

DISCUSSION PAPER SERIES

Discussion paper No. 186

Hold-up Problems in Contracting Out Waste
Collection Services

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January 2019



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Hold-up Problems in Contracting Out Waste Collection Services*

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Abstract

It is reported previously that, in contracting out waste collection services to private enterprises, there is generally an inverse relationship between the contracting-out rate and the contract price, but this inverse relationship levels out as the degree of contracting-out increases and the contract price even goes up eventually as the contracting rate approaches 100%. In this paper, we construct a simple bargaining model between municipal governments and private firms and identify how the bargaining equilibrium differs from an outcome where municipal governments can make take-it-or-leave-it offers to private enterprises. Through a simple simulation analysis, in addition, we demonstrate that hold-up concerns of local governments can indeed lead to a U-shaped relationship between the contracting-out rate and the contract price across different municipalities.

Keywords: bargaining, contracting-out, contract price, hold-up, waste collection

JEL Codes: H42, L33

*The authors thank useful comments by the participants of a workshop at Tohoku University of Community Service and Science. The usual disclaimer applies.

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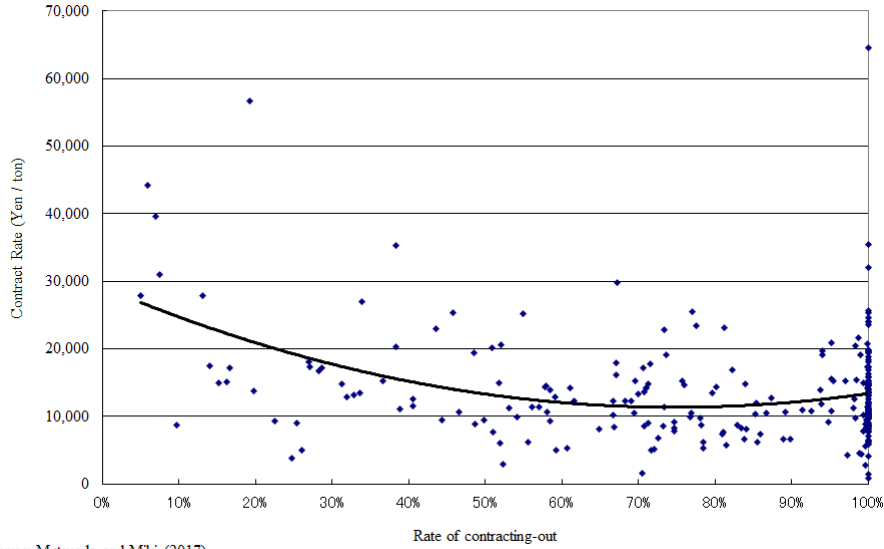
1 Introduction

It is common in developed nations that local authorities are legally responsible for the collection and disposal of household waste. Since around the 1980's, the contracting-out of household waste collection services to private firms has been widely promoted. In the case of Japan, contracting-out was encouraged primarily to ease the burden of municipal governments, which were sometimes financially troubled, by reducing the operating expenditure of waste collection services in general. This trend was further strengthened during the 90's when Japan experienced a prolonged recession and also when the privatization and contracting-out of "blue-collar" public services, including waste collection and disposal services, became even more politically fashionable among many developed countries.

Although there exist a number of empirical studies that identify significant cost savings from contracting out municipal waste collection services to private contractors,¹ few studies analytically examine what actually determines the political decision-makers' choice between private and public firms (Ohlsson 2003). One interesting feature of their decision-makings is that contracting-out is not necessarily an all-or-nothing deal, as we will see below for the case of household waste collection services in Japan. That is, it is often the case that a local government contracts out a certain portion of services to private firms but still keeps its own public operation unit despite the overwhelming empirical evidences that contracting-out would results in significant cost reductions for municipal governments.

In their recent study, Matsueda and Miki (2017) report that, based on their own survey conducted in 2004 for 412 local municipalities all across Japan, there was generally an inverse relationship between the contracting-out rate and the contract price, which is shown in Figure 1.

¹Based on the observations of 340 public and private firms in the US, Stevens (1978) indicated a cost decrease of 7 to 30% due to the contracting-out. For a sample of 205 Canadian cities, McDavid (1985) reported that public collection was 41% more expensive than private collection. Domberger et al. (1986) estimated the cost savings of 22% for contracting out household refuse collection in the UK. Reeves and Barrow (2000) showed that there is an enormous cost saving opportunity of around 45% for Ireland. Dijkgraaf and Gradus (2003) identified the cost savings of approximately 15 to 20% for the Netherlands.



