



An Interdisciplinary Research Project

## **FIRST RESEARCH WORKSHOP**

# **The Economics of Private Sector Participation in Water and Sanitation**

**Paper:**

**“Regulating Change in the Water Industry: The Role of  
OFWAT in the Redefinition of Public Service”**

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I'm interested in exploring the relationship between different modes of state regulation and particular ways in which water services are operationalised, in particular focussing on the managerial culture and the relationship between change in managerial cultures and state regulation.

To put that interest into context, between 1978 and 1986 I worked in the water industry for 8 years, for Yorkshire water, and during that time I became more aware that there was an increasingly serious mismatch between the ideology of public service and the ideologists, and I think, importantly, the trade unions legitimated their position and their role within the industry and the reality. And that reality was increasingly to do with inefficiency, managerial slack, various forms of corruption and so on. And I experienced these things. What I was interested in doing in a sense was to deconstruct the idea - the ideology - of public service. To explore the contradictions and the main ideas of public service, with particular regard to the public sector industry as existed then, but also the extent to which the privatisation of the industry and the development of new regulatory mechanisms overcame those contradictions. Or the extent to which those new contradictions were created but that overcame some of the old contradictions

but were nonetheless seriously undermining any notion of public service. I think that really developed alongside a theoretical interest (?) exploring concepts and ideas historically.

So what I do in this study is to argue that if one looks at the development of the water industry in England and Wales, it is possible to isolate four distinct periods of development: (1) starting with a particular configuration of regulation and delivery and these particular models are called the liberal water industry which developed from the 1830s until around about 1850s -1860s; (2) replaced by the municipal water industry - emerging in the middle of the 19th century until the second world war; (3) the managerial, or Keynesian water industry, focused on planning which emerged following the Second World War which finally decomposed in 1989 and finally; (4) the neo liberal water industry. What I want to do first is briefly go over the main features of those regulation delivery configurations in order to provide a context for the ways in which the OFWAT regime has resulted in a fundamental reinterpretation of public service. So what I want to argue is that each of the models develops out of the contradictions and limitations of the previous model and these provide not only historical bases of those, but possibly comparative models. If we look at the development in less developed countries these could also be useful there.

So the first period of development of the water industry in England and Wales is what we might call the liberal water industry. The context was important, and this was rapid industrialisation, something we see in the Third World now. But also I think it was a political context where notions of classical liberalism and laissez-faire were dominant, where there is a particular outlook towards public health based on self help and individualism. So this is the context in which the initial developments of the water

industry in England and Wales developed. The mode of provision was through private statutory water companies and by the middle of the 19th century the limitations of this model were becoming increasingly apparent in terms of the duplication of services, pollution of water supply, among other things, and this was highlighted by a series of Commissions which highlighted the inefficient and defective nature of private provision at that time. The result of that was a particular mode of regulation, a very light mode of regulation based on legislation to enable local authorities to set up rival supplies with the permission of water companies. Following the 1875 Public Health Act, local authorities were able to provide water services where no proper private services existed. And this was really the 'launching pad' of the municipal water industry, and the main period of municipalisation was really between 1875 and the start of the First World War. By 1914 there were over 300 municipal water undertakings which represent 80 percent of all undertakers and 82 percent of output. Again the political and social context is important here. I think it is important to look at the development of water services in their political, social - ideological contexts. The political and social context included the reformists and the expansion of the franchise, and the emergence of socialism. The label of "gas and water socialism" is something that was an insult and something that was also a label worn with pride by many local authorities at the turn of the century. Gas and water were seen as the principal road to socialism. So, the mode of provision at this time focussed on Local Authorities ad hoc and joint boards with regard to drainage, statutory water companies remained 20% of water undertakings. Again, at this time the mode of regulation was quite light, enabling legislation for Local Authorities to act through the Public Health Acts and a series of contradictions underlined this particular configuration. Firstly, a serious crisis of the municipal state,

