Coproduction of Local Public Goods with the Involvement of Neighborhood Associations

Bozhya-Volya Roman (PhD in Economics, Associate Professor)

Bozhya-Volya Anastasiya (PhD in Economics, Associate Professor)

National Research University "Higher School of Economics" in Perm (Russia)

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Abstract

Our paper presents the model of coproduction of local public goods with the involvement of neighborhood associations (NAs). It is the third alternative to the classical model of public service provision by public authorities (in-house option) or private contractor (contracting-out option). The results show that the participation of NAs is efficiency improving solution in local public goods production.

Close examination of collaboration between government and NAs in 70 largest Russian cities illustrates that providing financial support to NA, regional and local governments NAs simply aim to maintain political activity of citizens. But in close future coproduction of local public goods must become significant part of NAs activity.

Introduction

Creation of favorable living conditions in cities becomes more complicated. Coproduction of public services at the local level is naturally based on the involvement of communities, because they are more interested in the quality of local public goods then municipal governments that historically delegated to produce them. Local governments proceed the variety of forms of citizens' participation in landscaping, construction and repairing infrastructure, social support for the needy, sick and elderly care, etc. Generally, communities that act as the participants of coproduction are so-called neighborhood associations (NAs). They are defined as a civic organizations oriented toward maintaining or improving the quality of life in a geographically delimited residential area (Logan, 1990).

NAs commonly exist in every country and participate in providing of numerous categories of local services for instance land development, traffic parking, parks and playgrounds, police protection, etc. Collaboration of NAs with municipal authorities is natural because urban planning comes to be more multifaceted from year to year. And NAs are expected to bridge the gap between community members and government entities, but they have not reached their full potential yet (Bhattacharyya, 2004; Pekkanen, 2014; Holden, 2016).

It is important to specify a political role of NAs at the local level that supports the coproduction of local public goods. These organizations are nonprofits and are considered as the "grassroots" of modern civil society all over the world. From the public policy point of view during recent years NAs have evolved from neighborhood democracy to the part of "multigovernance". It means that they play an important role in deliberation, representation, allocation and provision of resources and collective goods at the community level (Fontan, 2009; Chaskin, 2015). Principles of communities participation in local development can be determined as self-help (the opposite of helpless dependency), felt needs (implies that development projects should respond to people's needs as they see them), and participation (taking part in the production of collective meanings) (Bhattacharyya, 2004). Neighborhoods attract attention as a locus of urban revitalization and collaborative governance. But in practice attained level of network governance has to be crucial (Davies, 2012). Opponents of "multigovernance" schemes suggest that nonprofit community-based organizations usually founded to create reliable voting constituencies for local elected officials (Marwell, 2004). This is the most insistent critique of NAs and routes of their development in many regions.

The history and strategies of NA's formation differ radically in Western and Asian countries. In American cities, for example, a majority of the NAs were formed to confront specific land-use changes that concerned residents (industrial/commercial development) and transportation issues (construction of major highway, trucking traffic in a residential area). City NAs appeared also in response to federal redevelopment programs and creation of NAs in neighboring districts (Logan, 1990). Regardless the ways NAs were formed, the local agenda for US NAs at present is just the same as in other countries. An overview of web-sites of Canadian NAs illustrates an identical list of questions.

In Eastern and Southeastern Asia NAs are widely cultivated. Governments in these countries actively tend citizens' initiatives in NAs foundation (Read, 2009). It is important to note that NAs in US and other European countries are nonprofit organizations, that are institutionally linked to the state rather than independent of it. Commonly state provide at least partial funding for NAs: many of them are independent and actively bid for public grants and contracts. Cummins label this kind of organizations as "GONGO" ("government organized nongovernmental organization"). It suggests the involvement of political resources in pursuit of an authentic expression of priorities in social issues with some degree of autonomy of organization itself (Cumming, 2010). Although in Asian countries NAs network is very extensive, it constitutes a potential resource only for developmental or governance-related initiatives (Read, 2009).