Source: Matsueda and Miki (2017)

Figure 1: Contracting-out rates and contract prices in Japan

The solid quadratic regression line also indicates that this inverse relationship flattens as the contracting rate increases, and the contract price even moves up eventually as the contracting rate approaches 100%. While Matsueda and Miki (2017) suggest several potential sources that could lead to the inverse relationship between the contract price and the rate of contracting-out, they did not discuss why the contract price levels out and even goes up as the rate becomes sufficiently close to 100%. Indeed, such a phenomenon has rarely been reported in previous empirical studies, much less investigated analytically. Those studies have mainly focused on the comparisons of the collection costs between fully-public and fully-contracted-out entities and, in our opinion, left some intriguing phenomena, such as this one, unexplored.

In this paper, we investigate into this U-shaped relationship by constructing a simple bargaining model between municipal governments and private enterprises. In particular, we focus on the municipalities' hold-up concerns. Most household wastes need to be hauled away within a fairly short time-frame, usually weekly or twice weekly, due to public health and sanitation concerns. Once a municipal government fully contracts out its waste collection services to private firms and stops investing in its internal unit, it could create an environment where a private firm is able to make a better case for a

higher contract price by shifting the balance of bargaining positions in favor of a private firm. In particular, a private firm could threaten to go on a strike unless the contract price is raised. Such an issue would become more serious when a local government loses some pertinent skills and information in conducting waste collection services in a fairly efficient manner within a particular district.

As we demonstrate analytically below in a bargaining equilibrium, an important consequence of this hold-up concern is that, by anticipating the potential problem, a local government might decide to keep a larger portion of waste collecting operation internally than its simple expenditure-minimization would justify. In Figure 1, we can see that there are many municipalities that choose quite high percentages of contracting-out, but still retain a certain share of internal provision of waste collection services. The hold-up possibility that they could potentially face is one probable rationale for cutting down on the rate of contracting-out for municipalities.²

Such a hold-up situation would be more likely to pose a serious problem with a fewer number of potential contractors in a market, because then market forces could not completely wipe out the effect of even a false claim and also because firms are easier to collude to raise a tender price. Domberger and Jensen (1997) write, “[c]ontracting out is likely to be more (less) successful whenever the availability of competitive supply in the market, both actual or potential, is large (small)”. In the following analysis, we suppose that the competitiveness of a contracting market is reflected in the relative magnitudes of bargaining powers between a municipality and a potential contractor.

In the next section we set up a simple analytical model and examine its implications in order to gain insights into how the contracting-out decision by a municipal government is affected by the hold-up concerns. In the following section, we conduct a simple simulation analysis to illustrate how a U-shaped relationship emerges between the rate of contracting-out and the contract price across different municipalities. The final section concludes the paper.

²This is a completely different kind of hold up situation that has been discussed in the literature. Domberger and Jensen (1997) mentioned that the public ownership of the assets, such as specialized vehicles, and the existence of “relation-specific investments” that are sunk expenditures by the contractor results in under-investment, following a more general argument by Hart (1995).

2 The Model

In this section, we set up a simple analytical model with a local government and a potential private contractor in order to gain some insights into how household waste collection services are contracted out and, especially, how the size of the contracting price is related to the degree of contracting-out in a municipality.

2.1 Basic Set-ups

Let us suppose that there are I municipalities in total and each municipality is indexed by $i \in \{1, \dots, I\}$. Each municipality contains J districts within itself and a district is indexed by $j \in \{1, \dots, J\}$.³ We assume that there is a total waste amount of G_{ij} that needs to be collected in a district j of a municipality i , and G_{ij} is given exogenously.

A budget-conscious municipal government aims to minimize its total expenditure associated with collecting this amount of waste by choosing how much of G_{ij} is collected by a public enterprise and how much of it is contracted out to a private firm. We assume that there is a unique private firm in each district, mainly for the sake of simplicity, and discuss the implications of having multiple private firms which can potentially serve the same district later in the context of the “generalized” Nash bargaining solution.

