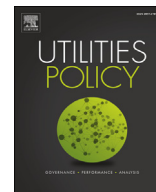


Contents lists available at [ScienceDirect](#)

Utilities Policy

journal homepage: www.elsevier.com/locate/jup

Meso-institutions: The variety of regulatory arrangements in the water sector

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ARTICLE INFO

Article history:

Received 30 November 2016

Received in revised form

3 March 2017

Accepted 1 May 2017

Available online xxx

Keywords:

Transactions

Meso-institutions

Regulation

Comparative analysis

Water utilities

ABSTRACT

There are many different ways to regulate water utilities. By focusing almost exclusively on regulatory agencies, the literature has missed important alternatives regarding the mechanisms through which the general rules of the game, defined at the macro-institutional level, interact with operators organizing transactions at the micro-level. Building on recent developments in organization theory and on the distinction between property rights and decision rights, this paper explores the variety of arrangements, identified as 'meso-institutions,' providing these links. The analysis is substantiated through a comparative approach to the drinkable water systems in France, England and Wales, and the Netherlands.

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1. Introduction

Douglass North once defined institutions as 'any form of constraints that human beings devise to shape human interaction' (1990a: 3). Institutions play this role by establishing rules and/or formalizing norms and by designing devices to implement them. A central aspect in that process and a key to effective institutions is the capacity of these rules and norms and their accompanying devices to reduce uncertainty, thus securing the provision of goods and services while minimizing transaction costs.

When it comes to drinking water, there are many sources of uncertainty, commanded by its very specific nature, which is that it is a resource conditioning the survival of human beings, with no known substitute. Uncertainty may have bio-environmental origins, as when there is drought, resource depletion, or pollution; it may be due to economic forces, as when monopolistic positions or the importance of sunk costs challenge accessibility; or it may come from socio-political factors, from collective values to conflicts of interests or wars threatening availability of water. This combination of essentiality for humans with numerous causes putting its provision at risk likely explains why drinking water is such a highly

regulated resource. However, this paper does not come back to the well-documented reasons WHY there is regulation in the water sector. It rather focuses on the various FORMS the exercise of regulation can take. Regulation is hereafter understood as the set of devices and mechanisms allocating and monitoring rights, modalities that vehicle societal arbitrages in the development and usage of the resource. This paper therefore presumes a variety of such institutional arrangements, which are the go-between linking operators and users to the general rules and norms framing the provision of drinking water.

Paradoxically, the complexity of these rules might by itself be an additional source of uncertainty. Several characteristics feed this complexity: (a) the diversity of rules embedded in water management, since these rules cover a large spectrum of technological, economic, environmental, and health issues; (b) the multi-level decision-making systems involved (local, regional, national, supra-national); (c) the existence of multiple users of the resource with potentially conflicting goals (e.g., urban consumption vs. agriculture, gardening or swimming pools vs. provision to the poor); (d) the cost of building and coordinating institutional arrangements to overcome these challenges; (e) the stickiness of institutions, making the feasibility of desirable changes uncertain.

There is already an abundant literature about the 'macro-institutions' dealing with such issues, from political systems to the judiciary and the administration. [Acemoglu and Robinson \(2012\)](#),

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Aoki (2001), Greif (2006), North (1990a), Ostrom (2005) are major references among hundreds of contributions. When it comes to the specific institutional arrangements needed to implement and monitor the rules and norms defined at this macro level, recent contributions focused almost exclusively on one form: regulatory agencies. Laffont and Tirole (1993) synthesized the view developed by mainstream economists, who consider the problem through the lens of agency theory: regulation is a principal-agent problem, and the key issue for a regulator is to find incentives to align various and often conflicting interests while reducing information asymmetries. On the institutionalist side, well-illustrated by Spiller (2009), the emphasis has been on the significance of political as well as economic transaction costs involved in the running of regulatory agencies. However, these approaches, which prevail in empirical analyses of the drinking water sector (Savedoff and Spiller, 1999; chap. 1; Tremolet and Binder, 2010), have little to say about this striking fact: there are many different modalities to implement rules and norms established at the macro-institutional level. The European Union is illustrative: the 'Drinking Water Directive' (1998) and the 'Directive 2000/60' (2000) provide guidelines thereafter embedded in different national laws that are themselves implemented through numerous different devices (public bureaus, which are administrative entities embedded in Ministries or Public Departments; regulatory agencies; etc.). However, these devices and the mechanisms through which they operate are rarely analyzed on their own.