around the turn of the century, whereby the rail companies were protesting because they were being made to pay for water and peoples sewage systems and this created huge political tensions. There were also technical limitations based on fragmentation and duplication. So, for example, some reservoirs in the north of England had six pipes all running to different cities, constituting a lack of coordination. This was highlighted during the 1930s when there was a serious drought which highlighted the limitations of this fragmented system. This was really the concept for the development of what I would call the managerial water industry. Again the context for the emergence of this particular configuration was the post war settlement, the Keynesian demand management. This was reflected really in important documents of the time, a 1944 White Paper which called for a national water policy based on a planned water economy, that was to be based on a central control, democratic control, and the subordination of diverse interest within the water cycle and water companies, the notion of the common good. I think you can also call this the Fabian water industry, as the notions of Fabian socialism and Fabian reform were quite central in the construction of this particular configuration.

The model of regulation then becomes much tighter, the 1945 Water Act forces a continuous wholesome supply, and facilitates cross-subsidisation. It set out a program of rationalisation that never happened. The problems of fragmentation continued to blight the post war water industry, the 1963 Water Resources Act attempted to overcome that through the establishment of the Water Resources Board, which was an attempt to engineer away the problems of water, by creating huge hydrological schemes to move water about, such as a tidal barrage across the wash, using canals to transport water from the Lake District to East Anglia and so on. But the problem was it never

happened, and what developed instead was an increasingly serious institutional paralysis within the water industry. Basically there was a lack of finances and fiscal limits on the local state through central government loan sanctions. But also an increasingly serious conflict within the water cycle itself. therefore, there was a conflict between undertakers who were interested in clean water, drinking water and those that were interested in getting rid of sewage cheaply without treating it. And the attempt to overcome that was the 1973 Water Act, which followed the Central Advisory Water Committee Report of 1971, which created the regional water authorities. The underlying principles of that, were integrated river basin management, which tended to overcome conflicts within the water cycle. It envisaged an efficient management of water with a planned investment programme. I have focussed on the reuse of water and the conservation of water resources rather than huge great engineering projects. The problem is that that didn't happen either and instead there was an increasingly tense fiscal crisis of the state. I think that the water industry in the public sector was subjected to increasingly strict financial controls or external finance limits, financial targets, form change and this led to a vicious circle of water companies being forced to increase prices while reducing services and cancelling capital projects. So, in a sense, what resulted from this particular configuration was the worst of all worlds: high prices, low service, and no investment.

Now, what I want to argue is that if you look at the political economy of this situation there are two main outcomes that are attempts to overcome these contradictions that happened while the water industry was still in the public sector or at least the vast majority was. The first is what you might call the de-politicisation of water, and I think we can see that in several ways. The 1983 Water Act for example

removed local government representatives from regional water authorities, removed trades union representatives, and replaced them with those streamlined boards made up of representatives of business. In terms of industrial relations brought to a head by the 1983 water workers strike, following that the dismantling of national collective bargaining led by Thames and then all the others followed. In terms of industrial restructuring, several changes occurred: new forms of commercial management, the contracting out of services, the development of enterprise companies, the introduction of customer relations within water authorities, and I suppose also the abolition of the National Water Council in 1983 as a national coordinating body for water services. And I think that, alongside a wider trend of realignment of the state in capital, not just the water industry, but the *whole* of the public sector was becoming increasingly dysfunctional for the economy, and one of the ways in which this has been overcome is a realignment of the state and capital. What this kind of restructuring allowed was the release of huge amounts of capital for capital investment, that had been blocked by public sector borrowing requirement loans, sanctions and so on, meaning that subsequent restructuring is more important than privatisation in effect. But also in the context of globalisation and the increasing importance of multinational corporations in the water sector, is close to between 6 and 10 % now of global capitalisation - a huge sector now as far as international markets are concerned. The 1989 Water Act which completes the construction of the neoliberal water industry, which I think is the last stage in the development of the UK water industry.

So, I was interested in exploring how the new loopholes of regulation impacted on traditional notions of public service, albeit that those traditional notions of public service, as I have tried to show within the managerial tradition, were problematic

anyway. I think the principles through which OFWAT works and its practice are clear attempts to overcome the contradictions of problems of the managerial water industry. The depoliticisation and the need to engage with global capital and markets, were a number of principles which are obvious from the way OFWAT was conceived. Firstly water services should be based on individual contractual relations, they should be depoliticised, they should be used as tools of macroeconomic policy, and they should not be tied in with government notions of social responsibility, social cohesion, and equity.