We suppose that, in the absence of any investment (or effort) by the municipal government, the marginal cost of collecting waste through a public channel, which is denoted by b_{ij} , is greater than the marginal collection cost by a private enterprise, c_{ij} . However, the marginal cost of public waste collection service can be lowered through a deliberate investment by a municipal government. Such an investment reflects a government’s efforts to keep its waste collection section operational and more efficient. Specifically, we assume that the following equation holds:

$$a_{ij} = b_{ij} - e_{ij}, \tag{1}$$

where e_{ij} is the level of investment by this particular municipal government i in each district j , and a_{ij} is the marginal cost of collecting waste by this public firm after the

³Alternatively, different districts can be interpreted as different types of household wastes, such as burnable, non-burnable and recyclable wastes.

investment. Thus, a size of investment is measured in terms of its contribution to the resulting reduction in marginal collection cost.

We suppose that the cost of investment is given by the following quadratic form: $\frac{1}{2}\gamma_{ij}(e_{ij})^2$. It seems reasonable that the value of γ_{ij} depends on the size of the waste, G_{ij} , since it would be more costly to decrease one unit of the marginal collection cost if the collection volume is larger, for instance, due possibly to a larger collection area or to an increase in the varieties of waste. Thus, we will rewrite γ_{ij} as $\gamma_{ij}(G_{ij})$ later, but, for the simplicity of notation, we suppress the function's argument for the time being. Furthermore, we assume that e_{ij} has no spillover effect to other districts.

The order of the interactions is as follows. First, each municipal government i chooses the contracting-out rate α_{ij} for each district j . Thus, $\alpha_{ij}G_{ij}$ amount of waste is collected by a public firm and $(1 - \alpha_{ij})G_{ij}$ amount of waste is contracted out to a private firm in a district j of a municipality i . Next, the municipal government chooses the amount of investment, e_{ij} .⁴ Finally, the contract price is determined through the negotiation between the municipal government and the private firm. Instead of modeling the negotiation process in a specific non-cooperative game-theoretic manner, we resort to the generalized Nash bargaining solution, following the now well-established works on incomplete contracts (e.g., Hart 1995).

2.2 The Total Expenditure Minimization

Before deriving the equilibrium outcome of the above sequential game that involves a bargaining, as a benchmark outcome, let us obtain the result where a municipal government can make a take-it-or-offer to a private firm. This is essentially the hypothetical case where the government does not have to deal with a potential hold-up issue at all.

For a given contracting-out rate, α_{ij} , let e_{ij}^O be the level of the municipal government's investment which minimizes the total expenditure associated with collecting the waste amount of G_{ij} , including the cost of investment as well as the payment to a private firm, which is simply its total collection cost in this case. Thus, e_{ij}^O solves the following minimization problem:

⁴It is also possible that a private sector makes an investment choice as well, but we do not model it for the sake of simplicity as it would not change the qualitative implications obtained below.

$$\min_{e_{ij}} (b_{ij} - e_{ij}) (1 - \alpha_{ij}) G_{ij} + c_{ij} \alpha_{ij} G_{ij} + \frac{1}{2} \gamma_{ij} (e_{ij})^2, \quad (2)$$

whose first-order condition leads to

$$e_{ij}^O = \frac{(1 - \alpha_{ij}) G_{ij}}{\gamma_{ij}}. \quad (3)$$

Given (3), the total-expenditure minimizing contracting-out rate, α_{ij}^O , solves the following problem:

$$\min_{\alpha_{ij}} (b_{ij} - e_{ij}^O) (1 - \alpha_{ij}) G_{ij} + c_{ij} \alpha_{ij} G_{ij} + \frac{1}{2} \gamma_{ij} (e_{ij}^O)^2. \quad (4)$$

In light of the envelope theorem, the first-order condition for (4) is given by

$$0 = - (b_{ij} - e_{ij}^O) G_{ij} + c_{ij} G_{ij} = -G_{ij} \left[(b_{ij} - c_{ij}) - \frac{(1 - \alpha_{ij}) G_{ij}}{\gamma_{ij}} \right], \quad (5)$$

which yields:

$$\alpha_{ij} = 1 - \frac{\gamma_{ij} (b_{ij} - c_{ij})}{G_{ij}}. \quad (6)$$

Since $-\frac{G_{ij}^2}{\gamma_{ij}} < 0$, the second derivative of the objective function in (2) is negative, implying the function is a concave and quadratic function in α_{ij} . Invoking that γ_{ij} is actually a function of G_{ij} , or, $\gamma_{ij} = \gamma_{ij}(G_{ij})$, therefore, we can conclude

$$\alpha_{ij}^O = \begin{cases} 0 & \text{if } \frac{\gamma_{ij}(G_{ij})}{G_{ij}} (b_{ij} - c_{ij}) \leq \frac{1}{2} \\ 1 & \text{if } \frac{\gamma_{ij}(G_{ij})}{G_{ij}} (b_{ij} - c_{ij}) > \frac{1}{2} \end{cases}. \quad (7)$$