This paper is about this last aspect. It explores the variety of institutional arrangements that can operate under the umbrella of common rules, as illustrated by the water sector in Europe. Focusing on the case of drinking water, it builds on recent developments in organization theory, with the central distinction between property rights and decision rights; and in institutional analysis, pointing out the role of transaction costs, to account for this diversity and the resulting trade-off among alternative solutions. Section 2 derives from these developments a framework that identifies 'ideal types' of regulatory arrangements grouped under the concept of 'meso-institutions'. Section 3–6 substantiates through three contrasted 'models': France, England and Wales, and the Netherlands, and the missing figure of 'pure markets'. Section 7 discusses the relevance of this typology and concludes by emphasizing the need to elaborate robust institutional indicators for an improved guidance of public policies.

2. Institutional framework: the key role of meso-institutions

The drinking water sector is deeply embedded into a highly regulated environment. This embeddedness comes out of characteristics (physical-chemical properties; non-substitutability; centrality to human survival; multi-dimensional externalities) that make drinking water a critical network infrastructure, highly exposed to socio-political interferences (Savedoff and Spiller, 1999; chap. 1; Moteff et al., 2003; Ioris, 2008; Kunneke et al., 2010). However, analyses taking this institutional environment on board remain mostly limited to the very general level of laws adopted and/or their roots in specific political systems (Savedoff and Spiller, 1999; Shirley, 2002; Finger and Kunneke, 2011; World Bank, 2010).¹ A framework is hereafter submitted making room for more specific institutional arrangements, called 'meso-institutions', that play a key role in linking the micro-level at which operators actually organize and deliver the service and the conditions under which

users can benefit, and the macro-level in which rules and norms framing these activities are embedded. Sections 3–6 will substantiate this framework with examples from European countries.

2.1. Institutional layers

There are an almost infinite number of definitions of institutions.² For its purpose, this paper sticks to (Davis and North (1971): 6) who qualified institutions as "... the set of fundamental political, social, and legal ground rules that establishes the basis for production, exchange and distribution," later complemented by North's emphasis on the role of these rules in shaping human behavior, an approach encapsulated by (Hodgson (2015b): 57) in the expression "integrated systems of rules that structure social interactions."

However, this broad perspective needs specification to capture what is at stake when it comes to the actual organization of transactions providing the backbone to network infrastructures such as drinking water. In this context, key issues concern the rules delineating the conditions under which related services can be delivered, and the allocation of rights to parties that actually organize transactions to do so. Hence the more focused definition of institutions as *the layers of rules that define, allocate, implement, and enforce rights through arrangements that shape how transactions can be organized.*

At the **macro-level**, at which rights are established through rules and norms, North (1991) suggested a distinction between formal and informal institutions. *Formal institutions* refer to the political, legal, and administrative systems through which rules shaping interactions among agents are defined. Laws or directives regulating the parameters for controlling the quality of water illustrate (EU, 1998; 2014). However, many rules and rights rely on non- or weakly formalized customs, norms, even beliefs (e.g., water as "a gift of God" for which users do not have to pay). These *informal institutions* often play a crucial role in framing the behavior of operators as well as users (Ostrom, 2014; Aoki, 2001; chap. 8; UNDP, 2013; chap. 2).

This distinction suggests that looking at something more than general rules is required to understand how the actual domain and modalities of action of operators and users are framed and the conditions under which a differentiated demand can be more or less satisfied. Complementary institutional arrangements must fill the gap between these macro- and micro levels.

2.1.1. The centrality of meso-institutions

Indeed, as emphasized in numerous analyses (e.g., North, 2004; Ostrom, 2005, 2014), laws, directives, or social norms organizing economic activities almost always remain abstract and/or ambiguous. They require 'interpretation' devolved to devices that 'translate' general rules into specific guidelines and to mechanisms that shape their implementation, thus adapting the definition and allocation of rights and their usage to the scope, space and time in which actors evolve.

This intermediate level linking actors and general rules is what '**meso-institutions**' are about. They are *arrangements through which rules and rights are interpreted and implemented, thus framing the domain of possible transactions among stakeholders.* The concept of meso-institutions does not refer to a spatial dimension, although there are rules defined and implemented at local or regional levels (e.g., municipal authorities); nor to micro-organizations, although regulatory power might be transferred to specific operators, as

¹ Finger et al. (2007) and Tremolet and Binder (2010) are among exceptions that intended to disentangle different arrangements, although without theoretical grounding.

² For discussions, see Acemoglu and Robinson, 2012, chaps. 2 and 3; and Hodgson, 2015a.

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