We investigate the collaboration experience between local governments and NAs in Russian Federation. The historical background of NA's development in Russia is closer to Asian countries. NAs were intensively cultivated in pro-government manner till the end of 2000th. As evidenced by practice NAs network enlargement is one of the priorities of local governance development in Russian cities and towns. We analyze the current practice of collaboration between local governments and NAs in 70 largest Russian cities and identify two patterns of contracts applied:

a) subsidies to maintain NAs formal political activity;

b) grants for real coproduction projects improving community living conditions.

Given the main aim of the collaboration between local government and NAs is the local public goods production, in our research we develop a normative model that rationalizes an economic justification for coproduction of local public goods with heavy NAs involvement. Traditionally local government can provide local public goods in-house, or contract out its provision to private companies. We argue that NAs involvement in the contracting out process brings substantial social benefits and advantageous both for public authorities and local communities.

What are the real benefits of contracting out local projects to NAs? To shed light on this question we develop a simple model that describes incentive schemes for quality improvement and cost reduction for public, private and NA-based local public goods provision in incomplete contract environment. Our findings help to explicitly explain the rationale for closer collaboration between municipality and local communities in Russia and other countries.

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Coproduction of Local Public Goods and the Role of Neighborhood Associations

Public goods coproduction can be investigated as an evolution stage of New Public Management. Gradually it was ranked as a distinct part of public service delivery (Pestoff, 2006; Bovaird, 2007; Osborne, 2013; Alford, 2013). Coproduction describes processes through which diverse inputs are contributed by individuals inhabiting particular localities. What is crucially important they are not belong to any official government agency primarily responsible for producing a particular public good or services.

Coproduction is traditionally defined as the mix of activities that both public service agents and citizens contribute to the provision of public goods and services. Officials are involved as professionals, or "regular producers", while "citizen production" is primarily based on voluntary efforts of individuals and groups directed to enhance the quality and/or quantity of the services they consume (Pestoff, 2013). From the local government point of view coproduction is the process of local public goods provision, for instance landscaping, planting of greenery, public safety, sports and children playgrounds etc. Citizens are motivated to maintain well-designed green spaces, constructions and other infrastructure, because their families use it every day. Moreover, people reside a daily life in a small community of their neighbors that encourages them to maintain safe and friendly environment in partnership with their neighbors. That is why the second important point of coproduction definition is that co-producers contribute substantial resources and consume the local public goods that it produced (Bovaird, 2007; Alford, 2002).

A significant part coproduction phenomenon researches is focused on the determinants influencing the efficiency of coproduction project. Among the most important factors are organizational abilities and motivation of (groups of) citizens. The co-producers who do take part should have appropriate skills and willingness to really contribute. Also it is important for them to have enough time available. The citizens should be aware that they have the opportunity to collaborate with local governance to solve problems and contribute to the community. Social connectedness should be mentioned as another key aspect of co-producers' motivation because their network (family, people being a co-producers already, people they meet during their activities in their community) made them aware of the possibility to be engaged or stimulate their interest in coproduction of local public goods (Alford 2002; Jakobsen, 2013; Eijk, 2015).

Some authors point trust and the perception of the government as significant factors of successful coproduction. The former must be better customized to achieve the standards of participatory democracy. But co-producers should trust the "system" when deciding whether to "enter" particular projects. In coproduction the client becomes a "key arbiter of service quality and performance". This will increase the provider's responsiveness and the client's sense of control, and will positively influence the client's perception of risks (Jakobsen, 2013; Fledderus, 2014). NAs' involvement also illustrates the citizens' satisfaction with how local government accounts for their opinion and anticipations (Bovaird, 2015)

Citizens have inclination to co-produce in a relatively narrow range of activities that are genuinely important for them (Bovaird, 2012; Alford, 2016). In that sense coproduction of local public goods gains superior significance - people more readily participate in coproduction that produce private value for them personaly. By contrast, the activities that involve largely public value are commonly the least-performed (Alford, 2016).

Among the most contemporary mainstreams is citizen coproduction in e-government (Linders, 2012) and other media-technologies (Meijer, 2012).

Summing up, coproduction of local public goods could be a successful practice, because citizens internalizing significant part of costs and benefits, are motivated to escalate their quality and to reduce the costs of their production. But residents should have appropriate abilities and resources (from money and enough time available to organizational competencies), and should be the corresponding partner of local governance (in terms of trust and NAs' reliability).