Note that the difference, $b_{ij} - c_{ij}$, measures how inefficient the public enterprise is in relation to the private firm before the investment and, if the difference is sufficiently large to allow the value of $\frac{\gamma_{ij}(G_{ij})}{G_{ij}} (b_{ij} - c_{ij})$ to exceed $\frac{1}{2}$, the municipal government i can minimize the total expenditure by entirely contracting out the waste collection service in its district j . Otherwise, the expenditure-minimizing choice is to provide the collection services totally on its own.

From (7), we can easily see that an increase in the cost of investment adjusted for

the scale of the waste, i.e., $\frac{\gamma_{ij}(G_{ij})}{G_{ij}}$,⁵ or in the *ex ante* difference between the marginal collection costs of the public and private sectors promotes the contracting-out, which are both quite intuitive.

2.3 The Bargaining Equilibrium

2.3.1 The Third (Bargaining) Stage

Given the levels of *ex post* marginal costs of collecting waste by the public and private enterprises, i.e., a_{ij} and c_{ij} , respectively, the total expenditure of collecting the waste G_{ij} to the municipal government is

$$a_{ij}(1 - \alpha_{ij})G_{ij} + c_{ij}\alpha_{ij}G_{ij} = [a_{ij}(1 - \alpha_{ij}) + c_{ij}\alpha_{ij}]G_{ij}, \quad (8)$$

if the contracting-out rate of α_{ij} is actually implemented. If all the waste collection is conducted publicly, the total cost is $a_{ij}G_{ij}$.

We suppose that the bargaining outcome is given by the generalized Nash bargaining solution. Let us assume that $a_{ij} > c_{ij}$ holds. Then, if we denote the players' payoffs as the negatives of the costs they respectively incur, the sum of the payoffs of the local government and the private firm can be written as

$$f_{ij} + g_{ij} = -[a_{ij}(1 - \alpha_{ij}) + c_{ij}\alpha_{ij}]G_{ij}, \quad (9)$$

where f_{ij} and g_{ij} are the respective payoffs of the private firm and the municipal government for this stage alone, only concerning this particular district. We suppose that the disagreement implies that the public sector must provide all the waste collection service for the district. In such a case, the government's payoff, i.e., g_{ij} is $-a_{ij}G_{ij}$, and the private firm's payoff, i.e., f_{ij} , becomes zero as it will not provide any service in this particular district.

With η ($0 \leq \eta \leq 1$) denoting the bargaining power of the private firm and, consequently, $1 - \eta$ the bargaining power of the municipal government, the respective parties'

⁵If $\gamma_{ij}(G_{ij})$ is linear in G_{ij} , the size of the waste has no effect on the chosen contracting-rate in (7). On the other hand, if $\gamma_{ij}(G_{ij})$ is strictly convex (*resp.* concave), a larger waste size encourages (*resp.* discourages) the contracting-out decision by the municipal government.

payoffs in the generalized Nash bargaining solution are the ones that solves the following problem:

$$\max_{f_{ij}, g_{ij}} f_{ij}^\eta (g_{ij} + a_{ij} G_{ij})^{1-\eta} \quad s.t. \quad f_{ij} + g_{ij} = -[a_{ij}(1 - \alpha_{ij}) + c_{ij}\alpha_{ij}] G_{ij}. \quad (10)$$

Solving the maximization problem above, we can obtain the private firm's payoff in the generalized Nash bargaining solution, denoted by f_{ij}^* , as

$$f_{ij}^* = \eta (a_{ij} - c_{ij}) \alpha_{ij} G_{ij}. \quad (11)$$

From (11), we can derive the contract price in the generalized Nash bargaining solution as

$$\eta (a_{ij} - c_{ij}) + c_{ij} = \eta a_{ij} + (1 - \eta) c_{ij}, \quad (12)$$

by taking into account the marginal cost of waste collection service by the private firm. It should be noted that, as η goes to zero, i.e., the bargaining power of the private firm diminishes, the contract price approaches its own marginal cost of collection. When $\eta = 0$, it effectively coincides with the non-bargaining case analyzed in the previous subsection.

