Regulation, Public Service Provision and Contracting

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Class 3 – Regulation, Contracts and Renegotiations
Asymmetric information leads to incentive problems that do not help to resolve the way public services should be provided (i.e. public vs. private).

Incomplete contracting leads to such trade-off, highlighting the role of renegotiations in contracts.

- Because of ex post renegotiations, incentives to invest ex ante are distorted.
- Vertical integration might resolve (partly) those issues.
Goal of today’s session: key ideas

- Renegotiation comes as a surprise in the complete contract framework
- One possibility is that they reflect lack of commitment of contracting parties
  - Opportunistic behaviors
  - Inefficient or Efficient renegotiation redistributing the surplus (net of investments) – hold-up
- Another possibility is that they reflect “cooperativeness” of contracting parties dealing with unanticipated events
  - Efficient renegotiations. Why? Reputation and contract renewals restraining opportunism
- Need for regulation?
  - Application to the European Directive on Concessions
GLS’s 2008 paper

Starting point:

- High rates of contract renegotiation in LDCs
- Guasch 2004 looked at 1,000 concession contracts signed in Latin American countries between 1989 and 2000
  - More than 50% are renegotiated, on average 2 years after their signature!
    - 76% in the water sector / 1.6 years after signature
    - 53% in the transport sector / 3.1 years after signature
  - “High rates of contract renegotiation have raised serious questions about the viability of the concession model … in developing countries” (p. 421)
Objectives

- To analyze the determinant of renegotiations in infrastructure concession contracts in Latin America
  - Transport and Water
  - 307 concession contracts awarded from 1989 to 2000.

- Potential determinants are
  - Regulatory institutions
  - Institutional features
  - Economic shocks
  - Characteristics of the contract
Concession contracts

- **Definition**
  - “A concession is the right to use the assets of a former state company for a limited period of time (usually 20 to 30 years), being fully responsible for all investments and having to secure a number of targets specified in the contract.”
  - So called “privatization” process
  - “At the end of the concession, all the assets go back to the government, so de facto the concession's only asset, in contrast to privatization, is the right to the cash-flow of the users' receipts from the service.” (page 422)
  - The concessionaire bears the demand risk

- **What alternatives?**
  - Traditional Procurement
  - PPP
Why focusing on renegotiations?

- The authors acknowledge that some renegotiation is desirable and is to be expected as contracts are in practice necessary incomplete but
- “the high incidence of renegotiations, particularly in early stages, appears to be beyond the expected or reasonable levels”.
- “In particular, it might indicate
  - “excessive opportunistic behavior by the new operators, both during the bidding stage (strategic underbidding by firms skilled at renegotiations) and after it” (p. 423)
    - Opportunistic behavior coming from the firm – hold-up
  - “extensive informational advantages that the enterprise possesses over the government (as well as, possibly, over other potential operators) and its perceived leverage vis à vis the government in a bilateral negotiation … in order to secure a better deal than the initial one”.
  - What else?
Main objective

- Because renegotiations are perceived as bad for social surplus, the objective of the paper is to find out what are their determinant in order to shed lights on the possible ways to limit them.
- A simple model to address main trade-offs
A simple model: ingredients

- The regulator offers a contract before the firm discovers its type
  - The “high cost” firm obtain a negative utility ex post and tries to renegotiate
- The regulator is maximizing the sum of consumers’ surplus and the firm utility
- Cost of public funds is introduced
- The contract is enforced with a probability depending on how much the regulator invested in an imperfect enforcement mechanism and the quality of existing institutions (judicial system, ….)
- If renegotiation occurs, it is costly i.e. a part of the surplus is destroyed
A list of propositions

- Negative shocks (decrease in demand, cost shocks) increase the probability of renegotiation
- The higher the contract incentives (price-cap), the higher the probability of renegotiation
  - But not exogenous: the most efficient firms might pick-up price-cap contracts
- Weight on the utility of the firm in the regulator maximization program in order to reflect possible “capture”
  - The more captured is the regulator, the more probably the contract is renegotiated
    - Associated with political changes at election times
- Good quality of existing institutions should reduce the probability or renegotiation
- The existence of a regulatory body should decrease the probability of renegotiation (i.e. more experience in concession contracting or less captures)
- Minimum income guarantee should reduce the probability to renegotiate
307 contracts, 12 years, leading to 1267 observations

Renegotiation?