As a coproduction partner of local government NAs have two type of resources: political advocacy and social capital. Many authors argue an importance of neighborhood-level political participation of citizens in policy development and implementation of local government level. The first important suggestion is that NAs preset the opportunity to apply policy-centered theory to a distinctively local form of political participation. And urban politics literature already discussed that city governments' policies and programs with respect to neighborhoods can affect citizens' political involvement in NAs. Cities development regarding neighborhoods should be based not on the principles of prevention of ghettos and other adverse phenomena, but mostly on complex investment project and comprehensive social work in disadvantaged areas (Gottlieb, 1997; Naparstek, 1997; Lloyd, 2014; Forrest, 2017). Subjective citizens' perceptions of neighborhood disorder also increases the likelihood of speaking to a politician or attending meetings (Michener, 2013).

Furthermore, current researches in urban development suggest two ways how city governments can foster citizens' participation in NAs: (1) empowerment and (2) stimulus for reactionary mobilization. In brief, city government can either encourage involvement at the neighborhood level by being responsive to neighborhoods as venues of interest aggregation and articulation and invoke neighborhood-based political mobilization by being unresponsive to neighborhood problems and ignoring problems that neighborhood residents perceive to be important threats to their quality of life (Sharp, 2012). With the purpose to stimulate NAs development empowerment is applied in a variety of countries – United States, UK, Russia, Japan (Alison, 2003; Taylor, 2000) . Reactionary mobilization were mentioned by some authors as response to the problem of racial and social change in United States (Sonenshein, 2004), Puerto Rico (Ribas, 2013) and Turkey (Yetiskul, 2016).

The second important resource in NAs disposal is their social capital. We can define it as the social organization, interpersonal trust, norms of reciprocity, and social engagement that foster community and social participation and which can be used to achieve a number of beneficial outcomes (Putnam, 1993). Some researches investigate social capital of neighborhoods through community gardening/beautification projects and neighborhood meetings (Alaimo, 2010; Houwelingen, 2012), others examine the influence of neighborhood social capital on residents' satisfaction (Hur, 2015) and on individual health of adults (Carpiano, 2007) and mobility of older adults (Rosso, 2014). Even storytelling can be analyzed as a source of social capital for neighborhoods (Nah, 2016). It is also important to recognize that social capital this level has some positive and may be negative moderating effect or the direct intervention in different local programs, especially social work (Coulton, 2005). It is also argued that for communities we shouldn't examine social capital, but "community psychology" which is more appropriate term to investigate this phenomenon (Perkins, 2002).

Important point of view on NAs effectiveness is their influence on homeowners' decisions. In a certain sense it reflects reverse understanding of the influence of social capital of NAs on citizens. Social capital that was accumulated by NAs subsequently may be promoted as an effective mean of stabilization and improvement of the quality of life in some urban neighborhoods (Sampson, 2002). There is little doubt that numerous problems of communities and the success in their resolution has some neighborhood effects on children and adolescents, on health level, poverty and criminal situation (Sampson 2002; Martin et al. 2017).

Thus neighborhood-level political participation of citizens has the influence on local policy development and the social capital of the NAs and it should be treated as a specific resource in coproduction of local public services. Consequently, capability to increase the political activity of citizens and capability to attract additional resources are significant characteristics of the NAs that must be exploited on the local level.

Incomplete Contracts in Coproduction of Local Public Goods

The question of the proper scope of government and the need for contracting out some public responsibilities was discussed by economists on the wave of New Public Management paradigm along with coproduction. We based our research on the fundamental contribution of Hart, Shleifer, and Vishny (1997). In this work they answered the question, when government should provide a public service in-house, and when it is optimally to contract its provision out. The basic idea is that the service provider – whether a government employee or a private contractor – can invest his time and efforts to improve the quality of the service and (or) to reduce the costs connected with provision. The cost reduction while positive in terms of private economic efficiency, has an adverse effect on quality. If a private contractor wants to improve quality and get a higher price, he needs to negotiate with the government since the former is a buyer of the service.

Important assumption made is that there are so many probable contingencies that it is impossible to anticipate them ex ante all and contract on how to deal with them in advance – contracts are incomplete (Hart, etc., 1997). We offer the third case – an involvement of NAs in local public good provision. Coproduction in this case assumes the shift of residual control rights to NAs, because they actively contribute their resources and they internalize significant part of costs and benefits resulting from options for renegotiation in the incomplete contract environment.