On the other hand, the government's payoff in the generalized Nash bargaining solution, denoted by g_{ij}^* , is

$$g_{ij}^* = -a_{ij} (1 - \alpha_{ij}) G_{ij} - (\eta a_{ij} + (1 - \eta) c_{ij}) \alpha_{ij} G_{ij}, \quad (13)$$

where the first term is the collection cost by the public enterprise and the second term is the payment made to the private firm, given the contract price above.

2.3.2 The Second (Investment) Stage

Taking into account the value of g_{ij}^* that is determined in the subsequent stage as in (13), the municipal government chooses the level of its investment e_{ij} that minimizes the total expenditure associated with collecting the waste of size G_{ij} . Hence, the government

solves the following the problem:

$$\min_{e_{ij}} -g_{ij}^* + \frac{\gamma_{ij}}{2} e_{ij}^2 = (b_{ij} - e_{ij}) (1 - \alpha_{ij}) G_{ij} + (\eta a_{ij} + (1 - \eta) c_{ij}) \alpha_{ij} G_{ij} + \frac{\gamma_{ij}}{2} e_{ij}^2, \quad (14)$$

given the level of α_{ij} that has been determined in the preceding stage. Its first-order condition is

$$(1 - \alpha_{ij}) G_{ij} + \eta \alpha_{ij} G_{ij} = \gamma_{ij} e_{ij}. \quad (15)$$

Here, the first term on the left hand side represents the effect of an increase in e_{ij} on its own collection cost and the second term is its effect on lowering the contracting-out price determined in the following stage by increasing the government's disagreement payoff. We can see that an increase in α_{ij} lessens the former effect but it boosts the latter effect.

From (15), we can see that the government's optimal level of investment, e_{ij} , is given by

$$e_{ij}^* = \frac{1 - (1 - \eta) \alpha_{ij}}{\gamma_{ij}} G_{ij} \geq e_{ij}^O, \quad (16)$$

which indicates that the direct effect of an increase in α_{ij} on the public waste collection cost overwhelms its effect on the government disagreement payoff in total. This implies that, when the contracting-out rate increases, the government responds by lowering its investment that reduces the public enterprise's collection cost, even if it recognizes that a smaller investment would worsen its bargaining position in the subsequent stage. Moreover, (16) implies that the equilibrium investment level is always lower than the social-cost minimizing investment level except for the case of no contracting-out whatsoever, i.e. $\alpha_{ij} = 0$ and also for the case where the private firm has no bargaining power in the subsequent negotiation stage, i.e., $\eta = 0$.

Given (16), we need the following condition for having $a_{ij} > c_{ij}$:

$$b_{ij} - e_{ij}^* > c_{ij} \Leftrightarrow \alpha_{ij} > \frac{1}{1 - \eta} \left[1 - \frac{\gamma_{ij}}{G_{ij}} (b_{ij} - c_{ij}) \right]. \quad (17)$$

The last condition may not be met when α_{ij} is sufficiently small. If that is indeed the case, the agreement between the government and the private firm will not be reached and all the waste must be collected by the public enterprise since it is more efficient than the private counterpart. As a result, the payoffs in the third stage alone will be $g_{ij} = -a_{ij} G_{ij}$

and $f_{ij} = 0$. In this case, the optimal investment by the government is given by the solution to the following problem:

$$\min_{e_{ij}} -g_{ij}^* + \frac{\gamma_{ij}}{2} e_{ij}^2 = (b_{ij} - e_{ij}) \alpha_{ij} + \frac{\gamma_{ij}}{2} e_{ij}^2, \quad (18)$$

which yields $e_{ij}^* = \frac{G_{ij}}{\gamma_{ij}} = e_{ij}^O$. If the condition (17) is met, the contract price in the bargaining equilibrium is

$$\eta (b_{ij} - e_{ij}^*) + (1 - \eta) c_{ij} = \left[\eta b_{ij} + (1 - \eta) c_{ij} - \eta \frac{G_{ij}}{\gamma_{ij}} \right] + \frac{\eta (1 - \eta) G_{ij}}{\gamma_{ij}} \alpha_{ij}. \quad (19)$$

Thus, the contract price increases as α_{ij} gets bigger because an increase in the contracting-out rate aggravates the disagreement payoff of the municipal government, which will work against the government in the following bargaining stage.