“We say that a concession contract is renegotiated when a major revision, not envisioned in the original contract, takes place”.

“Scheduled ordinary and extraordinary tariff revisions or minor adjustments to the contract are not considered to be a renegotiation”

Contracts signed with a regulator might be “lighter” with emphasis put on the process to accommodate with changes. Then more “adaptations” but less “renegotiations” when a regulator exist
# Variables

## Table 2

List of variables, source and summary statistics

<table>
<thead>
<tr>
<th>Dummy variables, 1 = Yes, 0 = No</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Renegotiation: Dummy variable indicating whether there was or not a renegotiation of the concession contract.</td>
<td>162 (52.8%)</td>
<td>145 (47.2%)</td>
</tr>
<tr>
<td>Renegotiation initiated by the firm</td>
<td>53 (17.3%)</td>
<td>254 (82.7%)</td>
</tr>
<tr>
<td>Renegotiation initiated by the government</td>
<td>94 (30.6%)</td>
<td>213 (69.4%)</td>
</tr>
<tr>
<td>Renegotiation initiated by both</td>
<td>15 (4.9%)</td>
<td>292 (95.1%)</td>
</tr>
<tr>
<td>Existence of regulatory body: Dummy variable indicating whether there was or not a regulatory body at the time of the concession first coming into operation.</td>
<td>180 (58.6%)</td>
<td>127 (41.4%)</td>
</tr>
<tr>
<td>Price cap: Dummy variable indicating whether the tariff regulation imposed by the regulator is a price cap.</td>
<td>283 (92.2%)</td>
<td>24 (7.8%)</td>
</tr>
<tr>
<td>Investment requirements: Dummy variable indicating whether there are or not investment requirements as part of the concession contract.</td>
<td>235 (76.5%)</td>
<td>72 (23.5%)</td>
</tr>
<tr>
<td>Private financing: Dummy variable indicating whether the project is funded entirely through private funds (without any financial investment of the state, whether local or national) or not.</td>
<td>160 (52.1%)</td>
<td>147 (47.9%)</td>
</tr>
<tr>
<td>Bidding process: Dummy variable indicating whether there was or not a bidding process to award the concession.</td>
<td>272 (88.6%)</td>
<td>35 (11.4%)</td>
</tr>
<tr>
<td>Minimum income guarantee: Dummy variable indicating whether there is or not a government guarantee in terms of minimum income promissory.</td>
<td>63 (20.5%)</td>
<td>244 (79.5%)</td>
</tr>
<tr>
<td>Arbitration process: Dummy variable indicating whether there is or not a formal set of arbitration processes stated in the contract providing for the settlement of a dispute between the concession holder and the government, should such a situation arise.</td>
<td>179 (58.3%)</td>
<td>128 (41.7%)</td>
</tr>
<tr>
<td>Election: Dummy variable indicating whether there were or not national elections (legislative or presidential) in any given year. Source: Political Database of the Americas. Georgetown University/Organization of American States. Center for Latin American Studies.</td>
<td>n.r.</td>
<td>n.r.</td>
</tr>
</tbody>
</table>
### Continuous variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>S.D.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Duration since award: Indicates the number of years a concession has been in operation since its award.</td>
<td>n.r.</td>
<td>n.r.</td>
</tr>
<tr>
<td>Duration of concession: Duration, in years, for which the concession is signed for.</td>
<td>21.77</td>
<td>8.95</td>
</tr>
<tr>
<td>Corruption: Index from Political Risk Service, International Country Risk Guide; annual values from 1989 to 1995, and 1998 value after that. Range from 1 to 6. Higher value means less corruption.</td>
<td>2.94</td>
<td>0.69</td>
</tr>
<tr>
<td>Exchange rate: Annual evolution of the real exchange rate (calculated as (index rate of year t− index rate of year t−1)/ index rate of year t). A positive value indicates depreciation. Source: Inter-American Development Bank.</td>
<td>n.r.</td>
<td>n.r.</td>
</tr>
</tbody>
</table>

