

Remunicipalization as the (Unintended) Outcome of Legal Transition: Analysing the Perspective of Principals

Veronika Petkovšek¹, Nevenka Hrovatin², Primož Pevcin³

Abstract

The starting point of the analysis is a legal change that happened with the introduction of the Public-private Partnership Act (PPPA) in Slovenia. The introduction of the law envisaged changes to the organization and delivery of local public services, where transition provisions focusing on phase-in and grandfathering were stipulated. This legal transition affected the decision-making of stakeholders being involved, either principals (state, municipalities) or agents (service providers). The paper at hand focuses on presenting the evidence on the outcomes of legal change in the water industry as a local public utility, where the analysis is based on the primary data collection via a self-prepared structured on-line questionnaire, sent to Slovenian municipalities as principals. The results obtained suggest that legal amendments have promoted a trend towards remunicipalization in the water industry, as the implementation of PPPA contributed to increased full public ownership in local public utility services provision. The most important motives for increasing full public ownership are management problems in a mixed-ownership enterprise, closely followed by simpler regulation on the part of the service provider, greater control over the service provider, more opportunities to influence business activities, and greater rationality and efficiency of business activities if we follow the answers of responding municipalities. Besides, the legal transition also increased the municipal ownership of public infrastructure. In the majority of cases the relationship between the infrastructure owner (municipality) and the infrastructure manager (public utility provider) has been settled with the transfer of public infrastructure into the business lease of the public utility provider. The motivating factors for and advantages of increased public ownership detected in our research present the benefits of remunicipalization, such as greater control over the provider and greater rationality and efficiency of business, better co-operation between the enterprise and the local community, developing expertise and increasing the quality of the services provision, better organization of work, faster job performance, lower costs of service provision, etc., although the respondents acknowledged potential disadvantages, such as the issues related to proper arranging concession relationship, lack of experience of the municipalities in providing control over the concessions and regulatory price policy.

Points for practitioners

The results of the analysis confirmed the standard theoretical reasons for re-municipalisation in local public utilities provision, and they are to be found in the context of motivating factors behind the pursuit toward full municipal ownership. However, the question remains whether the promotion of remunicipalisation was actually the initial intention of legal change. In this context, the research gives valuable insight and evidence on the outcomes of legal change, which should be of particular relevance for public policy makers, as the expected intentions of policies might not be aligned with actual outcomes after they are implemented.

Keywords: remunicipalization, principals, local public services, water industry

¹ Veronika Petkovšek, PhD, Assistant Professor, Faculty of Public Administration, University of Ljubljana, Ljubljana, Slovenia, veronika.petkovsek@fu.uni-lj.si

² Nevenka Hrovatin, PhD, Full Professor, School of Economics and Business, University of Ljubljana, Ljubljana, Slovenia, nevenka.hrovatin@ef.uni-lj.si

³ Primož Pevcin, PhD, Full Professor, Faculty of Public Administration, University of Ljubljana, Ljubljana, Slovenia, primoz.pevcin@fu.uni-lj.si

1 Introduction

Local governments face many challenges in selecting the most appropriate local public services delivery mechanism, which should, on the one hand, enable efficient service delivery, and on the other hand, enable fulfilling the needs of the local population. Therefore, municipalities face trade-offs in deciding whether to provide a certain local public service in-house or to contract it out to a private provider. As fiscal constraints and financial pressures increase, municipalities have to be even more careful in selecting the most appropriate service delivery mechanism, which is usually the one that provides a lower price for the delivery of services. Their decision is based on the features or characteristics of the service, a set of external constraints, and the production alternatives available (Rodrigues, Tavares & Araújo, 2012, p. 618).

When a municipality decides to deliver a local public service itself (in-house provision), it can establish a municipal department or create a structure with some degree of financial and administrative autonomy. In addition, it can also deliver the services through an autonomous entity, most commonly through a public (municipal) enterprise (Da Cruz, Berg & Marques, 2013, p. 105). Therefore, in-house provision can be defined as 1) the provision of local public services where the local government provides their services with their own departments, 2) a provision of services via a joint in-house department or shared services, 3) insourcing, which refers to taking in-house the elements of a private finance initiative (Sandford, 2019, pp. 4–5, 13) and as 4) the provision of services when the local authority itself creates a local enterprise to deliver the service (Wollmann & Marcou, 2010, p. 230). In-house provision of local public services and utilities is meaningful to the point where costs of further expansion become greater than the costs of giving the provision to external contractors (Nemec, Soukopová & Mikušová Meričková, 2015, p. 648).