2.3.3 The First (Contract) Stage

In this initial stage, the municipal government chooses the level of the contracting-out rate, α_{ij} , so as to minimize its total expenditure, including the cost of investment in the second stage. Therefore, it solves the following problem:

$$\min_{\alpha_{ij}} (b_{ij} - e_{ij}^*) (1 - \alpha_{ij}) G_{ij} + [\eta (b_{ij} - e_{ij}^*) + (1 - \eta) c_{ij}] \alpha_{ij} G_{ij} + \frac{\gamma_{ij}}{2} (e_{ij}^*)^2. \quad (20)$$

Let us, for the moment, suppose that the condition (17) holds for such a level of α_{ij} . In light of the envelope theorem again and combination with (16), the first-order condition for (20) is given by

$$\begin{aligned} 0 &= - (b_{ij} - e_{ij}^*) G_{ij} + [\eta (b_{ij} - e_{ij}^*) + (1 - \eta) c_{ij}] G_{ij} \\ &= - (1 - \eta) \left(b_{ij} - \frac{1 - (1 - \eta) \alpha_{ij}}{\gamma_{ij}} G_{ij} \right) G_{ij} + (1 - \eta) c_{ij} G_{ij}. \end{aligned} \quad (21)$$

Solving (21) for α_{ij} yields

$$\alpha_{ij} = \frac{1}{1 - \eta} \left[1 - \frac{\gamma_{ij} (b_{ij} - c_{ij})}{G_{ij}} \right], \quad (22)$$

which exactly coincides with the threshold of whether the agreement between the mu-

nicipal government and the private firm will be reached or not in (17). Since the second derivative of the objective function in (20) is $-\frac{(1-\eta)^2 G_{ij}^2}{\gamma_{ij}} < 0$, it is a concave and quadratic function in α_{ij} , and, therefore, the value of the objective function monotonically decreases as α_{ij} goes up from its value in (22).

If α_{ij} in (22) exceeds one-half, the government will collect all the waste through the public enterprise, i.e., $\alpha_{ij} = 0$, and the optimal investment becomes $e_{ij}^* = \frac{G_{ij}}{\gamma_{ij}}$. On the other hand, if α_{ij} in (22) is smaller than one-half, the optimal contracting-rate should be one. Invoking $\gamma_{ij} = \gamma_{ij}(G_{ij})$, once again, we can conclude that the optimal contracting-out rate, α_{ij}^* , which the municipal government should choose, is given by

$$\alpha_{ij}^* = \begin{cases} 0 & \text{if } \frac{\gamma_{ij}(G_{ij})}{G_{ij}} (b_{ij} - c_{ij}) \leq \frac{1}{2} + \frac{\eta}{2} \\ 1 & \text{if } \frac{\gamma_{ij}(G_{ij})}{G_{ij}} (b_{ij} - c_{ij}) > \frac{1}{2} + \frac{\eta}{2} \end{cases}. \quad (23)$$

which indicates that the choice of α_{ij}^* by the municipal government is distorted downwards in comparison with (7) which minimizes the total expenditure of waste collection without any bargaining. In the bargaining equilibrium, however, the municipal government tends to over-invest in the second stage in anticipation of the bargaining over the contract price in the subsequent stage, and this makes the contracting-out to the private enterprise a less attractive option for the municipal government. In summary, we can state the following:

Proposition 1. *As long as a private firm has a positive bargaining power, it is always the case that the contracting-out rate in the bargaining equilibrium is smaller than the expenditure-minimizing contracting-out rate in the absence of any bargaining power on the side of the private firm.*

We can also note that an increase in the cost of investment adjusted for the scale of the waste, i.e., $\frac{\gamma_{ij}(G_{ij})}{G_{ij}}$, or in the *ex ante* difference between the marginal collection costs of the public and private sectors, $b_{ij} - c_{ij}$, promotes the contracting-out, just as in the non-bargaining case.

3 Simulation

In this section, we present a simple simulation result which illustrate how a U-shaped relationship arises between the rate of contracting-out and the contract price across different municipalities.