Secondly, the institutionalisation of the profit market, and the creation of a quasi-market. Thirdly, a particular form of regulation which I think built on what was then the perceived wisdom of the efficiencies of electricity and telecoms regulation that the regulation should involve price, quality and service. Fourthly, competition, that is, the need to subject water operators to physical processes of competition. This can be seen in the regulatory patterns of OFWAT. Firstly, in the way that OFWAT operate in the market in the sense that it helps to balance the public interest emerging with incentives, devolved price regulation through RPI+X, quality regulation through the way in which companies have to draw up, be monitored against asset management plans, levels of service indicators, but also the regulation of service, the role of customer service in the regulation of complaints.

So what has been the impact of this on managerial culture? In order to explore this, research was done on four water companies in England and Wales. Two water companies that were previously regional water companies and two statutory water companies. Interviews were conducted with senior managers, managers and supervisors to explore how the new regulatory pressures to which they were subject have impacted

upon the management information systems and managerial culture and perceptions of public service. In general, there were four main findings in relation to all four companies. Firstly; the development of the OFWAT regulatory regime was directly responsible for the creation of new management information systems. Those management information systems have been primary in the development of new forms of management appraisal and management reward systems. Secondly; the development of new departments directly to interact with the regulator, so departments that have been established just to deal with one particular OFWAT indicator in some places. New posts in the regulation of quality, and also a new culture and in particular something that was very visible at all these water companies that there had been a development of quality management. I want to say something about that. Quality management builds on several principles and was very influential in the 1990s: total customer satisfaction, constant improvement, development of high trust team working relations, and the setting and assessment of statistical performance standards. That is one aspect of the managerial restructuring, and the other aspect was a partial devocalisation and sometimes partial demobilisation of trade unions across the water industry. I think the importance here is that the water industry had a very particular, political form of trade unionism within it, which saw itself as having a dual role; on the one hand to protect the terms and conditions of its members in a traditional trade union role and secondly a role in the public service - monitoring and holding management to account for service to consumers. This particular form of trade union has been marginalized and sidelined by new non-union forms of representation and bargaining. By way of a few examples. In one particular water company, which I called "Westwat", the OFWAT performance indicator set under the new management information systems and total quality

management, formed key results of the business that were constantly monitored and used as a basis for management reward and appraisal. But I think something that has been important across the water sector is the replacement of specialist managers by general managers. There has been a change in the managerial hegemony within the water industry. Within the managerialist water industry the engineer was king, the industry was dominated by engineers, but as part of the re-structuring process, something that has been very much increased by privatisation has been the replacement of the engineer by accountants, and the replacement of generalist managers. This was done in several ways. Within managerial hierarchies, all staff had been on cross sectional secondments; to be a manager you had to work in every department of the company so that you got a general view of the whole business. But management skills relegated engineering skills to the extent that the personnel managers did not care about people's technical ability, but appointed them for their managerial skill and then resolved the technical aspects. . They were not really concerned what managers knew about water.

Another company, which I have called "Citywat", introduced a "right first time" programme which was functional, But, interestingly, the former statutory water companies were more aware of the pressure of the city and the regulator. The staff of the former regional water authorities talk more about the pressure of regulation whereas those of the statutory water company would talk about the city and OFWAT. This was a change in focus that was articulated to me, a change in purpose of the product to the consumer, and then again a change in managerial hegemony from the engineer to the accountant. At "Shirewat", another statutory water company, all that was articulated to me there was the problem of "concretism", which is basically that engineers were obsessed on concrete, for building dams and pipes, and this was a real problem, , so