As Matrimort (2005) concluded, in the comprehensive contracting literature, welfare-maximizing planner can contract on anything that is observable, including the public good level. But the complete contracting approach is based on very demanding assumptions: the unified view of government, the ability for this government to fully commit to a policy and the absence of any collusion in the economy. The failure to satisfy any of these assumptions gives rise to a particular forms of incomplete contracting (Matrimort, 2005).

Also the impossibility of writing long-term contracts affects the trade-off between efficiency and rent extraction in various ways. One of the problems lies in the effects of renegotiation. While renegotiation increases allocative efficiency *ex post*, firms anticipate them and are tempted to let cost overruns happen in the belief that the government will anyway provide the additional funding needed through renegotiation (Matrimort, 2005).

The HSV model (Hart, etc. 1997) takes into account both assumptions of contracts incompleteness, effects of renegotiation and the influence of residual control rights allocation on costs and benefit structure. We borrow heavily from their contribution, but made some important additions in course with the aims and specifics of our research:

- *Cost of public capital*. We account for distortional aspect of public investments financed by additional taxation like Laffont, Tirole 1986. Doing so we aim to identify and study leverage effect of public investments which in turn depends on control rights distribution and corresponding mix of incentives. According to international practice NAs invest from 10 to 30% project expenditures thus NAs participation helps to significantly increase public welfare through the leverage.
- *Internalization of externalities.* Considering cost reducing investments as renegotiation option, unlike private investor, NAs internalizes most of adverse effects on local public good quality. We will show that provided with residual control rights in the incomplete contract settings NAs increases total social surplus through optimized cost cutting incentives.
- *Absence of control.* Last and the least important aspect: according to our research in most countries NAs don't receive control over the facility they build up in coproduction with local government. Taking aside some theoretical rigor it is not crucially important, especially assuming government's neutrality and residual control rights for NA being provided.

Model

<u>Basic Assumptions</u>

- Local government in production of local public good choose whether:
  - buy services from private contractor(s), who builds and (or) manages Facility
  - provide by itself (e.g. build and manage Facility through traditional procurement procedures)
  - involve NAs in co-financing and coproduction of local public good
- Residual control right and ownership are separated
- According to Russian and international practice of local public good coproduction is most cases private contractor(s) and NAs has only residual control rights and Facility remains in local government ownership. So, in line with HSV, NA and don't need approval for cost reduction. But quality should be contracted and maintained since local government pay for it.
- General cost and benefit structure – similar to HSV and later on (Bennett, 2006). Two types of investments: quality increasing and cost reducing.
- Demand for local public good provided by Facility doesn't depend on quality, but social benefits does
- Similar to Laffont and Tirole (1986), we take in to account distortional effects of public investment financed by taxes. So, in our model the shadow cost of public funds is more than 1. HSV doesn't consider

this aspect since they are focused primarily on optimal ownership structure in general, not on particular wealth distribution effects[1].

- Self-taxation – A – the amount of investments, provided by citizens founding NA

Public good yields benefit B to society and requires investment costs C to build the Facility for its provision. It is assumed that agent (private firm, NA or public manager) can devote effort to two types of "innovation" relative to the basic characteristics: a cost innovation and a quality innovation. It is supposed that a cost innovation leads to a reduction in costs C but is typically followed by reduction in quality (i.e., B decreases). Similarly, a quality innovation leads to an increase in quality, but is typically accompanied by an increase in costs.

Accordingly, similar to HSV: $B = B_0 - b(e) + \beta(i)$ and $C = C_0 - c(e)$, where e, i denote effort devoted to the cost innovation and quality innovation, respectively, $c(e) \geq 0$ is the reduction in cost innovation; $b(e) \geq 0$ is the reduction in quality corresponding to the cost innovation; and $\beta(i) \geq 0$ is the quality increase net of costs from the quality innovation. There are also standard assumptions about the convexity, concavity and monotonicity of b, c and β. It is also assumed that e, i, b and c are observable to both public and private partner, but are not verifiable (to outsiders) and hence cannot be part of an enforceable contract.