As we have identified in the previous section, for a given distribution of bargaining powers, there are two main factors which influences the municipal government's decision on whether to contract out or not waste collection services in a certain district: the cost of investment adjusted for the scale of the waste (or, the degree of investment efficiency) and the *ex ante* difference between the marginal collection costs of the public and private sectors.

In the following simulation analysis, we have eighteen municipalities, each of which contains four districts of the same size, and assign them different values of $\frac{\gamma_{ij}(G_{ij})}{G_{ij}}$ and $b_{ij} - c_{ij}$. For simplicity, we fix the level of the parameter η at one half, thus endowing the equal bargaining powers to a municipal government and to a private firm in each district. The two tables in the appendix summarizes the particular values assigned to the eighteen municipalities. The first eight municipalities contain districts with different degrees of investment efficiency and the same *ex ante* difference between the marginal collection costs by public and private enterprises, whereas the next ten municipalities contain district with the same degree of investment efficiency but varying *ex ante* cost differences within respective municipalities. The tables also describe the resulting rates of contracting and average contract prices for respective municipalities at the bargaining equilibrium.

By plotting the data in a similar fashion to Figure 1 and regressing them to a quadratic function, we obtain the following Figure:

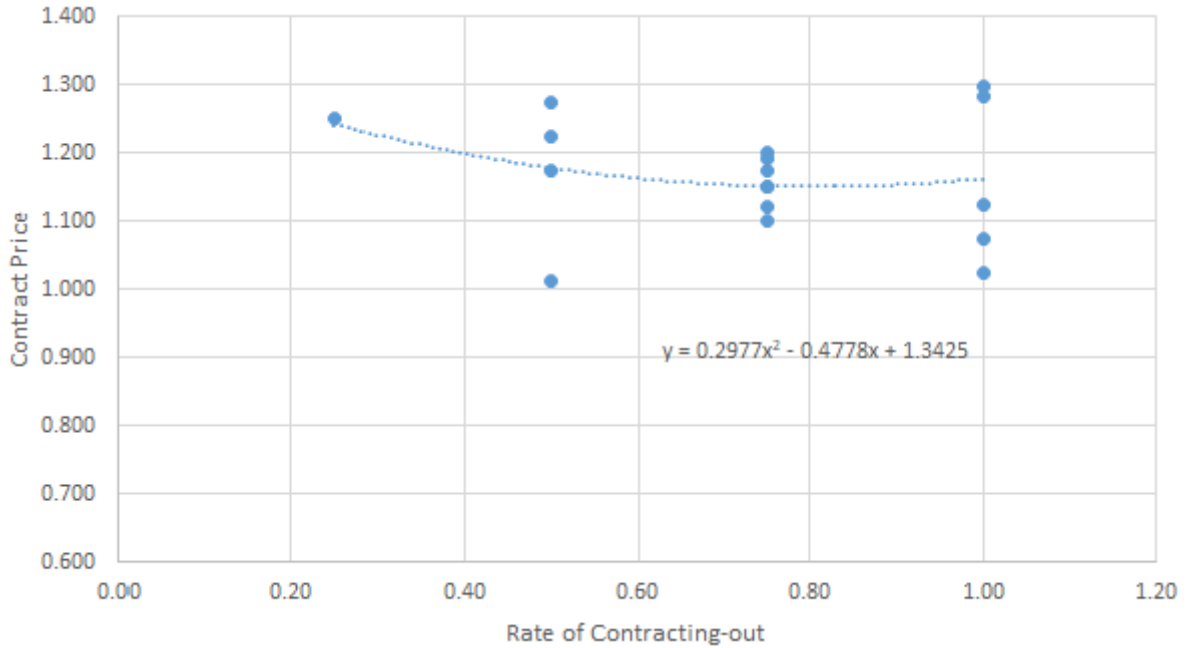


Figure 2: A simulation result

In fact, the equilibrium results obtained for the first eight municipalities gives a upward-sloping regression line, while the next ten municipalities produces a downward-sloping regression line. In combination, these two conflicting trends give rise to a U-shaped relationship observed in Figure 2. Thus, we argue that the bargaining model examined in the previous section can indeed yield a phenomena that was observed in Figure 1.

4 Concluding Remarks

By examining a sequential game model of contracting-out waste collection services, which also involves a bargaining over the contract price between the concerned parties, we analytically show that, due to hold-up concerns, a municipal government tends to over-invest in its own cost reduction and this leads to a smaller degree of contracting-out chosen by local government. We also show, through utilizing a simulation, that these results, in turn, can give rise to an U-shaped relationship between the contracting-out ratio and the contract price of waste collection services across multiple municipalities

with different characteristics.

