefore support Davin’s view that “privatisation [in New Zealand] would occur only at the insistence of central government and...that would take considerable political will at the central government level” (Davin, 1993, p.12), something that has, as yet, failed to emerge.

In spite of the difficulties described above, I believe the comparison between the countries has still proved to be a productive one. As discussed in chapter six, with both
Britain and Wales' completely privatized water industry, and some of New Zealand's local authorities' introduction of more commercial practices, there is a real danger that citizens are being excluded from the democratic control of a service which is a basic necessity. It must be of the utmost concern that the interests of citizens are being sidelined in favour of the "dogmatic assumption that markets are always good" (Foster and Braddon, 1996, p.294), the basis of the rationale for privatizing. The values which are central to the ideal of social citizenship - consideration of the well-being and needs of fellow citizens, equity, social justice, accountability and participation in matters concerning the public interest - have no place in its antithesis, the privatized citizenship model, which is fast gaining currency.

The "apolitical nature of consumerism" (Potter, 1988, p.156), with its foundation in the economic approaches to politics, has no concept of the consideration of others. This is likely to be the reason for the lack of effective means for the participation of citizens in the control of essential services such as water. The relationship, central in ideals of social citizenship, between "the governors and the governed, and administrators and the administrated" (Potter, 1988, p.156) is completely irrelevant to the ideas contained in the privatized citizenship model. Concerns for efficiency subordinate those values mentioned above, and the importance privatized citizenship places on satisfying individual wants excludes social and communitarian values contained within the notion of citizenship. It is thus a denial of the value of community.

Even when certain services are placed outside the public sector because of privatization, it does not necessarily mean that they are no longer public services (Foster and Braddon, 1996, p.300). Water services are fundamental in ensuring effective economic and social development. As well as being an essential for enabling a reasonable quality of life, as physical infrastructure, they are the basis of many other industries, and in New Zealand have much importance for Maori and the generation of hydroelectricity. Therefore, their control should not be relinquished to the market. Regulation also may not be enough to encourage the pursuit of public interest goals.

Ironically, in Britain and Wales, the very existence of regulation, designed to prevent water companies abusing their monopoly position, is an implicit recognition that the state has a role to play in the management of utilities even when privatized:
This has created a new phenomenon which could be termed 'state regulated market bureaucracies', whereby the introduction of market principles into public service areas, which by their nature must be seen to be fair and equitable in their provision, require regulation by the state through bureaucratic means and greater centralized control (Foster and Braddon, 1996, p.291).

The continued presence of the state in the form of regulation in the privatized water industry is a type of political intervention. In the absence of realistic competition, it is therefore a signal of the state's realization that only it can ensure that certain services and activities are provided in accordance with the public interest: “the state finds it difficult to withdraw from areas of the public sphere that directly bear on the welfare of its citizens” (Foster and Braddon, 1996, p.291).

In spite of the findings of this thesis, which ultimately suggest that privatizing water services is extremely problematic, first, because its former public utility status is still relevant and, second, because of considerations of citizenship and democracy, an important qualification must be made. Defining goods and services according to strict criteria, whether advocating privatization or not, is not enough to determine that they will be provided through the means deemed appropriate for that particular good (Donahue, 1989, p.19; Ranson and Stewart, 1989, pp.7-8). “Even where it has been decided that a service within the public sector should be subject to certain market forces, that in itself is a decision made in the political process” (Stewart and Clarke, 1987, p.170, emphasis added). Ultimately, a political decision made by individuals as citizens, not customers, must decide the limits of public and private goods according to the benefits it may have for the community.

In light of the previous point, it is interesting to note that the privatization of the water industry in the United Kingdom was the most unpopular of all the privatizations carried out by the government. In excess of three quarters of voters disapproved of the sale (Saunders and Harris, 1994, pp.49, 123-124). The increasingly commercial approach taken by many of New Zealand's local authorities has also generated much opposition. As Kelman has noted, “political choices in a democratic society do not only involve others, they also require the consent and participation of others in order to get made in the first place” (1987, p.93). The efficacy of the government and the local authorities in implementing a policy which the public finds wholly unappealing could be viewed as a
manipulation of the democratic process. For the purposes of concluding this thesis, it is sufficient to merely highlight this observation, as it could be the subject of another thesis in itself.

Nevertheless, in the United Kingdom, the government won elections in spite of its unpopular policies. Perhaps temporarily blinded by the prospect of becoming shareholders, or because the personal effort involved in actively protesting against privatization was too great, voters may not have realized the wider consequences of their actions. It seems quite ironic that the policy eventually came to fruition in spite of such opposition. As noted by Donahue:

Sadly, there is no reason to expect to expect the political process to lead to the right pattern of privatization. Unless we are luckier or more careful than we ought to be, political pressures will tend to retain for the public sector functions where privatization would make sense, and to privatize tasks that would be better left to government (1989, p.13).

As one critic of the application of the economic approaches to politics has noted: “Achieving good public policy...requires the presence of a significant public spirit in the veins of the body politic” (Kelman, 1987, p.81). Such approaches, which have been made a reality with the explosion of privatization since the early 1980s, are a danger to engendering any sense of “public spirit”\textsuperscript{176} in communities. It is difficult to see how individualistically oriented policies such as privatization, which encourage people to think primarily of their own wants, could ever ultimately result in a society in which all citizens’ wants and needs are met. In addition, transferring strategic public assets to the private sector in order to achieve greater efficiency (something, it should be pointed out, that is not necessarily correct), comes at the expense of basic democratic principles. One of the most fundamental roles undertaken by the state is the provision of social and economic welfare of their citizens as a precursor to democratic government. Privatization of essential services such as water can only harm the integrity of this role.

\textsuperscript{176} Kelman uses this term to mean “behavior motivated by the desire to choose good public policy” (1987, p.81).
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