The First-Best Solution

Our model (like HSV) take as a benchmark the first-best solution without contract incompleteness - e and i are contractible (or equivalently, where long-term contracts describing the production of public good can be written). In this case, public and private partners would choose e and i to maximize the total net surplus from their trading relationship, and divide the surplus between them using lump-sum transfers. B_0, C_0 and P_0 are contracted in the "zero" period and don't depend on e and i. We don't include them in maximization function. That is in the first-best, local government and private contractor solve:

(1) $$\max_{e,i}[-b(e) + c(e) + \beta(i) - e - i]$$

Given listed above assumptions, (1) has a unique solution (e^*, i^*), characterized by first-order conditions:

(2) $$-b'(e^*) + c'(e^*) = 1$$

(3) $$\beta'(i^*) = 1$$

In our model the case of the NA's involvement could be compared with this the first-best solution, because additional parameter A (a volume of citizens' self-taxation) is also contracted in the "zero" period and doesn't depend on e and i.

I. Equilibrium Under Private Contractor Residual Rights Control and Local Government Ownership of the Facility

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[1] Distortional nature of public investment is exhaustively discussed in existing literature on public economics, so we don't need to stop on this topic in more detail.

Under private contractor residual control rights in our model we develop Hart's equations with distortional effects of public investment financed by taxes, the parties' payoffs with this statement are

(4) $\qquad U_G = B_0 - P_0(t+1) + 0.5\beta(i) - b(e)$

(5) $\qquad U_M = P_0 - C_0 + 0.5\beta(i) + c(e) - e - i$

Let us suppose like HSV that the renegotiation takes place over the quality innovation, and the gains from renegotiation are $\beta(i)$, which are split 50:50. Since the parties are assumed to have rational expectations, private contractor chooses e and i to maximize U_M, that is, to solve

(6) $\qquad \max_{e,i}[0.5\beta(i) + c(e) - e - i]$

And the first-best conditions for (6) are

(7) $\qquad c'(e_M) = 1$

(8) $\qquad 0.5\,\beta'(i_M) = 1$

The total surplus S_M under private contractor residual rights control is then given by

(9) $\qquad S_M = B_0 - P_0 t - C_0 + \beta(i_M) - b(e_M) + c(e_M) - e_M - i_M$

II. Equilibrium Under Municipal Organization Residual Rights Control and Local Government Ownership of the Facility

Under local government residual control rights (public goods are produced by municipal organization), as in HSV model, the renegotiation takes place over the fraction λ of both the cost and quality innovations that public actor cannot internalize in full volume: $\lambda\{- b(e) + c(e) + \beta(i)\}$. In our model in this case we also add distortional effects of public investment financed by taxes.

The parameter λ is very important, since it effectively measures the weakness of the incentives of government employees. If the gains are split 50:50, the parties' payoffs are

(10) $\qquad U_G = B_0 - P_0(t+1) + (1-\lambda/2)\cdot\gamma$

(11) $\qquad U_M = P_0 - C_0 + \lambda/2\cdot\gamma - e - i$

In the case $\lambda=1$, when the municipal organization is completely irreplaceable, the parties split he gains from innovation 50:50. Municipal organization chooses e and i to solve

(12) $\qquad \max_{e,i}[\lambda/2\{- b(e) + c(e) + \beta(i)\} - e - i]$

And the first-best conditions for (12) are

(13) $\qquad \lambda/2(-b'(e_G) + c'(e_G)) = 1$

(14) $\qquad \lambda/2\cdot\beta'(i_G) = 1$

The total surplus S_G under public residual control rights is then given by

$$(15) \qquad S_G = B_0 - P_0 t - C_0 + \beta(i_G) - b(e_G) + c(e_G) - e_G - i_G$$

III. Equilibrium Under NAs Residual Rights Control and Local Government Ownership of the Facility

In our model we develop the third optional case of local public goods production that assume involvement of NA that has residual control rights (the ownership of the Facility remains with the local government). A is volume of citizens' self-taxation that will be added to the project financing. We also take into account distortional effects of public investment financed by taxes.