their response to that was to get rid of them all. So they got rid of 40% of the staff, numerous engineers and the immediate consequence of that was really serious technical and operational difficulties for some two years because all the engineers knew water systems inside-out. This was again an important dynamic towards the quality management because it involves a kind of a cultification of knowledge. It took this company about two years to overcome its technical problem resulting from the dismissal of the engineers. I think what we can see here is the way in which managers talk about competition and I call this the “Marks and Spencerisation” of the water industry, because every manager I spoke to talked about Marks and Spencers: "our competitors aren't ex-water companies, its Marks and Spencers", illustrating that competition is not how well you produce water or take away sewage, it is how you are perceived alongside M&S and Boots. So they seem to have a very abstract and general notion of competition and customer service, of who the customer actually is, or what the customer represents. At “Shirewat”, customer care entailed the emergence of units specifically to look after customers, meaning internal and external customers, and the customer care unit constantly monitored internal - external customer relations and the DG? indicators and introduced (?) discipline in treating efficiency within the company. I was also interested in how managers perceived these new mechanisms of customer representation. Managers highlighted some of the problems, firstly over generalisation, and here I think they said it points to the limits of depoliticising water at a profit. They constantly complained of over generalisation, as if a customer made a complaint and the water company rectified it then OFWAT would say that the same should be done for all customers, whereas the water companies were trying to constantly individualise customer relations. The second thing that managers talked about was the problem with

OFWAT's rational view of how a multi-service should be provided and customers were called irrational and stupid as if customers did not really know what they wanted nor understood the arguments about water and the costs and benefits of providing a particular level of service and so on. One manager said that customers wanted to pay lower water charges and have a bad service – dirty water and sewage running down the street - that was fine. The general perception of OFWAT amongst managers was it was too interventionist, it was constantly interfering with the regulation of the water industry. Secondly, it was unrealistic that OFWAT did not really understand the cost-benefit relationship between service, environmental levels and costs, tariffs and so on.

To make a couple of conclusions from that, I think the first question is really the relationship between ownership and regulation because, if you look at the water sector with its neoliberal restructuring, a tense period of restructuring occurred when the water industry was in the public sector. After privatisation, the most intense restructuring that occurred was in the form of statutory water companies. So is it ownership that is important in terms of particular modes of delivery, perceptions of public service or is it force fed regulation, and what is the relationship between the two? And of course, secondly, the private sector has always been involved in the water industry in some form so nothing has changed in that respect, so to me it is the form of regulation that has changed.

Secondly, there has been a fundamental shift in the locus of management within water companies, a shift to generic from concrete concerns, a shift in managerial hegemony. Also shifting conceptions of who the customer is, I think there has been a shift from a notion that the customer is concrete, that the company provides water and sewage, but the customer is a kind of abstract being that does not really exist except in a

focus group. There is plenty of evidence from the cases I looked at that there are increasingly serious operational difficulties, I think the case of British rail highlights a similar sort of problem, it is problematic to separate management from operational issues too much. In that sense, the neoliberal water industry is still ridden by very serious contradictions. On the one hand it leads to a massive increase in capital investment, but the question is what is the cost? Is the cost a less serious focus on operational matters, on what the customer gets and who the customer is on how workers are treated? I think we could perhaps see this as a change in the nature of water users as citizens. It would seem that these different modes of these different configurations show a shift in the relationship between rights and obligations, and I think that what we should see from municipal configuration onwards is a kind of emptying-out of any democratic content. Firstly to corporate modes of regulation, managerialism and then finally, to associationalism or contractualism, a civil society type assistantship which I think is quite problematic. The final thing is whether these contradictions are really resolvable; are we talking about contradictions that are part of a cataclysm that cannot be overcome, or can it be mediated in a better way, or are there other models of regulation that developed in other European countries that are better than this? The answer is I do not really know.

## Appendix – Overheads

### **Context:**

**Personal: Experience of waterworker - contradictory nature of ‘public service’**

**Academic: Contradiction in an historical context - exploration of water industry in England & Wales from 1820s - 1990s.**

### **State Regulation and the Politics of Public Service: The Case of the Water Industry (Mansell, 1999)**

- ☒ Liberal Water Industry**
- ☒ Municipal Water Industry**
- ☒ Managerial (Keynesian) Water Industry**
- ☒ Neo-Liberal Water Industry**

### **Distinct Modes of Regulation/Delivery**

**Developed from contradictions and limitations of Earlier forms**

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## **Liberal Water Industry**