Note: For variables varying over time, like the election dummy, duration since award, and macroeconomic variables, the summary statistics are meaningless and are omitted (denoted by n.r.: non relevant).
# Data

Table 3  
Characteristics of the concessions by sector

<table>
<thead>
<tr>
<th></th>
<th>Transport</th>
<th></th>
<th></th>
<th>Water</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
<td>Yes</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Renegotiations</td>
<td>99</td>
<td>119</td>
<td>63</td>
<td>29.2%</td>
<td>26</td>
<td>29.2%</td>
</tr>
<tr>
<td>Renegotiations initiated by firms</td>
<td>49</td>
<td>169</td>
<td>85</td>
<td>95.5%</td>
<td>77.5%</td>
<td>85</td>
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<tr>
<td>Renegotiations initiated by the government</td>
<td>35</td>
<td>183</td>
<td>85</td>
<td>95.5%</td>
<td>9.5%</td>
<td>85</td>
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<tr>
<td>Renegotiations initiated by both</td>
<td>15</td>
<td>203</td>
<td>100.0%</td>
<td>86.5%</td>
<td>86.5%</td>
<td>86.5%</td>
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<tr>
<td>Existence of regulatory body</td>
<td>168</td>
<td>50</td>
<td>77</td>
<td>33.3%</td>
<td>22.9%</td>
<td>86.5%</td>
</tr>
<tr>
<td>Bidding process</td>
<td>185</td>
<td>33</td>
<td>203</td>
<td>9.6%</td>
<td>83.9%</td>
<td>95.5%</td>
</tr>
<tr>
<td>Investment requirements</td>
<td>198</td>
<td>20</td>
<td>63</td>
<td>33.3%</td>
<td>22.9%</td>
<td>86.5%</td>
</tr>
<tr>
<td>Private financing only</td>
<td>139</td>
<td>79</td>
<td>79</td>
<td>36.2%</td>
<td>83.9%</td>
<td>85</td>
</tr>
<tr>
<td>Price cap regulation</td>
<td>199</td>
<td>19</td>
<td>199</td>
<td>91.3%</td>
<td>83.9%</td>
<td>85</td>
</tr>
<tr>
<td>Rate of return regulation</td>
<td>19</td>
<td>199</td>
<td>199</td>
<td>91.3%</td>
<td>83.9%</td>
<td>85</td>
</tr>
<tr>
<td>Arbitration process</td>
<td>172</td>
<td>46</td>
<td>172</td>
<td>21.1%</td>
<td>22.9%</td>
<td>86.5%</td>
</tr>
<tr>
<td>Minimum income guarantee</td>
<td>62</td>
<td>156</td>
<td>62</td>
<td>28.4%</td>
<td>71.6%</td>
<td>28.4%</td>
</tr>
</tbody>
</table>
### Results