If the in-house production of a certain local public service does not allow for the exploitation of scale economies and makes costs of production too high, a municipality can decide on an alternative production and delivery channel. This is usually in the form of the privatization of local public services or contracting out to private providers, and increasingly often also inter-municipal cooperation or joint provision of services (Bel, Fageda & Mur, 2013, p. 436). The problem regarding insufficient economies of scale usually arises as a result of the suboptimal size of local governments. Privatization and inter-municipal cooperation, therefore, serve as an avenue for the more efficient provision of local public services. Along with the exploitation of economies of scale, there are also other reasons (also connected to economy of scale), such as fiscal constraints and budget pressures, capital needs and investments, innovation, specific strategies for cost savings etc. (Hattery, 2015, pp. 60–61). However, it is quiet often nowadays that municipalities take the provision of local public services back into their own hands (Gradus and Budding, 2020; Gradus, Schoute and Budding, 2021; McDonald, 2019, p. 61; Wollmann, 2018, pp. 426).

The starting point of the analysis presented in the paper is a legal change that happened with the introduction of the Public-private Partnership Act (PPPA, Official Gazette of RS, no. 127/06) in Slovenia in 2006. The introduction of the law envisaged changes to the organization and delivery of local public services, where transition provisions focusing on phase-in and grandfathering were stipulated. This legal transition affected the decision-making of stakeholders being involved, either principals (state, municipalities) or agents (service providers), as it introduced important changes regarding the transformation of existing public enterprises (Brezovnik, 2009, p. 180; Trpin, 2007, pp. 5–6). The new regulation aimed to differentiate between »true« public enterprises that shall remain exclusively publicly owned to perform public service activities, and other public enterprises that shall be transformed into commercial companies. Two options were envisaged for the transformation of public enterprises with private equity stakes. One option was that a public enterprise could be transformed into a commercial company in accordance with the Companies Act. The other option offered that public enterprise status could be retained and the private equity stakes would in a way be nullified (Kocbek, 2011, p. 86). Under the new regulation, a public enterprise may only be an enterprise that is fully owned by the state or local government. Thus, the goal of the paper is, considering the extended period of transformation, to assess and scrutinized, which options were selected and for which reasons, where we focus on water industry in Slovenia. Thus, the paper at hand focuses on presenting the evidence on the outcomes of legal change in the water industry, where the goal is to assess the final outcomes of the reorganization process.

2 Theoretical framework and literature review

Although, EU's market liberalization has led to outsourcing and privatization of local service provision, as a reform to promote efficiency of municipal service delivery, in the last decade a trend towards remunicipalization has increased, where municipalities take the provision of local public services back in their own hands (Gradus & Budding, 2020; Wollmann, 2018, pp. 426). Remunicipalization is described with different terms: de-privatization,

reclaiming public services, taking services back in public hands, in-sourcing (McDonald, 2019, p. 61). With remunicipalization, municipalities strive to achieve greater municipal democracy and autonomy. However, transforming corporate ownership to public ownership does not necessarily lead to more democratic, equitable and sustainable economic system (Berlo et al., 2017, p. 1; Hanna, 2019, pp. 44-46).

Usually, the remunicipalization is intentional and is done by ending contract with private provider earlier or not renewing it after it expires. Such remunicipalization is very often a consequence of dissatisfaction with private provider, like rising costs, worsening service quality, public mistrust of private provider, corruption, not achieving infrastructure promises etc. However, sometimes municipalities are forced to remunicipalize, even though policy makers would prefer to retain private service provision. This happens due to high costs of monitoring, short-term contracts, reducing efficiency gains or on the other hand, due to insufficient number of private-sector bidders for a contract. There are also private firms that are unwilling to bid on what they see to be unprofitable contracts or they end contracts early. However, sometimes high costs of monitoring and regulating private contracts drive municipalities to re-municipalize, even though they may be satisfied with the quality of private service. This usually happens, with large, long-term concessions and with small, short-term contracts, where sophisticated and expensive regulatory management is required in both cases. Municipalities also face with costly teams of lawyers and bureaucrats that are required for contracting out, which of course reduces or reverses potential efficiency gains. Of course, re-municipalization is often braced by private providers, who use different strategies to maintain their position and to delay the process of remunicipalization (Berlo et al., 2017, p. 1; McDonald, 2019, p. 62).