### **Context:**

**Rapid Urbanization**  
**Classical Liberalism (laissez faire)**

**Mode of Provision: Private Undertakers (Statutory Water Companies)**

**1840s- 1850s: Series of Commissions highlight:**

**Wasteful effects of competition**  
**Defective quality from monopolies**

### **Mode of Regulation:**

- 1. Legislation to force supply on demand/limit prices & profits.**
- 2. 1848 Public Health Act: local authorities enabled to supply with permission of SWCs**
- 3. 1875 Public Health Act: local authorities enabled to supply where no or deficient SWCs provision exists.**

**>>> municipalization of water supply**

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## **Municipal Water Industry**

**1875 - 1914: 326 municipal water undertakings (80% of undertakings & 82% output)**

### **Context:**

**Reform Acts (expansion of franchise)  
Municipal (gas & water!) socialism**

### **Mode of Provision:**

- Local Authorities**
- Ad hoc/joint boards**
- Statutory water companies**

### **Mode of Regulation: (light)**

- Enabling legislation (special acts based on 1847 Water Works Clauses Act)**
- Public Health Acts**

### **Contradictions:**

#### **1. Fiscal Crisis of municipal state**

**Shift from democratic to technical control**

#### **2. Fragmentation, duplication and lack of coordination**

**Highlighted in series of droughts in 1930s**

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## **>>> Managerialization of the water industry**

### **Context: Keynesian Welfare State/Post-War Settlement**

#### **☒ National Water Policy (1944 White Paper)**

#### **☒ Planned Water Economy**

- Central Control**
- Democratic Control**
- Common Good**

#### **Mode of Regulation:**

#### **☒ 1945 Water Act**

- Continuous wholesome supply**
- Cross subsidization (urban/rural)**
- Rationalization**

#### **☒ 1963 Water Resources Act**

- hydrologically defined river boards**
- Water Resources Board**

#### **☒ Institutional Paralysis**

- finance (fiscal limits of local state/central govt. ‘Loan sanctions’).**
- conflict within ‘water cycle’**

#### **☒ 1973 Water Act (1971 CAWC Report)**

#### **Mode of Delivery:**

#### **☒ 10 Regional Water Authorities**

- integrated river basin management**
  - efficient management/planned investment programme**
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**Contradictions:**

☒ **Fiscal Crisis of the State >> reduced public spending**

☒ **Impact on Water Industry**

- external finance limits
- financial targets
- performance aims

**>>> increased prices/reduced service/cancellation of capital projects.**

**Depoliticization:**

☒ **1983 Water Act (local govt. & trade unions expelled from RWA boards)**

☒ **Industrial relations (1983 dispute/dismantling of national collective bargaining)**

☒ **Industrial Restructuring**

- management
- contracting out
- enterprise companies/internal markets

☒ **Abolition of National Water Council**

**Realignment of State & Capital:**

☒ **Global crisis of ‘over-accumulation’.**

☒ **Massive projected investment following privatization**

☒ **Globalization (water 6% of global capitalization)**

☒ **Water multinationals)**

☒ **1989 Water Act >> neo-liberalization of the water industry.  
Neo-Liberal Water Industry**

## **OFWAT**

### **Underlying Principles (model of regulation)**

- ☒ Individual contractual relations**
- ☒ Institutionalization of the profit motive**
- ☒ Regulation of price, quality and service**
- ☒ Comparative Competition**

### **Regulatory Practice**

- ☒ Market Proxy (balance public interest/managerial incentives)**
- ☒ Price regulation (RPI+K)**
- ☒ Quality Regulation**
  - asset management plans/level of service indicators**
- ☒ Regulation of Service**
  - Customer service committees/complaints**

## **State Regulation and Management Restructuring**

### **Fieldwork**

**Eastwat**

**-former RWAs**

**Westwat**

**Citywat- now PLC - large urban area**

**Shirewat - subsidiary of MNC - rural undertaker**

### **Interviews:**

**Senior executives**

**Managers**

**Supervisors**

*How have new regulatory pressures impacted on managerial systems and managerial culture?*