**Table 5**

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Existence of regulatory body</strong></td>
<td>-1.29*** (0.21)</td>
<td>-1.09*** (0.21)</td>
<td>-1.08*** (0.21)</td>
<td>-1.51*** (0.26)</td>
<td>-1.21*** (0.21)</td>
</tr>
<tr>
<td><strong>Price cap</strong></td>
<td>0.55* (0.33)</td>
<td>0.60* (0.33)</td>
<td>0.81** (0.33)</td>
<td>0.54 (0.33)</td>
<td>0.20*** (0.05)</td>
</tr>
<tr>
<td><strong>Duration since award</strong></td>
<td>0.20*** (0.04)</td>
<td>0.19*** (0.05)</td>
<td>0.20*** (0.05)</td>
<td>0.15*** (0.05)</td>
<td>0.20*** (0.05)</td>
</tr>
<tr>
<td><strong>Investment requirement</strong></td>
<td>0.78** (0.39)</td>
<td>0.60 (0.39)</td>
<td>0.65* (0.38)</td>
<td>0.62* (0.37)</td>
<td>0.68** (0.27)</td>
</tr>
<tr>
<td><strong>Private financing</strong></td>
<td>0.51** (0.27)</td>
<td>-0.11 (0.48)</td>
<td>0.15 (0.29)</td>
<td>0.68** (0.27)</td>
<td>0.21 (0.15)</td>
</tr>
<tr>
<td><strong>Bureaucratic quality</strong></td>
<td>-0.28** (0.13)</td>
<td>-0.35** (0.14)</td>
<td>-0.39*** (0.14)</td>
<td>-0.21 (0.15)</td>
<td>-0.70*** (0.14)</td>
</tr>
<tr>
<td><strong>Arbitration process</strong></td>
<td>0.73 (0.55)</td>
<td>0.73 (0.55)</td>
<td>0.73 (0.55)</td>
<td>0.73 (0.55)</td>
<td>0.73 (0.55)</td>
</tr>
<tr>
<td><strong>Corruption</strong></td>
<td>0.30* (0.18)</td>
<td>0.29 (0.19)</td>
<td>0.27 (0.19)</td>
<td>0.40* (0.20)</td>
<td>0.34** (0.17)</td>
</tr>
<tr>
<td><strong>Election-1</strong></td>
<td>-0.07*** (0.02)</td>
<td>-0.06*** (0.02)</td>
<td>-0.06*** (0.02)</td>
<td>-0.07*** (0.02)</td>
<td>-0.07*** (0.02)</td>
</tr>
<tr>
<td><strong>GDP growth-1</strong></td>
<td>-0.14*** (0.02)</td>
<td>-0.14*** (0.02)</td>
<td>-0.14*** (0.02)</td>
<td>-0.15*** (0.03)</td>
<td>-0.15*** (0.03)</td>
</tr>
<tr>
<td><strong>Exchange rate-1</strong></td>
<td>1.47** (0.65)</td>
<td>1.47** (0.65)</td>
<td>1.47** (0.65)</td>
<td>1.47** (0.65)</td>
<td>1.47** (0.65)</td>
</tr>
<tr>
<td><strong>Exchange rate-2</strong></td>
<td>4.60*** (0.90)</td>
<td>4.60*** (0.90)</td>
<td>4.60*** (0.90)</td>
<td>4.60*** (0.90)</td>
<td>4.60*** (0.90)</td>
</tr>
<tr>
<td><strong>Transport sector dummy</strong></td>
<td>1.25*** (0.25)</td>
<td>0.75** (0.34)</td>
<td>0.59 (0.39)</td>
<td>1.05*** (0.36)</td>
<td>0.96*** (0.34)</td>
</tr>
<tr>
<td><strong>Number of observations</strong></td>
<td>1267</td>
<td>1132</td>
<td>1100</td>
<td>1132</td>
<td>1122</td>
</tr>
<tr>
<td><strong>Log likelihood</strong></td>
<td>-143.59</td>
<td>-132.49</td>
<td>-130.97</td>
<td>-125.21</td>
<td>-144.92</td>
</tr>
</tbody>
</table>

