

Is the Private Sector more Efficient?

A cautionary tale

Introduction

This review finds **no conclusive evidence that one model of ownership (i.e. public, private or mixed) is intrinsically more efficient than the others**, irrespective of how efficiency is defined¹. Instead the literature suggests that the efficiency of service provision is dependent on the type of service (health, education, etc.) and other specific contextual factors (e.g. regulation, market competition).

... literature suggests that efficiency depends on factors such as country context, the sector, the market the firm operates in and the firm's organisation, rather than ownership.

This summary is not based on a systematic review but on an overview of key evidence in the field. It does not assess the methodological rigour of the studies cited, and it should be noted that different studies using the same data have produced conflicting results.

Most literature comparing ownership models looks at specific service sectors: health, education, water, sanitation, and so on. The literature that compares public and private provision in general tends to

be made up of opinion pieces (e.g. Simms, 2013) and lacks rigour in comparison to academic and policy studies. The rigorous literature that does exist suggests that efficiency depends on factors such as country context, the sector, the market the firm operates in and the firm's organisation, rather than ownership.

Challenges of comparison and defining efficiency

The key challenges to comparing efficiency between public and private ownership models are the range of models (including hybrids), and variations in defining efficiency. Different models of service provision vary in the types of goods they deliver and the characteristics of the sector they operate in (Batley & Larbi, 2004; Batley & Mcloughlin, 2015). This means each model is vulnerable to different causes of inefficiency and like-for-like comparisons are difficult. Efficiency is difficult to measure with certain types of goods and services, especially public goods which are non-rivalrous

and non-excludable: that is, where one person's use does not prevent another's use, and it is not possible to exclude those who do not pay from benefiting (e.g. street lighting). The type of market failure, the tasks involved in service delivery and how the service is demanded, also impact on service governance and consequently efficiency.

There are a range of definitions for efficiency. Efficiency can be defined based purely on cost, but also on the degree to which the provision of goods addresses issues of need or equity, and adapts to evolving demands and practices (Andrews & Entwistle, 2013; Stone, 2014). Most literature identified focuses on cost when referring to efficiency.

► Health:

Most of the literature identified in this review is focused on the health sector. In this sector there is no conclusive evidence that either public or private provision is more efficient (Hsu, 2010; Shen, Eggleston, Lau, & Schmid, 2007; Sibbel & Nagarajah, 2012). This finding is replicated across high-, middle- and low-income countries. However, the literature does highlight a difference between private for-profit and private non-profit providers. While private non-profit providers have similar levels of efficiency to public hospitals, many studies find that private for-profit hospitals have lower levels of efficiency than the other two models (Daidone & D'Amico, 2009; Dormont & Milcent, 2013; Shen et al., 2007; Sibbel & Nagarajah, 2012). Some literature suggests that perverse incentives to over-treat in private for-profit hospitals drives down efficiency (Basu, Andrews, Kishore, Panjabi, & Stuckler, 2012).

► Education:

In the education sector the evidence suggests a difference between high-income countries and others. In high-income countries the limited research shows conflicting results with different studies finding in favour of alternatively public or private ownership (Crespo-Cebada, Pedraja-Chaparro, & Santin, 2013; Mancebón & Muñiz, 2008; Perelman & Santin, 2011). In low- and middle-income countries, the evidence suggests greater efficiency of private schools (Coulson, 2009; Day Ashley et al., 2014). Greater efficiency in private provision has been attributed to lower pay, recruitment autonomy, and market-like conditions (Kingdon, 2009; Muralidharan & Kremer, 2009; PROBE Team, 1999). There is also some evidence to suggest that teacher absenteeism is lower in private schools and teaching quality is higher (Kingdon,

¹ Examples of types of efficiency explored within the literature include: productive, allocative, equitable, and dynamic (Andrews & Entwistle, 2013; Stone, 2014).



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2009; Kremer, Chaudhury, Rogers, Muralidharan, & Hammer, 2005; PROBE Team, 1999). Some studies on public-private partnerships suggest that a combination of public funding with private management can result in greater efficiency than other models (Kingdon, 2007).

▶ **Water, sanitation and waste:**

Studies on water, sanitation and waste present conflicting findings (Estache & Rossi, 2002; Hall & Lobina, 2005; Pérard, 2009; Prasad, 2006). Country studies find that in some cases private ownership (or private participation) is associated with greater efficiency (e.g. Italy - LoStorto, 2013), and in other cases less efficiency (e.g. France - Lannier & Porcher, 2014). In these sectors, geographic and other service delivery characteristics are more likely to determine efficiency than ownership (Hall & Lobina, 2005; Ichinose, Yamamoto, & Yoshida, 2013).

▶ **Privatisation of state owned enterprises:**

Studies which look at the comparative efficiency of enterprises before and after privatisation (i.e. the transfer of ownership from public to private) find that privatisation can lead to improved efficiency, but this is not always the outcome (D'Souza, Megginson, & Nash, 2005; Megginson & Netter, 2001). A significant number of high-income country studies find efficiency improves following privatisation, though this may be due, at least in part, to additional factors such as competitive pressures (which have been created in some cases without privatisation), regulation, institutional development and property rights enforcement (Djankov & Murrell, 2002; D'Souza et al., 2005; Megginson & Netter, 2001). Enterprises with substantial market power

often have not improved efficiency following privatisation, possibly as they are relatively insulated from competition (Vickers & Yarrow, 1991). Evidence from low- and middle-income countries is limited and more mixed. In some cases privatisation has increased efficiency (e.g. Nigeria - Agba, Ushie, Agba, & Nkpoyen, 2010), and in other cases there has been no difference (e.g. Iran - Alipour, 2013; Egypt - Omran, 2004; Bulgaria - Tatahi, 2012). The studies suggest there needs to be additional factors (e.g. a developed stock market) or prior reforms (e.g. national banking reforms) for privatisation to improve efficiency in these contexts.

Key points:

- ▶ No model of ownership (public, private, or mixed) is intrinsically more efficient than the others, but there are efficiency differences within certain service sectors and specific contexts.
- ▶ Literature which broadly compares efficiency between public and private models lacks rigour, whereas sectoral literature, especially in health and education, is more rigorous although often inconclusive.
- ▶ Efficiency of service provision under all ownership models depends on factors such as competition, regulation, autonomy in recruitment and salary, and wider financial and legal institutional development.

For a more detailed coverage of whether the Private Sector is really more efficient, please refer to the full paper at: <http://bit.ly/GCPSEvidence>

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UNDP Global Centre for Public Service Excellence

#08-01, Block A
29 Heng Mui Keng Terrace West Coast,
Singapore 119620

T: +65 6908 1063
F: +65 6774 4571
E: registry.sg@undp.org

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