Municipalities have proceeded remunicipalization in two ways; by repurchasing shares that were previously sold to private companies and by insourcing services that were previously outsourced. When the concession is expired, municipalities decide about remunicipalization, as an opportunity to bring services back in-house without transaction costs incurred with termination of contract. When the concession has not expired yet, there can be difficulties with the outgoing private provider about the compensation. Very high compensations are demanded and this is a strong deterrent to determination of contract (Hall et al., 2013, p. 206; Wollmann, 2018, p. 422). The negotiation process about the compensation is one of the key elements that a municipality has to consider when deciding for remunicipalization. Beside negotiation process, also users' involvement is one of the key elements. The involvement of users is essential, as they are key actors in the process and a municipality guarantees a democratic and efficient public service. It is also fundamental to evaluate the private provider's performance and the benefits and risks of returning to public provision; especially when considering the current situation of the public service in terms of investment needs and financial costs for guaranteeing an efficient performance. However, the remunicipalization process can vary according to local context, the condition of public service, the involvement of the local government, the duration of the contract, the degree of private participation etc. (Valdovinos, 2012, pp. 115-116).

3 Methodology and data

The majority of public utilities in Slovenia in the field of water and wastewater is managed locally, at the municipal level. Because of the new legislative provisions set in 2013, the regulation of local public utilities was transferred from central to municipal level. Therefore, municipal administration is now responsible for local public utilities regulation (Cerkvenik, 2015). The municipality prescribes the form of local public service provision by the decree, which regulates conditions for the provision and use of public goods; sources of funding and the manner of their formation; rights and obligations of users; position of the infrastructure for the public service (Grafenauer, 2009, p. 213).

As water and wastewater utilities are managed at the municipal level, the research sample includes all 212 Slovenian municipalities, as our analysis specifically focuses on the role of principals in the transformation process, if we follow framework of the principal-agent theory. The empirical research was done with primary data collection through online survey, sent to all Slovenian municipalities. A combination of open-ended questions, multiple-choice answers and Likert scale 1 – 5 is used (1 – I totally disagree, 2 – I disagree, 3 – I neither agree nor disagree, 4 – I agree, 5 – I totally agree). The answers were collected in the period from 2018 till 2020. The survey covers a broader field of water and wastewater management in Slovenia. It is a detailed and structured online questionnaire, developed by the authors. As the survey is rather long, the relatively low response rate is not surprising.

Table 1: Research population

Municipalities	Number	Share of total population (%)
Total research population	212	100
Total N of responses	42	19.8
N. of completed surveys	28	13.2
N. of incomplete surveys	14	6.6

(Source: authors)

Table 1 indicates that in total 42 municipalities (19.8% of total sample) responded to the survey, but only 28 municipalities fully completed the survey. The actual response rate (fully completed surveys) is 13.2%. However, this input should be considered in a sufficient manner to extrapolate the field experiences.

4 Results and discussion

Table 2 reveals that most of existing public enterprises have retained full public ownership. Almost 70% of public enterprises in the domain of water and wastewater management were already fully municipally owned, even before PPPA. Only a little less than 10% of public enterprises have transformed into full public ownership. The fact that the majority of public enterprises either retained or transformed into public enterprise with a full municipal ownership confirms the presence of trend towards re-municipalisation in local government in Slovenia, and the shift back from private to public provision.

Table 2: Retention of or transformation into full public ownership after PPPA

Retention/transformation	Share of municipalities (%)
Retention of full municipal ownership	67.78
Transformation into full municipal ownership	9.69
	N=30

(Source: authors)

Table 3 provides the results about the most important motives for retention or transformation of public enterprises. Management problems in a mixed-ownership enterprise, simpler regulation of the service provider, greater control over the service provider, more opportunities to influence the business activities, and more rational and efficient business activities were detected as the most important ones. The evidenced motives are known also as classical reasons for re-municipalisation. Therefore, we can argue that legal amendments (in the form of the PPPA) have served to promote the trend towards re-municipalisation in Slovenia.