Despite such a theoretical possibility and, moreover, increasing interest in contracting out household waste collection services over time, this U-shaped relationship has seldom attracted the attentions of researchers so far. The foremost importance should be given to further empirical investigations, and the relationship between the contracting-out rate and the contract price need to be scrutinized with more detailed data and also data from different regions.

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Appendix A: Simulation Data

i	j	$\frac{\gamma_{ij}(G_{ij})}{G_{ij}}$	b_{ij}	c_{ij}	contracting-out rate in i	average contract price in i
1	1	0.7	2.0	1.4	0.50	0.968
1	2	0.7	2.0	1.1		
1	3	0.7	2.0	0.8		
1	4	0.7	2.0	0.5		
2	1	0.8	2.0	1.4	0.50	1.013
2	2	0.8	2.0	1.1		
2	3	0.8	2.0	0.8		
2	4	0.8	2.0	0.5		
3	1	0.9	2.0	1.4	0.75	1.122
3	2	0.9	2.0	1.1		
3	3	0.9	2.0	0.8		
3	4	0.9	2.0	0.5		
4	1	1.0	2.0	1.4	0.75	1.150
4	2	1.0	2.0	1.1		
4	3	1.0	2.0	0.8		
4	4	1.0	2.0	0.5		
5	1	1.1	2.0	1.4	0.75	1.173
5	2	1.1	2.0	1.1		
5	3	1.1	2.0	0.8		
5	4	1.1	2.0	0.5		
6	1	1.2	2.0	1.4	0.75	1.192
6	2	1.2	2.0	1.1		
6	3	1.2	2.0	0.8		
6	4	1.2	2.0	0.5		
7	1	1.3	2.0	1.4	1.00	1.283
7	2	1.3	2.0	1.1		
7	3	1.3	2.0	0.8		
7	4	1.3	2.0	0.5		
8	1	1.4	2.0	1.4	1.00	1.296
8	2	1.4	2.0	1.1		
8	3	1.4	2.0	0.8		
8	4	1.4	2.0	0.5		

Table 1: Eight municipalities with different degrees of investment efficiency

i	j	$\frac{\gamma_{ij}(G_{ij})}{G_{ij}}$	b_{ij}	c_{ij}	contracting-out rate in i	average contract price in i
9	1	1.0	2.0	1.9	0.25	1.250
9	2	1.0	2.0	1.6		
9	3	1.0	2.0	1.3		
9	4	1.0	2.0	1.0		
10	1	1.0	2.0	1.8	0.50	1.275
10	2	1.0	2.0	1.5		
10	3	1.0	2.0	1.2		
10	4	1.0	2.0	0.9		
11	1	1.0	2.0	1.7	0.50	1.225
11	2	1.0	2.0	1.4		
11	3	1.0	2.0	1.1		
11	4	1.0	2.0	0.8		
12	1	1.0	2.0	1.6	0.50	1.175
12	2	1.0	2.0	1.3		
12	3	1.0	2.0	1.0		
12	4	1.0	2.0	0.7		
13	1	1.0	2.0	1.5	0.75	1.200
13	2	1.0	2.0	1.2		
13	3	1.0	2.0	0.9		
13	4	1.0	2.0	0.6		
14	1	1.0	2.0	1.4	0.75	1.150
14	2	1.0	2.0	1.1		
14	3	1.0	2.0	0.8		
14	4	1.0	2.0	0.5		
15	1	1.0	2.0	1.3	0.75	1.100
15	2	1.0	2.0	1.0		
15	3	1.0	2.0	0.7		
15	4	1.0	2.0	0.4		
16	1	1.0	2.0	1.2	1.00	1.125
16	2	1.0	2.0	0.9		
16	3	1.0	2.0	0.6		
16	4	1.0	2.0	0.3		
17	1	1.0	2.0	1.1	1.00	1.075
17	2	1.0	2.0	0.8		
17	3	1.0	2.0	0.5		
17	4	1.0	2.0	0.2		
18	1	1.0	2.0	1.0	1.00	1.025
18	2	1.0	2.0	0.7		
18	3	1.0	2.0	0.4		
18	4	1.0	2.0	0.1		

Table 2: Ten municipalities with various *ex ante* differences in marginal collection costs