Since Williamson’s 1976 study of franchise bidding for natural monopolies, there has been extensive debate concerning the degree to which transaction-cost problems actually afflict government franchising in practice. We contribute to this debate by proposing that municipalities vary in their ability to discipline franchisees, and that this heterogeneous ability affects franchise renewal patterns and the quasi-rents that franchisees can extract. We study the provision of municipal water services in France, a setting that is characterized by a mix of direct public provision and franchising of private providers. We find that municipalities with fewer than 10,000 residents pay a significant price premium for water provided by private franchisees as compared to publicly provided water, ceteris paribus; in contrast, larger municipalities do not pay a premium. We also find that larger municipalities are significantly less likely to renew an incumbent franchisee that charges an “excessive” price for water, while small municipalities’ renewal patterns are not influenced by franchisees’ excessive pricing. We interpret the results as evidence that although large municipalities are able to discipline franchisees and thus prevent extraction of quasi-rents, small municipalities are less able to do so.

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