The phenomenon of coproduction introduces the parameter γ that reflects the level of internalization of project costs and benefits by NAs (i.e. $b(e)$ and $\beta(i)$). The parties' payoffs with these statements are

$$(16) \qquad U_G = (1-\gamma) B_0 - (P_0 - A)(t+1) - (1-\gamma)(b(e) - \beta(i))$$
$$(17) \qquad U_{NA} = \gamma B_0 + (P_0 - A) - C_0 - \gamma \cdot (b(e) - \beta(i)) + c(e) - e - i$$

When renegotiation is assumed, that as in the case (II), the gains from renegotiation $\beta(i)$ local government and NAs split 50:50.

The parties' payoffs with these statements are

$$(18) \qquad U_G = (1-\gamma) B_0 - (P_0 - A)(t+1) - (1-\gamma)b(e) + 1/2 \cdot \beta(i))$$
$$(19) \qquad U_{NA} = \gamma B_0 + (P_0 - A) - C_0 - \gamma \cdot b(e) + 1/2 \cdot \beta(i)) + c(e) - e - i$$

According an individual rationality and incentives compatibility of NA:

IR_{NA}: $\gamma B_0 > A$ (in the "zero" period)

IC_{NA}: $\gamma b(e) + e < c(e)$ and $\gamma \beta(i) > i$

It is important to divide two cases: $\gamma < 0,5$ and $\gamma \geq 0,5$. In the first case NAs chooses e and i to maximize U_{NA}, that is, to solve

$$(20) \qquad \max_{e,i}[- \gamma \cdot (b(e) - \beta(i)) + c(e) - e - i]$$

And the first-best conditions for (20) are

$$(21) \qquad - \gamma b'(e_{NA}) + c'(e_{NA}) = 1$$
$$(22) \qquad \gamma \beta'(i_{NA}) = 1$$

In the case $\gamma \geq 0,5$ NAs implement i without approving of local government.

The total surplus S_{NA} under NA's residual rights control is then given by

$$(23) \qquad S_{NA} = B_0 - (P_0 - A)t - C_0 - b(e_{NA}) + \beta(i_{NA}) + c(e_{NA}) - e_{NA} - i_{NA}$$

Analysis of the Optimal Choice of the Form of Local Public Goods Production

A comparison of the first-best solutions for the cases of e^*, e_M, e_G and e_{NA} as far as i^*, i_M, i_G and i_{NA} illustrates the most important findings that $e_G > e_{NA} > e^* > e_M$ and $i_G >$, $i_M = i_{NA} > i^*$ consequently involvement of NAs is in some sense "second-best" in production of local public goods.

Practical implication of this finding is that an involvement of neighborhood association in local public goods production is economically justified in condition that an appropriate organizations have abilities and skills in project management and investment planning.

Existing contracts with Local Authorities – NAs in Russia

NAs in Russian cities and towns (called TOS) 5-7 years ago became the grassroots of public policies that focuses on the development of local governance in Russian cities and towns. In this case it is very important to define the most appropriate way to motivate these organizations to build up more intensively and to operate more effectively. The problem is that, on the one hand, NAs naturally are non-governmental organizations, their development depends on the evolution of civil society on an particular territory and their need to be self-motivated and self-determining. On the other hand, practice shows that in Russia to become credible economic agent NAs need significant assistance of local, regional and even federal authorities – financial support as a rule.

As we previously mentioned we analyze the current practice of collaborations between local government and NAs in 70 largest Russian cities and identify three forms of contracts applied: a) subsidies for all NAs in the city (in 53% of the surveyed cities), b) project grants for social programs of NAs (in 44% of the cities), c) "the Best NAs" grants (in 36% of the cities). The subsidies and "the Best NA" grants suppose narrow sponsorship of NAs to maintain their existence. It is valuable for local government the network of these organizations supports an appropriate level of citizens' political activity. Project grants represent initially coproduction of local public goods. We must come to conclusion that coproduction of local public good is not the main important form of the collaboration of local government and neighborhood association.

Moreover, to make coproduction of local public good more effective, it is important to delegate a residual control rights to neighborhood association. If they don't have any control over the process of coproduction and participate only as co-financer, it is impossible to achieve maximum total surplus in local public good production. But to share coproduction responsibilities, neighborhood association as we discussed earlier should obtain an appropriate skills and knowledge.

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