Table 3: Motivating factors for the full municipal ownership of a public enterprise

Motivating factor	Weighted average
Bad experience with a private provider with shares in utility	2.63
Simpler regulation of the provider	3.91
Greater control over the provider	4.02
More opportunities to influence the business	3.77
Greater rationality and efficiency of business	3.7
Use of in-house orders	3.34
Easier to obtain EU funds	2.84
Avoid public tenders for concessions	2.93
Avoid employee dismissal	2.52
	N=15

Note: A Likert scale 1–5 was used: 1 – I totally disagree, 2 – I disagree, 3 – I neither agree nor disagree, 4 – I agree, 5 – I totally agree.

(Source: authors)

Similar as the before mentioned motives, the municipalities also provided information about the advantages of the reorganization process (Table 4). The largest advantages are evidenced in better organization of work and in developing expertise and improving the quality of utility provision. Thus, high cost of monitoring and regulating private contracts often drives municipalities to re-municipalise. Basically, municipalities may be forced to re-municipalise, especially in the face of the high cost of monitoring, short-term contracts, deteriorating efficiency, insufficient private-sector bidders for a contract.

Table 4: Advantages of reorganization process

Advantage	Weighted average
Better organization of work	3.75
Developing expertise and improving the quality of utility provision	3.75
Municipality monitors the business of the enterprise according to the decree	3.58
Easier to obtain European funds	3.58
Better use of labour and capital	3.5
Lower labour costs	3.5
Better cooperation between the enterprise and the local community	3.5
Institutional, corporate, and governmental rights are prescribed by municipal decree	3.42
Better job performance	3.36
Lower costs for utility provision / Lower transaction costs	3.33
Lower costs for utility provision due to joint provision of utility (bundled services)	3.25
Total profit from a public enterprise is transferred to the budget and devoted to investment in infrastructure	3.17
Municipality has full control over the performance of public utility providers	3.08
Acquisition of additional municipal financial sources	2.92
	N=12

Note: A Likert scale 1–5 was used: 1 – I totally disagree, 2 – I disagree, 3 – I neither agree nor disagree, 4 – I agree, 5 – I totally agree.

(Source: authors)

Also some disadvantages can be observed in Table 5, which are not particularly significant. One is “arrangement of a concession relationship requires regulations from many legal acts”, followed by “higher price of public utility” and “regulatory price policy”. As disadvantages are not as significant as advantages, we can say that municipalities, as owners of public enterprises, see more advantages in the reorganization process.

Table 5: Disadvantages of reorganization process

Disadvantage	Weighted average
Arrangement of a concession relationship requires regulations from many legal acts	2.5
Higher price of public utility	2.44
Regulatory price policy	2.44
Municipality’s lack of experience in providing control over the concession in terms of maintaining quality of service for all users, maintaining and growing the value of the property for the municipality at justified prices for services	2.4
Municipality has no control over the concessionaire through founding and corporate rights	2.3
Higher transaction costs due to public tenders for concessions	2
Higher transaction costs for the municipality in controlling the concessionaire	2
Lower quality of public utility	1.9
	N=12

Note: A Likert scale 1–5 was used: 1 – I totally disagree, 2 – I disagree, 3 – I neither agree nor disagree, 4 – I agree, 5 – I totally agree.

(Source: authors)

In general the presented results identify classical reasons for re-municipalisation (management problems, regulation of the service provider, control over the service provider, influence over business activities, and rationality and efficiency of business activities). Similarly, the detected advantages of the reorganization process (e.g. municipality can monitor the business activities of the enterprise under the decree, municipality has full control over the performance of public utility providers) also identify drivers of re-municipalisation. Therefore motives and advantages confirm the fact that reorganization process of public enterprises promoted the trend towards re-municipalisation in Slovenia, at least if we take into the account water industry.

5 Conclusion

The research provides an insight into the final outcome of the reorganization process of public enterprises in water industry in Slovenia. Full municipal ownership has increased due to the PPPA, and has served to promote re-municipalisation in local government in Slovenia. Classical theoretical reasons for re-municipalisation can be observed. Thus, the motivating factors for and advantages of increased public ownership detected in our research present the benefits of remunicipalization, such as greater control over the provider and greater rationality and efficiency of business, better co-operation between the enterprise and the local community, developing expertise and increasing the quality of the services provision, better organization of work, faster job performance, lower costs of service provision, among others. Our research thus contributes to the growing literature on re-municipalisation, where we provide an empirical evidence on the field experience also in the CEE region. The issue thus remains, whether re-municipalisation was really intended, as the legislative framework supporting the legal change in the particular case was biased towards favouring market liberalisation concepts like privatization and outsourcing of public services.

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