**Marginal effects (dy/dx)**

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Existence of regulatory body</strong></td>
<td>-0.073</td>
<td>-0.050</td>
<td>-0.051</td>
<td>-0.075</td>
<td>-0.064</td>
</tr>
<tr>
<td><strong>Price cap</strong></td>
<td>0.009</td>
<td>0.011</td>
<td>0.009</td>
<td>0.009</td>
<td>0.010</td>
</tr>
<tr>
<td><strong>Duration since award</strong></td>
<td>0.006</td>
<td>0.005</td>
<td>0.006</td>
<td>0.003</td>
<td>0.006</td>
</tr>
<tr>
<td><strong>Investment requirement</strong></td>
<td>0.013</td>
<td>0.012</td>
<td>0.009</td>
<td>0.012</td>
<td>0.012</td>
</tr>
<tr>
<td><strong>Private financing</strong></td>
<td>0.012</td>
<td>-0.003</td>
<td>0.003</td>
<td>0.017</td>
<td>0.017</td>
</tr>
<tr>
<td><strong>Bureaucratic quality</strong></td>
<td>-0.009</td>
<td>-0.010</td>
<td>-0.011</td>
<td>-0.005</td>
<td>-0.020</td>
</tr>
<tr>
<td><strong>Arbitration process</strong></td>
<td>0.018</td>
<td>0.009</td>
<td>0.011</td>
<td>0.012</td>
<td>0.012</td>
</tr>
<tr>
<td><strong>Corruption</strong></td>
<td>0.010</td>
<td>0.009</td>
<td>0.009</td>
<td>0.011</td>
<td>0.012</td>
</tr>
<tr>
<td><strong>Election-1</strong></td>
<td>-0.002</td>
<td>-0.002</td>
<td>-0.002</td>
<td>-0.001</td>
<td>-0.001</td>
</tr>
<tr>
<td><strong>GDP growth-1</strong></td>
<td>-0.004</td>
<td>-0.004</td>
<td>-0.004</td>
<td>-0.003</td>
<td>-0.003</td>
</tr>
<tr>
<td><strong>Exchange rate-1</strong></td>
<td>0.043</td>
<td>0.135</td>
<td>0.135</td>
<td>0.135</td>
<td>0.135</td>
</tr>
<tr>
<td><strong>Exchange rate-2</strong></td>
<td>0.024</td>
<td>0.014</td>
<td>0.013</td>
<td>0.014</td>
<td>0.018</td>
</tr>
</tbody>
</table>

Dependent variable: Dummy variable indicating the occurrence of renegotiation initiated by the firm.
Standard errors in parenthesis. Coefficients significant at the 1% (***) , 5% (*) and 10% (*) level.

* For dummy variables, dy/dx is for discrete change from 0 to 1. For continuous variables, it corresponds to an increase by 1 unit.
Main Results

- The existence of a regulatory body
  - “In our data set, it is considered that there is an existing regulator if the specific concession is regulated by an agency distinct from the (local) government itself”.
  - The presence of such a regulator consistently implies an average reduction in the probability of renegotiation of between 5 and 7.3%.
- Price-cap contracts are used in more than 90% of the case and favor renegotiation.
Policy implications

- Need for independent and specialized regulators
  - Increased competencies at the contract negotiation stage
  - On-going flexible regulation at the execution stage (not captured in the data)
    - Flexibility without opportunism

- Cost-plus might be more attractive than price-cap for developing countries
  - Price cap raises the cost of capital
  - Price caps' greater riskiness and fragility to shocks led to more renegotiations
  - As contracts were renegotiated very quickly, about 2 years on average, after the award of the concession (Guasch, 2004), there was little risk bearing for firms
  - Firms kept the efficiency gains when business was good and renegotiated when it was poor.
  - Ultimately, by endogenizing the review period, renegotiations tended to transform many price caps into rate of return regimes in bad times, delegitimizing the price cap regime.
Remark 1.

- “High rates of contract renegotiation have raised serious questions about the viability of the concession model … in developing countries” (p. 421)
- Is this really specific to developing countries?
Renegotiations

- Renegotiations are the rule, not the exception

- Renegotiation rate of 121 PFI contracts signed before 2000 in the UK has been estimated at 55% (NAO [2001]) but the House of Commons (2011) pointed out the fact that one drawback of English PFIs is their rigidity!

- A recent study on Car Park concessions in France found out that the frequency of renegotiation is once every three years on average (de Brux & al 2011).
- Engel, Fisher, et Galetovic (2011) found concerning transport concessions signed since 1991 in the United States that “six out of twenty projects have undergone a major change in the initial contractual agreement, and two additional projects have pending renegotiations” ((2011), page 11)...
Remark 2

- Are we sure that renegotiations are usually non cooperative ones?
  - Win-Win-Win game?