**General Results: Directly resulting from new regulation.**

- Management information systems**
- New Departments**
- New Posts**
- New Culture - ‘quality management’**

## **Managerial Restructuring**

- ☒ Total Quality Management**
- ☒ Total Customer Satisfaction**
- ☒ Constant Improvement**
- ☒ High-Trust/Fieldwork**

**Performance standards/statistical assessment**

**(Partial) demobilization/marginalization of trade unions**

**Public service trade unionism**

**Highly 'political'**

**Dual focus - terms & conditions & 'service' issues**

**Westwat:**

- 1. OFWAT performance indicators >> new information systems and TQM**
- 2. Indicators form 'key results of business' and basis of management appraisal.**
- 3. 'Specialist' managers replaced by 'generalist' managers.**
  - ☒ Flattened managerial hierarchies/increased central control.**
  - ☒ Cross-functional secondments**
  - ☒ Management skills elevated above 'engineering skills'**
  - ☒ Technical skills 'engineered in'**

**Citywat**

- 1. More focus on City and OFWAT cf. Westwat**
- 2. 'Right first time' - focus on costs.**
- 3. Change in focus - product >> costs**
- 4. Change in managerial hegemony - engineering >> accountancy.**

**Shirewat:**

- 1. Problem of 'concretism'.**
- 2. Exit Programme ca. 40%**
- 3. Operational difficulties (loss of concrete knowledge in 'engineers heads')**
- 4. New information systems >> TQM**

## **Customer Service**

- Marks & Spencerization of the water industry**
- Competition generalized/abstract**

## **Shirewat**

### **Customer Care Unit (CCU)**

- DG Performance indicatorr embedded in management information and control systems**
- New departments (i.e. to monitor Condition J. DG. 2 - maintenance of pressure, etc.)**
- CCU: monitor all internal/external customer relations (information/complaints)**
- Company wide customer care training**

### **Customer Service Teams - Westwat**

- Introduced in all departments**
- Data for monthly report/appraisal**

## **Customer Care Committees**

- ☒ Introduced as independent bodies within OFWAT**
  
- ☒ Full time secretariat**
- ☒ Interest group representatives**
- ☒ ‘Regulation groups’ within companies**
  
  
- ☒ Functions**
  
  
- ☒ Consultation**
- ☒ Customer complaints**

## **Problems**

- ☒ Over-generalization**
  
- ☒ Rationality of OFWAT/Irrationality of consumers**
  
- ☒ Limits of neo-liberal Logic (right to poor service)**

## **General perceptions of OFWAT**

- ☒ Too interventionist between periodic reviews (‘too political’)**
  
- ☒ Unrealistic re. Costs and benefits of service/quality issues.**

## Conclusions

### 1. Ownership/Regulation

- ☒ **Post-1989 - restructuring most intense in former SWCs**
- ☒ **Established and enduring private sector involvement in UK water industry**

### 2. Management.

#### Abstract-Generic v. Concrete

- ☒ **Shift in managerial hegemony**
- ☒ **Shifting conceptions of customer concrete/abstract**
- ☒ **Operational difficulties (cf. Railway Industry)**

### 3. Contradictions of Neo-Liberalism.

- ☒ **Massive increase in capital investment**
- ☒ **Marginalization of real consumers & workers**

### 4. Citizenship

<b>Type</b>	<b>Control</b>	<b>Citizenship</b>	<b>Locus</b>
<b>Liberal</b>	<b>Private</b>	<b>Limited</b>	<b>Market</b>
<b>Municipal</b>	<b>Democratic</b>	<b>Direct (local)</b>	<b>Municipal State</b>
<b>Managerial</b>	<b>Technocratic</b>	<b>Corporate</b>	<b>Nation State</b>
<b>Neo-Liberal</b>	<b>Abstract</b>	<b>Associational/ Contractual</b>	<b>Civil Society</b>

## **5. Public Service.**

**☒ Enduring Contradiction (Where does ‘general interest’ lie?)**

**☒ Contract/abstract**

**☒ Use-value/value**

**1. Irresolvable? Limits to depoliticization.**

**2. Balance/Alternative Regulatory Models**