- Tools that may restrain firm’s opportunistic behaviors are
  - Reputation
  - The willingness to be renewed at the end of the contracts (repeated game)
Two complementary studies

- **Lock-in effect and renewal**
    - Main findings: lock-in effects exist only for small cities (See also Levin and Tadelis 2011 for the same conclusion in the US)

- **Impact of renegotiations**
Impact of renegotiations

- Investigate the impact of renegotiations on the satisfaction of parties and on contractual surplus
  - Surplus and parties’ satisfaction are nearly impossible to assess
  - **Assumption:** contract renewal indirectly measures the satisfaction of parties from their previous contractual relationship
  - **Explanation:** for a given contract that is ending, we can reasonably believe that if parties are satisfied, the probability to renew their contract is higher compared to the case where they would feel prejudiced.
Data

- Scope of the database:
  - Focus on 252 expired contracts / 477 renegotiations / 166 renewals
  - Contracts of 1 firm with 135 different municipalities
  - Signed between 1969 and 2008
  - Every renegotiation is codified
The impact of renegotiations on contract renewals.

- Who decide of contract renewal?
  - Municipalities for delegated-concession contracts – *intuitu personae principle* in France
  - Bidders for traditional contracts

- Data set:
  - 158 traditional contracts
  - 94 concession contracts

Important remark
# Renewal and Renegotiations

<table>
<thead>
<tr>
<th></th>
<th>All Contracts</th>
<th>Delegated Management</th>
<th>Public Procurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of expired contracts</td>
<td>252</td>
<td>94</td>
<td>158</td>
</tr>
<tr>
<td>Number of contract renewals</td>
<td>166</td>
<td>42</td>
<td>124</td>
</tr>
<tr>
<td>Rate of contract renewals</td>
<td>65.9</td>
<td>44.7</td>
<td>78.4</td>
</tr>
<tr>
<td>Average number of renegotiations per year of expired contracts</td>
<td>0.420</td>
<td>0.381</td>
<td>0.453</td>
</tr>
<tr>
<td>Average number of renegotiations per year of expired contracts leading to renewal</td>
<td>0.443</td>
<td>0.402</td>
<td>0.458</td>
</tr>
<tr>
<td>Average number of renegotiations per year of expired contracts not leading to renewal</td>
<td>0.391</td>
<td>0.364</td>
<td>0.433</td>
</tr>
</tbody>
</table>
What may explain the willingness of the parties to renew their contract together?

**Feature of renegotiations**

<table>
<thead>
<tr>
<th>Variables</th>
<th>Définitions</th>
</tr>
</thead>
<tbody>
<tr>
<td>NoReneg</td>
<td>1 if the contract was never renegotiated</td>
</tr>
<tr>
<td>Speed</td>
<td>Celerity of the 1st renegotiation after signature</td>
</tr>
<tr>
<td>AverageReneg</td>
<td>Frequence of renegotiations (per year)</td>
</tr>
<tr>
<td>Reneg…</td>
<td>Tariffs, Investments, Quality, FinanEq, Duration, Index</td>
</tr>
<tr>
<td>Scope</td>
<td>Number or renegotiated dimensions</td>
</tr>
</tbody>
</table>
What may explain the willingness of the parties to renew their contract together?

<table>
<thead>
<tr>
<th>Variables</th>
<th>Définitions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PastExperiences</strong></td>
<td>number of other expired contracts the private operator and the public authority had together at the date of expiration</td>
</tr>
<tr>
<td><strong>MultiContract</strong></td>
<td>number of other contracts the private operator and the public authority currently have together at the date of expiration</td>
</tr>
<tr>
<td><strong>SameArea</strong></td>
<td>number of other public authorities in the same region with which the operator has contracts at the date of expiration</td>
</tr>
<tr>
<td><strong>ChangeOfMayor</strong></td>
<td>1 if there was a change of mayor during the last year before the end of the contract</td>
</tr>
<tr>
<td><strong>Year</strong></td>
<td>year of expiration of the contract</td>
</tr>
<tr>
<td><strong>Size / Competition</strong></td>
<td>number of inhabitants of the municipality at the date of expiration</td>
</tr>
<tr>
<td><strong>Build</strong></td>
<td>1 if the construction of the infrastructure was included in the Contract</td>
</tr>
<tr>
<td><strong>Duration</strong></td>
<td>Duration of the contract</td>
</tr>
</tbody>
</table>
Estimates

$$Renewed_{it} = a.X_{it} + b.Y_{it} + e_i$$

**Where:**
- $Renewed_{it}$ = binary variable that indicates whether the contract $i$ is renewed or not at time $t$ *with the same private partner*
- $X_{it}$ is a vector of variables that groups the different features of renegotiations
- $Y_{it}$ is a set of control variables
- $e_i$ is the error term
Main result and implications

- **When there is discretionary power:**
  - There is an optimal level of renegotiations (0.5 – 0.7)
  - Some renegotiation types influence positively (negatively) the willingness of the parties to contract again together.
  - The scope of renegotiations and the celerity of the first one matter as well.

- Results vanished when there is no discretionary power (i.e. traditional procurement)

- **Implications:**
  - “the frequency of contract renegotiation may provide concessions 'relational' quality” (Spiller 2008)!
CONCLUSION

- What is regulation of public services?
  - A mix of complementing different instruments, used in accordance with the complexity of the transaction
Institutional dotation

Mecanisms of regulation outside the contract

Mecanisms of regulation within the contract

Contract issues
- Make or buy
- Auctions
- Incentives
Regulation of public services

Contract issues
- Make or buy
- Auctions
- Incentives
Regulation of public services

Mecanismos of regulation within the contract

- Credible commitment
- Penalties
- Auditing
- Governance of the contractual relationships
Regulation of public services

Mecanisms of regulation outside the contract

- Regulator
- Regulation rules (i.e. Directive / Law)
Institutional dotation

- Norms
- Corruption level
  - ...
A new Directive for concession contracts in Europe

- Objective? To spend public funds efficiently (large part of the European GDP!)
- Why? Because of current lack of transparency concerning awards
- No directive for « Service Concessions »
  - Often are observed direct awards of concession without any competition
    - Risk of favoritism
    - Corruption
Main Elements of the European Commission’s Proposal (December 2011)

Main (lawyers) idea: Let’s put in place rules of the game in order to foster competition and reduce public authorities’ discretionary power (i.e. reduce corruption and favoritism)

Solution is:

- Compulsory publication of call for tenders
- Obligations for the selection and award of concessions
  - Objective criteria
  - Weighted criteria when possible
- Pragmatic renegotiation rules
  - No more change than 5% of the price of the initial concession contract
But …

What the theory suggests is that knowing renegotiations WILL OCCUR:

- A (limited) discretionary power of the buyer (at the selection stage) might be necessary
- Reputation of bidders should enter into criteria (US. Vs Europe)
  - Select the one you know you will be able to (re)negotiate with because you will renegotiate for sure. This is a long term partnership…
  - Select the less opportunistic
    - Some empirical studies confirm this proposition: Pacini and Spagnolo 2011, Bajari-McMillan-Tadelis 2009

But then how to avoid favoritism and bad renegotiations?
The European Parliament view

« The rapporteur backs a legislative initiative in this field but wants it to be “light” - in other words, he believes that it is unnecessary to regulate all the details of the attribution of these contracts and wants to avoid red tape and extra costs, while defining a clear legal framework ».

- « The report stresses that the concession is similar to the economic concept of an incomplete contract which, by nature, will be modified, thus the flexibility of awarding entities is required in the execution procedure and in the terms of execution of the contract ».

- « Juvin also sets the goal of guaranteeing a balance between this negotiating margin and the need for transparent procedures to prevent any eroding of the principle of equal treatment, while keeping this from resulting in excessive costs ».
June 20th 2013

Florence School of Regulation speach:
« There will be no sector excluded from the Directive!!! »
Exclusion of water from the Concessions Directive: Statement by Commissioner Barnier

21/06/2013

“For months now, there have been reports that the European Commission is trying to privatise water by the back door, through its proposal on concessions. This has never been the intention. (...) Despite all the changes to the legal text, (...) it is my judgment that the text we now have relating to water (...) does not provide the reassurances that citizens expect (...). That is why the best solution now appears to remove water from the scope of the concessions directive”. Statement by Commissioner Barnier.
Political issues !!

- Next two classes